

Locke Lord QuickStudy: Labor Department's Final Rule on Independent Contractor Status – What Does It Mean Practically and Legally??

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It has been well over a year since the U.S. Department of Labor issued its proposed rule entitled “Employee or Independent Contractor Classification under the Fair Labor Standards Act.” The regulation was expressly intended to override the Trump Administration’s regulation covering the same subject, which the Biden Administration felt was weighted in favor of businesses. Earlier today, the Labor Department issued its final rule on independent contractor status under the FLSA. No surprise: little was changed substantively in comparison to the proposed rule. Only a few tweaks were made despite the fact that over 55,000 comments to the proposed regulation were posted in a two-month period by individuals and organizations both in support of and in opposition to the proposed regulation. The final rule addressing the independent contractor (IC) status of workers in the U.S. is an “employee-friendly” version that will undoubtedly prompt jubilation among worker advocate organizations and unions while creating consternation on the part of many businesses and otherwise legitimate ICs that want to retain IC status. The legal impact of the final rule, however, will hardly ripple the waters. After all, it is the courts that create law on this subject, not regulatory agencies. We nonetheless project that the final rule issued today will give renewed impetus to disaffected workers classified as independent contractors to file class actions seeking minimum wage, overtime payments, and employee benefits under applicable laws. This is likely to propel more companies using independent contractors to take steps to enhance their IC compliance by using a process such as [IC Diagnostics™](#) to restructure, re-document, and re-implement their relationships with ICs in a customized and sustainable manner, consistent with their business model.

The Final Biden IC Rule Replaces the Trump IC Rule

We covered in an earlier [blog post](#) the history of the Biden Administration’s proposed independent contractor classification rule issued in October 2022 (the “Proposed 2022 Rule”), discussing how it was intended to replace the rule issued by the Trump Administration in January 2021, only a month before that administration came to an end (the “2021 Rule”).

The 2021 Rule, as we noted in a [blog post](#) when that regulation was issued, focused on two “core” factors: the nature and degree of control over the work and the worker’s opportunity for profit or risk of loss. The 2021 Rule also identified three other less probative “non-core” factors: the amount of skill required for the work, the degree of permanence of the working relationship, and whether the work is an integral part of the purported employer’s business. This approach by the Trump Administration’s Labor Department was premised on its view that it was reciting the prevailing law under the so-called “economic realities test” created by the courts.

The Proposed 2022 Rule on independent contractor classification, which has now been issued in final form (the “2024 Rule”). As stated in the proposed Rule’s Executive Summary, instead of using the “core factors” and “non-core” factors that were the central considerations in the 2021 Trump Rule, “this final rule returns to a totality-of-the-circumstances analysis of the economic reality test in which the factors do not have a predetermined weight and are considered in view of the economic reality of the whole activity.”

The most meaningful difference between the 2021 Trump Rule and the new Biden 2024 Rule appears to be the current Administration’s effort to place more weight on one of the three “non-core” factors: whether the work is integral to the employer’s business. This factor almost universally favors employee status, thereby causing many courts over the past decade to give it less weight than the other factors under consideration. The 2024 Rule seeks to make that factor more important going forward, but it is unlikely the courts will change their precedent and give more weight to that factor.

The Biden 2024 Rule, like the Trump 2021 Rule, is preceded by a recitation and discussion of court decisions under the FLSA. Not surprisingly, the two rules view the cases quite differently. The commentary to the Trump Rule was akin to a legal brief for business advocates to support independent contractor status, while the commentary accompanying the new 2024 Rule is in the nature of a legal brief to support employee advocates, focusing on a similar body of court decisions yet viewing them from a more pro-employee perspective.

Here are the details of the final regulation: six specific factors (which are the same as those set forth in the Proposed 2022 Rule) should be considered in determining the so-called “economic reality” of the parties’ relationship, which has, for decades, also been the general focus of the courts:

1. Opportunity for profit or loss depending on managerial skill.
2. Investments by the worker and the potential employer.
3. Degree of permanence of the work relationship.
4. Nature and degree of control over the performance of the work and the economic aspects of the working relationship.
5. Extent to which the work is an integral part of the potential employer’s business.
6. Skill and initiative of the worker.

The Biden 2024 Final Rule also adds a *seventh factor*: “Additional Factors,” which is described as any factors that “in some way indicate whether the worker is in business for themself[ves], as opposed to being economically dependent on the potential employer for work.”

After each of the six factors listed in the final regulation, there is a one paragraph description of how the Labor Department believes the courts should apply each factor. That is the where the new final regulation varies from the Trump regulation in 2021 because these brief descriptions in the 2024 Rule are tilted in favor of employee status. However, the six factors themselves are similar to those recited by many courts as key to whether workers are employees or independent contractors in view of the economic realities of the parties.

In sum, the Biden 2024 Rule is unlikely to do little more than formally undo the Trump 2021 Rule and restore a totality-of-the-circumstances approach to determining IC status. Its focus on six factors (and a catch-all of additional factors) is hardly controversial, although the description of how the courts should apply each factor favors employee status.

The Final 2024 Rule Makes Very Few Changes to the Proposed 2022 Rule

We published a [blog post](#) in the early fall of 2023 entitled “Spoiler Alert on Upcoming Labor Department Regulation on Independent Contractor Status,” where we predicted that the final regulation would contain “few if any meaningful changes from the proposed regulation despite the tens of thousands of comments.” A comparison of the final regulation with the proposed regulation shows only a handful of relatively minor changes. Most of the tweaks between the Proposed 2022 Rule and the Final 2024 Rule issued today actually tilt the worker classification test slightly more in favor of employee status. Those tweaks are the following:

- The first factor dealing with profit or loss previously focused on whether the worker *exercises* managerial skill that affects the worker’s economic success or failure in performing the work, whereas the Final Rule now focuses on whether the worker *has opportunities* for profit or loss based on managerial skill. This is slightly more IC-friendly.
- The second factor addressing investments by the worker and potential employer is now more employee-friendly by expressly stating that the “costs that the potential employer imposes *unilaterally* on the worker ... are not evidence of ... investment and indicate employee status.”
- The fourth factor relating to the nature and degree of control over the performance of the work and the economic aspects of the working relationship now states, in a more employee-friendly way, that actions taken by a potential employer to comply with a specific law must be the *sole reason* for such control and any actions by a potential employer that exceeds strict compliance with law may be indicative of control.
- The sixth factor governing skill and initiative includes an employee-friendly addition that specialized skills are not necessarily indicative of independent contractor status “because both employees and independent contractors may be skilled workers.”

Why the 2024 Final Rule Has Virtually No Legal Significance

In early January 2021 when the Trump Administration issued its regulation on independent contractor classification, we noted in our [blog post](#) that “the regulation...would be ‘much ado about (almost) nothing.’” We remarked that, “unlike most regulations with hard and fast rules, the regulation was in the nature of an administrative interpretation comprising the Labor Department’s review of existing court decisions and its articulation of a preferred legal analysis ... [that] courts would give little if any deference to.” The Biden Administration’s final 2024 regulation is no different.

Regulatory bodies do not have the final say on who qualifies as an independent contractor and who does not; courts do. *Regulations are not laws*. While courts typically give deference to valid regulations, that is not a given where regulations keep changing and where the regulation appears to be little more than an agency’s interpretation of prior court decisions on a particular subject. The federal courts already have a repository of decisions on the issue of a worker’s IC status under the FLSA – part of the body of law cited by the commentaries to the 2021 and 2024 Rules. Those prior decisions have precedential value; regulations interpreting those precedents add little other than simply providing a court the current view of the incumbent administration on the issue.

Another reason why the final IC rule will be limited in its application is because it pertains to only one statute: the FLSA. The test for independent contractor status under the FLSA is not the same as the IC classification test under the Internal Revenue Code, ERISA, or the National Labor Relations Act. And, of course, each state has its own set of laws governing IC status and they contain an array of different tests, only a handful of which use the

economic realities test under the FLSA.

The 2024 Rule on IC status (like the 2021 Rule) is also of limited import because the Labor Department is an enforcement agency, not a judicial body, and it only brings lawsuits in court and does not make legal determinations. Further, the Labor Department typically files only a modest number of independent contractor misclassification cases in court each year, and most of those cases tend to be “low-hanging fruit” – cases in which the defenses are weak – where a court decision would likely be the same under both the Trump 2021 Rule and the Biden Administration’s 2024 Rule.

Lastly, the 2024 Final Rule, which is to be effective March 11, 2024 – 60 days after issuance – may be subject to court challenge, as are many other regulations. But rather than simply hoping that business organizations will obtain an injunction, or that a new Administration will be elected in 2025 and then change back to a rule similar to the one issued in 2021, there are steps companies can take to minimize their concerns that their IC relationships are at risk.

Takeaway

Workers operating their own small businesses and companies that utilize them are likely to be perplexed by the back and forth and back again at the Labor Department from one administration to the next on the issue of independent contractor classification. Businesses should consider a two-step approach to minimize any legal challenge to their independent contractor relationships: (1) enhancing their compliance with federal and applicable state independent contractor laws to maximize independent contractor compliance in the event a state or federal workforce or tax agency conducts an audit; and (2) minimizing the likelihood of class actions alleging independent contractor misclassification by including in their IC agreements a state-of-the-art arbitration provision with a class and collective action waiver or upgrading their existing arbitration agreement in view of the many recent developments in this area of the law.

Structuring, documenting, and implementing independent contractor relationships in a manner consistent with applicable law can serve to minimize the risk of IC misclassification liability – regardless of any regulation issued by the U.S. Department of Labor. Companies should avoid quick fixes or one-size-fits-all approaches, which not only tend to be ill-fitting but often backfire by creating evidence that the company’s practices deviate from the language in its IC agreement. Instead, many businesses have created independent contractor relationships that are customized and sustainable using a process such as [IC Diagnostics™](#) to restructure, re-document, and/or re-implement their IC relationships consistent with their existing business model.

Companies should also ensure they have an effectively drafted arbitration clause in their IC agreements. As we have previously stated in a [blog post](#) on this subject, “[w]hether an arbitration agreement in an independent contractor or employment setting will bar a class action depends as much of the wording in the arbitration clause as the applicable law, which is in flux and continues to evolve.” Savvy companies periodically reexamine and update existing arbitration clauses used in independent contractor agreements.

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