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Employment and Labor Insight: U.S. Department of Labor Publishes Final Rule Revising its “Economic Realities” Test for Independent Contractors

Insights
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The U.S. Department of Labor (DOL) published on January 10, 2024, its final rule revising its “economic realities” test for determining whether workers are employees or independent contractors under the Fair Labor Standards Act (FLSA). The new test takes effect **March 11, 2024**, and uses a multifactor, totality of the circumstances analysis that appears to narrow the definition of “independent contractor.” This change is poised to significantly impact employers relying on freelancers, consultants, contractors, and other gig-based services.

Upcoming Changes

The DOL is updating its approach for classifying workers by replacing its 2021 “economic realities” test with a new version effective March 11, 2024. This revised test weighs six factors equally to more comprehensively assess whether a worker is an employee or an independent contractor, moving away from the prior model that focused mainly on profit opportunities and employer control. These six factors include:

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 worker;

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

6. worker's skill and initiative.

According to the final rule guidance, the DOL will take an expansive approach to each factor. For example, when analyzing the "nature and degree of control" and "investments by the worker" factors, the DOL will focus on how scheduling, supervision, and price-setting are determined, and whether the worker's investment is entrepreneurial or capital in nature. The final rule guidance states the above six factors are not exclusive and allows for additional factors to be considered, if relevant to the worker's level of economic dependence.

By most accounts, the DOL's revised test will narrow the definition of "independent contractor" and result in more workers being classified as employees.

Why does this matter?

The FLSA requires employers to provide certain benefits, such as minimum wage and overtime pay, for employees but not for independent contractors. By narrowing the definition of "independent contractor," the DOL's new rule may increase the cost of doing business, and amplify the risk of worker misclassification. Such misclassification can result in individual and collective lawsuits against employers for backpay, interest, liquidated damages, and attorneys' fees, as well as civil penalties.

Legal Challenges

The DOL's final rule is already being challenged in court by employer groups seeking to block the rule from taking effect. While it is unclear if they will succeed, employers cannot afford to sit back and wait.

Important Next Steps

We recommend employers with independent contractors take the following proactive steps:

- Identify workers currently classified as independent contractors.
- Evaluate your current classification of gig workers, freelancers, consultants, and contractors.

- Review workplace policies, practices, and procedures to assess whether any workers currently classified as independent contractors may now look more like employees under the DOL's new test.
- Update contractor and consulting agreements with the new DOL framework.
- Update workplace policies and procedures to ensure independent contractors are not treated as employees.
- Train managers and talent acquisition teams on the difference between employees and independent contractors under the DOL's test and any relevant state laws.
- Consult with your Gunderson attorney to navigate these changes effectively and ensure compliance with the new regulations.

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