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The DOL Issues a Final Rule Returning the Independent Contractor Classification Analysis under the FLSA to a More Employee-Friendly Test, Forcing Employers to Think Critically About Their Use of Independent Contractors in the Workplace

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The U.S. Department of Labor (the “DOL”) recently issued a final rule (the "2024 Rule") which reverts the independent contractor analysis back to a multifactor, totality-of-the-circumstances review that, as compared to the current rule in place (the “2021 Rule”), will almost assuredly result in more workers being classified as employees under the Fair Labor Standards Act (“FLSA”). The 2024 Rule – which rescinds and replaces the 2021 Rule – has an effective date of March 11, 2024. According to the DOL, the 2024 Rule aims to bring the independent contractor versus employee analysis in line with longstanding judicial precedent resulting in a reduced risk of employees being misclassified as independent contractors. Employers should work now to ensure their compliance with the 2024 Rule by March 11th.

The DOL’s 2021 Rule

By way of a quick recap, the 2021 Rule, which has been widely considered to be employer friendly as compared to past rules, set forth five factors to consider when evaluating a worker’s status as an independent contractor or an employee: (1) the nature and degree of control over the work, (2) the worker's opportunity for profit or loss, (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. Two of these factors – the nature and degree of control over the work and the worker's opportunity for profit or loss– are “core factors,” meaning that they are considered the most important and receive more weight in the analysis than the remaining factors. In fact, the 2021 Rule states that the three less important factors – even when combined – are “highly unlikely” to outweigh the core factors in any classification analysis.

According to the DOL, the 2021 Rule fails to consider certain relevant facts (including whether the work performed was central to the employer’s business) and risked confusion and disruption in the workforce given its departure from legal precedent. For these reasons, on October 13, 2022, the DOL published a Notice of Proposed Rulemaking to rescind and replace the 2021 Rule.

The DOL's 2024 Rule

The 2024 Rule – which slightly modifies the earlier proposed rule based on the over 55,000 comments received from the public in the rulemaking process – provides for a six-factor economic realities test that, according to the DOL, aligns with both the federal courts' approach in evaluating worker classification and the DOL's pre-2021 guidance. These factors include:

1. Opportunity for profit or loss depending on managerial skill: This factor considers whether the worker has opportunities for profit or loss based on managerial skill (including initiative or business acumen or judgment) that affect the worker's economic success or failure in performing the work, e.g., specifically whether the worker determines or can meaningfully negotiate their pay for the work, or whether the worker has the ability to accept or decline jobs or can decide the order in which the jobs are performed;
2. Investments by the worker and the potential employer: This factor considers whether any investments by a worker are capital or entrepreneurial in nature and thereby generally support an individual business;
3. Degree of permanence of the work relationship: 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. On the other end, this factor weighs in favor of an independent contractor relationship when the work arrangement 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;
4. Nature and degree of control: This factor considers the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship, e.g., whether the potential employer sets the worker's schedule or supervises the performance of the work;
5. Extent to which the work performed is an integral part of the potential employer's business: This factor considers whether the work performed is an integral part of the potential employer's business, and specifically, this factor tilts in favor of an independent contractor relationship when the work performed is not critical, necessary, or central to the potential employer's principal business; and
6. Skill and initiative: This factor considers whether the worker uses specialized skills to perform the work and if those skills contribute to business-like initiative, or if the work is dependent on training from the potential employer.

Importantly, the 2024 Rule uses a totality-of-the circumstances analysis where no one factor is more heavily weighted than the others. The analysis also allows for the consideration of additional, unspecified factors where relevant, underscoring that the test should not be applied rigidly, but instead allows for flexibility in application based on the specific facts of a case.

To be clear, however, the 2024 Rule only revises the DOL's independent contractor analysis under the FLSA and does not impact the analysis on the standards or guidance used under any other federal (e.g., the Internal Revenue Code and the National Labor Relations Act), state or local laws. For example, the "ABC" test, used for evaluating an independent contractor relationship in states such as California and Massachusetts, remains unchanged and permits an independent contractor relationship only if all three factors of a three-factor test are satisfied. Further, and while the 2024 Rule is not binding, courts will likely use the 2024 Rule as guidance in deciding independent contractor FLSA cases.

What This Means for Employers

Employers should now evaluate how the 2024 Rule may impact their workforce, including whether the reclassification of certain independent contractors to employees is needed. Under the FLSA, the consequences of worker misclassification – civil and criminal penalties for owed back wages, DOL wage audits, defense of individual and collective actions filed by employees where double the back wages, attorney's fees, and costs are potential remedies – further support this type of critical and prompt workforce evaluation. As does the fact that individual states carry their own steep penalties for worker misclassification.

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