An Uber-Sized Deal

Proper Classification of Workers in the "Gig" Economy

By David J. Oberly

The hotly contested battle pitting gig economy companies against their workers and governmental bodies highlights the significant legal issues and consequences relating to the issue of worker classification.

Under the rapid and significant rise of what is commonly termed the "gig" economy—comprised of companies with business models based largely on alternative worker arrangements—a monumental tug of war is now in full force over the status of these workers and whether they are properly categorized as employees or independent contractors. As a general matter, answering the question of whether a company's workforce is composed of employees or independent contractors is one of the most complex and daunting tasks that employers face. With the variety of new business arrangements that have been created within the gig economy, recognizing the legal distinctions between categories of workers is especially arduous and problematic. However, getting the answer right is imperative, as misclassifying workers can expose a company to tremendous legal liability.

To add to the challenge, both governmental agencies and the plaintiffs' class action bar have upped the ante by questioning the classification of many of today's more prominent non-traditional employment relationships, especially those utilized frequently in the gig economy. While a definitive determination regarding the proper classification of gig economy workers remains uncertain, the ultimate outcome of this dispute will undoubtedly impact all sectors of this nation's economy and will help to mold the business models and relationships of tomorrow's companies.

Overview of the Gig Economy and the Implications of Workforce Classification

Recent advances in technology have spawned an entirely new business model that is commonly known today as the "on-demand, "sharing," "1099" or "gig" economy. This sector, which involves shared access to goods and services, has had a noteworthy impact on the nation as a whole, as the gig economy has begun to transform the marketplace and edge aside businesses operating under more traditional models. For example, ride-sharing companies such as Uber and Lyft have begun to displace traditional methods of transportation, most importantly taxicabs.

The hybrid business model of the gig economy utilizes a range of technology platforms—often via smartphone application—to connect customers directly with desired goods or services supplied by independent workers. Importantly, many gig economy business models have adopted

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varying types of alternative worker employment arrangements under which workers no longer have set, standard work hours, but rather work "on-demand"—either when needed or when the worker feels like doing so. Although the ability of an employee to work according to his or her personal preferences generally evidences an independent contractor relationship, gig economy workers ultimately fall into a grey area due to the fact that while they can pick and choose the hours they work, they may nonetheless be subject to significant control by companies over issues such as compensation and rules and requirements for performing their job responsibilities. Thus, the gig economy is making it increasingly difficult simply to categorize workers as employees or independent contractors.

The significance of whether a company's workers are classified as employees or independent contractors is immense. A range of benefits and protections—health insurance, minimum wage requirements, unemployment insurance, overtime pay, business expense reimbursement, and workers' compensation benefits, just to name a few—are available to employees, but not to independent contractors. Those benefits and protections come at a steep cost to employers. Moreover, businesses whose workers are classified as employees must also incur the cost of significant fringe benefits such as vacation time, sick leave, and holiday pay. Finally, in addition to the cost of benefits, employers face enormous potential legal liability as a result of holding the ultimate responsibility for any torts committed by their employees. Conversely, businesses that engage only independent contractors face none of these costs or liabilities.

Equally important, employers face severe consequences for misclassification of their workforce. Some of those consequences include having to pay back taxes, wages, and benefits, as well as civil penalties. Moreover, employers who are found to have misclassified employees as contractors also face liability under the Fair Labor Standards Act (and applicable state wage laws) for failure to pay overtime and minimum wage. In addition, if a finding is made that a company's independent contractors are actually employees, then all employment, benefit, and tax laws that the company didn't have to worry about before all suddenly apply—and on a retroactive basis.

As a general rule, gig economy companies generally classify their workers as independent contractors based on the reasoning that the workers can take or reject job opportunities according to their personal availability and preferences. Many workers, however, desire employee status in order to unlock the benefits and safeguards not bestowed on their contractor counterparts. Significantly, in recent years, lawmakers, governmental agencies, and workers themselves have ramped up their legal challenges to the position taken by gig economy companies. Those challenges are premised on the argument that workers who are misclassified as independent contractors instead of employees are being unfairly precluded from rights and protections to which they are legally entitled. To date, courts and administrative bodies have reached conflicting conclusions concerning the status of the gig economy workforce, and even the workforces of individual companies operating in this sector. Thus, the jury is still out in terms of a definitive answer to the question of whether workers in the gig economy are properly classified as employees or independent contractors.

The Big Four: Principal Worker Classification Tests

Determining the proper classification of a workforce is one of the most complex, challenging, and uncertain endeavors in the realm of employment law. To make matters more difficult, there is still no single test at the present time for establishing whether a worker is an employee or independent contractor, which is the combined result of a number of independent bodies of employment law. Rather, four common tests are utilized to determine an employment relationship.

The Common Law Control Test

The vast majority of laws governing the employment relationship utilize some variation of what is commonly known as the "common law control" test. The control test considers several essential aspects of the employment relationship: (1) an employer's federal tax obligations; (2) liability under federal employment statutes, such as anti-discrimination laws; (3) the Employment Retirement Income Security Act of 1974; and (4) the National Labor Relations Act. The common law test is used under both federal and state law to evaluate whether a worker is an employee or independent contractor.

The common law test focuses on the worker's right to direct the means and methods of completing his or her work. While many variations of the test exist, all share a significant common thread in that the worker will be classified as an employee if the employer possesses behavioral or financial control over the worker, as well as control of the employment relationship. As a general rule, the greater the control exercised over the terms and conditions of employment—and the means and manner of completing the work in particular—the greater the likelihood that a finding will be made that the worker is an employee as opposed to an independent contractor. Thus, companies must evaluate the totality of the circumstances to ascertain whether a worker retains sufficient autonomy to be classified as an independent contractor. Importantly, actual control is not necessary in many instances, as the mere right to control suffices to categorize a worker as an employee.

Under the control test, whether a person is an employee or independent contractor depends on the facts of the particular case, with the key question being who had the right to control the manner and means of doing the work. If such a right is retained by the employer, the relationship is that of

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employer and employee; but if the manner and means of performing the work is left to the worker, an independent contractor relationship is created. To determine whether the hiring party has the right to control the worker, courts generally examine a number of factors including the following: (1) the type of business and services rendered; (2) whether the worker is engaged in a distinct occupation or business; (3) whether the worker is subject to the same personnel practices and disciplinary rules as are admitted employees; (4) whether the work involved is usually completed under an employer's direction or by an unsupervised specialist; (5) the required skill involved in the completion of the work for which the worker is hired; (6) the manner in which entrepreneurial risk and reward are allocated, and whether the worker can realize a profit or loss; (7) the manner in which the company supervises the worker; (8) who provides the equipment and instrumentalities for the job; (9) the length of employment; (10) the method of payment; (11) the tax treatment of the hired party; (12) whether the work is part of the employer's regular business and/or necessary to it, or whether the worker's services can be substituted; (13) the intent of the parties; (14) the training provided to workers; (15) whether the worker can work for more than one business at a time and whether the worker is able to make his services available to the general public; and (16) any pertinent agreements or contracts.

As noted above, significant variations to the control test exist. For example, in 2014, the NLRB refined its multi-factor classification test in FedEx Home Delivery, 361 NLRB No. 55, which had a significant impact due to its broad application in determining the status of workers in both representation cases and unfair labor practice cases. The courts and the NLRB have held that determinations made in the context of the National Labor Relations Act should place more emphasis on whether the individual had an actual, as opposed to merely a theoretical, significant entrepreneurial opportunity for gain or loss. In addition, in 2013, the IRS retooled its traditional 20-factor test into an 11-factor analysis, which streamlined the test into three broad categories: (1) behavioral control; (2) financial control; and (3) type of relationship. For behavioral control, the IRS test focuses on the degree to which a company controls how a worker completes his or her job responsibilities. For financial control, the test analyzes the method of payment for the worker and whether the worker receives reimbursement for expenses. And for relationship control, the test focuses on contracts entered into by the parties, with an emphasis on analyzing the degree of permanency of the relationship involved.

The Economic Realities Test

In certain situations, the employment relationship is governed by a much broader "economic realities" test, which also considers certain control test factors, but which places a much more significant focus on the company's financial control over the worker and whether the worker is dependent on the business he or she serves. The economic realities test turns on several important aspects of the employment relationship: (1) the Family Medical Leave Act; (2) the Fair Labor Standards Act; and (3) the Equal Pay Act.

The economic realities test provides an expansive definition of "employee," and favors liberal employee classification. Where a worker is highly dependent on the business that he or she serves, and derives a significant portion of his or her income from the company, then the economic realities test favors classification of the worker as an employee. The rationale of this test is that it is important to compensate and protect those individuals who depend on their employer for financial security and well-being. Unlike an employee, a contractor does not depend solely on the company for economic stability; rather, the contractor can, and often has to, seek additional work from other companies.

The following factors, or certain variations of such, are typically analyzed under the economic realities test: (1) the extent to which the work performed is an integral part of the employer's business; (2) the worker's opportunity for profit or loss, depending on his or her managerial skill; (3) the extent of the relative investments of the employer and the worker; (4) whether the work completed requires special skills and initiative; (5) the permanency or duration of the relationship; and (6) the degree of control exercised by the employer.

Although the economic realities test contains some overlapping factors vis-à-vis the control test, the two tests are reviewed through different lenses. While the economic realities test reviews those factors focusing on the economic dependency of the worker, the control test analyzes factors focusing on the control exerted over the worker. Thus, it is plausible that these two tests based on the same set of underlying facts could lead to divergent conclusions concerning a particular worker's relationship.

The Hybrid Test

The third test, known as the "hybrid" test, combines elements of the right to control and economic realities tests, and focuses on the issue of control. Under this test, the economic realities of the relationship are analyzed, but the primary emphasis is placed on the company's right to control the manner and means of the worker's performance.

While control is the central factor considered under the hybrid test, that factor alone is not dispositive. In addition to the company's control over the means and manner of the worker's performance, the hybrid test considers special details in the relationship between a worker and the company for which he or she does work, including: (1) the type of occupation the worker is performing, and whether it requires expert supervision or can be completed by a specialist working alone; (2) whether the company retains a method for terminating the work relationship and whether that procedure is similar to the termination of an employee; (3) whether the worker accrues time off and retirement benefits; (4) the intention of the parties; (5) whether the company or the worker furnishes the equipment used and the place of work; (6) the length of time the individual has worked for the company; (7) the method of payment (time or job); (8) whether the work is an integral part of the company's business; and (9) whether the company pays social security taxes.

Ultimately, the hybrid test does not differ materially from the common law test, as both tests emphasize the hiring party's right to control the manner and means by which the work is accomplished. Thus, in practical terms, courts generally reach the same determination under either test.

The ABC Test

The final test is referred to as the "ABC" test, which is broad and includes most workers. This test is used primarily for unemployment compensation purposes at the state level.

Under the ABC test, which diverges significantly from the other classification tests, a worker is presumed to be an employee unless the company can establish all three of the following elements: (1) the worker is free from control or direction in the performance of the work; (2) the work is done outside the usual course of the firm's business and is done off the premises of the business; and (3) the worker is customarily engaged in an independent trade, occupation, profession, or business. Unless the worker meets all three elements, the worker is considered an employee. With respect to the first element, at least some variations of the analysis hold that the control criteria will not be satisfied if the company retains the right to exercise control over the work, even when the right is not exercised. Moreover, workers who form a business in response to an independent contractor work offer do not meet the "customarily engaged" or "independent" requirements relating to the final element.

Takeaways for Employers

The distinction between genuine independent contractors and employees is a crucial matter for employers of all industries and sizes. While the gig economy has proliferated in recent years, this sector is nonetheless still in its infancy, and will continue to create significant issues regarding classification that will need to be addressed and clarified moving forward. Unfortunately for employers, rarely is the determination of worker classification a clear-cut endeavor. Rather, the task requires an extremely fact-sensitive evaluation that will turn on the specific underlying circumstances of each particular case. With administrative agencies and plaintiffs' class action attorneys alike ramping up their efforts to dispute companies' independent contractor classifications, companies should anticipate greatly increased scrutiny of classifications with the potential for government audits and litigation.

In determining the proper classification of their workers, employers must carefully analyze and balance the benefits and drawbacks associated with each classification. Some businesses may choose to classify their service-providing workforce as employees from the outset in order to avoid the legal traps and ramifications flowing from successful misclassification litigation or administrative action. For those companies that wish to maintain their workers' status as independent contractors, a close eye should be kept on future developments in this narrow but important area of employment law, which will undoubtedly have a significant impact on the operations of the gig economy.

Furthermore, companies must take affirmative steps to minimize the risk of workforce misclassification. As a starting point, businesses should ensure that the company department charged with responsibility for classifying its workers possesses a deep and intricate understanding of this particularly complex and thorny issue of employment law. In addition, individuals in this department must also consistently maintain up-to-date knowledge regarding the contractors on the company's payroll in order to monitor compliance with classification requirements and obligations. Ideally, companies should develop a system for completing the classification evaluation process and for monitoring contractors in the company's employ for continued compliance going forward.

Utilizing personnel educated and trained in the minutia of classification law, companies must carefully evaluate and analyze the classification of their workforce and whether such classification can withstand legal scrutiny. As a general rule, it is of vital importance for employers to pinpoint who is in control of the work and who is overseeing and managing the worker. An individual who is employed solely for a single company and who is required to work for set hours on set days of the week is more likely to be classified as an employee, while an individual who maintains the flexibility to perform identical work for multiple companies and who can pick and choose when he or she wants to work is more likely to be categorized as an independent contractor. In making this assessment, all information demonstrating the nature and extent of the company's control over the worker, as well as the independence of the worker, should be reviewed and analyzed whenever the issue of worker status is evaluated. Moreover, for all classification evaluations, employers should maintain detailed written documentation of the facts considered in making the determination.

For current independent contractor engagements, employers should evaluate these ongoing employment relationships to ensure that the working arrangements are adequate to satisfy the applicable classification tests relevant to the particulars of each situation. If current relationships fail to satisfy the applicable tests, employers should work with counsel to retool the working arrangements so they better align with the tests in order to minimize the potential for future liability flowing from misclassification. And for future contractor engagements, companies should analyze the working relationship with contractors and the scope of work the contractor has been retained to complete before any non-employees complete any work on the company's behalf.

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Finally, companies can implement proactive measures regarding the working relationships they maintain with their work-

force in order to maximize the likelihood of obtaining a favorable judicial or administrative determination of the classification issue. A good starting point is to ensure that the company has written agreements with all workers explicitly specifying the worker's independent contractor status. However, a contract delineating the worker as a contractor, by itself, will fall far short of establishing that relationship. Rather, the company must also take specific steps to establish an actual relationship between the business and the worker that will allow the company to demonstrate that the worker operates as a contractor, and not an employee, in connection with the company's business. To this end, concrete steps can be taken to establish the extent to which the company has (or yields) control over the worker's behavior and compensation, as well as other aspects of the working relationship.

With respect to the issue of behavioral control, a company should not provide workers with any unnecessary instructions or requirements regarding the methods and means of completing assigned work, as the company must limit itself to maintaining control only over the end result of the work, but not the means of completing the work. The company should allow the worker to determine his or her hours, retaining control only with respect to the completion of the job. In addition, it is important that the company mandates that contractors provide their own supplies, equipment, insurance, and the like, to the greatest extent possible. With respect to financial control, a company should provide compensation on a per-project basis, and not on an hourly or time-oriented basis. In addition, the worker should be required to cover his or her business expenses, which companies normally only cover if the worker is an employee. Beyond that, where feasible, the company should allow the contractor to realize profit and loss by permitting the contractor to set his or her prices and to control advertising. Finally, with regard to controlling the working relationship, the company should limit the scope of the worker's employment by not allowing an open-ended agreement for continued work. In addition, the company should freely permit their workers to provide services to other individuals and companies. Lastly, although counterintuitive at first blush, the company should avoid creating an agreement where the worker's employment is at-will, as doing so creates the appearance of a typical employer-employee at-will relationship, as opposed to a specific, limited business arrangement that is standard in independent contractor relationships.

Conclusion

The hotly contested battle pitting gig economy companies against their workers and governmental bodies highlights the significant legal issues and consequences relating to the issue of worker classification. The stakes involved are immense: not only can employers be saddled with substantial additional costs and potential liabilities associated with employing employees, as opposed to independent contractors, but companies also face severe penalties for misclassifying their workforce. Further, the lack of a single set standard for resolving the classification issue creates significant potential pitfalls for companies that do not treat the issue with adequate care. However, by taking proactive measures to tailor relationships in a manner that will allow company work arrangements to satisfy the criteria for independent contractor status, and by continuously monitoring and re-evaluating these ongoing relationships as contractors perform services on behalf of the company, companies can minimize the risks posed by this thorny area of employment law. FD