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DOL PROPOSES RULE TO CLARIFY INDEPENDENT CONTRACTOR/ EMPLOYEE TEST

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On January 6, 2021, the Department of Labor ("DOL") announced a final rule aimed at trying to clarify the standard for determining whether someone is an "employee" or "independent contractor" under the Fair Labor Standards Act ("FLSA"). Absent any change in direction from the new Biden administration, the rule would go into effect on March 8, 2021 and would amend 29 CFR Chapter V by adding sections 795.100 through 795.110. In setting forth this new rule, the DOL aimed to provide less uncertainty in application of this test, especially in light of the novel issues raised by app-based, gig economy workers, among others. It is likely no coincidence that this new rule was promulgated on the heels of the passage of Proposition 22 in California, a ballot initiative that excepted app-based transportation and delivery companies from other laws that would have required these companies to classify their drivers as "employees" as opposed to "independent contractors."

Proper application of test is important because of the exposure for misclassification. Non-exempt "employees" under the FLSA are owed overtime wages while "independent contractors" are not. As was the case for these app-based ride-share companies, an employer's classification of employees or independent contractors could have significant legal ramifications, especially in the class-action context when "independent contractors" claim that they were misclassified as such and therefore are owed overtime wages that should have been paid to them as non-exempt employees under the FLSA.

With this final rule, the DOL set forth a multi-factor test that focuses largely on "economic dependence." If an individual is "economically dependent" on the employer for work, the individual is likely an employee. If the individual is in business for himself or herself, the individual is likely an independent contractor.

According to the DOL, this "economic dependence" test relies on the application of two factors:

1. The employer's nature and degree of control over the work. This factor focuses on the individual's exercise of substantial control over key aspects of the performance of the work, such as setting his or her own schedule, selecting his or her own projects, or having the ability to work for others.
2. The worker's opportunity for profit or loss based on initiative and / or investment. The Rule clarifies that there need not be an opportunity for profit or loss in both exercise of initiative and management of investment, for this factor to weigh one way or the other. Thus, the factor weighs toward the individual being an independent contractor to the extent the individual has opportunity for profit or loss based on either that individual's exercise of initiative or management of their investment in or capital expenditure on helpers, or material to further their work.

The DOL also identified several other factors, although these have less importance:

1. The amount of skill required for the work;
2. The degree of permanence of the working relationship between the individual and the employer; and
3. Whether the work is part of an integrated unit of production.

Ultimately however, the DOL would, in a way, recede from recommending rigid application of the test by concluding that the "actual practice of the parties involved is more relevant than what may be contractually or theoretically possible." This means that the factors explored above would, in real life, be weighed differently across different industries. For example, the authority to supervise or discipline an individual is of little relevance to a business that in practice rarely or never exercises such authority. Naturally, then, the factors would not be analyzed in a vacuum and an employer's actual practices should affect the weight given each factor determining an individual's economic dependence on an employer.

As a practical matter, it remains to be seen what the new Biden administration will do with this. It is possible the administration abandons the Rule entirely or limits its application. At the same time, challenges posed by technological advancements that allow for more worker flexibility – as well as demands from workers for increased flexibility in their own lives – may cause the Biden administration to keep this Rule in place. At this point, nothing is final, so we would recommend waiting to see what the new administration proposes before making any full-scale changes to how your business classifies its workers.