



December 13, 2022

VIA ELECTRONIC SUBMISSION: WWW.REGULATIONS.GOV

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

Ms. Amy DeBisschop
Director of the Division of Regulations, Legislation, and Interpretation
Wage and Hour Division
U.S. Department of Labor
Room S-3502
200 Constitution Ave., N.W.
Washington, DC 20210

Re: Notice of Proposed Rulemaking: Employee or Independent Contractor Classification Under the Fair Labor Standards Act (Document ID: WHD-2022-0003-0001, RIN: 1235-AA43)

Dear Ms. DeBisschop,

I. Introduction

Engine is a non-profit technology policy, research, and advocacy organization that bridges the gap between policymakers and startups. Engine works with government and a community of thousands of high-technology, growth-oriented startups across the nation to support the development of technology entrepreneurship through economic research, policy analysis, and advocacy on local and national issues.

Accessing and affording talent are significant barriers to startup formation and growth. The ability to hire independent contractors is crucial to the success of many startups that need flexible talent solutions, particularly in their early stages. Startups rely on independent contractors for a number of services, from accounting services, to graphic design, and more. Reverting to a multifactorial, unweighted test using a totality of the circumstances analysis would hinder the ability of startups to acquire needed flexible talent, requiring time and resources many startups may not have to both hire full-time employees and make the calculation itself of who qualifies as an employee vs. an independent contractor. We urge the Department of Labor (DOL) to refrain from replacing the 2021 independent contractor rule, or at minimum, when adopting a new rule, to consider the

significant impacts this change could have on the startup ecosystem and craft a rule that takes this understanding into account.

II. Contract Labor is Crucial for the U.S. Startup Ecosystem

Engine has iterated on multiple occasions the importance of hiring talent for new startups.¹ Most startups launch with incredibly lean budgets, and the decision of when, who, and how to hire is a careful calculation. Often, startups need different types of talent, including independent contractors, to meet their needs as they grow. Many startups rely on project-by-project work,² especially in their growth stages,³ and lack the workload or capacity to hire full-time talent. It is not simply a case of not having the funds for, or not wanting to spend the funds on compensation packages for full-time employees.

Research bears out both the importance of independent contractors in the startup ecosystem and the role contract labor fills. One study found that 57% of startups acknowledged “that the use of contractor labor is an essential part of their business models.”⁴ The study also indicated that 79% of startups have hired at least one independent contractor.⁵ Perhaps more importantly, the study found that 69% of respondents hired independent contractors because “startups needed individuals for one-off projects or they needed specialized talent they could not hire full time.”⁶ Respondents also highlighted factors like the need for flexibility as startups are inherently risky and because of the nature of fluctuations in demand for products and services.⁷

III. A Multifactorial, Totality of the Circumstances Approach Creates Uncertainty and Significant Barriers for Growing Startups

The shift back to a multifactorial test which uses a totality of the circumstances approach also indicates the Department fails to grasp the unique challenges faced by startups. Complex, ambiguous regulatory frameworks, like the approach taken in the proposed rule, can be an insurmountable challenge for startups. A founder may easily in good faith believe a worker to be a contractor but may be unable to make that determination when trying to parse the six factor analysis. Large established companies have the resources to hire legal professionals and employment

¹ Jennifer Weinhart, *Proposed Independent Contractor Policy Change Could Impact Startup Talent* (Oct. 13, 2022), <https://engineadvocacyfoundation.medium.com/proposed-independent-contractor-policy-change-could-impact-startup-talent-c3a4bf5a9472>.

² Jennifer Weinhart, *State Policy Update: The Nuts and Bolts of State Innovation Policy* (Sept. 17, 2021), <https://engineadvocacyfoundation.medium.com/state-policy-update-the-nuts-and-bolts-of-state-innovation-policy-afc45b86e4a0>.

³ Liya Palagashvili, *An Economic Analysis of Restricting Independent Work* (April 2021), https://www.mercatus.org/system/files/palagashvili_-_policy_brief_-_an_economic_analysis_of_restricting_independent_work_-_v1.pdf.

⁴ Liya Palagashvili, *Exploring How Regulations Shape Technology Startups*, https://www.mercatus.org/system/files/palagashvili_-_mercatus_research_-_exploring_how_regulations_shape_technology_startups_-_v1.pdf.

⁵ *Id.*

⁶ *Id.*

⁷ *Id.*

experts to navigate a changing regulatory landscape and to perform a complex assessment in order to determine a worker's status as an employee or independent contractor and similarly can shoulder the consequences if their calculus is wrong. Many startups, however, do not have that luxury—hiring assistance to ascertain whether they are meeting shifting regulatory requirements is outside the scope of many startups' budgets. Moreover, a new framework was adopted just last year, though legal challenges hampered its implementation, and already the landscape is shifting again with a new proposed rule. Repeatedly shifting regulatory frameworks mean cash-strapped startups may struggle to adapt, especially without significant guidance. And even for those startups that make a good faith attempt at determining a worker's status under the proposed rule, there may be consequences for assessing incorrectly. Unfortunately, if the proposed rule is adopted, many startups may be forced to forgo hiring, too fearful of hiring independent contractors. This could, unfortunately, spell closure for many startups. As Laura Good of Sacramento-based startup Startup Sac told Engine, regulations limiting a startup's hiring capability “can make it impossible for early-stage startups to get off the ground.”⁸ And Grant Leah, co-founder of Woodland-based startup Nytech, explained, “Without the ability to hire independent contractors to fill these voids, most startup ideas would never get off the ground.”⁹ The DOL acknowledges that no differing reporting or compliance requirements will be given to small businesses, but also fails to acknowledge the disproportionate burden the rule change will impose on these small businesses.

It is also important to note that regulatory changes that disproportionately affect small startups, may have an even greater effect on underrepresented founders. For example, Black-owned businesses are more likely to be small, with Black-owned firms disproportionately less likely to be employer firms—many are sole proprietorships—and some may rely on contract labor.¹⁰ And startups launched by underrepresented founders, including founders of color and women founders, already face significant barriers in their startup journeys, receiving a small fraction of investment and other capital, compared to their white male peers.¹¹ These startups may face even greater challenges, due to their capital constraints, in shouldering the burdens of changing employment regulations.

The 2021 independent contractor rule represented an instance of the government seeking to provide clarity for many businesses in need. By using a multifactor test under which two core factors were given extra weight, businesses were afforded a clearer picture of how to classify workers. But the proposed rule eliminates any clarity that could be gained by the 2021 rule. This iteration speaks to economic dependence on an employer, but also states that “economic dependence does not focus on the amount of income earned, or whether the worker has other income streams.” And the factors to be considered, like investments made by the worker vs. the employer are not always simple calculations. For example, the degree of permanence of a work relationship, which alludes to

⁸ Weinhart, *supra* note 2.

⁹ Edward Graham, *#Startups Everywhere: Woodland, California* (May 8, 2020), <https://www.engine.is/news/woodland-calif>.

¹⁰ Andre M. Perry et al., *Black-Owned Businesses in the U.S. Cities: The Challenges, Solutions, and Opportunities for Prosperity* (Feb. 14, 2022), Brookings, <https://www.brookings.edu/research/black-owned-businesses-in-u-s-cities-the-challenges-solutions-and-opportunities-for-prosperity/>.

¹¹ Engine, *Making the Startup Ecosystem More Equitable* (Nov. 2021), <https://static1.squarespace.com/static/571681753c44d835a440c8b5/t/6193d03ac7eb9c40442a6740/1637077051416/Making+the+Startup+Ecosystem+More+Equitable+11.15.pdf>.

project-by-project work in favor of an independent contractor designation, also acknowledges that the temporary nature of the work does not necessarily mean a worker is an independent contractor. Even a factor that is considered a core factor under the 2021 rule isn't without ambiguity—the nature and degree of control a worker has over their schedule can be complicated by necessary due dates and timelines many businesses have. Indeed, in looking at what issues, like compliance with legal and safety requirements, factor into the nature and degree of control, the Department acknowledges that “case law is not uniform on this issue.”¹² And companies are required to balance all of these factors, and while some may clearly indicate a worker should be an independent contractor, others may not be so clear.

IV. The Department Should Formulate the True Cost of the Proposed Rule to Startups and Ensure Compliance with the Small Business Regulatory Enforcement Fairness Act

The proposed rulemaking indicates under its Initial Regulatory Flexibility Assessment that federal agencies are required to consider the impact of possible rulemakings on small entities, and consider what alternatives may exist to minimize impact and solicit public comment, and whether or not the impact is significant.¹³ While the Department goes on to assess the number of small businesses that could be affected, what that impact entails, and any available alternatives, it is unclear if the Department has appropriately considered what the full, actual cost of the proposed rule may be for small businesses. Though the Department does not expect significant reclassification, it will likely be challenging to assess the true cost in the case of shifting contractors to employees. For those startups that err on the side of caution and hire or shift to full-time workers, they must also compete with larger technology companies for the same talent that are often able to offer more robust compensation packages, which can significantly drive up the cost of full-time talent. Moreover, it is unclear what the cost to small businesses would be in forgoing hiring altogether due to the proposed rule, either because of an inability to afford to do so, or because of fear of hiring altogether, and to identify what these talent decisions mean for startup growth. There may also be associated job losses for workers employed by small businesses.

The Small Business Regulatory Enforcement Fairness Act (SBREFA) indicates a recognition by Congress that small businesses are critical to the U.S. economy, and, “bear a disproportionate share of regulatory costs and burdens,”¹⁴ and as such, agencies need to be more responsive to small business concerns. While the Department indicates that they will provide a compliance guide if the rule is finalized, they have not indicated any differing compliance or reporting requirements for small businesses in the proposed rule. But SBREFA provides that agencies regulating small entities are required to provide for a reduction or waiver in civil penalties for violations of a statute or regulation when such conduct is not intentional or criminal, among other exceptions. It is unclear how the proposed rule, if implemented, will be enforced consistent with SBREFA, if the

¹² Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 87 FR 62218 (Proposed Oct. 13, 2022) at 62247.

¹³ *Id.* at 62272.

¹⁴ Small Business Regulatory Enforcement Fairness Act of 1996, PLaw 104-121.

Department does not accommodate differing compliance requirements by waiving or reducing penalties when circumstances warrant.

V. Conclusion

Engine is appreciative and understanding of the Department's efforts to ensure that employees are afforded the benefits to which they are entitled. However, the proposed rule is misguided in its efforts to achieve this outcome. By failing to recognize and appreciate the unique circumstances of startups and the critical role independent contractors play in the innovation ecosystem, this effort risks adding potentially insurmountable costs and increased barriers for startup founders. By using a totality of the circumstances approach, as opposed to relying on weighted factors, startups may be left to rely on outside employment counsel they simply cannot afford, be forced into hiring decisions that are not right for their company, or may fail to hire and grow altogether for fear of running afoul the rules. And this could result in job losses for workers that similarly seek flexibility. We urge you in finalizing any rule regarding the classification of employees and independent contractors to carefully consider the impacts of the rule on America's startup founders.

Sincerely,

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