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Department of Labor Finalizes Independent Contractor Classification Rule

"Economic Reality" Test Provides More Predictability as to When Workers Would Be Considered Employees or Independent Contractors, But the Biden Transition Team Has Announced Plans to "Potentially Freeze" the Rule Before it Takes Effect

SUMMARY

On January 7, 2021, the U.S. Department of Labor (the "Department") published a final rule establishing a new test for classifying a worker as an employee or an independent contractor under the Fair Labor Standards Act (the "FLSA" or the "Act") (the "Final Rule"). The Final Rule, which contains five distinct factors, focuses on whether a worker is "economically dependent" on an employer for his or her employment. Two factors, "the nature and degree of control over the work" and "the individual's opportunity for profit or loss," carry the most weight under the rule. Courts have previously evaluated the worker-employer relationship under competing multi-factor tests with overlapping factors. The Department's new five-factor test, which includes examples of facts weighing in one direction or the other, as well as examples of how the test should be applied in various situations, provides more predictability as to when a worker falls under the FLSA's minimum wage and overtime provisions. Although the Final Rule is scheduled to take effect on March 8, 2021, the Biden transition team has announced plans to "potentially freeze" the rule prior to that date.

BACKGROUND

The FLSA's minimum wage and overtime provisions establish certain duties that an employer owes to its nonexempt employees. Employers owe no such duties to independent contractors, *i.e.*, workers who are not "employees." The FLSA defines an "employee" as a person "employed by an employer" and defines "to employ" as "to suffer or permit to work."[1] The Act does not define "independent contractor."

Courts historically have interpreted these provisions with a range of similar but distinguishable multi-factor tests that generally employ five or six factors to calibrate the "economic reality" of the worker-employer relationship.[2] Under these tests, a worker's status as employee or independent contractor turns on whether the worker is "dependent upon the business to which [s/he] render[s] service."[3]

On July 15, 2015, during the Obama administration, the Department issued an Administrative Interpretation establishing a six-factor test for classifying workers as independent contractors and further stating that "most workers are employees under the FLSA." We previously discussed the 2015 guidance **here**. On June 7, 2017, under the Trump administration, the Department withdrew this guidance. The withdrawal announcement can be found **here**. On September 22, 2020, the Department proposed a new independent contractor rule using an economic realities test aimed at determining whether workers are economically dependent on the potential employer or are in business for themselves. We previously discussed the proposed rule **here**.

THE FINAL RULE

On January 7, 2021, ten weeks after the comment period for the proposed rule concluded, the Department published its Final Rule, which largely adopted its 2020 proposed rule. As with prior tests, the Final Rule aims to determine whether the worker is "economically dependent on [the] employer for work" or, rather, is "in business for him- or herself." Unlike prior tests, however, which the Department explained included "five or more overlapping factors," the Final Rule identifies "five distinct factors." Of the five factors, two "core factors" are "most probative": (1) "the nature and degree of control over the work;" and (2) "the individual's opportunity for profit or loss." The inquiry is usually complete where both core factors point toward the same classification. When the core factors diverge, three more factors come into consideration: (3) "the amount of skill required for the work;" (4) "the degree of permanence of the working relationship between the worker and the potential employer;" and (5) "whether the work is part of an integrated unit of production."[4]

For each of the five factors, the Department provides examples of facts that would push a worker toward one classification or the other:

- ***Control over the work***: A worker who "set[s] his or her own schedule . . . select[s] his or her projects," or has "the ability to work for others," especially the employer's competitors, is more likely to be an independent contractor. Where the employer "control[s] the individual's schedule or workload" or "directly or indirectly requir[es] the individual to work exclusively for the potential employer," the worker is more likely to be an employee.
- ***Opportunity for profit and loss***: Where the worker's potential profits or losses are "based on his or her exercise of initiative (such as managerial skill or business acumen or judgment) or management of his or her investment in or capital expenditure on, for example, helpers or equipment or material to further his or her work," the worker is more likely to be an independent contractor. Where the worker increases his or her earnings merely by "working more hours or faster," the worker is more likely to be an employee.

- ***Skill required***: The worker is more likely to be an independent contractor if "the work at issue requires specialized training or skill that the potential employer does not provide."
- ***Permanence in the working relationship***: The worker is more likely to be an independent contractor where the relationship is "by design definite in duration or sporadic, which may include regularly occurring fixed periods of work." However, "the seasonal nature of work by itself would not necessarily indicate independent contractor classification." By contrast, the worker is more likely to be an employee where the working relationship is "by design indefinite in duration or continuous."
- ***Integrated unit of production***: Where the worker is "segregable from the potential employer's production process," he or she is more likely to be an independent contractor than if he or she is "a component of the potential employer's integrated production process for a good or service," in which case the worker is more likely to be an employee.[5]

The Final Rule also provides illustrations applying the new economic reality test to six hypothetical fact patterns:

- ***Truck driver***: A worker who owns her own tractor-trailer and drives this truck for a logistics company "substantially controls the key aspect of the work" and is thus likely to be an independent contractor even though the logistics company installs a device on the tractor-trailer to limit and monitor the speed at which she drives, because the purpose of the device is to ensure her compliance with traffic laws and to enhance safety.
- ***Home-repair worker***: The opportunity for profit or loss factor weighs toward independent contractor status for a home-repair worker who receives work assignments from an app-based service connecting home-repair workers with households, because the worker "is able to meaningful[ly] increase his earnings by exercising initiative and business acumen and by investing in his own equipment."
- ***Side business***: A construction worker is paid a fixed hourly rate and receives specific task assignments from her employer. The worker also runs her own food truck on the weekends. In a challenge to the worker's classification by her construction employer, her profits from the food truck do not affect the opportunity for profit or loss factor with regard to her work for the construction company because the food truck is a "separate business."
- ***Ski resort***: A housekeeper at a ski resort starts working at the ski resort at the beginning of each winter and moves on to another job when the ski resort shuts down at the end of the winter. The fact that the housekeeper returns to the ski resort each winter supports the finding of permanence in the worker-employer relationship.
- ***Newspaper editor***: A newspaper editor is "part of an integrated unit of production of the newspaper," and thus likely to be an employee, where she is "involved in the entire production process of the newspaper, including assigning, reviewing, drafting, and laying out articles," and regularly performs her duties "in coordination with [other] employees" of the newspaper.
- ***Freelance journalist***: A freelance journalist is not "part of an integrated unit of production of the newspaper," and is likely to be an independent contractor, where his work for the newspaper is "limited to the specific articles that he submits."[6]

As these examples demonstrate, application of the rule depends on the specific facts at issue, rather than the industry or job-function of the hypothetical worker.

IMPLICATIONS

Although U.S. Secretary of Labor Eugene Scalia stated that the Final Rule was designed to "bring long-needed clarity" to the standards under the FLSA by "mak[ing] it easier to identify employees covered by the Act," employers should be mindful that the new administration likely will either postpone the effective date of the Final Rule or rescind the rule in its entirety. In fact, the Biden transition team has already announced that the new administration plans to "halt or delay" this particular regulation (together with other so-called "midnight regulations" recently pushed out by the Trump administration) on President-Elect Biden's first day in office. Significantly, in making that announcement, the Biden transition team criticized the rule as "mak[ing] it easier for companies . . . to avoid minimum wage and overtime protections . . . costing workers nearly $3.7 billion annually." As a result, it appears likely that the Department under the Biden administration, particularly one under President-Elect Biden's Secretary of Labor nominee Marty Walsh, will propose a rule that is materially different from the Final Rule.

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ENDNOTES

1 29 U.S.C. § 203(e)(1), (g).

2 *Compare*, *e.g.*, *Usery* v. *Pilgrim Equip. Co.*, 527 F.2d 1308, 1311 (5th Cir. 1976) (five factors), *with Sec'y of Labor* v. *Lauritzen*, 835 F.2d 1529, 1534–35 (7th Cir. 1987) (six factors).

3 *Lauritzen*, 835 F.2d at 1534 (quoting *Mednick* v. *Albert Enters., Inc.*, 508 F.2d 297, 299 (5th Cir. 1975)).

4 Independent Contractor Status Under the Fair Labor Standards Act, 86 Fed. Reg. 1168, 1246–47 (Jan. 6, 2021) (to be codified at 29 C.F.R. pts. 780, 788, 795).

5 *Id.*

6 *Id.* at 1247–48.

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