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# Court Challenges Filed to Final Independent Contractor Rule – But Does It Really Matter??

Labor & Employment Workforce Watch

**WRITTEN BY**

Richard Reibstein

As discussed in our QuickStudy of January 9, the U.S. Department of Labor has issued its long-awaited final rule setting forth its version of the test for independent contractor status under the federal Fair Labor Standards Act (FLSA). The regulation issued by the Biden Administration effectively rescinded and replaced the prior final rule on the same subject issued by the Trump Administration Labor Department. As we note below in our "Upshot," the Biden final rule will, as a legal matter, have little or no impact, for the reasons we identified in the QuickStudy. Yet, it has caused enormous consternation among business groups and legitimate independent contractors. This anxiety has prompted at least two court challenges to the new rule, both of which seek to enjoin it. While these cases play out in the courts, many companies have begun to enhance their compliance with federal and state independent contractor laws, some by use of a process such as IC Diagnostics (TM), which minimizes misclassification liability in a manner which is consistent with a company's existing business model.

***The first two legal challenges***

The Trump Administration's final rule on independent contractor status was issued only days before the Biden Administration took office in 2021. The Biden Labor Department then delayed and subsequently rescinded the Trump rule; however, it did not replace it at that time. The Coalition for Workplace Innovation (Coalition), along with the Associated Builders and Contractors of Southeast Texas and the Financial Services Institute, sued the Labor Secretary, arguing that these efforts to undo the Trump Rule violated the Administrative Procedure Act (APA).

A federal district court in Texas agreed, and the Biden Administration appealed the issuance of an injunction to the U.S. Court of Appeals for the Fifth Circuit. The injunction, along with the appeal, then was "stayed" pending the development of a new rule by the Biden Labor Department.

But once the Biden Administration's final rule was released in early January 2024, the Coalition and the other plaintiffs in the Texas case requested that the Fifth Circuit remand the case to the district court to consider whether the new final rule violated the APA. The Labor Department opposed the motion, arguing that a new lawsuit had to be filed because the old lawsuit did not address the new rule. On February 19, in an unpublished order, a three-judge panel agreed with the business groups and remanded the case back to the district court. The panel also granted the agency's request to vacate the prior ruling. Regardless of the path this litigation eventually takes, it would hardly be surprising if the district court eventually enjoins the final Biden rule. That injunction would likely be appealed to the Fifth Circuit once again, on what may be little more than a judicial merry-go-round.

The other legal challenge to the new rule is a recent lawsuit filed in a Georgia federal district court by four freelance workers who argue that the rule is unconstitutionally vague and that the Labor Department had no authority to issue it. The plaintiffs in that case also are requesting that the rule be enjoined. Commentators have not given this lawsuit much chance of success, but it is too early to handicap the matter.

***The Upshot***

The new final independent contractor rule has generated hundreds of news articles and legal commentaries, some favoring the new rule as finally giving rights to gig workers who have been denied the same benefits as traditional employees, and some characterizing it as an unworthy impediment to entrepreneurialism and freelancing. In our view, neither perspective is particularly valid because the final rule is not law; it is simply the legal position of the Labor Department. Only courts decide who is and who is not an independent contractor under the FLSA. While courts oftentimes give deference to an agency regulation, the Biden final rule, like the Trump rule it replaced, consists of nothing other than legal interpretations of judicial decisions applying the FLSA's so-called "economic realities" test. Essentially, the Trump and Biden rules are little more than extensive legal briefs on how to apply the economic realities test, and it is likely that few, if any, courts will accord weight to the final rule, even if it is not enjoined.

The final new independent contractor rule is also limited in its application because it pertains to only one statute: the FLSA. The test for independent contractor status under the FLSA varies significantly from the classification test for independent contractor status under other federal laws, including the Internal Revenue Code, the Employee Retirement Income Security Act (commonly referred to as ERISA), and the National Labor Relations Act. Further, states have an array of laws governing independent contractor status, many of which vary substantially from the economic realities test applicable to the FLSA.

The Biden rule on independent contractor status (like the Trump rule) is also of limited import because the Labor Department is an enforcement agency, not a judicial body, and it only pursues lawsuits in court and does not itself make legal determinations. In addition, the Labor Department typically files only a relatively few number of independent contractor misclassification cases in courts each year, and most of those cases tend to involve weak defenses to the Labor Department's allegation of independent contractor misclassification. Indeed, in most of the cases brought by the Labor Department, the court decision likely would be the same under either the Trump rule or the Biden rule.

***Takeaway***

Companies that utilize independent contractors are likely to be perplexed and, quite frankly, upset, by the back and forth and back again at the Labor Department from one administration to the next on the issue of independent contractor classification. In that regard, businesses may wish to consider a two-step approach to minimize any legal challenge to their independent contractor relationships.

First, companies can minimize the risk of independent contractor misclassification liability under the FLSA and other federal and state classification tests by structuring, documenting, and implementing independent contractor relationships in a manner consistent with applicable law. Many businesses have created independent contractor relationships that are customized and sustainable using a process such as IC Diagnostics (TM) to restructure, re-

document, and re-implement their independent contractor relationships in a manner which is consistent with their existing business models.

Second, employers can minimize the likelihood of class actions alleging independent contractor misclassification by ensuring they have a state-of-the-art arbitration clause in their independent contractor agreements with an enforceable class and collective action waiver. As we previously stated in a blog post on this subject, “[w]hether an arbitration agreement in an independent contractor or employment setting will bar a class action depends as much of the wording in the arbitration clause as the applicable law, which is in flux and continues to evolve.” Because this area of the law has changed considerably over the past few years, companies with existing arbitration clauses should determine if they need to be enhanced.

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