CLIENT ALERT: U.S. Department of Labor Issues Final Rule on Independent Contractor Classification under the FLSA

On January 10, 2024, the U.S. Department of Labor (the "Department") published a final rule (the "Final Rule") revising the Department's guidance on the proper standard for analyzing whether a worker is an employee or independent contractor under the Fair Labor Standards Act ("FLSA"). The Final Rule replaces the Department's 2021 Trump-era guidance and explains that a worker is not an independent contractor if they are, as a matter of economic reality, dependent on an employer for work. The test, and the six factors it considers, purports to assess whether a worker is in business for themselves, and therefore an independent contractor, or if they are dependent on an employer for work, and therefore an employee.

By way of background, employees are covered by the FLSA, while independent contractors are not. The FLSA itself does not define independent contractor and its definition of employee leaves significant room for interpretation. As a result, historically, the Department and courts applied various iterations of an economic realities test, which led to inconsistent decisions. In January 2021, the Department issued an interpretation on how to define an employee (the "2021 Rule"). The 2021 Rule identified five economic reality factors to determine a worker's status, and emphasized two of the five as core factors. The core factors were the nature and degree of control over the work and the worker's opportunity for profit and loss. These core factors were supposed to carry greater weight in the analysis.

Through the Final Rule, the Department rescinds the 2021 Rule and announces a multi-factor, totality-of-the-circumstances analysis to determine whether a worker is an employee or independent contractor. The Final Rule explains that the analysis should focus on whether the worker is economically dependent on the potential employer for work (and thus an employee) or whether the worker is in business for themselves (and thus an independent contractor). In order to determine "economic dependence," the Final Rule identifies six factors that "should guide an assessment of the economic realities of the working relationship":

1. the opportunity for profit or loss depending on managerial skill;
2. investments 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. skill and initiative (i.e., whether the worker uses specialized skills to perform the work and whether those skills contributed to business-like initiative).

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While the Department emphasizes these six factors, it also notes that additional, but unexplored, factors may be relevant to the overall question of economic dependence. No single factor (or set of factors) automatically determines a worker's status as either an employee or an independent contractor. The Final Rule purports to return the analysis to be more "consistent with existing judicial precedent and the Department's longstanding guidance" prior to the 2021 Rule.

The Final Rule also explores how some of the factors should be analyzed. For example, the Department explains that the investment factor should focus on whether the worker is making similar types of investments as the employer that would suggest the worker is operating independently, and not just the dollar value or size of the investments. Additionally, the Department includes a discussion about how scheduling, remote supervision, price setting, and the ability to work for others should be analyzed under the control factor.

The Final Rule is set to take effect on March 11, 2024. Business groups are expected to file legal challenges to its adoption.

Regardless of whether the Final Rule survives challenge, employers must continue to closely scrutinize how they classify workers. The Final Rule will bring attention to the classification of workers. Employers must navigate not only the Department's guidance under the FLSA, but also applicable state law, which may have different standards for classification under state wage and hour law. By way of example, Massachusetts has adopted a form of the ABC test for analyzing the employee vs. independent contractor question under the Massachusetts Wage Act.

Employers should consult with their MBJ attorney with questions about classifying workers as employees or independent contractors, the efforts by the Department to regulate these classifications, and the relevant state law approaches to classification.

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