**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF TEXAS**
**BEAUMONT DIVISION**

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| COALITION FOR WORKFORCE INNOVATION, ASSOCIATED BUILDERS AND CONTRACTORS OF SOUTHEAST TEXAS, ASSOCIATED BUILDERS AND CONTRACTORS, INC., and FINANCIAL SERVICES INSTITUTE, INC.<br><br>*v.*<br><br>JULIE SU, *in her official capacity as Secretary of Labor, United States Department of Labor*, JESSICA LOOMAN, *in her official capacity as Principal Deputy Administrator, Division of Wage and Hour*, and UNITED STATES DEPARTMENT OF LABOR | CIVIL ACTION NO. 1;21-CV-130-MAC |

**BRIEF OF *AMICUS CURIAE* DR. LIYA PALAGASHVILI**

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## STATEMENT OF INTEREST OF *AMICUS CURIAE*

Dr. Liya Palagashvili is a Senior Research Fellow at the Mercatus Center at George Mason University. Her research focuses on labor regulations and independent contracting. Dr. Palagashvili submits this brief as part of work as a Mercatus scholar.

The Mercatus Center, as an organization, takes no position on the arguments in this brief or issues in the case.

Petitioner's case is important to *amicus* because Dr. Palagashvili's research and expertise is on labor regulations that impact independent contracting.

## INTRODUCTION

The U.S. Department of Labor ("DOL") created a new regulation that narrows the definition of "independent contractor" (a self-employed worker) for purposes of the Fair Labor Standards Act ("FLSA").[1] The new regulation does this first by retracting the 2021 rule that was more favorable to the independent contractor status and second by providing the additional considerations to the six-factor factor economic realities test that significantly limit the circumstances under which a worker can legally be classified as an independent contractor. Practically, this means it will be more difficult for workers across all professions and occupations to engage in independent contracting work. This is the DOL's strictest version of the independent contractor rule in over four decades.

The DOL's analysis of the new regulations assumes an ideal scenario, rather than a realistic one. The DOL assumes the new regulation will merely lead to compositional changes in the workforce, meaning that all affected independent contractors will just become employees. This assumption is wrong and not grounded in any theoretical or empirical research, nor is there any anecdotal evidence to support this claim.

In the Notice of Proposed Rulemaking, the DOL stated that they would not attempt to quantify the number of potential independent contracting job losses.[2] They included "rule familiarization costs" as the **only** cost of the new regulation. After numerous public interest comments (including my own) urged the DOL to consider the significant potential costs associated with the regulation, especially those related to potential job losses, the DOL's final rule still did

[1] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 89 Fed. Reg. 1638 (Jan. 10, 2024) (to be codified at 29 C.F.R. pts 780, 788, 795).

[2] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 87 Fed. Reg. 62218 (proposed Oct. 13, 2022) (to be codified at 29 C.F.R. pts 780, 788, 795) ("Because the Department does not have data on the number of misclassified workers and because there are inherent challenges in determining the extent to which the rule would reduce this misclassification, much of the analysis is presented qualitatively, aside from rule familiarization costs, which are quantified.")

not attempt to quantify theses costs. In the final rule, the DOL again assumed an ideal scenario and stated, **"**The Department does not believe the rule will lead to job losses," without providing any research or empirical support for this claim.[3] The DOL dismissed the empirical research on job losses.[4] By improperly assuming an ideal situation where there are zero independent contracting jobs are lost and no other costs, the DOL provides a biased cost-benefit analysis that is not based on realistic or reasonable considerations.

Indeed, the empirical evidence demonstrate that many independent contractors would not receive the additional benefits associated with becoming employees, because many of them would neither become employees nor be able to maintain their contracting agreements.[5] This is because companies cannot extend all contracting positions into employment positions, thereby leaving many workers with fewer job opportunities altogether. In my public interest comment to the DOL[6] and in a meeting with the Office of Information and Regulatory Affairs where DOL members were present, I provided a detailed analysis of these job losses and other potential costs.[7]

[3] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 90 FR 1638. Federal Register, Vol. 89, No. 7 (Jan. 10, 2024).
[4] The DOL claims that research based on the ABC test for worker classification tests are not relevant. This is incorrect because both the DOL test and ABC tests create stricter rules for independent contractors and therefore the implications would be similar.
[5] Liya Palagashvili et al., "Assessing the Impact of Worker Reclassification: Employment Outcomes Post-California AB5," (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, January 31, 2024); Tanner Osman, How Many App-Based Jobs Would Be Lost by Converting Rideshare and Food Delivery Drivers from Independent Contractors to Employees in the Commonwealth of Massachusetts? (Los Angeles, CA: Beacon Economics, 2022); "Staffing to Address New Independent Contractor Test," California Legislative Analyst's Office, February 11, 2020, https://lao.ca.gov/Publications/Report/4151. Makeda Easter, "The AB5 Backlash: Singers, Actors, Dancers, Theaters Sound Off on Freelance Law," Los Angeles Times, February 12, 2020. Sophia Bollag and Dale Kasler, "California Workers Blame New Labor Law for Lost Jobs. Lawmakers Are Scrambling to Fix It," Sacramento Bee, February 10, 2020; Carolyn Said, "Musicians Say AB5 Strikes Sour Note with Gig-Driven Profession," San Francisco Chronicle, February 24, 2020; Clarissa Hawes, "Some California Truckers Exit State before AB5 Labor Law Takes Effect," FreightWaves, December 31, 2019.
[6] Liya Palagashvili, *Analyzing the Impact of the Department of Labor's Rule on Restricting Independent Contracting*, Public Interest Comment Submitted on December 13, 2022.
[7] EO 12866 Meeting 1235-AA43 on November 28, 2023 at 2:00pm. Attendees: Andrea Reyes (OMB/OIRA), Laurel Havas (OMB/OIRA), Claire Monteiro (OMB/OIRA), Lyda Harris (DOL), Rey Fuentes (DOL), Rina Maimudar (DOL), Robert Waterman (DOL/WHD), Stephen Davis (DOL/WHD), Amy Hunter (DOL). Meeting information here: https://www.reginfo.gov/public/do/viewEO12866Meeting?viewRule=true&rin=1235-AA43&meetingId=239073&acronym=1235-DOL/WHD

If a sufficient number of independent contractors are expected to lose their jobs without being extended an employment position, then the costs of the rule may outweigh the benefits. The DOL has an obligation to make reasonable determination of these costs before issuing a new regulation.

## ARGUMENT

### I. THE DOL ERRS IN ASSUMING THERE WILL BE ZERO CONTRACTING JOB LOSSES FROM THE NEW REGULATION

There are a set of contracting relationships that will be unaltered by this new regulation. In those cases, a contractor will neither realize the benefits of the new regulation (becoming an employee) nor will he lose his contracting job. These are contractors who are *unaffected* by the new regulation. The DOL explicitly states that they do not believe the rule will lead to widespread reclassification, which means there are a large number of independent contractors who will not be affected by this rule.[8]

The challenge is with the remainder of contractors who will be affected by the rule. For those who are affected, there are three possible scenarios for what happens to the contractor:

a. An organization alters the existing contracting relationship to make it legal under the new regulation. The contractor therefore remains a contractor, but the terms of the relationship have changed so that the relationship is now legal under the regulation; or

b. An organization reclassifies the contractor as a part-time or full-time employee; or

c. An organization ends the contracting relationship which is no longer legal, but does not make the contractor an employee.

The DOL improperly assumes that organizations will *only* respond with either (a) or (b). In their regulatory impact analysis, the DOL analyzes the costs and includes only "rule

[8] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 90 FR 1638. Federal Register, Vol. 89, No. 7, 62260 (Jan. 10, 2024).

familiarization" costs. In the benefits section, the DOL discusses the benefits of reduced misclassification from the rule.[9] Finally, the DOL provides an analysis of the transfers associated with this rule.[10] The transfers include fringe benefits, tax liabilities, and FLSA protections that will be a transfer from the company to the newly classified employee.

The implicit assumption in the benefits and transfers section is that affected independent contractors are reclassified as employees and will therefore realize the benefits from the new regulation. But the DOL does not include as part of its analysis the possibility of scenario (c) where some independent contractors who are affected by this rule *do not realize the benefits associated with the rule because they are not reclassified as employees and instead lose their jobs as independent contractors.*

The DOL is therefore utilizing an "ideal situation" framework in their analysis, rather than taking into consideration the realistic considerations. By refusing to analyze scenario (c), the DOL thereby avoids having to consider the most significant cost associated with this rule: How many independent contractors will lose their means of making a living?

Here is an example. A company is contracting with ten freelancer photographers, these contracting relationships are all *affected* by the rule, which means that organization will have to assess these contracting relationships and decide among the three scenarios for each contractor. Let's assume that the company decides that one photographer will become an employee, two will have their agreements altered in order to remain as contractors for the company, and eight contractors will be let go.

[9] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 89 Fed. Reg. 1638 (Jan. 10, 2024) (to be codified at 29 C.F.R. pts 780, 788, 795).
[10] *Id.*

This results in contracting job losses that need to be accounted for when providing a cost-benefit analysis of the new regulation. By assuming that scenario (c) does not occur, the DOL provides a biased cost-benefit analysis that favors their regulation. Indeed, the DOL explicitly states this in their new regulation without providing any research or empirical evidence to support the claim: "The Department does not believe the rule will lead to job losses."[11] This is an ideal situation, but not a reasonable or realistic one.

## II. THE NUMBER OF CONTRACTING JOB LOSSES IS NOT ZERO

We can assess the extent of contracting job losses by looking at the empirical research and anecdotal evidence. In 2019, California passed Assembly Bill 5 (AB5), which provided a stricter definition of independent contracting and made it more difficult to work as an independent contractor in the state of California.

My research team provided the first and only empirical investigation of reclassification policies in the United States by analyzing the effects of California's AB5. We use data from the Census Bureau's and Bureau of Labor Statistic's Current Population Survey on primary earnings.

What happened as a result of this California independent contracting rule? We find that AB5 was associated with a significant decline in self-employment and overall employment for affected occupations in California. Self-employment fell by 10.5 percent on average for affected occupations, while overall employment fell by 4.4 percent on average for affected occupations. Occupations with a greater prevalence of self-employed workers saw greater reductions in both self-employment and overall employment.

Importantly, our study does not find consistent evidence that number of employees increased for affected occupations in California post-AB5.

[11] *Id.*

In short, on average, 1 in 10 self-employed individuals lost self-employment opportunities in California among affected occupations, while there is no evidence of an accompanying increase in traditional employment opportunities among workers in affected occupations.

The results of our study are consistent with the anecdotal evidence. News articles by outlets like the New York Times and Los Angeles Times described job losses following AB5, especially for the creative community of freelancers, such as professional choral artists, classical performers and singers, dancers, actors and musicians.[12] Several other reports showed job losses for translators and interpreters, court transcript editors, writers and truck drivers.[13] Due to this backlash, California later exempted these professions, and many others, from AB5.

What our findings imply for the ten photographers scenario under the DOL rule is that most photographers are unlikely to become employees and that some photographers would lose their contracting opportunities.

It is important to emphasize here that even though California's rule and the DOL's rule are not identical, they will have similar implications because they both created stricter versions of the independent contractor test. This is indeed how all empirical economic research works: we rarely have the opportunity to test the exact same rule changes, but we learn from similar rule changes that occurred in the past. Because both the DOL rule and California's AB5 enacted a rule that makes it more difficult to be independent contractors, we expect directionally similar results, although with different magnitudes.

[12] Makeda Easter, *The AB5 backlash: Singers, actors, dancers, theaters sound off on freelance law*, LOS ANGELES TIMES (Feb. 12, 2020 2:16 PM).
[13] Allana Akhtar, *'It feels cold and heartless': Hundreds of California freelancers have been fired before holidays due to a state law meant to help Uber and Lyft drivers*, BUSINESS INSIDER (Dec. 18, 2019, 10:30 PM), https://www.businessinsider.in/strategy/news/it-feels-cold-and-heartless-hundreds-of-california-freelancers-have-been-fired-before-the-holidays-due-to-a-state-law-meant-to-help-uber-and-lyft-drivers/articleshow/72875233.cms; Sophia Bullag and Dale Kasler, *California workers blame new labor law for lost jobs. Lawmakers are scrambling to fix it*, NORTH BAY BUSINESS JOURNAL (Feb. 10, 2020).

### *A. The DOL Does Not Provide A Reasoned Cost-Benefit Analysis*

The DOL states that the primary benefit of the new regulation will be conferred to workers who would obtain employee benefits and protections as a result of the new regulation. If, under the new regulation, an independent contractor now becomes an employee, the DOL considers the value of these employee protections and fringe benefits for the worker as "benefits" when assessing the cost-benefit analysis of the new regulation.

However, the DOL does not provide an analysis of how many affected independent contractors will become employees who will now enjoy the additional employee fringe benefits and labor protections. Instead, the DOL assumes without research or evidence that in cases where an independent contracting relationship is no longer legal under the new regulation, the organization will turn that independent contractor into an employee.

Because the DOL does not examine the most significant potential consequence of the rule, it provides a biased and unreasonable cost-benefit analysis associated with the new regulation.

The DOL has been made aware of these costs. In my public interest comment, I explicitly pointed out the shortcoming of their analysis and urged the DOL to consider the significant potential costs associated with the regulation, especially those related to potential job losses:

> The DOL does not provide a "reasoned determination" that the benefits of the additional considerations to the economic realities test justify its cost. To assist the DOL in providing a reasoned determination, I outline the potential impact and cost considerations discussed later in this comment. Although costs and benefits are difficult to quantify, the DOL still must attempt to provide a fair and accurate cost-benefit assessment. This means the DOL should at least include ranges of estimates where specific numbers are unknown. Given how the proposed rule currently reads, the DOL seems to deliberately leave out the most significant negative consequences, in violation of Executive Order 13563."[14]
>
> "There are five considerations that the DOL has not included in providing a reasoned determination of the costs and benefits, of which the first is the most

[14] Liya Palagashvili, *Analyzing the Impact of the Department of Labor's Rule on Restricting Independent Contracting*, Public Interest Comment (submitted Dec. 13, 2022).

> significant because it presents a clear risk that the rule would not confer its intended benefits on most independent contractors, who would neither become employees nor be able to maintain their jobs as independent contractors."[15]

I also discussed the biases present in the DOL analysis with the Office of Information and Regulatory Affairs. Members of the DOL were present at this meeting and were again made aware of the fact that they did not provide a reasoned determination of the costs. At that meeting, I also highlighted the findings from our research on California's AB5, where a stricter regulation on independent contracting led to self-employment job losses without consistent evidence that the number of employees increased as a result of the new regulation.

The DOL's final rule still did not attempt to quantify these potential job losses and costs. Instead, in the final rule, the DOL stated, **"**The Department does not believe the rule will lead to job losses," without providing any research or empirical support for this claim. By improperly assuming that zero independent contracting jobs are lost, the DOL provides a biased cost-benefit analysis.

## III. IF A LARGE NUMBER OF CONTRACTORS LOSE THEIR JOBS, THE AGGREGATE BENEFIT OF THE NEW REGULATION IS NOT LIKELY TO OFFSET ITS AGGREGATE COST.

If a sufficient number of independent contractors are expected to lose their jobs without being extended an employment position, then the costs of the rule may outweigh the benefits. This means that many workers will lose their means of making a living. The DOL has an obligation to make a reasonable determination of the costs by assessing these job losses.

If the costs are properly assessed, it may be the case that the DOL rule does not pass the cost-benefit analysis.

[15] *Id.*

### *A. Empirical Research on Stricter Independent Contracting Laws*

Making it more difficult to work as an independent contractor does not come without costs. The empirical research indicates several costs associated with stricter independent contracting rule, none of which are addressed by the DOL. In my public interest comment, I outlined in detail all of these potential consequences. The DOL was therefore made aware of the potential costs associated with the rule but still did not include any of them when providing a cost-benefit analysis of the rule.

*i. Substantial Job Losses for Independent Contractors*.

As detailed in this amicus brief, many independent contractors would not receive the additional benefits associated with becoming employees, because many of them would neither become employees nor be able to maintain their jobs as independent workers. This is because companies will not extend all contracting positions into employment positions, thereby leaving workers with fewer job opportunities altogether. If a sufficient number of independent contractors are expected to lose their jobs without being extended an employment position, then the costs of the rule may outweigh the benefits.

*ii. Fewer Options for Individuals Facing Income Loss*.

Several studies show that independent contracting is an important source of income for those who face income loss and unemployment. Therefore, the loss of independent contracting opportunities would cause particular harm to these more vulnerable individuals. In the American Economic Review, the highest ranked economics journal, the economists report that workers who suffered a spell of unemployment are significantly more likely to turn to independent contracting for a source of income[16]. A study using IRS tax data also found that people turned to independent

[16] Lawrence F. Katz and Alan B. Krueger, *The Role of Unemployment in the Rise in Alternative Work Arrangements*, 5 AMERICAN ECON. REV. 107, 388 (2017).

contracting after they faced a loss of income or unemployment.[17] These studies should place our attention to the potentially harmful impact of restrictions on independent contracting for vulnerable individuals who have recently faced unemployment or income losses. The DOL rule could eliminate work opportunities for these individuals and thereby worsen their economic standing. The DOL does take into consideration this issue.

*iii. Fewer Options for Majority of Workers Who Prefer Independent Contracting*.

According to the Bureau of Labor Statistics, a majority of independent workers (79 percent) prefer their nontraditional job arrangements over a traditional employment arrangement.[18]

Independent work provides far more flexibility in terms of work schedule, which gives workers more freedom to choose what time and how often to work. By contrast, traditional employment often means a specified schedule (e.g., nine-to-five) and a specified quantity of work (e.g., 48 weeks a year). Approximately 73 percent of individuals engaged in independent contracting because of the increased flexibility of their work.[19] Workers cite that independent contracting gives them the flexibility to be more available as a caregiver for their family or say it gives them flexibility to address personal mental or physical health needs.[20] For gig workers, the value of flexibility is significantly high. Rideshare drivers would require salaries almost twice their earnings to accept an inflexible schedule that may come with employment.[21] And for the top 10 percent of couriers, losing flexibility is equivalent to a 15 percent pay cut.[22] The DOL does not

[17] Andrew Garin et al., *Is New Platform Work Different Than Other Freelancing?*, AEA PAPERS AND PROCEEDINGS 110, 157–61 (2020).
[18] US Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements—May 2017*, news release no. USDL-18-0942 (June 7, 2018) https://www.bls.gov/news.release/pdf/conemp.pdf
[19] Ozimek, *Freelance Forward Economist Report*.
[20] *Id.*
[21] M. Keith Chen et al., *The Value of Flexible Work: Evidence from Uber Drivers*, 6 J. OF POL. ECON. 127, 2735–94 (2019) https://www.anderson.ucla.edu/faculty/keith.chen/papers/Final_JPE19.pdf
[22] Laura Katsnelson and Felix Oberholzer-Gee, *Being the Boss: Gig Workers' Value of Flexible Work* HARVARD BUS. SCH. (working paper, May 2021) https://www.hbs.edu/ris/Publication%20Files/21-124_4a28fd0c-e395-46ce-b621-2b32c3dd2fa0.pdf.

take into account the value of flexibility for independent contractors and therefore the cost associated with reduced independent contractors. If the value of fringe benefits, tax liabilities, and FLSA protections are considered the benefits when more workers become employees, the DOL should also attempt to discuss the loss of flexibility that occurs when workers become employees. The DOL assumes away this issue by making a false comparison that employees have the ability to access flexible work arrangements. Asking a boss to come in late or leave early from work is not the same as the inherent flexibility that workers experience in true independent contracting relationships. This type of flexibility gives workers the ability to work when they want, where they want, and how often they want. The vast majority of employees do not have all three of these options.

*iv. Disadvantage Women's Employment Opportunities*.

Restricting independent work opportunities and reclassifying independent work as traditional employment would disadvantage women, many of whom tend to be the primary caregivers in their families and turn to independent work for the flexibility they need in their work schedules. Survey research reveals that 96 percent of women preferred to participate in independent work precisely because they need the flexibility in working hours.[23] A recent academic study shows that self-employment rates are higher for women who have young children and that self-employed female workers seem to have more flexibility in their work location, hours, and schedule as compared to women in traditional employment.[24] Mothers with young children at home use self-employment opportunities to spend an additional two hours per day with their

[23] Hyperwallet, *The Future of Gig Work Is Female: A Study on the Behaviors and Career Aspirations of Women in the Gig Economy* (2017) https://www.hyperwallet.com/app/uploads/HW_The_Future_of_Gig_Work_is_Female.pdf
[24] Katherine Lim *Self-Employment, Workplace Flexibility, and Maternal Labor Supply: A Life-Cycle Model*, ECONOMIC REVIEW OF THE HOUSEHOLD, 17(3): 805–42.

children.[25] The study concludes that overall, these self-employment work opportunities give mothers "more control over their work environment allowing them to better manage their household while working."[26] A reduction in independent contracting opportunities could therefore hamper women's labor participation.[27]

*v. Hamper Workers Who Had Contact with the Criminal Justice System.*

Restricting independent work would disproportionately harm the criminal justice population. A September 2022 IRS study finds that individuals who had their criminal records cleared after seven years go on to work in the gig economy (independent contracting) rather that in traditional employment.[28] The study finds no evidence that removal of records from criminal background checks (including for convictions or nonconvictions and for felonies or misdemeanors) increases the likelihood of these individuals having formal employment earnings.[29] The researchers conclude that the gig economy provides an important avenue to work for those who previously had a criminal record.

## CONCLUSION

The DOL issued a new regulation on independent contracting, which became the strictest version of the independent contractor rule in over four decades. Practically, this means it will be more difficult for workers across all professions and occupations to engage in independent contracting work.

[25] *Id.*
[26] Katherine Lim "Self-Employment, Workplace Flexibility, and Maternal Labor Supply: A Life-Cycle Model." Economic Review of the Household. 17(3): 805-842.
[27] Liya Palagashvili and Paola Suarez, *Women as Independent Workers in the Gig Economy,* MERCATUS (Working Paper, March 2021).
[28] Amanda Agan et al., *The Impact of Criminal Records on Employment, Earnings, and Tax Filing* IRS SOI JOINT STATISTICAL RESEARCH PROGRAM (working paper, Sept. 19, 2022).
[29] *Id.*

The DOL did not provide a reasoned cost-benefit analysis of this new regulation. The DOL provided an "ideal case" scenario that assumed zero job losses or assumed there would no other negative implications or costs associated with this rule, except for rule familiarization costs. Moreover, the empirical evidence indicates that when there are laws that restrict independent contracting, this results in declines of job opportunities for those workers, without consistent evidence that more of those workers become W-2 employees. This was indeed the case in California when it enacted a law that made it more difficult to be an independent contractor in the state of California.

The DOL also ignored all the empirical research and anecdotal evidence on this question. In their final rule, they claim that no research on stricter independent contracting rules can be used for this question because the DOL rule is different than those other rules. It's important to emphasize here that even though the types of rules for restricting independent contracting are not identical, they are often similar because they create stricter versions of the independent contractor test. This is indeed how all empirical economic research works: we rarely have the opportunity to test the exact same rule changes, but we learn from similar rule changes that occurred in the past. Thus, for example, because both the DOL rule and California's AB5 enacted a rule that makes it more difficult to be independent contractors, we expect directionally similar results, although with different magnitudes.

This Court should vacate the DOL rule and enjoin the DOL from enforcing the rule.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

The undersigned certifies that the foregoing document was filed electronically in compliance with Local Rule CV-5(a). I hereby certify that on this 3rd day of May, 2024, the foregoing was electronically filed with the Clerk of the Court using the CM/ECF system, which will send notification of such filing to all parties and counsel of record.

*/s/ Brooke Jones*
Brooke Jones