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EMPLOYMENT LAW

Independent Contractor vs. Employee: Rules Changes on Deck

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More than occasionally, our posts veer off the usual path for a nonprofit law blog; that is, federal tax-exemption law.

These side trips, though, are decidedly not casual or unimportant: Nonprofit organizations may be subject to a wide array of complex rules and regulations as well as the government oversight that goes along with them. Over the years, we've often landed in the dense thicket of employment law which may apply if an organization pays even a single person just a bit for this or that.

Anti-discrimination and harassment laws, worker health and safety mandates, employment-contract best practices and unlawful policies and procedures, wrongful terminations, and union-organizing rights and restrictions are just a few of the potential trip wires and traps for the unwary.

Then there's the deep and dark rabbit hole of the federal Fair Labor Standards Act (FLSA); particularly: (a) the worker classification rules and (b) the wage and hour requirements. Each is tough to understand, much less navigate successfully.

But soon U.S. employers – including nonprofits! – will face substantially revised regulations in *both* categories. The first new regulation's effective date is March 11, 2024. The government's work on the second is expected to be completed before the end of April.

These two new rules – together – will almost certainly result in a large financial hit for many organizations. Simply put, there will soon be far more workers reclassified out of "independent contractor" and into "employee" status, and a much larger percentage of those old (and new!) "employees" will qualify for overtime if they work extra hours.

Buckle up.

Imminent Overtime-Rule Changes

A few months ago, in *New Overtime Rules May Affect Nonprofits* (October 2, 2023) and *More on the Proposed Overtime Regulations* (October 5, 2023) we alerted you that "…as soon as early 2024, there could be a seismic shift in federally mandated worker compensation …. " That's because, under proposed Department of Labor regulations "… implementing the landmark Fair Labor Standard Act of 1938, U.S. employers across the board could be required to pay overtime for many more workers than under existing rules."

The designated public-comment period was extended several times until February 15, 2024. As expected, the DOL has been receiving quite an earful pro and con. Recently, officials announced they will be ready, in any event, to publish the final regulation by about the end of April. The effective date will likely be soon afterward.

It's not a question of *whether* more workers will be eligible for overtime if they clock in extra hours; there *will be* significant numbers of employees reclassified correctly (as they should have been all along) as hourly, non-managerial workers. The open question is how *high* the federal government will raise the compensation cutoff for determining who is a salaried (i.e., managerial-type) worker not entitled to overtime. The higher the cut-off, the more people in an organization will be overtime-eligible.

There's an important caveat, though, for nonprofits in certain jurisdictions including California. The new federal rule will make little or no difference because of prior state-level upward adjustments of the overtime compensation-cutoff level for workers in their jurisdictions.

However, in the remaining states that have not revised their formulas higher, nonprofit experts urge organizations there to prepare for "the eventuality of higher thresholds going into effect 'at some point in 2024.'" See *Don't Panic (Yet): What Your Nonprofit Needs to Know About the (Latest) New FLSA Overtime Rule* (Updated: September 2, 2023), 8 pp. PDF, *ncnonprofits.org*. "Nonprofit organizations 'will likely need to make adjustments to the pay and work plans for affected employees. These range from: raising salaries above the new threshold (estimated to end up somewhere between $55,000 and $60,000)'; reclassifying employees as non-exempt and assuming the expense of overtime pay, or adopting one of "more than a dozen other options laid out in this analysis."

That booklet from last September has eight bullet points of advice. The final one from the North Carolina Center for Nonprofits is: "Panic! (But only do this if you are reading this article for the first time after the final rule has been published and taken effect!)"

There are still several weeks before the new overtime final regulations are published and go into effect, but – fair warning – there *will be* significant changes that will cost employers much more money. Many more workers will be eligible for overtime pay than before.

Worker Classification Changes

On January 10, 2024, the plot thickened.

The United States Department of Labor published a new final regulation on employee vs. independent contractor status, with an effective date of March 11, 2024.

This new rule arises – like those overtime-pay changes coming down the lane shortly – under the landmark federal Fair Labor Standards Act of 1938. Enacted late in the Depression Era, this statute was a hallmark of the New Deal, offering multi-faceted protections and benefits to workers, including (affirming) the right to form unions.

Congress, however, provided little guidance: For example, the FLSA defines "employee" as "any individual employed by an employer"; further, that "employ" is defined as including "to suffer or permit to work."

The FLSA does not define "independent contractor" at all.

Many statutes are fairly sketchy affairs, leaving out important details needed to understand and implement them. The administrative agency charged with enforcing the law is given authority to work out and decide these particulars, following a carefully prescribed and uniform administrative regulatory process that ends in publication of formal regulations.

For many decades, the DOL could have drafted and published final regulations defining "independent contractor" or refining the fuzzy definition of "employee." . But none of that happened.

Over the years, though, the federal courts have filled in this gap, holding that "under the FLSA, the question is whether, as a matter of economic reality, the worker is economically dependent on the employer for work (and is thus an employee) or is in business for themself (and is thus an independent contractor)."

"There is no single rule for determining" this issue. Instead, the analysis involves a look at "…the facts of a situation, rather than assuming that a written label, contractual arrangement, or form of business decides if a worker is economically dependent on an employer."

The federal courts as well as the Department of Labor have, in "assessing economic dependence…historically analyzed the circumstances of the employment relationship, considering multiple factors to analyze whether a worker is an employee or an independent contractor, with no factor or factors having predetermined weight."

Reversing Course – and Back Again

On its way out the door, on January 7, 2021, the prior Administration published a new rule, "Independent Contractor Status Under the Fair Labor Standards Act," effective March 8, 2021. The rationale: "The U.S. Department of Labor … is revising its interpretation of independent contractor status under the Fair Labor Standards Act … to promote certainty for stakeholders, reduce litigation, and encourage innovation in the economy."

The Biden Administration acted quickly to prevent this "2021 Independent Contractor Rule" from taking effect. There followed a period of uncertainty as opponents of the new Administration's action – primarily business groups and freelancers – pursued legal challenges. Eventually, the

Administration decided to nullify the 2021 rule (published, but never having gone into effect), and start over through the standard process of drafting and publishing new regulations.

In the January 10, 2024, *Frequently Asked Questions*, the DOL explains: Q: "Why is the Department replacing the guidance it issued in the 2021 Independent Contractor Rule?" A: "The Department believes that the 2021 Independent Contractor Rule does not fully comport with the text and purpose of the FLSA as interpreted by courts. Specifically, … [it] includes provisions that are in tension with longstanding case law and the Department's prior guidance on independent contractor status,…."

Disapproval by the current executive branch of the 2021 Rule most particularly is because of "…its designation of two "core factors"—control and opportunity for profit or loss—which are given a greater predetermined weight in the analysis…."

The Biden DOL further explained why leaving the 2021 Rule in place would be problematical: It "…would have a confusing and disruptive effect on workers and businesses alike due to its departure from decades of case law describing and applying the multifactor economic reality test as a totality-of-the-circumstances test."

The bottom line under this new rule, scheduled to take effect on March 11th, is a certainty that *many* workers will be reclassified *out* of "independent contractor" status and into the "employee" category. That change has many ripple effects, one of which happens to be that more workers – newly classified as "employees" – will get overtime and other worker protections and benefits.

Helpful Official Publications

The primary documents published by the Department of Labor in connection with announcement of the new regulation are a helpful first-step in generally understanding what's about to happen. See:

- *US Department of Labor Announces Final Rule on Classifying Workers as Employees or independent Contractors Under the Fair Labor Standards Act* (January 9, 2024) *News Release*, *dol.gov*
- *Final Rule: Employee or Independent Contractor Classification Under the Fair Labor Standards Act, RIN 1235-AA43* (January 10, 2024) U.S. Department of Labor, *dol.gov*
- *Frequently Asked Questions – Final Rule: Employee or Independent Contractor Classification Under the FLSA*, (January 10, 2024), U.S. Department of Labor, *dol.gov*
- *Small Entity Compliance Guide* (January 10, 2024) U.S. Department of Labor, *dol.gov*. "A guide to assist small businesses to comply with the final rule, including an overview of the rule, the six factors of the economic reality test, common questions, and additional resources."]

Conclusion

There's much more to explain about this tricky "independent contractor" vs. "employee" regulation. And while the executive branch is done tinkering around with this long-overdue change (that it believes furthers the pro-worker legislative intent of the New Deal Congress), this March 11th effective date may not be the end of the story.

First, there's the complicating twist of state labor rules that don't necessarily coincide exactly with these new (i.e., readopted) federal definitions and tests. Most notable is California's worker-classification scheme. Assembly Bill (AB) 5 – enacted just before the pandemic – includes the strictest independent-contractor tests in the nation; much tougher than the new/reinstated federal standard. AB 5 was, and continues to be, controversial, but it has survived legal challenges. It remains, though, a formidable chunk of law to understand and apply.

Second, there are already legal challenges in the wings to the new federal worker-classification regulation. These lawsuits could cause delays in the effective date or nullify the rule.

Third, there's one more bombshell that may come out of the U.S. Supreme Court in the next months, the result of which could put in doubt the validity of this and all other federal regulations. It's a challenge to the so-called "Chevron Deference" practice. See *Supreme Court likely to discard Chevron* (January 17, 2024) Amy Howe, SCOTUS Blog, *scotusblog.com.* In a year marked by nerve-wracking court-watching, this is a very big deal indeed.

Next time, we'll dive further into both of these labor-law tsunamis about to hit.

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