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U.S. Department of Labor Implements New Rule to Clarify Worker Classification under FLSA

By Aaron Ross

The US Department of Labor Wage and Hour Division has finalized a new rule to determine whether a worker is an employee or an independent contractor under the Fair Labor Standards Act. This rule will go into effect on March 11, 2024. The new rule is important for employers, as correctly identifying independent contractors is key to determining whether minimum wage and overtime laws apply, among other issues.

History

As early as the 1940s, the US Department of Labor and courts have applied an economic reality test to determine if a worker was an independent contractor. This test has typically included multiple factors and is based on a totality-of-the-circumstances analysis. The factors included in the economic reality test typically included the opportunity for profit or loss, investment, permanency, control, and whether the work is an integral part of the employer's business. In applying this test, no one factor was given a predetermined weight.

In January 2021, a proposed new rule was published by the US Department of Labor which applied an economic reality test with five factors. Two of the five factors in the new proposed economic reality test [nature and degree of control over the work, and the worker's opportunity for profit or loss] were stated to be core factors, and were considered more probative in determining independent contractor status. In May 2021, the US Department of Labor withdrew the proposed new rule and litigation ensued.

Economic Reality Test

The new rule adopts an economic reality test which uses multiple factors to determine if a worker has economic dependence and thus is an employee, or if a worker is in business for themselves and thus an independent contractor. These factors are meant as tools to conduct a totality-of-the-circumstances test when making the determination of employee versus independent contractor. The new rule indicates that no one factor is necessarily dispositive and the weight to give to each factor may depend on the facts and circumstances surrounding each relationship between worker and potential employer. The new rule sets forth that the following six factors should be considered in making this determination.

1 - the opportunity for profit or loss depending on managerial skill. The new rule further indicates that the following factors may be relevant in making this determination:

a. whether the worker determines or can meaningfully negotiate the charge or pay for the work provided;

b. whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed;

c. whether the worker engages in marketing, advertising, or other efforts to expand their business or secure more work; and

d. whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space.

In applying the factors to the facts and circumstances, a worker having no opportunity for a profit or loss suggests that the worker is an employee.

2 - the investments by the worker and the potential employer. This factor considers whether any investments by a worker are capital or entrepreneurial in nature, and if so, these investments are indicative of an independent contractor status. Under the new rule, investments by a worker would be capital or entrepreneurial if the investments 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.

3 - the degree of permanence of the work relationship. This factor leans toward a worker being an employee when the work relationship is indefinite in duration, continuous, or exclusive of work for other employers. Conversely, this factor suggests a worker is an independent contractor when the 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.

4 - nature and degree of control. The new rule indicates that 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 that suggest a worker is an employee, applying the nature and degree of control factor, are 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, uses technologic means to supervise the performance of the work, or reserves the right to supervise or discipline workers.

5 - the extent to which the work performed is an integral part of the potential employer's business. The new rule indicates that 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.

6 - skill and initiative. This factor suggests a worker is an independent contractor when the worker uses specialized skills to perform work and when those skills contribute to business-like initiative. Facts that suggest a worker is an employee under the skill and initiative factor are when the worker is dependent on training from the potential employer to perform the work.

The new rule further indicates that additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the Fair Labor Standards Act. The new rule does not provide examples of what additional factors may be relevant in making the determination, but instead leaves the analysis open to consider any factors that in some way indicate whether the worker is in business for themself, as opposed to being economically dependent on the potential employer for work.

The new rule is significant for employers in conducting an analysis of whether a worker is truly and employee or an independent contractor. The new rule takes effect on March 11, 2024. The attorneys

in Roetzel's Employment Law Group are able to provide assistance with questions and to provide guidance on the new rules.

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