

HR Insights

The Business Implications of the DOL's New Independent Contractor Rule

On Jan. 9, 2024, the U.S. Department of Labor (DOL) released a [final rule](#), effective March 11, 2024, revising the agency's guidance on how to analyze who is an employee or independent contractor under the Fair Labor Standards Act (FLSA). This final rule rescinds the current independent contractor rule that was published on Jan. 7, 2021. If this rule becomes effective, it may result in classifying a greater number of workers as employees—not independent contractors. This change would be significant, particularly in the gig economy, as it would afford more individuals rights and protections under the FLSA.

It's critical that employers understand the new rule and its potential impacts on their businesses as the final independent contractor rule could significantly affect employers' operational and compliance costs as well as increase their litigation risks. Although the final rule will not impose any new requirements on employers until it becomes effective, employers should familiarize themselves with the rule and evaluate what changes they may need to implement.

This article provides an overview of the DOL's new independent contractor rule and outlines how this rule may impact businesses. Due to the significant impact this new rule may have on organizations, employers should consult with their legal counsel to address any specific questions or concerns.

Overview of the DOL's New Independent Contractor Rule

Under the FLSA, employees are entitled to minimum wage, overtime pay and other benefits. Independent contractors are not entitled to these protections and benefits. Misclassifying workers as independent contractors can have serious financial and legal consequences for employers, including costly litigation, penalties and attorney fees.

The final rule rescinds the 2021 Independent Contractor Rule and returns to the pre-2021 rule precedent. In doing so, the final rule restores the multifactor, totality-of-the-circumstances analysis to assess whether a worker is an employee or an independent contractor under the FLSA. The final rule ensures that all economic realities test (ERT) factors are analyzed equally without assigning a predetermined weight to a particular factor or set of factors. These six factors include:

- The opportunity for profit or loss depending on managerial skill
- Investments by the worker and the potential employer
- The degree of permanence of the work relationship
- The nature and degree of control
- The extent to which the work performed is an integral part of the potential employer's business
- The worker's skill and initiative

In addition to focusing on the six ERT factors, the new rule allows additional factors to be considered if they are relevant to the overall question of economic dependence. According to the DOL, this final rule will reduce the risk of employees being misclassified as independent contractors while providing a consistent approach for businesses that engage with individuals who are in business for themselves.

It's likely that the DOL's new independent contractor rule will be challenged in court. This could delay the final rule's implementation. There's currently a lawsuit pending over the Biden administration's attempt to withdraw the 2021 Independent Contractor Rule in May 2021. In that case, a federal court concluded that the Biden administration violated federal law in rescinding the regulation and reinstated the 2021 rule. This lawsuit has been delayed for months while the DOL prepared its new rule. The case will now likely restart since the agency released the final rule.

The New Rule's Potential Impact on Employers

The 2021 Independent Contractor Rule made it easier for employers to classify workers as independent contractors under the FLSA. This rule focused on two core factors: the nature and degree of the worker's control over the work and the worker's opportunity for profit and loss based on initiative and/or investment. These factors carried more weight in determining the status of independent contractors than the three other ERT factors (the amount of skill required for the work, the degree of permanence of the working relationship and whether the work is part of an integrated unit of production). However, the DOL's new rule will likely make it more difficult for employers to classify workers as independent contractors by reinstating the complex multifactor and totality-of-the-circumstances analysis, which is generally viewed as more employee-friendly. As a result, the new rule will likely lead to more employees being classified as employees.

The DOL's final rule will likely significantly increase the risk of employee misclassification for employers. Consequently, employers may face increased liability risks, such as class action lawsuits or administrative actions, for not providing FLSA-required benefits and protections to workers. This will likely impact small businesses more than larger organizations because they generally do not have the resources or necessary staffing to address complex compliance issues, such as employee classification under the FLSA.

Classifying more workers as employees under the FLSA will likely have major implications for the gig economy. Gig workers (e.g., delivery drivers) are typically classified as independent contractors. If these workers are reclassified as employees under the DOL's new rule, industries that rely on these workers, such as construction, transportation and media, will likely be impacted more than others. This could result in businesses being less likely to hire or rely on gig workers.

Preparing for the DOL's New Rule

Although the DOL's final rule does not impose any new requirements on employers until it becomes effective, employers should become familiar with the final rule and evaluate what changes they may need to adopt if the rule becomes effective. Employers can prepare for the DOL's new independent contractor rule by ensuring that they comply with all employee classification requirements under the FLSA. This is especially important for organizations that rely on independent contractors. While the final rule imposes a different standard than the 2021 rule, most employers are likely already familiar with the new rule, as it mirrors an earlier standard that existed before the 2021 rule.

Employers can better ensure compliance with the DOL's final rule by taking the following actions:

- Audit existing working relationships with gig workers, freelancers, independent contractors and employees.
- Determine whether any workers' classification must be changed in light of the final rule.
- Review any agreements with gig workers, freelancers, independent contractors and employees to ensure they comply with the final rule.
- Update employment policies and procedures to align with the DOL's final rule.
- Train managers on the FLSA's worker classification requirements.

While the DOL's final rule only applies to the FLSA, many states have their own rules for determining worker classification. To avoid potential violations and penalties, employers need to be familiar with all laws that apply to their organizations. Employers are encouraged to seek legal counsel to discuss specific issues and concerns related to employee classification requirements.

Summary

If the DOL's final rule becomes effective, it will significantly impact most employers. Savvy employers will take the time to revisit their worker classifications and understand the final rule's potential impact on their organizations. By taking a proactive approach and reassessing worker classification, employers can help ensure they meet any compliance requirements and mitigate any potential legal risks.

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