Davis-Bacon, FLSA and Joint Employment Concerns
I. Fair Labor Standards Act Update

A. Status of potential revisions to the salary-basis threshold.

Since 2004, for an employer to classify a worker as an exempt “white collar” employee, the employee must be paid a salary of no less than $455 per week ($23,660 a year). On May 23, 2016, the U.S. Department of Labor finalized changes to the white collar exemption rules that were expected to increase the required salary level to $913 per week ($47,476 annually), with inflation adjustments every three years starting in 2020. The changes had an effective date of December 1, 2016. Prior to their going into effect, however, a federal district court judge enjoined their implementation. In the interim, Donald Trump was elected President, causing many to predict that the revised rules would be modified, or scrapped altogether. Thereafter, the same district court struck down the revised rules as exceeding the DOL’s authority on August 31, 2017.

The U.S. Department of Justice appealed the decision on behalf of the DOL on October 30, 2017. New U.S. Secretary of Labor Alexander Acosta explained the government appealed the ruling to ensure the DOL retained the authority to write the overtime rule. On November 6, 2017, the U.S. Court of Appeals for the Fifth Circuit granted the government’s motion to temporarily stay the case so that the DOL could engage in additional rulemaking to address the appropriate salary level.
The process for further revising the salary basis rules is well underway. The DOL published a Request for Information on July 26, 2017, seeking comments on the stayed 2016 revisions, including whether the proposed revised rule effectively identifies employees with exempt duties, whether a different salary level would more appropriately identify such employees, the basis for setting a different salary level, and why a different salary level would be more appropriate or effective. The comment period ended on September 25, 2017.

The DOL received more than 200,000 submissions in response to its Request for Information. After the comment period closed, the DOL announced that it would propose a new rule by October 2018. That date has recently been extended, and now the anticipated release date is January 2019. Usually there is a 60-90 day public comment period following the release of a proposed rule, which means that a revised rule (if any) will probably not become effective until late in 2019.

Some commentators are skeptical that a revised rule will be implemented before the 2020 presidential election – an event that could have significant effects. One reason for the delay in formulating a new rule is that the nomination of President Trump’s pick for the position of Administrator of the DOL’s Wage and Hour Division – South Carolina attorney Cheryl Stanton – remains pending in the Senate. The anticipated date for the release of a final rule has been delayed once already, and it is not inconceivable it could be delayed further. Moreover, whatever the outcome of the rulemaking process, the Fifth Circuit Court of Appeals retains jurisdiction over the initial 2016 challenge to the rule. It is likely
that a renewed challenge will be made to the DOL’s authority to implement the revised rule, and that implementation of the rule could be delayed by further court challenges. If a Democrat is elected president in 2020, prior to the implementation of a revised rule, it is likely that administration would change sides (again), and try to resurrect/implement the currently-enjoined 2016 rule.

Stay tuned for future developments. This could go several different directions, all of which are likely to significantly impact employers.

B. The U.S. Supreme Court dismantles the longstanding “narrow construction” rule in Encino Motorcars, LLC v. Navarro.

For decades, courts – from the Supreme Court on down – have narrowly construed the FLSA’s white collar exemptions. The Supreme Court has restated this rule many times, and the lower courts have followed, citing this principle in virtually every significant case involving overtime exemptions.

That approach changed dramatically on April 2, 2018. In Encino Motorcars, LLC v. Navarro, the Supreme Court held that service advisors at an automobile dealership are exempt from the FLSA’s overtime requirements. In reaching its decision, however, the Supreme Court overturned more than 70 years of established caselaw regarding how courts must construe the FLSA’s overtime exemptions. Justice Thomas, writing for a 5-4 majority, explained:

The Ninth Circuit also invoked the principle that exemptions to the FLSA should be construed narrowly. We reject this principle as a useful guidepost for interpreting the FLSA.
(Opinion at 9 (emphasis added, citation omitted)). The Court stated that “[b]ecause the FLSA gives no ‘textual indication’ that its exemptions should be construed narrowly, ‘there is no reason to give [them] anything other than a fair (rather than a “narrow”) interpretation.’” (Id. (citation omitted)). The opinion further states that “exemptions are as much a part of the FLSA’s purpose as the overtime-pay requirement. We thus have no license to give the exemption anything but a fair reading.” (Id. (citation omitted)).

*Encino Motorcars*, therefore, eliminates a major argument for wage-hour plaintiffs’ counsel previously made in virtually every FLSA exemption case. Since the 1940s, courts addressing FLSA exemptions have invoked the narrow construction rule – and application of the rule has often been outcome-determinative. Indeed, in the hands of some courts, the rule acted beyond that of a tie-breaker, but instead created almost an automatic presumption of non-exempt status unless the employer could show an exemption “plainly and unmistakably” applied.

This makes proving the existence of an exemption easier for employers. After *Encino Motorcars*, employers now must show only their reading of the exemption is more consistent with the statutory and regulatory text, rather than showing that there is little or no doubt about the matter. This ruling could also affect an analysis of the employer’s “good faith” and the ability of misclassified employees to recover additional wages, liquidated damages, and attorney’s fees.
Note, however, that this decision does not change state law in any way. Depending upon the jurisdiction, state courts could continue to construe exemptions narrowly, leading to more state-law claims, or a diversion in legal standards. Of course, Encino Motorcars also provides employers with additional arguments under state law, particularly if the language of state-law exemptions is the exemptions tracks the language of the FLSA.

II. **Joint Employer Update**

A. **Withdrawal of Obama-era guidance on the federal joint-employer test by the Trump Administration.**

On June 7, 2017 the DOL announced it was rolling back an Obama-era policy that attempted to increase regulatory oversight of joint employer and independent contractor businesses.

Until 2015, the DOL interpreted the joint employer doctrine to apply only where one business had “direct control” over another business’s workplace. In 2015 and then again in 2016, under then-Labor Secretary Tom Perez, the DOL changed course, and began finding that a business may be a joint employer even if it exerted “indirect control” over another’s workplace. The 2015 and 2016 guidance significantly expanded the conditions for when one business could be held liable for employment law violations at another company. The 2015-2016 informal guidance was widely criticized, with employers concerned that traditional franchise, parent-subsidiary, and independent contractor relationships between businesses would be unnecessarily and unfairly undermined.
The DOL signaled last year, however, that it was returning to a “direct control” standard. Moreover, the DOL’s announcement rescinded its guidance on independent contractors, which essentially stated that the DOL considered most workers to be employees under the Fair Labor Standards Act and that it was likely to apply a broad definition of “employee” and “employer” when investigating a company’s practices. The change in approach by the DOL, to state the obvious, was a big win for businesses and business groups, including within the construction industry.

B. Status of Browning-Ferris, Hy-Brand, and the Trump NLRB.

1. Background.

In 2015, the National Labor Relations Board changed its test for determining when two entities constitute joint employers under the National Labor Relations Act – the federal law governing (among other things), collectively bargained workplaces – in Browning-Ferris Industries of California, Inc. Under Browning-Ferris, two or more entities are “joint employers” of a single workforce if (1) they are both employers within the meaning of the common law; and (2) they share or co-determine those matters governing the essential terms and conditions of the employment. The Browning-Ferris decision significantly expanded the number of situations when an entity can constitute an “employer” and potentially have liability for workers or independent contractors it does not control.
You may notice some symmetry here: the “indirect control” standard discussed in the previous section – involving the DOL’s determination under the FLSA as to who constitutes an “employer” – is similar to the standards adopted by the NLRB in *Browning-Ferris*.

Two years after *Browning-Ferris*, President Trump appointed labor attorney William Emanuel to serve as one of the Board’s five members. Before Emanuel was appointed, however, he practiced law at Littler Mendelson, a firm that represented a party in *Browning-Ferris* and in a subsequent appeal.

Shortly after Emanuel joined the Board, he participated the NLRB’s *Hy-Brand Industrial Contractors, Ltd. and Brandt Construction Co.*, 365 NLRB No. 156 (2017) ("Hy-Brand") decision, which overturned *Browning-Ferris*. In *Hy-Brand*, the NLRB rejected the reasoning of *Browning-Ferris* and returned to its pre *Browning-Ferris* standard, focusing again on whether an entity actually controls the workers at issue. Emanuel did not recuse himself in *Hy-Brand*, even though his prior firm had litigated the same underlying issues in *Browning-Ferris*. *Hy-Brand* was rightly characterized as a victory for employers.

On February 9, 2018, however, the Office of the Inspector General issued a Memorandum finding that, because Emanuel’s former law firm was involved in *Browning-Ferris*, he should have recused himself from participating in the *Hy-Brand* decision. The Office of Inspector General wrote that Emanuel’s participation in the Hy-Brand decision “when he otherwise should have been recused exposes a serious and flagrant problem and/or deficiency” in the Board’s
processes. Based upon the recommendation from the Office of Inspector General, the NLRB issued an Order vacating *Hy-Brand* decision, pending further proceedings before the Board.

2. **What is next?**

The vote in *Hy-Brand* was 3-2, with Board members voting strictly along party lines. Republican Members Philip A. Miscimarra and Marvin E. Kaplan voted with Emanuel to overturn *Browning-Ferris*. Democratic Members Mark Gaston Pearce and Lauren McFerran dissented, and voted to uphold *Browning-Ferris*. Miscimarra’s term ended and Trump-appointee John F. Ring (formerly a management-side attorney with Morgan Lewis) replaced him on April 16, 2018. One presumes that Ring, like his predecessor, would vote to overturn *Browning-Ferris*.

The next appointment to the NLRB will take place when Pearce’s term expires on August 27, 2018. If tradition is maintained, the vacancy will be filled by a Democrat who, presumably, will similarly vote to retain the *Browning-Ferris* standard.

Thus, with Emanuel likely to recuse himself in any case considering the future viability of *Browning-Ferris*, there will be a 2-2 deadlock – meaning that there will be no deviation – at the Board level – from *Browning-Ferris* in the near future.
It is unclear, however, how the order vacating *Hy-Brand* will affect employers in the near future. That event certainly creates an atmosphere of uncertainty for employers who engage in franchise or independent-contractor or subcontractor arrangements with other businesses. By vacating *Hy-Brand*, the Board returned to the *Browning-Ferris* test, at least technically. This will preclude lower ranking Board agents from overtly applying *Hy-Brand* standards for the time being. Under the current administration, however, it has become ever more unlikely that lower ranking Board agents will aggressively apply *Browning-Ferris* to find joint employment. The Trump Administration has also significantly reduced the Board’s resources, thus discouraging Board agents from pursuing borderline cases.

In short, these developments have muddied the waters and delayed a final resolution. The Board may well return to the *Hy-Brand* test at some point, but employers should monitor the situation in order to know when that ultimately occurs.

C. The Supreme Court declines to review the joint-employer test in *Hall v. DirecTV*.

As exemplified by the discussions above, joint-employer issues have been at the forefront in recent months, with the current presidential administration actively working to undo the policies and practices of the Obama years. Ultimately, these issues (in both the NLRA and FLSA contexts) may reach the Supreme Court for final resolution.
In *Hall v. DirecTV*, however, the Supreme Court declined – for now – to address the issue. That case involved claims against DirecTV and others that satellite TV technicians should have been treated as employees rather than independent contractors, and therefore paid additional overtime and/or minimum wages. Despite working as independent contractors through third-party subcontractors, the technicians alleged that DirecTV dictated nearly every aspect of their work, including requiring them to purchase and wear DirecTV shirts, carry DirecTV identification cards, display the DirecTV logo on their vehicles, review DirecTV training materials, follow DirecTV’s standardized policies and procedures, and receive their work assignments through DirecTV’s system. In addition, they contended DirecTV exercised quality control over their work, impose compensation-related penalties for unsatisfactory service, and could effectively terminate them by refusing to assign them work.

The technicians filed FLSA collective-action lawsuits across the United States. In a Maryland case a District Court judge dismissed the case on the pleadings, ruling that the technicians had failed to adequately allege facts showing that DirecTV was a joint employer since DirecTV did not directly hire or fire the technicians and DirecTV did not otherwise control their compensation. On appeal, a Fourth Circuit panel reversed, concluding that the technicians had alleged sufficient facts based on a more lenient standard for joint employment. The Fourth Circuit took an expansive view of whether DirecTV could be considered an employer under the FLSA, following an approach similar to the
DOL’s 2015-2016 guidance, described above. It remanded the case to the District Court for further litigation.

Given the Fourth Circuit’s departure from the majority approach, DirecTV appeared to have a good chance at getting the Supreme Court to take up the joint-employer issue, but the Court denied review. We don’t know why the Supreme Court declined to resolve the FLSA joint-employer test using the Hall case. Perhaps it did not want to take on the joint-employer issue on a motion to dismiss, with only pleadings setting forth allegations rather than having evidence and testimony to establish the relationships in the case. Or, perhaps the Court is waiting to see if Congress or the Department of Labor will issue new rules on this topic.

D. California-specific developments.

1. California’s new joint-employer rule applicable to contractors.
   a. Overview.

   On October 14, 2017, Assembly Bill (AB) 1701 was signed into law as California Labor Code § 218.7. This law imposes potential liability on general contractors for their subcontractors’ failure to pay wages, fringe benefits, or other benefits to workers.

   Labor Code §218.7 applies to construction contracts “for the erection, construction, alteration, or repair of a building, structure, or other private work” entered on or after January 1, 2018. It makes general contractors (or direct
contractors) liable for subcontractors’ failure to pay wages, fringe benefits, or other benefit payments or contributions (at any tier) including subcontractors’ failure to pay any interest incurred on such wages, fringe, or other benefits. The law does not obligate general contractors, however, to pay for penalties or liquidated damages that may otherwise be assessed against a subcontractor. Actions under the new law can be brought by either individual workers, a union, a joint labor-management cooperation committee, or the Labor Commissioner. Successful plaintiffs can recover attorney’s fees, expert fees, and costs.

Claims must be brought within one (1) year from the earlier of the following dates: (1) a Notice of Completion of the direct contract is recorded; (2) a Notice of Cessation of the direct contract is recorded; or (3) The work covered by the direct contract is actually completed.

b. Practical Implications.

General contractors with projects in California should therefore take several steps to ensure their protection in light of this new law. Potential protective measures are outlined below:

- **Ensure contractual indemnity provisions are updated.** General contractors can include broad indemnity provisions that include claims arising from the subcontractor’s failure to pay wages and benefits. General contractors can also require subcontractors to include similar provisions in their own contracts with sub-subcontractors that would require lower tier
subcontractors to also defend and indemnify the general contractor for claims arising under the statute.

- **Retain the right to audit subcontractors.** Contracts should include audit provisions requiring, at a minimum, subcontractors and sub-subcontractors to provide payroll records and project award information, with specific deadlines for such production, subject to termination of their contract. General contractors should request these payroll records and review them throughout a project to ensure the subcontractor is properly paying wages. Records similar to the certified payroll reports required on prevailing wage projects should be required. While a subcontractor’s failure to provide these records will not relieve the general contractor of liability under the statute, a subcontractor’s failure to comply with contractual audit requirements can provide a basis to withhold payments as “disputed,” until the subcontractor provides the requested records.

- **Require payment bonds from subcontractors:** General contractors should require subcontractors and sub-subcontractors to provide payment bonds. The inability or unwillingness to provide a bond may be indicative of a subcontractor’s compliance with applicable labor laws.

- **Require Personal Guarantees:** If the project warrants, and a subcontractor’s principal may have substantial personal assets, general contractors may choose to require personal guarantees from a subcontractor’s owners, partners or key personnel to ensure compliance.
• **Ensure contracts contain withholding and back-charges provisions for violations.** General contractors should update their agreements to include withholding and back-charge provisions permitting them to withhold or charge back subcontractors for disputed amounts, for claims brought against them, and for failure to comply with applicable audit, bond, and guarantee requirements.

2. **California’s rules regarding the hiring of temporary employees through labor contractors.**

   Remember also that effective January 1, 2015, California Labor Code section 2810.3 expanded the scope of liability of “client employers” that obtain workers through labor contractors. The statute’s legislative history suggests that it was enacted to protect workers’ rights in the absence of control by a third party. *Johnson v. Serenity Transp., Inc.*, No. 15-cv-02004-JSC, 2016 U.S. Dist. LEXIS 8404, at *22 (N.D. Cal. Jan. 22, 2016).

   Thus, any client employer that obtains workers through an agency or contractor must share in the liability for any wage and workers compensation issues. Further, the code provides that a client employer cannot shift all of the liability for wage and workers compensation violations. However, the law does provide that the client employer can seek indemnity from the labor contractor for violations.

3. **The California Supreme Court adopts a new test for who constitutes an “employee” under California law.**
On April 30, 2018, in *Dynamex Operations West, Inc. v. The Superior Court of Los Angeles County* (No. S222732), the California Supreme Court unanimously displaced the common law test for independent contractors it traditionally used for three decades, and adopted the so-called "ABC test." Under the ABC test, workers are presumed to be employees, and employers may classify workers as independent contractors only if they prove all three elements of the test.

Under the ABC test, which is used in other jurisdictions such as New Jersey, Massachusetts and Connecticut, workers are now *presumed* to be employees unless *employers* – who have the burden of proof – establish all of the following:

A. The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of such work and in fact;

B. The worker performs work that is outside the usual course of the hiring entity's business; *and*

C. The worker is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed.
The California Supreme Court explained, for example, that a plumber hired by a retailer to repair a bathroom leak would not be considered performing work that is part of the store's usual business and would properly be considered an independent contractor. When a bakery hires cake decorators, however, "the workers are part of the hiring entity's usual business operation and the hiring business can reasonably be viewed as having suffered or permitted the workers to provide services as employees."

This could have serious implications for multiple industries, including the construction industry. Depending upon how the ABC test is applied, virtually any subcontractor working on a general contractor’s construction project could be deemed the general contractor’s employee. It is clear that Dynamex will have a significant impact. Because the case is so new, however, we will have to wait for further developments to determine just how much the decision will change the conduct of business in California.

III. Davis-Bacon Update

A. Recent legislative attempts to undermine Davis-Bacon.

The most interesting recent developments on the Davis-Bacon Act front have been multiple legislative attempts to repeal or scale back the statute. These include:

- The Transportation Investment Recalibration to Equality ("TIRE") Act (S. 195), sponsored by Sen. Jeff Flake (R-AZ) – seeking to suspend Davis-
Bacon’s prevailing wage requirements on all highway construction projects (currently in committee);

- The FAA Reauthorization Act of 2018 (H.R. 4, sponsored by Rep. Steve King (R-4th Iowa)) – seeking an outright repeal of the prevailing wage provisions of the Act (currently in committee);

- The Davis-Bacon Repeal Act (S. 244), sponsored by Sen. Mike Lee (R-UT)) – seeking an outright repeal of the prevailing wage provisions of the Act (currently in committee);

Thus far, none of these bills have passed committee. An earlier attempt by Representative Paul Gosar (R-4th, AZ) to attach a Davis-Bacon repeal to a defense bill failed. Remarks made by President Trump in 2017, however, have suggested that a revision of Davis-Bacon may be on the administration’s agenda.

B. The D.C. Circuit’s 2016 decision on public-private projects.

While the case is now two years old, District of Columbia v. Department of Labor bears mention. In that case, the United States Court of Appeals for the District of Columbia struck down an attempt by the DOL to significantly expand the Davis-Bacon Act to apply to the construction of a Public-Private partnership project.

The DOL sought to apply the Act to CityCenterDC, a mixed-use development on the site of the DC Convention Center. In connection with the project, the Washington, D.C. government entered into a 99-year ground lease
with a developer, who agreed to build the CityCenterDC project. The developer entered into separate contracts with general contractors for the project’s construction. The DC government had the right to approve the general contractors and their respective contracts with the developer but, importantly, it was not a party to those contracts. DC provided no public funding, and does not own or operate any businesses or facilities on the project.

A local carpenter’s union made a request to the DOL seeking a finding that Davis-Bacon applied to the project. The Administrator of DOL’s Wage and Hour Division found the Act applied, and was affirmed by the DOL’s Administrative Review Board. In response, the DC government filed suit in federal court challenging the ruling.

In a scathing opinion, the DC Circuit characterized DOL’s position as a “a massive, atextual, and ahistorical expansion of the Davis-Bacon Act.” The Court held that the Act did not apply to CityCenterDC for two reasons: (1) the DC government was not a party to the construction contracts; and (2) because it determined the CityCenterDC was not a public work.

The DOL argued that the CityCenterDC ground lease and development agreement, the contracts relating to the project to which DC was a party, were construction contracts because both parties contemplated the developer would enter into related construction contracts. The Court rejected this argument, taking a literal view of the term “contract for construction” which it held means “a contract in which one party will perform construction in exchange for the other
The Court found the CityCenterDC ground lease and development agreement was not a construction contract because they provided the developer would enter into construction contracts with general contractors, who would be paid by the developer. The Court rejected the DOL's attempt to expand the term “contract for construction” to embrace any lease, land-sale, or development contract between the federal or DC government which required the other party undertake more than an incidental amount of construction.

Additionally, the Court found the CityCenterDC project was not a “public work,” because it did not involve either (1) public funding of construction; or (2) government ownership or operation of the completed facility. The Court rejected DOL’s argument that CityCenterDC was a public work because it produces indirect benefits for the public like creating jobs and tax revenues. The Court held that such limited and indirect effects do not “transform the Davis-Bacon Act into an all-encompassing prevailing wage law for private development projects in D.C.” To drive its point home, the recognized that while the concept of a “public work” may be elastic, “it cannot reasonably be stretched to cover a Louis Vuitton.”

Developers, therefore, should explore similar public-private arrangements related to construction on publicly-owned land and in related circumstances.