The U.S. Department of Labor's Final Independent Contractor Rule:

PROPER CLASSIFICATION IS CRITICAL

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On January 10, 2024, the U.S. Department of Labor (DOL) issued the highly anticipated Final Rule concerning the classification of workers as independent contractors versus employees. The Rule took effect on March 11, 2024. According to the DOL, the Rule comports more with the purpose and text of the Fair Labor Standards Act (FLSA), which governs, among other things, minimum wages and overtime compensation that must be paid to employees. The Rule will undoubtedly make it more difficult for businesses to classify workers as independent contractors going forward.

As expected, the DOL's return to a "totality-of-the-circumstances economic realities" test has been met with significant concern from businesses. Understanding the proper classification of workers is crucial to avoid liability under the FLSA.

Damages for violations include:

- unpaid wages
- liquidated damages in an amount equal to unpaid wages
- civil monetary penalties, and
- plaintiffs' attorneys' fees.

Individual lawsuits can be costly, but class action lawsuits filed under the FLSA can be extraordinarily expensive.

STANDARDS FOR DETERMINING WORKER STATUS

The FLSA does not apply to independent contractors. Oddly, the FLSA provides no guidance on how to classify someone as an employee or independent contractor. Left with no guidance, courts fashioned standards for determining a worker's status which focused on the "economic realities" of the working relationship. In 1947, the U.S. Supreme Court outlined several factors to consider. Those factors, or a variation of them, have been applied by courts and the DOL for many years, though somewhat inconsistently.

The Final Rule explains how six factors of the economic realities test should be applied going forward, with a focus on the "totality of the circumstances." A great deal of flexibility is incorporated into the Rule, with the DOL's indication that the non-exhaustive factors may apply, or not, and may be given less or greater weight depending on the circumstances of each individual case. The ultimate inquiry, according to the DOL, is the "economic dependence" of a worker. The amount of money the worker earns, or whether he or she has multiple sources of income, is not determinative.

THE ECONOMIC REALITIES FACTORS

The DOL offered significant guidance regarding the factors to be considered when determining the status of a worker.

- *Opportunity for profit or loss depending on managerial skill.* Does a worker have managerial skills that can affect their economic success? Considerations can include whether the worker can negotiate the charge or amount of pay for the work provided, accept or decline jobs, and choose the order and time in which work is performed. Whether a worker engages in marketing or advertising to gain more work or expand his or her business, makes decisions to hire others, purchases materials or equipment, and rents space in which to conduct business should also

be considered. If a worker has no opportunity for profit or loss, he or she would likely be considered an employee. The fact that a worker can choose to work more hours or perform more fixed-rate work to increase pay does not indicate managerial skill, according to the Rule.

- *Investments by the worker and potential employer.* Are investments by a worker capital or entrepreneurial in nature? To assist in making that determination, the DOL indicated that the cost of tools for a specific job and costs an employer imposes on a worker are not capital or entrepreneurial such that they would indicate independent contractor status. Instead, relevant investments would typically "support an independent business and serve a business-like function," including increasing a worker's ability to perform more or different types of work, reduce costs or extend market reach. The DOL noted that investments considered under this factor need to be viewed relative to an employer's overall investments in its business. Though the amount of such investments does not have to be the same in terms of dollar value, whether the worker makes similar types of investments that would allow the worker to operate independently in the employer's field or industry should be evaluated.

- *Degree of permanence of the work relationship.* Is the work relationship "indefinite, continuous, or exclusive of work for other employers"? If a worker performs project-based or sporadic work and markets his or her services to multiple businesses, that will tend to indicate an independent contractor relationship. The DOL noted, however, that if characteristics of a particular industry are such that a worker could not perform work on a permanent basis, that would not necessarily lead to a conclusion that the worker was an independent contractor unless the worker was exercising independent business initiative.

- *Nature and degree of control.* How much control, including reserved control, does the potential employer exercise over a worker's performance of work and the economic aspects of the relationship? Issues such as whether the potential employer sets a worker's schedule, supervises the worker's performance of work, and limits the ability of the worker to perform work for other businesses should be considered. Additionally, whether a business controls aspects such as rates charged for services provided by a worker and advertising of a worker's products or services should be evaluated. The DOL pointed out that actions a potential employer takes for the purpose of complying with a specific law or regulation do not indicate control; however, actions taken by a business to go above mere compliance and serve its own quality control, safety, or customer service standards may indicate control under this factor. The more control a potential employer has, the more likely a worker will be considered an employee.

- *Extent to which the work performed is an integral part of the potential employer's business.* Is the work performed by an individual "critical, necessary, or central to the potential employer's principal business"? The inquiry should consider the actual work functions performed by a worker, not whether a particular individual performing those functions is critical, necessary, or central to the business.

- *Skill and initiative.* Does a worker use specialized skills to perform work, and do those skills contribute to a "business-like initiative"? If an employer trains a worker how to do a job or the worker does not use special skills in performing work, this factor weighs in favor of classification as an employee. If a worker is hired for his or her training and skills and uses those skills in connection with a business-like initiative, classification as an independent contractor is likely.

The DOL indicated that other factors may also be used to determine independent contractor status. The mere fact that a worker has additional sources of income, however, is not relevant. It seems clear that the DOL intends for a greater number of workers to be classified as employees under the Rule.

ADDITIONAL CONSIDERATIONS

If a worker would properly be considered an employee under the Rule, he or she may not waive rights under the FLSA by signing an independent contractor agreement. Further, the Rule only applies to the FLSA. Any other applicable federal, state, or local law concerning the classification of workers as employees or independent contractors should still be followed with regard to claims outside of the FLSA.

PRACTICAL EFFECT

The Final Rule could have a significant impact on the gig economy, which includes short-term contracts and freelance work instead of permanent jobs. Many app-based platforms have typically classified gig workers and delivery drivers as independent contractors. Other industries likely to be significantly impacted include transportation and logistics, construction, healthcare, accounting and finance, customer service, consulting, and computer and IT services. Opponents of the Final Rule argue that it reduces the flexibility of individuals to work how and when they want and will negatively impact the economy overall. Critics also believe that the Rule brings substantial uncertainty and confusion for businesses that will struggle to apply the factors as outlined by the DOL. There is also an expectation that the Final Rule will result in tremendous litigation, including class actions.

With regard to litigation, courts have been considering multiple factors in determining whether a worker is an employee under the FLSA or an independent contractor for a number of years. As such, whether the Rule will have the impact the DOL intends is uncertain. Actually, if the Rule will stand at all remains to be seen. Business groups have indicated they will launch legal challenges, and a Republican member of the Senate Health, Education, Labor and Pensions Committee announced he will seek to repeal the Rule.

WHAT SHOULD EMPLOYERS DO?

Employers should act now to prevent lawsuits since the Rule took effect on March 11, 2024. Businesses that currently have workers classified as independent contractors should review workers' status to determine whether they should be reclassified as employees under the Rule. In addition, managers should be trained to ensure they follow the law concerning, among other things, overtime and minimum wages regarding any reclassified employee. Employers should consult with knowledgeable legal counsel for guidance concerning the Final Rule pending the outcome of legal challenges that are certain to come.

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