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Federal Judge Blocks Significant Portions of DOL's Joint Employer Rule

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On September 8, 2020, Federal District Court Judge Gregory Woods struck down critical parts of the U.S. Department of Labor's (DOL) new joint employer rule, which took effect in March of this year and which was intended to narrow the scope of joint employer liability under the Fair Labor Standards Act (FLSA).

Among other things, Judge Woods found that the DOL's interpretation of the circumstances under which two separate entities can or should be considered "joint employers" for FLSA purposes did not comport with the broad definitions and remedial purposes of the Act itself. He also found that the DOL failed to justify its significant departure from its prior DOL interpretations, and the rule was therefore "arbitrary and capricious" in violation of the Administrative Procedure Act.

The September 8 ruling by Judge Woods is subject to further review, and the DOL has said that it is weighing its options. In the meantime, employers will have to wait, once again, for definitive guidance regarding joint employment under the FLSA.

Background

Traditionally, one entity may be deemed a "joint employer" of another entity's employee under the FLSA if it exerts a certain degree of control over the other entity's employee. By way of illustration, this scenario may play out in the context of a business that contracts with a staffing agency for manpower. Whether a business is considered a "joint employer" for the purposes of the FLSA has significant consequences in terms of a business's FLSA compliance obligations and potential liability for federal wage and hour law violations.

Obama-Era Guidance

In 2016, the DOL departed from the traditional test, announcing a new, significantly broader standard for evaluating joint employer status under the FLSA. In its Administrator's Interpretation No. 2016-1, subtitled "Joint employment under the Fair Labor Standards Act and Migrant and Seasonal Agricultural Worker Protection Act," ("AI 2016-1") the agency outlined an analytical framework that would make it far more difficult for employers to avoid joint employment liability. Under this framework, employment arrangements are categorized as either "horizontal" or "vertical" joint employment.

"Horizontal joint employment" involves two companies that are *related* in some way, but are distinct economic units. In this scenario, the following factors are relevant to the "joint employer" analysis: common ownership; overlapping officers, directors, executives, or managers; common control over operations; centralized administrative functions; supervision of one employer by the other; shared supervisory authority over employee; shared clients; agreements between employers.

"Vertical joint employment" involves two *unrelated* employers who agree that an employee of one company will perform services that benefit another company. The factors considered in the context of "vertical joint employment" are focused on the "economic realities" of the relationship. Employers were particularly troubled by the test's potential to reach employment agreements that would not likely have been considered joint employment under former guidance. The factors considered include: direction, control, or supervision of the employee's work beyond reasonable oversight; an employer's influence over the other employer's employment decisions; length of the relationship between employers; whether the nature of the employee's work was rote, repetitive, and unskilled; whether the employee's work was integral to the putative joint employer's business; whether the employee works on premises owned by the putative joint employer; whether the putative joint employer provides tools or materials to the employees.

Although the AI 2016-1 does not carry the same legal weight in the courts as a regulation that had been the subject of full public vetting via notice-and-comment rulemaking, it signaled a significant, and alarming, departure in the DOL joint employment enforcement policy.

DOL's New Rule

To employers' relief, AI 2016-1 was upended earlier this year when the DOL enacted its long awaited new "joint employer" rule. The DOL's new rule set forth a four-factor balancing test for determining "joint employer" status under the FLSA, which addresses whether the putative joint employer: (1) hires or fires the employee; (2) supervises and controls the employee's work schedule or conditions of employment to a substantial degree; (3) determines the employee's rate and method of payment; and (4) maintains the employee's employment records. No one factor is dispositive and the weight of any individual factor depends on the facts of each case. This new rule was a significant departure

from AI 2016-1, assuring employers that so long as they did not actually exercise one or more of these control factors, they would not face joint employer liability under the FLSA.

Challenges to DOL's Joint Employment Rule

The DOL's joint employment rule came under attack by a group of 17 states and the District of Columbia, which sued in the Southern District of New York to block the DOL from enforcing the rule. [1] Leading business groups including the International Franchise Association, the Chamber of Commerce of the United States of America, HR Policy Association, the National Retail Federation, Associated Builders and Contractors, and The American Hotel and Lodging Association subsequently intervened and joined the lawsuit as defendants. The plaintiffs contended that the rule made workers "even more vulnerable to underpayment and wage theft" and created a perverse incentive for businesses to "offload their employment responsibilities to smaller, less sophisticated companies with fewer resources." They further alleged that the rule violated the Administrative Procedure Act and was arbitrary and capricious in that it impermissibly departed from the DOL's prior interpretations. Judge Gregory Woods agreed and granted partial summary judgment for the plaintiffs on September 8, 2020.

With respect to vertical employment relationships, Judge Woods found that the DOL had failed to justify why it departed so significantly from the prior rule and did not adequately explain its reasons for changing the rule. The DOL's analysis failed to account for the costs to workers and how the new rule's benefits justified those costs. Without a more developed rationale, the judge concluded that the new rule was "arbitrary and capricious." Further, Judge Woods took issue with the conflicts between the FLSA's broad definitions of "employer" and "employee" and the new rule's extremely narrow definition of joint employer. Since the new rule required an entity to actually exercise, rather than just reserve the right to exercise, one of the four control factors, the joint employer standard conflicted with the FLSA.

As a result, the portion of the DOL's rule that applies to "vertical employment relationships" has been vacated. The rule's application to "horizontal employment relationships," however, remains unchanged.

What's Next for Employers

As noted above, the district court's ruling is subject to appeal, either by the DOL or the business group intervenors. In the meantime, employers who share employees or who contract with staffing agencies are wise to carefully assess those relationships to avoid unintended indicia of joint employer status. Employers should also consider whether the businesses with whom they share employees have conducted wage and hour audits and whether any indemnification provisions for joint employer lawsuits are part of their agreements.

If you have any questions about compliance with state, federal, and local statutes and regulations, Carlton Fields' Labor and Employment Group can assist you with structuring your employment relationships to avoid liability.

[1] The case is *New York et al v Scalia et al*, U.S. District Court, Southern District of New York, No. 20-01689.

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