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June 3, 2019

Legal Update

The Future of Independent Contractor Classification: As 9th Circuit and DLSE Expand *Dynamex*'s Reach, DOL and NLRB Find Gig Economy Workers Contractors Under Federal Law

As we previously reported, the California Supreme Court's landmark decision in *Dynamex Operations West, Inc. v. Superior Court* adopted a new worker-friendly standard, known as the "ABC test," for determining whether workers are properly classified as employees or independent contractors under the California Industrial Welfare Commission's ("IWC") Wage Orders. On May 2, 2019, the Ninth Circuit expanded the effect of the decision in *Vazquez v. Jan-Pro Franchising International, Inc.*, holding that *Dynamex* must be applied retroactively and providing guidance on how to apply Prong B of the ABC test. The next day, California's wage and hour enforcement agency, the Division of Labor Standards Enforcement ("DLSE"), issued an opinion letter further expanding *Dynamex's* reach by opining that the ABC test applies to claims for "waiting time penalties" under Labor Code section 203 and for reimbursement under Labor Code section 2802. On May 30, 2019, the California State Assembly passed A.B. 5, which seeks to codify *Dynamex* and, with the exception of certain specified professions, requires that the ABC test be used in determining the status of workers with respect to *all* provisions of the Labor Code and Unemployment Insurance Code, rather than solely for the IWC Wage Order requirements, unless another definition or specification of "employee" is provided. The bill will need to be passed by the California Senate.

By contrast, the US Department of Labor ("DOL") and the National Labor Relations Board ("NLRB" or "Board"), applying a less stringent standard, recently found workers in the gig economy to have been properly classified as independent contractors, not employees, under the Fair Labor Standards Act ("FLSA") and the National Labor Relations Act ("NLRA").

The Ninth Circuit's Decision in *Vazquez*

In 2008, a putative class action was filed by janitor-franchisees of Jan-Pro Franchising International, Inc. ("Jan-Pro"), an international janitorial cleaning business. The plaintiffs alleged that Jan-Pro had developed a "three-tier" franchising model to avoid paying janitors minimum wages and overtime compensation by misclassifying them as independent contractors. In May 2017, a

California district court granted summary judgment for Jan-Pro, concluding that the individuals performing the cleaning services were independent contractors. The plaintiffs appealed. While the appeal was pending, the California Supreme Court issued *Dynamex*, in which it adopted the narrower ABC test for determining worker classification.

On May 2, 2019, the Ninth Circuit held that *Dynamex* must be applied retroactively because it was a "clarification rather than a departure from established law," and there was thus no basis to apply it only prospectively. Although the Ninth Circuit remanded the case to the district court to consider whether the plaintiffs were misclassified under the *Dynamex* standard, the Court of Appeal nonetheless offered "observations and guidance" regarding the implications of the factual record that had been developed thus far "[a]s an aid to the [district] court" in applying the ABC test. The Ninth Circuit:

- Clarified that *Dynamex* applies equally in the franchise context and that previous decisions addressing franchisor/franchisee vicarious liability in the tort context do not affect application of the ABC test in the independent contractor inquiry.
- Provided guidance on analyzing Prong B of the ABC test, which addresses whether the hiring entity is engaged "in the same usual course of business as the putative employee." The court laid out the various formulations that courts have used to frame the Prong B inquiry and that should be considered, including (i) whether the employee's work is necessary to or merely incidental to that of the hiring entity, (ii) whether the employee's work is continuously performed for the hiring entity and (iii) what business the hiring entity proclaims to be in.

In connection with each of the Prong B formulations, the Ninth Circuit observed that Jan-Pro's business ultimately depends on someone performing cleaning and thus fundamentally depends on a supply of unit franchisees for its business and that Jan-Pro actively and continuously profits from the performance of these cleaning services. The court directed the district court to consider "whether Jan-Pro's business model relies on unit franchisees continuously performing cleaning services." Finally, the court noted that courts generally consider how a business describes itself on its websites and in its public advertisements in determining the usual course of its business, noting that, although Jan-Pro argued that it is in the business of "franchising," its website describes it as a "commercial cleaning company."

DLSE Opinion Letter Expanding the Scope of *Dynamex*

The day after the Ninth Circuit decided *Vasquez*, the DLSE issued an opinion letter expanding *Dynamex's* reach. The DLSE opined that, under *Dynamex*, "[w]hen a claim 'derive[s] directly from,' or 'rest[s] on' an obligation imposed by a wage order, the ABC test applies to determine questions of employee status" and noted that *Dynamex* and decisions following it have therefore applied the ABC test to Labor Code sections enforcing minimum wage, overtime, meal and rest periods and itemized pay stubs (e.g., Labor Code Sections 226, 226.7, 512, 1182.12, 1194 and 1197). Accordingly, the DLSE opined that (a) the ABC test should apply to employees who seek waiting time penalties under Labor Code section 203 in misclassification cases involving underlying minimum wage and overtime obligations and (b) all reimbursement claims under section 2802 "that enforce specific [reimbursement] requirements directly set forth in the wage orders are also governed by the ABC test."

DOL Opinion

By contrast, on April 29, 2019, the DOL issued an opinion finding that service providers working for a virtual marketplace company ("VMC")—i.e., a gig economy company—are independent contractors, not employees, under the FLSA.

In FLSA2019-6, the DOL advised that "the touchstone of employee versus independent contractor status has long been 'economic dependence.'" The DOL applied the six-factor "economic realities" test to analyze whether the VMC's service providers were properly classified as independent contractors. In doing so, the DOL advised that employee status is not determined by "simply counting factors" but rather by "weighing the factors in order to answer the ultimate inquiry of whether the worker is engaged in business for him or herself or is, instead, dependent upon the business to which he or she renders service."

The DOL explained that the VMC's business is to provide a referral service through which service providers connect with end-market customers and that the VMC itself is not receiving services from the service providers. As a result, the service providers are working for consumers through the virtual marketplace, not for the VMC itself. In analyzing the six factors of the "economic realities" test, the DOL found that:

- The VMC does not appear to exert employer-like control over service providers because it does not impose particular duties, shifts or quotas on them or inspect their work for quality or rate of performance; rather, the VMC gives workers the flexibility to choose if, when, where, how and for whom they will work.
- The workers have complete autonomy to pursue any and all external opportunities at their leisure, including work for competitors, both during the relationship and after it ends, and the relationship is not permanent because the workers provide services through the VMC on a project-by-project basis.
- The VMC requires service providers to purchase all necessary resources for their work and does not reimburse them for those purchases. Indeed, while the VMC invests in the virtual referral platform used by service providers, that reliance only marginally decreases the workers' relative independence because they can use similar software on competitor platforms.
- The service providers have "considerable independence" from the VMC because they can choose between service opportunities and competing virtual platforms, are not provided training by the VMC and exercise managerial discretion in order to maximize their profits.
- The service providers retain control over their compensation opportunities because they can choose different types of job with different prices, take as many jobs as they see fit and negotiate the price of their jobs.
- The service providers are not integrated into the VMC's referral business because they are not involved in developing, maintaining or otherwise operating the virtual platform but instead use it as consumers to acquire service opportunities.

NLRB Advice Memo

Similarly, on May 14, 2019, the NLRB released an advice memorandum, dated April 26, 2019, in which it found that, "[a]pplying the common-law agency test," UberX and Uber BLACK drivers were properly classified as independent contractors rather than employees under the National Labor Relations Act ("NLRA"). Applying the non-exhaustive ten-factor test enumerated in the Restatement (Second) of Agency and "view[ing] [them] through the 'prism of entrepreneurial

opportunity,'" the NLRB found that, overall, UberX drivers "operated with a level of entrepreneurial freedom consistent with independent-contractor status."

In so ruling, the Board found that Uber drivers are afforded "significant entrepreneurial opportunity by virtue of their near-complete control of their cars and work schedules." The Board emphasized that drivers can choose when and how long to log into and remain on the Uber app, where to log into the app within the broad confines of a geographic market and whether and when they want to work for competitors of Uber. While the NLRB noted that Uber set baseline fares and that drivers could not subcontract their work, routinely reject trips based on expected profitability or attempt to divert business to Uber competitors, the Board found that these terms only affected their entrepreneurial opportunity *while performing rides through the app*. Since drivers had unlimited freedom to drive or perform other work outside the app, the impact on their overall entrepreneurial independence was diminished.

Takeaways for Employers

- The *Vazquez* decision and DLSE opinion letter, which amplify the effects of *Dynamex*, in conjunction with the California State Legislature's attempts to codify *Dynamex* with respect to all provisions of the Labor Code, increase the likelihood of increased litigation over worker misclassification in California. California employers should thus proceed with caution when retaining independent contractors and ensure they are compliant with the ABC test as interpreted by both the decision and opinion letter.
- By contrast, the DOL's and NLRB's opinions, while not binding authority, should provide comfort to employers in the gig economy that their workers may qualify as independent contractors—at least under federal law—to the extent their positions fit within the economic realities test or common-law agency test described in the opinions. Employers should thus consider how similar their operations are to those described in the letters and determine if any modifications should be made to ensure their workers are considered independent contractors under federal law, while simultaneously considering more restrictive state law rules in the jurisdictions in which the employers operate.
- Multi-state employers with employees in California and other states applying standards that are more restrictive than federal law will have to decide whether to observe the more restrictive standard across the board or adopt different standards in different jurisdictions.

For more information about the topics raised in this Legal Update, please contact the following lawyer.

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