

DOL Returns To Longstanding Approach to 'Economic Reality' Test in Final Independent Contractor Rule

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Takeaways

Employers should review their independent contractor relationships to ensure accurate classification of workers, especially those entered since 2021. The final rule broadens the definition of employee, both compared with the 2021 standard and the pre-2021 standard, so it may be more challenging for employers to classify workers as independent contractors. Accurate classification of workers is critical to avoid claims for minimum wage and overtime violations, which can be costly and disruptive to businesses.

Finally, employers should remember that the final rule only revises the DOL's interpretation under the FLSA and has no effect on other laws—federal, state, or local—that use different standards for employee classification. Therefore, employers remain subject to state-specific and locality-specific tests about employee and independent contractor distinctions.

Earlier this month, the U.S. Department of Labor (DOL) published a [final rule](#) for determining employee or independent contractor status under the Fair Labor Standards Act (FLSA). The final rule largely tracks the DOL's proposed rule (which we discussed [here](#)) with some modifications following public comments. The final rule will likely expand the number of workers who are "employees" (instead of independent contractors)—particularly for gig economy workers, such as ride-share and food-delivery drivers. The rule rescinds the DOL's 2021 Independent Contractor Rule, issued under the Trump Administration in 2021 and is scheduled to take effect on March 11, 2024.

The Final Rule

The final rule restores the pre-2021 approach to the "economic reality" test, which weighs six factors to determine if a worker is an employee or an independent contractor. The final rule considers the "totality of the circumstances," with no pre-determined weight given to any one factor. The 6 factors are:

1. Opportunity for profit or loss depending on managerial skill;
2. Financial stake and nature of any investments in the work;
3. Degree of permanence of the work relationship;
4. Nature and degree of control over the person's work;
5. Extent to which the work performed is essential to the employer's business; and
6. Worker's skill and initiative.

The final rule's ultimate inquiry remains whether the "economic reality" is that the worker is in business for themselves or is economically dependent on the potential employer. Where the 2021 Independent Contractor Rule assigned greater weight to two "core factors" (control and opportunity

for profit or loss), the final rule returns to a “totality of the circumstances” approach to the economic reality test, meaning all six factors are relevant to the analysis.

Modifications from the Proposed Rule

In response to approximately 55,400 public comments, the DOL modified some of the concepts and language originally included in the proposed rule. For example:

- The final rule clarifies proposed language addressing “investments by the worker and the employer.” Under the final rule, investments that are “unilaterally imposed” by a business on a worker do not suggest independence. If a business requires a worker to buy a hard-hat, for example, the worker’s “investment” in the hard-hat does not make the worker more likely to be an independent contractor. But tools/equipment a worker buys at their own initiative suggests independence and weighs in favor of an independent contractor relationship. This is a retreat from the proposed rule, which would have treated all costs borne by the worker to perform their job as *indicative* of employee status.
- The final rule further clarifies that the consideration of the “relative” investment made by the worker in comparison to those investments made by the business should focus on the qualitative nature of the investment (instead of a dollar-for-dollar comparison). The consideration is whether the worker is making “similar types of investments” as the business, even if on a smaller scale, that “suggest the worker is operating independently” and could support independent contractor status.
- The proposed rule stated that, even when a business exercises control to comply with other laws, that control still indicates employee status. The final rule clarifies, however, that when a business acts with the “sole purpose” of complying with specific applicable state, federal, tribal, or local laws or regulations, those actions will *not* indicate “control” over the worker. This change alleviates some concern from businesses that the proposed rule could have left employers with conflicting legal obligations; however, it remains unclear how the “sole purpose” standard will operate in practice. If a business requires legal compliance beyond its specific legal obligations, the additional control may still indicate employee status.
- The final rule provides that a worker’s ability to earn more by working more is not entrepreneurial opportunity for profit or loss if the worker is “paid a fixed rate per hour or per job.” If the worker is paid by another method, the ability to earn more by working more may suggest independence.
- The final rule also clarifies that specialized skill alone does not indicate the worker is economically independent. Rather, the final rule explains that both employees and independent contractors can be specialized. The proper question is whether the worker uses specialized skill “in connection with business-like initiative.”

While these modifications help clarify aspects of the proposed rule that employer-side commenters found particularly concerning, the final rule is clearly an expansion of the DOL’s definition of employee, and many features of the final rule will make it more difficult to classify certain workers as independent contractors. For example, the final rule more closely examines the business’s control over an individual’s work and the extent to which the individual’s work is essential to the company’s business. While these changes may be intended to focus on the classification of gig economy workers, the new final rule may result in a broadening of employee status for independent contractor relationships across industries.

For questions about this final rule and compliance, contact our [labor and employment](#) team here at Haynes Boone.