LANDMARK LEGAL FOUNDATION
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Employee or Independent Contractor Classification Under the Fair Labor Standards Act; Extension of Comment Period

Agency: Wage and Hour Division, U.S. Department of Labor

Comment Period Opens: October 13, 2022

Comment Period Closes: December 13, 2022

Comment Submitted: December 13, 2022

Document Number: 2022-23314

RIN: 1235-AA43

Landmark Legal Foundation ("Landmark") advocates for the immediate revocation of this Proposed Rule.

There are four major shortcomings Landmark has identified with the Proposed Rule:

1. **Maintains a state of uncertainty.** By failing to prioritize various elements of the economic realities test, the Proposed Rule causes great uncertainty for workers and businesses.

2. **Fails its purported beneficiaries on economic policy grounds.** By limiting the availability of independent work, the Proposed Rule would immediately harm several sectors essential to American economic growth.

3. **Opens the door to rent-seeking.** Tighter regulation of the independent contractor industry would incentivize rent-seeking that is repugnant to honest governance.

4. **Hinders the federal government itself.** The federal government also employs independent contractors for such activities as reviewing regulatory comments. The Proposed Rule would jeopardize the completion of this important work.

Below, we will explain how each of these factors discredit the Proposed Rule and invoke the need to maintain the 2021 Rule as the interpretative policy of the Wage and Hour Division.

1. The Proposed Rule Would Create Uncertainty

"In the [Wage and Hour Division's] view, the preferred environment is the status quo ante where employers are uncertain how to classify a worker under the economic realities test because they cannot know how WHD will evaluate the different factors. That lack of clarity and certainty puts employers at risk of WHD enforcement and private litigation, and can impede businesses from engaging many smaller businesses or sole proprietors."

– Marc Freedman, Vice President, Workplace Policy Employment Policy Division of the U.S. Chamber of Commerce.[1]

Over the years, Congress has enacted laws to protect employees from "substandard wages and oppressive working hours."[2] The cornerstone of this legislation is the Fair Labor Standards Act of 1938 ("FLSA"), which established guidelines for the treatment of full-time employees.

When employers fail to treat employees in accordance with the FLSA, they are subject to costly litigation or administrative proceedings. The statute primarily empowers the Wage and Hour Division of the Department of Labor ("WHD") to enforce these disciplinary processes. Accordingly, as complaints are brought to their office, the WHD constantly makes decisions as to who is protected under FLSA and to what extent. The WHD therefore must exercise discretion on the definition of a protected employee. Historically, this discretion caused great uncertainty in independent contractor relationships.

The FLSA never properly delineates the meaning of independent contractor ("IC"). Thus, the FLSA does not clarify when employers may hire outside support without investing in the associated expenses of full employment. Under the law, full-time employees are entitled to benefits ranging from overtime pay to insurance coverage – requirements that are neither offered to nor necessarily appropriate for ICs. Sometimes, however, a putative contractor might be unsure if they count as an employee and ask the courts to clarify their status. This uncertainty has caused endless litigation over "misclassifications." Moreover, the risk of these disputes arising between workers and their putative employers has often dissuaded business from offering jobs to "contingent workers" (i.e., independent contractors) in the first place.[3]

It is also true that "[v]ague laws invite arbitrary power."[4] Courts have recognized the need for uniformity in WHD decision-making. In 1947 the U.S. Supreme Court established an "economic realities test" for the WHD to apply when deciding whether a worker qualifies as an employee.[5] This six-factor test has remained in use for over seven decades. However, it has not

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[1] U.S. Chamber of Commerce, https://www.uschamber.com/workforce/independent-contractors/comments-dol-re-independent-contractor-status-under-the-fair-labor-standards-act-withdrawal (last visited Dec. 13, 2022).
[2] Barrentine v. Arkansas-Best Freight Sys., Inc., 450 U.S. 728,739 (1981).
[3] *Hiring Independent Contractors: 5 Risks to Avoid,* MBO Partners (Sep. 21, 2020), https://www.mbopartners.com/blog/misclassification-compliance/what-are-the-risks-of-hiring-independent-contractors/, (last visited Dec. 13, 2022).
[4] Sessions v. Dimaya, 138 S. Ct. 1204, 1223 (2018) (Gorsuch, J., concurring).
[5] See: *United States v. Silk*, 331 U.S. 704 (1947); *Bartels v. Birmingham*, 332 U.S. 126 (1947); and *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947).

been applied by the federal courts in a manner sufficiently consistent to resolve the economic uncertainty surrounding the hiring of contingent workers.[6] In particular, its six competing prongs have confused more than clarified what is most germane in identifying somebody as an independent contractor.

Many workers prefer to retain an independent status. In addition to greater economic flexibility – namely, the ability to reject certain work assignments without forsaking one's entire career – ICs enjoy identifying as their own boss and setting their own hours.[7] These workers come from a vast array of industries – ranging from truck drivers and shopping mall Santas to journalists and software engineers. [8] As others have pointed out, these flexible benefits are especially applicable to marginalized members of the economy such as working mothers.[9]

Nonetheless, when businesses risk a misclassification lawsuit for hiring these independent workers, they are forced to offer fewer of these contracts. This represents a massive compliance cost of the uncertainty imposed by the six-factor test. It is well established in economic literature that vague regulations cause economic strife for businesses without necessarily bringing them into harmony with government intentions. As a research paper from the American Enterprise Institute phrased it:

> "If uncertainty between firms and regulators is high, information frictions between firms and regulators should increase firms' administrative and control costs without corresponding compliance improvements."[10]

In January 2021, President Trump's WHD proposed a rule ("2021 Rule") to finally clarify these classifications. Under this rule, two factors in particular – "degree of control" and "opportunities for profit or loss" – would henceforth be the most probative in deciding whether a worker qualifies as an employee. In layman's terms, the extent to which a) the worker decides her own work schedule, or b) has an equity stake in her side of the business, would become "more relevant" than other factors in deciding whether she is independent. This simple proposal streamlines both parties' understanding of the WHD process, reducing the likelihood of costly

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[6] The 2021 Rule provides a few efficient summaries of the courts' divergent approaches towards applying the Economic Realities Test. Read them in detail at paragraph 40 (https://www.federalregister.gov/documents/2021/01/07/2020-29274/independent-contractor-status-under-the-fair-labor-standards-act#p-40) and paragraph 60 (https://www.federalregister.gov/documents/2021/01/07/2020-29274/independent-contractor-status-under-the-fair-labor-standards-act#p-60).

[7] *Empowering the New American Worker: Independent Work,* The CATO Institute (November 10, 2022), https://www.cato.org/publications/facilitating-personal-improvement-independent-contracting-gig-work, (last visited Dec. 13, 2022).

[8] *Independent Contractors: Hear real stories of workers impacted by job-killing regulations,* Independent Women's Forum, https://www.iwf.org/chasing-work-independent-contractors/, (last visited Dec. 13, 2022).

[9] *Five reasons California's Assembly Bill 5 has been devastating to women,* Americans For Prosperity (Nov. 6, 2020), https://americansforprosperity.org/five-reasons-californias-assembly-bill-5-has-been-devastating-to-women/, (last visited Dec. 13, 2022).

[10] Stan Veuger and Kristin Wilson, *Can Regulatory Oversight Help Firm Performance? Evidence from U.S. Commercial Banks,* American Enterprise Institute (Jul. 24, 2015), https://www.aei.org/wp-content/uploads/2015/07/regulatory-oversight1.pdf?x91208, (last visited Dec. 13, 2022).

court disputes. As a result, it encourages businesses to hire ICs more liberally, as they are less likely to fear a misclassification dispute.

Unfortunately, the current WHD has fought to reverse the economic and administrative progress created by the 2021 Rule. The October 2022 Proposed Rule ("Proposed Rule") attempts to codify the *status quo ante* of a multi-faceted economic realities test. By complicating the distinction between ICs and employees, the Proposed Rule will discourage the hiring of freelancers or other contingent workers. Downstream of this hiring slowdown, the Proposed Rule will inflict deleterious results on the economy and government accountability.

2. The Proposed Rule Would Harm the U.S. Economy

Independent Work is An Engine of Economic Progress

Research indicates that independent contractors are one of the fastest growing components of the American economy. The freelancing platform MBO Partners recently produced two reports indicating the extent of this growth. Their findings indicate that:

- At the end of 2022, over 64.6 million independent workers were carving their own path nationwide.[11]
- This total had grown a whopping 26% since the end of 2021 – translating to nearly 13 million new independent jobs. [12]
- By February 2024, one out of every three members of the corporate workforce will be a contingent worker. [13]

This remarkable growth in ICs is part of an economic revolution resulting in highly skilled workers earning highly touted wages. Contrary to the assumptions of the WHD in the Proposed Rule, businesses are not turning to contingent workers to skimp on wages and benefits. Indeed, these contingent workers are often hired to provide bespoke services that could not be easily obtained through a sluggish employee hiring process. The most common reasons for hiring ICs, according to the MBO reports, included "Boosting Productivity" and "Accessing Skills in Short Supply." In the survey, "Saving on Costs" was only a top priority for 14% of hiring business.[14]

Contingent workers themselves do not feel victimized by an economic squeeze. To the contrary, they seem to enjoy their independence. In a survey conducted by the Coalition for Workforce Innovation, 94% of independent workers enjoyed their current arrangement.[15] Their

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[11] *State of Independence in America 2022*, MBO Partners (last visited: Dec. 13, 2022), https://www.mbopartners.com/state-of-independence/soi-22/.
[12] Ibid.
[13] *The Contingent Labor Imperative: How Agile Enterprises Succeed in a Modern Workforce Model*, MBO Partners, https://www.mbopartners.com/state-of-independence/contingent-labor-report/, (last visited Dec. 13, 2022).
[14] Ibid.
[15] *National Survey of 600 Self-Identified Independent Contractors Conducted January 2020*, Coalition for Workforce Innovation, https://rilastagemedia.blob.core.windows.net/rila-web/rila.web/media/media/pdfs/letters%20to%20hill/hr/cwi-report-final.pdf, (last visited Dec. 13, 2022).

satisfaction comes on the heels of an impressive boon for their earning potential. A large portion of the contingent worker revolution is comprised of Americans choosing to supplement an existing source of income. In light of inflation and recession, 71% of part-time independents told MBO that they chose to become ICs to enhance existing earnings.[16] Moreover, 64% of independents reported that they chose to become ICs "completely" on their own accord – as opposed to being pressured into doing so.[17] The WHD's Proposed Rule would quash these newfound economic freedoms.

On the high end, contingent workers can also do very well for themselves. Roughly one-in-five full time independents earn over $100,000 annually.[18] In raw totals, that represents over 4.4 *million* individuals earning six-figure salaries through their contingent work. This proportion of high earning ICs has consistently grown during the last three years as rising online work paired with the worker-friendly 2021 Rule to promote freelancing activities. However, were the WHD to implement their Proposed Rule, these massive gains could be wiped out – destroying a revolutionary business model in its nascent stages.

Independent Work is Essential to the Logistics Sector

According to the MBO reports, much of the growth in the contingent work sector has come from online jobs. However, traditional industries also rely heavily on an independent contractor model. Many of these industries are indispensable to the survival of the broader American economy.

When discussing the role of independent contractors, one cannot ignore the trucking industry. The "owner-operator" is a standby of the logistics sector, encompassing at least 400,000 drivers who own their rigs and set their own delivery schedules. These independent truckers are essential to America's supply chain, delivering billions of dollars' worth of merchandise nationwide.[19] Were the WHD to implement the proposed rule, it would become substantially harder for these independent truckers to obtain contracts – exacerbating a critical nationwide trucker shortage.[20] Moreover, if forced to become employees, many of these truckers would simply leave the industry; many independent truckers prioritize their "load discretion" (time, place, and content) and autonomy in their schedule.

Independent truckers are also among the safest and most efficient elements of the American supply chain. For starters, owner-operators are highly experienced drivers. As of 2021, independent truckers are roughly *370%* less likely to get in a crash than the national industry

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[16] *State of Independence in America 2022,* MBO Partners, https://www.mbopartners.com/state-of-independence/soi-22/, (last visited Dec. 13, 2022).
[17] Ibid.
[18] Ibid.
[19] *Industry/Owner-Operator Facts*, Owner-Operator Independent Drivers' Association, https://www.ooida.com/wp-content/uploads/2021/03/Trucking-Facts.pdf, (last visited Dec. 13, 2022).
[20] Jennifer Smith, *Where Are All the Truck Drivers? Shortage Adds to Delivery Delays*, Wall Street Journal (Nov. 3, 2021), https://www.wsj.com/articles/truck-driver-shortage-supply-chain-issues-logistics-11635950481, (last visited Dec. 13, 2022).

average.[21] Unlike employee drivers, independent truckers can also carry loads for multiple clients during a trip. This makes them less likely to "deadhead," or drive an empty load while travelling to or from a pickup site. By reducing the prevalence of deadheading, independent truckers reduce the total number of trucks on the road, reduce fuel consumption, reduce emissions, reduce risks of injury and death to all drivers on the road, and reduce wear and tear on American highway infrastructure. By increasing the prevalence of employee-only operators, the WHD Proposed Rule would increase all these social costs.

The companies hiring independent truckers would also be harmed by the Proposed Rule. Freight brokers who do opt to hire full-time employee drivers would face steep challenges in implementation. These firms, unused to hiring many of their own truckers, will have a much more difficult time weeding out incompetent and dangerous operators and (because of increased employee overhead) face dramatically increased costs per load. As of now, freight brokers comprise a massively expanding industry – drawing nearly $50 billion of annual revenue as of 2021.[22] Were the WHD to implement their Proposed Rule, however, they could easily cause many such firms to collapse. This would erase tens of billions in economic growth.

Trucking is just one segment of the transportation industry, which is itself only a part of the national economy. Unforeseen social costs would undoubtedly arise in a multitude of other industries from a more restrictive regulatory scheme for ICs.

3. The Proposed Rule Would Promote Rent-Seeking

In addition to its harrowing economic effects against industries reliant on independent work, implementing the Proposed Rule would also compromise the trustworthiness of the IC regulatory process. By restoring a confusing standard of analysis, the Proposed Rule would incentivize efforts by businesses to bypass the *de jure* classification of their employees. Most likely, these efforts would take the form of lobbying by special interests able to afford government access.

California Exemplifies Corruption in Strict IC Classification Regimes

For an example of how the Proposed Rule might play out, one may consider the recent developments in California misclassification law. In the 2018 ruling *Dynamex Operations West v. Superior Court*, the California Supreme Court ruled in favor of several delivery drivers seeking damages for their misclassification as independent contractors.[23] Not only did the court

[21] *Industry/Owner-Operator Facts*, Owner-Operator Independent Drivers' Association, https://www.ooida.com/wp-content/uploads/2021/03/Trucking-Facts.pdf, (last visited Dec. 13, 2022).
[22] Allied Market Research, *Freight Brokerage Market to Garner $90.7 Billion by 2031: Allied Market Research*, GlobeNewsWire (Aug. 30, 2022), https://www.globenewswire.com/en/news-release/2022/08/30/2506990/0/en/Freight-Brokerage-Market-to-Garner-90-7-Billion-by-2031-Allied-Market-Research.html, (last visited Dec. 13, 2022).
[23] *Dynamex Operations W. v. Superior Court*, 4 Cal. 5th 903 (2018).

award the drivers their backpay, but in a unanimous opinion the judges also rewrote the standard by which California wage orders apply to "employees." The judges established an "ABC Test" to prove that any worker was indeed an independent contractor. Contrary to years of precedent, the ABC Test made it incumbent upon employers to prove that any hire was *not* an employee. As a result, California's courts had enshrined a radically anti-employer regime surrounding IC classification law.

Dynamex was an egregious instance of legislating from the bench. Unfortunately, this sort of judicial overreach is made all the more likely when labor agencies themselves fail to clarify their tests – such being the case under the Proposed Rule, for instance. Beyond these judicial issues, however, *Dynamex* was the harbinger of serious governance failures surrounding California employment law.

The California legislature quickly took notice of the judicially imposed standard. In September 2019, little more than a year following the *Dynamex* ruling, Gov. Gavin Newsom signed California Assembly Bill 5 ("AB5") into law.[24] AB5 codified into law the court's ABC Test and extended the test to all employee disputes, ranging from wage orders to health insurance. Coupled with California's unusually stringent civil penalties for employee misclassification, AB5 set the bar for the nation's strictest employment law regime.

Business recognized the risks that AB5 posed to their profits. The bill, applied at face value, would force hundreds of thousands of erstwhile contractors into either an expensive employment arrangement or total separation from their former client. Seeking to protect themselves, over 30 different industries successfully lobbied for an exemption (written into the bill itself) from AB5's IC provisions. The likes of lawyers and journalists received protection from the legislature, but truck drivers did not.

Even after AB5 was passed, other special interests not exempted by the law pushed to be free from the ABC Test's radical provisions. In 2020, delivery app corporations (namely Uber, Lyft, and DoorDash) expended at least $200 million lobbying California voters to pass a referendum that would exempt gig drivers from employee status.[25] The referendum, known formally as Proposition 22, passed with a strong majority of the vote. Ironically, it benefited the lobbying companies directly at the expense of a worker constituency (i.e., Uber drivers) often invoked as the key beneficiaries of polices like the ABC Test.[26]

Of course, the Proposed Rule is not the same as the ABC Test found in *Dynamex* or AB5. For instance, the nature of the present case would direct rent-seeking towards the WHD instead of the legislature. Nonetheless, the present situation bears two core similarities to the California

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[24] *California Assembly Bill 5 (2019),* Ballotpedia, https://ballotpedia.org/California_Assembly_Bill_5_(2019), (last visited Dec. 13, 2022).
[25] Jeremy B. White, *Gig companies break $200M barrier in California ballot fight*, Politico (Oct. 29, 2020), https://www.politico.com/states/california/story/2020/10/29/gig-companies-break-200m-barrier-in-california-ballot-fight-9424580, (last visited Dec. 13, 2022).
[26] Kari Paul, *Prop 22: why Uber's victory in California could harm gig workers nationwide*, The Guardian (Nov. 11, 2020), https://www.theguardian.com/us-news/2020/nov/11/california-proposition-22-uber-lyft-doordash-labor-laws, (last visited Dec. 13, 2022).

example. First, by promoting a relatively unclear policy more likely to wind up in litigation, the WHD, in effect, will defer its policymaking to the courts. Second, the Proposed Rule will likely trigger business to incur additional costs from lobbying as part of an effort to seek clarification and protect their own parochial interests.

4. The Proposed Rule Would Hinder Federal Government Interests

The U.S. federal government normally employs between three and four *million* contractors throughout its departments.[27] Given the uncertainty of the economic realities test, these workers could have their positions jeopardized by a single federal circuit court case. These at-risk workers serve a myriad of essential roles, providing specialized and on-call services just like their private-sector counterparts put at risk by the Proposed Rule. At the government level, however, the loss of these employees would cause substantial issues for citizens nationwide.

For example, the federal government regularly employs contractors to review regulatory comments in instances such as this.[28] It is even possible that the Department of Labor hires outside consultants to analyze their notice-and-comment regulations, such as the current Proposed Rule.

Were these consultants to be considered under the "totality of circumstances" test proposed in the WHD rule, they may be more properly reclassified as government employees. In that situation, would it be fair to strip them away from their existing jobs and put them through a burdensome process of onboarding as government employees? Would it be fair to fire them, if those overhead costs were not worth the benefits of a given project? In either case, would it be equitable for the government to exempt its own contractors from these burdens if it applies them to workers in the private sector?

Based on their use of consultants in the past, the federal government relies on the flexibility afforded by independent contractors. The same needs exist in the private business community, as well.

Conclusion

The Proposed Rule on the status of independent contractors would result in harmful outcomes for contractors, employers, and the federal government itself. In its current state, the

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[27] Paul C. Light, *The True Size of Government: Tracking Washington's Blended Workforce, 1984–2015*, The Volcker Alliance (October 2017), https://www.volckeralliance.org/sites/default/files/attachments/Issue%20Paper_True%20Size%20of%20Government.pdf, (last visited Dec. 13, 2022).

[28] *Clean Air Act Regulatory Development Support*, ERG, https://www.erg.com/project/clean-air-act-regulatory-development-support#:~:text=Support%20EPA%20in%20drafting%20rule%20and%20preamble%20language%20and%20in%20summarizing%20and%20responding%20to%20public%20comments%20on%20proposed%20rules, (last visited Dec. 13, 2022).

implementation of the Proposed Rule would harm essential sectors of the American economy, undermine trust in the institutional process, and drown the employee-classification process in confusing legal doctrines. The WHD should revoke this Proposed Rule immediately.

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