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Finding the Middle Ground: Establishing a Third, Hybrid Worker Classification

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Finding the Middle Ground: Establishing a Third, Hybrid Worker Classification

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In 2015, the California Labor Commissioner's Office handed down a decision that struck fear into the hearts of Uber's top executives: a former Uber driver was reclassified as an employee, rather than as an independent contractor[2]. Uber, like the majority of gig economy companies, only hires workers as independent contractors. This classification is essential to helping Uber grow, offer greater-value products and services, and grant its workers more flexibility. However, it also protects Uber from liability claims and allows Uber to deny its workers benefits and rights exclusive to full time employees, like overtime pay and unionization. The California decision poses a serious financial risk to many of America's newest companies and to the independent contractors relying on them for employment, as it threatens to completely restructure the business model of the gig economy. This decision, along with countless other cases, provide further support for the growing consensus that worker classification reform is needed.

The current worker classification dichotomy of employee and independent contractor has proven itself inadequate with the evolving US workforce. We propose that a third classification of worker, called the "dependent contractor", be created. This classification will improve workers' well-being by simultaneously maintaining the flexibility granted to independent contractors and by allowing certain protections and benefits that, until now, have been exclusive to employees. It will also reduce worker classification litigation, improve the government's tax-collecting efforts, and protect a burgeoning industry from regulatory risk.

This paper will start by examining the origins of the current worker dichotomy in Section I, which will showcase the need for a new, third classification of worker. The characteristics and features of this new classification, the "dependent contractor", will be explained in Section II and compared to employees and independent contractors. Section III will explain a proposed plan of implementation, which contains an update to the Fair Labor Standards Act and state-level legislation.

I. Background

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[2] Mike Isaac and Natasha Singer, *California Says Uber Driver is Employee, Not a Contractor*, N.Y. TIMES, JUNE 17, 2015, https://www.nytimes.com/2015/06/18/business/uber-contests-california-labor-ruling-that-says-drivers-should-be-employees.html (last visited November 2018).

The Fair Labor Standards Act[3], passed by Congress in 1938, is the defining federal statute on labor classification. It establishes two categories of workers: employees and independent contractors. When it was written, most employees were unskilled, highly replaceable workers that needed protections and rights against their employers. Therefore, the FLSA granted employees, among other things, a minimum wage, overtime pay, and the right to sue for workplace violations. These rights and privileges were not granted to independent contractors, who were seen as highly skilled workers. Congress reasoned that because of their unique abilities, independent contractors were able to negotiate with employers from a position of strength and didn't need the same protections that employees needed. Instead, independent contractors were provided a level of flexibility to their work not available to employees[4].

While a dichotomy of workers was adequate at the time, it is poorly applicable to the current worker environment, which has been radically changed by the emergence of the gig economy[5]. The gig economy is any marketplace where temporary, flexible jobs are commonplace, and companies tend to hire independent contractors and freelancers instead of full-time employees. The rising gig economy stands in contrast to the traditional economy of full-time workers who rarely change positions, choosing instead to focus on a lifetime position at a single company.

Gig economy workers are hired on as independent contractors and typically provide their product or service through an app. For example, a gig economy worker might provide taxi services through Uber and Lyft, food delivery through GrubHub, or hostel services through Airbnb. These independent contractors are often unskilled and highly replaceable. Indeed, they seem similar to the employees for whom the FLSA was originally written yet are denied any corresponding privileges. In addition, there are many cases that give the impression that they are not even granted the flexibility that comes with being an independent contractor. For example, these gig economy workers are not allowed to set their own prices and must obey certain rules of conduct or risk being terminated. This confusion has led to a large number of individual lawsuits and class actions throughout the United States. Because of the current worker environment, we propose that a third category of worker, called the "dependent contractor", be established.

II. Characteristics of the Dependent Contractor

The dependent contractor would serve as a hybrid classification that shares characteristics of both employees and independent contractors. These characteristics can be divided into three categories: civil rights, liability, and miscellaneous benefits. While the amendment to the FLSA

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[3] Fair Labor Standards Act of 1938., 75 P.L. 718, 52 Stat. 1060, 75 Cong. Ch. 676 (June 25, 1938).

[4] Nicholas L. DeBruyne, *UBER DRIVERS: A DISPUTED EMPLOYMENT RELATIONSHIP IN LIGHT OF THE SHARING ECONOMY*, 92 Chi.-Kent L. Rev. 289, (2017), *available at https://advance.lexis.com/api/document?collection=analytical-materials&id=urn:contentItem:5N65-8C30-00CT-S1WX-00000-00&context=1516831*.

[5] QUORA, *What Are The Pros And Cons Of The Gig Economy?*, WWW.FORBES.COM, https://advance-lexis-com.erl.lib.byu.edu/api/document?collection=news&id=urn:contentItem:5V55-87R1-DXVP-5201-00000-00&context=1516831 (last visited January 8, 2019).

will mandate certain characteristics be attributed to this third classification, other benefits will be left to the discretion of states.

A. Civil Rights

Independent contractors do not enjoy the same civil rights protections afforded to employees. A defining trait of independent contractors is that they are loosely tied to the companies that hire them, receiving pay for the temporary work they are hired to complete. In accordance with this process, independent contractors are allowed to avoid rigorous background checks and other tests common in the hiring of employees. However, this simple hiring process currently does not include protections provided for in the Civil Rights Act of 1964[6] or under Title IX[7]. Scant legal recourse can be found in section 1981 of the Civil Rights Act of 1866 but that also fails to make mention of gender discrimination[8]. One recent filing with the Ninth Circuit US Circuit of Appeals addresses the issue of whether or not workers were misclassified as independent contractors and illegally denied certain benefits guaranteed to employees. Implicit in this case is the understanding that if the workers are found to be independent contractors no violations occurred because independent contractors are not privy to the same employment rights as employees[9]. Failing to provide these protections for any kind of worker is regressive and provides no tangible economic benefit to the contractor or the company that hires them.

This issue is of such importance that it needs to be written and enforced at the federal level, in accordance with other vital labor legislation. The Fair Labor Standards Act (FLSA), the Civil Rights Act and Title IX are all federal legislation, as they protect workers across the country from discrimination and bias in hiring processes. We recommend that said protections be considered given the current circumstances of independent contractors. The existence of other civil rights, like the right to unionize or the right to fair wages, are more economic in nature and should be left to the discretion of individual states.

One such example of Federal labor legislation that left discretion to the states was the Taft-Hartley Act of 1947[10]. While States were expanding their labor regulations during the 1930's, the influx of workers returning from WWII led to conflicts with employers, including lengthy strikes and unions setting up "closed shops" where enrollment in unions was mandatory for employment. In order to correct these and other unfair labor practices, the Taft-Hartley Act was

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[6]The Civil Rights Act of 1964, §2000D Et Seq. (2019).
[7]Title IX of the Education Amendments of 1972, 20 U.S.C. A§ 1681 ET. SEQ. (2019).
[8] Civil Rights Act of 1866, 42 U.S.C. § 1981 (2019).
Any protections that are provided for in the Civil Rights Act/Title IX fail to extend to independent contractors; Section 1981 can be used when arguing for "Intentional" racial/ethnic discrimination, commonly deflected by the counter-claim that the businesses policies had an unseen discriminatory effect
[9] California Trucking Association v. Su., 903 F.3d 953, (9th Cir. 2018).
[8] Labor Management Relations (Taft-Hartley) Act, 29 U.S.C. § 141-§197 (2019).

passed by Congress. While enforced at the federal level, this act allowed states the freedom to enact "right-to-work" laws[11].

"Right-to-work" laws allow states to "prohibit unions from negotiating security agreements with employers requiring that non-union employees pay an agency fee. These laws aim at undermining unions as they exist to incentivize workers to abstain from paying union fees[12]." Currently such laws are enforced in 28 states[13], exhibiting the flexibility that states can have even under federal labor legislation. This precedence of allowing states to exercise flexibility over employment further supports the assertion that a variety of characteristics of the dependent contractor should be determined at the state level.

B. Liability

One right of independent contractors is the ability to make their own decisions about how to carry out their work. An employee, however, is usually required to follow certain protocol or a company's code of conduct. For example, if an independent contractor is contracted to build a roof for a house, the independent contractor can pick his own materials, choose which hours of the day to work, decide where to place the supporting struts, etc. An employee tasked with building a roof under similar conditions, however, might be required to source material from a specific supplier, spend a certain number of hours testing the quality of the construction, be required to place supporting beams every four feet, or to receive approval from his manager before installing the construction. Because of the independent contractor's work flexibility, they are held responsible to their customers for the result of their work, not how it was completed. This extends to the instances where companies hire independent contractors; due to this lack of control over their work execution, these companies are not held liable for any errors committed by these contractors.

On the contrary, we see with Uber drivers that these workers often must abide by a company's rules or risk termination. These drivers, which are currently classified as independent contractors, must follow Uber's "tips", or rules, that outline procedures the driver should follow. If an Uber driver violates these rules, he is given a warning. Consistent violation can lead to the permanent deactivation of the driver's account[14].

However, the control some companies exercise over their independent contractors has been justified by the courts, such as deadlines and monitoring the worker's working conditions[15].

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[9] Funk et al., *Right-to-Work Law,* WORKPLACE FAIRNESS (2018), https://www-lib-byu-edu.erl.lib.byu.edu/cgi-bin/remoteauth.pl?url=http://search.ebscohost.com.erl.lib.byu.edu/login.aspx?direct=true&db=funk&AN=ri050100&site=ehost-live&scope=site

[12] Nigel E. Jeffries, *A Closer Look at Labor Law*, CHARLESTON GAZETTE-MAIL, Jan. 17, 2018, at P1C

[13] *Id.*

[14] *Uber Community Guidelines*, UBER, https://www.uber.com/legal/community-guidelines/us-en/ (last visited Feb. 6, 2019)

[15] Doe v. Wal-Mart Stores, Inc., U.S. Dist. LEXIS 98102 (D. Cal. Mar. 30, 2007).

Courts have ruled that these types of requirements are permissible as they do not impose direction of the daily activity of the worker[16]. However, in *O'Connor v Uber Technologies, Inc.*, the plaintiffs argued that the Uber workers needed to be reclassified to employee status due to the "litany of detailed requirements imposed on them by Uber[17]." Several class-action suits like this are currently under debate throughout the country, showing the need for a more effective solution than binary re-classification.

Independent contractors that must abide by guidelines and procedures of their employers should be classified as dependent contractors and share liability with their hiring company. Because companies exercise less control over dependent contractors than employees, companies should, to an extent, be less liable for their dependent contractors. Establishing the exact amount of liability employers of dependent contractors should assume is extremely complicated and lies somewhere less than complete assumption of liability and more than zero assumption of liability. We recognize, however, that this is not a detailed analysis and encourage further research into liability sharing between employers and dependent contractors.

C. Miscellaneous Benefits

Dependent contractors do not have a reliable way to track the amount of time spent working for a particular company. Alan Krueger and Seth Harris, two distinguished economists, co-authored a paper where they advocate the idea that worker benefits requiring minimum hours worked would not transfer well to a hybrid third classification[18]. Michael L Nadler and the Hamilton Project both argue that worker's benefits that are related to the number of hours worked should not be granted to a hybrid classification, such as the proposed dependent contractors. For example, sick leave, paid vacation days, overtime wages, or ACA eligibility are tied to the number of hours a person works. Dependent workers—like independent contractors—would have control over how much time they spend working because they would also have significant discretion in determining how to perform their jobs. In addition, independent contractors that labor in the gig industry will often work for multiple companies at the same time. For example, many Uber drivers also work for Lyft, a similar ride-share company, and will be logged into both apps simultaneously[19]. This difficulty in determining when a dependent contractor is working for a specific company further supports the conclusion that all

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[16] *Id.*

[17] O'Connor v. Uber Techs., 904 F.3d 1087, (9th Cir. 2017).

[18] Seth D. Harris and Alan B. Kreuger, *A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The 'Independent Worker',* THE HAMILTON PROJECT (DEC. 2015), http://www.hamiltonproject.org/assets/files/modernizing_labor_laws_for_twenty_first_century_work_krueger_harris.pdf. In this paper for "The Hamilton Project" titled "A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The 'Independent Worker'" they discuss the possibility of a third classification and the economic implications; they mention that the reality of a third class that retains characteristics of the independent contractors such as freedom of hours, makes it "impossible to administer".

[19] *Id.*

miscellaneous benefits that are time-dependent should not be automatically granted to dependent contractors.

A miscellaneous benefit that should be automatically granted to dependent contractors regards tax collection. To help minimize errors in tax collection, companies that hire dependent contractors should be obliged to withhold federal income taxes for Social Security, Medicare, and Federal Unemployment. Under current employer-contractor relationships, the independent contractor is responsible for knowing how much in taxes he owes to the federal government. Many independent contractors are often unaware of their tax obligations, especially when working for multiple gig companies. Correspondingly, "between 2010 and 2015, the number of taxpayers penalized for underpaying estimated taxes increased nearly 40%"[20]. Dependent contractors should have the benefit of companies withholding their federal income taxes, protecting the dependent contractors from IRS audits and penalties. This means that dependent contractors should have W-4s filed with the companies they do business with and these companies should issue W-2s to the IRS. Adjusting from processing the W-9 to the W-4 form is a simple process, and the IRS reporting can be easily integrated with the reporting of the company's employees.

III. Road to Implementation

Implementing a third category of worker requires legislative action at both the federal and state level of government. First, the U.S. Congress should pass an amendment to the Fair Labor Standards Act providing for the third classification "the dependent contractor." In addition to creating this third classification, the amendment should also (1) grant dependent contractors the right against employment discrimination, (2) require companies that hire dependent contractors to assume an increased percent of assumption of liability, (3) deny dependent contractors benefits that are time-dependent in nature, and (4) allow states to grant additional rights and benefits to dependent contractors through state legislation.

A. Amending the Fair Labor Standards Act

While the US Congress is can quickly become gridlocked between party lines on hot button issues, the amendment to the Fair Labor Standards Act should find appeal on both sides of the aisle. Congressmen that are most interested in protecting workers will be happy to support legislation that increases benefits for over forty million citizens[21]. The amendment would also make companies more accountable for their workers' actions by mandating shared liability, which provides harmed consumers a more reliable path towards legal relief. Congressmen that are interested in protecting America's free market and supporting US businesses and the economy should find that many companies, especially gig economy companies, will want this

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[20] *The Cost of Misclassification*, MBO PARTNERS, *Why Does the IRS Care About Worker Classification?*, (Oct. 5, 2017), https://www.mbopartners.com/blog/the-cost-of-misclassification-government (last visited November 2018).

[21] *Id.*

legislation to be passed. By creating a hybrid category of worker, these companies will be better protected from bet-the-company litigation[22], where one unfavorable decision can ruin the entire business model.

An example of this bet-the-company litigation is worker misclassification lawsuits. Creating a third classification will reduce the money and resources many companies spend in litigating classification lawsuits. Worker misclassifications also negatively impact tax collection. MBO Partners, an enterprise that streamlines contracting for self-employed professionals, estimates that tens of billions of dollars of tax revenue is lost due to improper worker classification[23]. It has been stated that "Misclassifying employees as independent contractors and failing to provide W-2 forms can subject an employer to back taxes of as much as 41.5% of the contractors' wages, according to the IRS. And these penalties can go back for three years[24]." If a company is accused of intentionally misclassifying employees for financial gain, they can be subjected to audits, fines of up to $500,000 and jail time. In addition, according to the recent 2017 Hiscox Guide to Employee Lawsuits, an annual study that analyzes the total impact of employee charges and litigation among states, businesses had on average a 10.5% chance of having an employment charge filed against them. It also revealed that 76% of these claims end with no payment by the insurance company[25], but that does not cover the amount of time and money lost to legal preparation. Allowing companies to correctly identify their workers allows them to get ahead of potential lawsuits, while simultaneously avoiding conflicts with the IRS that could stain their company for years.

B. States' Discretion

While the federal government will mandate a minimum level of benefits and rights to be granted to dependent contractors, we believe that states should have complete discretion in determining whether to exceed the federal government's minimum requirements. The level of employment law and regulation varies greatly across states; some tend to exceed federal regulations. others focus on creating optimal environments for business with low levels of regulation. This discretion has been described as the "race to the bottom", an economic term that can be defined as the competition that arises when jurisdictions compete to attract business by cutting wage and labor regulation[26]. Due to autonomy that states and localities have in America,

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[22] Michael L. Nadler, *Independent Employees: A New Category of Workers For the Gig Economy*, 19, NC. L. REV. 443 (2018) http://ncjolt.org/wp-content/uploads/2018/05/Nadler_Final.pdf.

[23] *Why Does the IRS Care About Worker Classification?*, MBO PARTNERS, (Oct. 5, 2017), https://www.mbopartners.com/blog/the-cost-of-misclassification-government.

[24] Michael Haberman, *Do You Know the Penalties for Improperly Classifying Employees as Independent Contractors*, SHRM, (Dec. 18, 2015), https://blog.shrm.org/blog/do-you-know-the-penalties-for-improperly-classifying-employees-as-independet.

[25] *The 2017 Hiscox Guide to Employee Lawsuits*, HISCOX, https://www.hiscox.com/documents/2017-Hiscox-Guide-to-Employee-Lawsuits.pdf.

[26] *Race to the Bottom*, LEXICON.FT.COM, http://lexicon.ft.com/Term?term=race-to-the-bottom (last visited Jan 16, 2019)

this competition between states' regulatory environments create a downward pressure on labor regulation, causing prices, often including wages, to fall. While this "race" relies on the assumption that all labor regulation imposes costs that an employer would seek to avoid[27], this federal regulation would create a net value for society, similar to the federally mandated minimum wage. The federal minimum wage, while imposing a cost on business nationwide, provides a baseline protection for employees around the country. This amendment would provide similar protections

Allowing states to fine tune the characteristics of the dependent contractor classification both respects the federalist system of the US government and helps states tailor their legislation to the unique needs and features of their state. The "race to the bottom" is allowed to continue to the benefit of the consumer in the way of lower prices of goods, while maintaining protections for workers that fall under the dependent contractor.

IV. Conclusion

The US Congress should pass legislation that amends the Fair Labor Standards Act, creating a third, hybrid classification of worker, the dependent contractor. The characteristics of the dependent contractor will include benefits both from employees, such as the protection from employment discrimination, while ensuring the same work flexibility granted to independent contractors. States will have the discretion to grant dependent contractors more rights and benefits than what have been outlined in Section II according to the wishes of their citizens. By creating this third classification, the US Congress will improve the working lives of over forty million Americans, help provide business-model security to some of the nation's fastest growing businesses and improve the country's tax-collection efforts.

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[27] Steven L. Willborn, *Labor Law and the Race to the Bottom*, MERC. L. REV., Jan. 1 2017, at 369 https://www.lib.byu.edu/cgibin/remoteauth.pl?url=http://search.ebscohost.com/login.aspx?direct=true&db=asn&AN=96714717&site=ehost-live&scope=site (last visited Dec. 29, 2018)