Independent Contractors and the Gig Economy: Objective Standards Needed to Provide Guidance

The hiring of independent contractors is a popular and lawful tool employers use as a part of their overall business model. For businesses, it is a cost-effective way in which to address specialized needs. For entrepreneurs, it is a way in which to maximize profits and grow their own business. Businesses have utilized independent contractors for years and have always struggled with the subjective and conflicting standards at the federal and state levels with regard to who qualifies as an employee versus an independent contractor. With the creation of the gig economy that significantly relies upon the use of independent contractors, the proper classification of individuals as independent contractors has intensified.

The Gig Economy

The "gig economy" refers to a business model that utilizes independent contractors to fulfill temporary positions, jobs, or short-term projects. While the use of independent contractors for short-term needs is not new in the business environment, the way in which the independent contractor is retained, and by whom, is new. Through the use of technology and software applications on smart phones, businesses can quickly connect a consumer with an independent contractor who is available to perform the task or assignment. For example, companies such as Uber and Lyft provide the platform through which a consumer can connect with an available driver for a ride.

Although the size of the gig economy is hard to define given the lack of any comprehensive data collection, several publications have provided estimates of the size and growth of this sector.

- In October 2016, McKinsey Global Institute (MGI) published a study titled "Independent Work: Choice, Necessity, and the Gig Economy" that estimated there are 54 million to 68 million workers who are independent earners, which the study defines as individuals who have a high degree of autonomy in determining their workload, are paid by task, assignment, or sale of an asset/lease of property, and have a short-term relationship between the worker and the customer. MGI determined that 20%–30% of the working population in the United States is independent workers/earners.
- A recent poll in *Time* magazine indicated that approximately 44% of adults in the United States have participated in the gig economy as either a consumer or worker.
- In a study for American Action Forum (AAF) in July 2015, Will Rinehart and Ben Gitis estimated that from 2002 to 2014, the number of workers in the gig economy grew from 8.8% to 14.4%.
- An article by The Foundation for Economic Education, "Turning Independent Contractors Into Employees Would Kill the Gig Economy," stated that the number of active Uber drivers grew from 160,000 in 2015 to more than 650,000 in 2016.

MGI estimates that of the 54 million to 68 million individuals in the gig economy, approximately 70% of the individuals are engaged in the gig economy by choice, while 30% participated out of necessity. The study stated "[m]ost independent workers have actively chosen their working style and report high levels of satisfaction with it." The MGI study also found that approximately 44% of the independent workers relied upon the earnings in the gig economy as their primary income, while 56% of the independent workers used the gig economy for supplemental income.

A separate study by JPMorgan Chase & Co. published in February 2016, titled "Paychecks, Paydays, and the Online Platform Economy," found similar results with regard to the workers who utilize the gig economy for primary versus supplemental income. The JPMorgan study distinguished between "labor platform" workers, meaning those who utilize an online intermediary to connect customers with freelance or contingent workers who perform an assignment; and "capital platforms," who utilize an online intermediary to connect customers with individuals who rent assets or sell goods.

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The JPMorgan study found that only 25% of workers on the labor platform relied upon income earned in the gig economy as a primary source of income (75% of the worker's total income); and "the vast majority—82 percent of labor platform participants and 96 percent of capital platform participants—relied on platform earnings for less than 25 percent of their income." The JPMorgan study also stated that "[r]eliance on labor platforms has remained stable over time in terms of both the fraction of months that participants are active and the fraction of total income earned on platforms in active months."

In November 2016, JPMorgan Chase & Co. released another study, "The Online Platform Economy—Has Growth Peaked," which reached the following conclusions:

• Participation in the labor platform has doubled year after year; however, participation in the capital platform has "leveled off";

• Monthly earnings from the labor platform have fallen by 6% since June 2014;

• Turnover in both the labor and capital platforms is high, with participants exiting the platforms within 12 months of joining;

• Nonemployed individuals are more likely to continue participation in the platforms longer than 12 months; and

• As the traditional labor market improves, recruiting and retaining participation in either platform may become more difficult for businesses in the gig economy.

Benefits/Disadvantages of the Gig Economy

One of the primary attractions to the gig economy is the flexibility for individuals to set their own schedule. In the MGI study, the independent workers who chose to work as freelance agents rated their level of satisfaction as higher than employees who worked in traditional jobs. The study stated that the independent workers are "more engaged in their work, and they relish the chance to be their own boss and have more control over their hours."

Independent workers who work in the gig economy out of necessity also cited flexibility as the main benefit to the work they received. The Foundation for Economic Education stated that being self-employed "is beneficial to workers because it allows them to have flexible hours and to be their own boss." The article also referenced a recent survey that showed three-quarters of drivers for Uber actually preferred having control of their schedule, hours worked, and being their own boss.

Conversely, the primary disadvantage for individuals working in the gig economy is the lack of income security. Independent contractors are not covered by labor standards such as minimum wage, overtime, or unemployment insurance. They also are not entitled to employer benefits, such as health insurance, paid time off, or 401(k)s.

A July 12, 2015, *New York Times* article by Noam Scheiber titled "Growth in the 'Gig Economy' Fuels Work Force Anxieties," stated that "many live with the uncertainty of not knowing how long they will go between assignments, during which time they earn no income from the company." The MGI study also stated that individuals who work in the gig economy out of necessity are less satisfied with their income level and security than those in traditional jobs.

Classifying Individuals as Employees vs. Independent Contractors

Ensuring the proper classification of an individual as an employee versus an independent contractor has always been a daunting task for any business/employer, especially in California, given the subjective and inconsistent analysis that is used to determine whether an individual qualifies as an employee versus an independent contractor. This analysis is no different with individuals working in the gig economy.

The common law test for determining the status of an individual as an employee versus an independent contractor was set forth by the California Supreme Court in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal.3d 342 (1989), and focuses primarily on who has the right to control the details of the work performed, but also includes consideration of the following factors:

• Whether the relationship may be terminated "at will";

• Whether the individual performing services is engaged in a business distinct from the principal's;

• Whether the work performed is typically done under the direction of the principal or without supervision;

• What the required skill is to perform the job;

• Whether the principal supplies the tools and the worksite;

• What is the length of time for which the services are to be performed, i.e., is it ongoing or is there a set deadline for the services to end;

• What is the method of payment, i.e., hourly or by the job; and

• Whether the parties believe they are creating the relationship of employer-employee.

No single factor in this analysis, including the right to control, is determinative. Moreover, the analysis is not based upon the "totality of the circumstances," meaning that even if an employer satisfies a majority of these factors in favor of independent contractor classification, there is no guarantee that such a classification is accurate. Rather, the application and importance of each factor is determined on a case-by-case analysis.

A recent appellate decision in *Dynamex Operations West, Inc. v. Superior Court*, 2014 WL 5173038 (2014), complicated the issue even further by providing another interpretation as to whether an individual is an employee versus an independent contractor. Specifically, in *Dynamex*, the court relied upon the Industrial Welfare Commission (IWC) Wage Orders definition of an "employee," rather than the common law factors set forth above to determine the proper classification. The IWC definition is broader than the common law factors, and therefore arguably includes more individuals as employees rather than independent contractors.

In August 2014, the Ninth Circuit Court of Appeals issued a significant decision in *Alexander et al., v. FedEx Ground Package System, Inc*., 765 F.3d 981 (9th Cir. 2014), wherein it determined that despite the entrepreneurial aspects of the relationship between the drivers of FedEx, evidence that FedEx had the right to control and actual control over the drivers was the primary factor.

To add to the confusion and intimidation of this analysis for employers, not all state or federal agencies utilize the common law test. In fact, the California Department of Industrial Relations, which utilizes the common law test, admits that an individual may be considered an independent contractor for its purposes, but an employee for another state agency's test, and vice versa. Accordingly, even if the Internal Revenue Service or Division of Labor Standards Enforcement confirms that in its opinion the individual is an independent contractor, another federal or state agency such as the U.S. Department of Labor or Franchise Tax Board could subsequently determine otherwise.

In March 2015, the Little Hoover Commission released a report titled "Level the Playing Field: Put California's Underground Economy Out of Business," in which the commission set forth several recommendations to limit activity in the underground economy. The commission's Recommendation No. 3 was for the Legislature to enact a law that defines independent contractor and is applicable to all state agencies.

Litigation in the Gig Economy

In November 2014, the gig economy became a focus of the independent contractor debate when drivers for Uber Technologies, Inc. (Uber) filed a class action in the Northern District Court of California, claiming that they were misclassified as independent contractors. Shortly thereafter, a similar lawsuit was filed by drivers against Lyft, Inc. making the same allegation. Uber and Lyft both filed a motion for summary judgment, requesting the court to determine as a matter of law that the drivers were classified correctly. Both motions were denied.

In the Lyft case, the court, in its order denying the motion for summary judgment, made the following observation: "The test the California courts have developed over the 20th Century for classifying workers isn't very helpful in addressing this 21st Century problem . . . [a]bsent legislative intervention, California's outmoded test for classifying workers will apply in cases like this. And because the test provides nothing remotely close to a clear answer, it will often be for juries to decide."

In April 2016, Uber agreed to a proposed settlement of the action that would provide 385,000 drivers with $100 million to divide amongst them. The settlement, however, allowed Uber to continue to classify the drivers as independent contractors. In January 2016, Lyft reached a settlement of approximately $12.25 million in its class action; the settlement also allowed the company to continue to classify the drivers as independent contractors.

Labor unions objected to both settlements and urged the judge in both cases to reject the proposed settlements, primarily due to the provision that allows the companies to continue to classify drivers as independent contractors. In both cases the judges rejected the settlements due to the monetary amount being too low, but did not indicate any concerns with regard to the drivers maintaining independent contractor status.

In October 2015, Amazon "Prime Now" drivers filed a class action in Los Angeles Superior Court claiming they were misclassified by the company as independent contractors. In November 2016, Uber faced another class action lawsuit in New York from its foot and bike couriers, who also allege they have been misclassified as independent contractors.

Recent Federal Activity

In July 2015, Administrator David Weil published Administrator's Interpretation 2015-1, which outlined the Fair Labor Standards Act's (FLSA) use of the term "suffer or permit" for employee status and warned that most workers are employees under this board definition.

In the Equal Employment Opportunity Commission (EEOC) Strategic Enforcement Plan for Fiscal Years 2017–2021, the EEOC identified under its "Emerging and Developing Issues priority," the need to address "issues related to complex employment relationships and structures in the 21st century workplace, focusing specifically on temporary workers, staffing agencies, independent contractor relationships, and the on-demand economy." Although the EEOC has focused on the misclassification of independent contractors for several years, this indicates the EEOC's targeted focus on the gig economy.

With the transition in the federal administration in January 2017 to President Donald Trump, the focus and targeted issues by the EEOC and other labor agencies could change with regard to the gig economy.

Recent California Activity

In 2016, Assemblymember Lorena Gonzalez (D-San Diego) introduced AB 1727, which sought to allow all independent contractors to collectively bargain with a "hosting platform" defined as "a facility for connecting people or entities seeking to hire people for work with people seeking to perform that work, using any medium of facilitation, including, but not limited to, a dispatch service, an Internet Web site, or other Internet-based site," on issues related to work assignments, compensation, and terms of service. The bill ultimately failed in the Assembly Judiciary Committee.

Although much broader, AB 1727 was similar to the local ordinance adopted by Seattle in 2015 that provided drivers for ride-hailing apps the opportunity to collectively bargain on compensation and other working conditions. Shortly after the adoption of this local ordinance, the U.S. Chamber of Commerce filed a lawsuit challenging the legality of the ordinance in federal court. One of the bases for the challenge was that the ordinance violates federal antitrust law. In August 2016, the judge dismissed the lawsuit on the basis that th e U.S. Chamber lacked standing to bring the lawsuit.

CalChamber Position

The challenge employers face with regard to properly classifying individuals as employees versus independent contractors has been an issue in California for years. The growth of the gig economy has simply mainstreamed the challenge.

Given the significant benefits and financial opportunities the gig economy has and continues to provide to numerous individuals, simply shutting down the business models that operate in this economy by deeming all individuals as employees or allowing such individuals to collectively bargain should not be the answer. Rather, California should look at a balanced approach to addressing the concerns of individuals working in the gig economy as well as preserving the benefits the gig economy provides.

As indicated by the court in the Uber and Lyft cases, the traditional notions of who qualifies as an employee versus an independent contractor may be outdated and in need of further review by the Legislature. All employers in California, including those in the gig economy, would benefit from objective standards that provide better guidance of who qualifies as an employee versus an independent contractor.

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January 2017