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# Classification as Employee More Likely Under DOL's New Rule

Not long after we rang in the new year, the Department of Labor ("DOL") promulgated its Final Rule on how to analyze if a worker is an employee or independent contractor under the Fair Labor Standards Act ("FLSA"). Specifically, the "Employee or Independent Contractor Classification Under the Fair Labor Standards Act" Rule ("Independent Contractor Rule") rescinds the standard adopted by the Department of Labor in January 2021 and replaces it with the more nebulous, multifactor analysis previously applied by the Agency based on longstanding judicial precedent. The new Independent Contractor Rule takes effect on March 11, 2024 and is likely to result in significantly more workers being classified as employees as compared to the 2021 Rule. 

## History of the Independent Contractor Analysis

The FLSA requires all employers to pay their employees a minimum wage for all hours worked, as well as overtime (1.5 times their regular rate of pay) for all hours worked in excess of 40 hours per week. However, the FLSA also exempts certain types of workers from these requirements, including independent contractors, who are not considered employees under the law. Despite explicitly exempting independent contractors from coverage under the FLSA, the law does not define the term "independent contractor", nor does it provide any structure to determine whether a worker is an employee or an independent contractor. Thus, in enforcing the provisions of the FLSA, the DOL applied a multifactor analysis termed the "economic reality test" developed based on Supreme Court precedent.

Specifically, the Court laid out six nonexclusive factors that should be considered in determining whether a worker is an employee or independent contractor:

- Nature and degree of control over the worker;
- Extent work performed is integral to potential employer's business;
- Permanency of employment relationship;
- Degree of investment in equipment and facilities by worker;
- Opportunity for profit or loss based on managerial skills; and
- Level of skill, initiative, and independent judgment.

The DOL detailed the economic reality test in guidance, but, prior to 2021, there had never been a regulation explicitly explaining or requiring application of the economic reality test or any other analysis for determining independent contractor status. The amorphous nature of the economic reality test resulted in a lot of ambiguity

and inconsistency in its application by the DOL and by the various federal courts considering misclassification allegations, as well as uncertainty among employers as to whether workers were properly classified. Thus, in January 2021, the DOL promulgated its first Independent Contractor Rule, which shifted course toward a narrower, more streamlined analysis.

### **DOL's 2021 Independent Contractor Rule**

On January 7, 2021, while still under the Trump Administration, the DOL promulgated an Independent Contractor Rule intended to “clarify and sharpen the contours of the economic reality test used to determine independent contractor classification under the FLSA.” In the Preamble to the Rule, the DOL explained its determination that the prior analysis had been a source of confusion because there was no guidance on how to prioritize or balance the various factors in assessing economic dependence of the worker on the potential employer. It also pointed to changes in the modern workforce and needs of industry, such as shorter tenures for workers and increased transaction costs for industry, that shifted the significance of certain of the prior factors like the extent the work performed is integral and the permanence of the employment relationship.

As a result, the DOL's 2021 Rule focused its analysis on two core factors — (1) the nature and degree of control over the work, and (2) the worker's individual opportunity for profit or loss – citing these as the “most probative” of economic dependence. The Rule also provided examples of how to apply the factors and allot the proper weight to the two core factors over the others identified in the Rule. This Rule was set to take effect on March 8, 2021, but the DOL under the Biden Administration delayed the implementation date and ultimately withdrew it in May 2021. A lawsuit filed challenging the DOL's authority to delay and rescind the 2021 Rule resulted in a Texas federal court holding both actions unlawful and reinstating the Rule in March 2022. The DOL appealed, but that appeal was stayed pending issuance of the proposed and final rules.

### **The New Independent Contractor Standard**

The DOL issued its Proposed Rule in October 2022 and, after the Notice and Comment period, promulgated the Final Rule earlier this month. The Agency asserts that its decision to rescind the 2021 Rule is appropriate because the 2021 Rule does not fully comport with the FLSA's text and purpose or the case law applying the economic reality test, which relied on a variety of factors to analyze economic dependence. Conversely, the DOL advises that the new Independent Contractor Rule “aligns with longstanding judicial precedent” by reverting back to the multifactor analysis that gives no greater weight to any individual factor. In its press release announcing the new Independent Contractor Rule, the DOL makes clear its intent that this rule will lead to more workers being classified as employees, explaining that the rule seeks to “combat employee misclassification” of workers as independent contractors.

Under the new Rule, “an employer suffers or permits an individual to work as an employee if, as a matter of economic reality, the individual is economically dependent on that employer for work.” Specifically, the rule sets forth six factors to guide any assessment of the economic realities of the working relationship between a worker and an employer with guidance on how each factor should be applied. Those factors are:

- *Opportunity for profit or loss depending on managerial skill.*
  - Whether the worker exercises managerial skill that affects the worker's economic success or failure in

performing the work.

- *Investments by the worker and the potential employer.*
  - Whether any investments by a worker are capital or entrepreneurial in nature.
- *Degree of permanence of the work relationship.*
  - This factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration or continuous, which is often the case in exclusive working relationships. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, non-exclusive, contract-based or sporadic.
- *Nature and degree of control.*
  - This factor considers the employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship.
- *Extent to which the work performed is an integral part of the potential employer's business.*
  - This factor focuses on whether the function a worker performs is an integral part of the potential employer's business, not whether any individual worker in particular is an integral part of the business.
- *Skill and initiative.*
  - Whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative. Where the worker brings specialized skills to the work relationship, it is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

The new Rule specifies that no factor has a predetermined weight – all should be analyzed together – and the importance of any one factor will depend on the facts of each individual case. It also explains there may be additional factors relevant to the analysis that indicate whether the worker is in business for themselves or economically dependent on the employer.

### **Impact of the New Rule**

As was the clear intent of the DOL, the reinstated multifactor test and the criteria for applying it provide more opportunities for workers who might have previously been classified as independent contractors, to be classified as employees. The rule accomplishes this in several ways, including boosting the weight given to the degree of permanence of the working relationship between worker and employer, and reemploying consideration of whether work performed is integral to the employer's business. The new Independent Contractor Rule also puts increased emphasis on reserved but unexercised control in evaluating whether a worker is actually an employee. Because the Rule will inevitably result in more workers being classified as employees, it is likely to generate increased costs for employers, particularly those who depend on independent contractors to fulfill certain aspects of their operations (i.e., those operating in the gig economy) as well as heightened risk of misclassification claims.

But the full impact of the Rule is still unclear as it already faces a legal hurdle. Last week, a group of freelance writers and editors filed the first lawsuit challenging the legality of the new Independent Contractor Rule, asking a

Georgia federal court to strike it down as unconstitutionally vague. The lawsuit also requests the Rule's implementation be temporarily blocked while the lawsuit is ongoing. More such legal challenges are likely to follow from various businesses and business groups. Senate Republicans have also announced a plan to introduce a resolution to repeal the Rule under the Congressional Review Act. But that effort seems unlikely to be successful due to the slim Democratic majority in the Senate and per the veto authority of the President.

Thus, for now, employers should operate under the assumption that this new Rule will take effect in March and evaluate classification of their workers based on the multifactor analysis provided therein. Conn Maciel Carey will be following this Rule closely and will be sure to keep you apprised of any updates.