January 4, 2021

Transition to a Biden Administration: Recent Developments and the Continuing Debate Concerning Worker Classification

Recent developments have drawn renewed attention to the debate concerning the appropriate standard for determining whether a worker should be considered an employee or an independent contractor under federal and state wage and hour laws. On the federal level, the Department of Labor (the "DOL") announced a proposed rule regarding worker classification under the Fair Labor Standards Act (the "FLSA") in September, which represents the latest attempt by the agency to clarify the long-standing "economic reality" test for determining independent contractor status. Given the upcoming administration change, however, it is unclear whether this latest DOL rule will be finalized.[1] Instead, President-elect Joseph Biden stated that he would establish a federal standard modeled on the "ABC" test recently adopted by the California Supreme Court[2] for all federal labor, employment and tax laws—including the FLSA. Under that test, employee status is presumed unless the employer can satisfy certain conditions.[3]

On the state level, following judicial and legislative adoption of the "ABC" test in California, voters approved Proposition 22, a ballot measure which allows hiring businesses to continue to classify app-based transportation and delivery drivers as independent contractors while providing certain alternative benefits that are similar to those available to employees.[4] Other states may promulgate new classification standards, on a statewide and/or industry-specific basis, in the future.[5]

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1 Independent Contractor Status Under the Fair Labor Standards Act (Sept. 25, 2020), 85 Fed. Reg. 60,600, 60,634 (to be codified at 29 CFR Parts 780, 788 and 795), https://www.govinfo.gov/content/pkg/FR-2020-09-25/pdf/2020-21018.pdf.

2 *Dynamex Operations W., Inc.* v. *Superior Court*, 416 P.3d 1 (Cal. 2018).

3 Joe Biden for President: Official Campaign Website, https://joebiden.com/empowerworkers/.

4 Website of California Secretary of State Alex Padilla, "Proposition 22: App-Based Drivers and Employee Benefits," https://electionresults.sos.ca.gov/returns/maps/ballot-measures/prop/22.

5 For example, following the enactment of AB 5, New York Governor Andrew Cuomo stated that he may propose measures that would "redefine[] a worker as an employee, as opposed to an independent contractor." Michael Gormley, "NY Weighs Reshaping Labor Laws for the Gig Economy," Newsday (Sept. 16, 2019), https://www.newsday.com/news/region-state/gig-economy-1.36268501.

In light of these events and in anticipation of the transition to a Biden administration, we summarize below the recent changes in the DOL FLSA worker classification guidance, as well as developments in California regarding the newly approved ballot measure.

The DOL's Shifting "Economic Reality" Test Applicable to FLSA Claims

The question of whether an individual worker should be classified as an employee or, instead, as an independent contractor under the FLSA can have enormous significance for workers and businesses. The FLSA requires covered employers to pay their nonexempt employees at least the federal minimum wage for every hour worked and overtime pay for every hour worked over 40 in a workweek, and mandates that employers keep certain records regarding their employees.[6] These requirements do not apply to independent contractors, but the FLSA does not define that term. Instead, the FLSA defines "employer" to include "any person acting directly or indirectly in the interest of an employer in relation to an employee,"[7] "employee" as "any individual employed by an employer"[8] and "employ" as "includ[ing] to suffer or permit to work."[9]

The DOL has periodically issued and revised its guidance on how to distinguish independent contractors from employees using different variations of a multifactor "economic reality" test that analyzes various indicators of economic dependence.[10] In the two most recent iterations of its guidance, the DOL has alternately expanded and contracted the "economic reality" test, though in the context of the DOL's rulemaking, that test only applies to the FLSA, not to other federal, state or local laws that may apply different tests for independent contractor classifications.[11]

In 2015, during the Obama administration, the DOL explained that the definition of "employ" under the FLSA is "expansive," and that the economic reality test should be applied in recognition of the broad "suffer or permit" standard under the law.[12] According to the DOL's 2015 guidance (the "2015 Guidance"), an appropriate application of the economic reality test considers: (i) the extent to which the work performed is an integral part of the employer's business; (ii) the worker's opportunity for profit or loss depending on his or her managerial skill; (iii) the extent of the relative investments of the employer and the worker; (iv) whether the work performed requires special skills and initiative; (v) the permanency of the relationship; and (vi) the degree of control exercised or retained by the employer.[13] Notably, as the DOL noted at the time, under this standard, "most workers are employees under the FLSA."[14] The 2015 Guidance also cautioned that the "control" factor should not be given undue weight and that the above factors should be considered in totality to determine whether a worker is economically dependent on the employer, and thus an employee.[15]

Two years later, the 2015 Guidance was withdrawn by the DOL under the Trump administration,[16] foreshadowing a pendulum swing towards a more narrowly focused "economic reality" test. Subsequently in April 2019, the DOL issued an opinion letter that

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6 *See* DOL, "Wages and the Fair Labor Standards Act," https://www.dol.gov/agencies/whd/flsa.

7 29 U.S.C. 203(d).

8 29 U.S.C. 203 (e).

9 29 U.S.C. 203 (g).

10 *See* 85 Fed. Reg. at 60,604–05.

11 *See* DOL, Administrator's Interpretation No. 2015-1 (July 15, 2015); 85 Fed. Reg. 60,600.

12 DOL, Administrator's Interpretation No. 2015-1 at 2–5.

13 *Id*. at 4.

14 *Id*. at 2.

15 *Id*.

16 *See* DOL, "US Secretary of Labor Withdraws Joint Employment, Independent Contractor Informal Guidance" (June 7, 2017), https://www.dol.gov/newsroom/releases/opa/opa20170607.

concluded that workers of a gig economy employer are independent contractors, applying the same "economic reality" test articulated in the 2015 Guidance.[17]

In September 2020, the DOL issued a proposed rule adopting a revised "economic reality" test for determining employee status (the "PR") for purposes of the FLSA.[18] Under the PR's economic reality test, there are two "core factors" that are "highly probative" in determining whether a worker is economically dependent on the employer for work and, thus, appropriately treated as an employee under the FLSA: (1) the nature and degree of the worker's control over the work; and (2) the worker's opportunity for profit or loss.[19] In addition, three other factors may be considered: (1) the amount of skill required for the work; (2) the degree of permanence of the working relationship between the worker and the potential employer; and (3) whether the work is part of an integrated unit of production.[20] Notably, when promulgating this revised test, the DOL stated that it expected the PR "to result in more independent contractor opportunities which bring with them autonomy and job satisfaction."[21]

As of the date of this memorandum, the PR still has not been finalized. As the Democratic presidential nominee, Biden expressed that his intended focus, if elected President, would be to ensure that workers—especially those in construction, service industries and other industries—are not misclassified as independent contractors.[22] Thus, under President-elect Biden, the DOL is expected to either withdraw the PR or, if it has become final, initiate a new rulemaking process to rescind it.

Specifically, under the Biden administration and consistent with the President-elect's published plan concerning worker classification in the "gig economy" (the "Biden Plan"),[23] the DOL may propose the establishment of a federal standard modeled on the California Supreme Court's "ABC" test for all federal labor, employment and tax laws. The "ABC" test presumes that an individual is an employee unless the employer demonstrates each of the following: (a) the worker 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 worker performs work that is outside the usual course of the hiring entity's business; and (c) the worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed.[24]

In vowing to work with Congress to establish this new federal standard for worker classification, the Biden Plan stated that there is an "epidemic of misclassification" due to ambiguous legal tests that give "too much discretion to employers . . . and too little direction to government agencies and courts."[25] Moreover, the Biden Plan promised that the administration would support the Protecting the Right to Organize Act (the "PRO Act")[26]—which would implement the "ABC" test as the test for determining

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17 DOL, FLSA2019-6 (Apr. 29, 2019), https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/2019_04_29_06_FLSA.pdf.

18 Our memorandum on the DOL's Proposed Independent Contractor Regulation can be found at the following url: https://www.paulweiss.com/practices/litigation/employment/publications/us-department-of-labor-proposes-independent-contractor-regulation?id=38019.

19 85 Fed. Reg. at 60,639.

20 *Id.*

21 *Id.* at 60,634.

22 *See* Official Biden-Harris Campaign Website, "The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions," https://joebiden.com/empowerworkers/.

23 Official Biden-Harris Campaign Website, "The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions," https://joebiden.com/empowerworkers/.

24 *See Dynamex Operations W. Inc*, 416 P.3d at 34; *Hargrove* v. *Sleepy's, LLC*, 106 A.3d 449, 458 (2015) (citing N.J.S.A. 43:21-19(i)(6)).

25 Official Biden-Harris Campaign Website, "The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions," https://joebiden.com/empowerworkers/.

26 Protecting the Right to Organize Act of 2019 (H.R.2474), 116th Congress, https://www.congress.gov/bill/116th-congress/house-bill/2474/text.

independent contractor status with respect to the National Labor Relations Act (the "NLRA").[27] The PRO Act, which passed the House of Representatives last February, also seeks to expand various labor protections related to employees' rights to organize and collectively bargain in the workplace, including through amending the definition of employees covered under the NLRA.

It is important to note that, regardless of the substance of the DOL rule for assessing worker classification under the FLSA that is ultimately promulgated in the months to come, existing worker classification tests under other federal laws or state laws would not be affected. For example, the FLSA does not preempt state wage and hour laws,[28] and states are permitted to set their own worker classification standards, as long as they are not inconsistent with the general goals of the FLSA.[29] Thus, regardless of the DOL's rule, states and localities may choose to maintain and/or establish more stringent standards that make it more difficult to classify a worker as an independent contractor.

California's "ABC" Test & Proposition 22

The California Supreme Court's 2018 Ruling in Dynamex Adopting the "ABC" Test

A prime example of a state worker classification standard that diverges from the DOL's "economic reality" test as endorsed by the PR is the "ABC" test adopted in 2018 by the California Supreme Court in its landmark decision in *Dynamex Operations West* v. *Superior Court of Los Angeles County*,[30] which was subsequently codified by the California state legislature as California Assembly Bill 5 ("AB 5").

In *Dynamex*, two delivery drivers filed a putative complaint against Dynamex, a nationwide courier and delivery service, after the company adopted a new policy under which all drivers would be considered independent contractors rather than employees.[31] Among other things, the plaintiffs alleged that such a change violated the relevant California labor code and wage orders[32] because the drivers who were newly classified as independent contractors performed essentially the same tasks in the same manner as they had before the policy change.[33]

After concluding that the "ABC" test is the "most consistent with the history and purpose" of the California's wage orders,[34] the *Dynamex* court ruled that in order to properly classify a worker as an independent contractor, a business must establish that: (i) the worker is substantially free from the hiring entity's control;[35] (ii) the worker's role is not comparable to those of employees whose services are provided within the usual course of business;[36] and (iii) it has not prevented the worker from going into business for

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27 Official Biden-Harris Campaign Website, "The Biden Plan for Strengthening Worker Organizing, Collective Bargaining, and Unions," https://joebiden.com/empowerworkers/.

28 *See Hart* v. *Rick's Cabaret Int'l, Inc.*, 967 F. Supp. 2d 901, 922 (S.D.N.Y. 2013) ("The Second Circuit, however, has recently noted that the FLSA and NYLL analyses may differ."); *Hayward* v. *IBI Armored Servs., Inc.*, 954 F.3d 573, 575 n.2 (2d Cir. 2020).

29 *See Metro. Life Ins. Co.* v. *Massachusetts*, 471 U.S. 724, 757 (1985).

30 *Dynamex Operations W., Inc.*, 416 P.3d at 35.

31 *Id.* at 6.

32 In California, wage orders set forth the wages, hours and working conditions in certain industries or occupations. *See* California Department of Industrial Relations, "Industrial Welfare Commission Wage Orders," https://www.dir.ca.gov/IWC/WageOrderIndustries.htm. The question at issue in *Dynamex* was whether workers should be classified as independent contractors for purposes of wage orders for the transportation industry.

33 *Id.* at 9.

34 *Id.* at 42.

35 *Id.* at 36.

36 *Id.* at 37.

themselves.[37] Failure to satisfy any of the "ABC" test's three factors may disqualify the worker from independent contractor status.[38] Applying the "ABC" test to the underlying dispute, the court allowed the Dynamex drivers to pursue their wage claims on a class-wide basis.[39] Notably, the issue of whether the ruling in *Dynamex* applies retroactively to earlier-filed worker misclassification suits is currently before the California Supreme Court, following the Ninth Circuit's withdrawal of its initial decision answering this question affirmatively.[40]

Other jurisdictions have also applied the "ABC" test in the wage and hour context. For example, in adopting the test in 2015, the New Jersey Supreme Court stated that it "provide[s] more predictability and may cast a wider net than the FLSA 'economic realities' standard."[41] The following year, the Seventh Circuit applied the "ABC" test in a putative class action lawsuit against a same-day delivery service involving allegations of worker misclassification under Illinois law.[42]

Passage of AB 5

In 2019, prompted by the *Dynamex* decision, the California Assembly passed Assembly Bill 5.[43] AB 5 provided that, under California's state wage and hour law, a worker is presumptively considered an employee unless the putative employer, under the three-part "ABC" test, demonstrates otherwise.[44] As explained above, the "ABC" test permits workers to be classified as independent contractors only if the hiring business demonstrates that the worker in question satisfies each of three conditions: (a) that the worker 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; *and* (b) that the worker performs work that is outside the usual course of the hiring entity's business; *and* (c) that the worker is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed."[45]

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37 *Id*. at 39.

38 *Id.* at 39–40.

39 *Id*. at 42.

40 *Vazquez* v. *Jan-Pro Franchising Int'l, Inc*., 939 F.3d 1045 (9th Cir. 2019). In May 2019, the Ninth Circuit initially held that the "ABC" test applied retroactively and remanded the case to the district court to rule on the merits in accordance with the decision in *Dynamex*. *Vazquez* v. *Jan-Pro Franchising Int'l, Inc*., 923 F.3d 575, 580 (9th Cir.*), reh'g granted, opinion withdrawn*, 930 F.3d 1107 (9th Cir. 2019), *and on reh'g*, 939 F.3d 1045 (9th Cir. 2019), *and opinion reinstated in part on reh'g*, 939 F.3d 1050 (9th Cir. 2019). Four months later, a Ninth Circuit panel withdrew its earlier ruling and certified the question of *Dynamex*'s retroactive application to the California Supreme Court. *Vazquez* v. *Jan-Pro Franchising Int'l, Inc*., 930 F.3d 1107 (9th Cir. 2019). Among other things, the Ninth Circuit noted that California's highest court should decide the retroactivity issue given its potential importance to California businesses and workers. *Vazquez* v. *Jan-Pro Franchising Int'l, Inc*., 939 F.3d 1045, 1049 (9th Cir. 2019). *See* Jon Steingart, "Calif. Justices Weigh Whether Dynamex Ruling Is Retroactive," Law360 (Nov. 3, 2020), https://www.law360.com/articles/1324738/calif-justices-weigh-whether-dynamex-ruling-is-retroactive.

41 *Hargrove* v. *Sleepy's, LLC*, 220 N.J. 289, 314, 106 A.3d 449, 464 (2015).

42 *See Costello* v. *BeavEx, Inc.*, 810 F.3d 1045, 1048 (7th Cir. 2016).

43 *See* Eli Rosenberg, "Can California Rein in Tech's Gig Platforms? A Primer on the Bold State Law That Will Try," The Washington Post (Jan. 14, 2020), https://www.washingtonpost.com/business/2020/01/14/can-california-reign-techs-gig-platforms-primer-bold-state-law-that-will-try/.

44 AB 5, https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5.

45 *Dynamex Operations W., Inc*., 416 P.3d at 34 (emphasis in original).

Proposition 22

California voters recently curtailed the impact and applicability of AB 5 through their passage of the Proposition 22 ballot measure in the November general election. Proposition 22 allows certain app-based rideshare and delivery drivers to be classified as independent contractors. Nearly 60% of the electorate voted in favor of the measure.[46]

Proposition 22 does more than just roll back the scope of cases in which the "ABC" test applies. Among other things, Proposition 22 requires hiring businesses to: (i) provide an hourly wage for time spent driving equal to 120% of either a local or a statewide minimum wage; (ii) provide a health insurance stipend for workers who drive at least 15 hours a week; (iii) pay medical costs if a driver is injured while driving or waiting; and (iv) develop sexual harassment policies and take additional measures to protect the safety of drivers and customers.[47] The official voter information guide for Proposition 22 anticipated that the measure would have the fiscal effects of lowering costs for rideshare and delivery companies, which in turn would allow companies to charge lower fares and fees, and increase the income earned by drivers.[48]

As a result of the passage of Proposition 22, California businesses that hire app-based rideshare and delivery drivers may no longer be subject to the AB 5 presumption that a worker is an employee for purposes of wage and hour claims arising under California labor code and wage orders.[49]

Implications for Employers

- The Biden administration may seek significant changes to the worker classification test under the FLSA and other federal employment, labor and tax laws. For example, the DOL under the Biden Administration may withdraw the PR (if not yet finalized) or initiate a new rulemaking process to rescind it. As such, it is important for employers to stay abreast of potential changes in DOL guidance concerning the FLSA and/or other federal statutes. Even if finalized, the PR would only address classification of workers under the FLSA.

- In the context of state wage and hour laws, the California Supreme Court's decision in *Dynamex* and AB 5 adopted the "ABC" test for worker classification, which is arguably a more stringent standard than the federal "economic reality" test. However, the impact and applicability of that standard was curtailed by California voters through their passage of the Proposition 22 ballot measure in November. It is thus important to review independent contractor agreements and existing worker arrangements to maintain compliance with potentially relevant state and local laws concerning worker classification.

- It is possible that similar movements to provide for specific classification and benefits for "gig economy" workers may follow in other states through measures by the executive, legislative and/or judicial branches—and possibly via ballot initiatives. It is important to stay abreast of any upcoming initiatives surrounding industry-specific federal and state standards.

The PR can be found here.

Our September 29, 2020 memorandum on the promulgation of the PR can be found here.

The *Dynamex* decision can be found here.

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46 Taryn Luna, "California voters approve Prop. 22, allowing Uber and Lyft drivers to remain independent contractors" L.A. Times (Nov. 3, 2020), https://www.latimes.com/california/story/2020-11-03/2020-california-election-tracking-prop-22.

47 *See* Proposition 22, 1883 (19-0026A1), Changes Employment Classification Rules for App-Based Transportation Drivers. Initiative Statute, https://voterguide.sos.ca.gov/propositions/22/.

48 See *id.*

49 AB 5, http://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB5; *see* Proposition 22, 1883. (19-0026A1).

The text of AB 5 can be found here.

Additional information about Proposition 22 can be found on the website of the California Secretary of State, which can be found here.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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