Legal Update Article

DOL Withdrawal of Trump-Era Independent Contractor Final Rule Unlawful, Court Rules

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The U.S. Department of Labor (DOL) unlawfully delayed and then withdrew the Independent Contractor (IC) Final Rule, published in the waning days of the Trump Administration, a federal court in Texas has held. *Coalition for Workforce Innovation et al. v. Walsh*, No. 1:21-cv-00130-MAC (E.D. Tex. Mar. 14, 2022). As a result of the court's ruling, the withdrawal of the IC Final Rule is invalid, and the IC Final Rule goes into effect immediately – at least for now.

The Final Rule, which never took effect prior to its withdrawal in May 2021 by the current administration, established a uniform standard for determining a worker's status as an "independent contractor" under the Fair Labor Standards Act (FLSA).

Background

The FLSA guarantees a minimum wage for all hours worked and overtime for any hours worked over 40 per week for all covered, non-exempt employees. As the U.S. Supreme Court first noted more than 70 years ago, individuals who perform services for a company as an independent contractor are not afforded the FLSA's minimum wage and overtime protections because they are not "employees." The FLSA, however, says little about how to distinguish an employee from an independent contractor.

Over the years, both the courts and the DOL had developed similar, yet somewhat varying, standards for determining whether an individual is an employee or an independent contractor, most of which focused on the "economic reality" of the relationship between the employer and the individual. Those standards were derived from six, non-exclusive factors originally presented by the Supreme Court in two cases decided on the same day, *United States v. Silk*, 331 U.S. 704 (1947), and *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947).

The factors are:

1. The employer's versus the individual's degree of control over the work;
2. The individual's opportunity for profit or loss;
3. The individual's investment in facilities and equipment;
4. The permanency of the relationship between the parties;
5. The skill or expertise required by the individual; and
6. Whether the work is "part of an integrated unit of production."

As the district court noted in invalidating the Final Rule's withdrawal, for the last 70-plus years, both the courts and the DOL have applied these factors inconsistently, sometimes reaching opposite conclusions when applying what appear to be essentially the same facts.

The Final Rule

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The IC Final Rule, issued during the previous administration, states that it seeks to lend clarity and uniformity to the analyses, while maintaining the same "economic reality" underpinnings of the analysis, that is, "whether, as a matter of economic reality, the workers depend upon someone else's business for the opportunity to render service or are in business for themselves." Rather than treat the analytical factors as unweighted or affording them equal weight, the IC Final Rule elevates the comparative value of two "core" factors: "the nature and degree of the individual's control over the work" and "the individual's opportunity for profit or loss." According to the IC Final Rule, when both of these factors support, or contradict, the existence of an independent contractor relationship, courts routinely have relied on them as controlling the determination. The IC Final Rule states that these factors are the "most probative" and therefore should be "afforded greater weight." However, if these two factors are inconclusive, then three other factors should be considered: the skill or expertise required by the individual; the permanency of the relationship between the parties; and whether the work is "part of an integrated unit of production."

DOL's Delay and Withdrawal of the IC Final Rule

Shortly after the Biden Administration arrived in January 2021, the DOL temporarily delayed the IC Final Rule's March 7, 2021, effective date. Shortly thereafter, the DOL issued a Notice of Proposed Rulemaking (NPRM) to withdraw the IC Final Rule altogether. DOL provided only a brief window for comment and, in May 2021, withdrew the IC Final Rule in wholesale fashion, asserting that it "is inconsistent with the FLSA's text and purpose, and would have a confusing and disruptive effect on workers and businesses alike due to its departure from longstanding judicial precedent." However, the DOL "did not propose and is not [] issuing regulatory guidance to replace the guidance that the Independent Contractor Rule would have introduced . . . but is instead leaving in place the current economic realities test which allows for determinations that some workers are independent contractors."

The District Court's Invalidation

Now, a Texas federal court has concluded that the DOL's actions, both in delaying the effective date of the IC Final Rule (referred to as the "Delay Rule") and in withdrawing it (the "Withdrawal Rule"), violated the Administrative Procedure Act (APA). The APA establishes the rulemaking procedures for federal administrative agencies, including "formulating, amending, or repealing a rule." If an agency's rulemaking actions are determined to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law," the court said, they must be declared unlawful and set aside. In most circumstances, rulemaking under the APA requires a public notice-and-comment period before an agency may implement a new rule, or modify or rescind an existing one, and exceptions to the notice-and-comment period are "narrowly construed."

In declaring the Delay Rule invalid, the court first concluded that it constituted an amendment or rescission of an existing rule, and therefore was a substantive rule itself, requiring a proper notice-and-comment period. Moreover, because the IC Final Rule was a legislative rule that included a notice-and-comment period, a revision to that rule – as the Delay Rule was – likewise required a sufficient notice-and-comment period. The DOL's assertion that the IC Final Rule was merely "interpretive," and therefore did not require notice and comment, was belied by the fact that the Agency clearly felt

compelled to use the notice-and-comment requirement when it enacted the IC Final Rule in the first place.

In this case, the 19-day notice-and-comment period for the Delay Rule not only was too short – as such comment periods typically must last at least 30 days – but responders were limited to commenting only on the issue of the delay, rather than being able to comment on the substance or merits of the IC Rule. As a result, the court held that the "content restriction" of the comment period "was so severe in scope" that there was "no meaningful opportunity for comment." Thus, concluded the court, the Delay Rule violated the APA.

Moreover, the court found that the *Withdrawal* Rule was "arbitrary and capricious" because the DOL failed to consider alternatives to outright rescission of the IC Final Rule. In fact, noted the court, the DOL refused to even consider comments that addressed any such alternatives, instead stating that "any commenter feedback addressing or suggesting such a replacement or otherwise requesting that the [DOL] adopt any specific guidance if the Rule is withdrawn will be considered to be outside the scope of this NPRM." As the court noted, several alternatives were available, including but not limited to implementing a version of the IC Final Rule that did not elevate any factors; adopting a regulation that listed five or six factors, as some courts had done; or even adopting the seven factors the DOL previously had set forth in its Fact Sheet discussing the independent contractor-versus-employee analysis.

In light of the varying interpretations and applications of the "economic realities" test adopted by the courts and the DOL over the decades that had created "confusion among businesses and workers as to whether an employment relationship exists," the IC Final Rule's stated purpose was to provide clarity to the analysis. Instead, the court noted, the DOL rescinded the IC Final Rule and flatly shut down any potential consideration of alternatives to its withdrawal, leaving employers and employees with the same confusion that had existed prior to the IC Final Rule. Citing U.S. Supreme Court precedent, the court concluded that such a failure to consider alternatives necessarily constituted arbitrary and capricious action.

Takeaway

The status of federal wage and hour law on the independent contractor-versus-employee analysis remains in flux. It remains to be seen whether the Biden Administration will challenge or appeal the court's ruling. However, the new rule does not affect how states (*e.g.*, California) determine who qualifies as an independent contractor under their respective wage and hour (and other) statutes. The IC Final Rule also would not redefine who qualifies as an independent contractor under the Internal Revenue Code, the National Labor Relations Act, or other federal laws. Finally, of course, the DOL may yet again undertake formal rulemaking on the issue and adopt a new final rule that evades the APA shortcomings on which the district court based its ruling.

Jackson Lewis attorneys will continue to keep you informed of further developments. In the meantime, if you have any questions about the Independent Contractor Final Rule, the independent contractor analysis, or any other wage and hour issue, please consult the Jackson Lewis attorney(s) with whom you regularly work.