Is the Gig Up? Worker Misclassification in the Technology Age

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The legal issues underlying "worker misclassification" claims are hardly new. Worker wage claims asserting misclassification of a worker's status under state and federal law have been around for decades. Similarly, state claims seeking unemployment and certain tax contributions from employers have been increasing for many years. But despite these long-standing trends, the number of workers calling themselves independent contractors, "gig workers" or "freelancers" has dramatically increased for many years. Such growth can in part be explained by the desire to limit contributions towards benefit payments and social security contributions, but that is not the entire story. Many workers want the freedom and independence that such jobs bring, including flexible work schedules and other non-traditional "benefits."

By way of background, according to one recent study by Paychex, the trend towards independent contractors peaked in 2017 with an 11% percent increase, year over year, which decreased to a 5% percent increase, year over year, in 2018. But this rate is still much greater than hiring by small business employers[1] in general, which has been tracking at about 1% per year, since 2013.

With respect to gig workers – loosely defined as groups of employees who work for companies in the new technology-based economy – millions have been added to the payrolls of technology companies over the last decade. Also, so-called "freelancers" are increasing in a number of industries, including graphic arts, literary works and IT-related fields, among others. In fact, McKinsey found that between 20-30% of the entire European and North American workforces are classified as independent workers. In short, over the last decade, there has been a dramatic shift in the workplace towards contracting with independent workers despite the ongoing legal misclassification risks associated with this trend.

These conflicting trends are clearly on display in a recent California Superior Court decision, *California v. Uber and Lyft, et al.* (the Uber decision). In the Uber decision, the trial court ruled on a motion to enjoin Uber and Lyft from characterizing their drivers as independent contractors under California's newly enacted legislative framework to address worker status (AB 5). The court ruled that because it was unlikely that either Uber or Lyft would prevail, they were enjoined and ordered to treat their drivers as employees.

Under AB 5, California's legislature codified its version of the "ABC Test." Under this test, companies must show, in order to avoid the presumption that its workers are employees, that all three prongs of the test are met:

1. The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract and the performance of the work in fact;
2. The person performs work that is outside the usual course of business of the hiring entity's business; and
3. The person is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed.

In reviewing these prongs, the court had little trouble enjoining Uber and Lyft, ruling that "it's this simple: ... [the] drivers do not perform work that is 'outside the usual course' of [Defendants'] business." As a result, Uber and Lyft failed, according to the court, to prove prong "B," and for the purposes of the motion, its workers were deemed employees.

It would seem likely that under this rationale many "gig" companies would not be able to satisfy this prong of the ABC Test. Importantly, since roughly 33 states use some variation of the ABC Test, the Uber decision will have great significance to employers throughout the country and not just California.

In response to the court's injunction, on August 10, 2020, Uber and Lyft advised that they may each stop doing business in California and immediately appealed seeking a stay of the trial court's injunction – which was granted, with an oral argument date set for October 13. Interestingly, Uber and Lyft must put together a plan of compliance by early September in case the preliminary injunction is affirmed on appeal and, as discussed below, Proposition 22 fails to pass.

As alluded to, this issue may be mooted by the upcoming November election in California. This is because thousands of California citizens petitioned for a public referendum – Proposition 22 – to be placed on the ballot seeking to undue AB 5.

Proposition 22 would consider app-based drivers to be independent contractors and not employees or agents. Therefore, the ballot measure would override AB 5 (signed in September 2019) on the question of whether app-based drivers are employees or independent contractors.

The ballot initiative defines *app-based drivers* as workers who (a) provide delivery services on an on-demand basis through a business's online-enabled application or platform or (b) use a personal vehicle to provide pre-arranged transportation services for compensation via a business's online-enabled application or platform. Examples of companies that hire app-based drivers include Uber, Lyft and DoorDash, among many others. Notably, the ballot measure would not affect how AB 5 is applied to other types of workers.

If passed by California's voters in November, some gig employers could avoid hundreds of millions of dollars in future liability associated with the misclassification issue. In short, it appears that many gig workers do not want to change their status, contrary to certain viewpoints that they are being taken advantage of by their employers. There is no doubt that companies will be closely watching this outcome as it could mark the beginning of a nationwide drive to blunt the force of the ABC Test.

At the same time, artificial intelligence (AI) may resolve this issue in another way: if driverless vehicles are accepted and implemented in California, there may be no workers to classify. In fact, in February, California agreed that Uber could begin re-testing its driverless vehicles on public roads. But the timeline is unclear as to when such a change would occur.

In the meantime, however, there is almost certainly going to be state-by-state battles over misclassification of workers and the Uber decision may mark the beginning of a long battle over tax revenue as well. The COVID-19 pandemic has created massive budget shortfalls for many states, namely the loss of tens of billions of dollars of tax revenue from business closures and a massive reduction in sales tax revenue. At the same time, and depending on whose numbers that you want to use, states (and the federal government) are losing billions of dollars in tax revenue due to worker misclassification. It would seem likely, therefore, that both the federal government (depending on the election outcome) and a majority of the states (given their depleted tax revenue base and unemployment funds) will aggressively enforce misclassification rules under the ABC Test. If so, this could be a multi-billion dollar liability for employers.

In the final analysis, the Uber decision may create legislative responses on how to deal with this growing class of workers in an attempt to harmonize the new gig workforce and the needs of business with the existing legal classification structures that largely prevent such changes with the attendant loss of tax revenue. In short, at least in the near-term, the path forward will be a rocky one.

It is also important to recognize that organized labor has an interest in this outcome, as the re-classification of millions of workers from independent contractor status to employee status would potentially provide millions of "new employees" to organize since the National Labor Relations Act does not apply to independent contractors, only employees. As mentioned above, it may also accelerate the use of AI.

The Uber decision is likely to be the first battle of what will likely be a long and drawn out affair between both sides of this issue. Potentially, states will likely take a more aggressive approach in the near-term, while workers and gig employers may indeed continue to seek political and legislative solutions. At the same time, AI may well change the workplace much faster than most people think given the extensive financial incentives to move in this direction given the economic fallout from the pandemic. Stay tuned.

If you have any questions, please reach out to James Anelli (anellij@whiteandwilliams.com; 201.368.7224) or another member of the Labor and Employment Group.

[1] Small business employers are defined as "an employer with less than 50 employees."

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