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October 26, 2020

The Honorable Eugene Scalia  
Secretary  
United States Department of Labor  
200 Constitution Avenue NW  
Washington, D.C. 20210

Amy DeBisschop, Director  
Division of Regulations, Legislation, and Interpretation  
Wage and Hour Division  
United States Department of Labor, Room S-3502  
200 Constitution Avenue NW  
Washington, D.C. 20210

**Re: Notice of Proposed Rulemaking, *Independent Contractor Status Under the Fair Labor Standards Act*, 85 Fed. Reg. 60,600 (Sept. 25, 2020), RIN: 1235-AA34.**

Dear Secretary Scalia and Ms. DeBisschop:

We write on behalf of the states of New York, Massachusetts, Pennsylvania, California, Colorado, Connecticut, Delaware, the District of Columbia, Hawaii, Illinois, Iowa, Maine, Maryland, Michigan, Minnesota, New Jersey, New Mexico, North Carolina, Oregon, Rhode Island, Vermont, Virginia, Washington, and Wisconsin, the Cities of Philadelphia and Pittsburgh, as well as municipal agencies the New York City Department of Consumer and Worker Protection and the Office of Labor Standards for the City of Chicago to oppose the proposed rulemaking by the U.S. Department of Labor (“DOL”) to change the test of whether workers are “employees” or independent contractors under the Fair Labor Standards Act (“FLSA”). *See Independent Contractor Status Under the Fair Labor Standards Act*, 85 Fed. Reg. 60,600 (Sept. 25, 2020) (“Proposed Rule”).<sup>1</sup>

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<sup>1</sup> Many of the undersigned state Attorneys General also submitted a comment, dated September 29, 2020, requesting that DOL extend the comment period from 30 to 60 days

The experiences of many of the undersigned state Attorneys General, cities, and municipal agencies (collectively, “State AGs”) in enforcing labor laws and protecting workers make clear that adopting the Proposed Rule would harm the people DOL is meant to protect. We believe that the Proposed Rule does not adequately reflect today’s workplace relationships, in which growing numbers of businesses are using alternative work arrangements, which often lead to less accountability for employers and less compliance with labor laws. In addition, some employers deliberately misclassify employees as independent contractors in order to evade legal accountability. The Proposed Rule further complicates these problems as it encourages businesses to avoid FLSA liability by relying on DOL’s new test to classify their workers as independent contractors. In today’s economy, unreasonably broadening independent contractor status will leave millions of workers vulnerable to violations of the FLSA, corresponding state laws, and other state and federal labor and employment laws; will increase costs and make labor law enforcement more difficult in our jurisdictions; and will hurt law-abiding employers. The COVID-19 pandemic greatly exacerbates each of these challenges.

The State AGs believe that, if finalized, the Proposed Rule would violate the Administrative Procedure Act (“APA”), which requires an agency to “examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made.” *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (quotation omitted). DOL fails to meet this standard for the Proposed Rule in at least two ways. First, the Proposed Rule is contrary to law because it contravenes the statutory text and purposes of the FLSA and established court precedents as to the definition of “employee” and independent contractor status. Second, finalizing the Proposed Rule would be arbitrary and capricious because DOL fails to provide a satisfactory explanation for the Proposed Rule, setting forth insufficient evidence and unsupported assertions, claiming, without basis, that introducing a new independent contractor test will “promote certainty for stakeholders, reduce litigation, and encourage innovation in the economy.” 85 Fed. Reg. 60,600. Further, these assertions are insufficient justification for a rule that conflicts with the FLSA’s remedial purposes of protecting workers.

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(<https://www.regulations.gov/document?D=WHD-2020-0007-0015>). DOL rejected this request despite our understanding that it has provided at least 60 days for public comment with respect to every other significant proposed regulation that the Wage and Hour Division has published in 2019 and 2020, simply asserting that 30 days is a “sufficient period of time to comment” (*see* <https://www.regulations.gov/document?D=WHD-2020-0007-0193>).

**I. The State AGs’ Experience Demonstrates that the Proposed Rule Will Increase Misclassification of Workers in their States and Make Law Enforcement More Difficult**

**A. The State AGs are interested parties with expertise in labor and employment issues.**

The undersigned State AGs enforce laws that protect workers’ economic security, health, and welfare. Some State AGs directly investigate and prosecute violators of minimum wage, overtime, and anti-discrimination laws, and some defend enforcement actions by state departments of labor in administrative or judicial appeals. It is important to note that virtually all statutory protections for workers—such as minimum wage, overtime, anti-discrimination, and paid leave—are premised on their status as employees.

States, through their departments of labor or through their attorneys general offices, are responsible for enforcing labor standards. Accordingly, state enforcers must determine whether a worker is an employee or an independent contractor as a preliminary matter, in order to establish that they are subject to wage and hour and other protections. *See, e.g., Cal. v. Uber Techs., Inc.*, No. A160701, 2020 WL 6193994 (Cal. Ct. App. Oct. 22, 2020) (affirming grant of preliminary injunction requiring Uber and Lyft to refrain from classifying hundreds of thousands of drivers as independent contractors pursuant to California’s ABC test in action brought by California Attorney General and City Attorneys of Los Angeles, San Diego, and San Francisco for restitution, penalties, and injunctive relief); *Tianti v. William Raveis Real Estate, Inc.*, 651 A.2d 1286, 1290–91 (Conn. 1995) (concluding that, according to the ABC test, real estate agents were employees because the employer retained the right to control the means and methods of their work); *McKissic v. Bodine*, 201 N.W.2d 333 (Mich. App. 1972) (reaffirming the “economic reality” test first enunciated by *United States v. Silk*, 331 U.S. 704 (1947)); *Anfinson v. Fedex*, 281 P.3d 289 (Wash. 2012) (adopting the economic reality test as the state test for misclassification); *MKI Assocs., LLC v. N.J. Dep’t of Labor & Workforce Dev.*, 2019 N.J. Super. Unpub. LEXIS 2088 (N.J. App. Div. 2019), cert. denied, *MKI Assocs. v. N.J. Dep’t of Labor & Workforce Dev.*, 224 A.3d 1064 (N.J. 2020) (affirming administrative determination that therapists who worked for MKI were employees not independent contractors).<sup>2</sup> To that end,

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<sup>2</sup> *See also* Press Release, The Commonwealth of Massachusetts Office of the Attorney General, Braintree Temp Agency Will Pay \$100,000 in Citations over Labor Violations (July 29, 2019), <https://www.mass.gov/news/braintree-temp-agency-will-pay-100000-in-citations-over-labor-violations> (company agreed to pay over \$100,000 in restitution to 102 employees to settle allegations that the company misclassified employees as independent contractors and failed to comply with a number of other wage and hour laws); Press Release, New York State Attorney General, A.G. Underwood Announces \$2 Million Settlement With FedEx For Misclassifying And Underpaying Its Delivery Drivers (Dec. 20, 2018), <https://ag.ny.gov/press-release/2018/ag-underwood-announces-2-million-settlement-fedex-misclassifying-and-underpaying> (Fed Ex agreed to create \$2 million fund to resolve lawsuit alleging that its drivers had been unlawfully misclassified as independent contractors); Press Release; Office of the Attorney General for the District of Columbia, AG Racine Announces National Electrical Contractor Will Pay \$2.75 Million to Workers and the District to Resolve Wage Theft Lawsuit (January 15, 2020) (on file

many states have statutes with identical or similar language defining “employees,” and use the same test that federal courts use under the FLSA—*i.e.*, the “economic reality” test—to determine whether a worker is an employee or independent contractor under their state laws,<sup>3</sup> while other states have their own tests, including the three-prong “ABC” test.<sup>4</sup>

For decades, labor standards enforcers and courts in many jurisdictions have applied the economic reality test to determine whether an individual is an employee or an independent contractor. Under this multi-factor test, the totality of the circumstances is considered and no one factor is dispositive. *See infra* Section II.A. The Department posits that its Proposed Rule—which is still a multi-factor test—will “lead to increased precision and predictability in the economic reality test’s application.” 85 Fed. Reg. at 60,600. The opposite is true; this rule will create confusion, not clarity. The Proposed Rule departs from the statutory text and Supreme Court precedent and is contrary to established application of the economic reality test. The Proposed Rule will lead to increased numbers of unscrupulous or unsophisticated employers classifying workers as independent contractors, even where such classification would run counter to separate state law tests. The Proposed Rule will foster confusion among both workers and employers over whether DOL’s interpretation applies to state laws and will require state regulators and worker advocates to expend resources explaining that state laws, that were previously analyzed interchangeably with federal law, should no longer be interpreted in tandem. This problem will similarly require public education and increased enforcement in jurisdictions

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with author), <https://oag.dc.gov/release/ag-racine-announces-national-electrical-contractor> (Power Design, Inc., a national electrical contractor, was required to pay \$2.75 million to workers and the District as part of a settlement in a wage theft and worker misclassification case. The settlement with OAG resolved a 2018 lawsuit against Power Design and two subcontractors that staffed its worksites for allegedly misclassifying more than 500 electrical workers as independent contractors instead of employees to cut labor costs.)

<sup>3</sup> The following states generally use the economic reality test to determine whether a worker is an employee or independent contractor: the District of Columbia, Hawaii, Illinois, Maryland, Michigan, New York, Pennsylvania, Rhode Island, and Washington.

<sup>4</sup> Under the ABC test, a worker is considered an employee and not an independent contractor, unless the hiring entity satisfies all three of the following conditions: The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both contractually and in fact; the worker performs work that is outside the usual course of the hiring entity’s business; and the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed. The following states use the ABC test to determine whether a worker is an employee or independent contractor: California, Connecticut, Delaware, the District of Columbia (construction industry only), Iowa, Maryland (construction and landscaping industries only), Massachusetts, New Jersey, New York (construction industry only), and Vermont. Pennsylvania uses a variation of the ABC test in the construction industry, replacing the “outside the usual course of business” condition with a requirement that the worker and employer have a written contract for construction services. Colorado, Maine, Minnesota, North Carolina, and Virginia use their own multi-factor tests, distinct from the economic reality test and the ABC test.

with stricter, more worker-protective tests, like the ABC test. An increase in misclassification under state laws will result in increased costs to state regulatory agencies from an uptick in complaints and from an increased burden on safety net programs, like unemployment insurance and Medicaid.

**B. The nature of employment relationships today makes enforcement more difficult.**

The need for proper classification of workers is critical given the evolving nature of the labor market, which the Proposed Rule acknowledges. 85 Fed. Reg. at 60,608 (noting that the “modern economy” contains “technological and social change—such as falling transaction costs, the transition from more of an industrial economy to more of a knowledge economy, and shorter job tenures”). As the State AGs who enforce and defend state wage and hour laws know, changing technology and workplace norms make labor enforcement more difficult today than ever before.

**1. Alternative work arrangements have become more prevalent in the modern economy.**

Unlike the twentieth century economy, when large employers like General Motors, IBM, and Macy’s dominated industry landscapes and employed thousands of workers, today’s labor market is very different.<sup>5</sup> Whether to reduce costs or avoid legal liabilities, companies are utilizing “alternative work arrangements” with more frequency.<sup>6</sup> These alternative work arrangements consist of utilizing independent contractors (often to do work that is essential to the business), temporary workers, and staffing agencies.<sup>7</sup> Industries characterized by alternative work arrangements include but are not limited to janitorial work, housekeeping, home care, construction, agriculture, and product delivery.<sup>8</sup>

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<sup>5</sup> See David Weil, *The Fissured Workplace: Why Work Became So Bad for So Many and What Can Be Done to Improve It*, 28 (2014).

<sup>6</sup> See Mark Erlich and Terri Gerstein, *Confronting Misclassification and Payroll Fraud: A Survey of State Labor Standards Enforcement Agencies*, Harvard Law School Labor and Worklife Program, 28–29 (2019), <https://lwp.law.harvard.edu/files/lwp/files/misclassification.pdf> (commenting on the growth of the alternative workforce and noting that, “[w]hen part-time employees are included in these calculations, the U.S. Government Accounting Office concluded that alternative work arrangements increased from 35.3 to 40.4 percent of employment from 2006 to 2020”).

<sup>7</sup> *Id.* at 28 (although a majority of American workers are employees subject to labor regulations, “there has been an evolution into ‘alternative work arrangements,’ a broadly defined category that includes independent contractors.”); see also David Weil, et al., *The Future of Real Jobs: A Prospect Roundtable*, The American Prospect (May 14, 2019), <https://prospect.org/economy/future-real-jobs-prospect-roundtable/>.

<sup>8</sup> See generally Catherine Ruckelshaus and Ceilidh Gao, *Who’s the Boss: Restoring Accountability for Labor Standards in Outsourced Work*, National Employment Law Project, 9–27 (2014), <https://www.nelp.org/wp-content/uploads/2015/02/Whos-the-Boss-Restoring->

Digital platforms that try to blur the lines between technology and service sectors—often commonly referred to as the “gig” or “on-demand” economy—are part of the alternative work arrangements shaping the modern economy and further complicating the inquiry into whether a worker is an employee or an independent contractor.<sup>9</sup> These types of businesses “use internet-based technology platforms . . . to coordinate and manage on-demand piecemeal work in a variety of service industries, from taxi to food delivery to domestic work.”<sup>10</sup> Many digital platform companies aim to “have it both ways”—benefiting from work done in accordance with strict company standards while evading the obligations of an employment relationship by classifying workers as independent contractors.<sup>11</sup> These types of alternative work arrangements leave workers without wage and hour protections or access to benefits.<sup>12</sup>

## **2. Alternative work arrangements, including the use of independent contractors, result in higher rates of misclassification and wage and hour violations.**

In certain alternative work arrangements, employers disproportionately shift costs to workers, often misclassifying workers in the process. For example, some businesses do not allow workers to perform services without first buying a franchise, *see Awuah v. Coverall N. Am., Inc.*, 707 F. Supp. 2d 80 (D. Mass 2010) and *Awuah v. Coverall N. Am., Inc.*, 952 N.E.2d 890 (Mass 2011) (concluding that franchisees—individual workers—were misclassified as independent contractors), or setting up their own corporations and purchasing workers’ compensation insurance.<sup>13</sup> Other businesses require workers to pay for their own training programs, background checks, and certification courses.<sup>14</sup>

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[Accountability-Labor-Standards-Outsourced-Work-Report.pdf](#) (describing industries impacted by labor outsourcing and contracting, including janitors, fast-food, home care, food service, warehouse and logistics, agricultural, staffing industry, port trucking, and public contracting).

<sup>9</sup> See Maya Pinto et al., *Rights at Risk: Gig Companies’ Campaign to Upend Employment As We Know It*, National Employment Law Project, 1–2 (2019),

<https://www.nelp.org/publication/rights-at-risk-gig-companies-campaign-to-upend-employment-as-we-know-it/>.

<sup>10</sup> *Id.* at 1.

<sup>11</sup> See Weil, et al., *supra* note 7.

<sup>12</sup> See Katharine G. Abraham, et al., *Measuring the Gig Economy: Current Knowledge and Open Issues*, Nat’l Bureau of Econ. Research, Working Paper No. 24950 (2018),

<https://www.nber.org/papers/w24950.pdf>.

<sup>13</sup> See Press Release, The Commonwealth of Massachusetts Office of the Attorney General, New Hampshire Drywall Company Agrees to \$500,000 Settlement to Resolve Claims it Misclassified Workers (February 2, 2017), <https://www.mass.gov/news/new-hampshire-drywall-company-agrees-to-500000-settlement-to-resolve-claims-it-misclassified>.

<sup>14</sup> See Ken Armstrong, et al., *Meet the Customer Service Reps for Disney and Airbnb Who Have to Pay to Talk to You*, ProPublica (October 2, 2020), <https://www.propublica.org/article/meet-the-customer-service-reps-for-disney-and-airbnb-who-have-to-pay-to-talk-to-you>.

Significantly, the rise of alternative work arrangements leads to increased wage and hour violations and complicates law enforcement as labor regulators need to first determine whether a worker is an employee as a matter of fact and law *before* being able to recover any unpaid wages.<sup>15</sup> While some businesses properly classify workers as independent contractors in lawful alternative work arrangements, others unlawfully misclassify workers in order to limit monetary and legal liabilities.

Recent state data on misclassification also demonstrates the reach of this issue:

- In California, the Labor Commissioner’s Office has seen an unprecedented growth in willful misclassification over the last several years. In 2018, even prior to the enactment of Assembly Bill 5, the Labor Commissioner’s Bureau of Field Enforcement issued citations totaling \$1.295 million for willful misclassification.<sup>16</sup>
- Between 2015 and October 2020, the Fair Labor Division of the Massachusetts Attorney General’s Office issued 111 citations and assessed \$520,350 in penalties for violations of the state’s misclassification law. In 2017, the Massachusetts Department of Unemployment Assistance identified 50 misclassified workers and \$11,225 in unreported wages because of referrals from the Massachusetts Council on the Underground Economy.<sup>17</sup>
- Between 2015 and 2019, the Colorado Department of Labor and Employment issued 40-45 determinations and orders per year, finding misclassification violations. Some investigations involved claims that implicated company or sector-wide misclassification issues.

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<sup>15</sup> See Françoise Carré, (In)dependent Contractor Misclassification, Economic Policy Institute, Briefing Paper #No. 403 (2015), <https://files.epi.org/pdf/87595.pdf> (“directly employed workers, even when unionized, find it more difficult to seek and obtain their employer’s compliance with labor standards in settings where misclassification is common, and misclassified workers can be made to work with substandard terms of employment”); see also Erlich and Gerstein, *supra* note 6 at 5 & n.1 (“In recent decades, there has been a sharp increase in employers misclassifying workers as independent contractors when they should be treated as employees.” (citing studies)); James B. Rebitzer and David Weil, Findings and Implications of the RSI Report to the Joint Task Force on Employee Misclassification and the Underground Economy: Contractor Use, Analysis, and Impact Results, Technical Advisory Board Report, 14 (2014), [https://www.mass.gov/files/2017-07/technical-advisory-board-report\\_0.pdf](https://www.mass.gov/files/2017-07/technical-advisory-board-report_0.pdf) (drawing on data from the Massachusetts Department of Unemployment Assistance, the Massachusetts Department of Revenue, and the Internal Revenue Service, the Technical Advisory Board concluded that between 2001 and 2010, “15% of audited establishments engaged in misclassification or paying under-the-table and that 4% of employees in all audited establishments were misclassified.”).

<sup>16</sup> See California Labor Commissioner’s Office, 2017-2018 Fiscal Year Report on the Effectiveness of the Bureau of Field Enforcement, 6 (2018), [https://www.dir.ca.gov/dlse/BOFE\\_LegReport2018.pdf](https://www.dir.ca.gov/dlse/BOFE_LegReport2018.pdf).

<sup>17</sup> See Massachusetts Council on the Underground Economy, 2017 Annual Report, 9 (2017), <https://www.mass.gov/doc/cue-annual-report-2017-0/download>.

- Between 2014 and 2019, the Minnesota Department of Labor Industry’s Construction Codes and Licensing Division opened 2,250 cases and issued 1,597 orders and notices of violation for misclassification in the construction industry.
- As of April 2019, the Pennsylvania Department of Labor & Industry estimated 15 percent of Pennsylvania employers misclassified workers, resulting in about 275,000 misclassified employees and \$103 million in lost unemployment compensation revenue annually. The top industries for misclassification were: construction, trucking, domestic services, food services, and administrative services.<sup>18</sup>
- Between 2019 and 2020, the Rhode Island Department of Labor and Training resolved approximately 45 misclassification cases (where more than one worker was misclassified) for over \$450,000 in penalties.
- Since April 2016, Virginia’s Targeted Audit and Investigative Enforcement Unit of the Virginia Employment Commission has closed 106 cases involving worker misclassification. These cases resulted in \$125,420,261 paid to 4,741 misclassified workers. Industries with the highest rates of misclassification included drywall, carpentry (framing), roofing, other construction, trucking, and health care.

### **3.The misclassification of workers harms workers, states, and law-abiding employers.**

The misclassification of employees as independent contractors is detrimental to workers, states, and law-abiding employers. First, misclassified workers are not entitled to basic protections such as timely payment of wages, timekeeping records, pay stubs, paid leave, and reimbursement for expenditures that primarily benefit the employer (e.g., uniforms, travel expenses). They also suffer suppressed wages.<sup>19</sup> Finally, outsourced workers experience wage theft at an astonishing rate.<sup>20</sup>

Despite evidence that independent contractors experience increased rates of wage theft and wage suppression, DOL asserts, as an abstract economic principal without clear evidence, that increased independent contractor arrangements can result in higher base earnings for workers (*i.e.*, an “earnings premium”). *See* 85 Fed. Reg. at 60,627 (“the data provides mixed evidence of this earnings premium”). Any “higher rate of pay” that a worker may appear to receive as an independent contractor is offset by the costs that shift to workers in these

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<sup>18</sup> Written Testimony of Jennifer L. Berrier, Deputy Secretary, Dep’t of Labor & Industry Before the House Labor & Industry Committee (April 29, 2019) (on file with author).

<sup>19</sup> *See* Ruckelshaus and Gao, *supra* note 8 at 15–17 (“Once outsourced, workers’ wages suffer . . . ranging from a 7 percent dip in janitorial wages, to 30 percent in port trucking, to 40 percent in agriculture; food service workers’ wages fell by \$6 an hour.”).

<sup>20</sup> *See, e.g., id.* at 10 (noting that the incidence of wage theft for outsourced janitorial workers was 26 percent for minimum wage violations and 71.2 percent for overtime violations).



arrangements, including insurance, operating costs, and tax liabilities.<sup>21</sup> The earnings premium would need to be higher than it typically is to account for these added costs.<sup>22</sup>

In addition to increased law enforcement actions, misclassification results in lost revenue and increased administrative burdens and costs for states.<sup>23</sup> Due to misclassification, states suffer from a loss of tax revenue they would otherwise receive from payroll taxes and a loss of funds to unemployment insurance, workers' compensation, and paid leave programs.<sup>24</sup> States also incur additional costs, such as providing health care coverage and hospital costs for uninsured workers, as misclassified workers cannot access benefits like health insurance, 401(k) plans, or unemployment insurance, and often lack appropriate workers' compensation coverage.<sup>25</sup> Further complicating matters, DOL's Proposed Rule would result in increased administrative costs to states with tests that mirror the federal one, as they would need to invest time and resources into training agency employees and educating the public that the longstanding economic reality test still governs.<sup>26</sup> States with stricter and more protective misclassification

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<sup>21</sup> See Sarah Leberstein and Catherine Ruckelshaus, *Independent Contractor vs. Employee: Why Independent Contractor Misclassification Matters and What We Can Do To Stop It*, National Employment Law Project, 3 (2016), <https://s27147.pcdn.co/wp-content/uploads/Policy-Brief-Independent-Contractor-vs-Employee.pdf> (businesses utilize independent contractor arrangements to drive down payroll costs while the costs are shifted to workers and law-abiding businesses).

<sup>22</sup> See *id.* (“[A] construction worker earning \$31,200 a year before taxes would be left with an annual net compensation of \$10,660.80 if paid as an independent contractor, compared to \$21,885.20 if paid properly as an employee.”).

<sup>23</sup> See, e.g., Lisa Xu and Mark Erlich, *Economic Consequence of Misclassification in the State of Washington*, Harvard Labor and Worklife Program, 2 (2019), [https://lwp.law.harvard.edu/files/lwp/files/wa\\_study\\_dec\\_2019\\_final.pdf](https://lwp.law.harvard.edu/files/lwp/files/wa_study_dec_2019_final.pdf) (“Federal and state governments lose substantial revenues from taxes that would have been paid had the workers had been properly treated as employees. These include income taxes and Social Security and Medicare payroll taxes (due to anticipated underreporting of income by misclassified employees), as well as unemployment insurance taxes and payments into state-administered workers' compensation funds.”).

<sup>24</sup> See, e.g., Karl A. Racine, *Issue Brief and Economic Report, Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry*, 13 (September 2019), <https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf> (Attorney General report noting that misclassification results in Social Security and Medicaid losing significant resources, state-run unemployment insurance programs going underfunded, and workers' compensation premiums going unpaid).

<sup>25</sup> See, e.g., Michael P. Kelsay, et al., *The Economic Costs of Employee Misclassification in the State of Illinois*, 11–14 (2006), [http://www.faircontracting.org/wp-content/uploads/2012/09/Illinois\\_Misclassification\\_Study.pdf](http://www.faircontracting.org/wp-content/uploads/2012/09/Illinois_Misclassification_Study.pdf).

<sup>26</sup> In addition, the disparity between state and federal law regarding classification of employees could open employers up to criminal liability if they classify workers as independent contractors according to the federal test, in violation of state law. For example, Minnesota's Commerce Fraud Bureau investigates employers who evade the state's workers' compensation insurance laws and can bring criminal charges for violations. See, e.g., *State v. Mehr*, Compl., 27-CR-20-

laws (*i.e.*, laws that make it more likely that a worker is classified as an employee),<sup>27</sup> may experience increased costs to state regulatory agencies from an uptick in complaints alleging misclassification under state law.

Many states track the impact of misclassification on their economies. For example, in 2018, the Division of Unemployment Insurance within the Maryland Department of Labor, Licensing and Regulations (DLLR) conducted 2,124 unemployment insurance audits and identified 9,344 misclassified workers, representing \$42,806,603 in unreported taxable wages. Audits in the construction and landscaping industries conducted under the Workplace Fraud Act identified an additional 1,197 misclassified workers, representing \$8,230,192 in unreported taxable wages. In 2019, the New Jersey Department of Labor Employer Accounts section found that 159,752 workers were misclassified, \$18,553,298,402.63 in taxable wages were underreported, and \$1,082,190,691.02 in contributions were underreported according to the Department's audit application system. This was an annual audit of just 1 percent of all registered New Jersey employers, implying that the true costs of misclassification are much greater.<sup>28</sup> In the first three quarters of 2020, the Illinois Department of Employment Security audited 1,550 employers for their compliance with the state unemployment act and determined that 582 employers had collectively misclassified 75,239 employees as independent contractors. These employers failed to report \$344,348,362.22 overall in taxable wages. This represents a significant increase in misclassifications identified by department audits in the first three quarters of calendar year 2020 alone when compared to 2019.

Finally, misclassification hurts employers “who play by the rules.”<sup>29</sup> Employers that properly classify employees and run their businesses in accordance with wage and hour laws operate at a competitive disadvantage when competing for the same work with employers that skirt the law.<sup>30</sup> Law-abiding businesses pay the proper taxes and insurance premiums, functionally subsidizing the businesses that do not comply with the law. In short, misclassification undermines fair market competition.

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1763 (filed Jan. 17, 2020), <https://www.hennepinattorney.org/-/media/Attorney/Leroy-Mehr-Criminal-Complaint.pdf>; see also MPR News, *Charges: Minnesota Drywall Employees Stiffed Out of Worker Comp* (Jan. 21, 2020), <https://www.mprnews.org/story/2020/01/21/charges-minnesota-drywall-employees-stiffed-out-of-workers-comp>; see also Star Tribune, *Minnesota Owners of Drywall Company Admit Stealing \$300k in Workers' Comp Scheme* (Oct. 13, 2020), <https://www.startribune.com/minnesota-owners-of-drywall-company-admit-stealing-300k-in-workers-comp-scheme/572712741/>.

<sup>27</sup> The following states categorize their test for labor enforcement more likely to classify workers as employees than independent contractors (as compared to the test federal courts use under the FLSA): California, Connecticut, Massachusetts, Minnesota, New Jersey, Vermont, and Virginia.

<sup>28</sup> See generally State of New Jersey, Department of Labor and Workforce Development, Report of Governor Murphy's Task Force on Employee Misclassification (July 2019), <https://www.nj.gov/labor/assets/PDFs/Misclassification%20Report%202019.pdf>.

<sup>29</sup> Carré, *supra* note 15 at 3.

<sup>30</sup> See Ruckelshaus and Gao, *supra* note 8 at 1.

While failing to properly classify workers as employees is already a pervasive problem due to the fissured nature of the modern economy, DOL’s Proposed Rule would result in greater opportunity for misclassification. As the Department admits, the “Proposed Rule could lead to an increase in the number of independent contractor arrangements,” 85 Fed. Reg. at 60,626. Because the Proposed Rule makes it easier for employers to classify workers as independent contractors, many employers may rush to do so—misclassifying workers in the process. The risk of misclassifying large swaths of workers is particularly concerning given the pandemic our nation is still facing. Workers and businesses are struggling more than ever, leading Congress to temporarily extend unemployment insurance to independent contractors who would otherwise not qualify for those benefits. Notably, Congress, as part of its roughly \$2 trillion response bill, allocated pandemic unemployment assistance for independent contractors—indicative of both the increased prevalence of independent contractors in our economy as well as the increased harm that independent contractors face during the pandemic. Classifying more workers (lawfully or not) as independent contractors would leave more individuals and families without assistance in a uniquely difficult time.

**C. DOL must not issue the Proposed Rule in the midst of a global pandemic and without adequate consideration of the consequences to workers.**

DOL announced the Proposed Rule in the midst of the global COVID-19 pandemic—days after a week in which more than 26 million people claimed unemployment benefits.<sup>31</sup> Of those out of work, “[n]early five million people are approaching long-term joblessness over the next two months,” meaning they have been without work for 27 weeks or more.<sup>32</sup> Long-term unemployment and permanent job losses are growing. *Id.* Those still working are concerned about paid sick leave protections.<sup>33</sup> And while some states and municipalities, including Massachusetts, New York City and State, Philadelphia, California, Connecticut, the District of Columbia, Maine, Maryland, Michigan, New Jersey, Rhode Island, Vermont, and Washington require paid sick or similar leave by law generally or in specific COVID-19-related circumstances, independent contractors generally do not qualify.<sup>34</sup> Mass. Gen. Laws ch. 149 § 148C (2015); N.Y.C. Admin. Code Section 20-913(f)(iii); NYLL § 190; 9 Phila. Code § 9-4100 to 4116; Cal. Lab. Code §§ 245, *et seq.*; Conn. Gen. Stat. Sec. 31-57r(3); D.C. Code § 32-531.01; 26 M.R.S. § 637; Md. Code Ann., Lab. & Empl. § 3-1301(e); Mich. Comp. Laws

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<sup>31</sup> Press Release, Unemployment Insurance Weekly Claims, U.S. Dep’t of Labor (Sept. 25, 2020), <https://oui.doleta.gov/press/2020/092420.pdf> (reporting unemployment numbers for the week ending September 19).

<sup>32</sup> Jeanna Smialek, et al., *Workers Face Permanent Job Losses as the Virus Persists*, The New York Times (Oct. 3, 2020), <https://www.nytimes.com/2020/10/03/business/economy/coronavirus-permanent-job-losses.html>.

<sup>33</sup> See Janice Fine, et al., *Maintaining effective U.S. labor standards enforcement through the coronavirus*, Washington Center for Equitable Growth, 2 (Sept. 2020), <https://equitablegrowth.org/research-paper/maintaining-effective-u-s-labor-standards-enforcement-through-the-coronavirus-recession/> (discussing survey of Californians).

<sup>34</sup> See National Conference of State Legislatures, *Paid Sick Leave* (July 21, 2020), <https://www.ncsl.org/research/labor-and-employment/paid-sick-leave.aspx>.

§ 408.962(e); N.J. Stat. Ann. § 34:11D-1 et seq; R.I. Gen. Laws § 28-57-5; 21 Vt. Stat. Ann. § 481(5); Wash. Rev. Code 49.46.200, .210; Wash. Admin. Code 296-128-600 through -860.

During this period of record unemployment, workers are at greater risk for wage and hour violations.<sup>35</sup> High unemployment also decreases the likelihood that vulnerable workers will file a complaint with an enforcement agency because workers fear losing their positions, despite suffering from wage theft.<sup>36</sup> As a result, states will face greater difficulty in enforcing wage and hour laws. The consequences of the fissured workplace and misclassification are amplified during the pandemic.

Despite the strain the pandemic puts on workers, DOL has chosen this moment to restructure the long-established test for determining whether a worker is an employee or independent contractor. But the Proposed Rule may lead employers to reclassify (correctly or not) many workers overnight, exactly the concern DOL expresses over the ABC test. *See* 85 Fed. Reg. at 60,636. The consequences of reclassification and misclassification at this time are concerning to workers who rely on workplace protections and benefits only available to employees, including employer-provided health insurance and paid leave programs. The risk of reclassification is a significant concern to states whose benefits agencies have been processing record numbers of unemployment claims and implementing new programs in conjunction with federal agencies.<sup>37</sup> At a time of unprecedented levels of extended unemployment, proper classification and unemployment insurance payments are particularly crucial. Businesses are not only being devastated by reductions or elimination of work, but those that follow the law, properly classify employees, and continue to pay unemployment insurance will likely be forced to replenish the funds as a result of the Rule.

DOL must not finalize the Proposed Rule during this once-in-a-century pandemic.

## **II. If Finalized, the Rule Would Violate the APA**

The APA requires agencies to engage in “reasoned decisionmaking” that rests on a “logical and rational” “consideration of the relevant factors.” *Michigan v. EPA*, 576 U.S. 743, 750 (2015) (quotation omitted). An agency is required to “examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made” when promulgating a rule. *See State Farm*, 463 U.S. at 43 (quotation omitted). Further, when “its new policy rests upon factual findings that contradict those which underlay its prior policy,” an agency must explain the departure from its existing views. *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009).

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<sup>35</sup> *See* Fine, *supra* note 33 at 2 (comparing current, record unemployment rates to trends observed during the Great Recession, 2007-09).

<sup>36</sup> *See id.* at 3.

<sup>37</sup> *See, e.g.*, Eli Rosenberg, *Six months, and a grim milestone: 26th-straight week of record-level unemployment claims*, The Washington Post (Sept. 17, 2020), <https://www.washingtonpost.com/business/2020/09/17/new-unemployment-claims-september/>.

The Proposed Rule fails to meet the APA’s requirements. First, the Proposed Rule conflicts with established judicial precedent and is inconsistent with the broad and expansive protections of the FLSA. Second, DOL fails to provide a satisfactory justification for the Proposed Rule, including an explanation of its change in policy, and offers no evidence to support its asserted rationale for it, thus failing to demonstrate that its justification does not “run[] counter to the evidence before [it].” *Fox Television*, 556 U.S. at 552. Accordingly, DOL should withdraw the Proposed Rule.

**A. The Proposed Rule is not in accordance with the FLSA and case law interpreting it.**

The Proposed Rule violates the FLSA by implementing a crabbed reading of the definition of “employee,” contrary to the Supreme Court’s direction that it “must not be interpreted or applied in a narrow, grudging manner.” *Tenn. Coal, Iron & R. Co. v. Muscoda Local No. 123*, 321 U.S. 590, 597 (1944). Instead, the FLSA must be interpreted with its “remedial and humanitarian . . . purpose” in mind, specifically to protect “those who sacrifice a full measure of their freedom and talents to the use and profit of others.” *Id.* When conducting rulemaking, an agency must account for the “preeminent factor” that Congress intended to characterize its statutory authority. *State Farm*, 463 U.S. at 55; *cf. Alaska Oil & Gas Ass’n v. Jewell*, 815 F.3d 544, 556 (9th Cir. 2016) (“The standard [the agency] followed . . . was in accordance with statutory purpose and hence could not have been arbitrary, capricious, or contrary to law.”). The Proposed Rule’s interpretation of the FLSA is unlawfully narrow, departing from the text and purpose of the statute.

The Proposed Rule changes the traditional “economic reality” test with six factors to be weighed appropriately, depending on the facts, into one that emphasizes two factors above all others and inappropriately narrows several areas of inquiry. First, the Proposed Rule provides that “economic dependence” is the “ultimate inquiry” in determining a worker’s status but focuses on whether the “individual is economically dependent on that employer *for work*.” 85 Fed. Reg. at 60,639 (proposed 29 C.F.R. § 795.105(b)) (emphasis added) (citations omitted). The Proposed Rule then stresses the “nature and degree of the individual’s control over the work” and the “opportunity for profit or loss” as two “core factors” which, “if they both point towards the same classification,” create “a substantial likelihood that is the individual’s accurate classification.” *Id.* (proposed § 795.105(c), (d)(1)). The Proposed Rule offers three additional factors: (1) “the amount of skill required for the work”; (2) “the degree of permanence of the working relationship between the individual and the potential employer”; and (3) “whether the work is part of an integrated unit of production.” *Id.* (proposed § 795.105(d)(2)). Finally, the Proposed Rule explains that “the actual practice of the parties involved is more relevant than what may be contractually or theoretically possible.” *Id.* (proposed § 795.110).

**1. The Proposed Rule is inconsistent with the FLSA’s text and purpose.**

The FLSA’s text, purpose, and legislative history demonstrate the meaning of “employer,” “employee,” and “employ.” See 29 U.S.C. §§ 203(d), (e), (g). “The principal congressional purpose in enacting the FLSA was to protect all covered workers from substandard wages and oppressive working hours[.]” *New York v. Scalia*, No. 20-996, 2020 WL 2857207, at \*1 (“*Scalia I*”) (quoting *Mei Xing Yu v. Hasaki Rest., Inc.*, 944 F.3d 395, 402 (2d Cir. 2019)).

“Consistent with [that] ‘remedial and humanitarian’ purpose, Congress adopted definitions of ‘employ,’ ‘employee,’ and ‘employer’ that brought a broad swath of workers within the statute’s protection.” *Id.* (quoting *Salinas v. Com. Interiors, Inc.*, 848 F.3d 125, 133 (4th Cir. 2017)). Indeed, the term “employee” was “given the broadest definition that has ever been included in any one act.” *United States v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945) (quoting 81 Cong. Rec. 7657 (1937) (statement of Sen. Hugo Black)). Further, “the remedial nature of the statute further warrants an expansive interpretation of its provisions so that they will have the widest possible impact in the national economy.” *Herman v. RSR Sec. Servs. Ltd.*, 172 F.3d 132, 139 (2d Cir. 1999) (internal quotation marks omitted).

While the FLSA does not explicitly define “independent contractor,” it defines “employer” as “any person acting directly or indirectly in the interest of an employer in relation to an employee,” 29 U.S.C. § 203(d), “employee” as “any individual employed by an employer,” *id.* at 203(e), and “employ” “includes to suffer or permit to work,” covering a wide range of employment arrangements, *id.* at 203(g). The “suffer or permit” language did not appear in the bill that became the FLSA when it was first introduced.<sup>38</sup> The FLSA bill did, however, include provisions exempting small businesses and there was some debate over how to “prevent evasion by cutting large businesses into small units.”<sup>39</sup> In subsequent drafts, the small employer exemption was deleted and the “suffer or permit” language incorporated after consideration of state laws that dispensed with a willful violation standard for one that “make[s] the employer responsible for conditions of employment which he permits or suffers to exist in his place of business,” even if the employer does not directly employ the worker that experiences the violation.<sup>40</sup> The “suffer or permit” language was derived from the child labor statutes of thirty-two states and the District of Columbia, *see Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728 n.7 (1947), and reflects Congress’s intent to stop businesses from using creative work arrangements to shirk their responsibilities to employees and focus the FLSA on the realities of employment.

The “suffer or permit” language elevates the practical reality of the employment situation over its technical form.<sup>41</sup> It was “plainly designed to comprehend all the classes of relationship which previously had been designated specifically as likely means of avoidance of the Act,” including inappropriate use of the “independent contractor” label.<sup>42</sup> Indeed, the legislators that passed the bill envisioned that “the factory which sends out and makes use of people in their homes are not exempted just because they are using premises they do not pay any rent for,” specifically referencing a provision designed to “prevent the circumvention of the act or any of its provisions through the use of agents, independent contractors, subsidiary or controlled

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<sup>38</sup> See Bruce Goldstein, et al., *Enforcing Fair Labor Standards in the Modern American Sweatshop: Rediscovering the Statutory Definition of Employment*, 46 U.C.L.A. L. Rev. 983, 1094–95 (1999).

<sup>39</sup> *Id.* at 1095.

<sup>40</sup> *Id.* at 1098.

<sup>41</sup> See 46 U.C.L.A. L. Rev. at 1100–01.

<sup>42</sup> *Id.* (quoting Brief of the Administrator at 27–29, *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947) (No. 562)).

companies, or home or off-premise employees, or by any other means or device.”<sup>43</sup> In this way, the legislative history demonstrates that the statutory language was intended to consider the economic reality of the worker-employer relationship as distinct from the common law control factors that were deliberately *not* incorporated into the statute. See Brief of the United States at 701, *United States v. Silk*, 331 U.S. 704 (1947) (No. 312) (“On the periphery are many persons whose physical work may not be controlled to any substantial extent, *although they work for and are dependent on and are economically controlled by the employer* to the same extent as those whose work is subject to control.” (emphasis added)). The Proposed Rule is untethered to the FLSA’s statutory language and legislative history, substituting the preferred view of DOL for that mandated by Congress.

## **2. The Proposed Rule runs afoul of Supreme Court and established circuit court precedent**

The Proposed Rule also departs from Supreme Court precedent establishing the appropriate test for an “employee” under the FLSA. For nearly three-quarters of a century, the Supreme Court has held that whether a worker is a covered “employee” under the FLSA is governed by the economic reality test. The Court first announced the economic reality test in the context of the National Labor Relations Act (“NLRA”) and Social Security Act (“SSA”). See *N.L.R.B. v. Hearst Publications*, 322 U.S. 111, 129 (1944), *overruled in part by Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) (analyzing “employee” under the NLRA based on “the facts involved in the economic relationship”); *United States v. Silk*, 331 U.S. 704, 713, 716 (1947) (analyzing “employee” under the SSA and describing analysis set forth in *Hearst* as considering whether workers were “employees” “as a matter of economic reality”), *superseded by statute as recognized by United States v. W.M. Webb, Inc.*, 397 U.S. 179, 187–88 (1970). The Court applied the economic reality test to the FLSA the same day it decided *Silk*. *Rutherford*, 331 U.S. at 730. In *Silk*, the Court explained that “degrees of control, opportunities for profit or loss, investment in facilities, permanency of relation and skill required in the claimed independent operation are important for decision. No one is controlling nor is the list complete.” *Silk*, 331 U.S. at 716. In *Rutherford*, the Court found that the “[the NLRA and SSA] are persuasive in the consideration of a similar coverage under the [FLSA],” and applied the *Silk* factors, adding a sixth—whether the workers formed “part of [an] integrated unit of production.” 331 U.S. at 723, 729. The Court held that the “determination of the relationship does not depend on . . . isolated factors but rather upon the circumstances of the whole activity.” *Id.* at 730. These seminal cases make clear that the test must examine each factor and not elevate the significance of any particular factor.

Since *Rutherford*, the Court has reaffirmed that “‘economic reality’ rather than ‘technical concepts’ is to be the test of employment.” *Goldberg v. Whitaker House Coop., Inc.*, 366 U.S. 28, 33 (1961) (internal citation omitted); see also *Tony and Susan Alamo Found. v. Sec’y of*

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<sup>43</sup> *Joint Hearings before the S. Committee on Education and Labor and the H. Committee on Labor on S. 2475 and H.R. 7200 Bills to Provide for the Establishment of Fair Labor Standards in Employments in and Affecting Interstate Commerce and for Other Purposes* (“*Joint Hearings*”), Part 1 at 77 (June 2-5, 1937) (testimony of Robert H. Jackson, Dep’t of Justice) (describing “home work”).

*Labor*, 471 U.S. 290, 301 (1985) (“[t]he test of employment under the Act is one of ‘economic reality’”) (quoting *Goldberg*).<sup>44</sup> In determining that the homeworkers in question in *Goldberg* were employees, the Court noted that the workers were not “self-employed” or “independent, selling their products on the market for whatever price they can command.” *Goldberg*, 366 U.S. at 32. Even though the workers were formally organized as a cooperative, the Court found controlling that the workers were “regimented under one organization, manufacturing what the organization desires and receiving the compensation the organization dictates,” and that the “management . . . can hire or fire the homeworkers.” *Id.* The *Alamo Foundation* Court likewise put little stock in the formalities of the employment arrangement; it focused on the fact that the workers were “entirely dependent upon the Foundation for long periods, in some cases several years.” *Alamo Found.*, 471 U.S. at 301.

In each of the cases, the Court has examined facts relevant to the economic reality of the relationship before it, but it has never endorsed any specific factors as priorities or elevated above all others. *See, e.g., Rutherford*, 31 U.S. at 730; *Goldberg*, 366 U.S. at 33; *Alamo Found.*, 471 U.S. at 301. Instead, the Supreme Court—again, for more than seventy years—has rejected a focus on “isolated factors” but instead insisted that determination of whether a worker is a covered employee requires consideration of “the circumstances of the whole activity.” *Rutherford*, 331 U.S. at 730. Because it is well settled that “[a]ll [the Court’s] interpretive decisions, in whatever way reasoned, effectively become part of the statutory scheme,” *Kimble v. Marvel Entm’t, LLC*, 576 U.S. 446, 456 (2015), and the Supreme Court has continued to apply a holistic, economic reality test, DOL’s proposed departure from precedent is contrary to settled law.

The circuit courts, too, have uniformly applied the flexible factor test, typically including: (1) the nature and degree of the alleged employer’s control as to the manner in which the work is to be performed; (2) the alleged employee’s opportunity for profit or loss depending upon his managerial skill; (3) the alleged employee’s investment in equipment or materials required for his task, or his employment of workers; (4) whether the service rendered requires a special skill; (5) the degree of permanency and duration of the working relationship; and (6) the extent to which the service rendered is an integral part of the alleged employer’s business. *See Scantland v. Jeffrey Knight, Inc.*, 721 F.3d 1308, 1312 (11th Cir. 2013) (citations omitted); *Brock v. Superior Care, Inc.*, 840 F.2d 1054, 1058–59 (2d Cir. 1988) (citations omitted). “No one of these factors is dispositive; rather, the test is based on the totality of the circumstances.” *Superior Care*, 840 at 1059 (citations omitted).

The Proposed Rule departs from decades of circuit court precedent applying the economic reality test, considering different factors and weighing the particular facts of the case

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<sup>44</sup> As the Proposed Rule acknowledges, in 1948, Congress abrogated the Court’s interpretations of the definition of “employee” for the NLRA and SSA in favor of a common law rule. However, Congress did *not* amend the FLSA. 85 Fed. Reg. at 60,602. DOL attempts to support the Proposed Rule by citing a 1948 Senate report, which rejected using the economic reality test for determining who is an “employee” under the NLRA and SSA. *See* 85 Fed. Reg. at 60,605-06. But the fact that Congress did not similarly amend the FLSA demonstrates that it found the test appropriate for purposes of the FLSA, undercutting DOL’s reliance on the Report.



to determine whether a worker is an employee or an independent contractor. The factors “are aids—tools to be used to gauge the degree of dependence of alleged employees on the business with which they are connected.” *Usery v. Pilgrim Equip. Co., Inc.*, 527 F.2d 1308, 1311 (5th Cir. 1976). “[A]ny formalistic or simplistic approach . . . must be rejected.” *Id.* Instead, “[b]roader economic realities are determinative.” *Id.* at 1315. See also *Hopkins v. Cornerstone Am.*, 545 F.3d 338, 343 (5th Cir. 2008) (“To determine if a worker qualifies as an employee, we focus on whether, as a matter of economic reality, the worker is economically dependent upon the alleged employer or is instead in business for himself.”); *Baker v. Flint Engineering & Const. Co.*, 137 F.3d 1436, 1440 (10th Cir. 1998) (the economic realities of the relationship govern, and the focal point is whether the individual is economically dependent on the business to which he renders service or is, as a matter of economic fact, in business for himself); *Superior Care*, 840 F.2d at 1059 (“The ultimate concern is whether, as a matter of economic reality, the workers depend on someone else’s business . . . or are in business for themselves.”). “Ultimately, in considering economic dependence, the court focuses on whether an individual is ‘in business for himself’ or is ‘dependent upon finding employment in the business of others.’” *Scantland*, 721 F.3d at 1312 (quoting *Mednick v. Albert Enters., Inc.*, 508 F.2d 297, 301–02 (5th Cir. 1975)).

As the circuit court precedent demonstrates, the inquiry must remain flexible enough to consider all of the circumstances of the relationship between the worker and the employer, using factor tests as signposts and considering those facts most relevant to the particular situation. Thus, DOL’s focus on two factors as “core” factors deserving greater weight while minimizing the importance of the others is contrary to law. See, e.g., *Superior Care*, 840 F.2d at 1059 (“No one of these factors is dispositive; rather, the test is based on a totality of the circumstances.”).

### **3. The Proposed Rule’s specific factors are contrary to law.**

In addition to the critical flaws in the overall test, specific factors defy established precedent as well. In contravention of that longstanding test, DOL changes the focus of the “control” factor, omits an entire factor—whether a worker’s job is “integral” to the business, and adds an “actual practice” requirement.<sup>45</sup>

First, the proposed control factor incorrectly focuses on the *worker’s control over the work*. Well-established precedent makes clear that the proper focus is the *employer’s control over the worker*. Compare 85 Fed. Reg. at 60,612 (describing the first economic reality factor as “the nature and degree of the individual’s control over the work”) with, e.g., *Scantland*, 721 F.3d at 1316 (analyzing “control over workers” by the alleged employer); *Saleem*, 854 F.3d at 141 (the employer “exercised minimal control over Plaintiffs” in two respects and “[t]his lack of control, while not dispositive, weighs in favor of independent contractor status.” (citations

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<sup>45</sup> DOL’s proposal to omit the consideration of the worker’s investment in the business, instead considering only the worker’s “opportunity to earn profits or incur losses based on . . . management of his or her investment in or capital expenditure on” the work, 85 Fed. Reg. at 60,639 (proposed § 795.105(d)(1)(ii)), also inappropriately subordinates the investment factor to the opportunity for profit or loss. Courts consider both factors, often together, but investment “is, itself, indicative of independent contractor status,” *Saleem v. Corp. Transp. Group, Ltd.*, 854 F.3d 131, 144 n.29, especially in smaller businesses.

omitted)); *Usery*, 527 F.2d at 1312–13 (“Control” of the worker over the work “is only significant when it shows an individual exerts such a control over a meaningful part of the business that she stands as a separate economic entity.”). This makes sense in the context of the longstanding economic reality test, which seeks to determine whether the worker is economically dependent on the employer consistent with the FLSA’s broad, remedial purpose. It properly focuses the “control” inquiry on the employer, not the employee, because analyzing whether the employer controls the worker indicates whether the worker is economically dependent on the employer or truly in business for themselves.

Likewise, the Department’s proposed “integrated unit” factor is contrary to law—it flouts established precedent and wholly omits whether a worker performs “integral” work, the “primary work of the alleged employer.” *Donavan v. DialAmerica Mktg., Inc.*, 757 F.2d 1376, 1385 (3d Cir. 1985). Proposed section 795.105(d)(2)(iii) explains “[w]hether the work is part of an integrated unit of production” should be considered but “is different from the concept of the importance or centrality of the individual’s work to the potential employer’s business.” 85 Fed. Reg. at 60,639; *see also id.* at 60,618 (explaining the “integrated unit” factor “may have limited applicability in the modern economy”). However, under well-established circuit court precedent, the relevant inquiry is whether the worker’s work is an integral part of the business, which could be satisfied by being part of an integrated unit, or by being integral to the business. *See, e.g., Dole v. Snell*, 875 F.2d 802, 811 (10th Cir. 1989) (explaining “many courts have examined whether or not the type of work performed by the alleged employees is an integral part of the business” and concluding that the work performed by cake decorators is “obviously integral to the business of . . . selling cakes which are custom decorated”); *Sec’y of Labor v. Lauritzen*, 835 F.2d 1529, 1537-38 (7th Cir. 1987) (“It does not take much of a record to demonstrate that picking the pickles is a necessary and integral part of the pickle business . . .”).

Finally, DOL’s proposal to emphasize the “primacy of actual practice” is contrary to law, and even narrower than the common law conception of employment. *See, e.g., New York v. Scalia*, No. 20-996, 2020 WL 5370871 at \*25–26 (S.D.N.Y. Sept. 8, 2020) (“*Scalia II*”) (vacating DOL’s final rule regarding the definition of “joint employment” under the FLSA, discussing the rule’s requirement that a putative joint employer must “actually exercise” control as, read generously, equivalent to the common law standard, while the FLSA definitions broadened the common law conception).<sup>46</sup> In *Scalia II*, the court held that DOL had improperly narrowed the “control” factor of the inquiry to the common law standard, displacing the FLSA’s broad definitions of “employer,” “employee,” and “employ.” Here, the Department’s focus on the “primacy of actual practice” suffers from the same flaw. While the “economic reality” test must consider actual practice, reserved authority in an agreement, like the looming sword of Damocles, will often influence what the parties do and cannot be disregarded as the Proposed Rule seems to dictate. *See Saleem*, 854 F.3d at 142 (“[I]t is not what [Plaintiffs] *could* have done that counts, but as a matter of economic reality what they actually *do* that is dispositive.”).

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<sup>46</sup> “Fundamentally, [the joint employment and independent contractor] inquiries seek to answer the same question: Whether a worker and an entity have formed an employment relationship.” *Id.* at \*22 n.19.

Together, these changes are not a clearer restatement of the economic reality test; instead, they improperly rewrite the law to tip the scales away from a finding that a worker is an employee covered by the protections of the FLSA. The Proposed Rule is contrary to statute and judicial precedent and should be withdrawn.

**B. The Proposed Rule is arbitrary and capricious because DOL has not provided adequate justification for the change.**

DOL proposes a rule that arbitrarily creates a new test for whether a worker is an employee or an independent contractor. As discussed above, departing from decades of precedent, DOL's test inappropriately selects two factors as "core" factors, shifts the focus from whether the employer controls the worker to whether the worker controls the work and altogether eliminates consideration of whether a worker's work is "integral" to the putative employer's business. Additionally, DOL fails to provide evidence or reasoning in support of its change and offers no explanation for how the Proposed Rule accounts for the evolving landscape of employment described above. Indeed, DOL makes no effort to determine how many workers will be affected by its novel interpretation; nor does it explain why the change in interpretation is needed. DOL's purported reasons for the Proposed Rule fail to justify the new test, especially in light of the well-settled statutory purpose of the FLSA to protect a broad swath of workers. The State AGs set forth above concrete evidence that the Proposed Rule will negatively impact workers in direct contravention of the FLSA. *See supra* Section I.B. If DOL proceeds in the face of this evidence, then the final rule will be arbitrary and capricious.

**1. DOL lacks data to support the Proposed Rule.**

Under *State Farm*, the Supreme Court requires that an agency "examine the relevant data and articulate a satisfactory explanation for its action." 463 U.S. at 43. The *State Farm* Court rejected an agency's explanation as arbitrary where "there [was] no direct evidence in support of the agency's finding." *Id.* at 52. Where an agency fails to reflect upon contrary evidence or treats contrary evidence in a conclusory fashion, the proposed rule will not survive judicial scrutiny. *See Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 241 (D.C. Cir. 2008) (finding conclusory dismissal of empirical data on a critical factor in the decision lacking a reasoned explanation). Courts have found that "a complete failure to . . . grapple with contrary evidence . . . disregard[s] entirely the need for reasoned decisionmaking." *Fred Meyer Stores, Inc. v. NLRB*, 865 F.3d 630, 638 (D.C. Cir. 2017).

While DOL claims that the "substantive effect of the rule is not intended to favor independent contractor or employee classification relative to the status quo," it admits that the Proposed Rule "could lead to an increase in the number of independent contractor arrangements." 85 Fed. Reg. at 60,626. And yet, DOL makes no effort to quantify that increase, acknowledging that the "Department has not quantified the potential change to the aggregate number of independent contractors that may occur if this proposed rule is finalized." *Id.* at 60,623. This is particularly problematic because as DOL also acknowledges (1) independent contractors pay more in taxes than employees; (2) unlike employees, independent contractors must obtain their own unemployment insurance, workers' compensation, and health care coverage; and (3) unlike employees, independent contractors are not covered by the FLSA's minimum wage and overtime pay requirements. *Id.* at 60,636–637. With respect to potential

transfers from workers to employers, the Proposed Rule states, “[a]lthough employer-provided benefits could decrease, and tax liabilities could increase” for workers newly classified as independent contractors, the “Department believes the net impact on total compensation should be small in either direction.” *Id.* at 60,626. DOL provides no data or explanation for the logic-defying conclusion that a reduction in employer-provided benefits and an increase in tax liabilities could result in a net *increase* in total compensation. Moreover, without empirical data, DOL has no basis to “believe” that the net impact would be “small.” This unsupported assumption renders the rule arbitrary and capricious if finalized.

In an apparent attempt to downplay the disadvantages of independent contractor status, DOL relies on the theoretical assumption that “any reduction in benefits and increase in taxes is likely to be offset by higher base earnings—referred to as an ‘earnings premium.’” *Id.* at 60,626–627; *see also id.* at 60,629 (“*Conceptually*, the Department expects that independent contractors would earn more per hour than traditional employees in base compensation as an offset to employer-provided benefits and increases in tax liabilities.” (emphasis added)). But in the same paragraph, DOL itself concedes that the data provides mixed evidence of this earnings premium. *Id.* at 60,627. In fact, not only does the data provide mixed evidence, but it often shows that an independent contractor earns *significantly less* than a worker paid as an employee for similar work.<sup>47</sup> Once more, DOL’s abstract exercise ignores the likely real-world impacts on the workers it is statutorily-obligated to protect. DOL also admits that it does not know the extent to which the Proposed Rule will lead employers to reclassify employees as independent contractors (as opposed to the Rule encouraging businesses to create independent contractor arrangements for new hires) and that “if current employees change classifications, then there may be transfers.” 85 Fed. Reg. at 60,627. Again, DOL makes no effort to quantify these transfers.

Prior to the Proposed Rule and as described above, misclassification of employees as independent contractors has been found in an increasing number of workplaces and leaves workers vulnerable to wage and hour violations. The Proposed Rule encourages employers to create independent contractor arrangements and will likely increase the prevalence of misclassification as businesses view the new test as favoring independent contractor status and may be confused about distinctions between the new FLSA test and more worker-protective tests under state laws. DOL completely fails to account for costs to workers and costs to States from misclassification and the Proposed Rule’s expanded conception of independent contractor status. DOL acknowledges that misclassification “is generally agreed to be common” but that the “prevalence of misclassification is unknown.” *Id.* at 60,625. While researchers have noted that it is difficult to ascertain the precise magnitude of the problem “[b]ecause independent

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<sup>47</sup> *See, e.g.,* Leberstein & Ruckelshaus, *supra* note 21 at 3 (“As a result of their outsized tax burden, the prevalence of wage and other violations, and unreimbursed businesses expenses, misclassified workers’ net income is often significantly less than for similar workers paid as employees.”). Indeed, this is consistent with data collected by the Bureau of Labor Statistics, which found in a 2017 study that earnings for independent contractors—\$851—were lower than for workers in traditional arrangements—\$884. Contingent and Alternative Employment Arrangements - May 2017 (June 7, 2018), [https://www.bls.gov/news.release/archives/conemp\\_06072018.htm](https://www.bls.gov/news.release/archives/conemp_06072018.htm).

contractor misclassification is fraud,”<sup>48</sup> DOL completely disregards the extensive research that has already been done in this area. Research into the prevalence of misclassification has been conducted not only by academics and independent think tanks,<sup>49</sup> but by federal government researchers.<sup>50</sup> See *supra* Section I.B (citing data demonstrating prevalence of misclassification). In fact, the Bureau of Labor Statistics—a DOL sub-agency—asserted just two months ago, “It’s our job at BLS to keep up with these new work relationships and figure out how to measure them.”<sup>51</sup> If DOL fails to examine and grapple with this data and evidence, a final rule will be arbitrary and capricious.

In addition to transfers from workers to employers, DOL fails to account for the foreseeable administrative and enforcement costs the Proposed Rule would impose on states. For example, workers will almost certainly file complaints over reclassification, increasing states’ enforcement burdens. Moreover, to the extent workers are reclassified, employers will no longer disburse payroll taxes or contribute to workers’ compensation and unemployment insurance systems. The Proposed Rule completely fails to address these problems. Plus, where state law has traditionally relied on federal interpretations of the FLSA, states will incur costs to clarify for employers that the state will continue to apply the longstanding economic reality test—not DOL’s new interpretation. In states with laws that are more worker-protective than the economic reality test, they will also have to engage in public outreach to ensure businesses are not confused about their obligations.

## **2. The asserted bases for the Proposed Rule are insufficient and unsupported.**

DOL claims that the Proposed Rule will “promote certainty for stakeholders, reduce litigation, and encourage innovation in the economy.” 85 Fed. Reg. 60,600. However, the test departs from decades of Supreme Court and Circuit precedent. DOL offers no explanation for how the Proposed Rule, which rests on the assertion that the circuit courts have misconceived

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<sup>48</sup> Carré, *supra* note 15 at 8. Carré also notes that calculating the magnitude is also made challenging because “misclassified workers [] may not be aware of their status.” *Id.*

<sup>49</sup> See *e.g.*, *id.*; see also Erlich and Gerstein, *supra* note 6.

<sup>50</sup> See, *e.g.*, Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention,” U.S. Government Accountability Office (2009), <https://www.gao.gov/assets/300/293679.pdf> (citing tax year 1984, IRS study from 1984 tax year estimating that U.S. employers misclassified a total of 3.4 million employees and DOL-commissioned 2000 study finding that 10 percent to 30 percent of firms audited in 9 states misclassified at least some employees). DOL includes a link to this report on its website, but apparently did not review it in issuing the NPRM.

<https://www.dol.gov/agencies/whd/flsa/misclassification>. The Bureau of Labor Statistics found, in May 2017, there were 10.6 million independent contractors (6.9 percent of total employment), though it did not assess whether they were properly classified or not. Contingent and Alternative Employment Arrangements - May 2017 (June 7, 2018), [https://www.bls.gov/news.release/archives/conemp\\_06072018.htm](https://www.bls.gov/news.release/archives/conemp_06072018.htm).

<sup>51</sup> New Recommendations on Improving Data on Contingent and Alternative Work Arrangements (Sept. 20, 2020), <https://blogs.bls.gov/blog/tag/independent-contractors/>.

economic reality after 80 years of litigation honing their tests, will provide “clarity” (besides repeating the word 35 times in the NPRM). The Proposed Rule is still a multi-factor test and “no single factor is dispositive,” but it also elevates the significance of two factors above all others—an approach that no court has ever taken. *Id.* at 60,639. Therefore, if finalized, the rule’s divergence from precedent will only lead to confusion. And in states with more restrictive classification tests, the new test will add further confusion. DOL acknowledges that some states have more stringent limitations on who may qualify as independent contractors under the FLSA. But DOL disregards this issue by simply asserting that it is “not well positioned to interpret the precise scope of each state’s wage and hour laws,” so it cannot “definitively determine the degree to which workers in particular states would or would not be affected by this proposed rule.” *Id.* at 60,626 n.85.<sup>52</sup>

DOL’s claim that the Proposed Rule will reduce litigation is also unsupported. As noted, the Proposed Rule creates a five-factor test that no court has articulated or implemented. *See supra* Section II.A. If the Proposed Rule is finalized, employers will find themselves caught between DOL’s new lax standard versus circuit court precedent and state standards that are faithful to longstanding Supreme Court precedent. The Proposed Rule would create confusion for future adjudications as the new test has no developed body of law to direct and guide its application and would still require a case-by-case analysis to clarify its meaning, leading to more—not less—litigation. Employing an entirely new standard, rather than one already applied by “most courts,” 85 Fed. Reg. 60,600, would raise additional fact-intensive questions as to which workers qualify as employees and which qualify as independent contractors, generating more uncertainty about legal obligations. And there will likely be an increase in litigation stemming from employees being reclassified and misclassified as independent contractors.

The Proposed Rule also claims to encourage innovation for digital platform companies and others, 85 Fed. Reg. at 60,610 (discussing “multi-apping and other economic innovations”), but it provides no empirical evidence or data demonstrating that employers now hesitate to engage in innovative arrangements. In fact, digital platforms have become a part of the modern economy, *see supra* Section I.B.1.; they have not been stifled by the current test. DOL fails to address evidence contrary to its bases for the Proposed Rule—that employers are not, in fact, hesitant to enter business relationships for labor even with the existing independent contractor test.<sup>53</sup> In any event, encouraging innovation among employers is not a valid justification to the extent that it conflicts with the statutory purposes of protecting workers; indeed, the legislative

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<sup>52</sup> In explaining the test, DOL at times relies on an earlier, historical understanding to justify the approach (*e.g.*, relying on *Rutherford* to assert that the test should only consider whether the work was “part of an integrated unit of production” rather than whether the work was important, 85 Fed. Reg. at 60,608–609 & n.20) and at other times relies on features of the modern economy to justify its interpretation (*e.g.*, claiming that a minimal personal investment does not necessarily indicate economic dependence, *id.* at 60,609). Tellingly, this arbitrary picking and choosing results in favoring independent contractor status.

<sup>53</sup> *See* Maya Pinto et al., *supra* note 9 at 2-3.

history demonstrates that the text of FLSA was crafted to “prevent the circumvention of the act” through innovative business arrangements.<sup>54</sup>

As discussed above, the FLSA seeks to protect a broad swath of workers and provides the “broadest definition . . . ever . . . included in any one act” to the term “employee.” *See supra* Section II.A.1. Moreover, DOL’s originating act provides that the agency’s purposes are to protect workers: “to foster, promote, and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance their opportunities for profitable employment.” 29 U.S.C. § 551. The fact that DOL provides no evidence of the impact that the Proposed Rule would have on employees exposes the true purpose of the Proposed Rule—to limit employer liability for FLSA violations.<sup>55</sup> Thus, the Proposed Rule disregards both the statutory purpose of the FLSA and the overall purpose of DOL.

### 3. The Proposed Rule fails to justify changes to DOL’s interpretation of the FLSA.

Under the APA, “when an agency changes its interpretation of a particular statutory provision, this change . . . will be set aside if the agency has failed to provide a ‘reasoned explanation . . . for disregarding facts and circumstances that underlay or were engendered by the prior policy.’” *Catskill Mountains Chapter of Trout Unlimited, Inc. v. Env’tl. Prot. Agency*, 846 F.3d 492, 523 (2d Cir. 2017) (quoting *Fox Television*, 556 U.S. at 516). And the agency “must be cognizant that longstanding policies may have engendered serious reliance interests that must be taken into account.” *Dep’t of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1913 (2020) (quoting *Encino Motorcars, LLC v. Navarro*, 136 S. Ct. 2117, 2126 (2016)). “It would be arbitrary and capricious to ignore such matters.” *Id.*

As the Proposed Rule acknowledges, DOL has applied a multifactor analysis “very similar” to the test courts use since at least 1954. 85 Fed. Reg. at 60,604. And DOL has repeatedly reiterated this multifactor economic reality analysis and promulgated regulations applying it to sharecroppers and tenants (29 CFR 780.330(b)), certain forestry and logging operations (29 CFR 788.16(a)), and agricultural workers (29 CFR 500.20(h)(4)). *Id.* In the 2015 AI, DOL had reaffirmed the multifactor test regarding misclassification, but withdrew the 2015

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<sup>54</sup> *Joint Hearings*, at 77; *supra*, Section II.A.1.

<sup>55</sup> In contrast, DOL’s prior policy on independent contractor status, which was disseminated in 2015 and withdrawn in 2017 without explanation, observed that “[m]isclassification of employees as independent contractors is found in an increasing number of workplaces” and, “[a]lthough independent contracting relationships can be advantageous for workers and businesses, some employees may be intentionally misclassified as a means to cut costs and avoid compliance with labor laws.” Administrator’s Interpretation No. 2015–1, *The Application of the Fair Labor Standards Act’s “Suffer or Permit” Standard in the Identification of Employees Who Are Misclassified as Independent Contractors* (“2015 AI”). Accordingly, the 2015 AI endeavored to set forth an interpretation of independent contractor status that would further the FLSA’s goals of protecting workers; the guidance noted that “applying the economic realities test in view of the expansive definition of “employ” under the Act, most workers are employees under the FLSA.” *Id.*

AI without any explanation in 2017. *See supra* note 55. The Proposed Rule only includes a footnote acknowledging its withdrawal, failing to explain—let alone provide a reasoned explanation for—its departure from the 2015 AI’s guidance and application of the six economic realities factors. 85 Fed. Reg. at 60,604 n.7. The 2015 AI highlighted the problem of misclassification of employees as independent contractors, which “in part reflect[s] larger restructuring of business organizations.” 2015 AI at 1. The 2015 AI noted that DOL’s Wage and Hour Division (“WHD”) “continues to receive numerous complaints from workers alleging misclassification, and the Department continues to bring successful enforcement actions against employers who misclassify workers.” *Id.* The Proposed Rule does not even mention complaints alleging misclassification, thereby “disregarding facts and circumstances that underlay . . . the prior policy.” *Catskill Mountains*, 846 F.3d at 523. The 2015 AI also noted that misclassification results in lower tax revenues for government and an uneven playing field for employers who properly classify their workers. The Proposed Rule disregards these facts as well.

In addition to failing to explain the reason for the change, DOL fails to account for the serious reliance interests that its longstanding policy has engendered among workers classified as employees under the longstanding test. For those employees who are reclassified as independent contractors under the Proposed Rule, they may lose employer-sponsored health insurance and retirement accounts as well as workers’ compensation and unemployment insurance coverage. It is no response to say that the reclassified worker can simply get health insurance through their spouse. *See id.* at 60,627 (discussing the ways independent contractors receive health insurance). As noted, DOL has not tried to quantify the number of workers who will be reclassified, let alone determine the extent to which reclassified workers have partners on whom they can rely for health insurance. Plus, DOL does not take into account the possibility that both spouses will be reclassified under its new test. Because DOL has not attempted to quantify transfers from reclassified workers to employers and ignores employees’ reliance interests, the Proposed Rule would be arbitrary and capricious if finalized.

The Proposed Rule also does not consider the reliance interests of employers who have arranged their businesses based on the longstanding economic reality test. Changing the test could disrupt contracts, business plans, and staffing models, and as previously noted, hurt law-abiding employers who are outbid by competitors who cut costs through payroll fraud.

Additionally, many states have relied on the FLSA’s independent contractor standard in developing and interpreting their own independent contractor test under state laws. *See supra* note 3. The Proposed Rule could call into question decades of state law interpretations and require state law enforcement agencies, state courts, and federal courts interpreting state laws to expend considerable resources to clarify independent contractor status under state labor law. DOL’s sudden departure from decades of court precedent and regulatory interpretation of the independent contractor test would upend these reliance interests as well.

#### **4. The Proposed Rule fails to consider the alternative of not regulating.**

DOL discusses three alternatives to its chosen approach but only mentions in passing the “alternative of not regulating.” 85 Fed. Reg. at 60,634. Its failure to discuss the alternative of not regulating further renders the Proposed Rule arbitrary and capricious. The State AGs urge



DOL to forego rulemaking here or to codify the six-factor “economic reality” balancing test that WHD has “long applied” rather than finalizing a new rule of its own creation.

### III. Conclusion

If finalized, DOL’s new independent contractor test would contravene the FLSA and court precedent and violate the APA. The Proposed Rule fails to grapple with the realities of today’s economy, ignores the widespread problem of misclassification, and puts forth a test that favors independent contractor status, leaving workers vulnerable to wage and hour violations—all during a once-in-a-century pandemic, which has left millions unemployed.

For the foregoing reasons, the Proposed Rule should be withdrawn.

Sincerely,



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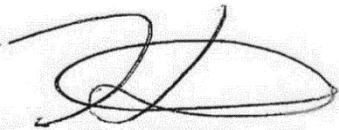
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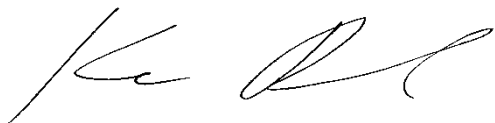
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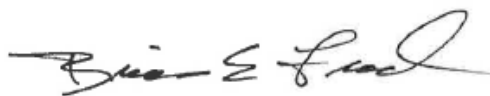
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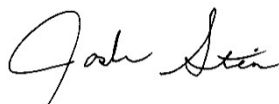
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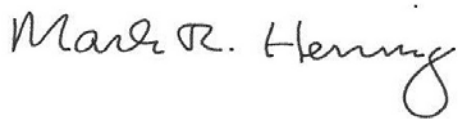
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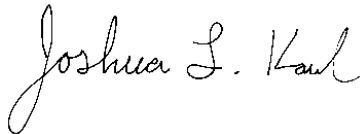
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