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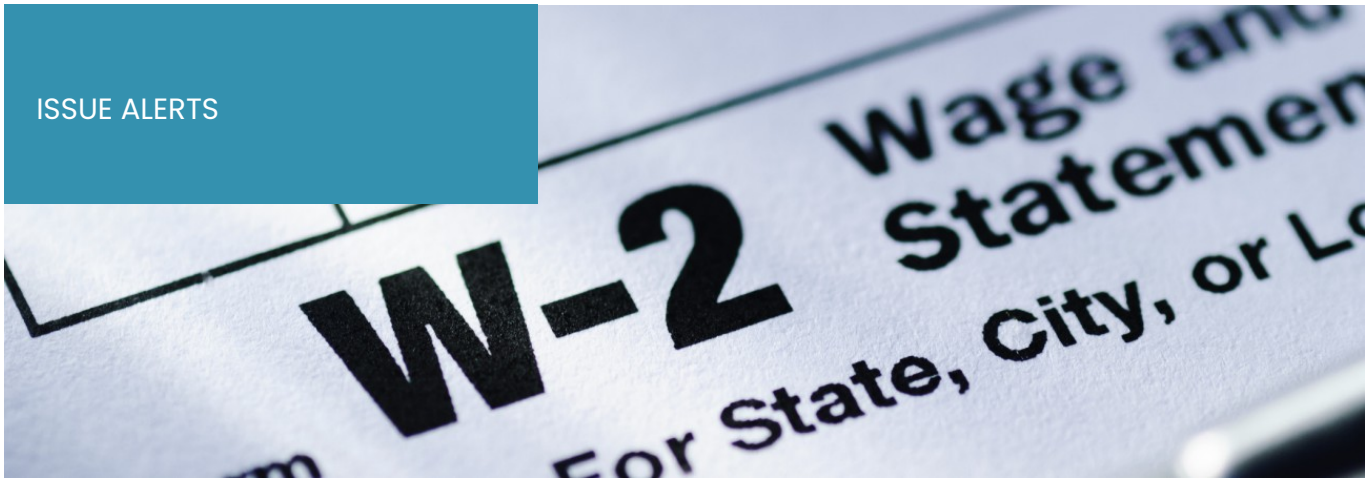

RINGING IN THE NEW YEAR, THE U.S. DEPARTMENT OF LABOR PUBLISHES FINAL RULE ON INDEPENDENT CONTRACTOR CLASSIFICATION UNDER THE FLSA

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By: Forrest T. Rhodes Jr. and Travis D. Hanson

Last week, the United States Department of Labor ("DOL") published a Final Rule revising the regulations that govern whether a worker should be classified as an employee or independent contractor ("IC") under the Fair Labor Standards Act ("FLSA"). The Final Rule, which is scheduled to take effect on March 11, 2024, rescinds the Trump administration IC regulation and replaces it with a framework that the DOL views as "more consistent with the FLSA as interpreted by longstanding judicial precedent." In reality, even though the Final Rule predominantly reinstates the previously longstanding multi-factor "economic realities" approach to assessing IC status, it also incorporates the current administration's pro-employee views into how each factor should be construed, which will invariably make it more difficult for employers to justify many IC relationships.

THE 2021 IC RULE

Implemented in the waning days of the Trump administration, the 2021 IC Rule marked a somewhat stark departure from how the DOL and courts had historically considered worker classification under the FLSA. Specifically, the 2021 IC Rule identified five factors relevant to this analysis, but two of those factors (the nature and degree of control over the work and the worker's opportunity for profit and loss) were designated as "core factors" that were to be given the most weight in assessing the appropriate classification. The other three factors (the amount of skill required for the work, the degree of permanence of the working relationship, and whether the work was part of an integrated production unit) were viewed as less probative, and the DOL indicated it was "highly unlikely" that these three factors could outweigh the two core factors. All things considered, the 2021 IC Rule was viewed as a pro-business shift designed to result in more workers being appropriately classified as ICs under the FLSA.

THE 2022 PROPOSED RULE

In October 2022, the DOL began the process to revise the 2021 IC rule by publishing proposed new regulations for public review and comment. The 2022 Proposed Rule focused on a six-factor totality of the circumstances approach and eliminated the preference that was given to the two core factors.

THE 2024 FINAL RULE

The Final Rule, announced last week, largely tracks the 2022 Proposed Rule, with some slight modifications based on feedback received from more than 55,000 commenters. Under the Final Rule, the DOL identified six factors (discussed below) that should be considered in assessing whether a worker is an employee or IC under the FLSA. None of these factors are assigned a predetermined weight and the ultimate question is whether a worker is economically dependent on the potential employer for work, when considered under the totality of the circumstances. Of note, the Final Rule also provides guidance on the application of the six factors, which the DOL will likely argue should carry significant regulatory weight.

1. Opportunity for profit or loss depending on managerial skill

This factor looks at whether the worker has opportunities for profit or loss, but focuses on opportunities based on managerial skill that affect the worker's economic success or failure in performing the work. Some examples the DOL provided on this factor include the worker's ability to meaningfully negotiate pay rates or control over the order/timing of job performance, whether the worker engages in marketing or other efforts to grow business, or makes decisions to hire others, purchase materials, or rent space.

Having an opportunity for profit or loss counsels in favor of IC status; however, the DOL also noted that certain decisions that impact compensation, such as how many hours to work or how many jobs to accept when such work is done at fixed rates per hour or job are generally not indicative of managerial skill, so they do not support IC status. But, where a worker can decide for themself what jobs to take based on the potential for profit, the ability to negotiate their pay, or the time or resources necessary to complete the job, this factor may weigh in favor of an IC finding.

2. Investments by the worker and the potential employer

This factor assesses whether and how the worker invests in their business. Under the Final Rule, the worker's investments must be entrepreneurial in nature (i.e., "serve a business-like function, such as increasing the worker's ability to do different types of or more work, reducing costs, or extending market reach") to support an IC finding. In simpler terms, there is a difference between costs a potential employer requires a worker to expend and costs a worker voluntarily incurs in furtherance of their business. The worker's investments should further be analyzed on a relative basis with the potential employer's investments in its overall business. Where the worker is making similar types of investments, even if made on a smaller scale, those facts suggest the worker is operating independently and weigh in favor of IC status.

3. Degree of permanence of the work relationship

This factor looks at the duration and frequency of the relationship between the worker and potential employer. In most cases, a long-term or indefinite relationship signifies the worker is an employee. But the inverse is not always true where the terms of the relationship are not the result of the worker's making. For example, a seasonal worker is not an IC just because the relationship is only expected to last for a short and definite period.

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4. Nature and degree of control

This factor weighs "the potential employer's control, including reserved control, over the performance of the work and the economic aspects of the working relationship." Notably, the reserved control language is critical as the DOL may use that to focus on the right to control a worker's performance, even where the potential employer does not actually exercise that control.

In assessing control, relevant facts include whether the potential employer sets a schedule for the worker, supervises the worker's performance of the work, limits the worker's ability to work for others, or disciplines the worker. Who controls the economic aspects of the relationship is also a relevant consideration. Of note, actions taken to ensure a worker's compliance with specific legal requirements are not indicative of control, but control over non-legal requirements such as adherence to the potential employer's standards regarding safety, quality control, or customer service, may demonstrate control.

5. Extent to which the work performed is an integral part of the potential employer's business

This factor evaluates the importance of the worker's services to the potential employer's business. In particular, the analysis focuses on whether the work performed is "critical, necessary, or central" to the business. Without oversimplifying the issue, the closer a worker is to the core services the business provides, the more likely that worker is an employee. For example, for a shoe manufacturer, the workers that make the shoes are likely integral to the potential employer's business, while the workers that clean the warehouse at night may not be.

6. Skill and initiative

This factor looks at the worker's skills, but it's not enough to simply show that the worker has a specialized skill set; rather, what's relevant to the IC analysis is the worker's use of those specialized skills in connection with business-like initiative.

TAKEAWAYS

- Although the Final Rule represents a return to the factors that the DOL and the courts have historically used to analyze these issues, by removing any preference for the two factors that often favored IC status and by limiting how some of the other factors must be assessed, the Final Rule will likely result in more workers being found to be employees rather than ICs.
- A more pro-employee view of employment was a stated goal of the current administration, so employers should keep that in mind when assessing these factors.
- The Final Rule directly addresses FLSA compliance, but the DOL and the Internal Revenue Service have a separate memorandum of understanding through which the DOL will notify the IRS of misclassified employees that it discovers. Thus, potential liability could go beyond what the FLSA addresses.
- If your organization utilizes ICs, you should assess whether those workers can still be classified as ICs considering this new guidance. This analysis can sometimes be complicated, so we encourage you to engage your wage/hour counsel in this review if you have any questions. If you don't have wage/hour counsel, we would welcome the opportunity to partner with you on this project.
- While the current effective date of the Final Rule is March 11, 2024, multiple pro-employer groups have threatened litigation to stop it. It's best to be pro-active about these issues but recognize that what appears to be the new Final Rule might not turn out that way. And, even if the Final Rule goes into effect, it remains to be seen what deference courts will give these new regulations moving forward.

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FOR MORE INFORMATION

If you have questions or want more information regarding the final rule on independent contractor classification under the FLSA and its possible effects on your organization, contact your legal counsel. If you do not have regular counsel for such matters, Foulston Siefkin LLP would welcome the opportunity to work with you to meet your specific needs. For more information, contact Forrest Rhodes, Jr. at 316.291.9555 or frhodes@foulston.com or Travis Hanson at 913.253.2132 or thanson@foulston.com. For more information on the firm, please visit our website at www.foulston.com.

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