FEDERAL JUDGE STRIKES DOWN DEPARTMENT OF LABOR JOINT EMPLOYER RULE

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Labor, Employment, and Workplace Safety Alert

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On September 8, 2020, Judge Gregory Woods of the U.S. District Court for the Southern District of New York struck down the heart of the U.S. Department of Labor's (DOL) final rule revising DOL regulations on joint employer status under the Fair Labor Standards Act (FLSA).[1]

The final rule (available here) narrowed the test for "vertical" joint employment under the FLSA by adopting a four-part balancing test to determine whether another entity that simultaneously benefits from an employee's work is a joint employer (for example, a staffing agency or franchisor). The DOL's test focused on the entity's degree of control over the employee by assessing the ability to hire and fire, the right to supervise the employee's work schedule, authority over the employee's pay, and maintenance of employment records.[2] This was a significant departure from the DOL's prior test for vertical joint employment, which looked holistically at the relationship to determine whether the economic realities show that the employee is economically dependent on the potential joint employer.[3]

After the issuance of the final rule in January 2020, a coalition of 17 states and the District of Columbia immediately challenged the final rule under the Administrative Procedure Act (APA). With his ruling, Judge Woods sided with the coalition, vacating the revised standard for vertical joint employer liability because it "conflicts with the FLSA" and is arbitrary and capricious. The final rule did not substantively change the test for "horizontal" joint employment, and the ruling left that test intact.[4]

THE FINAL RULE FAILS ON TWO GROUNDS

Judge Woods held that the final rule violates the APA on two grounds.

First, the final rule conflicts with the FLSA because it improperly relies on the FLSA definition of "employer" as the sole textual basis for determining joint employer status. This approach contradicts the FLSA's plain text, prior DOL interpretations of the FLSA, and relevant case law from the Supreme Court and lower courts.

The FLSA defines "employer" to "include any person acting directly or indirectly in the interest of an employer in relation to an employee." 29 U.S.C. §203(d). Judge Woods found that DOL's singular focus on this definition to set the joint employer test ignored the circularity of that definition and the interconnectedness of the FLSA's definitions of "employer," "employee," and, most importantly, "employ." The FLSA's definition of "employ" is central to the joint employer inquiry, he explained, as the term's "'suffer or permit to work' standard gives 'substance and enormous breadth' to the otherwise unhelpful definitions."

Judge Woods concluded that the DOL's use of the FLSA definition of "employer" to narrow the joint employer test ignores the well-established principle that the FLSA's terms must be interpreted expansively to effectuate the

FLSA's broad remedial purpose. He explained that this purpose is achieved by defining the joint employment relationship based on the economic dependence of the worker, not restricting it to a four-part test based entirely on control.

Second, the final rule is arbitrary and capricious because the DOL did not explain why it departed from its prior interpretations of joint employer status or why the final rule conflicts with the joint employment regulations under the Migrant and Seasonal Agricultural Workers Protection Act. The final rule is also arbitrary and capricious because DOL failed to adequately consider the final rule's cost to workers.

While Judge Woods acknowledged that the DOL's justifications for implementing the final rule to promote uniformity and provide clarity were valid, he explained that the DOL "must do better than this." Any future rulemaking, he cautioned, must adhere to the text of the FLSA and Supreme Court precedent, must include an explanation for departing from the DOL's prior interpretation, and must consider important costs and explain why the benefits of the new rule outweigh those cost.

NEXT STEPS

The government has not yet announced whether it will appeal the ruling. However, a group of trade associations intervened in the district court case and may advocate for the government to challenge the ruling.

In the meantime, businesses should evaluate their current arrangements and work with counsel to identify and mitigate potential joint employment risks (especially in the context of franchises, staffing agencies, and subcontractors) because a joint employer can be liable for the proper payment of an employee's wages under the FLSA.

It is important to note that Judge Woods' ruling only impacts the DOL's final rule on vertical joint employment under the FLSA. It does not impact the National Labor Relations Board's (NLRB) similar control-based rule that went into effect in April 2020, or the Equal Employment Opportunity Commission's anticipated rule.[5] This ruling could, however, embolden opponents of those rules and lead to additional lawsuits in the future.

K&L Gates is closely monitoring developments and is poised to advise clients on matters impacted by this ruling.

FOOTNOTES

[1] The case is State of *New York et al. v. Eugene Scalia et al.*, No. 1:20-cv-01689 (S.D.N.Y. Sept. 8, 2020).

[2] *See* Kathleen D. Parker, Amy L. Groff, and Jonathan R. Vaitl, *Department of Labor Issues Final Rule to Clarify Joint Employer Standard*, K&L GATES (Jan. 17, 2020), available here.

[3] Additional information on the DOL's "economic realities" test for vertical joint employment is available here. *See* Amy L. Groff and Brianne Bridegum, *Department of Labor Announces Broad Interpretation of Joint Employment*, K&L GATES (Feb. 12, 2016).

[4] "Horizontal joint employment" occurs when two or more employers employ an individual for different sets of hours in a workweek. Additional information on horizontal joint employment is available here. See Amy L. Groff and Brianne Bridegum, *Department of Labor Announces Broad Interpretation of Joint Employment*, K&L GATES (Feb. 12, 2016).

5 Additional information on the NLRB's joint employer rule is available here. *See* Sang-yul Lee, Amy L. Groff, Melanie Stratton Lopez, and Kathleen D. Parker, *The National Labor Relations Board Issues Second in Trio of Agency Rules to Clarify its Joint Employer Standard*, K&L GATES (Mar. 2, 2020).

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