



December 12, 2022

VIA ELECTRONIC SUBMISSION

The Honorable Martin J. Walsh
Secretary, U.S. Department of Labor
200 Constitution Avenue, NW
Washington DC 20210

Re: Employee or Independent Contractor Under the Fair Labor Standards Act (FLSA), 87 Fed. Reg. 62218 (Oct. 13, 2022).

Dear Secretary Walsh:

On October 13, 2022, the Department of Labor (DOL) proposed a rule that would determine whether a worker is an independent contractor or employee under the Fair Labor Standards Act (FLSA).¹ This letter constitutes the Office of Advocacy's (Advocacy) public comments on the proposed rule.

Advocacy is concerned that DOL's Initial Regulatory Flexibility Analysis is deficient for this rule. DOL significantly underestimates the economic impacts of this proposed rule on small entities at less than \$25 annually per business. Small businesses told Advocacy that they are very confused on how to classify their workers and comply with DOL's regulations. DOL's proposed rule may be detrimental and disruptive to millions of small businesses that rely upon independent contractors as part of their workforce. Independent contractors who may also be small businesses also believe that they may lose work because of this rule.

Advocacy recommends that DOL reconsider this proposal. In the alternative, Advocacy recommends that DOL clarify certain factors in this proposed test and resolve any conflicts with existing federal requirements. Advocacy also urges DOL to reassess the compliance costs from this rule in a Supplemental Initial Regulatory Flexibility Analysis. As part of that supplemental analysis, DOL should consider significant alternatives that would accomplish the objectives of

¹ Employee or Independent Contractor Under the Fair Labor Standards Act (FLSA), 87 Fed. Reg. 62218 (Oct. 13, 2022). (hereinafter "2022 Proposed Rule").

the statute while minimizing the economic impacts to small entities as required by the Regulatory Flexibility Act (RFA).

I. Background

The Office of Advocacy

Congress established the Office of Advocacy under Pub. L. 94-305 to represent the views of small entities before Federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA). As such, the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,² as amended by the Small Business Regulatory Enforcement Fairness Act,³ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, the RFA requires federal agencies to assess the impact of the proposed rule on small entities and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.⁴ The agency must include a response to these written comments in any explanation or discussion accompanying the final rule's publication in the *Federal Register*, unless the agency certifies that the public interest is not served by doing so.⁵

Advocacy's comments are consistent with Congressional intent underlying the RFA, that "[w]hen adopting regulations to protect the health, safety, and economic welfare of the nation, federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public."⁶

The Proposed Rule

On October 13, 2022, the DOL's Wage and Hour Division proposed a rule that would determine whether a worker is an independent contractor or an employee under the FLSA.⁷ Under the FLSA, companies are required to provide benefits such as minimum wage and overtime to employees, but not to independent contractors.⁸

² 5 U.S.C. §601 et seq.

³ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. §601 et seq.).

⁴ Small Business Jobs Act of 2010 (PL. 111-240) §1601.

⁵ *Id.*

⁶ *Id.*

⁷ See 2022 Proposed Rule.

⁸ 29 U.S.C. § 206 – 207 (Dec. 1977).

DOL applies an economic reality test to determine whether a worker is an employee or an independent contractor.⁹ The economic reality test focuses on whether a worker is economically dependent on an employer for work or is in business for themselves. The proposed rule would rescind a 2021 final rule which highlighted two core factors that were more probative and carried more weight in the analysis: the nature and degree of control over the work and a worker's opportunity for profit or loss.¹⁰ DOL's 2021 final rule also identified three less probative non-core factors: the amount of skill required for the work, the degree of permanence of the working relationship between the worker and the employer, and whether the work is part of an integrated unit of production.¹¹

The effective date of the 2021 final rule was March 8, 2021. In March and May 2021, DOL published rules delaying and then withdrawing the final rule.¹² On March 14, 2022, the Federal district court in the Eastern District of Texas issued a decision vacating both DOL's delay and withdrawal rules due to violations of the Administrative Procedure Act. The district court vacated both rules and concluded that the 2021 final rule became effective as of March 8, 2021.¹³

The current rule is the 2021 final rule. However, this proposed rule is rescinding the 2021 final rule, and returning to the traditional multi-factor economic reality test that analyzes the totality-of-the-circumstances in a business. Under this proposed rule, the economic reality factors would be:

1. The opportunity for profit or loss depending on managerial skill.
2. The investments by the worker and the employer.
3. The degree of permanence of the work relationship.
4. The nature and degree of employer control.
5. The extent to which the work performed is an integral part of the employer's business.
6. The worker's use of skill and initiative.
7. Additional factors may be considered if they are relevant to the ultimate question of whether the workers are economically dependent on the employer for work or in business for themselves.¹⁴

⁹ See 2022 Proposed Rule.

¹⁰ Independent Contractor Status Under the Fair Labor Standards Act (FLSA), 86 Fed. Reg. 1168 (Jan. 7, 2021). (hereinafter "2021 Final Rule").

¹¹ *Id.* at 1246-1257, Economic reality factors.

¹² Independent Contractor Status Under the Fair Labor Standards Act (FLSA); Delay of Effective Date, 86 Fed. Reg. 12535 (Mar. 4, 2021); Independent Contractor Status Under the Fair Labor Standards Act (FLSA); Withdrawal, 86 Fed. Reg. 24303 (May 6, 2021).

¹³ *Coalition for Workforce Innovation v. Walsh*, No. 1:21-CV, 2022 WL 1073346 (E.D. Tex. Mar. 14, 2022). The district court concluded that the DOL "failed to provide meaningful opportunity for comment in promulgating the delay rule" and "failed to 'show good cause for making the delay rule effective immediately upon publication.'" The district court also held that DOL acted in an arbitrary and capricious manner in its withdrawal rule by "failing to consider potential alternatives to rescinding the Independent Contractor Rule."

¹⁴ See 2022 Proposed Rule, 29 CFR Part 795 § 795.110, Economic reality test to determine economic dependence.

II. Advocacy's Small Business Concerns

DOL's Initial Regulatory Flexibility Analysis identified 6.5 million small establishments or small governments with a population of fewer than 50,000 who could potentially hire independent contractors, and who could be affected by this rulemaking. The agency has identified the industries with the highest number of independent contractors as professional business services and construction industries, with approximately 2.7 million and 2 million workers respectively. DOL also estimates that 22.1 million independent contractors may be impacted by this rule. DOL notes that these independent contractors may be small businesses and may also hire independent contractors.¹⁵

On November 9, 2022, Advocacy held a small business roundtable with DOL officials and over 250 small businesses, nonprofits, and their representatives. These small entities represented a variety of industries including construction, education, energy, health care, hospitality, and transportation. The roundtable was also attended by independent contractors, who may also be small businesses, providing services such as music lessons, transportation, and writing. The following comments are reflective of issues raised during this roundtable and in other conversations with small entities.

Advocacy is concerned that DOL's Initial Regulatory Flexibility Analysis (IRFA) is deficient and severely underestimates the economic impacts of this rule on small businesses and independent contractors. DOL only estimates minimal costs for small entities to read the rule. However, DOL has failed to estimate any costs for small businesses and independent contractors to reclassify workers as independent contractors, for lost work, and for business disruptions. Advocacy urges DOL to reassess the compliance costs from this regulation in a Supplemental Initial Regulatory Flexibility Analysis. As part of that supplemental analysis, DOL should consider significant alternatives that would accomplish the objectives of the statute while minimizing the economic impacts on small entities as required by the Regulatory Flexibility Act (RFA).

Small business and independent contractors supported the 2021 final rule, which simplified the process of hiring workers to two core factors: the nature and degree of control over the work and the worker's opportunity for profit or loss.¹⁶ DOL's proposal rescinds the 2021 final rule, which has only been in place for a brief time, without adequate justification. DOL is returning to the traditional multi-factor economic reality test that analyzes the totality-of-the-circumstances in a business. Under this test, the economic reality factors are not assigned a predetermined weight and each factor is given full consideration. Small businesses commented that they found this test very confusing, and they could not be certain if they were classifying their independent contractors correctly. The only way that employers would have certainty is by classifying their

¹⁵ See 2022 Proposed Rule, Page 62265 and 62272, Executive Order 12866 Section and Regulatory Flexibility Act Section.

¹⁶ Independent Contractor Status Under the Fair Labor Standards Act (FLSA), 86 Fed. Reg. 1168 (Jan. 7, 2021). (hereinafter "2021 Final Rule").

workers as employees. This rule may be biased towards finding an employment relationship. Advocacy recommends that DOL reconsider this proposal. In the alternative, Advocacy recommends that DOL clarify certain factors in this proposed test and resolve any conflicts with existing federal requirements.

1. DOL’s Initial Regulatory Flexibility Analysis Underestimates the Compliance Cost of this Rule for Small Businesses

DOL has underestimated the compliance costs and administrative burdens of this rule for small businesses and independent contractors. In the IRFA section, DOL only estimates 30 minutes or under \$25 for small businesses and 15 minutes or \$5 for independent contractors to read and understand this rule.¹⁷ In DOL’s 2021 final rule, the agency estimated cost savings due to increased clarity to be \$447.1 million per year, and cost savings due to reduced litigation to be \$48.7 million per year.¹⁸ Small business feedback suggests that at least some of these cost savings would be lost due to the 2021 final rule rescission. DOL should include these compliance costs in the IRFA.

Small businesses at Advocacy’s roundtable expressed frustration at these low compliance cost estimates for a rule that is almost 200 pages long.¹⁹ At a reading speed of 200 words per minute, it would take four hours to read a 50,000-word rule.²⁰ Small businesses noted that they may have to hire expensive outside professionals to help make this worker determination, as they may be liable for hundreds of thousands of dollars if they get this classification incorrect. Small businesses also noted that they could have litigation risks and costs associated with this rule. Most small businesses do not have legal, tax, and human resource staff. Microbusinesses and freelancers commented that they do not have the funds to pay outside professionals for advice.²¹ A tax professional told Advocacy this rule would make it harder to provide guidance to employers and independent contractors, as even they were not sure how to classify certain workers under this rule.

Advocacy believes that DOL underestimates the employer costs that stem from this rule, such as the cost to reclassify some current independent contractors to employees. DOL estimates these costs in the Executive Order 12866 or cost benefit analysis section,²² but DOL does not estimate

¹⁷ See 2022 Proposed Rule at 62272, IRFA, Compliance Requirements of the Proposed Rule, Including Reporting and Recordkeeping.

¹⁸ See 2021 Final Rule at 1211, Executive Order 12866 Section.

¹⁹ See 2022 Proposed Rule. The original rule that was released by DOL was close to 200 pages on a Word document. The proposed rule in the Federal Register has smaller text and is around 80 pages.

²⁰ U.S. Dep’t of Health and Human Services, *Guidelines for Regulatory Impact Analysis*, 26 (2016).

²¹ U.S. Small Business Administration, Office of Advocacy, *Small Business Facts, The Role of Microbusinesses Employers in the Economy*, (Aug. 2017). According to this fact sheet, microbusiness employers (firms with 1-9 employees) are the most common kind of employer firm.

²² See 2022 Proposed Rule at 62259- 62237, Executive Order 12866 and Initial Regulatory Flexibility Analysis.

these costs in the RFA section. These costs include employer-provided fringe benefits like health insurance, retirement, and paid leave. DOL estimated that the value of these fringe benefits could average more than \$15,000 annually per full-time independent contractor and almost \$6,000 per part-time independent contractor. Other employer costs include tax liabilities and FLSA protections such as overtime, higher wages, bonuses, and other related compensation.²³ DOL makes the unsupported assumption that there would not be widespread reclassification of workers due to this rule. DOL also assumes that any employer costs to reclassify workers are due to an improper misclassification to begin with.²⁴ However, Advocacy believes that some number of independent contractors who qualify under the current rule will not qualify under the rule as proposed. Advocacy recommends that DOL provide an estimate of how many small businesses will be impacted by reclassification and estimate these compliance costs.

Small businesses and independent contractors who hire freelancers to provide specialized services may have to make tough decisions regarding these workers, as they will face the increased cost of hiring an employee or the liability of keeping the worker as an independent contractor. With this large increase in cost for the same work, it is unreasonable to assume all businesses would simply choose to or even be financially able to absorb these costs and continue operating exactly as they did before. A percentage of the affected businesses will forgo the activities previously performed by freelancers, which will be a cost of lost work for both the business and the contractor.

This proposal may also be detrimental to industries that rely upon independent contractors as a central part of their business model, such as direct sales, insurance, financial advisors, construction, and trucking. This rule may add costs, liability, and disruption for small business operations in these industries. These businesses may be unable to make significant changes to their business model. For example, the construction industry relies upon a complex business model with multiple tiers of contractors, subcontractors, and independent contractors with specialized knowledge and skills to complete individual projects. Representatives from the trucking industry commented that these changes will exacerbate the worker shortages for truck drivers, and lead to more supply chain issues. DOL should estimate these compliance costs in their IRFA.

Many independent contractors or freelance workers, who may also be small businesses, believe they will lose work because of this rule.²⁵ Advocacy received feedback from an independent contractor in Minnesota who hires numerous freelancers to complete copywriting and video editing. This business said, “These rules are disproportionately cumbersome and burdensome for microbusinesses and solopreneurs. We don’t yet have the revenue stream to hire people even part-time, and yet pulling in the expertise or skill of others is how we can flourish and grow.” A representative from the National Association of Women Business Owners commented that many

²³ *Id.* at 62267.

²⁴ *Id.* at 62260.

²⁵ *Id.* at 62272, IRFA, Compliance Requirements.

women-owned businesses are freelance workers that started during the pandemic. These women value the flexibility, profitability, and the work/life balance that comes with an independent contractor work arrangement.

The dozens of freelance workers at Advocacy’s roundtable also stated that they wanted to keep their status as independent contractors and did not want to be employees. Advocacy also heard from individuals with disabilities and those living in rural communities who also preferred the flexibility and autonomy that comes with working remotely as independent contractors. “Freelancing has been my path to independence and staying out of a nursing home,” said a disabled freelance editor, “I don’t want to see this pathway closed.” DOL should include these compliance costs for independent contractors in its IRFA.

2. DOL Should Clarify Certain Confusing Factors

Advocacy recommends that DOL reconsider this proposal. In the alternative, Advocacy recommends that DOL clarify certain factors in this proposed test and resolve any conflicts with existing federal requirements. There are problematic factors in the multi-factor test that may limit the use of independent contractors by small employers and may limit the ability of other small businesses to maintain their status as independent contractors.

Degree of Permanence

Small businesses were concerned with the factor that looks at the “degree of permanence of the working relationship between the individual and the potential employer.”²⁶ This factor also looks at the exclusivity of this relationship, and whether there is a contract for services that is automatically renewed. Small businesses and independent contractors have commented that they have many long-term client relationships and contracts with third parties such as vendors and service providers that may last years. This continuity of work and experience should not make these workers automatically employees.

Small businesses stressed that independent contractors are an essential part of the modern business landscape, to hire for specialized skill and to handle workplace shortages. For example, small retailers and members of the National Retail Federation told Advocacy that they utilize a group of independent contractors for specialized skillsets such as video and photography for advertising and special events, marketing, tailoring and independent sales. Retail businesses may not have the budget or have enough work for a full-time staff for these positions, and they do not have the skills-in house. Restaurant businesses told Advocacy that they utilized third-party delivery drivers to survive the pandemic and expressed concern that this business model would be threatened by this rule because they have continuous relationships with multiple companies. Advocacy recommends that DOL clarify this factor.

²⁶ *Id.* at 62243, Degree of Permanence of the Work Relationship.

Nature and degree of control

DOL does not identify any federal rules that conflict with the proposed rule in the IRFA. At Advocacy’s roundtable, small businesses were concerned that the control factor may conflict with requirements for employers to ensure that their workers comply with federal requirements for safety and other mandates. The rule states that control exerted by the employer “for purposes of complying with legal obligations, safety standards, or contractor or customer services standards may be indicative of control.”²⁷

For example, a representative from the Associated Builders and Contractors commented that a general contractor must enforce compliance by subcontractors and independent contractors with workplace safety rules.²⁸ A representative from the American Trucking Associations was also concerned with this factor, as motor carriers must also enforce many safety requirements over its 350,000 independent contractors who are owner-operators or subcontract drivers. For example, motor carriers must ensure that contracted truck drivers have state-issued commercial driver’s licenses and follow limits on the numbers of hours of service they can complete in a day.²⁹ Many other third-party contracts have similar requirements to follow federal and state mandates. Advocacy recommends that DOL remove this provision from the control factor.

Work performed is an integral part of an employer business

Small businesses and independent contractors were also concerned with the factor that analyzes whether the work performed is an “integral part of the employer’s business,” or “the work they perform is critical, necessary, or central to the employer’s principal business.”³⁰ Advocacy received feedback from small businesses and independent contractors who outsource many services that are important aspects of their business, such as bookkeeping, computer and web design, editorial and writing work, and language translation.

Many of these freelancers commented that they believe that their work is critical to the employer’s principal business, otherwise they would not have been hired. A Pennsylvania independent contractor in the technology field hires numerous other independent contractors who have the skillset needed for a particular engagement. This contractor stated, “Most people in the technology field are specialists in one area or another, so it is impossible for a microbusiness to staff for all needs. Without the ability to hire on an as needed basis, my company wouldn’t be able to bid on or accept any contracts.”

Small businesses in many industries such as construction, trucking, direct sales, insurance, and financial advisors have flourished with the independent contractor model for a majority of their

²⁷ See 2022 Proposed Rule at 62275, Nature and Degree of Control.

²⁸ A representative from Associated Builders and Contractors stated that general contractors, subcontractors, and their independent contractors must comply with Dep’t of Labor requirements for safety under 29 U.S.C. §§ 651-678 (1976) [OSHA].

²⁹ 49 C.F.R. § 395.1(e), Hours of Service of Drivers (1999).

³⁰ See 2022 Proposed Rule at 62243, Extent to which the work performed is an integral part of the employer’s business.

workforce and are concerned this provision may force a change to a less productive and more expensive business model. Advocacy recommends that DOL provide more guidance on this provision that would allow current successful models to continue.

Additional Factors

Small businesses expressed concern with the open-ended factor that states that “additional factors may be relevant in determining whether the worker is an employee or independent contractor.”³¹ Advocacy recommends that DOL strike this provision from the list of factors, as it is too vague.

Recommendations

1. DOL Should Complete a Supplemental IRFA

Advocacy urges DOL to reassess the compliance costs from this regulation in a Supplemental IRFA. As part of that supplemental analysis, DOL should consider significant alternatives that would accomplish the objectives of the statute while minimizing the economic impacts to small entities as required by the RFA.

2. DOL Should Continue to Monitor and Assess Current Rule

Advocacy recommends that DOL reconsider this proposal. Small business and independent contractors that attended Advocacy’s roundtable support keeping the current rule because the test is clear and predictable. The 2021 final rule has been in place for only a brief period, and DOL has not been able to analyze the impact of the rule on small businesses. DOL has also not provided an adequate justification on why the 2021 rule is being rescinded. DOL should continue to monitor and assess the economic impacts of the current rule to the small business community.

3. DOL Should Clarify Economic Reality Test Factors

Advocacy recommends that DOL clarify the economic reality test factors enumerated in this letter. DOL should also consider other small business recommendations that would clarify this rulemaking.

4. DOL Must Publish a Small Business Compliance Guide

For each rule requiring a final regulatory flexibility analysis, section 212 of SBREFA requires the agency to publish one or more small entity compliance guides.³² Agencies are required to publish the guides with publication of the final rule, post them to websites, distribute them to industry contacts, and report annually to Congress.³³ Advocacy is available to help DOL in the writing and dissemination of this guide.

³¹ *Id.* Additional factors.

³² Small Business Regulatory Enforcement Fairness Act, Pub. Law 104-121 § 212.

³³ The Small Business and Work Opportunity Act of 2007 added these additional requirements for agency compliance to SBREFA.

5. DOL Should Complete More Small Business Outreach

Advocacy thanks DOL for participating in our Small Business Roundtable on this rule and for providing a briefing to stakeholders. Advocacy appreciates that DOL provided multiple outreach sessions to employers and employees on the topic of the independent contractor classification before the rule was released. Advocacy recommends that DOL complete more outreach, marketing, education, and training to small businesses and independent contractors on this rule after it is finalized. Small businesses recommend webinars, short videos, fact sheets, check lists, and examples to help with regulatory compliance.

III. Conclusion

Advocacy is concerned that DOL's IRFA is deficient and significantly underestimates the economic impacts of this rule to small businesses and independent contractors. Small businesses and independent contractors have told Advocacy that this rule may be disruptive and detrimental to the millions of businesses in industries that rely upon the independent contractor model. Advocacy recommends that DOL reconsider this proposal. In the alternative, Advocacy recommends that DOL clarify certain factors in this proposed test and resolve any conflicts with existing federal requirements. Advocacy urges DOL to reassess the compliance costs from this regulation in a Supplemental Initial Regulatory Flexibility Analysis. As part of that supplemental analysis, DOL should consider significant alternatives that would accomplish the objectives of the statute while minimizing the economic impacts to small entities as required by the Regulatory Flexibility Act (RFA).

If you have any questions or require additional information, please contact me or Assistant Chief Counsel Janis C. Reyes at (202) 798-5798 or by email at Janis.Reyes@sba.gov.

Sincerely,

/s/

Major L. Clark, III
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Office of Advocacy
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/s/

Janis C. Reyes
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