Federal Department of Labor Releases New Independent Contractor Rule

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A hot button issue in employment law has been the classification of individuals as employees versus independent contractors. The misclassification of workers can lead to significant liability for employers. Whether a worker qualifies as an "employee" or an "independent contractor" is a fact-specific question, and depends on the independent contractor test being applied, which will vary based on the particular law at issue. There is no single independent contractor test that courts apply which resolves this question for all purposes. An employee might be considered an employee under one law (say, worker's compensation law) but be considered an independent contractor under a different law (unemployment compensation law). This is because different laws at both the federal and state level use different tests.

New FLSA Rule

Federal statutes, such as the Fair Labor Standards Act (FLSA) and the National Labor Relations Act (NLRA), also prescribe their own tests. Recently, the Federal Department of Labor (Department) published its final rule which revises the test that the Department will use moving forward to determine independent contractor status under the FLSA. Because the FLSA is a very important wage and hour statute that applies to most public and private sector employers, understanding this new rule is imperative for all employers who use independent contractors.

This new FLSA rule will go into effect on **March 11, 2024**. Until that date, the current rule remains in effect. This new rule will **only** apply to the FLSA, and the Department has stated that it will **not** impact how the Department will analyze independent contractor status under other laws which have their own tests, such as the NLRA.

6-FACTOR TEST

Under the new rule, the Department will apply a 6-factor test to assess the "economic reality" of whether a worker qualifies as an employee or an independent contractor. The new rule is expected to make it more difficult for organizations to classify workers as independent contractors rather than employees. No single factor is to be given particular weight, and the factors should all be considered as a whole. The Department has also made clear that each of the 6 factors do not have to be met in every case for a classification to apply. In addition, the Department has stated that the 6 listed factors are not exhaustive and that other evidence might be relevant to the analysis depending on the particular case. Generally speaking, the label (independent contractor or employee) that a worker and the employer assign to the relationship will not be dispositive because the factors look to the on-the-ground reality of the situation. The factors that the Department will consider moving forward are as follows:

1. whether the worker has an opportunity for profit or loss depending on managerial skill;
2. what kinds of investments have been made by the worker and the potential employer;
3. the degree of permanence of the work relationship;
4. the nature and degree of control;
5. the extent to which the work performed is an integral part of the potential employer's business; and
6. the skill and initiative associated with the work.

FACTS RELEVANT TO EACH FACTOR

The Department has elaborated on the sort of facts that are relevant to each factor. Under the profit or loss factor, generally speaking, employees who are paid an hourly wage or set salary do not stand an opportunity to make either a profit or a loss in connection with their work. Independent contractors who agree to perform a job for a fee, by contrast, have the opportunity for profit or loss due to material and labor costs, among other things.

The second factor considers the nature of the investments a worker makes. The Department has stated that workers who make investments which are "capital or entrepreneurial" in nature look more like independent contractors than employees. "Capital or entrepreneurial" investments are those that serve a business-like function such as business marketing and expansion of services. Employees are not

responsible for making these types of investments, and therefore, the existence of such investments would generally weigh in favor of classification as an independent contractor.

Under the third "length and duration of the relationship" factor, a classic characteristic of true independent contractor status is the definite, finite relationship between a business and a service provider. Independent contractors tend to enter into contracts to perform specified projects, as opposed to being engaged on an ongoing or even seasonal basis.

Under the fourth factor, the inquiry is how much control an employer exerts over the work of the individual. The Department has stated that factors relevant to the "control" analysis 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." True independent contractors generally work for multiple businesses at a time and can often set their own schedules for performing work. By contrast, true employees are subject to greater control on a day-to-day basis by their employer.

The fifth factor concerns whether the work being performed is central to the employer's business. Generally, work that is central to an employer's business is performed by employees, rather than independent contractors. For instance, if the employer's business is manufacturing widgets, an independent contractor may not build the widgets, but instead may help implement a software package to better track inventory.

Under the sixth and final factor, the inquiry is whether the work being performed is specialized in nature and whether the worker relies on those specialized skills to build the worker's business. This factor will not always clearly cut in one direction because both employees and independent contractors can perform specialized work. Therefore, the critical inquiry under this factor is whether the worker relies on the specialized skills to help drive their own business.

Conclusion

As stated, this list of 6 factors is not exhaustive and parties may introduce other evidence which is relevant to the classification of the employment relationship. The type of additional evidence which will be considered will depend on the particular circumstances of the situation. This is a particularly complex area of the law. Additionally, there are pending legal challenges to this rule that could further complicate matters. We encourage employers to reach out to a member of the Boardman Clark Labor and Employment Practice Group with questions.

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