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NAVIGATING THE DOL'S INDEPENDENT CONTRACTOR FINAL RULE

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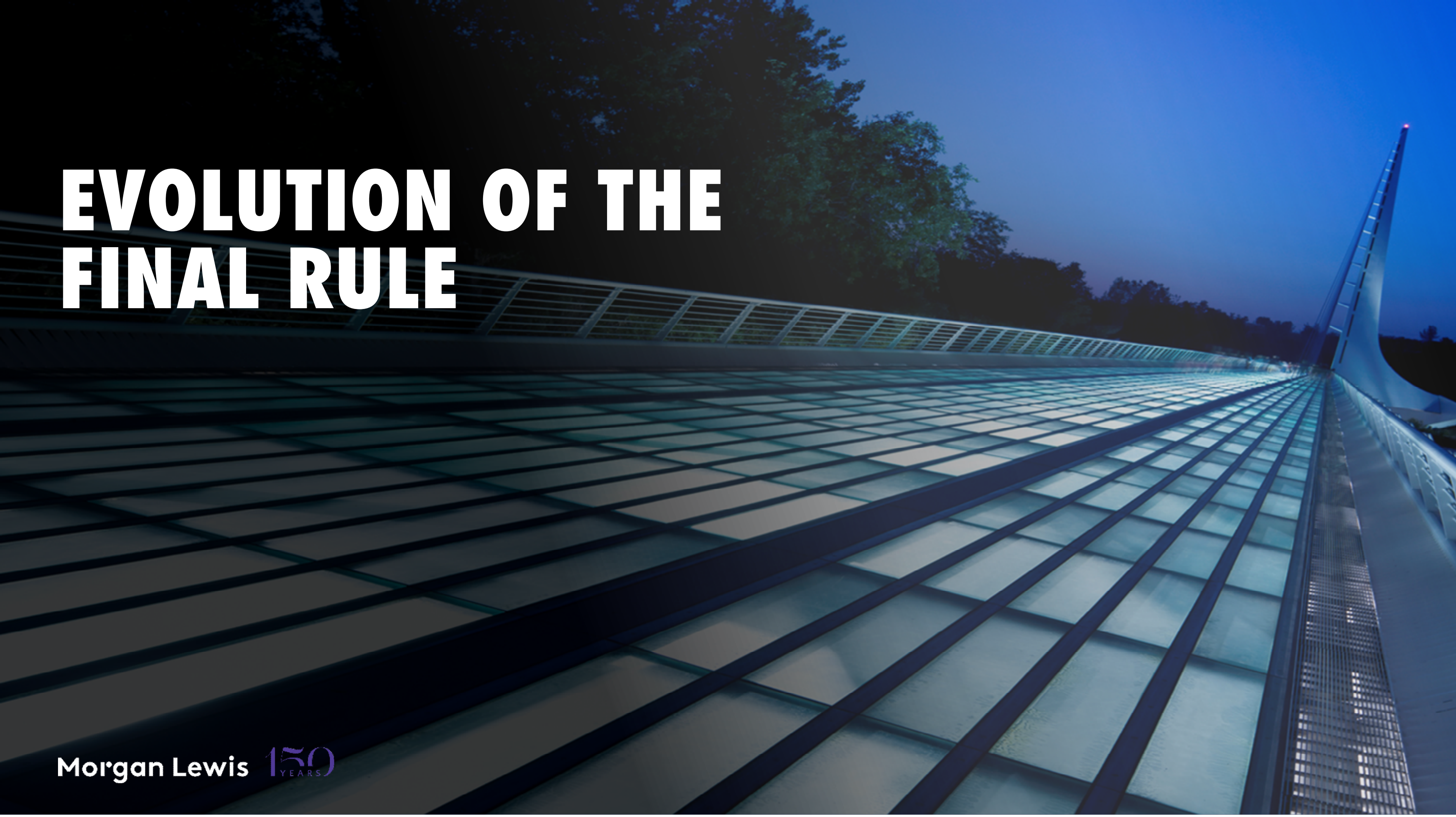
EVOLUTION OF THE FINAL RULE



Evolution of the Final Rule

- In January 2021, the DOL issued a Rule (the 2021 Rule) identifying five economic reality factors to be considered when determining whether a worker is properly classified as an independent contractor under the FLSA.
- The 2021 Rule highlighted 2 of the 5 factors—the nature and degree of control over the work and the worker's opportunity for profit or loss—as the "core factors" most probative of the nature of the relationship and stated that if those factors suggest a certain classification there is a substantial likelihood the worker should be classified that way.
- The other 3 factors—the amount of skill required for the work, the degree of permanence of the working relationship, and whether the work is part of an integrated unit of production—were stated to be "highly unlikely" to outweigh the probative value of the core factors.
- The 2021 Rule was set to become effective on March 8, 2021. However, its implementation was delayed, and on May 6, 2021 the DOL attempted to withdraw the 2021 Rule in its entirety.

Evolution of the Final Rule

- In March 2022, a Texas federal district court vacated the delay and withdrawal, ruling that the 2021 Rule had become effective as of March 8, 2021.
- On October 13, 2022, the DOL published a new Proposed Rule regarding independent contractor status under the FLSA (effectively mooting the court ruling).
- After considering 55,400 comments by industry and employee groups, contractor organizations, and others, the DOL has now published its Final Rule, which will become effective on March 11, 2024.

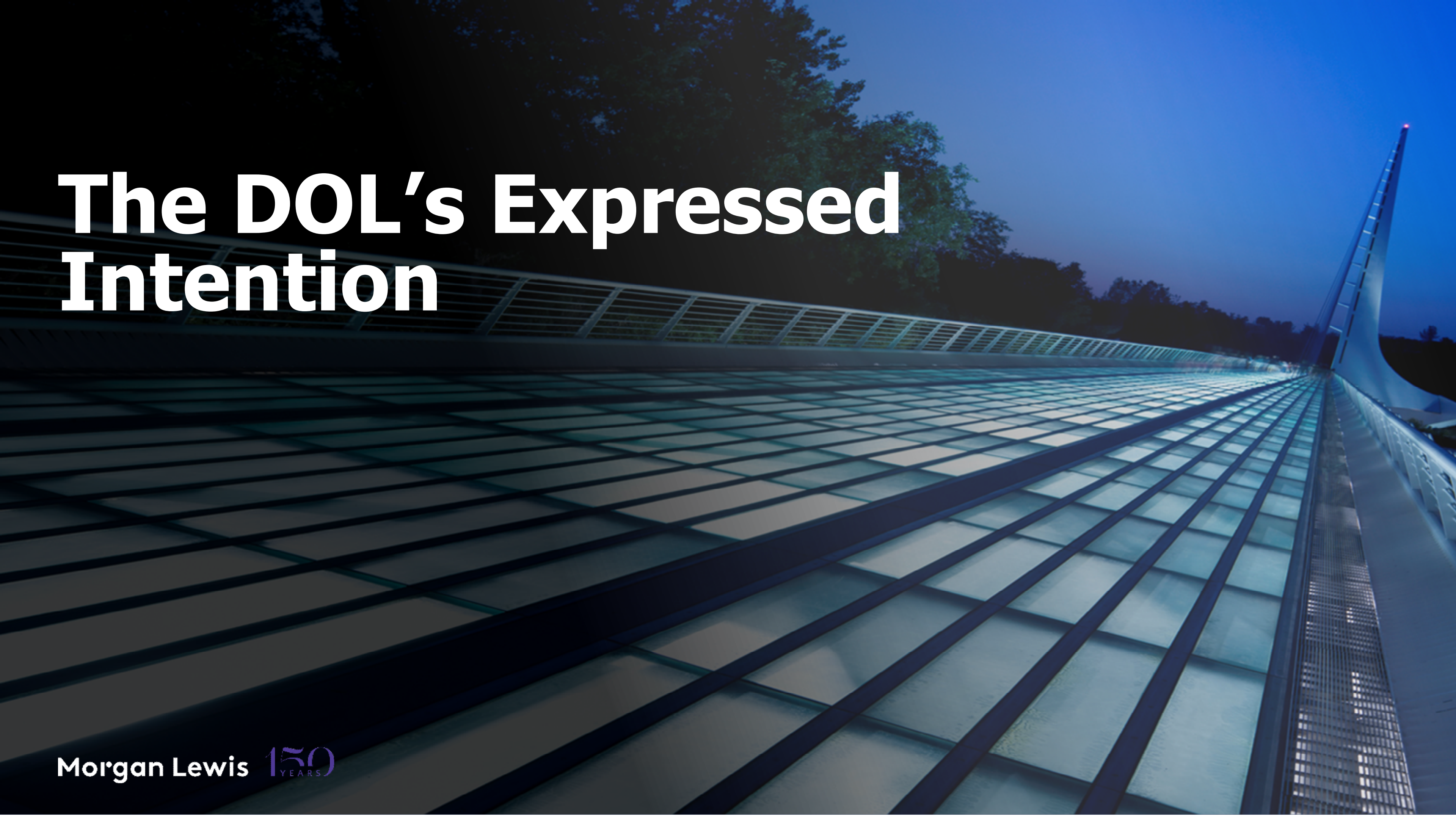
Scope of the Final Rule

Big Picture Look at the Final Rule

- Big picture -- the Final Rule marks a return to the DOL's pre–Trump-era guidance and a renewed focus on whether, as a matter of "economic reality," a worker is dependent on a company/putative employer for work (not income) (and thus an employee) or is in business for themself (and thus an independent contractor).
- While the Final Rule retains the same 6 nonexhaustive factors described in the Proposed Rule, DOL modifications and the extensive accompanying narrative guidance soften the anticipated impact for some companies and industries engaging independent contractors.
- Overall, the Final Rule may be more employee-friendly than the Trump-era guidance, but, if upheld from very likely challenges, it may not have a material impact on the current independent contractor landscape.

Scope of the Final Rule

- The Final Rule only applies to the FLSA. It has no impact on any state wage and hour, unemployment or other laws that do not follow the FLSA for determining whether a worker should be classified as an employee or independent contractor.
  - For example, California, Massachusetts, and several other states apply an "ABC Test" (with some exceptions) under which a worker is considered an employee unless the hiring entity satisfies three conditions distinct from (but in some instances similar to) the factors in the Final Rule.
- Additionally, the Final Rule does not define who may qualify as an independent contractor under other federal statutes or laws such as the Internal Revenue Code or NLRA.
- Accordingly, regardless of the DOL's guidance on who qualifies as an independent contractor under the FLSA, companies should always review whether and how different federal and state laws may apply to their workforce.

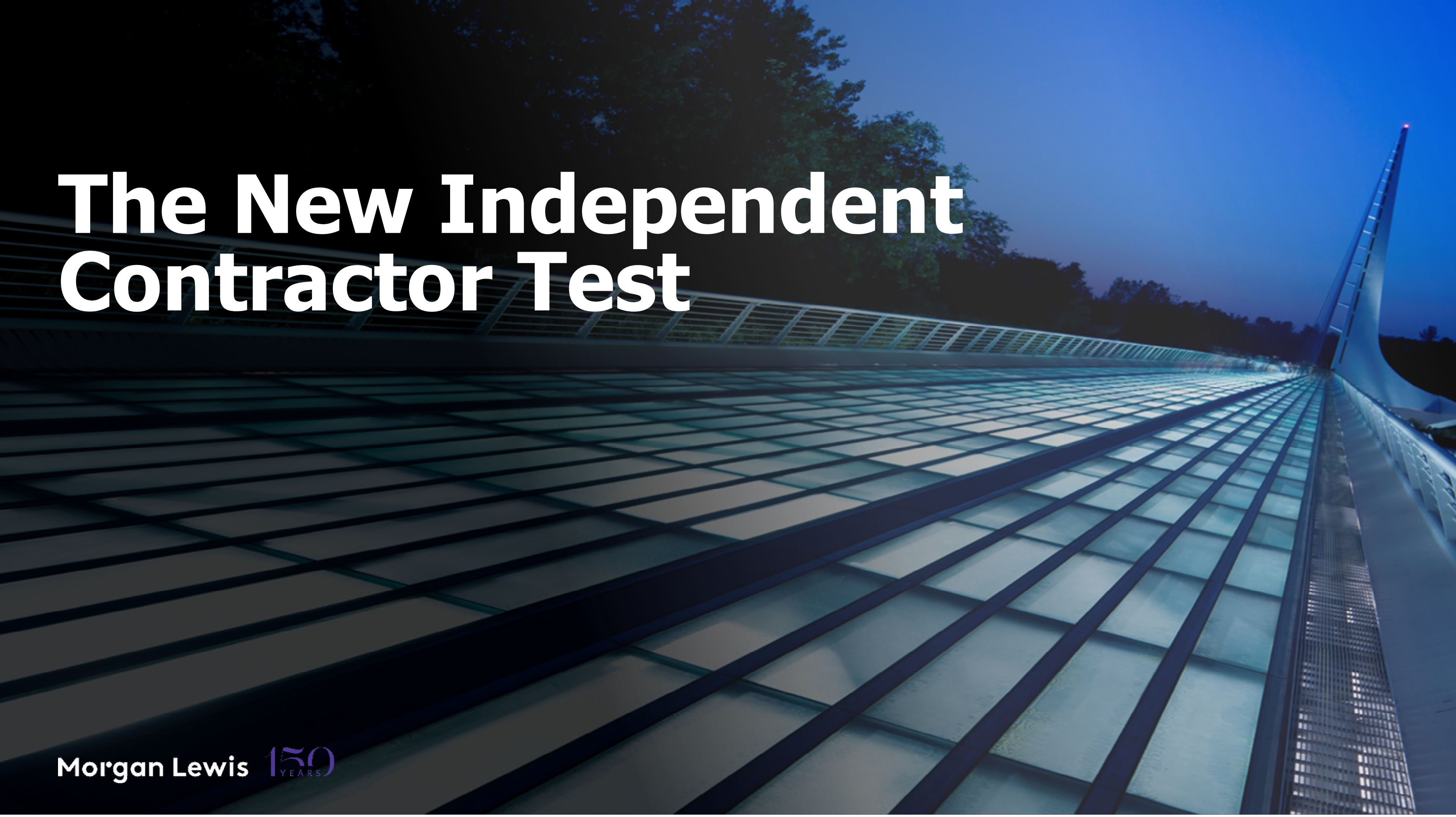


The DOL’s Expressed Intention

The Final Rule is Not Intended to Result in Widespread Worker Reclassifications

- The DOL takes the position that the Final Rule will not result in individuals classified for decades as independent contractors now being deemed employees.
- The DOL views the Final Rule as a return to the test used prior to the 2021 IC Rule and "reflective of decades of case law applying a multifactor economic reality test."
- The DOL adopted the position of some commenters who stated that workers properly classified as independent contractors prior to the 2021 IC Rule will likely continue to be properly classified as independent contractors under this Rule and disagrees with other commenter assertions that this rule will "cause workers who have long been properly classified as independent contractors … to improperly lose their independent status."

The New Independent Contractor Test



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Executive Summary of New Test

- The test is now a (i) non-exhaustive; (ii) totality of the circumstances; (iii) multifactor; (iv) economic realities test.
- The focus and “ultimate inquiry” of the analysis is whether as a matter of economic reality, the worker is economically dependent on the employer for work (and is thus an employee) or is in business for themself (and is thus an independent contractor).

Executive Summary of New Test

- Rather than giving primacy to only two factors as indicators of economic dependence, the Department believes that developing the concept of economic dependence is better accomplished by explaining how each of the six factors can illuminate the distinction between economic dependence on the employer for work and being in business for oneself.
- The DOL further states that the inquiry is whether the worker is dependent on the employer for **work** rather than dependent on the employer for **income**.

The DOL Does Not Believe that Providing Services to Multiple Companies Demonstrates True Independence

- DOL says economic dependence does <u>not</u> focus on the amount the worker earns or whether the worker has other sources of income.
- The question of economic dependence is the ultimate inquiry.
- The DOL opines that the individual can be economically dependent on all of the entities with which the individual has a relationship
  - This theoretically means that that worker will have multiple employers, even if the worker receives a *de minimis* amount of revenue from an entity.
- The DOL outlines several factors to aid in assessing economic dependence under a totality-of-the-circumstances approach.

Factor 1 - Opportunity for Profit or Loss Based on the Exercise of Managerial Skill

Factor 1: Opportunity for Profit or Loss Based on Exercise of Managerial Skill

- Focuses on whether the worker exercises “managerial skill” that affects the worker’s economic success or failure in performing the work.
- The DOL identifies a nonexclusive list of facts that may be relevant when considering this factor:
  - whether the worker determines or can meaningfully negotiate the charge or pay for the work provided;
  - whether the worker accepts or declines jobs or chooses the order/time in which the jobs are to be 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, or rent space.

Factor 1: Opportunity for Profit or Loss Based on Exercise of Managerial Skill

- The DOL identifies instances of managerial skill, such as efforts to expand a business or secure more work, hiring others, and purchasing materials and equipment, as affecting a worker's opportunity for profit or loss.
  - The inclusion of these facts in the example suggests that the DOL believes that traditional marketing is not required for a worker to be classified as an independent contractor, but affirmative efforts to engage in marketing may be probative of the worker acting in a way consistent with being in business for themselves.

Factor 2: Investments by the Worker and the Potential Employer

Factor 2: Investments by the Worker and the Potential Employer

- The Final Rule adopted a qualitative assessment of the worker’s investment rather than the originally proposed quantitative comparison of the parties’ level or amount of investments.
  - The business community was concerned that the proposed rule measured quantitatively whether a company and a worker were making equal magnitude investments in the business – which could rarely be shown.
  - DOL has made clear that while dollar value or percentage is a factor, the key is whether the worker is making similar types of investments as the employer (albeit on a smaller scale) that would suggest that the worker is operating independently.

Factor 2: Investments By the Worker and the Potential Employer

- The inquiry looks more broadly at whether the worker is making investments of the type that allow the worker to operate independently in the worker's industry or field rather than investments specifically for the engagement at issue.
- To support contractor status, the investments must be "capital" or "entrepreneurial" in nature.

“Capital” or “Entrepreneurial” Investments

- Investments that are capital or entrepreneurial in nature are those that increase the worker's ability to do different types of or more work, reduce the costs of the business, or extend market reach.
- Capital or entrepreneurial investments tend to help a worker work for multiple companies—a characteristic of an independent business.
- The use of materials that the worker already owns (i.e., driving a personal vehicle for work appointments, cell phone, insurance), without modification, to perform services does not constitute a capital or entrepreneurial investment.

“Capital” or “Entrepreneurial” Investments

- By contrast, if the worker purchases a vehicle, equipment or tools for a business purpose and those materials will help the worker perform services for multiple companies, those will constitute capital or entrepreneurial investments.
- Employer control can negate the worker’s investment:
  - DOL opines that if a company requires a certain investment and dictates the terms of the investment, that undercuts the entrepreneurial nature of the investment.
  - For example, if the company mandates the purchase of insurance and dictates the insurer and policy, that diminishes/eliminates the entrepreneurial nature

Factor 3: Degree of Permanence of the Work Relationship

Factor 3: Degree of Permanence of the Work Relationship

- DOL says this factor weighs in favor of 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.
- The DOL recognizes and appreciates that people who are in business for themselves often rely on repeat business and long-term clients or customers
  - Where the worker's exercise of discretion (rather than work frequency requirements or contractual obligations imposed by the company) results in repeat engagements, the duration of the relationship will not be indicative of employment status.

Factor 3: Degree of Permanence of the Work Relationship

- Must look at whether the worker controls the conditions of the engagement, sets their own fees, decides when and if to work, can decline opportunities, or can work for other clients/customers.

- An exclusive relationship alone is not determinative of the economic reality of the working relationship, but is a factor.
  - Facts regarding exclusivity of a work relationship are salient under the permanence and control factors.
  - Those facts can be outweighed by others.

Factor 4: Nature and Degree of Control

Factor 4: Nature and Degree of Control

- Unlike the 2021 Rule, the Final Rule does not place heightened or "core" emphasis on this factor.
- The Final Rule highlights setting a worker's schedule, compelling attendance, or directing or supervising the work as examples of "direct" control and setting prices for services, restricting a worker's ability to work for others, and relying on technology or digital tools to supervise a workforce as examples of "indirect" control.
- The Final Rule's approach differs from the Proposed Rule in key respects:
  - Proposed Rule specified that it may be appropriate to consider whether a worker is required to comply with legal, safety, or quality control obligations as part of the control analysis, and would indicate control.

Factor 4: Nature and Degree of Control

– Concerns by commenters prompted the DOL to modify its stance.

– Final Rule provides that company actions taken to ensure compliance with laws and regulations are <u>not</u> indicative of employer control.

– Only actions that go beyond compliance with a specific, applicable Federal, State, Tribal, or local law or regulation and instead serve the company's own compliance methods, safety, quality control, or contractual or customer service standards may be indicative of control.

Other Control Guidance

- The DOL considered comments related to whether a company's use of technology to track business information should be considered evidence of employer-type control.
  - Highlighting the fact that companies may use technology to track critical business information, the Final Rule clarifies that "the relevant consideration is not simply the employer's use of technology to supervise, but the use of technology 'to supervise the performance of the work.'"
  - The mere fact that a company collects, tracks, or retains data related to the work performed by the worker does not suggest employer control. There must be a showing that the data is collected and used to control performance of the services.

Other Control Issues Addressed by the DOL

- **Control Over Prices or Rates.** The DOL rejected commenters' suggestions to "de-emphasize the relevance of control over prices or rates of service" in the control analysis, but acknowledged that some roles and industries do not allow for such control and noted that the absence of such control is not singularly determinative of employment status.
- **Schedule Control.** The Final Rule notes that a worker's purported ability to set their own schedule provides only "minimal evidence" of independent contractor status if the worker's ability to pick one's hours or "arrange the sequence or pace of the work" is dictated by stringent requirements imposed by the potential employer that effectively limit the number of available hours or negate meaningful scheduling flexibility.
  - Moreover, under the Final Rule, the power to decline work and maintain a flexible schedule is "not alone" persuasive evidence of independent contractor status when the company may discipline a worker for refusing work.

Other Control Issues Addressed by the DOL

- **Need for Supervision of the Role.** The Final Rule indicates that where the nature of the employer's business or the work makes direct supervision unnecessary, a lack of physical supervision does not automatically compel a contractor finding.
- **Remote Supervision.** Remote supervision through technology—for example, monitoring systems that track a worker's location and productivity—may be indicative of employer control depending on the circumstances. The absence of in-person supervision is not determinative of whether there is employer control.

Unexercised or Reserved Control

- Under the Proposed Rule actual control was given greater weight than reserved or unexercised control.
- The DOL declined to create a bright line rule that assigns a predetermined and immutable weight or level of importance to reserved rights, viewing that as incompatible with the totality-of-the-circumstances inquiry.
- Thus, “unexercised” or “reserved” rights (i.e., “right to control”) remain part of the control analysis with the weight to be determined on a case-specific basis.

Factor 5: Work as an Integral Part of the Employer's Business

Factor 5: Work as an Integral Part of the Employer’s Business

- 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.
- Final Rule calls for a “common-sense” approach to this factor that asks whether the company could function without the service performed by the type of worker at issue (not the services of the particular worker).
  - Answering that question, requires considering whether the work is important critical, primary, or necessary to the business.

Factor 5: Work as an Integral Part of the Employer’s Business

  - According to the DOL, in most cases, if a potential employer’s primary business is to make a product or provide a service, then the workers who are involved in making the product or providing the service are performing work that is integral to the potential employer’s business.

- Indicators that a worker is integrated into an employer’s main production processes, such as whether the worker is required to work at the employer’s main workplace or wear the employer’s uniform, may illustrate an employer’s control over the work being performed.

Integral Factor - No Industry-Specific Carveouts; Regulatory Requirements Are Part of The Analysis

- Commenters requested clarification for their specific industries, expressing concerns that in certain industries laws and regulations mandate relationships such that the work performed would be considered an integral part of the potential employer's business.
  - Examples: insurance industry, financial services industry, real estate industry – where regulations require that agents/advisors associate with industry firms.
- The DOL declined to create industry-specific exemptions for industries where workers are required to affiliate with industry firms.
- That said, the Final Rule notes that the underlying legal and regulatory framework should be considered when evaluating this factor (as well as the control factor).
- This preserves the argument (in regulated industries) that the integral part of the business factor should be viewed as at most a neutral factor.

Factor 6: Skill and Initiative

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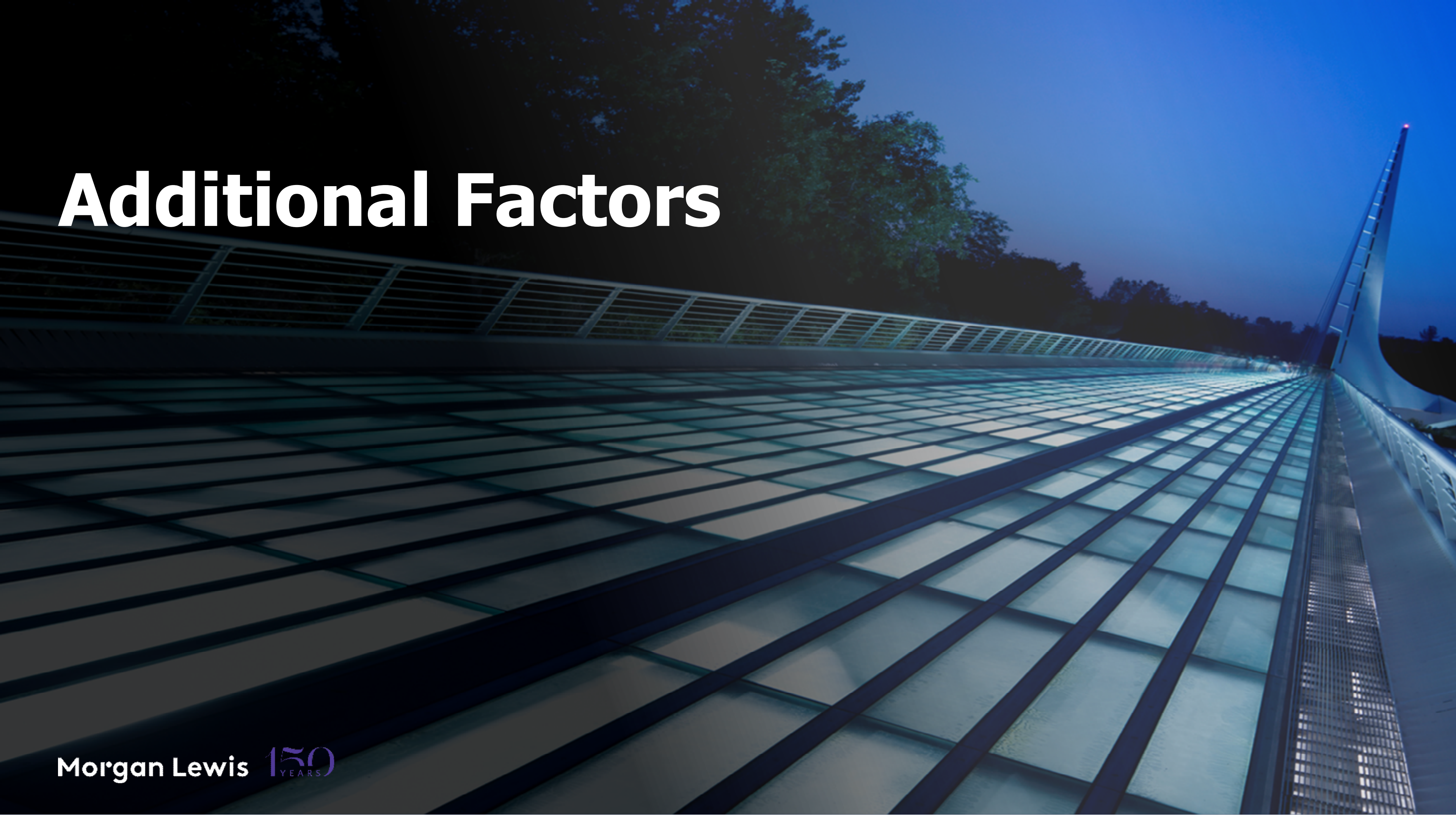
- Considers whether the worker uses specialized skills that contribute to business-like initiative.
  - If the work does not require previous experience, the worker is dependent on company training to perform the work, or the type of work requires no training at all (like driving that does not involve a CDL), the DOL believes the work likely lacks specialized skill and initiative.
- Where the worker brings specialized skills to the work relationship, the DOL says this fact is not itself indicative of contractor status because both employees and independent contractors may be skilled workers.
- It is the worker's use of those specialized skills in connection with business-like initiative that indicates that the worker is an independent contractor.

Factor 6: Skill and Initiative

- The DOL notes that unskilled workers may be contractors.
- Be Careful That Training Does not Negate this Factor
  - Basic training in a workplace, such as paying for a first-aid certification class, does not prevent a finding that a worker uses specialized skills to perform the work. The analysis should focus on whether the worker is dependent on training from the employer to perform the work.



Additional Factors

Other Factors

- The Final Rule notes that the six enumerated factors are intended to be "nonexhaustive" and that "additional factors which indicate that the worker is economically dependent on the potential employer for work or in business for themself can be considered."
- However, the DOL again declined to identify any particular additional factors that may be considered.
- This leaves the door open for industry or relationship-specific facts to be considered as part of the economic realities analysis.

Takeaways From the Final Rule

Practical Effect and Business Outlook

- The Final Rule marks a departure from the 2021 Rule insofar as
  - the DOL moves away from considering the exercise of control and the opportunity for profit and loss as the "core factors" in the economic realities analysis;
  - DOL suggests evidence of work performed for multiple companies may not in all instances be dispositive of independent contractor status;
  - a potential employer's "control" regarding safety, health, or customer or quality standards that goes beyond legal obligations may in some instances be seen as one factor supporting employee status; and
  - the DOL believes that only worker investments that are capital and entrepreneurial in nature—and not unilaterally imposed by a potential employer—will weigh in favor of an independent contractor finding.

Practical Effect and Business Outlook

- Those changes may impact whether certain workers, in certain industries, may be classified as independent contractors.
- The DOL will use the standard set forth in the Final Rule in its FLSA enforcement efforts. However, it is unclear how much deference courts will give the new standard, particularly considering the DOL's significantly vacillating approach to determining independent contractor status in recent years.
- As the Final Rule provides, "[t]he analysis . . . cannot be conducted like a scorecard or a checklist," and one or more factors in one situation may be more probative than a host of other factors going the opposite way." As such, companies should continue to review how their workers are classified and be mindful of how the classification of their workers may be viewed under the Final Rule's new test.

DOL Opens the Door For Sub-Regulatory Industry-Specific Guidance

- The DOL rejected the suggestion from several industry groups to provide industry-specific or occupation-wide exemptions or carve-outs.
- In formulating a rule of broad application, the DOL noted that there may be a need for more specific subregulatory guidance addressing particular industries or occupations.
- Subregulatory guidance includes Administrator Interpretations offering opinions on how the rule applies to specific industries, occupations or factual situations.
- Several industry groups are likely to seek subregulatory guidance clarifying how the Final Rule applies to their situation.

Next Steps & Action Items:

- Companies should consider auditing current independent contractor engagements and agreements to determine what changes can be made to align existing relationships with the DOL's evolved guidance as to the factors supporting independent contractor status.
- The Final Rule may prompt inquiries from workers about independent contractor classifications. Companies should prepare for questions from workers on those issues.
- In certain, limited cases, the guidance from the DOL's Final Rule will support making changes to staffing models or reclassifying workers from independent contractor to employee.
  - That will require developing a communication strategy, conducting training, designing timekeeping, scheduling and compensation policies and practices, and revising benefit plans.

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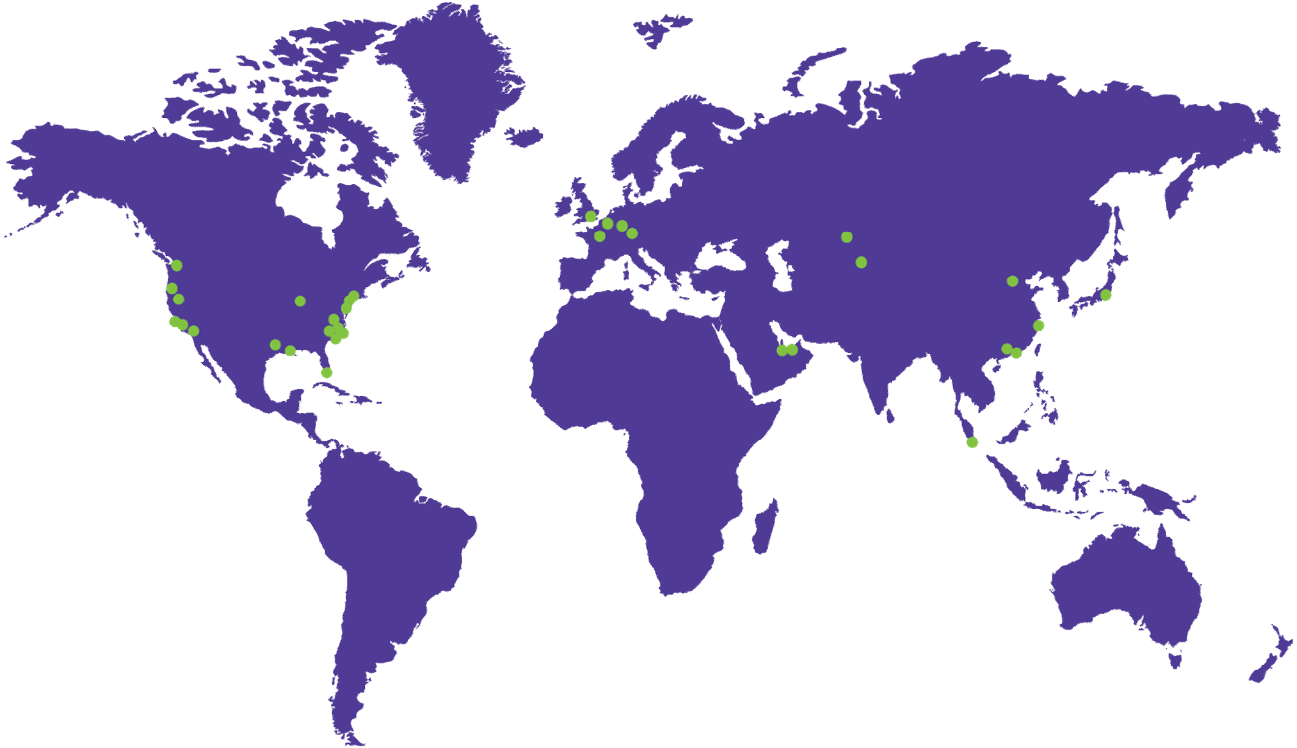

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