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December 13, 2022

By Electronic Filing (*http://www.regulations.gov*)

The Honorable Martin J. Walsh
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, *Employee or Independent Contractor Classification Under the Fair Labor Standards Act*, 87 Fed. Reg. 62,218 (Oct. 13, 2022) RIN 1235-AA43.

Dear Secretary Walsh and Director DeBisschop:

We write on behalf of the States of New York, California, Colorado, Connecticut, Delaware, Hawaii, Maine, Maryland, Michigan, Minnesota, Nevada, New Jersey, Rhode Island, Washington, the Commonwealths of Massachusetts and Pennsylvania, the District of Columbia, the City of Philadelphia, the Pennsylvania Department of Labor & Industry and the Washington Department of Labor & Industries (the "State AGs") to support the proposed rulemaking by the U.S. Department of Labor (the "Department" or "DOL") relating to the classification of workers under the Fair Labor Standards Act (the "FLSA"). The Department proposes to rescind the rule entitled "Independent Contractor Status under the Fair Labor Standards Act" (the "2021 Rule") and to revise the test for determining employee or independent contractor classification under the FLSA. *See Employer or Independent Contractor Classification Under the Fair Labor Standards*

Act, 87 Fed. Reg. 62,218 (Oct. 13, 2022) (the "Proposed Rule"). The State AGs strongly support rescission of the 2021 Rule and request that the Department also consider our prior comments opposing the 2021 Rule.[1]

The enforcement experiences of the undersigned in protecting workers favor adoption of the Proposed Rule. In place of the 2021 Rule, the Proposed Rule restores DOL's decades-long approach to employee classification based on the economic realities test, which is more consistent with judicial precedent and the FLSA's text and purpose. Accordingly, the State AGs urge the Department to move expeditiously to finalize the Proposed Rule.

I. 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 violations 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. Employers who misclassify workers as independent contractors therefore deprive workers of wages, benefits, and other employment protections. Studies have demonstrated that worker misclassification is a significant and pervasive problem that cheats workers out of billions of dollars in wages on an annual basis.[2] Accordingly, the State AGs have a vested interest in the test used by the Department to determine employee status.

Workers and employers rely on the DOL for clarity and consistency. 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 multifactor test, the totality of the circumstances is considered and no one factor is dispositive. *See infra* Section III.B.

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[1] These comments are available at: https://downloads.regulations.gov/WHD-2020-0007-1711/attachment_1.pdf (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); https://downloads.regulations.gov/WHD-2020-0007-3093/attachment_1.pdf (Attorneys General of New York, Pennsylvania, California, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, North Carolina, Oregon, Rhode Island, Vermont, Virginia, and Washington); https://downloads.regulations.gov/WHD-2020-0007-4213/attachment_1.pdf (states of Pennsylvania, New York, California, Colorado, Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, North Carolina, Oregon, Rhode Island, Vermont, Virginia, and the District of Columbia, in addition to the Minnesota Department of Labor and Industry, the Pennsylvania Department of Labor and Industry, and the Washington State Department of Labor and Industries).

[2] *Misclassification, the ABC test, and employee status*, Economic Policy Institute (June 16, 2021), https://www.epi.org/publication/misclassification-the-abc-test-and-employee-status-the-california-experience-and-its-relevance-to-current-policy-debates/.

A. State AGs Are Responsible for Enforcing Federal, State, and Local Laws and/or Defending Enforcement Actions by State Agencies.

States, through their departments of labor or through their attorneys general, are responsible for enforcing labor standards. Accordingly, state enforcers must determine whether a worker is an employee or an independent contractor as a preliminary factor to establish that they are subject to wage and hour and other protections under state and federal law. State AGs have extensive experience bringing worker misclassification enforcement actions that have secured millions of dollars in wages, benefits, and injunctive relief for misclassified workers. *E.g.*, *People v. Uber Techs., Inc.*, 270 Cal. Rptr. 3d 290 (Cal. Ct. App. 2020) (California AG enforcement action securing preliminary injunction prohibiting misclassification of ride-hail drivers; preliminary injunction subsequently dissolved after passage of Proposition 22); Consent Order, *D.C. v. Dynamic Contracting, Inc.*, No. 2021 CA 003768 B (D.C. Super. Ct. 2022) (District of Columbia AG enforcement action recovering over $1M in worker restitution and penalties for misclassified construction); Settlement Agreement, *People v. FedEx Ground Package Sys., Inc.* No. 402960/10 (N.Y. Sup. Ct. 2018) (New York AG enforcement action recovering $2M in worker restitution for misclassified delivery drivers); *Tianti v. William Raveis Real Est. Inc.*, 651 A.2d 1286 (Conn. 1995) (Connecticut Commission of Labor enforcement action recovering over $20,000 for misclassified real estate brokers); *E. Bay Drywall, LLC v. Dep't of Lab. & Workforce Dev.,* 278 A.3d 783 (N.J. 2022) (New Jersey AG enforcement action recovering unemployment and disability benefits contributions from employer misclassifying workers).[3] To that end, 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, while other states have their own tests, including the three-prong "ABC" test.

The State AGs have prioritized enforcing worker misclassification because it causes extensive harm to workers, states, and law-abiding employers. First, misclassified workers are typically denied basic protections such as minimum wage, overtime, timely payment of wages, timekeeping records, pay stubs, paid leave, and reimbursement for expenditures that primarily benefit the employer (e.g. uniforms, travel expenses). In addition to increased law enforcement actions, misclassification results in lost revenue and increased administrative burdens and costs to states.[4] Due to misclassification, states suffer a loss of tax revenue they would otherwise

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[3] *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; 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), 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 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.).

[4] *See, e.g.*, Lisa Xu & Mark Erlich, Economic Consequence of Misclassification in the State of Washington, Harvard Labor and Worklife Program, 4 (2019), https://lwp.law.harvard.edu/files/lwp/files/wa_study_dec_2019_final.pdf

receive from payroll taxes and a loss of funds to unemployment insurance, workers' compensation, and paid leave programs.[5] States also incur additional costs, such as providing health care coverage and hospital costs for uninsured workers, as misclassified workers cannot access benefits like employer-provided health insurance, 401(k) plans, or unemployment insurance, and often lack appropriate workers' compensation coverage.[6] Finally, misclassification hurts employers "who play by the rules."[7] Employers that properly classify employees and run their business in accordance with wage and hour laws operate at a competitive disadvantage when competing for the same work with employers that skirt the law.[8] Law-abiding businesses pay the proper taxes and insurance premiums, functionally subsidizing the businesses that do not comply with the law, while tax increases necessitated by shortfalls in state trust funds impact law-abiding businesses as well.

B. The Flexibility of the Economic Realities Test is Necessary to Protect Workers in Light of Changing Work Arrangements.

As State AGs who enforce and defend state wage and hour laws, we know that a flexible standard that considers the totality of the circumstances is required to address changing work arrangements. The multifactor economic realities test addresses this need because no one factor is controlling, nor is the list exhaustive. This allows for the test to adapt to changing work arrangements and ensure that the most vulnerable workers remain protected under the FLSA.

In the modern economy, companies have used changing work arrangements as a fig leaf to aggressively misclassify workers, going as far as to classify their entire core workforce as independent contractors. This is particularly seen in the "gig" economy, where companies that do business by selling a service online—take for example, delivery—have repeatedly taken the position that they do not employ the workers that perform that service (here, the delivery driver), instead classifying them all as independent contractors. A business model where companies can unilaterally evade employment obligations as to their most essential workers strains credulity. It

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("Federal and state governments lose substantial revenues from taxes that would have been paid had the workers had [sic]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.").

[5] *See, e.g.*, Office of the Attorney General for the District of Columbia, Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry, 12 (2019), https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf (District of Columbia AG 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).

[6] *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.

[7] *See* Françoise Carré, (In)dependent Contractor Misclassification, Economic Policy Institute, Briefing Paper #No. 403 (2015), https://files.epi.org/pdf/87595.pdf

[8] *See* Catherine Ruckelshaus et al., 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-Accountability-Labor-Standards-Outsourced-Work-Report.pdf.

also denies vulnerable workers basic wage-and-hour protections, and in many cases, leaves them holding the bag as to routine business costs ordinarily borne by employers. This problem has recurred and proliferated across multiple industries. The State AGs have sued ride-hail companies for misclassifying their drivers as independent contractors, a delivery company for misclassifying its delivery couriers as independent contractors, and a customer service company for misclassifying its customer service agents as independent contractors.[9] In each of these cases, misclassification shorted workers of their wages and forced them to bear the costs of routine business expenses ordinarily paid for by employers, such as costs for travel, tools, and training.

Moreover, courts have applied multifactor balancing tests to see through this type of systemic misclassification. For example, in *Matter of Lowry (Uber Techs., Inc. – Commissioner of Labor)*, the New York Appellate Division affirmed that a gig worker performing driving services for a ride-hail company should have been classified as an employee due to multiple factors, including the company's control over the driver's pay and on-the-job conduct—and as a result, was entitled to unemployment insurance benefits. 189 A.D.3d 1863 (N.Y. App. Div. 2020). In *Awuah v. Coverall North America,* a janitorial company was found to have misclassified all of its janitorial workers as independent contractors under the guise they were "franchisees" who had purchased a cleaning business. 707 F. Supp. 2d 80 (D. Mass. 2010). The damages to workers arising from this misclassification were significant and varied, and included unlawful franchise fees tantamount to "requir[ing] employees to buy their jobs from employers," as well as costs for insurance premiums that were improperly shifted to workers. *Awuah v. Coverall N. Am., Inc.*, 952 N.E.2d 890, 900 (Mass. 2011).

Finally, the global COVID-19 pandemic and its enduring health concerns have exposed and amplified the harsh consequences of a fissured workplace, misclassification, and its impact on vulnerable workers—disproportionately women and people of color.[10] Misclassified workers who are fired from their employment arrangements are not able to obtain traditional state unemployment benefits as a safety net. This fact decreases the likelihood that vulnerable workers will file a complaint with an enforcement agency because workers fear losing their positions, despite suffering wage theft. As a result, states face greater difficulty in enforcing wage and hour laws as the violations are hidden by economic insecurity and fear. The flexibility of the economic realities test is therefore essential in adapting to the changing nature of work and ensuring that vulnerable workers remain protected by the FLSA.

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[9] *See Uber Techs,* 270 Cal. Rptr. 3d 290 (California AG enforcement action against ride-hail companies); *Massachusetts v. Uber Techs., Inc.*, No. 2084-CV-01519-BLS1, 2021 WL 1222199, at *1 (Super. Ct. Mar. 25, 2021) (Massachusetts AG enforcement action against ride-hail companies); *D.C. v. Shipt, Inc.*, No. 2022 CA 4909 B (D.C. Super. Ct. filed Oct. 24, 2022) (District of Columbia AG enforcement action against delivery company); *D.C. v. Arise Virtual Solutions, Inc.*, No. 2022 CA 000247 B (D.C. Super. Ct. filed Jan. 19, 2022) (District of Columbia AG enforcement action against customer service company).

[10] *See, e.g.,* Jocelyn Frye, On the Frontlines at Work and at Home: The Disproportionate Economic Effects of the Coronavirus Pandemic on Women of Color, Center for American Progress (2020), https://www.americanprogress.org/wp-content/uploads/2020/04/WOCcorona-report-1.pdf; Nicole Bateman & Martha Ross, Why has COVID-19 been especially harmful for working women?, Brookings Institution (2020), https://www.brookings.edu/essay/why-has-covid-19-been-especially-harmful-for-working-women/.

II. The State AGs Support the Proposed Rule and Rescission of the 2021 Rule

A. The Proposed Rule Is Consistent with the Text and Purpose of the FLSA, Supreme Court and Federal Court Decisions, and Prior DOL Guidance.

The Proposed Rule properly restores the multifactor economic reality test—based on the totality of the circumstances—to determine the employment status of an individual under the FLSA, in accordance with the broad definitions and purpose of the FLSA, Supreme Court and circuit court decisions, and decades of DOL guidance.

1. The FLSA Requires a Broader Scope of Employee Coverage than the Common Law.

The FLSA defines "employer," "employee," and "employ," but does not explicitly define "independent contractor." Specifically, "employer" is defined as "any person acting directly or indirectly in the interest of an employer in relation to an employee." 29 U.S.C. § 203(d). "[E]mployee" is defined as "any individual employed by an employer." *Id.* § 203(e)(1). And "employ" "includes to suffer or permit to work." *Id.* § 203(g). The FLSA's text, purpose, and legislative history illuminate the meaning of "employer," "employee," and "employ" and demonstrate that these broad definitions extend the FLSA's protections to a wide range of employment arrangements beyond those covered under the common law.

The FLSA became law "in the midst of the Great Depression [] to combat the pervasive 'evils and dangers resulting from wages too low to buy the bare necessities of life and from long hours of work injurious to health.'" *Salinas v. Com. Interiors, Inc.*, 848 F.3d 125, 132 (4th Cir. 2017) (quoting S. Rep. No. 75-884, at 4 (1937)). Congress enacted the FLSA "principal[ly]…to protect all covered workers from substandard wages and oppressive working hours[.]" *New York v. Scalia*, 464 F. Supp. 3d 528, 533 (S.D.N.Y. 2020) (quoting *Mei Xing Yu v. Hasaki Rest., Inc.*, 944 F.3d 395, 402 (2d Cir. 2019)). In addition to "improving working conditions," the FLSA "reflects Congress' desire to eliminate the competitive advantage enjoyed by goods produced under substandard conditions." *Citicorp Indus. Credit, Inc. v. Brock*, 483 U.S. 27, 36 (1987) (citing 29 U.S.C. § 202(a)). The FLSA requires that employers pay a minimum wage per hour and overtime of one and a half times the regular rate to nonexempt employees and keep certain records regarding those employees. 87 Fed. Reg. at 62,220 (citing 29 U.S.C. §§ 206(a)(c), 207(a), 211(c)).

The FLSA's "remedial and humanitarian purpose" led to these broad definitions of "'employ,' 'employee,' and 'employer,' that brought a broad swath of workers within the statute's protection." *Salinas*, 848 F.3d at 133. 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).

The "suffer or permit" language under the definition of "employ" was included specifically to prevent employers from circumventing the FLSA by designating employees as independent contractors.[11] By defining "employ" to include "suffer or permit to work," Congress expanded the FLSA's coverage beyond the common law employment test which looks only to factors such as an employer's "right to control." By contrast, "[t]o permit to work was broader. It did not require the affirmative act of engaging a person to work, but only a decision to allow the work to take place.... [T]o suffer to work was broader still. To suffer in this context meant to tolerate or to acquiesce in. It required only that the business owner have the reasonable ability to know that the work was being performed and the power to prevent it. Thus, work performed as a necessary step [to produce] a product was almost always suffered or permitted by the business owner."[12]

The Supreme Court has recognized that the FLSA's definitions are "comprehensive enough to require its application to many persons and working relationships, which prior to this Act, were not deemed to fall within an employer-employee category." *Walling v. Portland Terminal Co.*, 330 U.S. 148, 150-51 (1947). Further, "putting on an 'independent contractor' label does not take the worker from the protection of the Act." *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 729 (1947). The "striking breadth" of "employ" in the FLSA "stretches the meaning of 'employee'" beyond the common law definition. *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992). Thus, under the FLSA, employment status is not based on traditional common law agency principles but is more expansive to convey the protections of the FLSA onto individuals suffered or permitted to work.

2. <u>The Supreme Court and Federal Circuit Courts of Appeals Rely on the Economic Reality Test to Determine Employment Status under the FLSA.</u>

The statutory language of the FLSA 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.[13] *See* Brief for the United States at 21, *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)). And 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.

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[11] *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, 1100–01 (1999) (quoting Brief of the Administrator at 27–29, *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947) (No. 562)).

[12] *Id.* at 984.

[13] Under the common law control test, courts focus on whether the hiring entity controls the manner and means by which the work is performed. While some of the factors examined under the common law test are also found in the economic reality test (e.g., skill, duration of working relationship, source of tools and equipment), courts recognize that the common law test's narrow focus on control is more permissive to independent contracting arrangements, which is contrary to the FLSA's broad definition of "employ." 87 Fed. Reg. 62,270.

As explained in the Proposed Rule, to give effect to the FLSA's intentionally broad definition of employment, courts determine if an employment relationship exists through a holistic evaluation of the economic realities of that relationship. The Supreme Court first established the economic reality test in analyzing the definition of "employee" under the National Labor Relations Act ("NLRA") and Social Security Act ("SSA"). *See NLRB v. Hearst Publ'ns*, 322 U.S. 111, 129 (1944) (analyzing "employee" under the NLRA based on "the facts involved in the economic relationship"); *Silk*, 331 U.S. at 713, 716 (analyzing "employee" under the SSA and describing analysis set forth in *Hearst* as considering whether workers were "employees" "as a matter of economic reality"). 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." 331 U.S. at 716. Then, 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 723-24, 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 demonstrate that whether someone is an employee depends on each listed factor, none of which is more important than any other. [14]

Since *Rutherford*, the Supreme 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 Lab.*, 471 U.S. 290, 301 (1985) ("[T]he test of employment under the Act is one of 'economic reality[.]'"). 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." 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.* at 32-33. In *Alamo Foundation*, the 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." 471 U.S. at 301 (citation omitted).

As the Proposed Rule discusses, the federal circuit courts have also applied the economic reality test for decades, considering different factors and weighing the particular facts of the case to determine whether a worker is an employee or an independent contractor. 87 Fed Reg. at 62,221-22. The factors typically include: (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

[14] As the Proposed Rule points out, in 1947 and 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. The fact that Congress did not similarly amend the FLSA demonstrates that it found the test appropriate for purposes of the FLSA. 87 Fed. Reg. at 62,221.

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 e.g.*, *Scantland v. Jeffry Knight, Inc.*, 721 F.3d 1308, 1311-12 (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 F.2d at 1059 (citations omitted). 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 Eng'g & Const. Co.*, 137 F.3d 1436, 1440 (10th Cir. 1998) ("[T]he economic realities of the relationship govern, and the focal point is whether the worker is economically dependent on the business to which the individual renders service or is, as a matter of economic fact, in business for himself.") (citations omitted); *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 Proposed Rule indicates, some courts apply the factors with some variations, but all of the courts of appeals agree that 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. *See* 87 Fed. Reg. at 62,222.

3. Prior DOL Guidance Relies on the Economic Reality Test to Distinguish Independent Contractors from Employees under the FLSA.

As the Proposed Rule states, the DOL "has applied a multifactor economic reality test since the Supreme Court's opinions in *Rutherford* and *Silk.*" 87 Fed. Red. at 62,222. The DOL has repeatedly reiterated this multifactor economic reality analysis and promulgated regulations applying it to sharecroppers and tenants (29 C.F.R. § 780.330(b)), certain forestry and logging operations (29 C.F.R. § 788.16(a)), and agricultural workers (29 C.F.R. § 500.20(h)(4)). *Id*. at 62,223. The Proposed Rule also notes that the DOL has issued numerous opinion letters on the question of employee or independent contractor status containing recitations of the *Silk* factors, sometimes omitting or adding a factor, but emphasizing that the right to control is not the dispositive factor in the analysis. 87 Fed. Reg. at 62,222.

In 2015, the DOL issued Administrator's Interpretation No. 2015-1 ("2015 AI"), in which the DOL reaffirmed the multifactor test regarding misclassification. 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 "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 2015 AI was withdrawn in 2017.

Up until the 2021 Rule, the DOL had issued guidance since the 1940s on employee versus independent contractor status that encompassed the multifactor economic reality test using a totality of the circumstances approach. The Proposed Rule's return to this longstanding guidance provides clarity and stability to the employment classification test.

B. The State AGs Support Rescission of the 2021 Rule.

Because the Proposed Rule is consistent with the FLSA, federal court decisions, and prior DOL Guidance, the Proposed Rule (and rescission of the 2021 IC Rule) will restore clarity to the worker classification analysis and benefit workers, employers, and the public.

As the State AGs have explained in prior comments, the 2021 Rule is contrary to the purpose and text of the FLSA, judicial interpretations of the FLSA, and prior regulatory guidance. The 2021 Rule improperly elevated control and opportunity for profit and loss as the most probative ("core") factors in determining employee status; narrowed the totality of the circumstances test; and imposed a "primacy of actual practice" analysis. Because the 2021 Rule departed from legal precedent—and it could take years of litigation to determine if and how courts will adopt its analysis—it must be rescinded.[15] Therefore, replacing the 2021 Rule with the Proposed Rule, which is consistent with precedent, will provide workers and businesses with clear guidance.

III. The State AGs Support the Economic Reality Test to Determine a Worker's Status as an Employee or Independent Contractor

The State AGs applaud the Department's proposal to restore the economic reality test and a totality of the circumstances analysis. The Proposed Rule offers strong protections against workers being improperly classified, with no factor(s) bearing more weight than the others, 87 Fed. Reg. at 62,234 (Proposed § 795.110(a)), and restores clarity to the entirety of the worker classification analysis. The Proposed Rule also returns the analysis for the investment, control, and integral factors to formulations more consistent with case law and the FLSA. Additionally, the Proposed Rule recommends eliminating the 2021 Rule's anomalous, restrictive primacy of actual practice approach and reinstituting a less prescriptive interpretation. 87 Fed. Reg. at 62,257-59. The State AGs offer comments in broad support of these proposed changes.

[15] The 2021 Rule has thus far not been interpreted in any court, meaning its rescission will not upend any reliance interests, create a split among the circuits, or encourage forum shopping. *Dep't of Homeland Sec. v. Regents of the Univ. of Cal.,* 140 S. Ct. 1891, 1913 (2020) ("When an agency changes course … it must be cognizant that longstanding policies may have engendered serious reliance interests that must be taken into account") (internal quotation marks omitted).

A. The State AGs Support a Totality of the Circumstances Analysis.

The State AGs support the Proposed Rule weighing the economic reality test's factors under a totality of circumstances analysis as it is consistent with decades of federal court precedent and protects workers from misclassification.

The Proposed Rule restores the proper balance to the economic reality test and maintains that the factors are not to be applied mechanically nor viewed as an exhaustive list. 87 Fed. Reg. at 62,257. "This language stresses that the economic reality is what matters, and not labels or formalities." *Id.* For example, it may be the case that possessing a certain business license may support a finding that a worker is in business for himself. But if such license is *required by the employer*, it may instead be evidence of the employer's degree of control, rather than an indication that the worker is in business for himself as a matter of economic reality. Thus, the Department recognizes that additional factors should be considered either independently, or under any of the enumerated factors, so long as such factors are relevant to the question of economic dependence or independence, and not mere formalities. *Id.*

As explained above, circuit courts and labor standards enforcers have long relied on the economic reality test using factors articulated in *Silk* and *Rutherford* to determine worker classification. *See supra* Section II.A.2. Courts recognize that a rigid inquiry is simply incompatible with a totality of the circumstances analysis. Thus, a varied, comprehensive assessment must take place in order to consider all such relevant evidence. Assigning higher probative value to any one factor undermines the others, and suppresses relevant criteria that could otherwise be pertinent to the analysis. This altogether creates a higher likelihood that a worker will be misclassified, and contradicts the remedial purposes of the FLSA. *See Rutherford*, 331 U.S. at 729.

The need for a multifactor test is particularly salient in today's economy. As discussed above, the labor market is evolving, with the rise of nontraditional work arrangements, including increased telework and an expanding "gig" economy. Such work arrangements require a meaningful assessment of multiple factors—something a rigid rule may not permit. Without a multifactor analysis, gig workers, for example, will be at a higher risk of misclassification and will be unable to avail themselves of the worker protections under the FLSA. Thus, the worker classification test must allow consideration of all of the various aspects of gig work and the larger gig economy trends.

The Proposed Rule aptly addresses these concerns. As the Proposed Rule notes, the two main benefits of the Proposed Rule—to both workers and businesses—are increased consistency and reduced misclassification. 87 Fed. Reg. at 62,266-67. The Proposed Rule will guide workers and employers in properly classifying workers as employees or independent contractors under long-recognized standards.

At the same time, reducing misclassification serves the dual purposes of the FLSA: it provides protections to workers who suffer or permit to work for their employer, and it protects law-abiding businesses by reducing the effect of an "unfair method of competition in

commerce." 29 U.S.C. § 202(a), (b). The Proposed Rule discusses a 2020 report from the National Employment Law Project (NELP), which concluded that 10-30 percent of employers misclassify their employees as independent contractors.[16] A June 2022 report has found that at least 10 percent of New York State's workers are misclassified as independent contractors.[17] Recent estimates of misclassification in Pennsylvania indicate that approximately 259,000 workers in Pennsylvania are wrongly classified as independent contractors.[18] Misclassified workers receive less pay and fewer benefits than employees. By contrast, when workers are properly classified it leads to increased wages and benefits, such as health insurance and retirement plans. In turn, this reduces the potential burden on the States to care for those workers when they fall ill or are left jobless through no fault of their own. In addition, workers classified as employees typically split the payment of payroll taxes with their employer, whereas workers classified as independent contractors must pay the entire self-employment tax amount. It is often the case that workers improperly classified as independent contractors are unaware they are solely responsible for these tax deductions, which results in financial distress for those workers unable to meet their tax obligations.

B. The State AGs Support the Proposed Rule's Specific Modifications to the Economic Reality Factors.

The Proposed Rule also includes specific modifications to the factors considered in the economic reality test, each of which is a reversal of the 2021 Rule's standards:[19] (1) reinstituting the consideration of investment as a standalone factor in the analysis, 87 Fed. Reg. at 62,240 (Proposed § 795.110(b)(2)); (2) providing additional analysis of the control factor, *id.* at 62,246 (Proposed § 795.110(b)(4)); and (3) returning to the previously held interpretation of the integral factor, *id.* at 62,253 (Proposed § 795.110(b)(5)). These changes to the economic reality analysis are consistent with case law and Department guidance and better serve the purposes of the FLSA.

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[16] 87 Fed. Reg. at 62,266 (citing NELP, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries*, (Oct. 2020), https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-workers-federal-state-treasuries-update-october-2020/.

[17] James A. Parrot & L.K. Moe, For One in 10 New York Workers, "Independent Contractor" Means Underpaid and Underprotected, Center for New York City Affairs at the New School 1, (2022), https://static1.squarespace.com/static/53ee4f0be4b015b9c3690d84/t/62b29d354dfc96468ac9a02b/1655872843122/CNYCA+June+21+IC+report.pdf.

[18] The employers of these misclassified workers, therefore, do not pay unemployment compensation taxes—an estimated annual loss to the Unemployment Compensation Trust Fund of $91 million. Penn. Dep't of Lab. & Indus., Joint Task Force on Misclassification of Employees Final Report, 12(2022), https://www.dli.pa.gov/Individuals/Labor-Management-Relations/llc/Documents/Act-85-Final-Report.pdf.

[19] The State AGs offer their comments on these three specific modifications since they constitute the most significant changes from the 2021 Rule.

1. The State AGs Support Reinstating Investment as a Standalone Factor.

The Proposed Rule considers the investment factor and the opportunity for profit or loss factor as standalone, independent factors. 87 Fed. Reg. at 62,240-243 (Proposed § 795.110(b)(2)). The Department recognizes that most circuit courts have considered these factors separately since the Supreme Court's first articulation of the factors in *Silk*.[20] Furthermore, not only is separating the two factors consistent with the case law, it is also consistent with the remedial legislative purpose of the FLSA. *See supra* Section II.A.1.

To always consider a worker's investment as it solely relates to the opportunity for profit or loss unduly constrains the consideration of the worker's investment. For example, a landscaper may invest in tools to conduct their work, but that investment merely enables them to perform the duties assigned to them by the landscaping company and is not an exercise of managerial skill in an effort to realize profits or experience loss on the job. The landscaper's investments should enter the analysis separate from the landscaper's opportunity for profit or loss, so as not to be viewed as a contributor to those profits or losses.

The Proposed Rule further proposes that worker investment be analyzed relative to employer investment, an analysis in which many circuit courts already engage. *See* 87 Fed. Reg. at 62,242, n.305 (collecting cases). Although some circuit courts have not adopted this relative-comparison approach, they have not expressly rejected its usefulness. *Id.* at 62,242. Performing the analysis in this way aids in determining economic dependence by taking into account all relevant information about the amount and type of investments made by worker and employer. In the landscaper and landscaping company example, one would compare the significance of the landscaper's investment in tools against the landscaping company's investment in large capital expenditures, such as equipment, client marketing, and advertising. On this factor, under the Proposed Rule, the example likely favors employee status, since the landscaper's investment in tools would not be enough to support a finding of economic independence when compared to the company's investments in machinery and building a client base.

2. The State AGs Support the Proposed Rule's Analysis of the Degree of Control Factor.

The Proposed Rule restores the balance to the economic reality test by eliminating the designation of two factors as "core" factors—the nature and degree of control over the work and worker's opportunity for profit or loss—which elevated their role in the analysis compared to the other three factors. The State AGs support this elimination. Specifically, the control factor must be analyzed equally among the factors of the economic reality test because otherwise the test would more closely resemble the narrower common law control test, while the FLSA supports a broader test. *See supra* Section II.A.1.

[20] 87 Fed. Reg. at 62,240 n.279 ("The Second Circuit and the D.C. Circuit are alone among the circuit[s] in treating the worker's opportunity for profit or loss and the worker's investment as a single factor."); *See, e.g.*, *Franze v. Bimbo Bakeries USA, Inc.*, 826 F. App'x 74, 76 (2d Cir. 2020) (listing five factors for the worker classification analysis); *Morrison v. Int'l Programs Consortium, Inc.*, 253 F.3d 5, 11 (D.C. Cir. 2001) (same) (citing *Superior Care*, 840 F.2d at 1058-59). Furthermore, though the Second and D.C. Circuit courts assess the two factors together, they have held investment "is, itself, indicative of independent contractor status." *Saleem v. Corp. Transp. Grp., Ltd.,* 854 F.3d 131, 144 n.29 (2d Cir. 2017).

Further, the Proposed Rule provides additional clarity as to how the "control" factor influences the classification analysis. 87 Fed. Reg. at 62,246-53 (Proposed § 795.110(b)(4)). The case law is clear that the appropriate focus for this factor must be on the employer's control over the worker, and *not* the worker's control over the work. *See, e.g.*, *Scantland*, 721 F.3d at 1316 (analyzing "control over workers" by the alleged employer); *Saleem*, 854 F.3d at 141 (finding that the employer "exercised minimal control over Plaintiffs" in two respects and that a "lack of control, while not dispositive, weighs in favor of independent contractor status." (citations omitted)); *Usery*, 527 F.2d at 1312–13 (finding that "[c]ontrol [of the worker over their work] is only significant when it shows an individual exerts such a control over a meaningful part of the business that [the worker] stands as a separate economic entity.").

The Proposed Rule identifies some of the relevant ways in which employers may exercise control over workers, such as setting work schedules and compelling attendance or directing or supervising the work being performed, while emphasizing that the absence of any of these sub factors does not necessarily weigh in favor of independent contractor status. 87 Fed. Reg. at 62,246. The Proposed Rule also recognizes that certain legal obligations imposed on workers by employers, such as health and safety or quality control standards, are relevant to the economic reality analysis as they may constitute evidence of an employer exerting control over an employee. 87 Fed. Reg. at 62,247. Thus, the broad question of whether the employer retains "meaningful control over the economic aspects" of the work relationship is the ultimate inquiry. *Id*. (internal quotation marks omitted). For example, where a worker can theoretically elect to work certain shifts, but the worker's ability to actually work their preferred shifts is determined by the employer based on its fluctuating need for staff during peak business hours, the worker's scheduling flexibility is thus dictated by the employer's business needs which weighs in favor of employee status.

Requiring the factfinder to consider the "employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship," 87 Fed. Reg. at 62,275 (Proposed § 795.110(b)(4)), is the appropriate interpretation of the control factor and properly accounts for the variety of today's work arrangements.

3. <u>The State AGs Support the Proposed Rule's Clarification Regarding "Integral" Versus "Integrated Unit of Production" Analyses.</u>

The Proposed Rule aptly clarifies that it is *not* the "integrated unit of production" that is of consequence to the determination of employee status; rather, it must be determined whether the work performed is an "integral part of the employer's business." 87 Fed. Reg. at 62,253.

On this factor, the Proposed Rule is consistent with both the Department's longstanding interpretation (pre-2021 Rule) and circuit court precedent. *See, e.g.*, *Dole v. Snell*, 875 F.2d 802, 811 (10th Cir. 1989) (holding "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 Lab. 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 …"). The Proposed Rule's distinction is clear: a worker

who performs work that is integral to furthering the employer's business is more likely to be an employee than a worker whose services or products are peripheral or tangentially related to the employer's business. 87 Fed. Reg. at 62,253.

The Proposed Rule makes clear this distinction by offering the example of a large tomato farm that employs workers to pick tomatoes during harvest season. This farm may also employ an accountant to provide non-payroll accounting support, such as filing the farm's annual tax return. The tomato pickers are integral to the company's business because picking tomatoes is an integral part of farming tomatoes. However, accounting support is not critical, necessary, or central to the company's business (tomato farming). In this scenario, the integral factor indicates employee status for the tomato pickers and independent contractor status for the accountant. 87 Fed. Reg. at 62,254. This shifted focus is more consistent with case law and Department guidance and better serves the purposes of the FLSA.

C. The State AGs Support the Rescission of the Restrictive Primacy of Actual Practice Approach.

The States AGs also support the Proposed Rule's consideration that "[e]very fact that is relevant to economic dependence should be considered in the analysis," 87 Fed. Reg. at 62,258, and that unexercised contractual powers among the parties may be equally as relevant to determining economic dependence as exercised powers. Economic dependence determinations require a look at the totality of the circumstances, which by definition may include any relevant unexercised contractual powers.

The Department rightly recognizes that the parties' actual practice is not more relevant than any other factor as to the question of economic dependence. *Id.* It may be true in some cases that the actual practice of the parties sheds more light on the economic dependence inquiry than theoretical possibilities. However, in other instances theoretical or contractual possibilities will reveal more about the economic realities than the parties' actual practice. The Department's example demonstrates this point: a company that reserves the right to supervise workers, but in practice rarely makes supervisory visits, may still influence the performance of its workers without exercising such supervisory rights. *Id.* Thus, viewing this reserved supervisory right in light of the economic realities may be more illustrative of the economic relationship between the parties than the company's infrequent use of its reserved supervisory rights.

IV. The Department Thoroughly Analyzed Alternative Potential Means to Regulate

The Department assessed the viability of four regulatory alternatives before putting forth the Proposed Rule. The alternatives considered by the Department were: (1) codifying the common law test; (2) codifying the ABC test; (3) a partial rescission of the 2021 Rule; and (4) rescission of the 2021 Rule and providing subregulatory guidance on employee or independent contractor classification. Ultimately, the Department determined that each of these alternatives is flawed and a full rescission of the 2021 Rule and replacement with the Proposed Rule is most appropriate for clarity and consistency with the FLSA. The undersigned State AGs agree.

First, codifying the common law control test is not feasible because it is inconsistent with the FLSA. The common law test used to distinguish between employees and independent contractors under other federal laws, such as the Internal Revenue Code, is not proper in the context of the FLSA. The common law test, which focuses on control rather than economic dependence, provides a narrower definition of employment than the broad "suffer or permit" language of the FLSA. Therefore, the common law test conflicts with the broad statutory definition of "employ" in the FLSA.

Second, the ABC test arguably protects against employee misclassification better than other tests in use. Although several of the undersigned State AGs apply the ABC test, the State AGs understand the Department believes it is constrained under current law from implementing the ABC test under the FLSA, as stated in the Proposed Rule.

Third, retaining portions of the 2021 Rule that are consistent with the Proposed Rule would not provide needed clarity because the governing principle of the 2021 Rule was a marked departure from the Department's longstanding position. Although there is overlap between the 2021 Rule's factors and the Proposed Rule's factors, the existence of "core" factors in the 2021 Rule fundamentally changed the analysis. The emphasis on two "core" factors—the nature and degree of the workers' control over their work and the opportunity for profit or loss based on the initiative, investment, or both—negated the need to fully consider the remaining factors. Since the Proposed Rule focuses on the totality of circumstances in analyzing the economic reality test's factors, a full rescission of the 2021 Rule is needed to provide clarity to workers, employers, and the public.

Finally, merely rescinding the 2021 Rule and issuing subregulatory guidance will not provide the direction necessary to achieve consistent application of the economic reality test. Subregulatory guidance is not as robust as promulgating a new rule. Here, a new rule is necessary because the 2021 Rule was such a drastic departure from the status quo. The Proposed Rule will provide needed regulatory guidance for the consistent application of the economic reality test by courts and employers.

V. Conclusion

We thank the Department for the opportunity to comment. The Proposed Rule accords with the intent of the FLSA, federal court decisions, and prior Department guidance. The Proposed Rule restores clarity to the worker classification analysis and benefits workers, employers, and the public. For the foregoing reasons, the signatory State AGs urge the Department to swiftly adopt the Proposed Rule.

Sincerely,

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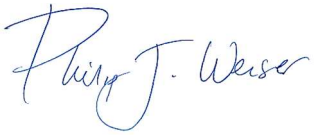

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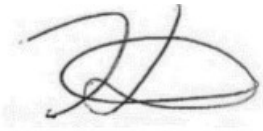

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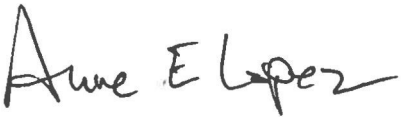

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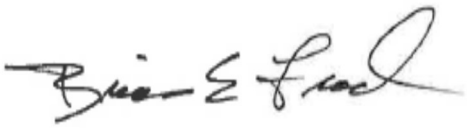

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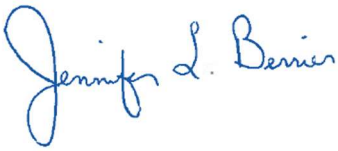

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