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DEPARTMENT OF LABOR ISSUES FINAL RULE ON DEFINITION OF INDEPENDENT CONTRACTOR

On January 7, 2021, the U.S. Department of Labor (DOL) published a Final Rule on the definition of an independent contractor under federal law. The Final Rule clarifies the DOL's interpretation of the Fair Labor Standards Act's (FLSA) classification provision to determine whether to classify a worker as an employee or independent contractor.

A. Overview of the FLSA's Definition of Employee

The FLSA requires covered employers to pay nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked over 40 in a workweek. The FLSA also mandates that employers keep certain records regarding their employees. A worker who performs services for an entity as an independent contractor, however, is not an employee under the FLSA. Therefore, the FLSA does not require such an entity to pay an independent contractor minimum wage or overtime pay, or to keep certain records regarding the worker.

The FLSA does not define the term "independent contractor," but it defines "employer" as "any person acting directly or indirectly in the interest of an employer in relation to an employee," *see* 29 U.S.C. 203(d), "employee" as "any individual employed by an employer," *id.* at 203(e) (subject to certain exceptions), and "employ" as "includ[ing] to suffer or permit to work," *id.* at 203(g). Many courts and the DOL have interpreted the "suffer or permit to work" standard to require evaluation of the worker's economic dependence on the potential employer and have developed a multifactor test to analyze whether a worker is an employee or an independent contractor.

Unfortunately, this "economic reality" test has not been clearly defined or consistently articulated. Therefore, the DOL has adopted, as a final rule, guidance to increase precision in application of the economic reality test, which hopefully will in turn benefit workers and businesses and encourage economic innovation and flexibility.

B. The "Economic Reality" Test

The DOL's Final Rule reaffirms an "economic reality" test to determine whether an individual is "economically dependent" on another for work, making the individual an "employee" covered by the FLSA, or whether the individual is in business for themselves, making the individual an "independent contractor." The Final Rule identifies two "core factors" as the most probative for determining whether a worker is economically dependent on someone else's business:

- the nature and degree of control over the work; and
- the individual's opportunity for profit or loss.

If these two "core factors" point to different conclusions on a worker's status, three other factors may provide further guidance:

- 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.

The Final Rule states that the parties' *actual practices* are more relevant than what is contractually stated or theoretically possible. For example, the potential to exercise control is less significant under the Final Rule than the *actual* exercise of control.

To illustrate these principles, the Final Rule provides several examples, including:

- *Example 1:* An editor works part-time, from home, for a newspaper and is responsible for assigning and reviewing articles to be published. Sometimes the editor also writes or rewrites articles. The editor is responsible for determining the layout and order in which articles appear in the newspaper. She also makes decisions in coordination with several full-time editors, who make similar decisions with respect to articles and who are employees of the newspaper.

  The DOL's Final Rule indicates the editor is likely an employee of the newspaper. The editor is part of an integrated unit of production of the newspaper because she is involved in the newspaper's entire production process, including assigning, reviewing, drafting, and laying out articles. She also performs the same work as employees of the newspaper in coordination with them. The fact that the editor works from home does not outweigh these more probative considerations of the "integrated unit" factor.

- *Example 2:* A worker works full time performing home renovation and repair services for a residential construction company. In performing the construction work, the worker is paid a fixed hourly rate, and the company determines how many and which tasks she performs. She is also the part owner of a food truck, which she operates on weekends and which generates substantial profits for her.

  The DOL's Final Rule indicates that the worker is likely an employee with regard to the construction work, because she is paid a fixed hourly rate, the company determines her work assignments, and she does not have a meaningful opportunity for profit or loss. However, while the worker earns substantial profits through her food truck, that is a separate business from her work in the construction industry, and therefore is not relevant to the question of whether she is an employee of the construction company.

The Final Rule can be found **HERE** and is scheduled to take effect on March 8, 2021.

With the upcoming change of administration, it is unclear whether there will be efforts to amend or overturn the new standard. Employers should continue to monitor DOL guidance in considering whether any changes to their business arrangements are necessary.

For more information on these issues, please reach out to Tara Stingley or another member of Cline Williams' Labor and Employment Law Section.