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New Department of Labor Proposed Rule Makes It Easier to Classify Workers as Independent Contractors under the Fair Labor Standards Act

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On Tuesday, September 22, the United States Department of Labor's Wage and Hour Division announced a proposed rule that clarifies whether a worker is an employee or an independent contractor under the Fair Labor Standards Act (FLSA).

The proposed rule adds a new Part 795 to the Code of Federal Regulations. Employees are subject to the FLSA's minimum wage and overtime protections, whereas independent contractors are not. In the past, courts across the nation have implemented varying multifactor tests to determine whether workers are employees or independent contractors. These tests can be unwieldy and make it challenging for companies to predict outcomes. The Department of Labor's proposed rule clarifies that the department will use the “economic reality test,” and it identifies two core factors and three guideposts that make up the test. The economic reality test is more business-friendly and makes it easier for employers to classify workers as independent contractors.

The Economic Reality Test

The “economic reality test” is a test to determine whether a worker is economically dependent on a company for work or if the worker is in business for him or herself. If the worker is economically dependent, the worker is an employee. If the worker is in business for him or herself, the worker is an independent contractor. The proposed rule identifies two “core factors” that should be considered when deciding whether a worker is economically dependent:

- **The nature and degree of the worker's control over the work.** To the extent the worker exercises substantial control over the performance of the work, including setting work hours and selecting work projects, this factor weighs in favor of the worker being an independent contractor. To the extent the putative employer exercises substantial control over the performance of the work, including controlling work hours, workload, and requiring exclusivity, this factor weighs toward the worker being an employee.

- **The worker's opportunity for profit or loss based on initiative and/or investment.** To the extent a worker has an opportunity to earn more or less profit based on the worker's own investment in the business or initiative (for example, business acumen or skill), the factor weighs toward independent contractor status. To the extent a worker's profit or loss is based on the worker's ability to work more efficiently or the putative employer giving the employee more or less hours, this factor favors classification of the worker as an employee.

If these factors do not point in the same direction, there are three other considerations that are still relevant "guideposts": (1) the amount of skill required for the work; (2) the degree of permanence of the working relationship between the worker and the potential employer; and (3) whether the work is part of an integrated unit of production. Finally, the proposed rule advises that the actual practice of the parties is more relevant than what may be contractually or theoretically possible.

What if a State Has a Law Adopting a Different Test?

Some states have passed laws that make it challenging to classify a worker as an independent contractor. For example, under Colorado law, a worker is presumptively an employee unless: (1) the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; and (2) the worker is customarily engaged in an independently established trade, occupation, profession or business of the same nature as that involved in the work performed. If you are in a state like Colorado that has a law providing workers with more protection than the Department of Labor's proposed rule, you must follow state law.

Companies that are in states providing workers with less protection than the Department of Labor's proposed rule will need to comply with the final version of the federal regulation.

"Safe Harbor" Defense

Employers may rely on Part 795 as a "safe harbor" defense to liability and liquidated damages under the FLSA.

What Happens Next

- We expect that the proposed rule will be published in the Federal Register in the next couple of weeks. At that point, the proposed rule will be available for review and public comment for thirty days. The Department of Labor will then review the comments and issue a final rule.
- Stay tuned for updates regarding the final rule.

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