

Department of Labor New Rule - Classification of Employees and Independent Contractors

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This presentation is for informational purposes and does not contain or convey legal advice. The information herein should not be used or relied upon in regard to any particular facts or circumstances without first consulting a lawyer.

The image features a central white horizontal band. Above and below this band are abstract, layered blue shapes in various shades of cyan and blue, creating a sense of depth and movement. The text 'Background Information' is centered within the white band.

Background Information

Timeline of Rules

- January 2021: DOL published final rule on the classification of employees and independent contractors.
- March 2021: Rule delayed under the Biden administration, and then withdrawn in May 2021.
- March 2022: Texas federal court stopped the delay and withdrawal, and reinstated the 2021 Rule, effective March 2021.
- June 2022: DOL announced plans to propose a new rule to replace the 2021 Rule.
- October 2022: DOL publishes proposed rule.
- January 2024: DOL published final rule that creates multi-factor test, rescinding the Trump Rule.

Why the Rule Matters

- Under the Fair Labor Standards Act (FLSA), **employees are entitled to minimum wage, overtime pay and other employment benefits.** Other federal and state laws provide additional benefits to employees, including protections against discrimination and collective bargaining.
- **Independent contractors are not entitled to these benefits,** but they generally have more flexibility to set their own schedules and work for multiple companies at one time.
- Under this new and stricter standard, businesses may be responsible for providing these employment benefits to individuals previously classified as independent contractors.

2021 Rule

Factors for Determining IC Status

- The 2021 Rule included a five-factor test.
- Two factors were prioritized:
 - The nature and degree of the individual's control over their work
 - The individual's opportunity for profit or loss
- If those two factors did not clearly indicate the proper classification, three additional factors were considered:
 - The amount of skill required
 - The degree of permanence of the working relationship
 - Whether the work was part of an integrated unit of production

2024 Rule

- 2021 Rule is rescinded and replaced by the new rule, effective March 11, 2024.
- 2024 Rule likely makes it harder to classify workers as independent contractors rather than employees.

Factors for Determining IC Status

- Six-factor test focused on the *economic realities* of the relationship between a worker and a potential employer.
- Equal weight is given to each factor, and no one factor is determinative and not all factors need be met.
- The six factors are not exhaustive, - additional factors may be considered if appropriate.

Economic Reality Test - Key Inquiry

Is individual *economically dependent* on the business to which he/she provides services, or is he/she in business for him or herself.

- An **employee** is generally dependent on the employer's business.
- An **independent contractor** is generally engaged in a business of their own and not beholden to a single company for all of his income/business.

Factor 1

Opportunity for Profit or Loss Depending on *Managerial Skill*

- Facts in favor of independent contractor:
 - ability to negotiate the compensation for the work performed.
 - able to accept or decline work and determine the schedule of performance.
 - markets or advertises for work
 - authority to purchase equipment/materials and secure workspace.
- If no profit or loss opportunity, this will weigh in favor of an employment relationship.
- Ability to earn more pay by working more hours or taking more jobs when paid at a fixed amount is not necessarily evidence of managerial skill/independent contractor status.

Factor 2

Investments by the Worker and the Potential Employer

- Investments by a worker to expand their work/increase their market presence → independent contractor (“capital or entrepreneurial” and serve a business-like function).
- Costs “unilaterally imposed” on a worker by a potential employer are not evidence of “capital or entrepreneurial investment” and generally indicate employee status.
- Companies should evaluate the scope of worker investments on a relative basis to determine if the investments are similar to those of the company even if smaller in scale - indicates operational independence and a contractor relationship.

Factor 3

Degree of Permanence of the Work Relationship

- If relationship is “definite in duration, nonexclusive, project-based, or sporadic” due to the worker having own business/ performing work for other parties – more likely to be independent contractor.
- If nature of the work is “indefinite in duration, continuous, or exclusive of work for other employers” – more likely to be employee.
- BUT, if lack of permanence of work relationship is due to industry-specific or operational reasons, this is not necessarily determinative of independent contractor status, unless it is in conjunction with the worker exercising their own independent business initiative.

Factor 4 - Nature and Degree of Control

- Independent contractor has more control over
 - their own schedule
 - the work performed,
 - flexibility to work for other parties.
- In an employment relationship, the employer determines
 - the worker's schedule
 - manages the work being performed, or
 - explicitly restricts the worker's ability to perform work for other parties.
- Employer's compliance with legal requirements, is not indicative of control, but some things may indicate more control over the worker.
 - actions beyond general compliance with applicable regulations
 - compliance with internal policies, to maintain safety or quality control, or to satisfy service levels or.

Factor 5 - Extent to Which Work Performed is an Integral Part of the Employer's Business

- An independent contractor has an independent business that would exist with or without a single employer.
- Work performed is “critical, necessary, or central to the potential employer’s principal business” and the work depends on the existence of the employer’s business.
- ***Integral: Is the potential employer unable to function without the service performed by the workers?***

Factor 6 - Skill and Initiative

- If person uses “specialized skills in connection with business-like initiative” more likely to be contractor.
- If worker depends on training from the potential employer to perform their work and does not bring any specialized skills – more likely to be employee.
- Specialized skills alone not enough since both employees and contractors can be skilled workers.

Key Takeaways

- **Opportunity for Profit/Loss**

- If workers do not have the opportunity for profit, it is likely an employment relationship.

- **Investments by the Worker**

- investments in their own equipment vs. reliance on company

- **Integral Part of the Business**

- Workers in the pyrotechnics industry perform functions that are “critical, necessary, or central to the potential employer’s principal business” -this factor could weigh in favor of an employment relationship.

Key Takeaways for the Industry

- Consider **proactively reviewing how workers** prior to the effective date of the Final Rule on **March 11, 2024 or soon thereafter**.
- Businesses that use **franchising, subcontracting, and staffing firms** should pay particular attention - they may face greater regulatory scrutiny and legal exposure under the DOL's Final Rule.

Why does this matter? **Liability under FLSA**

- minimum wage and overtime **back pay**
- **liquidated damages,**
- **attorneys' fees- private actions and class actions**
- **court orders**
- **civil penalties - \$1100 per violation (per employee!)**
- **criminal penalties – \$10,000 per violation/six months for second offense**

Other Agencies/Other Tests

Various Tests for Contractor Status

- Different agencies use different tests!
- Each test differs in the factors used and how such factors are weighted, there is the possibility that a **worker may be deemed an employee under one or more tests and a contractor under another.**
- Companies should be consistent with classification as treatment of a worker as an employee under one test, may trigger employee status under another test.

Internal Revenue Service (IRS)

- The IRS generally uses common law
 - 20 factors in deciding whether an individual is an independent contractor or an employee.
<https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee>
- These factors fall into three main categories:
 - Behavioral Control
 - Financial Control
 - Relationship of the Parties

Occupational Safety and Health Administration (OSHA)

- OSHA regulations do not generally protect independent contractors working for someone who is not their employer.
- In practice, OSHA defers to the DOL rule/standard for classifying employees and independent contractors.

National Labor Relations Board (NLRB)

- In 2019 - NLRB broadened the standard for classification as an independent - with a specific focus on the amount of entrepreneurial opportunity for economic gain and control over the individual's work.
- In 2022, the NLRB also announced that it would review and consider replacing the existing standard for determining who is an independent contractor.

State Tests for Contractor Status

- Federal rule likely to be baseline for who is considered an employee, even under state law.
- States are not preempted by using a standard that classifies individuals as employees who might be contractors under federal law.
- Some states have also started providing employment benefits to independent contractors, which could be impacted by a new federal standard.
- California ABC test – must meet all three to be a contractor.

Conclusion

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