January 26, 2024

U.S. Department of Labor Finalizes Independent Contractor Rule

On January 10, the U.S. Department of Labor (DOL) published a **final rule** establishing a new test to determine whether a worker is properly classified as an employee or independent contractor under the Fair Labor Standards Act (FLSA). The final rule rescinds a 2021 rule addressing this issue and adopts a six-factor test focused on the "economic reality" of the relationship between a putative employer and a worker. The final rule goes into effect on March 11.

How Did We Get Here?

As we previously discussed **here**, in 2021 the DOL issued an employer-friendly version of the worker classification rule. That rule used a five-factor test to determine whether a worker was properly classified as an employee or independent contractor, with two of those factors considered "core factors" that received more weight than the others. Following the change of administration, in 2022 the DOL sought to replace the 2021 rule by returning to a standard often used by courts to determine a worker's status as an employee or independent contractor under the FLSA. That standard uses a six-factor analysis to examine whether a worker is, as a matter of economic reality, economically dependent on the putative employer under the totality of circumstances.

2024 Final Rule

With only a few minor variations, the 2024 final rule is substantially the same as the rule the DOL proposed in 2022. Like the 2022 proposed rule, the final rule returns to the totality-of-the-circumstances analysis, which applies a six-factor test, with no factor holding more weight than any other. The DOL also issued a **FAQ** providing guidance on its interpretation of the application of the six factors. Below are the six factors, along with highlights of the DOL's guidance regarding how they will be applied:

- *Opportunity for profit or loss depending on managerial skill.* This factor focuses on whether the worker exercises managerial skill that affects the worker's economic success or failure in performing the work. The following facts, among others, may be relevant: whether the worker determines or meaningfully negotiates the charge or pay for the work provided; whether the worker accepts or declines jobs or chooses the order and/or time in which the jobs are performed; whether the worker engages in marketing, advertising or other efforts to expand their business or secure more work; and whether the worker makes decisions to hire others, purchase materials and equipment, and/or rent space. The DOL's guidance notes that "[i]f a worker has no opportunity for profit or loss, then this factor suggests that the worker is an employee."
- *Investment by the worker and the potential employer.* This factor considers whether any investments by the worker are capital or entrepreneurial in nature, for example, by "increasing the worker's ability to perform different types of or more work, reducing costs, or extending market reach." The worker's investments should support an independent business or serve a businesslike function for this factor to indicate independent contractor status. By contrast, and in a slight change from the 2022 proposed rule, costs to a worker of tools and equipment to perform a specific job, costs of a worker's labor

and costs that the putative employer imposes unilaterally on the worker, for example, are not evidence of capital or entrepreneurial investment but rather indicate employee status.

- *Degree of permanence of the work relationship.* The DOL's guidance indicates that "this factor weighs in favor of the worker being an employee when the work relationship is indefinite in duration, continuous or exclusive of work for other employers" and "weighs in favor of the worker being an independent contractor 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." However, the guidance indicates that "where a lack of permanence is due to operational characteristics that are unique or intrinsic to particular businesses or industries and the workers they employ, rather than the workers' own independent business initiative," it is not necessarily indicative of independent contractor status.
- *Nature and degree of control.* This factor considers the putative employer's control over the performance of the work and the economic aspects of the working relationship. This analysis may include, among other things, evaluation of 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." In a slight change from the 2022 proposed rule, the final rule indicates that "actions 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." However, the DOL's guidance makes clear that actions taken by the putative employer that go beyond compliance with specific laws or regulations and instead serve the potential employer's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control.
- *Extent to which the work performed is an integral part of the potential employer's business.* The DOL's guidance provides that "[t]his factor does not depend on whether any individual worker in particular is an integral part of the business, but rather whether the function they perform is an integral part of the business." In an effort to clarify what it means to be an *integral* part of the business, the final rule defines "integral" as whether the *business function* the worker performs is "critical, necessary, or central to the employer's principal business" rather than whether the worker themself is integral to the organization.
- *Skill and initiative.* When the worker does not use specialized skills in performing the work or is dependent on training from the putative employer to perform the work, this factor indicates employee status. The final rule clarifies that whether the worker brings specialized skills to the work relationship is not itself indicative of independent contractor status. Rather, this factor supports independent contractor status where the worker uses those specialized skills in connection with businesslike initiatives.

While the final rule establishes six factors, it also hedges by indicating that this is a non-exhaustive list of factors and noting that additional factors may be relevant if such factors demonstrate that the worker is in business for themself or is economically dependent on the putative employer for work.

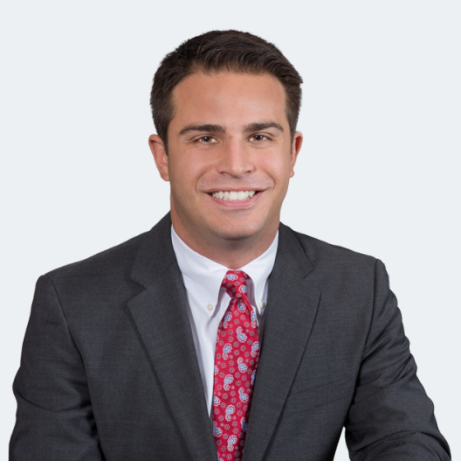
Don't Forget About State Laws

The final rule relates only to worker classifications under the FLSA. The DOL made clear that the final rule has "no effect on other laws—federal, state, or local—that use different standards for employee classification" because "[t]he FLSA does not preempt any other laws that protect workers, so businesses must comply with all federal, state, and local laws that apply and ensure that they are meeting whichever standard provides workers with the greatest protection." Many states (including, for example, New Jersey and Connecticut) have more stringent tests for determining independent contractor status, so employers must ensure that their classification of workers also complies with any applicable state laws.

Bottom Line

The final rule makes it more difficult for a worker to qualify as an independent contractor rather than an employee. When the final rule takes effect, the risk of potential misclassification will increase, resulting in heightened potential liability for employers that use independent contractors. In addition, there have been increased enforcement initiatives at the state level to identify and penalize employers that misclassify workers as independent contractors. As such, it is important that employers take action, including auditing their workforce for potential worker misclassifications and implementing policies and procedures to prevent misclassifications in the first instance.

Authors



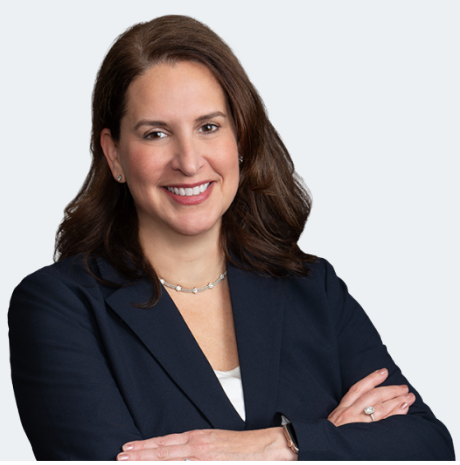
James M. Leva

Partner

Parsippany, NJ | (973) 966-8416

Stamford, CT | (973) 966-8416

jleva@daypitney.com



Heather Weine Brochin

Partner

Parsippany, NJ | (973) 966-8199

New York, NY | (212)-297-5800

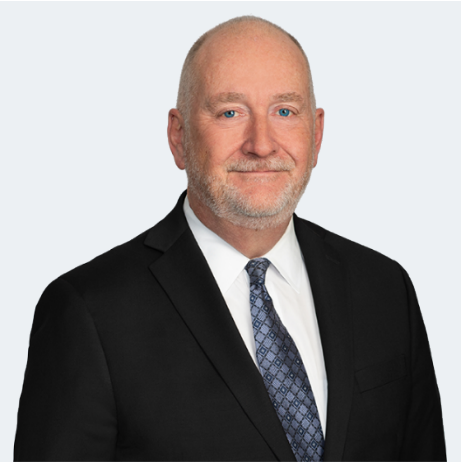
hbrochin@daypitney.com

Alexis Abuhadba

Associate

Parsippany, NJ | (973) 966-8113

aabuhadba@daypitney.com

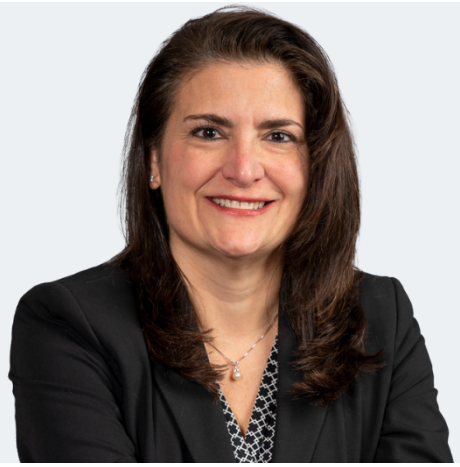


Glenn W. Dowd

Partner

Hartford, CT | (860) 275-0570

gwdowd@daypitney.com

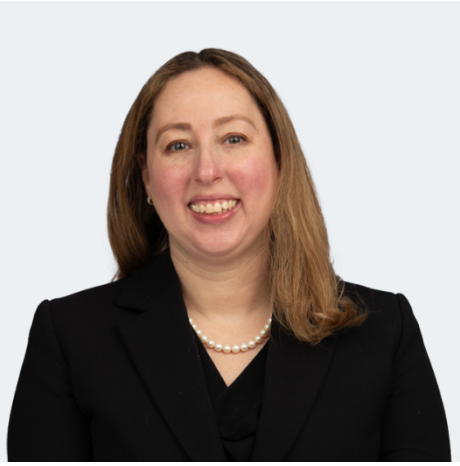


Francine Esposito

Partner

Parsippany, NJ | (973) 966-8275

fesposito@daypitney.com



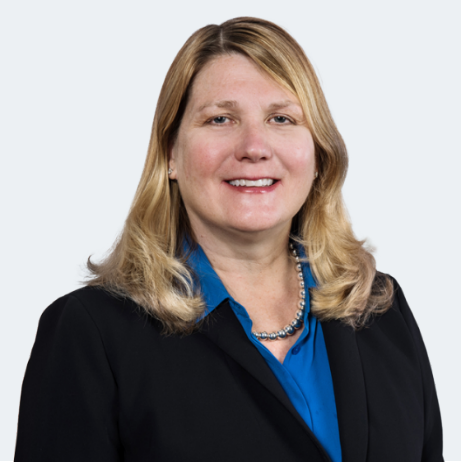
Rachel A. Gonzalez

Partner

Parsippany, NJ | (973) 966-8201

New York, NY | (212) 297-5800

rgonzalez@daypitney.com



Theresa A. Kelly

Partner

Parsippany, NJ | (973) 966-8168

tkelly@daypitney.com

Daniel L. Schwartz

Partner

Stamford, CT | (203) 977-7536

New York, NY | (212) 297-5800

dlschwartz@daypitney.com