Special Report

Labor Department Releases Independent Contractor Final Rule, Revising Standard

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The U.S. Department of Labor (DOL) has released its long-anticipated Final Rule revising the standard for determining whether a worker is an employee or independent contractor under the Fair Labor Standards Act (FLSA). The Final Rule, published in the Federal Register on Jan. 10, 2024, is slated to take effect on March 11, 2024. Legal challenges are expected.

The Final Rule formally rescinds the independent contractor rule issued by the DOL during the Trump Administration a few years ago and provides a different interpretation of how the "economic realities" test should be applied.

While the DOL announced that "this rule is not intended to disrupt the businesses of independent contractors who are, as a matter of economic reality, in business for themselves," business groups have argued the new rule only adds confusion and will result in workers improperly designated as employees when they instead are operating as independent contractors. The DOL's change of course concerning the proper standard so quickly after a different standard was announced a few years ago, and following a change in administration, might reduce any deference courts will give to the new rule if it becomes effective.

Background

The FLSA guarantees a minimum wage for all hours worked and overtime pay for any hours worked over 40 per week for all covered, non-exempt employees. Individuals who perform services for a company as an independent contractor are not afforded the FLSA's minimum wage and overtime protections because they are not "employees." The FLSA itself, however, is silent on how to distinguish an employee from an independent contractor. Although it had issued occasional subregulatory guidance on the question over the years, DOL did not engage in formal rulemaking until the Trump Administration.

Courts developed similar standards for determining whether an individual is an employee or an independent contractor. Most of these standards focused on the "economic reality" of the relationship between the hiring entity and the individual. The standards came from six non-exclusive factors originally set forth by the U.S. Supreme Court in a pair of 1947 decisions. These factors are:

1. Opportunity for profit or loss depending on managerial skill;
2. Investments by the worker and the potential employer;
3. Degree of permanence of the work relationship;
4. Nature and degree of control;

5. Extent to which the work performed is an integral part of the potential employer's business; and

6. Skill and initiative.

The courts and the DOL have applied these factors, or some similar variation of them, for more than 70 years. But they applied the factors inconsistently and have given the factors different degrees of weight, sometimes reaching opposite conclusions based on what appear to be essentially the same facts.

Rescinded 2021 Independent Contractor Rule

During the Trump Administration, the DOL sought to resolve the tension created by decades of inconsistent and subjective application of the factors. In January 2021, the DOL for the first time adopted a formal independent contractor rule (2021 IC Rule).

The 2021 IC Rule elevated the comparative value of two "core" factors: "the nature and degree of the individual's control over the work" and "the individual's opportunity for profit or loss." The 2021 IC Rule explained that these factors are traditionally the "most probative" and therefore should be "afforded greater weight" than the other factors. Some argued this made it easier to classify workers as independent contractors. Proponents of the rule argued this only clarified and helped identify workers who are properly performing work as independent contractors.

After the Biden Administration took office, DOL first delayed implementing the 2021 IC Rule and then withdrew the rule altogether in May 2021. According to the Biden DOL, such a "predetermined and mechanical weighting of factors is not consistent with how courts have, for decades, applied the economic reality analysis." Rather than proposing a new rule at that time, though, the DOL simply rescinded the 2021 IC Rule, leaving in place the judicially created applications of the law. In March 2022, however, a Texas federal court held that both the delay in implementing the 2021 IC Rule and the rule withdrawal were unlawful. That court reinstated the 2021 IC Rule. The DOL appealed that ruling, but the appeal was stayed in light of the anticipated issuance of new proposed regulations.

The Final Rule published on Jan. 10 replaces the 2021 IC Rule. In doing so, the DOL stated the Trump rule and its "core factors" approach did not comport with the FLSA's text and statutory purpose, even though DOL itself proposed the rule just a few years before.

According to DOL, the 2021 IC Rule prohibited consideration of whether the work performed by the individual is central or important to the "potential employer's" business (the phrase adopted in the Final Rule to refer to the business or hiring entity in question). Under the Final Rule, the "integral" question asks not whether the worker's role is an integrated unit of production but whether the worker's role is an integral part of the potential employer's business.

The 2021 IC Rule also did not consider a worker's investment and initiative as a stand-alone factor; this factor was evaluated only as part of the "opportunity for profit or loss" analysis. The Final Rule also omits a 2021 IC Rule provision that downplayed a potential employer's reserved, but unexercised, right of control over a worker in the independent contractor analysis.

The DOL takes the position that rescission of the 2021 IC Rule is severable from the

substantive Final Rule and operates independently. Therefore, according to DOL, even if its new Final Rule is invalidated or enjoined, the 2021 IC Rule rescission stands on its own and the prior rule would *not* remain in effect.

New Rule

Consistent with the agency's longstanding position that the economic reality of the relationship between the worker and potential employer should be evaluated based on the "totality of the circumstances," the Final Rule returns to the six economic reality factors that both the DOL and federal courts historically have applied, with minor variations as interpreted by circuit courts.

The Final Rule states that the six factors are to be applied equally, with no factor to be given predetermined weight over other factors. No single factor or subset of factors will be dispositive. The factors should not be considered in isolation. The Final Rule clarifies that, in some cases, one or more factors may be more probative than others, while in other cases one or more factors may be irrelevant. According to the DOL, this approach offers the flexibility required when applying the FLSA in the modern economy because, as these six factors are non-exhaustive, other considerations may arise in a given situation.

At bottom, "economic dependence is the ultimate inquiry for determining whether a worker is an independent contractor of an employee," the Final Rule states. The analysis is whether the worker is in business for themself. Moreover, the amount the worker earns, or whether the worker has other sources of income, is not determinative of economic dependence.

Comparison With Proposed Rule

The Final Rule largely conforms to the proposed rule issued by the DOL on Oct. 13, 2022, with slight modifications based on a review of more than 55,000 comments received during the rulemaking period. In the Final Rule, the DOL explained that:

- The worker's payment of costs unilaterally imposed by the hiring entity should not be considered "investments" because they are not truly indicative of entrepreneurial investment. The Final Rule explains that, when comparing investments made by the worker and potential employer, the analysis should focus on the types of investments made by each and not focus exclusively on the relative size of the investments.

- The "degree of permanence" considers the temporal duration of the relationship and will not be overcome by the non-exclusivity of the worker's commitment to the potential employer, and ought to consider whether the temporal nature of the work is characteristic of the industry or a worker's independent business initiative.

- Actions taken by a potential employer for the sole purpose of complying with applicable laws or regulations are not indicia of control over a worker, but the company's compliance methods, including quality control or customer service standards, may be probative of control over the worker.

- The "degree of control" analysis will consider circumstances that might limit the worker's ability to work for others including "demands on a worker's time," and other restrictions, such as monetary penalties and threats to terminate the worker or reduce the worker's shifts.

- The "skill and initiative" factor focuses on the worker's use of specialized skills *in connection with business-like initiative* that is indicative of an independent contractor and not just whether the worker must be skilled to perform the work.

Economic Reality Factors

As revised, the Final Rule text identifies and describes the operative economic reality factors:

1. *Opportunity for profit or loss depending on managerial skill.* This factor considers whether the worker has opportunities for profit or loss based on managerial skill (including initiative or business acumen or judgment) that affect the worker's economic success or failure in performing the work. The following facts, among others, can be relevant: whether the worker determines or can meaningfully negotiate the charge or pay for the work provided; whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed; whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space. If a worker has no opportunity for a profit or loss, then this factor suggests that the worker is an employee. Some decisions by a worker that can affect the amount of pay that a worker receives, such as the decision to work more hours or take more jobs when paid a fixed rate per hour or per job, generally do not reflect the exercise of managerial skill indicating independent contractor status under this factor.

2. *Investments by the worker and the potential employer.* This factor considers whether any investments by a worker are capital or entrepreneurial in nature. Costs to a worker of tools and equipment to perform a specific job, costs of workers' labor, and costs that the potential employer imposes unilaterally on the worker, for example, are not evidence of capital or entrepreneurial investment and indicate employee status. Investments that are capital or entrepreneurial in nature and thus indicate independent contractor status generally support an independent business and serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach. Additionally, the worker's investments should be considered on a relative basis with the potential employer's investments in its overall business. The worker's investments need not be equal to the potential employer's investments and should not be compared only in terms of the dollar values of investments or the sizes of the worker and the potential employer. Instead, the focus should be on comparing the investments to determine whether the worker is making similar types of investments as the potential employer (even if on a smaller scale) to suggest that the worker is operating independently, which would indicate independent contractor status.

3. *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, continuous, or exclusive of work for other employers. This factor weighs in favor of the worker being an independent contractor when the work relationship is definite in duration, non-exclusive, project based, or sporadic based on the worker being in business for themself and marketing their services or labor to multiple entities. This

may include regularly occurring fixed periods of work, although the seasonal or temporary nature of work by itself would not necessarily indicate independent contractor classification. Where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, this factor is not necessarily indicative of independent contractor status unless the worker is exercising their own independent business initiative.

4. *Nature and degree of control.* This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship. Facts relevant to the potential employer's control over the worker include whether the potential employer sets the worker's schedule, supervises the performance of the work, or explicitly limits the worker's ability to work for others. Additionally, facts relevant to the potential employer's control over the worker include whether the potential employer uses technological means to supervise the performance of the work (such as by means of a device or electronically), reserves the right to supervise or discipline workers, or places demands or restrictions on workers that do not allow them to work for others or work when they choose. Whether the potential employer controls economic aspects of the working relationship should also be considered, including control over prices or rates for services and the marketing of the services or products provided by the worker. Actions taken by the potential employer for the sole purpose of complying with a specific, applicable Federal, State, Tribal, or local law or regulation are not indicative of control. Actions taken by the potential employer that go beyond compliance with a specific, applicable Federal, State, Tribal, or local law or regulation and instead serve the potential employer's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control. More indicia of control by the potential employer favors employee status; more indicia of control by the worker favors independent contractor status.

5. *Extent to which the work performed is an integral part of the potential employer's business.* This factor considers whether the work performed is an integral part of the potential employer's business. This factor does not depend on whether any individual worker in particular is an integral part of the business, but rather whether the function they perform is an integral part of the business. This factor weighs in favor of the worker being an employee when the work they perform is critical, necessary, or central to the potential employer's principal business. This factor weighs in favor of the worker being an independent contractor when the work they perform is not critical, necessary, or central to the potential employer's principal business.

6. *Skill and initiative.* This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to business-like initiative. This factor indicates employee status where the worker does not use specialized skills in performing the work or where the worker is dependent on training from the potential employer to perform the work. Where the worker brings specialized skills to the work relationship, this fact is not itself indicative of independent contractor status because both employees and independent contractors may be skilled workers. 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.

7. *Additional factors.* Additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the FLSA, if the factors in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the potential employer for work.

No ABC Test

In FAQs released alongside the Final Rule, the DOL stated that the Final Rule does not adopt the "ABC" test used in California and elsewhere. That test is more likely to find workers are "employees" and makes it much harder to use independent contractors. (Concerns that the DOL would seek to adopt a nationwide ABC test has been a key source of contention in the ongoing effort by the Biden Administration to win Senate approval of Julie Su, Acting Secretary of Labor, to a permanent appointment. For details, see our blog post, Nomination of Acting DOL Secretary Julie Su is Sent Back to the White House.)

Potential Impact

"It is the Department's obligation to administer and enforce the FLSA to ensure that workers who should be covered under the Act are properly classified as employees," the DOL said in announcing the Final Rule, noting its goal of combatting worker misclassification. "This final rule ensures that such workers receive the FLSA's wage and hour protections, and that employers that comply with the law are not placed at a competitive disadvantage when competing against employers that misclassify employees."

Whether the Final Rule will have the intended impact is unclear. Most federal circuits courts already have established legal tests in place for determining independent contractor status. Moreover, the U.S. Supreme Court this term will take up an important administrative law case that asks the justices to reconsider the "Chevron" doctrine, in which courts grant considerable deference to certain federal agency regulations. The Court's eventual decision in *Relentless, Inc. v. Department of Commerce* (No. 22-1219) and *Loper Bright Enterprises v. Raimondo* (No. 22-451) could sharply restrict the DOL's authority to enforce the Final Rule in the courts.

Further, the Final Rule likely will face legal challenge. Business groups already have signaled they will oppose the rule. Republican members on the Senate Health, Education, Labor and Pensions Committee have indicated they will seek to repeal the Final Rule under the Congressional Review Act.

Finally, the DOL's independent contractor Final Rule only defines independent contractor status under the FLSA. The standard does not apply to other federal laws, including the National Labor Relations Act, or state wage and hour laws (or lawsuits alleging independent contractor misclassification under those statutes). Nor does the DOL's framework control the analysis in other legal contexts where a worker's independent contractor status may be determinative, such as liability under employment discrimination laws.

Jackson Lewis attorneys are available to discuss the impact of the Final Rule on employers' business operations. If you have any questions about the Final Rule, the independent contractor analysis, or any other wage and hour issue, please consult the

Jackson Lewis attorney(s) with whom you regularly work.

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