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January 11, 2024 • Advisory • www.atllp.com

U.S. DEPARTMENT OF LABOR ISSUES NEW INDEPENDENT CONTRACTOR REGULATIONS

Yesterday, Jan. 10, 2024, the U.S. Department of Labor (DOL) published a final rule revising its analysis of independent contractor status under the federal Fair Labor Standards Act (FLSA), set to take effect March 11, 2024. The updated regulations will replace the DOL's prior rule from 2021 pertaining to independent contractor classification and will effectively reinstate the "economic realities" approach traditionally employed by courts. The final rule provides certain factors employers should consider in classifying workers as either employees or independent contractors—a critical distinction because the FLSA's wage and hour requirements only apply to *employees*.

The DOL published independent contractor guidance in 2021 (the "2021 IC Rule") which involved a five-factor test, with two "core" factors: (1) the nature and degree of control over the work, and (2) the worker's opportunity for profit and loss. The DOL proposed a new rule in October 2022, which rescinded the 2021 IC Rule and included six-factors to be weighed using a "totality of the circumstances" approach (i.e., no more "core factors"). The final rule, announced yesterday, largely solidifies the proposed six-factor test with some minor tweaks. In simple terms, the six-factor analysis focuses on determining whether, as a matter of economic realities, the worker is *dependent* on the employer for work. This more closely aligns with the analysis previously used by the DOL and federal courts to analyze whether a worker meets the definition of an independent contractor.

Key provisions of the final rule and the six-factor test are summarized below:

1. OPPORTUNITY FOR PROFIT OR LOSS DEPENDING ON MANAGERIAL SKILL.

This factor considers "whether the worker exercises managerial skill that affects the worker's economic success or failure in performing the work." If a worker has no opportunity for profit or loss other than working more hours, that worker is more likely an employee than an independent contractor. However, if the worker can make decisions for themselves outside of hours worked that would enable them to earn more income (such as choosing the jobs they take on, determining the rate of pay for specific jobs, or making decisions regarding who they would hire to assist them in completion of the

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job), it is more likely that they are properly classified as an independent contractor.

2. INVESTMENTS BY THE WORKER AND THE POTENTIAL EMPLOYER.

This factor considers "whether any investments by a worker are capital or entrepreneurial in nature." If a worker purchases or provides their own tools and equipment to complete the work, that investment in capital is more entrepreneurial in nature and is more indicative of an independent contractor relationship. But just because a worker uses something they own or lease to perform work does not necessarily mean the investment is entrepreneurial in nature, particularly if the tool or equipment is something the worker would likely have obtained anyway (like a personal vehicle or insurance). On the other hand, if a worker accumulates a significant amount of capital to perform work, that would be a factor indicating an independent contractor relationship. For example, if investments allow a worker to perform additional work (beyond just working more hours), such as advanced technology or systems, or allow them to extend their market reach, those investments are more likely entrepreneurial in nature.

3. DEGREE OF PERMANENCE OF THE WORK RELATIONSHIP.

This factor tilts in favor of employee status when the "work relationship is indefinite in duration or continuous, which is often the case in exclusive working relationships." By contrast, this factor would weigh in favor of independent contractor status "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."

Stated another way, an indefinite or continuous relationship is often indicative of an employment relationship, but the absence of an indefinite or consistent relationship with an employer is not necessarily indicative of an independent contractor relationship if it is not due to the worker's own determination. Having seasonal or temporary work does not necessarily mean that the worker lacks incentive or is not dependent upon the employer for work, but instead, this is simply a characteristic of particular industries.

4. NATURE AND DEGREE OF CONTROL.

Previously considered a "core" factor, this factor weighs the employer's control (even reserved control) over the individual's work and the economic aspects of their relationship, such as setting prices or rates for services. Relevant facts would include who sets the worker's schedule, whether the employer supervises the worker's performance (including through "technological supervision"), whether the employer actually limits the worker's ability to work

elsewhere, and whether the employer reserves the right to discipline them.

Importantly, the final rule clarifies that an employer's actions taken "with the sole purpose" of complying with federal, state, tribal or local law do not indicate control. Alternatively, if the employer goes beyond such regulations and enforces compliance with its *own* internal policies or standards, that might indicate control for purposes of this factor.

5. EXTENT TO WHICH THE WORK PERFORMED IS AN INTEGRAL PART OF THE POTENTIAL EMPLOYER'S BUSINESS.

This factor does not consider whether the *individual* themself is integral to the business; rather, it considers whether the *function* they provide to the employer is an integral part of the business. The more integral the work is, the more likely it is that the individual is an employee as opposed to an independent contractor.

6. SKILL AND INITIATIVE.

The last factor considers the level of specialized skill required by the job and whether those skills "contribute to a business-like initiative." The less specialized skill required for the job, or alternatively, the more dependent a worker is on the employer to acquire those specialized skills, the more likely the individual will be considered an employee. Of course, employees may also use specialized skills, so that factor is not determinative.

These six factors are not all inclusive, as explicitly stated in the final rule. Rather, the DOL directs employers to look at the big picture of each employment relationship to determine whether someone fits the requirements of an independent contractor. The DOL also expressed that one factor is not more important than another, but rather they should be examined as a whole, potentially even considering other significant factors in a particular relationship.

The DOL indicated the final rule aims to reduce the risk of employees being misclassified as independent contractors. Importantly, the final rule does **not** impact the analysis for employee classification in other contexts—such as under the Internal Revenue Code, the National Labor Relations Act or under more specific state laws. The analysis under each of these distinct legal frameworks remains varied and complex. Accordingly, employers must ensure they are classifying workers in compliance with all applicable federal, state and local laws.

Employers should expect heightened scrutiny over independent contractor relationships as a result of this rule change and are encouraged to review the final rule and consult with employment counsel to ensure their worker classification policies and practices comply with the FLSA. For questions, please

contact your regular Armstrong Teasdale lawyer or one of the listed authors.