Bloomberg BNA

Daily Labor Report®

WAGE & HOUR

What's been called by many the ''gig economy'' burst on the scene in recent years. While companies are still figuring out this new business model, courts, government agencies and plaintiffs' class action lawyers are taking note and increasing their scrutiny. Questions abound with respect to whether and how wage/hour and other laws apply to gig economy workers. In this Bloomberg Law Insights article, Morgan Lewis attorneys Michael Puma and Alyssa Kovach discuss how the law has developed so far and, most importantly, how companies can limit their risk.

The Gig Economy Takeover: What Your Business Needs to Know

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I. The What Economy?

The gig economy is a market model in which workers contract with organizations for temporary, short-term engagements. Typically, a worker has the ability to pick and choose when he or she will work and how often. There are two major sub-groups in the gig economy. The first group deals with personal services, like Uber, Lyft, and Handy. These companies serve as intermediaries who connect consumers with services. The second group deals with goods and impersonal services, like AirBnB and Etsy. These companies serve as intermediaries who connect buyers and sellers.

Gig economy companies often rely solely on contractors and independent workers as the entire basis for their business model. Independent workers are those workers who regularly engage in freelancing, contract work, consulting, temporary assignments, or on-call work each week for income, opportunity, and satisfaction. As of 2015, there were 42.1 million independent workers 21 years or older in the Unites States. Of these 42.1 million, 17.8 million were full-time, 12.4 million were part-time, and 11.9 million were occasional independents. Those independent workers generated more

 ISSN 0418-2693

than $1.15 trillion in revenue in 2014. That is equal to nearly 7 percent of U.S. GDP.

The rapid rise of this ''on-demand'' economy can be attributed largely to its flexibility, accessibility and affordability. Today's workforce does not simply want *work*, they want more control over *how* they work. Workers in the gig economy get to decide where to work, when to work, and they get to be their own boss. Consumers benefit from the accessibility of on-demand services that fit into their busy lifestyles and employers have a more flexible workforce. So, what's the problem?

II. Understand the Risks

A. Heightened Governmental Scrutiny. While there are undeniable benefits to the gig economy, the novelty and rapid expansion poses legal uncertainties and has resulted in heightened scrutiny of all independent contractor relationships. On July 15, 2015, the Department of Labor issued an Administrator's Interpretation setting forth the test that it will apply in determining whether an individual qualifies as an independent contractor or employee. In the Administrator's Interpretation, the DOL stated that individuals who are ''economically dependent'' on an employer should be treated as employees. Moreover, the DOL said that in applying its independent contractor test, it would take the position that the FLSA should be liberally construed to provide broad coverage such that most workers are considered employees under the FLSA. For example, in looking at whether a worker should be classified as an employee or independent contractor, it is the DOL's position that not even working offsite, controlling one's own hours, and having little supervision—the traditional hallmarks of independent contractor status—would be ''indicative of independent contractor status.''

Although the Administrator's Interpretation is not a formal regulation and thus not binding on employers or the courts, it does reflect the DOL's enforcement position. This means that DOL investigators will be guided by this expansive take on who should be classified as an employee or independent contractor. Additionally, although courts have developed their own tests for determining who is properly classified as an independent contractor, courts often look to the DOL's guidance in applying the FLSA. The plaintiffs' bar also is certain to use the position advanced by the DOL in lawsuits brought by allegedly misclassified contractors. Consequently, the Administrator's Interpretation presents a legitimate risk to companies who use independent contractors. Additionally, other federal agencies, such as the IRS, have their own multi-factor classification tests that could be relevant for the assessment of liability for failure to withhold income taxes, pay employer payroll taxes, or provide health coverage under the Affordable Care Act (''ACA''). The extent to which other agencies would rely upon the DOL's determination in these contexts may vary. If a worker is found to be an employee rather than an independent contractor, the liability can include (depending on the circumstances) back wages, tax liability, retroactive exposure for employee benefits (including potentially significant penalties under the ACA), unpaid unemployment and workers' compensation insurance contributions, fines, and penalties.

B. State Law Concerns. In addition to heightened scrutiny from the federal government, employers in the gig economy must also take into account states with unique and more demanding requirements. For instance, California law considers a company's right to control a worker claimed to be an independent contractor, even if there is little control in fact. Plaintiffs' lawyers argue that this makes California contractor misclassification claims particularly susceptible to class certification where there is a fairly uniform contract, given that it is the contract that determines the right to control.

In other states like Massachusetts, the so-called ''ABC test'' determines independent contractor status. This test is quite different from the traditional tests under the FLSA and the tax code, which are balancing tests that focus on inquiries into control, the expectations of the parties, and which party bears expenses. Those were issues that could be managed by a written agreement memorializing the independent contractor relationships. Instead of a balancing test, the three factor ABC test puts the burden on the putative employer to prove each of its three elements. In other words, the failure to prove just one results in a finding of employee status. These three factors in some states are: (A) freedom from control; (B) service outside the usual course of the employer's business; and (C) work in an independent trade, occupation, procession, or business. Factor B can become the plaintiffs' focus in litigation given that many companies use independent contractors for core business functions. At bottom, gig economy companies need to know the laws that apply in the states where they are using contractors and carefully evaluate varying related risks state by state.

III. Mitigate the Risks

A. Common Sense Approach. Every company's starting point in navigating these risks should be to identify contractors. This sounds easy enough, but many companies do not have any central control over these relationships and have no idea what independent contractors are serving varying parts of the business. After identifying the ''who,'' it is important to address the ''why''—why are these individuals being treated as contractors rather than employees? Undertaking this assessment is crucial to taking calculated risks if appropriate and avoiding unexpected surprises down the road. Many companies will answer the ''why'' question by saying that is how we have always done it, or that's what the workers want, or that's just how the industry works. But consider whether any of those answers are a good reason to take on considerable risk.

The next step is to break down into buckets the kinds of contractors the company is using and consider which create the most risk, including how they relate to the company's business and the laws of the states where they perform services. Some contractors may be appropriate for reclassification and others may be more suitable for mitigation measures. To the extent reclassification occurs for some workers, communication is the key. With the wrong message, the workers will view the reclassification as essentially an admission that they previously were misclassified.

B. Contract Improvement. One of the first and most basic measures to mitigate risk is to improve contracts with independent workers. Many form independent

  DLR ISSN 0418-2693

contractor agreements used by companies are quite dated. They frequently have not been modified to address developments in state law, let alone the DOL's new interpretation. Contracts at a minimum generally should clearly state the parties' expectations of a contractor (not employment) relationship, confirm the specialized skills offered by the contractor and that they will bear their own expenses, and make clear the very limited aspects of company control over the contractor, if any at all. Contracts also provide an opportunity to put the contractor on notice that he or she will not be eligible for any benefit plans offered to employees.

To best avoid the threat of costly, time consuming class and collective action lawsuits, it may be advisable to include an arbitration agreement into every independent worker's contract with a class and collective action waiver. For large groups of contractors performing the same or similar functions, this may be particularly important to protecting the company. The Supreme Court has approved such provisions over and over again in recent years even when the cost of providing an individual claim in arbitration exceeds the potential recovery and even when they are forced on individuals as a requirement of doing business.

However, this is not a one-size-fits-all solution. Arbitration has a number of downsides in comparison to litigation in court, including looser rules of evidence, less chance of winning on dispositive motions, and limited appeal rights. In addition, mandatory arbitration is under attack from multiple angles, including proposed legislation and in National Labor Relations Board opinions, so this also may not be a permanent solution.

C. Changes Beyond the Contract. Beyond the language of the agreement with a contractor, there are other ways to reduce risk. One option is to alter the form of payment from hourly to a lump-sum, project-based payment from which contractors pay their own expenses, which further reduces control and increases economic independence. The same is true for eliminating or loosening restrictions on contractors having their own employees or subcontractors. Another option may be to work only with contractors that are incorporated and have multiple clients. These workers are thus less reliant on the company for their livelihood and are more likely to be seen as independent business people rather than company employees.

D. Creative Solution to Benefits Issues. The lack of benefits is touted as a significant governmental concern related to the gig economy. As mentioned above, addressing benefits in the Contract is one strategy for mitigating the risks associated with failing to offer benefits to contractors. In addition, companies in the gig economy should review their benefit plans to ensure that they clearly define the workers that are entitled to benefits and defer to the company's classification of an individual for benefits purposes, regardless of later reclassification by a court or governmental agency.

There are several potential non-traditional solutions that could eventually become available to companies in the gig economy to reduce a company's level of exposure to benefits claims. One such proposal is to support a portable benefits system where workers receive benefits that are tied to the workers themselves rather than any one business. Under this system, either the intermediaries or workers (depending on the program) pay into the benefits programs that include Social Security, workers' compensation, unemployment insurance funds, paid leave and sick days, retirement matching, and Medicare. The amount paid is based on tasks, hours logged, and income generated for business, among other things. Multiple businesses could contribute into the system which follows the worker from job to job. This structure may look familiar to companies that are familiar with multiemployer (i.e., union) benefit plans or, to a lesser extent, professional employer organizations (PEOs). The system could be administered by the government, a newly created hybrid public-private entity, a bank or credit union, or a nongovernmental entity like a nonprofit. While such a system would not solve all of the challenges, it could provide gig economy workers with flexibility and security. But this proposal is ambitious and presently a long way from reality.

IV. Conclusion

The new gig economy creates many opportunities for companies, workers and consumers. At the same time, the businesses at the center of the gig economy have targets on their backs given increased litigation over contractor status and the DOL's new guidance. There is no reason yet for companies to abandon what has become a successful business model, but they would be wise to consider the mitigation measures proposed above and to continue to monitor closely the rapidly evolving law in this area.