On January 6, 2021, the Department of Labor (“DOL”) announced a final rule clarifying the standard under the Fair Labor Standards Act (“FLSA”) for determining whether a worker is an independent contractor versus an employee. This distinction is critical under the FLSA, as employers must comply with its minimum wage and overtime requirements for employees, but not independent contractors. The regulatory guidance outlined in the final rule regarding independent contractor status is generally applicable across all industries, replaces all previous DOL interpretations of independent contractor status under the FLSA, and is intended to be the governing interpretation for this analysis going forward. The DOL published the final rule in the Federal Register on January 7, 2021, and the effective date of the rule is March 8, 2021.

According to the DOL, the purpose of the new rule is to provide much-needed clarity to workers and employers by making it easier to identify employees covered by the FLSA. The rule replaces the seven-factor economic realities test that, until now, the DOL and most courts have used when analyzing a work relationship to determine independent contractor versus employee status. The DOL stated that its hope is that streamlining and clarifying the test to identify independent contractors will reduce worker misclassification, reduce litigation, increase efficiency, and increase job satisfaction and flexibility.

With these goals in mind, the rule reaffirms an “economic reality” test to determine whether an individual is economically dependent on a potential employer for work (and thereby an employee under the FLSA) or is in business for him or herself (and therefore an independent contractor). The rule identifies multiple factors that are important to consider, but its first two factors are identified as the “core factors” that are most important to the analysis. Those two factors are:

- The “nature and degree of control over the work”; and
- The worker’s “opportunity for profit or loss” based on initiative and/or investment.

The more control an employer has over key aspects of the performance of the work, the more likely it is that the worker is an employee rather than an independent contractor. Further, the DOL explained
that the second factor weighs towards the individual being an independent contractor to the extent
the individual has an opportunity to earn profits or incur losses based on his or her exercise of
initiative regarding management and expenditures.

In addition to these two core factors, the rule also identifies three other “guideposts” that may help in
the analysis. The additional factors are:

- the amount of skill required for the work;

- the degree of permanence of the working relationship between the worker and the potential
  employer; and

- whether the work is part of an integrated unit of production.

According to the DOL, not all facts or factors are equally important (if they are important at all) as to
whether, as a matter of economic reality, an individual is in business for him/herself. The core factors
are more probative of the question of economic dependence (or lack thereof) than the other factors,
and thus carry greater weight in the analysis than the guideposts. Further, the rule explains that, in
evaluating the individual’s economic dependence on the potential employer, the “actual practice of
the parties involved is more relevant than what may be contractually or theoretically possible.” For
example, according to the rule, “an individual’s theoretical abilities to negotiate prices or to work for
competing businesses are less meaningful if, as a practical matter, the individual is prevented from
exercising such rights.” Likewise, a business’ contractual authority to supervise or discipline an
individual may be less relevant if in practice the business never exercises such authority. The rule
also provides multiple fact-specific examples applying the factors and demonstrating how they should
be analyzed in practice.

In its comments to the rule, the DOL expressed its belief that this rule will “significantly clarify to
stakeholders how to distinguish between employees and independent contractors under the [FLSA].”
Although the new rule is scheduled to take effect on March 8, 2021, its future and longevity remain
uncertain because President-Elect Biden’s administration is expected to review (and possibly
rescind) this rule, in addition to other rules promulgated by the outgoing administration in its last few
months. President-Elect Biden’s administration likely will advocate for more employee-friendly rules
than the those implemented by the Trump administration. Bolstered by critics of this rule who believe
that it ultimately benefits employers by making it easier for companies to classify their workers as
independent contractors rather than employees, thereby depriving workers of rights under the FLSA,
there is a chance that the Biden administration reassesses the implementation of this rule. As always,
we will keep you posted as new updates on this issue emerge, but in the meantime, employers
should familiarize themselves with the new rule, and reach out to counsel if they have any questions
regarding the proper way to classify their workers under this revised standard.

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