The Gig Economy and Independent Contractors: Why You Should Care About Misclassification Issues

Alan R. Kabat
Bernabei & Kabat, PLLC
Washington D.C.

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In today's economy, there has been a significant increase in "independent contractors" in the labor market. Almost any platform-enabled, app-based labor is usually considered by the employer to be an independent contractor relationship, not the traditional employer-employee relationship. Uber, the ride-sharing platform, is the best known example, but almost any kind of short-term, "on demand," "sharing economy" or "gig economy" work, including that done by the freelancers at We Work, may also be treated as an independent contractor by the business entity.

This essentially reflects the outsourcing of labor, where businesses avoid the costs associated with employee staff – such as unemployment insurance, workers' compensation, overtime and even protections from discrimination – by insulating themselves with layers of subcontracting with so-called independent contractors. This labor market shift, sometimes known as the "fissuring of the workplace," is not a new phenomenon – it started decades ago when taxi cab companies began treating their drivers as independent contractors, and soon spread to other occupations as businesses began to understand the payroll and other savings associated with a shift to classifying workers as independent contractors instead of employees. *See generally* Veena Dubal, *Winning the Battle, Losing the War? Assessing the Impact of Misclassification Litigation on Workers in the Gig Economy*, 2017 WISC. L. REV. 739 (2017); David Weil, *The Fissured Workplace: Why Work Became So Bad for So Many and What Can be Done to Improve It* (2014); National Employment Law Project, *Who's the Boss: Restoring Accountability for Labor Standards in Outsourced Work* (2014).

Why does that matter? Because fundamentally, it reflects a transfer of labor costs from the business to the worker, and a concomitant loss of bedrock employee rights and protections. The vast majority of federal, state, and local employment laws do <u>not</u> protect independent contractors. Some statutes specifically exclude independent contractors, such as the National Labor Relations Act, while many statutes have been interpreted by the courts as excluding independent contractors. A short list of these statutes includes:

1. National Labor Relations Act, 29 U.S.C. § 152(3) ("The term 'employee' . . . shall not include . . . any individual having the status of an independent contractor . . .").

2. Fair Labor Standards Act, overtime and minimum wage laws, 29 U.S.C. § 206.

3. Family and Medical Leave Act, 29 U.S.C. § 2611(3).

4. Occupational Safety and Health Act, 29 U.S.C. § 651.

5. Title VII, 42 U.S.C. § 2000e-5 *et seq.*

6. Age Discrimination in Employment Act, 29 U.S.C. § 630(f).

7. Americans with Disabilities Act, 42 U.S.C. § 12111.

8. ERISA and related benefits claims.

9. Many comparable state and local statutes.

See Veena Dubal, *Wage Slave or Entrepreneur? Contesting the Dualism of Legal Worker Identities*, 105 CAL. L. REV. 65, 72-75, 86-87 (2017) (collecting examples); Shu-Yi Oei & Diane M. Ring, *Tax Law's Workplace Shift*, at 16-18 [manuscript] (2018) (same).

One significant exception is 42 U.S.C. § 1981, as that covers contracts, and, as with a breach of contract claim, is one of the few remedies available to an independent contractor.[1] However, Section 1981 only covers race and certain national-origin claims.

Also, several of the federal whistleblower statutes that are enforced by OSHA have been interpreted by rulings of some Administrative Law Judges as extending to independent contractors, although other ALJs have held that an independent contractor was not protected by these statutes.

[1] *See, e.g., Jones v. A.W. Holdings, LLC*, 484 Fed. Appx. 44, 48 (7th Cir. 2012) ("Although her independent-contractor status defeats her Title VII claim, Jones may still proceed on her claims of discrimination and retaliation under § 1981, which is not limited to employees."); *Brown v. J. Kaz, Inc.*, 581 F.3d 175, 181 (3d Cir. 2009) ("We thus agree with the decisions that hold that an independent contractor may bring a cause of action under section 1981 for discrimination occurring within the scope of the independent contractor relationship."); *Dalton v. Avis Rent A Car System, Inc.*, 336 F. Supp. 2d 534, 537 n.7 (M.D.N.C. 2004) ("In determining the prima facie case for § 1981 actions, it is of no consequence that the plaintiff is an agent or independent contractor instead of an employee."), *aff'd on other grounds*, 131 Fed. Appx. 936 (4th Cir. 2005).

So what is a true independent contractor? Fundamentally, an independent contractor is someone who is in business for herself, who does a specialized job, and essentially supplies a finished product.

To determine whether a worker is an independent contractor or employee, the courts have developed several analytical frameworks, which often depend on the type of employment claim. In some circumstances, these four tests may lead to the same outcome for the same person, but it is possible that some persons may be deemed an employee under one test for one statute and an independent contractor under another test for another statute. The existence of multiple tests is in part due to the fact that different statutes have different goals (remedial goals versus broader humanitarian goals). These tests include:

Common law of agency test – employer's control over means and manner of worker's performance.	National Labor Relations Act Title VII Age Discrimination in Employment Act ERISA Workers' Compensation (state)
Economic realities test – employer's control and worker's economic dependence on the employer	FLSA wage/hour claims Family Medical Leave Act Social Security Act
ABC test – a simpler version of the control test: "(1) whether the worker is free from direction or control; (2) whether the worker performs the work off the premises of the business; and (3) whether the worker is engaged in a 'customarily' independent trade."	Many state unemployment benefits laws, including Maryland. Maryland's Workplace Fraud Act, which makes it unlawful to misclassify an employee as an independent contractor in the construction and landscaping industries.
IRS 20-factor test (whether company controls only the results of the work, not its execution)	Virginia, unemployment benefits

See Veena Dubal, *Wage Slave or Entrepreneur? Contesting the Dualism of Legal Worker Identities*, 105 CAL. L. REV. 65, 72-75 (2017)); Shu-Yi Oei & Diane M. Ring, *Tax Law's Workplace Shift*, at 27-31 [manuscript] (2018).

A key problem is that misclassification occurs disproportionately in occupations that are over-represented by women and minorities, including teacher's aides, real estate brokers and agents, maids and housekeepers, home health care aides, and hairdressers. *See* Charlotte S. Alexander, *Misclassification and Antidiscrimination: an Empirical Analysis*, 101 MINN. L. REV. 907, 924-25 (2017). Many of these workers are low on the economic scale, and hence less likely to realize that they can use litigation or legislation as a way to resolve their misclassification and workplace issues. Further compounding the problem is the decline in union power and membership, leaving many of the more vulnerable workers subject to exploitation without a ready means to find out what action they can take.

Another problem with misclassification is that the workers who are truly independent contractors may be unaware that they are required to pay the full amount of Social Security and Medicare taxes, instead of the employer paying half of those taxes. 26 U.S.C. § 1401. While they do not have to pay unemployment insurance taxes, they also cannot claim unemployment benefits.

It should be noted that the December 2017 tax legislation added Section 199A to the Internal Revenue Code, allowing individuals to take a 20 percent deduction from their qualified business income if they are independent contractors or otherwise are a passthrough taxpayer (such as the owner of a Subchapter S corporation). *See* 26 U.S.C. § 199A; 26 C.F.R. § 1-199A-5(d)(1).

This highly favorable tax treatment may motivate some employees to convert to independent contractor status, without realizing that they are foregoing nearly all their protections under the labor and employment laws. *See* Shu-Yi Oei & Diane M. Ring, *Tax Law's Workplace Shift* [manuscript] (2018). This change in the tax code may have significant effects for the workplace:

> A key theme that has emerged in the ongoing debate is concern over the potential effect of § 199A on work and labor. This concern has manifested itself in the form of a specific critique but one that is symptomatic of a more generalized worry. The specific critique that commentators have advanced is that the new deduction creates a strong incentive for individuals to give up employee status and its accompanying benefits and to become independent contractors in order to claim the deduction. **This shift, if it occurs, could signal a dramatic transformation of the American workplace. A worker's status as an employee or an independent contractor has implications that extend far beyond tax law into minimum wage, collective bargaining, workplace benefits, health and safety, and anti-discrimination law. Widespread reclassification of workers as independent contractors, or large-scale abandonment of traditional jobs in favor of self employment, could significantly decrease worker eligibility for these protections and increase the precariousness of work.**

> The more generalized worry underpinning the specific critique is that work itself and the security it offers are changing, and that tax law may be accelerating that transformation. **New § 199A is one example of a tax provision that could make precarious work relationships more pervasive and lead to a decline of worker security**.

Id. at 3-4 (emphasis added) (citations omitted).

Remedies in the courts? Litigation has proven a very mixed bag for these workers who allege that they were misclassified. In some cases, they are subject to arbitration agreements that not only shift the determination of their status to the arbitrator, but also preclude class-action arbitration, making it much more difficult and expensive for an individual worker to prevail. Note that the Supreme Court recently held that class-action waivers in arbitration were acceptable, and did not violate the National Labor Relations Act. *Epic Systems Corp. v. Lewis*, 584 U.S. __, 138 S. Ct. 1612 (2018) (5-4 decision).

California, as usual, is an outlier – the Supreme Court of California recently unanimously held that workers are presumed to be employees not contractors for purposes of "wage order" claims under state law, and put the burden of proof on employers to show that an individual is an independent contractor under the aforementioned ABC test. *Dynamex Operations West, Inc. v. Superior Court of L.A. County*, 4 Cal. 5th 903, 416 P.3d 1 (2018). *Dynamex* involved drivers for a courier service who the company treated as independent contractors; the Supreme Court also upheld the class certification order. It remains to be seen whether *Dynamex* will be extended to other California state law claims, let alone adopted by courts in other states.

Uber has been named as a defendant in numerous employment law suits across the country. It has successfully defended some on the grounds that the plaintiff(s) did not opt-out of the arbitration agreement that Uber imposes on all of its drivers. U.S. District Judge Garbis of the District of Maryland recently granted Uber's motion to compel individual arbitration in a putative class action that had both common-law claims and claims under the Maryland Labor Law (in treating drivers as employees but not paying them as employees). *Varon v. Uber Technologies, Inc.*, No. MJG-15-3650, 2016 WL 1752835 (D. Md. May 3, 2016), *reconsideration denied*, 2016 WL 3917213 (D. Md. July 20, 2016). Judge Garbis rejected plaintiff's argument that the arbitration agreement was a contract of adhesion and that the class action waiver was substantively unconscionable, since the plaintiff could have opted-out of the arbitration agreement. District courts in other circuits have similarly granted Uber's motions to compel arbitration. *See, e.g.*, *Mumin v. Uber Technologies, Inc.*, 239 F. Supp. 3d 507 (E.D.N.Y. 2017), *reconsideration denied*, 2017 WL 1737636 (E.D.N.Y. May 2, 2017).

Similarly, the Ninth Circuit, in two decisions, held that Uber drivers could be required to arbitrate all of their wage-related claims against Uber, except for drivers who had either (1) opted

out of the arbitration agreement, or (2) had brought claims under California's Private Attorney General Representative statute, a law that specifically precludes arbitration. *O'Connor v. Uber Technologies, Inc.*, 904 F.3d 1087 (9th Cir. 2018); *Mohamed v. Uber Technologies, Inc.*, 848 F.3d 1201 (9th Cir. 2016). Since Uber's arbitration agreement precludes class-action arbitration, that means that even if one arbitrator finds that a single driver was misclassified or otherwise can bring an employment claim, that finding will not extend to other drivers.

Most recently, the U.S. Supreme Court unanimously held that the "transportation worker exclusion" to the Federal Arbitration Act, 9 U.S.C. § 1, includes independent contractors, not just employees, and that this exclusion allows employees in the transportation industry to escape arbitration, here truck drivers who had claims for violation of the federal, Missouri, and Maine wage laws. *New Prime Inc. v. Oliveira*, 586 U.S. __, 139 S. Ct. 532 (2019). Justice Gorsuch's opinion for the Court explained that the Federal Arbitration Act referred to "workers," not "employees," and that at the time the FAA was enacted, the statutory term "contract of employment" "did not necessarily imply the existence of an employer-employee or master-servant relationship," *id.* at 542, so that independent contractors in the transportation industry were encompassed by the FAA.

However, the impact of the *New Prime* decision may be limited by earlier court rulings holding that the "transportation worker exclusion" only applied to individuals who themselves were directly engaged in interstate commerce, usually by driving a vehicle across the state lines. Several lower court decisions have refused to apply this exclusion to couriers and other delivery drivers who only engaged in intra-state transportation. *See, e.g.*, *Lee v. Postmates, Inc.*, No. 18-cv-03421-JCS, 2018 WL 4961802, at *7-*8 (N.D. Cal. Oct. 15, 2018); 2018 WL 6605659, at *6-*7 (N.D. Cal. Dec. 17, 2018) (couriers and delivery drivers not engaged in interstate commerce), appeal docketed No. 19-15024 (9th Cir. Jan. 4, 2019); *Levin v. Caviar, Inc.*, 146 F. Supp. 3d 1146, 1152-54 (N.D. Cal. 2015) (same). This issue is also pending with respect to Amazon drivers. *Rittmann v. Amazon.com, Inc.*, No. 2:16-cv-01554-JCC (W.D. Wash.).

There are two pending appeals at the Ninth Circuit, the older stayed pending resolution of *New Prime*. *Van Dusen v. Swift Transp. Co.*, appeal docketed, No. 17-15102 (9th Cir. Jan. 19, 2017); *Lee v. Postmates, Inc.*, appeal docketed, No. 19-15024 (9th Cir. Jan. 4, 2019).

If the FAA's exclusion does not apply to workers engaged in wholly intra-state transportation, then there could be an inconsistent result: Uber drivers in Washington, D.C. – who regularly transport passengers to the airports and elsewhere in Maryland and Virginia – could avail themselves of the exclusion, while Uber drivers in San Francisco – who are unlikely to transport passengers to Nevada, Oregon, or Mexico – could not do so.

Legislative Remedies? Commentators have noted that the legislative effort to amend the labor and employment statutes with respect to independent contractors has more often focused on employer-initiated legislation that excludes independent contractors. A number of states, including Florida, North Carolina, Arkansas, and Indiana, have recently passed legislation "codifying the position of on-demand transportation platform companies that their drivers are independent contractors," and Alaska also did so with respect to its workers' compensation laws after Uber left Alaska when it was fined for violating the workers' compensation law. *See* Veena Dubal, *Winning the Battle, Losing the War? Assessing the Impact of Misclassification Litigation on Workers in the Gig Economy*, 2017 WISC. L. REV. 739, 754 (2017).

In contrast, several states have misclassification statutes that attempt to protect independent contractors, although sometimes limited in scope. The Maryland Workplace Fraud Act, Md. Code Ann.., Labor & Empl. Art, § 3-901 *et seq*., provides some protection, but limited to independent contractors in the construction and landscape services industries. Similarly, two cities have passed legislation that attempts to provide greater protection to independent contractors – Seattle gave on-demand transportation workers (Uber, Lyft, etc.) the right to collectively bargain under local law, and New York expanded its wage laws to provide better coverage for freelancers. *See* Veena Dubal, *Winning the Battle, Losing the War? Assessing the Impact of Misclassification Litigation on Workers in the Gig Economy*, 2017 WISC. L. REV. 739, 755-56 (2017). Legislative reform on behalf of independent contractors is more likely to succeed when there is a strategic partnership with both unions and workers' rights organizations as part of a broader policy campaign.

Litigation alone is not the remedy, and employment lawyers need to look at the big picture in addressing misclassification issues, as Professor Veena Dubal of UC Hastings College of the Law recently wrote:

> Politically-integrated misclassification litigation is much easier discussed than enacted, especially by dispersed, atomized workers and decentralized advocates operating across both public and private arenas. However . . . on-demand gig economy firms have carried out their own form of politically-integrated advocacy—defending lawsuits, lobbying for new laws to protect their independent contractor model, and deploying savvy public relations campaigns that include the mobilization of consumers. Labor, by contrast, has almost solely relied on lawsuits.
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> While litigation has taken the center stage in the fight against the contemporary gig economy, the case studies from the antecedent gig economy are clear: even if successful, these lawsuits will not make insecure work secure. After spending twenty years litigating misclassification cases, Beth Ross, who valiantly led FedEx drivers through

> multi-state litigation, through a win in *Estrada* and *Alexander* emphasized, "Litigation is not the answer. It is part of the strategy, but not the answer."

Id. at 802.

In conclusion, misclassification is an important problem, and one that will likely increase in the future in the absence of significant and coordinated action to defend bedrock employee rights and protections. Employment lawyers need to consider both litigation and legislation as a way to address the imbalances created by the modern gig economy and the proliferation of independent contractors.