U.S. DOL Issues New Rule on Independent Contractor Classification, Returning to More Employee-Friendly Analysis

Description

By Morgan E. Hedly and Michael A. Gamboli

The U.S. Department of Labor (DOL) published a new rule (the â€œNew Ruleâ€•) on January 9, 2024, defining â€œindependent contractorâ€• under the Fair Labor Standards Act (FLSA).Â Effective March 11, 2024, the rule returns to a six-factor test that asks whether, as a matter of economic reality, a worker is economically dependent on the employer or is in business as an independent contractor.

The distinction between employees and independent contractors determines whether the FLSA applies. Â 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*. Â On the other hand, individuals who perform services for a company as *independent contractors* are not afforded the FLSAâ€™s minimum wage and overtime protections.

As many employers know, a finding of misclassification can result in expensive penalties, such as unpaid overtime and minimum wage, liquidated damages and attorneysâ€™ fees.Â If the IRS suspects an employer intentionally misclassified its employees, it can levy additional penalties for the misclassification, including criminal charges.

Why is the DOL Issuing a New Rule?

By way of background, the FLSA itself is silent on how to distinguish an employee from an independent contractor and, until 2021, the DOL had not defined â€œindependent contractorâ€• by regulation.Â Instead, it published subregulatory guidance which laid out factors relevant to worker classification.

In addition, over the last 70 years, courts have developed standards similar to the DOLâ€™s guidance, most of which focus on the â€œeconomic realityâ€• of the relationship between the hiring entity and the worker and consider the following six non-exclusive factors:

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 employerâ€™s business.
6. Skill and initiative needed to perform the work.

In January 2021, under the Trump Administration, the DOL finalized a formal rule (the â€œ2021 Ruleâ€•) for the first time.Â This rule consisted of a more employer-friendly five-factor test, focusing on two â€œcoreâ€• factors: the principalâ€™s right to control and the workerâ€™s opportunity for profit or loss. Â It explained that these factors are traditionally the â€œmost probativeâ€• and therefore should be â€œafforded greater weightâ€• than the other factors.Â If the two core factors pointed in the same direction, the analysis ended. Â If they pointed in different directions or produced no clear result, the rule considered three â€œguidepostâ€• factors: the relationshipâ€™s length or permanence, the workerâ€™s special skills, and the workâ€™s integration into the principalâ€™s operations.

Soon after the Biden Administration took office, the DOL rescinded the 2021 Rule.Â However, a Texas federal

court reinstated the 2021 Rule, holding that both the delay in implementing the 2021 Rule and the rule withdrawal were unlawful and that the 2021 Rule was still in effect. Â Taking an alternative avenue, the DOL finalized the New Rule on January 8, 2024, which effectively rescinds the 2021 Rule and, in its place, adopts the previously relied upon six-factor test.

The New Rule Returns to a Six-Factor â€œTotality of Circumstancesâ€• Analysis

Fundamentally, the 400-page New Rule returns to the six economic reality factors that both the DOL and federal courts historically have applied, where no single factor or group of facts is assigned any predetermined weight.

The six-factor test of the New Rule includes:

1. The workerâ€™s potential for profit or loss.
2. Investments by the worker and the employer.
3. The permanence of the relationship.
4. The degree of the employerâ€™s control over the work.
5. How integral the work is to the employerâ€™s business.
6. The workerâ€™s skill or initiative.

The New Rule addresses and explains each of these factors and refines several details in an attempt to have these factors applied more uniformly.Â Notably, the New Rule provides, *inter alia*, that (a) fixed hourly or per-job payments do not demonstrate entrepreneurial opportunity; (b) the comparison of investments should focus on their nature rather than their amount; (c) the control exercised to comply with legal requirements does not automatically classify a worker as an employee; (d) costs imposed by the employer for necessary tools do not indicate independent contractor status; and (e) specialization alone does not define independent contractor status.Â As has been the case with respect to the question of whether a worker is properly classified as an employee or independent contractor, regardless of the applicable guidance, the answer is based on a very fact-intensive inquiry regarding the specific position in question.

Intersection Between Final Rule and Other Worker Classification Laws

Employers should take note that the analysis that courts undertake in deciding whether workers are independent contractors or employees varies across state lines and depends upon what specific claims are at play.Â The New Rule specifically addresses the classification of independent contractors under the FLSA. Â It does not change any other laws that use different standards for employee classification (i.e., the IRC, EEOC, or NLRA).

The New Rule also has no effect on state wage-and-hour laws and employers must therefore consider all laws that apply and ensure that they are meeting whichever standard provides workers with the greatest protection.Â For example, under Rhode Island law, courts focus on whether the alleged employer has the â€œrightâ€• to exercise control over the means and manner by which the worker performs their duties. Â Under Massachusetts law, employers must pass the â€œA-B-Câ€• test, which is more restrictive than the DOLâ€™s New Rule, making it more challenging for Massachusetts employers to classify workers as independent contractors. Â Under this test, the work performed must be: (a) done without the direction and control of the employer, both under the contract terms and in the performance of work; (b) performed outside the usual course of the employer's business; and (c) done by someone who customarily engages in an independently established trade, occupation, profession or business of the same nature as that involved in the service performed for the employer.

Recommendations for Businesses

Starting March 11, 2024, courts and DOL investigators will likely treat the New Rule as the controlling standard for audits and other compliance actions. Â While the New Rule probably will not lead to widespread reclassification of workers, employers should review their classification policies and procedures and consult with counsel to ensure that they are considering the totality of the circumstances.Â Experienced counsel can

also assist in implementing or refining a standardized system to help clarify the status of all new hires as well as assist in conducting routine checks to ensure that workers hired as independent contractors have not become employees over time due to a shift in the nature of their work.

The Employment & Labor Practice Group at Partridge Snow and Hahn LLP is available to answer questions about the Final Rule or the independent contractor analysis under any other state or federal workers classification laws.

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