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U.S. Department of Labor Promulgates Final Independent Contractor Rule Under the Fair Labor Standards Act

The U.S. Department of Labor (the "DOL") recently issued a final rule[1] ("the Final Rule") regarding the standard for determining whether a worker is properly classified as an employee or independent contractor under the Federal Labor Standards Act (the "FLSA").

The Final Rule formally rescinds and replaces an earlier rule (the "2021 IC Rule") which used a five-factor economic reality test comprised of two more probative "core factors" and three less probative "non-core" factors. The Final Rule adopts the following six-factor totality-of-the-circumstances analysis in which the factors do not have a predetermined weight: (1) the worker's opportunity for profit or loss; (2) investments by the worker and the potential employer; (3) the degree of permanence of the work relationship; (4) the nature and degree of control by the potential employer; (5) the extent to which the work performed is an integral part of the potential employer's business, and (6) the worker's skill and initiative.[2]

The Final Rule is scheduled to go into effect on March 11, 2024 and will only apply to the FLSA. It will not apply to other federal, state or local laws that may utilize different, and perhaps more stringent, tests for independent contractor classifications.

Background

The FLSA requires covered employers to pay their nonexempt "employees" at least the federal minimum wage and overtime pay, and mandates that employers keep certain records regarding their employees. These requirements do not apply to "independent contractors," a term that is undefined under the statute. The FLSA does, however, contain broad definitions of the terms "employee," "employer" and "employ."[3]

Federal courts and the DOL have historically applied a multifactor, totality-of-the-circumstances economic reality test, with no factor being dispositive, to determine whether a worker is an employee or an independent contractor under the FLSA.[4] In January 2021, the DOL under the Trump Administration published the 2021 IC Rule, which elevated two core factors in the worker classification analysis as the most probative: (1) the nature and degree of control over the relevant work and (2) an individual's opportunity for profit or loss.[5] The 2021 IC Rule also identified the following three less probative non-core factors:

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1 Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 89 Fed. Reg. 1,638 (Jan. 10, 2024) (to be codified 29 C.F.R. Parts 780, 788 and 795), https://www.federalregister.gov/d/2024-00067.

2 Final Rule at 1,742–43.

3 "Employee" is defined as "any individual employed by an employer." 29 U.S.C. § 203 (e). "Employer" is defined to include "any person acting directly or indirectly in the interest of an employer in relation to an employee," *Id.* § 203(d). "Employ" is defined to "include[] to suffer or permit to work." *Id.* § 203(g).

4 For a more in-depth discussion on the history of the economic reality test preceding the 2021 IC Rule, see our September. 29, 2020 Memorandum.

5 2021 IC Rule at 1,168.

(1) the amount of skill required for the work; (2) the degree of permanence of the working relationship between the worker and the potential employer; and (3) whether the work is part of an integrated unit of production.[6] The 2021 IC Rule stated that if the two core factors pointed toward the same classification, there was a substantial likelihood that it was the worker's accurate classification, and that it was "highly unlikely" that the three non-core factors could outweigh the combined probative value of the two core factors.[7] As described in the Final Rule, the 2021 IC Rule "marked a departure from the consistent, longstanding adoption and application of the economic reality test by the courts and the [DOL].[8]

While the effective date of the 2021 IC Rule was March 2021, shortly after the Biden Administration took office, the DOL published a rule delaying the 2021 IC Rule's effective date and then ultimately published a rule withdrawing the 2021 IC Rule.[9] In explaining its decision to withdraw the 2021 IC Rule, the DOL stated that the 2021 IC Rule, including the rule's prioritization of the two core factors, was "in tension with the FLSA's text and purpose, as well as relevant judicial precedent" and would have narrowed the independent contractor test, resulting in workers losing FLSA protections.[10] The DOL's attempts to delay and withdraw the 2021 IC Rule were stalled after a federal district court in the Eastern District of Texas (the "District Court") found in March 2022 that the DOL's delay and withdrawal rules violated the Administrative Procedure Act.[11] The District Court did not address the validity of the 2021 IC Rule, but found that it became effective on the original effective date of March 8, 2021 and was still in effect at the time of the decision.[12] Subsequent to the DOL's appeal to the U.S. Court of Appeals for the Fifth Circuit, the case ("*Coalition* v. *Walsh*") was stayed during the pendency of the new rulemaking procedure.[13] On January 11, 2024, a day after the publication of the Final Rule, the plaintiffs-appellees requested that the court lift the stay in *Coalition* v. *Walsh* and remand the case to the U.S. District Court for the Eastern District of Texas for further proceedings. The following day, the DOL opposed the plaintiffs-appellees' request to remand and requested that the court vacate as moot the District Court's final judgment.[14]

The Proposed Rule

On October 13, 2022, the DOL published a proposed rule[15] (the "Proposed Rule"), which sought to rescind and replace the 2021 IC Rule.[16] Stating that the misclassification of employees as independent contractors remains "one of most serious problems" facing workers and businesses,[17] the Proposed Rule explained that the 2021 IC Rule did not fully comport with the FLSA's text and purpose as interpreted by courts and departed from decades of case law applying the economic reality test.[18] According to

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6 2021 IC Rule at 1,168.

7 2021 IC Rule at 1,246.

8 Final Rule at 1,638.

9 Final Rule at 1,639.

10 DOL, US Department of Labor to Withdraw Independent Contractor Rule (May 5, 2021), https://www.dol.gov/newsroom/releases/whd/whd20210505#:~:text=Independent%20Contractor%20Rule-,US%20Department%20of%20Labor%20to%20withdraw%20Independent%20Contractor%20Rule,the%20Fair%20Labor%20Standards%20Act.

11 Final Rule at 156. *See Coal. for Workforce Innovation* v. *Walsh*, No. 1:21-CV-130, 2022 WL 1073346 (E.D. Tex. Mar. 14, 2022), *appeal filed*, No. 22 22-40316 (5th Cir. May 13, 2022).

12 *Coal. for Workforce Innovation*, 2022 WL 1073346, at *20. *See* Final Rule at 156.

13 *Coalition* v. *Walsh*, 22-40316, ECF No. 27 (June 10, 2022).

14 *Id*. Dep't of Labor Opp. Motion, ECF No. 60 (Jan. 12, 2024).

15 Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 87 Fed. Reg. 62,218 (Oct. 13, 2022) (to be codified 29 C.F.R. Parts 780, 788 and 795), https://www.federalregister.gov/d/2022-21454.

16 Proposed Rule at 62,219.

17 Proposed Rule at 62,225.

18 Proposed Rule at 62,225.

the Proposed Rule, the 2021 IC Rule narrowed the economic reality test by limiting the facts that may be considered as part of the test, such as consideration of whether the work performed by a worker is central to the employer's business, which the DOL believed is relevant in determining the ultimate inquiry.[19]

The Proposed Rule clarified that the ultimate inquiry is whether, as a matter of economic reality, the worker is either "economically dependent on the employer for work or in business for themselves."[20] To answer this ultimate inquiry of economic dependence, the DOL set forth six non-exclusive factors to be evaluated under a totality of the circumstances framework, which included (1) opportunity for profit or loss; (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.[21] The Proposed Rule also included a catch-all provision stating that these factors were not exhaustive and that "additional factors may be relevant" in the analysis if such factors in some way indicate that the worker is in business for themselves, as opposed to being economically dependent on the employer for work.[22] According to the DOL, the Proposed Rule's multifactor economic reality test would aid in "evaluating modern work arrangements," among other things, due to its flexible, comprehensive, and nuanced approach to evaluating different industries and occupations.[23]

The Final Rule

On January 10, 2024, the DOL, after receiving and reviewing approximately 55,400 comments on the Proposed Rule from interested parties, published the Final Rule, effective March 11, 2024.[24] The Final Rule largely conforms to the Proposed Rule, with slight modifications.[25]

Like the Proposed Rule, the Final Rule adopts an economic realities test that analyzes an employee's classification through the totality of the circumstances of the worker-employer relationship.[26] The Final Rule affirms the same ultimate inquiry of economic dependence and notes that a worker is not an independent contractor if the worker is economically dependent on an employer for work.[27] The Final Rule provides additional context for the relevant factors used to analyze employee or independent contractor status under the FLSA:

1) **Opportunity for profit or loss**: This factor considers whether the worker is using a managerial skill to affect the worker's opportunity for profit or loss. The following facts may be relevant: whether the worker determines or meaningfully negotiates their pay; accepts or declines jobs or has power over timing; produces their own advertising; and makes decisions to hire others, purchase materials and equipment, and/or rent space.[28] Employee, rather than independent contractor, status tends to be indicated if workers have no opportunity for a profit or loss.[29]

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19 Proposed Rule at 62,232.

20 *Id.*

21 Proposed Rule at 62,219.

22 Proposed Rule at 62,275.

23 Proposed Rule at 62,227.

24 Final Rule at 1,639.

25 *Id.*

26 Final Rule at 1,716.

27 Final Rule at 1,711.

28 Final Rule at 1,671.

29 *Id.*

2) **Investments by the worker and the potential employer**: This factor considers whether any investments by a worker are "capital or entrepreneurial" in nature.[30] Independent contractor, rather than employee, status tends to be indicated if workers make capital or entrepreneurial investments.[31] In response to certain comments regarding the unilateral nature of some costs imposed by potential employers on workers, the Final Rule clarified that costs that are unilaterally imposed are not indicative of a worker's capital or entrepreneurial investment.[32]

3) **Degree of permanence of the work relationship**: This factor considers whether the work relationship is "indefinite in duration, continuous, or exclusive of work for other employers."[33] Independent contractors tend to have working relationships that are definite in duration, nonexclusive, project-based or sporadic. However, seasonal or temporary work does not necessarily indicate independent contractor status, according to the Final Rule.[34]

4) **Nature and degree of control**: This factor considers whether the potential employer sets the worker's schedule, compels attendance, supervises the work (including "technological means of supervision," such as by means of a device or electronically), controls the prices or rates for services and marketing, and explicitly limits the worker's ability to work for others.[35] Whereas the Proposed Rule stated that "[c]ontrol implemented by the employer for purposes of complying with legal obligations, safety standards, or contractual or customer service standards may be indicative of control,"[36] the Final Rule now states that "[a]ctions 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."[37] On the other hand, "[a]ctions taken by the potential employer that go beyond compliance with a specific, applicable . . . 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."[38]

5) **Extent to which the work performed is an integral part of the potential employer's business**: This factor considers whether the function that a worker performs is ''critical, necessary, or central to the employer's principal business."[39] When the work performed is critical, necessary or central to the potential employer's principal business, employee status is suggested.[40] When the work performed is not critical, necessary or central to the potential employer's principal business, independent contractor status is suggested.[41]

6) **Skill and initiative**: This factor considers whether the worker uses specialized skills to perform the work and whether those skills contribute to entrepreneurial investment.[42] If a worker uses specialized skills, this tends to indicate independent contractor status.[43] The Final Rule clarifies ambiguity from the Proposed Rule and states that "[w]here the worker brings specialized skills to

30 Final Rule at 1,676.

31 *Id.*

32 Final Rule at 1,685.

33 *Id.*

34 *Id.*

35 Final Rule at 1,690.

36 Proposed Rule at 62,275.

37 Final Rule at 1,694 (emphasis added).

38 *Id.*

39 Final Rule at 1,707.

40 *Id.*

41 Final Rule at 1,710.

42 Final Rule at 1,713.

43 *Id.*

the work relationship, this fact is not itself indicative of independent contractor status because both employees and independent contractors may be skilled workers."[44] Rather,"[i]t is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor."[45]

Just like the Proposed Rule, the Final Rule also states that factors in addition to the above six factors may be relevant if those factors indicate a worker is in business for themself rather than being economically dependent on the potential employer for work, which according to the DOL is the "ultimate inquiry" for determining independent contractor status.[46]

Additionally, while it was suspected that the DOL might establish a federal standard modeled after California's "ABC" test—which presumes that an individual is an employee unless the employer demonstrates the existence of certain factors—the DOL clarified that the Final Rule does not adopt an "ABC" test and instead relies on the long-standing multi-factor economic reality test.[47]

Implications for Employers

- As the Final Rule only addresses classification of workers under the FLSA, employers are encouraged to take steps to maintain compliance with all other potentially relevant federal, state and local laws concerning classification of workers.

- Employers should consider reviewing and updating independent contractor agreements with an eye toward compliance with the Final Rule, recognizing that the ultimate inquiry is whether, as a matter of economic reality, the worker is either "economically dependent on the employer for work or in business for themselves."

- Employers should consider evaluating the economic reality/actual practice surrounding their independent contractor and employee relationships against the Final Rule test to ensure proper classifications under the FLSA.

- Given that the lawsuit surrounding the DOL's delay and withdrawal of the 2021 IC Rule is still pending, employers may consider monitoring the Final Rule for any further developments, including any potential legal challenges against the Final Rule.

The Final Rule can be found here.

The Proposed Rule can be found here.

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44 Final Rule at 1,743.

45 *Id.*

46 *Id.*

47 Frequently Asked Questions – Final Rule: Employee or Independent Contractor Classification under the FLSA, https://www.dol.gov/agencies/whd/flsa/misclassification/rulemaking/faqs#. The "ABC" test presumes that an individual is an employee unless the employer demonstrates each of the following: (a) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; (b) the worker performs work that is outside the usual course of the hiring entity's business; and (c) the worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed. *See Dynamex Operations W*. v. *Superior Ct.*, 4 Cal. 5th 903, 957 (2018).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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