

Accountability for Employers or Independence for Contractors? Accomplishing AB5’s Labor Classification Goals in the Gig Economy

*Chelsea Rauch**

CONTENTS

I. UPDATES TO CALIFORNIA EMPLOYMENT LAW	567
A. <i>The Implications of Dynamex’s Codification</i>	568
B. <i>Governance Under S.G. Borello & Sons, Inc. v. Department of Industrial Relations</i>	570
II. EMPLOYEE CLASSIFICATION STANDARDS UNDER FEDERAL AND STATE LAW	572
A. <i>Federal Classification Standards</i>	572
B. <i>Comparative State Employment Classification Statutes</i>	574
1. New York	574
2. Massachusetts	576
3. Washington	577
C. <i>The ABCs of Loopholes</i>	577
III. THE MIXED RESPONSE TO AB5	580
A. <i>Employers’ Fight for an Exemption</i>	580
B. <i>Workers Divided</i>	583
C. <i>COVID-19 Complications</i>	584
IV. ACHIEVING AB5’S GOAL	586

The rise of the gig economy—nontraditional earning activities existing “outside of traditional, long-term employer-employee relationships”—has led workers and employers alike into ambiguity when it comes to worker classification.¹ While public discourse on the gig

*J.D. Candidate, Seattle University School of Law, 2021. Thank you to my family, friends, and law school cohort for your enduring support and encouragement both within and outside the walls of Sullivan Hall.

economy centers on companies like Uber and Lyft, gig workers freelance in many industries: “information” jobs (including media, telecom, and data processing) comprise the leading industry in the gig economy, followed by finance and insurance work, agriculture, manufacturing, education, and health-care services.² Indeed, in a recent survey by the BCG Henderson Institute, 4% of respondents in the United States indicated that gig work is their primary source of income, with an additional 10% of respondents indicating that gig work is their secondary source of income.³ In other markets around the world, those percentages are even higher: 12% of respondents in China use gig work as their primary income source with an additional 33% indicating that gig work is a secondary income source, and in India, 31% of respondents use gig work as a means of secondary income.⁴ The delineation between employee and independent contractor is becoming murkier in these sectors because modern gig work does not share all characteristics associated with either employment category traditionally used in the United States: employee and independent contractor.

U.S. employment law traditionally classifies workers as either employees or independent contractors; each worker under this traditional legal rubric can only be classified as one or the other—there can be no ambiguity or overlap.⁵ An employee is generally defined as “a person hired for a regular, continuous period to perform work for an employer who maintains control over both the service details and the final product.”⁶ In contrast, an independent contractor is generally defined as “a worker who performs services for others, usually under contract, while at the same time retaining economic independence and complete control over both the method by which the work is performed and the final product.”⁷ The classification as either an employee or an independent contractor depends

1. *What Is a Gig Worker?*, GIG ECON. DATA HUB (2019), <https://www.gigeconomydata.org/basics/what-gig-worker> [<https://perma.cc/JHV9-MHYL>].

2. JUDITH WALLENSTEIN, ALICE DE CHALENDAR, MARTIN REEVES & ALLISON BAILEY, BOS. CONSULTING GRP., *THE NEW FREELANCERS: TAPPING TALENT IN THE GIG ECONOMY* 6 (2019), http://image-src.bcg.com/Images/BCG-The-New-Freelancers-Jan-2019_tcm9-211593.pdf [<https://perma.cc/J97T-GTSE>] (surveying 11,000 workers in eleven countries: the United States, the United Kingdom, Germany, France, Spain, Sweden, Japan, India, Indonesia, China, and Brazil); *see also* *What Kinds of Work Are Done Through Gigs?*, GIG ECON. DATA HUB (2019), <https://www.gigeconomydata.org/basics/how-many-gig-workers-are-there> [<https://perma.cc/N5E7-MFJT>].

3. WALLENSTEIN ET AL., *supra* note 2, at 5.

4. *Id.*

5. NAT'L FED'N OF INDEP. BUS., NFIB GUIDE TO INDEPENDENT CONTRACTORS: HOW TO DETERMINE A WORKER'S CLASSIFICATION 2 (2019), <https://ua.nfib.com/foundations/legal-center/compliance-resource-center/legal-guide-series/> [<https://perma.cc/LX23-ZG2G>].

6. *Id.*

7. *Id.*

on two factors: (1) the nature of the work performed for the employer and (2) the amount of control the employer exerts over that worker.⁸

The distinction between these two categories can be monumental and “has considerable significance for workers, businesses, and the public generally.”⁹ Independent contractors are neither governed by the Fair Labor Standards Act (FLSA), the National Labor Relations Act (NLRA), nor the Family and Medical Leave Act (FMLA)¹⁰ like employees, who “qualify for a range of legally mandated benefits and protections.”¹¹ These employee benefits and protections include minimum wage, overtime pay, adherence to health and safety workplace requirements, retirement plans, health plans and benefits, the right to unionize, and certain protections from termination.¹² Hirers are also obligated to comply with all state and federal regulations that govern an employee’s wage rate, the hours they work, and the working conditions an employee is subjected to; pay their portion of Social Security and a myriad of taxes related to the employment of a worker classified as an employee; and provide workers’ compensation insurance to each employee.¹³ However, businesses bear none of these burdens when hiring workers categorized as independent contractors because they do not receive the same labor law benefits and protections as employees.¹⁴ Businesses are also not responsible for paying independent contractors’ payroll taxes and are generally not liable for the negligent acts of its contractors.¹⁵ Clearly, employers stand to gain an overall competitive and economic advantage if they classify their workers as independent contractors rather than employees because they can skirt the mandatory protections employers are required to provide to their employees. Unfortunately, these economic advantages incentivize some employers to misclassify their workers all too willingly.

On September 18, 2019, California Governor Gavin Newsom signed into law Assembly Bill 5 (AB5) in direct response to these misclassification issues, which amended California Labor Code Section 3351 and added Section 2750.3.¹⁶ AB5 was drafted and passed to “help

8. *See id.*

9. *Dynamex Operations W., Inc. v. Superior Ct.*, 416 P.3d 1, 4 (Cal. 2018).

10. SUSAN PRINCE, *FLSA EMPLOYEE EXEMPTION HANDBOOK* ¶ 121 (2019), 2018 WL 7958132 (Independent Contractors).

11. SETH D. HARRIS & ALAN B. KRUEGER, *THE HAMILTON PROJECT, A PROPOSAL FOR MODERNIZING LABOR LAWS FOR TWENTY-FIRST-CENTURY WORK: THE “INDEPENDENT WORKER”* 2 (2015), https://www.hamiltonproject.org/assets/files/modernizing_labor_laws_for_twenty_first_century_work_krueger_harris.pdf [<https://perma.cc/EP43-63XR>].

12. *Id.*

13. *Dynamex*, 416 P.3d at 4–5.

14. *Id.* at 5.

15. *See id.*

16. 2019 Cal. Legis. Serv. ch. 296 (West) (Assembly Bill No. 5).

ensure that California's workers who perform core work under company control versus as independent businesses have access to basic labor and employment protections and benefits denied independent contractors" and "protect law-abiding businesses that properly classify workers from unfair competition from companies that cut costs by misclassifying workers."¹⁷

The law codifies the Supreme Court of California's holding in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County* that individuals are employees, not independent contractors, unless the employer can meet the "ABC" test—a test many states across the country already utilize.¹⁸ The test requires employers to prove that their independent contractors: (A) operate free from the hiring entity's control, (B) perform work outside of the hiring entity's usual course of business, and (C) are independently established in the trade that they are providing to that hiring entity.¹⁹

AB5 has spurred controversy and debate since it was initially introduced by California Assemblywoman Lorena Gonzalez, and this controversy has only continued since the law came into effect in January 2020.²⁰ In fact, in spite of the new law, Uber declared that it will proceed with business as usual and will not re-classify its workers as employees.²¹ The company, along with Lyft and DoorDash, launched a two hundred million dollar ballot initiative (Proposition 22) in California to classify app-based drivers as independent contractors—"the most expensive initiative" in the history of California.²² The initiative was approved by California voters in the November 3, 2020, general election, a result celebrated by tech company founders and reproved by legislators for the all-too-apparent control gig companies wield on "the future of workers."²³

With guaranteed political challenges to AB5 already underway, the California legislature (and other states that may follow California's lead) must strengthen the statute's language to better achieve its initial goal of protecting workers from misclassification. While the ABC test is an

17. Celine McNicholas & Margaret Poydock, *How California's AB5 Protects Workers from Misclassification*, ECON. POL'Y INST. (Nov. 14, 2019), <https://www.epi.org/publication/how-californias-ab5-protects-workers-from-misclassification/> [<https://perma.cc/MZS9-BGE4>].

18. *Dynamex*, 416 P.3d at 34–42.

19. *Id.*

20. Carolyn Said, *AB5, California's Landmark Gig-Work Law, Takes Effect Jan. 1 Amid Controversy*, S.F. CHRON. (Dec. 31, 2019) [hereinafter *Amid Controversy*], <https://www.sfchronicle.com/business/article/AB5-California-s-landmark-gig-work-law-takes-14942512.php> [<https://perma.cc/7YYZ-GLM4>]; see also McNicholas & Poydock, *supra* note 17.

21. Press Release, Tony West, Chief Legal Officer, Uber, Inc., Update on AB5 (Sept. 12, 2019), <https://www.uber.com/newsroom/ab5-update/> [<https://perma.cc/82HS-ZM7A>].

22. Kate Conger, *Uber and Lyft Drivers in California Will Remain Contractors*, N.Y. TIMES (Nov. 4, 2020), <https://www.nytimes.com/2020/11/04/technology/california-uber-lyft-prop-22.html> [<https://perma.cc/LD3C-698N>].

23. *Id.*

effective starting point to prevent misclassification, the statute's language—particularly prong C of the ABC test—could prove to be the statute's Achilles' heel.

Part I of this Note will consider how AB5 has updated the definition of employee and independent contractor under California statutory law. Part II will compare California's new law with federal employee classification standards and will explore the benefits and detriments of the ABC test as seen in other states' legislation. Part III will examine the gig industry's response to both sides of the debate: supporting or opposing the law. Lastly, Part IV will propose a potential remedy to AB5's weaker language regarding prong C of the ABC test.

I. UPDATES TO CALIFORNIA EMPLOYMENT LAW

Prior California law defined an employee as “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.”²⁴ Under AB5, the definition of “employee” now includes:

an individual providing labor or services for remuneration who has the status of an employee rather than an independent contractor, unless the hiring entity demonstrates that the individual meets all of specified conditions, including that the individual performs work that is outside the usual course of the hiring entity's business.²⁵

Under the California Supreme Court's holding in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County*—and for the purposes of the California Labor Code, the Unemployment Insurance Code, and wage orders²⁶ of the California Industrial Welfare Commission—a worker is presumed to be an employee unless the hiring entity can demonstrate the following:

(A) The person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; (B) the person performs work that is outside the usual course of the hiring entity's business; and (C) the person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.²⁷

24. 2019 Cal. Legis. Serv. ch. 296 (West).

25. *Id.*

26. Regulating the wages, hours, and working conditions required and applicable to an employer's industry. See generally *Industrial Welfare Commission Wage Orders*, CAL. DEP'T OF INDUS. RELS. (Dec. 2019), <https://www.dir.ca.gov/iwc/WageOrderIndustries.htm> [<https://perma.cc/D6H6-UADE>].

27. CAL. LAB. CODE § 2775(b)(1)(A)(B)(C) (West 2020) (reciting the ‘ABC’ test).

A. *The Implications of Dynamex's Codification*

Dynamex created a presumption “that a worker who performs services for [an employer] is an employee for purposes of claims for wages and benefits arising under [fair] wage orders issued by the Industrial Welfare Commission.”²⁸ The *Dynamex* court tasked itself with deciding which standard applies under California law to determine whether a worker should be classified as an independent contractor or as an employee for wage-order purposes, affecting employer obligations like paying minimum wage and instituting hour and pay restrictions under the Fair Labor Standards Act.²⁹ In that case, two delivery drivers (who, along with later parties, were certified as a class) filed a complaint against their employer, *Dynamex*, for misclassifying its drivers as independent contractors, leading to the “violation of the provisions of Industrial Welfare Commission wage order No. 9, the applicable state wage order governing the transportation industry . . . [and] various sections of the Labor Code.”³⁰

The class of drivers worked solely for *Dynamex* and did not employ any other drivers independently.³¹ The court relied on *Martinez v. Combs*, a California Supreme Court case which held that employing workers under the California wage order is defined as: “(a) to exercise control over the wages, hours or working conditions, or (b) to suffer or permit to work, or (c) to engage, thereby creating a common law employment relationship.”³² Under this reasoning, the trial court rejected *Dynamex's* argument that the standard applied in the case of *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*,³³ when applied to wage orders, was the “only appropriate standard . . . [to distinguish between] employees and independent contractors.”³⁴

Dynamex appealed that decision, but the Court of Appeal agreed that the *Martinez* definitions, when applied in the wage order context, are similarly applicable when distinguishing between an employee and an independent contractor.³⁵ However, the appellate court also held that “insofar as the causes of action in the complaint seek reimbursement for business expenses . . . that are not governed by the wage order and are obtainable only under section 2802 of the Labor Code, the *Borello*

28. 2019 Cal. Legis. Serv. ch. 296 (West).

29. *Dynamex Operations W., Inc. v. Superior Court*, 416 P.3d 1, 5–7 (Cal. 2018).

30. *Id.* at 5.

31. *Id.* at 6–7.

32. *Martinez v. Combs*, 231 P.3d 259, 278 (Cal. 2010).

33. *S.G. Borello & Sons, Inc. v. Dep't of Indus. Rels.*, 769 P.2d 399 (Cal. 1989). *Borello*, a 1989 labor law case, will be discussed in detail in the following section.

34. *Dynamex*, 416 P.3d at 6.

35. *Id.* at 7.

standard is the applicable standard for determining whether a worker is properly” classified.³⁶ Despite Dynamex’s appeal on the wage-order issue,³⁷ the Supreme Court of California upheld the lower court’s determination that the *Martinez* “suffer or permit to work” definition of “employ” is a valid method of evaluating worker classification for purposes of the obligations imposed by the wage order.³⁸ Furthermore, the court held that the definition must be interpreted broadly to treat workers as employees and “thereby provide the wage order’s protection to[] *all* workers who would ordinarily be viewed as” being employed by that business.³⁹ The Supreme Court’s holding “create[d] a presumption that a worker who performs services for a hirer is an employee for purposes of claims for wages and benefits arising under wage orders issued by the Industrial Welfare Commission.”⁴⁰

As a result, AB5 codifies *Dynamex*’s three-part test (the ABC test) in California statutory law to determine whether a worker is an independent contractor or an employee. The ABC test underscores that although working as an independent contractor can be advantageous to workers and businesses, it also maximizes “the risk that workers who should be treated as employees may be improperly misclassified as independent contractors.”⁴¹ The law also “provide[s] that any statutory exception from employment status or any extension of employer status or liability remains in effect.”⁴² If a court rules that the ABC test cannot be applied because the type of work falls within one of AB5’s exceptions, then the determination of employee status will be governed by *Borello*.⁴³ AB5 “appl[ies] retroactively to existing claims and actions to the maximum extent permitted by law while other provisions apply to work performed on or after January 1, 2020.”⁴⁴

In addition to the *Dynamex* court’s concerns about workers receiving proper wages for their work, the court also reasoned that treating employees as independent contractors gives businesses a competitive and economic advantage over those that rightfully classify their workers as employees.⁴⁵ These misclassifications take billions of dollars in tax

36. *Id.* at 6.

37. *Id.* at 7.

38. *Id.*; see *Martinez v. Combs*, 231 P.3d 259, 282 (Cal. 2010).

39. *Dynamex*, 416 P.3d at 7.

40. 2019 Cal. Legis. Serv. ch. 296 (West).

41. *Dynamex*, 416 P.3d at 5.

42. 2019 Cal. Legis. Serv. ch. 296 (West).

43. *Id.*; see *S.G. Borello & Sons, Inc. v. Dep’t of Indus. Rels.*, 769 P.2d 399 (Cal. 1989).

44. 2019 Cal. Legis. Serv. ch. 296 (West).

45. *Dynamex*, 416 P.3d at 5.

revenue from federal and state governments but, most importantly, deprive millions of workers of the labor law protections they are entitled to.⁴⁶

B. Governance under S.G. Borello & Sons, Inc. v. Department of Industrial Relations

If the ABC test is inapplicable to a case, the determination is guided by *Borello*.⁴⁷ In that case, the Supreme Court of California considered whether agricultural laborers who were harvesting cucumbers under a written “sharefarmer” agreement should be classified as independent contractors.⁴⁸ The grower asserted that the agricultural laborers were independent contractors and not employees “because they manage[d] their own labor, share[d] the profit or loss from the crop, and agree[d] in writing that they [were] not employees.”⁴⁹ The court held that the harvesters’ work, while seasonal, followed the usual course of conduct of an employee: they were not “entrepreneurs operating independent businesses for their own accounts” and, in line with public policy, “they and their families [were] obvious members of the broad class to which workers’ compensation protection [was] intended to apply.”⁵⁰ Additionally, the grower controlled business operations on his property and did not directly supervise workers on just one integrated step in the cucumber crop production process; the grower therefore “retain[ed] all necessary control over a job [that could] be done only one way.”⁵¹ As a result, the court held that the workers must be classified as employees.⁵² Thus, *Borello* introduced a multi-factor test to distinguish between employees and independent contractors still used today in circumstances where *Dynamex*’s ABC test does not apply.

46. JOBS WITH JUST., BILLIONS IN REVENUE LOST DUE TO MISCLASSIFICATION AND PAYROLL FRAUD 1 (2010), https://www.jwj.org/wp-content/uploads/2010/08/100809misclassificationfactsheetfinal_logo.pdf [<https://perma.cc/P6FA-DTLL>]. See generally WAGE & HOUR DIV., U.S. DEP’T OF LAB., GET THE FACTS ON MISCLASSIFICATION UNDER THE FAIR LABOR STANDARDS ACT [hereinafter GET THE FACTS], <https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/misclassification-facts.pdf> [<https://perma.cc/4PWT-S9LN>].

47. Occupations exempt from *Dynamex*’s ABC test and therefore governed by *Borello* include: licensed insurance agents, certain licensed health care professionals, registered securities broker-dealers or investment advisers, direct sales salespersons, real estate licensees, commercial fishermen, workers providing licensed barber or cosmetology services, and others performing work under a contract for professional services, with another business entity, or pursuant to a subcontract in the construction industry.

2019 Cal. Legis. Serv. ch. 296 (West).

48. *S.G. Borello & Sons, Inc. v. Dep’t of Indus. Rels.*, 769 P.2d 399, 400–01 (Cal. 1989).

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at 42.

Among the list of occupations governed by *Borello*,⁵³ contracts for professional services are one of the most problematic. Under AB5, a worker providing professional services may be classified as an independent contractor if the employer can satisfy six factors: (1) “[t]he individual maintains a business location, which may include the individual’s residence”;⁵⁴ (2) the individual has a business license for the work;⁵⁵ (3) “[t]he individual has the ability to set or negotiate their own rates for the services performed”;⁵⁶ (4) “the individual has the ability to set [their] own hours”;⁵⁷ (5) “[t]he individual is customarily engaged in the same type of work performed under contract with another hiring entity or holds themselves out to other potential customers as available to perform the same type of work”;⁵⁸ and (6) “[t]he individual customarily and regularly exercises discretion and independent judgment in the performance of the services.”⁵⁹ Here, the term “individual” includes workers who provide their services “as a sole proprietor or other business entity.”⁶⁰

Furthermore, under AB5, the *Dynamex* test does not apply “to a bona fide business-to-business contracting relationship” if an entity is “formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation.”⁶¹ In these cases, *Borello* will apply if the contracting business can show:

- (1) The business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work
- (2) The business service provider is providing services directly to the contracting business rather than to customers of the contracting business
- (3) The contract with the business service provider is in writing and specifies the payment amount, including any applicable rate of pay, for services to be performed, as well as the due date of payment for such services.
- (4) If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- (5) The business service provider maintains a business location, which may include the business

53. See 2019 Cal. Legis. Serv. ch. 296 (West).

54. Determination of Status as Employee or Independent Contractor, CAL. LAB. CODE § 2778(a)(1) (2020).

55. *Id.* § 2778(a)(2).

56. *Id.* § 2778(a)(3).

57. *Id.* § 2778(a)(4).

58. *Id.* § 2778(a)(5).

59. *Id.* § 2778(a)(6).

60. *Id.* § 2778(b)(1).

61. 2019 Cal. Legis. Serv. ch. 296 (West).

service provider's residence, that is separate from the business or work location of the contracting business. (6) The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed. (7) The business service provider can contract with other businesses to provide the same or similar services and maintain a clientele without restrictions from the hiring entity. (8) The business service provider advertises and holds itself out to the public as available to provide the same or similar services. (9) . . . [T]he business service provider provides its own tools, vehicles, and equipment to perform the services . . . (10) The business service provider can negotiate its own rates. (11) . . . [T]he business service provider can set its own hours and location of work. (12) The business service provider is not performing the type of work for which a license from the Contractors' State License Board is required⁶²

The *Borello* standard, when applied to business-to-business contracts, can create a dangerous loophole. While the labor code here may have been drafted with the intent to exempt a situation where one company hired a truly independent and established company to perform a service separate from the hiring company's business, it can also be abused by employers and workers alike. To avoid classification as employees, workers could establish—and employers demand that they establish—a sole proprietorship or other business entity to bypass the ABC test altogether. They could thus continue working for their employer as independent contractors even though they do not meet the guidelines under such classification.

II. EMPLOYEE CLASSIFICATION STANDARDS UNDER FEDERAL AND STATE LAW

A. Federal Classification Standards

Under federal law, employment classification standards are more stringent than many state tests, yet still fall short of California's ABC Test: "Employers may not misclassify an employee for any reason, even if the employee agrees," if the employee prefers the misclassification, or if misclassifying workers in a particular way is common industry practice.⁶³ The United States Department of Labor (DOL) acknowledges that "some employers still incorrectly treat workers who are employees under [the FLSA] as independent contractors."⁶⁴ Despite this, the DOL operates

62. CAL. LAB. CODE §§ 2776(a)(1)–(12) (2020).

63. GET THE FACTS, *supra* note 46.

64. *Id.*

under the presumption that an individual is an employee; the burden is placed on the employer to prove otherwise.⁶⁵

Under the FLSA, an employee “is one who, as a matter of economic reality, follows the usual path of an employee and is dependent on the business, which he or she serves.”⁶⁶ “The employer-employee relationship . . . is tested by ‘economic reality,’ rather than ‘technical concepts,’”⁶⁷ depending on how dependent the individual is on the employing entity.⁶⁸ The focal point of the FLSA Economic Reality Test is whether the individual is economically dependent on the business at which they work or is, as a matter of economic fact, in business for themselves. Although the Supreme Court of the United States has indicated that there is no single rule or test for determining whether an individual is an employee or independent contractor under FLSA, generally the Court considers the following factors: “(1) the degree of control exerted by the . . . employer over the [individual]; (2) the [individual’s] opportunity for profit or loss; (3) the [individual’s] investment in the business; (4) the permanence of the working relationship; . . . (5) the degree of skill required to perform the work”;⁶⁹ (6) “the amount of initiative, judgment, or foresight in open market competition with others required for the success of the claimed independent contractor”; [and] (7) “[t]he degree of independent business organization and operation.”⁷⁰

The Fifth Circuit Court of Appeals concluded that each test-factor should be applied to examine the “ultimate concept” of employee dependence on the business.⁷¹ If individuals do not meet this test of economic reality, they must be treated as employees for FLSA purposes.⁷² If individuals only work on short-term assignments or if they contract with other businesses—thereby failing to render themselves fully dependent on their relationship with the hirer—it is likely that no employee-employer relationship exists.⁷³ Factors immaterial to the employment relationship include “where [the] work is performed, the absence of a formal employment agreement, . . . whether an . . . independent contractor is

65. *Cf.* PRINCE, *supra* note 10.

66. WAGE & HOUR DIV., U.S. DEP’T OF LAB., FACT SHEET 13: EMPLOYMENT RELATIONSHIP UNDER THE FAIR LABOR STANDARDS ACT (FLSA) (2008) [hereinafter FACT SHEET 13], <https://www.dol.gov/sites/dolgov/files/WHDL/legacy/files/whdfs13.pdf> [<https://perma.cc/6TQC-4JW8>].

67. *Id.*

68. *Id.*

69. Doty v. Elias, 733 F.2d 720, 723 (10th Cir. 1984).

70. FACT SHEET 13, *supra* note 66.

71. Hopkins v. Cornerstone Am., 545 F.3d 338, 343 (5th Cir. 2008).

72. *See id.*

73. *See* PRINCE, *supra* note 10.

licensed by state [or] local government,” and “time or mode of pay.”⁷⁴ Now, let us survey the ABC Test and similar guidelines that have been adopted by states other than California.

B. Comparative State Employment Classification Statutes

Approximately two-thirds of states in the United States employ some form of the ABC test to determine whether workers are employees or independent contractors.⁷⁵ In this section, we will consider both the successes and weaknesses of the ABC test as implemented in several states, particularly the loopholes present in Prong C with regard to their application to corporations and limited liability corporations.

1. New York

New York labor law states that “[a]ny person performing services for a contractor shall be classified as an employee unless the person is a separate business entity”; this exception extends to “any sole proprietor, partnership, corporation or entity that may be a contractor” when the business entity meets twelve criteria (which chiefly include “performing the service free from the direction or control over the means and manner of providing the service, subject only to the right of the contractor for whom the service is provided to specify the desired result”).⁷⁶ While New York courts rely on common law to determine whether a worker is classified as an employee or independent contractor, they weigh factors very similar to the ABC test, including the following: whether the worker is under the employer’s control and supervision in performing the job; whether the business normally carries out that type of work; and “whether the worker has an independently established business offering services to the public, similar to the service they are performing for the employer”⁷⁷ (similar to Prong C of California’s ABC test).

In 2014, the New York legislature passed an additional law—the New York State Commercial Goods Transportation Industry Fair Play Act (Fair Play Act)—which is essentially an ABC test that alters the state’s existing common law test to determine whether commercial delivery

74. FACT SHEET 13, *supra* note 66.

75. Howard Sokol, *New York’s Fair Play Act Changes Rules of the Road for the Commercial Goods Transportation Industries*, HOLLAND & KNIGHT (Jan. 31, 2014), <https://www.hklaw.com/en/insights/publications/2014/01/new-yorks-fair-play-act-changes-rules-of-the-road> [<https://perma.cc/Y6HE-7ZAQ>].

76. N.Y. LAB. LAW § 861-c (McKinney 2010).

77. N.Y. DEP’T OF LAB., ANNUAL REPORT OF THE JOINT ENFORCEMENT TASK FORCE ON EMPLOYEE MISCLASSIFICATION 1, 3 (2015) [hereinafter ANNUAL REPORT JOINT ENFORCEMENT TASK FORCE], <https://www.labor.ny.gov/agencyinfo/PDFs/Misclassification-Task-Force-Report-2-1-2015.pdf> [<https://perma.cc/SA3Z-E2UA>].

drivers in New York should be classified as employees or independent contractors. The Fair Play Act creates a rebuttable presumption that any driver who “(1) posses[es] a state-issued commercial driver’s license, (2) perform[s] transportation services of commercial goods, and (3) work[s] for a ‘commercial goods transportation contractor’” is an employee.⁷⁸ To rebut that presumption, the Fair Play Act requires employers to meet twelve requirements under a Separate Business Entity Test:

- (1) Be performing the service free from the direction or control over the means and manner of providing the service subject only to the service subject only to the right of the contractor to specify the desired result.
- (2) Not be subject to cancellation when its work with the contractor ends.
- (3) Have a substantial investment of capital in the entity beyond ordinary tools and equipment and a personal vehicle.
- (4) Own the capital goods and gain the profits and bear the losses of the entity.
- (5) Make its services available to the general public or business community on a regular basis.
- (6) Include the services provided on a federal income tax schedule as an independent business.
- (7) Perform the services under the entity’s name.
- (8) Obtain and pay for any required license or permit in the entity’s name.
- (9) Furnish the tools and equipment necessary to provide the service.
- (10) Hire its own employees without contractor approval, pay the employees without reimbursement from the contractor and report the employees’ income to the Internal Revenue Service.
- (11) Have the right to perform similar services for others on whatever basis and whenever it chooses.
- (12) The contractor does not represent the entity or the employees of the entity as its own employees to its customers.⁷⁹

The Fair Play Act also imposes stiff financial and criminal penalties on employers who willfully violate the law: “a \$2,500 fine per misclassified employee for [the] first violation and up to \$5,000 . . . for a second violation within a five year period.”⁸⁰ Employers can also be subject to a criminal misdemeanor for violation of the law “with a penalty of up to 30 days in jail, up to a \$25,000 fine and debarment from Public Work for up to one year for a first offense.”⁸¹ Subsequent offenses are “punishable by up to 60 days in jail” and a \$50,000 fine.⁸²

Compliance with the Fair Play Act is regulated by New York’s Joint Enforcement Task Force on Employee Misclassification (JETF). The task force was established in 2007 to combat the impact employee

78. Sokol, *supra* note 75.

79. N.Y. DEP’T OF LAB., FAIR PLAY ACT: NEW YORK STATE CONSTRUCTION INDUSTRY, <https://www.labor.ny.gov/formsdocs/factsheets/pdfs/P738.pdf> [<https://perma.cc/QV5K-Z2WN>].

80. *Id.*

81. *Id.*

82. *Id.*

misclassification has “on the residents, businesses and economy in New York State.”⁸³ In 2014, the JETF investigated concerns across industries—from construction to restaurants to retail establishments—and uncovered “\$52 million in unreported wages,” approximately “\$1.6 million in additional unemployment insurance contributions,” and over ten thousand misclassified workers.⁸⁴ For example, in the state’s construction industry alone, the JETF conducted six investigations “result[ing] in the discovery of nearly \$2.7 million in unreported wages, nearly \$104,000 in unemployment insurance contributions due, . . . [and] 230 misclassified workers.”⁸⁵ The JETF also swept through the commercial goods transportation industry months after the passage of the Fair Play Act, uncovering underpayments of wages totaling \$379,000.⁸⁶ Now, labor advocates in New York are working to officially impose the ABC test as the new standard to combat worker exploitation in direct response to Uber and Lyft’s leadership in the gig economy.⁸⁷

2. Massachusetts

Massachusetts found similar success in its pursuit of employers who misclassify their employees. Under Massachusetts Unemployment Insurance Law, a worker is considered an employee unless the employer can meet the elements of the state’s ABC test.⁸⁸ However, the state lays out several exemptions for individuals working as “agricultural laborers, domestic servants who work in private homes, and services performed by individuals employed by their sons, daughters, or spouses.”⁸⁹ In 2008, Governor Deval Patrick established Massachusetts’s Joint Enforcement Task Force (JTF) on the Underground Economy and Employee Misclassification.⁹⁰ As a result, the JTF reported the recovery of over \$15 million in “wage restitution, state taxes, unemployment taxes, fines, and

83. ANNUAL REPORT JOINT ENFORCEMENT TASK FORCE, *supra* note 77, at 2.

84. *Id.* at 7.

85. *Id.* at 9.

86. *Id.* at 10.

87. Dana Rubinstein, *Coalition Takes Shape in New York to Challenge Gig Economy’s Business Model*, POLITICO (Sept. 6, 2019), <https://www.politico.com/states/new-york/albany/story/2019/09/06/coalition-takes-shape-in-new-york-to-challenge-gig-economys-business-model-1174079> [https://perma.cc/8FU2-UF8J].

88. MASS. GEN. LAWS ch. 151A, § 2 (2004).

89. *Massachusetts: Resources and Developments*, WORKERCLASSIFICATION.COM (2020), <https://www.workerclassification.com/State-Resources/Massachusetts> [https://perma.cc/A7RB-NBG8].

90. EXEC. OFF. OF LAB. & WORKFORCE DEV., JOINT ENFORCEMENT TASK FORCE ON THE UNDERGROUND ECONOMY AND EMPLOYEE MISCLASSIFICATION: ANNUAL REPORT 1 (2013) [hereinafter MASS. JETF], <https://www.mass.gov/files/2017-07/annual-report-2013.pdf> [https://perma.cc/NYS4-G2DT].

penalties” in 2013, and since the establishment of the task force, the state has recovered nearly \$60 million in funds lost due to misclassification.⁹¹

3. Washington

The ABC test has a relatively long history in Washington. In 1991, Washington passed a statute that applied the ABC test to unemployment compensation tax disputes. Under that law, an employer must prove the following to demonstrate it is exempt from liability for unemployment compensation taxes:

(1)(a) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his or her contract of service and in fact; and (b) Such service is either outside the usual course of business for which such service is performed, or that such service is performed outside of all the places of business of the enterprises for which such service is performed; and (c) Such individual is customarily engaged in an independently established trade, occupation, profession, or business, of the same nature as that involved in the contract of service.⁹²

Washington recently considered two bills that would apply the ABC test across the state’s labor laws, giving workers an avenue to challenge misclassifications and empowering state agencies to investigate and enforce compliance.⁹³ However, the bills failed to advance during session.⁹⁴

C. The ABCs of Loopholes

Despite the success many states have achieved through the implementation of the ABC test and the regulation of worker classifications by various taskforces, the strategy has not been infallible. Evidence shows that some employers and workers have utilized various strategies to avoid liability under strict classification statutes by reclassifying their independent contractors as business entities rather than

91. *Id.* at 2, 4.

92. WASH. REV. CODE § 50.04.140 (1991).

93. Rebecca Smith, *Washington State Considers ABC Test for Employee Status*, NAT’L EMP. L. PROJECT (Jan. 28, 2019), <https://www.nelp.org/blog/washington-state-considers-abc-test-employee-status> [<https://perma.cc/8KBU-S7RK>].

94. Richard Meneghello, *Could 2020 Be the Year of the California Copycats? Other States Line Up to Consider Misclassification Statutes*, FISHER PHILLIPS: BLOG (Oct. 21, 2019), <https://www.fisherphillips.com/gig-employer/could-2020-be-the-year-of-the> [<https://perma.cc/RCU8-JN66>].

employees⁹⁵—trends that California’s legislature should be wary of as more companies push back on AB5. This strategy can be successful because some state laws “provide that corporations cannot be employees” and others “fail to address whether different corporate forms can be considered employees.”⁹⁶ This arrangement allows employers to work with independent businesses rather than individual people.⁹⁷ Additionally, some employers will classify workers who might otherwise be reclassified as employees under strict statutes “as franchisees, partners or owners of the employers’ own business.”⁹⁸

For example, Minnesota saw a rise in workers forming limited liability corporations following the passage of its misclassification statute.⁹⁹ In one case, the Minnesota Department of Employment and Economic Development (DEED) determined that a construction company “had misclassified several workers as independent contractors.”¹⁰⁰ The judge found that some workers who owned business entities should still be categorized as employees under state statute, considering several factors including: (1) the utilization of company letterhead with the entity’s name (which often incorporated the worker’s name in some way) when submitting invoices and (2) naming the owner of the company as the individual who performed the work.¹⁰¹ The court held that workers may be considered independent contractors in cases where the name of the business entity is listed on invoices as the entity doing the work, even if the owner of the business entity itself is the actual individual completing the job.¹⁰² The statute at issue “unambiguously states that an invoice must be ‘in the name of the business entity.’”¹⁰³ The court, therefore, rejected the assertion “that a first-name designation of the individual who owns the business entity satisfies the requirement that invoices are submitted in ‘the name of the business entity.’”¹⁰⁴

95. Anna Deknatel & Lauren Hoff-Downing, *ABC on the Books and in the Courts: An Analysis of Recent Independent Contractor and Misclassification Statutes*, 18 U. PA. J.L. & SOC. CHANGE 53, 80 (2015).

96. *Id.* (referencing MINN. STAT. ANN. § 181.723 (West 2014) and MASS. GEN. LAWS ANN. ch. 149, § 148B (West 2014)).

97. *Id.* at 80–81.

98. *Id.* at 81.

99. ADVISORY TASK FORCE ON EMP. MISCLASSIFICATION, MINN. DEP’T OF LAB. & INDUS., REPORT TO THE 2011-2012 BIENNIUM, EIGHTY-SEVENTH LEGISLATURE 8 (2011) [hereinafter ADVISORY TASK FORCE], <https://www.leg.state.mn.us/docs/2011/mandated/110509.pdf> [<https://perma.cc/3PHB-6ULV>].

100. *A-1 Constr., Inc. v. Dep’t of Emp. & Econ. Dev.*, No. A16-0436, 2016 WL 6670779, at *1 (Minn. Ct. App. Nov. 14, 2016).

101. *Id.* at *3.

102. *Id.*

103. *Id.* at *2 (quoting MINN. STAT. § 181.7234(B)(2) (2014)).

104. *Id.* at *3.

In some states, there have also been recorded instances of employers requiring their workers to obtain independent business licenses before being hired to avoid employee classification.¹⁰⁵ In *Kabrick v. Employment Secretary Department of Washington*, the plaintiff was a taxi driver for a Washington-based taxi company.¹⁰⁶ While she provided her own cab to perform her work duties, she was required to obtain an independent business license, mark her car with the taxi company's signage, and comply with a company dress code.¹⁰⁷ The Washington Court of Appeals held that, despite the correlation between the car's signage and the required dress code, she could not be considered an employee of the cab company because her involvement with the cab company was limited to that of a dispatcher-driver relationship,¹⁰⁸ a finding due in part to her independent business licensure.

Most notably, since the passage of AB5 in September 2019, some California contractors have incorporated or registered as limited liability companies to remain classified as independent contractors.¹⁰⁹ Data from the California Secretary of State also shows an increase in registrations for corporations and limited liability companies.¹¹⁰ One language interpreter reported that she incorporated "because [she] understand[s] that companies that hire [her] here in California would require [her] to be incorporated or run the risk of finding themselves in trouble."¹¹¹ In fact, some agencies have already asked the interpreter if she is incorporated; she said that while the process was "complicated and expensive . . . 'it gives [her] ease of mind.'"¹¹²

This tactic is further encouraged by the National Federation of Independent Business (NFIB), which instructs employers to require an independent contractor to incorporate, which will make the worker "an employee of his or her own corporation, and not the employee of the business that hired the worker."¹¹³ "Though not guaranteed," the organization states that requiring workers to incorporate will "improve the likelihood that" that an examining agency will find that a worker is an independent contractor and not an employee.¹¹⁴

105. See *Kabrick v. Emp. Sec'y Dep't*, No. 20126-1-III, 2002 WL 91270, at *2 (Wash. Ct. App. Jan. 24, 2002).

106. *Id.*

107. *Id.* at *4-5.

108. *Id.* at *14-15.

109. *Amid Controversy*, *supra* note 20.

110. *Id.*

111. *Id.*

112. *Id.*

113. NAT'L FED. OF INDEP. BUS., *supra* note 5, at 13.

114. *Id.*

III. THE MIXED RESPONSE TO AB5

A. Employers' Fight for an Exemption

In applying these facts and standards to AB5's impact on individual companies in the gig economy, Uber's Security Exchange Commission (SEC) proxy statement reads: "[o]ur business would be adversely affected if Drivers were classified as employees instead of independent contractors."¹¹⁵ Uber believes such a change could cost the company \$500 million per year¹¹⁶ and would require the company to fundamentally alter its business model, detrimentally affecting its business and financial condition.¹¹⁷ Business leaders outside of California have similar misgivings about AB5. Ken Pokalsky, Vice President of the Business Council of New York State, expressed concern that an overly broad worker-classification law like AB5 "would increase costs for businesses by 15% to 20%," stating, "[i]t's not just an impact on the employer, but an impact on workers who want to engage."¹¹⁸ If Uber and similar companies classified its drivers as employees, they would incur additional expenses for compensating drivers associated with wage and hour laws (including minimum wage, overtime, and meal and rest period requirements), employee benefits, social security contributions, taxes, and penalties.¹¹⁹ The law also reaches far outside of the rideshare industry; healthcare companies posit that they may not be able to staff remote clinics or fill jobs if they must classify as employees medical specialists who prefer flexible work that independent-contractor status affords.¹²⁰

Uber believes that its drivers should be classified as independent contractors because "they can choose whether, when, and where to provide services on [the] platform, are free to provide services on . . . competitors' platforms, and provide a vehicle to perform services on [the] platform."¹²¹ Rideshare companies argue that, should employee status be required as it is under AB5, drivers' ability to set their own flexible schedule would disappear, drivers would not be permitted to work for competitors, and the

115. Uber Technologies, Inc., Registration Statement (Form S-1) 13 (Apr. 11, 2019) [hereinafter Uber Statement], <https://www.sec.gov/Archives/edgar/data/1543151/000119312519103850/d647752ds1.htm> [<https://perma.cc/PME2-MD4N>].

116. Carolyne Said, *AB5 Gig Work Bill: All Your Questions Answered*, S.F. CHRON. (Sept. 18, 2019), <https://www.sfchronicle.com/business/article/AB5-gig-work-bill-All-your-questions-answered-14441764.php> [<https://perma.cc/2AXW-W7BC>].

117. Uber Statement, *supra* note 115, at 12.

118. Jimmy Vielkind, *New York Lawmakers Consider Reclassifying Gig Workers*, WALL ST. J. (Oct. 16, 2019), <https://www.wsj.com/articles/new-york-lawmakers-consider-reclassifying-gig-workers-11571261569> [<https://perma.cc/T6TB-PCAL>].

119. Uber Statement, *supra* note 115, at 28.

120. Said, *supra* note 116.

121. Uber Statement, *supra* note 115, at 28.

companies would “limit the number of drivers so they’re not paying for idle time.”¹²²

Additionally, Uber has stated that the costs associated with defending, settling, and resolving pending and future lawsuits on this matter would be detrimental to its business.¹²³ As of December 2019, “more than 60,000 [d]rivers who had entered into arbitration agreements with [Uber] have filed (or expressed an intention to file) arbitration demands” based on misclassification claims.¹²⁴ Two such recent cases in federal court are *O’Connor, et al. v. Uber Technologies, Inc.* and *Yucesoy v. Uber Technologies, Inc.*—both class actions in which Uber agreed to pay \$20 million to drivers contracted with Uber in California and Massachusetts (a state that also currently employs a form of the ABC test).¹²⁵ The plaintiffs in those cases sought damages based on independent contractor misclassification, tips law violations, and tortious interference with contractual or advantageous relations.¹²⁶

In 2019, Uber and Postmates (an app-based grocery delivery service) along with two individual drivers from those companies sought an injunction to block AB5 in the U.S. District Court for the Central District of California “to defend the ‘fundamental liberty to pursue their chosen work as independent service providers and technology companies in the on-demand economy.’”¹²⁷ They requested declaratory and injunctive relief against AB5’s requirements as invalid and unenforceable under the constitutions of the United States and California; they also lamented not being included in AB5’s “laundry list” of exemptions.¹²⁸ The court rejected the request for relief, reasoning in part that California’s interest “in protecting exploited workers to address the erosion of the middle class and income inequality” meets rational basis review and does not unconstitutionally deprive gig workers of working in their chosen occupation.¹²⁹ However, the lawsuit was appealed to the Ninth Circuit,¹³⁰

122. Said, *supra* note 116.

123. Uber Statement, *supra* note 115, at 28.

124. *Id.*

125. *Id.*

126. *See id.*

127. Carolyn Said, *Uber, Postmates Sue California in Federal Court over State Gig-Work Law AB5*, S.F. CHRON. (Dec. 31, 2019) [hereinafter *Uber, Postmates Sue*], <https://www.sfchronicle.com/business/article/Uber-Postmates-sue-California-over-California-14940425.php#> [<https://perma.cc/46AP-H3RJ>] (quoting Complaint at ¶ 1, *Olson v. California*, No. 19-cv-10956 (C.D. Cal. Feb. 10, 2020), 2020 WL 905572).

128. Complaint, *supra* note 127, ¶¶ 24, 25.

129. *Olson v. California*, No. 19-cv-10956, 2020 WL 905572, at *6, *10 (C.D. Cal. Feb. 10, 2020).

130. Catherine Shu, *Judge Rejects Uber and Postmates’ Request for an Injunction Against California’s Gig Worker Law*, TECHCRUNCH (Feb. 10, 2020), <https://techcrunch.com/2020/02/10/>

with the companies warning that litigation costs for this suit and others will likely be passed down to customers across industries, resulting in higher prices for Uber and Lyft.¹³¹

What's more, on May 5, 2020, the Attorney General of California and City Attorneys of Los Angeles, San Diego, and San Francisco made a motion for preliminary injunction against Uber and Lyft for "ongoing and widespread violations of A.B.5."¹³² In response to Uber and Lyft's motion to stay the litigation until after the November 2020 election,¹³³ the judge stated that Uber and Lyft "are not entitled to an indefinite postponement of their day of reckoning."¹³⁴ When applying the ABC test here as a preliminary measure, the judge further commented: "It's this simple: Defendants' drivers do not perform work that is 'outside the usual course' of their businesses. Defendants' insistence that their businesses are 'multi-sided platforms' rather than transportation companies is flatly inconsistent with the statutory provisions that govern their businesses as transportation network companies."¹³⁵ And, despite the companies' complaints that AB5 will cause grave harm to their business models, the court acknowledged that there is a cost associated with restructuring their businesses, but those "costs are only those required in order for them to bring their businesses into compliance with California law."¹³⁶

As a result, the preliminary injunction was granted, enjoining Uber and Lyft from classifying their drivers as independent contractors under Labor Code 2570.3 and from "violating any provisions of the Labor Code, the Unemployment Insurance Code, and the wage orders of the Industrial Welfare Commission."¹³⁷ California Attorney General Xavier Becerra praised the order, stating that "[California] and workers shouldn't have to

judge-rejects-uber-and-postmates-request-for-an-injunction-against-californias-gig-worker-law/
[<https://perma.cc/MCJ4-HBJJ>]; see also Olson, 2020 WL 905572.

131. Cf. *Uber, Postmates Sue*, supra note 127.

132. *People v. Uber Technologies, Inc.*, No. CGC-20-584402, 2020 WL 5440308, at *1 (Cal. Super. Ct. Aug. 10, 2020).

133. Uber and Lyft initiated a campaign to support California Proposition 22, App-Based Drivers as Contractors and Labor Policies Initiative. The legislation, which appeared on California's ballot for the November 3, 2020, general election and was approved, proposed that rideshare and delivery drivers be defined as independent contractors. The passage of this legislation carves out an exemption under AB5 for companies like Uber and Lyft. *California Proposition 22, App-Based Drivers as Contractors and Labor Policies Initiative (2020)*, BALLOTEDIA, [https://ballotpedia.org/California_Proposition_22,_App-Based_Drivers_as_Contractors_and_Labor_Policies_Initiative_\(2020\)](https://ballotpedia.org/California_Proposition_22,_App-Based_Drivers_as_Contractors_and_Labor_Policies_Initiative_(2020)) [<https://perma.cc/RY8T-XF4B>].

134. *Uber*, 2020 WL 5440308, at *1.

135. *Id.* at *3.

136. *Id.*

137. *Id.* at *18–19.

foot the bill when big businesses try to skip out on their responsibilities.”¹³⁸ However, Uber and Lyft appealed and requested a stay, threatening to shut down operations in California if their motion was denied.¹³⁹ A stay was granted until the issue can be fully adjudicated; as a result of Proposition 22’s passage, litigation will continue but with a narrower scope.¹⁴⁰

B. Workers Divided

In response to the lower court’s preliminary injunction, Lyft said: “Drivers do not want to be employees, full stop,”¹⁴¹ which begets the following question: what *do* workers want? Brandon Castillo, spokesperson for the Protect App-Based Drivers & Services Coalition, believes that “lawmakers are ‘forcing an employment model that just doesn’t work for the nature of this work.’”¹⁴² Lyft drivers like Akamine Kiarie, a college student who drives for the company to pay for his classes, agrees: if he were treated as an employee under California’s new law, “he might have to work set hours that would conflict with his classes.”¹⁴³

However, Castillo and Kiarie’s views are not representative of every worker in the gig economy. Lyft driver Edan Alva believes that Uber, Lyft, and DoorDash’s ploy to seek a carve-out under AB5 “avoid[s] accountability”¹⁴⁴ and “is not right.”¹⁴⁵ Alva, speaking for the 20,000 rideshare drivers comprising the We Drive Progress Coalition, said, “After working 80 hour weeks, sleeping in our cars, and surviving on poverty wages, drivers organized and won support for AB5 from both the public and lawmakers.”¹⁴⁶ Likewise, Steve Smith, spokesperson for the California Labor Federation (CLF), views AB5 as “a significant worker victory” and aims to organize rideshare drivers and other gig workers once

138. Press Release, Xavier Becerra, Cal. Att’y Gen., Attorney General Becerra Secures Early Court Victory in Fight to Protect Workers Against Unlawful Employee Misclassification by Uber and Lyft (Aug. 10, 2020), <https://www.oag.ca.gov/news/press-releases/attorney-general-becerra-secures-early-court-victory-fight-protect-workers> [https://perma.cc/7BQZ-S9CS].

139. Faiz Siddiqui, *Uber and Lyft to Continue Operating in California*, WASH. POST (Aug. 20, 2020), <https://www.washingtonpost.com/technology/2020/08/20/uber-lyft-shutdown/> [https://perma.cc/9T69-FDD4].

140. *See id.*; Conger, *supra* note 22.

141. Bobby Allyn, *California Judge Orders Uber and Lyft to Consider All Drivers Employees*, NPR (Aug. 10, 2020), <https://www.npr.org/2020/08/10/901099643/california-judge-orders-uber-and-lyft-to-consider-all-drivers-employees> [https://perma.cc/H9RW-9ZU6].

142. Adam Beam, *Lyft, Uber Will Ask California Voters to Block Employee Law*, ASSOCIATED PRESS (Oct. 29, 2019), <https://apnews.com/article/dfde34e13abf49388da2a262684fb1e0> [https://perma.cc/N5T5-4LK5].

143. *Id.*

144. Alexia Fernández Campbell, *Uber and Lyft Have Launched a Campaign to Avoid Government Regulation in California*, VOX (Oct. 29, 2019), <https://www.vox.com/identities/2019/10/29/20938109/ab5-uber-lyft-ballot-initiative-referendum> [https://perma.cc/8GUY-45VG].

145. Beam, *supra* note 142.

146. Fernandez, *supra* note 144.

they are reclassified as employees.¹⁴⁷ The CLF initiated a voter education campaign in an unsuccessful attempt to combat Proposition 22;¹⁴⁸ the loss was particularly acute for the labor leader since “[v]irtually every leading Democratic presidential candidate endorsed AB5 and backed similar legislation at the federal level.”¹⁴⁹

C. COVID-19 Complications

When AB5 was originally passed, the California legislature—along with the rest of the world—could not have predicted the devastation and economic stresses COVID-19 would bring to individuals, families, and the national economy. By U.S. government estimates, the unemployment rate in May 2020 could have reached as high as 16%, “comparable . . . to the Great Depression of the 1930s.”¹⁵⁰ By August 2020, three million individuals were receiving unemployment benefits in California, bringing the unemployment rate in that state to an estimated 13.3%.¹⁵¹

The pandemic has exacerbated the divisiveness that already exists in the wake of AB5’s enactment. Some workers have struggled to find temporary online work as certain companies have ceased hiring workers in California due to the requirement of treating them as employees, not contractors, in some instances.¹⁵² Other companies are wary of working with California contractors simply because the risk of violating the law is too high, and the work can be easily outsourced to workers who reside in other states (and thus can be classified as independent contractors).¹⁵³

Supporters of AB5 “say workers can’t wait any longer for healthcare coverage, paid sick leave and other protections in the face of a fast-moving pandemic,” hailing COVID-19 as “the biggest example of why the majority of workers need this kind of backup [and benefits].”¹⁵⁴ Assemblywoman Gonzalez agrees, stating that many workers have been

147. *Amid Controversy*, *supra* note 20.

148. *Id.*

149. *Id.*

150. Rakesh Kochhar, *Unemployment Rose Higher in Three Months of COVID-19 than It Did in Two Years of the Great Recession*, PEW RSCH. CTR. (June 11, 2020), <https://www.pewresearch.org/fact-tank/2020/06/11/unemployment-rose-higher-in-three-months-of-covid-19-than-it-did-in-two-years-of-the-great-recession/> [<https://perma.cc/L3F3-FPZY>].

151. Lorena Iniguez Elebee, Thomas Suh Lauder, Ryan Menezes & Matt Stiles, *Tracking How the Coronavirus Crushed California’s Workforce*, L.A. TIMES (Aug. 21, 2020), <https://www.latimes.com/projects/california-coronavirus-cases-tracking-outbreak/unemployment/> [<https://perma.cc/44L9-M367>].

152. See Johana Bhuiyan, *Coronavirus Is Supercharging the Fight over California’s New Employment Law*, L.A. TIMES (Mar. 26, 2020), <https://www.latimes.com/business/technology/story/2020-03-26/coronavirus-disrupted-their-income-now-their-calls-for-california-to-take-action-on-ab5-are-getting-louder> [<https://perma.cc/7J3G-4MUC>].

153. *Id.*

154. *Id.*

reclassified under AB5 and are now receiving workers' compensation and unemployment insurance that they would not have received otherwise—benefits that are more important now than ever.¹⁵⁵ Those against the legislation state that “any regulation that takes opportunities for workers off the table will do more harm than good” during the pandemic-induced economic downturn.¹⁵⁶ Another opponent urged legislators to delay AB5's implementation until after the pandemic: “We can talk about reforming the rules around independent contractors when this is all over.”¹⁵⁷

Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act, states are permitted to provide Pandemic Unemployment Assistance (PUA) to independent contractors who would not ordinarily qualify for unemployment benefits for up to thirty-nine weeks, the amount of which is calculated under each state's unemployment insurance laws.¹⁵⁸ While the CARES Act provided temporary relief for some independent contractors, it merely serves as a temporary fix to the misclassification issue—one that simply defers the problem until those benefits are exhausted or until the pandemic ends and contractors are left in the lurch once again.

However, legal experts state that the CARES Act, along with a recent court decision denying an emergency injunction that would have required Lyft to immediately reclassify its workers as employees,¹⁵⁹ “renders the argument for immediate reclassification unconvincing.”¹⁶⁰ If reclassified, some workers, including part-time Lyft drivers, would not even qualify for paid sick leave (which is limited to only three days per year anyway); reclassification during the pandemic could also “jeopardize drivers' eligibility for emergency benefits under the CARES Act.”¹⁶¹ Courts are now grappling with the question of whether a law intended to

155. *Id.*

156. *Id.*

157. *Id.*

158. *Unemployment Insurance Relief During COVID-19 Outbreak*, U.S. DEP'T OF LAB., <https://www.dol.gov/coronavirus/unemployment-insurance> [<https://perma.cc/3WER-ET2N>] (Frequently Asked Questions).

159. *See Rogers v. Lyft, Inc.*, 452 F. Supp. 3d 904, 909 (N.D. Cal. 2020) (order granting in part and denying in part defendants' Motion to Compel Arbitration). The Northern District of California judge reasoned that millions of unemployed individuals will rely on federal and state emergency aid during the pandemic; while granting the injunction would allow employees to possibly qualify for sick pay, the pay itself would be small. *Id.* at 910. Furthermore, an emergency injunction could have the effect of causing drivers to lose the opportunity to benefit from emergency assistance from the federal government, which would aid the workers substantially more than sick pay. *Id.*

160. Nicole Clark, *What Happens to Gig Workers When a California Assembly Bill Meets the Coronavirus?*, ABA J. (May 7, 2020), <https://www.abajournal.com/voice/article/what-happens-when-ab5-meets-covid-19> [<https://perma.cc/DC6S-FESR>].

161. *Id.*

improve workers' rights could be a detriment during an unpredictable and deadly pandemic.

IV. ACHIEVING AB5'S GOAL

AB5 was signed into law to ensure that the millions of workers in California who are exploited as independent contractors through misclassification practices are given the rights and protections they deserve, such as minimum wage, workers compensation, unemployment insurance, and paid sick and family leave.¹⁶² With the emergence of the gig economy, legislators and business leaders must regulate gig companies to strike a fair balance between protecting workers' rights and avoiding regulatory penalizations for companies contributing to the U.S. economy. Generally, due to the limitations of state statutes, employers are usually not penalized for worker misclassification.¹⁶³ Instead, they are sometimes, and in some places, "penalized for related failures to obtain workers compensation insurance or withhold taxes from employees' wages."¹⁶⁴ The potential for employers to engage "in organized tactics to disempower workers" in the face of ambiguity and confusion is high.¹⁶⁵ Those workers—the very people state statutes employing the ABC test (such as AB5 does) aim to protect—must be safeguarded.

Prong C of the ABC test, which requires a worker to be customarily engaged in an independently established business or trade in order to be classified as an independent contractor, is especially problematic in the pursuit of AB5's policy goals. A concerning tactic that some unscrupulous employers in ABC states exploit to avoid employee classification is to require workers to incorporate or establish their own limited liability company so they can be classified as independent contractors. The establishment of what are essentially fraudulent independent businesses goes against the spirit of AB5 and takes further advantage of workers who are faced with the choice to either comply with company demands to establish an independent business or else lose work entirely.

The purpose of Prong C is to establish whether an individual is actually engaged in the operation of an independent business, not whether the individual simply has the capability to do so. In *Garcia v. Border Transportation Group, LLC*, the California Court of Appeals held that a taxi driver was not considered an independent contractor because there

162. 2019 Cal. Legis. Serv. ch. 296 (West).

163. See ADVISORY TASK FORCE, *supra* note 100, at 7.

164. *Id.*

165. Marjorie Elizabeth Wood, *Victims of Misclassification*, N.Y. TIMES (Dec. 15, 2013), <https://www.nytimes.com/2013/12/16/opinion/victims-of-misclassification.html> [<https://perma.cc/9RFN-K36W>].

was insufficient evidence to show he actually had an independent business; he did not provide services for other entities independently of his relationship with the defendant.¹⁶⁶ The *Garcia* court further held that Prong C was intended to ask whether the plaintiff “independently ha[d] made the decision to go into business for himself or herself” and had taken “the usual steps to establish and promote his or her independent business” through actions like “incorporation, licensure, advertisements, routine offerings to provide services of the independent business to the public or to a number of potential customers, and the like.”¹⁶⁷ The “appropriate inquiry under part (C) is whether the person engaged in covered employment actually has such an independent business, occupation, or profession, not whether he or she could have one.”¹⁶⁸

Verification that workers truly fall under Prong C because they choose independently to go into business for themselves is vital and crucial to meet the ABC test’s legislative intent. Unfortunately, language under California’s Labor Code as amended by AB5 is not strong enough to meet this goal. Indeed, since AB5’s passage, there has been “a big increase in applications [in California] to set up limited liability companies” to allow gig workers to hold onto their independent contractor status.¹⁶⁹ From 2018 to 2019, LLC registrations in California increased 5.71%.¹⁷⁰ One professional speculated that the sharp spike in registrations was because workers were anticipating the passage of AB5 and knew these registrations could be one loophole to get around it.¹⁷¹ A Los Angeles-based employment attorney added: “If you want to continue to at least try to be an independent contractor in the state of California, you need to go get a business license It is maybe the only exception that they can qualify for under AB5.”¹⁷² This upward trend in LLC registrations is primarily amongst workers in traditional independent-contractor roles like consultants, although prior to the November 2020 general election, industry thought leaders believed that LLCs “could be an option for more [Uber and Lyft] drivers in the future” had Proposition 22 not passed.¹⁷³ Part-time drivers in particular have voiced their concerns about the

166. *Garcia v. Border Transp. Grp., LLC*, 239 Cal. Rptr. 3d 360, 372–74 (2018).

167. *Id.* at 369.

168. *Id.* at 372 (quoting *Dynamex Operations W., Inc. v. Superior Ct.*, 416 P.3d 1, 39 n.30 (Cal. 2018)).

169. Michelle Cheng, *Independent Contractors Are Already Finding Ways to Work Around AB5*, QUARTZ (Jan. 30, 2020), <https://qz.com/1793028/california-workers-are-setting-up-more-llcs-after-ab5> [<https://perma.cc/RZP3-V423>].

170. *Id.*

171. *Id.*

172. *Id.*

173. *Id.*

liability protections offered under an LLC designation should they register and fight to maintain their independent-contractor status.¹⁷⁴

To achieve AB5's goal, to strengthen *Garcia's* holding (which sets concrete benchmarks for obtaining independent-contractor designation), and to disincentivize fraudulent LLCs, the California legislature should draft stricter language prohibiting this kind of end-run around Prong C. The language would be one step forward in achieving AB5's true goal: that only true independent contractors should be rightfully granted that status. To strengthen AB5's language to determine whether a worker is a legitimate independent contractor as opposed to an employee who has just incorporated to achieve independent contractor status, California must learn from other states that have more experience with the ABC test. AB5 could combat false incorporation by employing a test modeled after New York's Separate Business Entity Test, which New York applies when determining whether a worker is a legitimate independent contractor. Of utmost importance, such a test should include language that helps courts and administrative enforcement agencies clearly demarcate separate business entities from true employees vis-à-vis the employing business.

Such language might require that a sole proprietor, partnership, corporation, or other separate business entity fulfill the following elements: (1) invest a substantial amount of capital in the business entity, beyond ordinary tools and equipment to accomplish the service; (2) perform the services under its own name and not the hiring entity's name; (3) hire its own employees without the hiring entity's approval; and (4) represent to the public that the separate business entity's workers who perform the services do not operate as the hiring entity's employees. In the cases of Uber and Lyft in particular, the Prong C loophole would effectively be closed to fraudulent incorporations and LLCs as they would struggle to meet all four elements: drivers often only own the car they are using to transport people and the cell phone needed to interface with the app (which do not go beyond the ordinary tools and equipment necessary to accomplish the service); drivers perform their services under the hiring employer's name instead of their own; and the rideshare companies hold out to the public that the drivers work for them and are not separate contracting businesses.

The direct effects of AB5 on workers and business entities remain to be seen, but public discourse for and against the legislation has been overwhelming. The law is still very much a living document, which is a preferable approach to a new law struggling to be implemented during a pandemic. For example, after AB5's passage, Governor Newsom signed

174. *See id.*

into law AB2257, creating even more exemptions for individuals working in the music industry, “photographers, photojournalists, freelance writers, editors, and newspaper cartoonists,” “people who provide underwriting inspections and other services for the insurance industry,” people involved with international exchange visitor programs, consultants, real estate appraisers, and more.¹⁷⁵

California legislators will continue to finesse their state’s labor laws to better protect workers in the gig economy while supporting the economic and business models of employers across the state. To achieve the goal that AB5 set out to accomplish, the legislature must strengthen AB5’s language to limit workarounds to the law as it pertains to the establishment of incorporations and limited liability companies. It would also be prudent to monitor and observe incorporation trends as the law continues to be implemented and to adjust the statute as necessary to support workers’ desires and vision for their own employment.

And, segueing to the importance of considering workers’ visions for their own employment, perhaps that is the solution in the interim as we await the end of the COVID-19 pandemic. Misclassified workers are at the mercy of their employers, either waiting to see if they will be reclassified as employees under California labor law—where it is uncertain whether they will qualify for the little sick leave they are owed—or if they will continue on in their independent contractor classifications, where they may continue to benefit from the more generous CARES Act (at least for now). Staying mandatory reclassifications under AB5 in the gig economy could help Californians get by in these devastating times—companies would still be free to reclassify their workers now, or they could wait until the pandemic ends to make the switch. This should be done in conjunction with efforts to educate workers on the range of complicated benefits and detriments of classifications under AB5 and COVID-19 emergency aid. It should also encourage an open dialogue between workers, employers, and the legislature about how the workers wish to be classified. Workers could have more of a say regarding their status as they try to support themselves and their families, and out-of-state companies could be encouraged to bring their business back to California to provide more gig work for Californians. While not a perfect solution, especially when considering the balance of power within the employer-employee relationship, this proposal is a building block for the future.

Lawmakers today have the unique opportunity to set the course for the next wave of workers who will surely meet new challenges that were unmet at the turn of the century by traditional employees. The passage of

175. 2020 Cal. Legis. Serv. ch. 38 (West) (Assembly Bill No. 2257).

AB5 is a step forward for California and sets a strong precedent for states looking to model their own laws after the state's labor code. However, adjustments to the law must be made to fully realize AB5's important goal of rightfully providing employees with labor protections and protecting businesses from competitors that use employee misclassification as a cost-cutting device. Stricter language in AB5's Prong C—namely, borrowing from New York's Separate Business Entity Test framework—is one such way to combat fraudulent independent businesses seeking to avoid employee classification. Additionally, open dialogue between legislators and leaders from industries seeking exemption is vital to ensure AB5's success. The changing nature of work—and of the world—calls for a change in its governance, and California has taken a step forward to meet that need via its ABC test. Now, that test must be strengthened.