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DOL Restores Pre-2021 "Economic Realities" Test for Employee / Independent Contractor Classifications Under the FLSA

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On January 10, 2024, the U.S. Department of Labor (DOL) published its final rule providing guidance on how to classify workers as employees or independent contractors under the Fair Labor Standards Act (FLSA). In doing so, the DOL rescinded a prior rule from 2021 on the same subject that made it easier for employers to classify workers as independent contractors.

The DOL's new rule becomes effective March 11, 2024. The new rule includes a six-factor "economic realities" test. Workers are more likely to be classified as employees under this new test. Under the new six-factor test, equal weight will be given to each of the following factors, but no one of them is determinative:

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 that impact the worker's economic success or failure in performing the work. If a worker has no opportunity for a profit or loss, then this factor suggests that the individual is an employee. Notably, workers who are paid a fixed rate per hour or per job and who earn more money by working more hours or taking more jobs are not necessarily evidencing the requisite "managerial skill" to support independent contractor status under this factor.
2. **Investments by the worker and the potential employer.** This factor considers whether the worker's investments are capital or entrepreneurial in nature. When the worker is making similar types of investments as the potential employer (even if on a smaller scale), it is more likely that the worker is an independent contractor. Investments in tools or equipment that the potential employer unilaterally imposes on the worker suggest that the worker is an employee.
3. **Degree of permanence of the work relationship.** This factor weighs in favor of an employee classification when the work relationship is long term, indefinite, or exclusive of work for other employers. This factor weighs in favor of an independent contractor classification when the work relationship is for a defined term, nonexclusive, project-based, or sporadic. However, a lack of permanence in the work relationship does not necessarily determine independent contractor status if it is due to the industry-

specific or operational reasons of the potential employer, unless it is in conjunction with the worker's independent business initiative.

4. **Nature and degree of control.** This factor considers the potential employer's control over the performance of the work and the economic aspects of the working relationship. More control by the potential employer favors employee status; more control by the worker favors independent contractor status. Actions taken by the potential employer to comply with applicable federal, state, tribal, or local laws do not necessarily indicate that the worker is an employee. However, the DOL will consider actions that potential employers take that extend beyond applicable legal requirements for their own benefit or convenience as an indication that the worker is an employee.
5. **Extent to which the work performed is an integral part of the potential 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. This factor weighs in favor of the worker being an independent contractor when the work they perform is not critical, necessary, or central to the potential employer's principal business. If the potential employer is unable to function without the service performed by the worker, then the service the worker provides is likely integral.
6. **Skill and initiative.** This factor considers whether the worker uses specialized skills to perform the work. The rule provides that specialized skill alone does not indicate that the worker is an independent contractor. What is relevant for this factor is whether the worker uses specialized skills "in connection with" business-like initiative.

Although the DOL stated that no factor or set of factors in the new rule has a predetermined weight, it has signaled a heightened interest in analyzing the worker's investment in the work and whether the service being performed by the worker is an integral part of the employer's business. The DOL has also stated that additional factors may be relevant if they indicate whether the worker is in business for themselves (i.e., an independent contractor) or economically dependent on the employer for work (i.e., an employee).

Departure from DOL's 2021 Rule

The DOL issued the prior iteration of the worker classification rule, known as the "core factors" test, in January 2021. Under the Trump-era core-factors test, courts and employers could classify workers as independent contractors based on just two factors, even if the broader economic-reality test indicated otherwise: the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss. If those two factors did not resolve the classification question clearly, the analysis then required consideration of three additional factors: the amount of skill required, the degree of permanence of the working relationship, and whether the work was part of an integrated unit of production. The core-factors test was a more business-friendly approach to the independent contractor standard when compared to the new economic-realities test that uses an employee-friendly interpretation of how each of the six factors in the test should be applied. As a result, more workers will be classified as employees than independent contractors under the new economic-realities test.

Consequences of Misclassification

Failure to take steps to comply with this new rule may result in significant repercussions under the FLSA. If an employer is covered by the FLSA, it generally must provide minimum wage and overtime pay protections to its employees and comply with certain recordkeeping requirements. However, these FLSA protections do not apply to independent contractors. So if workers are found to be misclassified as independent contractors, the employer will face FLSA liability, which could include minimum wage and overtime back pay, liquidated damages, and attorneys' fees, not to mention potential injunctive relief and civil or criminal penalties.

Key Takeaways for Employers

Employers and their counsel should review how they classify workers before the new rule becomes effective on March 11, 2024. Employers reliant on subcontracting, franchising, and staffing firms should pay particular attention to this new worker classification rule because they may face greater regulatory scrutiny and legal exposure than businesses that rely more heavily on employees.

When conducting a review of the classifications of the workers providing services to your business, keep the following in mind:

- Evaluate each position holistically using the new six-factor economic-realities test. The analysis should not stop there—the new rule allows consideration of any additional factors that are relevant to the "ultimate inquiry," i.e., whether a worker is economically dependent on an employer. Once all relevant factors have been analyzed, classify workers accordingly.
- Keep tabs on how the DOL ultimately enforces the new rule to identify potential trends that may be different from existing FLSA case law.
- There are already challenges to the new rule being filed in court, so it will be important to monitor the status of those challenges as they unfold if they alter or otherwise affect the implementation of the new rule as written.
- If your business has workers in states that use more stringent classification laws like the "ABC" test (for example, California, Illinois, Massachusetts, and New Jersey), note that the DOL's new rule does not supplant these state laws. Employers must comply with all laws that apply and ensure that they are meeting whatever standard provides workers with the greatest protection.

Alston & Bird's Labor & Employment Group regularly counsels clients on numerous issues related to classification of employees and is well-positioned to provide guidance and assistance to clients on this significant development.

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