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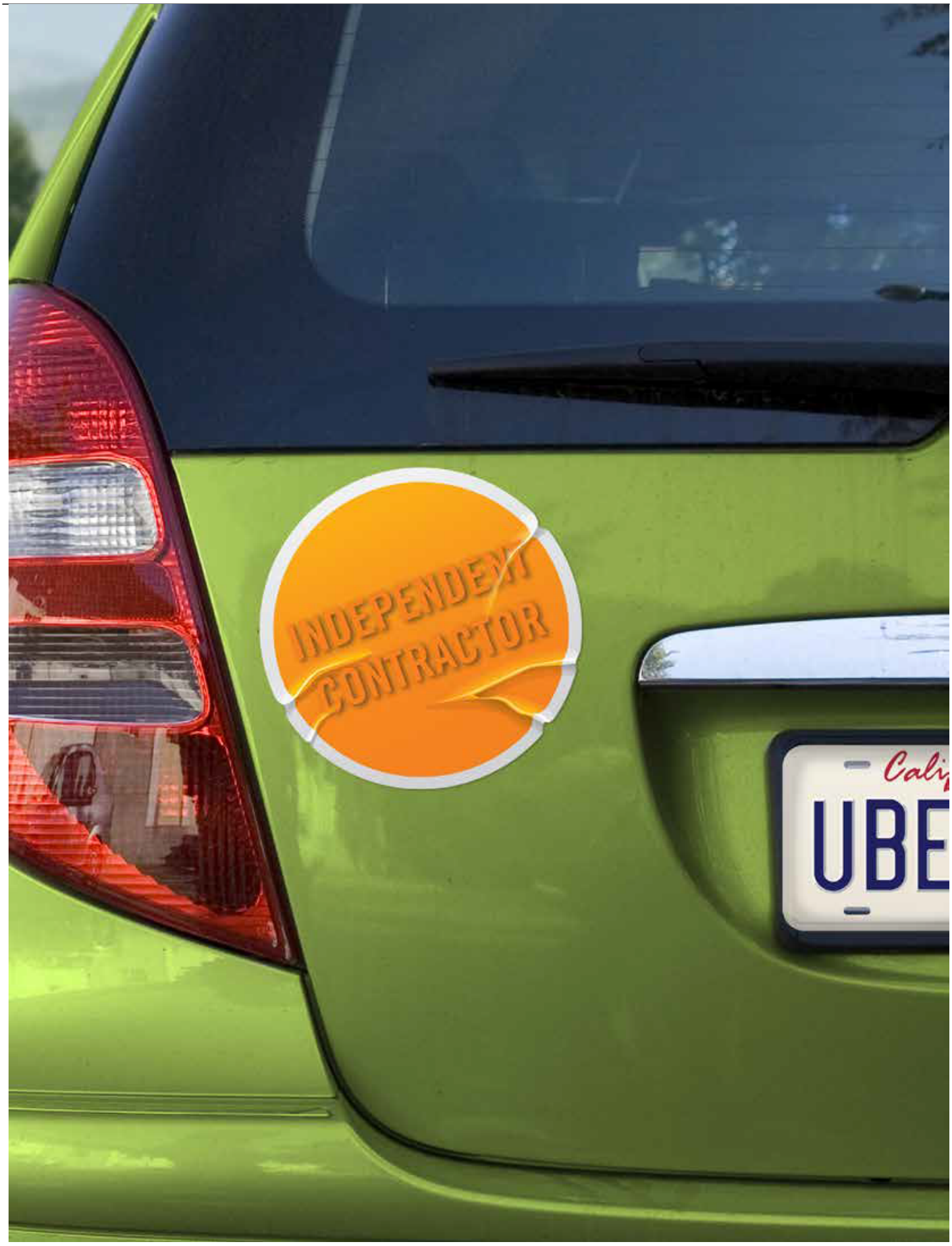
Technology-Driven Businesses and Industrial-Era Regulations: Independent Contractor Relationships in the Age of Uber

Employment and Labor

Litigation and Dispute Resolution


INDEPENDENT
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UBE


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CHEAT SHEET

- ***The Uber litigation.*** Trouble for Uber began in 2013, when drivers filed a class action in federal district court in San Francisco, CA. Drivers sought overtime, gratuities, and reimbursement for vehicles, gas, and other expenses.
- ***Based on precedent.*** A California Supreme Court case and two Ninth Circuit cases have been
  leading authorities guiding the court's denial of Uber's motion for summary judgment. In all of the cases, the court ruled favorably for the plaintiffs, who argued that they were employees.

- ***Summary judgment***. The court ultimately denied Uber's motion for summary judgment on the basis that there was at least sufficient indication of an employment relationship to create a case. If the case does proceed to trial, the likelihood of appeal is high no matter who prevails.
- ***Lessons learned.*** Companies that work with independent contractors should be vigilant, and in-house counsel should scrutinize the relationship to ensure that employers remain compliant.

Uber's ride sharing service was only founded in 2009. Its staggering growth rate has made it a household name across the United States and its global ambitions are clear. The company's success has shaken up the transportation industry, bringing some of its more traditional competitors to their knees. But lately, Uber has been burdened by litigation regarding a decades-old legal issue that threatens the viability of the company's business model.

The issue concerns employment status. The plaintiffs in the litigation, who are all Uber drivers, claim they are employees. Uber, however, maintains they are independent contractors. The distinction is important because, among other reasons, businesses must withhold and pay taxes on wages paid to the former but not the latter. If the drivers were misclassified, Uber may be held liable for significant back taxes, penalties, etc. For even a single driver, this could run into the six-figure range. And it is estimated that Uber has more than 300,000 drivers.

The issue is worthy of the attention of in-house counsel because nearly every company works with independent contractors, to one extent or another. Usually, the relationship is taken for granted, but misclassification challenges are becoming more common. They can arise in court or in state/federal administrative proceedings and they can be very expensive.

The issue can arise in other contexts as well. For example, nearly every employer is required to maintain workers compensation insurance coverage, and nearly every insurance carrier requires an audit at the termination/renewal of the policy. During the course of the audit, some carriers will re-classify independent contractors as employees if there is no certificate of insurance on file, which may affect premiums.

The question therefore becomes, how can employers protect themselves? Although numerous state and federal courts have addressed the distinction between independent contractors and employees, there sometimes is no easy answer, particularly for employers who do business across state lines. Furthermore, many authorities in this area of law evolved in the industrial era with economic models very different from those of today's technology-driven businesses. The aim of this article is to provide a brief overview of the Uber litigation, which is perhaps the largest or at least the most publicized litigation regarding this issue currently, as well as a brief overview of leading authorities at play.

About Uber

Uber primarily makes software that individuals can use with a smartphone or other device to connect with an available driver. Hence the term "ride sharing service." Uber charges individuals requesting the service, and remits the bulk of the charges to the driver. Like other transportation providers, Uber's charges are based on the number of miles traveled and the duration of the ride. Uber keeps a percentage of the charges as its fee-per-ride.

Drivers must successfully complete Uber's application and interview process. Among other things, the process includes a background check and a city knowledge test. Drivers must also sign contracts with Uber explicitly providing that the relationship is that of principal and independent contractor.

The Uber litigation

Trouble for Uber began in 2013 when drivers filed a class action in federal district court in San Francisco. From there, the situation has only snowballed. In 2015, the court denied a motion for summary judgment filed by Uber and certified the case as a class action.

Initially, the class included Uber drivers nationwide, but later, the court limited it to drivers in California. Since then, other class actions have been filed in Indiana, Massachusetts, and Texas. Drivers in other states may soon follow suit (no pun intended).

Drivers seek overtime, gratuities, and reimbursement for vehicles, gas, and other expenses. Drivers also seek civil penalties under the Private Attorneys General Act (PAGA). By their own estimate the value of the former claims is US$854.4 million, and the value of the PAGA claims is over US$1 billion.

Uber agreed to settle for up to US$100 million in 2016, and observers thought a clear-cut resolution to the legal question was in jeopardy. Drivers were to receive individual shares of the settlement based on the number of miles driven for the company, but would also remain independent contractors.

Then, later in 2016, the court rejected the settlement, indicating that it was not "fair, adequate, and reasonable." In its rejection the court noted (1) that the amount offered to drivers was just 10 percent of what the lawsuit claimed the drivers were owed, and (2) that Uber would pay only US$1 million in civil penalties, which, as mentioned, could otherwise total more than US$1 billion. This means we may yet get a clear-cut resolution, but as of this point the court has declined to reset the trial date due to the fact that interim appeals are pending.

In related proceedings, the California Labor Commissioner ruled that an Uber driver was indeed an employee, not an independent contractor. The Unemployment Insurance Appeals Boards for both

California and New York have also ruled that Uber drivers are employees and eligible to obtain unemployment benefits. Likewise, the Bureau of Labor and Industries of the State of Oregon has issued an Advisory Opinion that Uber drivers are employees.

Also, in June 2017, Uber drivers filed a new lawsuit against Uber's founder and former CEO Travis Kalanick and Garrett Camp, its co-founder and board chairman, based on California law indicating that individuals who advise companies to classify workers as independent contractors — who are later determined to be employees — are personally liable for the companies' wage violations. This shows just how serious this issue can be not only for employers, but also for a company's leaders.

Leading authorities

A California Supreme Court case and two Ninth Circuit cases were leading authorities guiding the court's denial of Uber's motion for summary judgment. In all of the cases, class action plaintiffs claimed they were employees, while their defendant employers maintained they were independent contractors. Each court ruled favorably for the plaintiffs.

In *S.G. Borello & Sons, Inc. v. Dep't of Indus. Relations*, 48 Cal. 3d 341 (1989), the defendant, Borello, was a cucumber farmer, and the plaintiffs were migrant agricultural laborers. The parties entered a written agreement deeming themselves principal and independent contractors. The farmer did not directly supervise the laborers in the performance of their work. They managed their own labor, furnished their own tools and equipment, and shared in the profit and loss of the crop.

The California Supreme Court's analysis of employer/employee relationships in this case is the seminal analysis in California. Both of the preceding Ninth Circuit cases relied on the *Borello* analysis in their findings. In the opinion, which has been heavily cited by courts both in and outside of the state, the California Supreme Court enumerated a number of indicia of the relationships. The most significant of the indicia is the putative employer's "right to control work details." The greater the right to control, the more likely it is that an employer/employee relationship exists.

Ultimately this is the reason the court concluded that the laborers were employees. **The court found that the control exercised by the farmer was "pervasive." The farmer owned the land, decided which crops to plant, when to plant them, and how much to sell them for, etc. The laborers' work was limited to simple manual labor that could be performed correctly in only one way.** Supervision of the work was unnecessary because the farmer controlled diligence and work quality through its payment system. "Thus, all meaningful aspects of this business relationship . . . [were] controlled by [the farmer]."

The court also embraced a number of "secondary indicia" of employer/employee relationships including:

- (a) whether the one performing services is engaged in a distinct occupation or business; (b) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; (c) the skill required in the particular occupation; (d) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; (e) the length of time for which the services are to be performed; (f) the method of payment, whether by the time or by the job; (g) whether or not the work is a part of the regular business of the principal; and (h) whether or not the parties believe they are creating the relationship of employer-employee."

The court also noted five additional factors developed by the Ninth Circuit:

- "(1) the alleged employee's opportunity for profit or loss depending on his managerial skill; (2) the alleged employee's investment in equipment or materials required for his task, or his employment of helpers; (3) whether the service rendered requires a special skill; (4) the degree of permanence of the working relationship; and (5) whether the service rendered is an integral part of the alleged employer's business."

The court indicated, however, that these "individual factors cannot be applied mechanically as separate tests; they are intertwined and their weight depends on particular combinations." Also, "[t]he label placed by the parties on their relationship is not dispositive, and subterfuges are not countenanced."

In *Alexander v. FedEx Ground Package Sys., Inc.*, 765 F.3d 981 (9th Cir. 2014), the defendant, FedEx, contracted with the plaintiff drivers to deliver packages. Drivers provided their own vehicles, but FedEx had very specific requirements for the vehicles. For example, it required the vehicles to be painted "FedEx white," and marked with the FedEx logo. FedEx did not expressly dictate working hours, but did tell its drivers what packages to deliver, on what days, and at what times. Drivers also were required to wear FedEx uniforms and groom themselves according to FedEx's appearance standards.

Applying *Borello*, the Ninth Circuit found that the drivers were employees as a matter of law because the most important factor — the right to control — strongly favored employee status. In reaching its conclusion, the court gave particular weight to FedEx's control over delivery schedules, vehicle specifications, and uniforms/grooming/appearance. The court did not believe the other *Borello* factors "strongly favor[ed] either employee status or independent contractor status."

In *Narayan v. EGL, Inc.*, 616 F.3d 895 (9th Cir. 2010), the defendant, EGL, was a Texas-based company that provided worldwide air and ocean freight forwarding. It contracted with the plaintiff drivers for freight pick-up and delivery services. Drivers signed an employer-drafted form in which they expressly acknowledged they were independent contractors. Drivers owned their own vehicles, and supplied some of the equipment used to deliver packages (e.g., hand trucks, lift gates). EGL ordered drivers to report for work at a set time each morning, and drivers could be subject to disciplinary action for showing up late. Drivers also were required to wear EGL-branded shirts, safety boots, and an EGL identification card.

Again applying *Borello*, the Ninth Circuit found "there existed at the very least sufficient indicia of an employment relationship . . . such that a reasonable jury could find the existence of such a relationship" and it remanded the case to the district court. The court looked at EGL's control over many details of the drivers' performance, considering many of the same details as the court in *Alexander*. These included control over conduct, work hours, vehicle specifications, uniforms, etc.

The devil is in the details when it comes to these cases and very similar fact patterns can yield different outcomes. Indeed, Uber cited many cases similar to *Alexander* and *Narayan* where courts found in favor of independent contractor relationships.

To make matters more complicated, different states apply different standards. In the *Narayan* case, for example, independent contractor declarations, signed by the drivers, compelled the trial court to hold they were independent contractors under Texas law. The ruling was reversed in large part due to the fact that the appellate court determined California law applied, and that California does not

regard such declarations as controlling.

Uber and driver contentions

Drivers argue that the level of control exercised by Uber is considerable. “Uber is deeply involved in marketing its transportation services, qualifying and selecting drivers, regulating and monitoring their performance, disciplining (or terminating) those who fail to meet standards, and setting prices.” Uber instructs drivers to, amongst other things: “make sure you are dressed professionally;” send the client a text message when one to two minutes from the pickup location; “make sure the radio is off or on soft jazz or NPR;” and “make sure to open the door for your client.” Uber also requests passengers to give drivers a star rating and feedback, and then uses these ratings and feedback to monitor/discipline/terminate drivers, and so on.

All of these contentions are hotly disputed. **Uber dubs itself a technology company, not a transportation company. It contends that it exercises minimal control over drivers, and that they completely control how to give the rides they accept.** It merely provides suggestions, and does not actually require drivers to dress professionally or listen to soft jazz or NPR. Drivers, for the most part, can work as much or as little as they like. Uber has no control over whether drivers even report for work. It is only permitted to terminate drivers with notice or upon material breach of governing contracts. Drivers set their own hours and work schedules, provide their own vehicles, and are subject to little direct supervision. Drivers also sign an agreement expressly stating that no employment relationship is created.

The court ultimately denied Uber’s motion for summary judgment for reasons similar to those in *Narayan*. Applying *Borello*, it found there were at least sufficient indicia of an employment relationship to create a triable issue. If the case does proceed to trial, the likelihood of appeal is high no matter who prevails (as mentioned above, interim appeals have already been filed). The likelihood an appeal could set new precedent is also high. Indeed, the court seemed to hint at this very fact in its ruling, indicating that “[t]he application of the [*Borello*] test of employment — a test which evolved under an economic model very different from the new “sharing economy” — to Uber’s business model creates significant challenges. Arguably, many of the factors in that test appear outmoded[.]”

Lessons

It’s unfortunate, but sometimes there is no easy solution for employers in this area of law. While the IRS now offers concerned employers (and employees) the option of filing Form SS-8 to request a formal determination, this may accelerate adverse proceedings for the employer if an unfavorable determination is made. Also, the extent to which the determination would be binding in state or federal courts is unclear. In proceedings like the Uber litigation classification is usually a question of state law.

For these reasons, companies that work with independent contractors (as nearly all do) should be vigilant, and in-house counsel should scrutinize such relationships. This is certainly a case where the proverbial ounce of prevention is worth a pound of remedy. One prudent course of action may be to ensure that contracts expressly identify relationships as independent contractor relationships. Numerous courts have stated that they take such agreements into consideration. Sadly there are no magic words or model provisions for the agreements, but local case law (e.g., *Borello*) may provide guidance.

Do not assume, however, that such agreements by themselves are sufficient, because in states like California they clearly are not. Consider the following questions:

- Is there control over the means or manner of accomplishing the work?
- Is there a right to discipline or discharge at will?
- Is there monitoring or supervision over the work? Is there control over work hours?
- Are uniforms required and/or is a dress code enforced?
- Are vehicles and/or equipment supplied for the work?
- Is liability insurance provided?

A "yes" to any of these questions, although not dispositive, is indicative of an employee relationship. In such cases, in-house counsel may find it wise to take a closer look at the relationship, and local authorities. It is always important to look at local authorities because it is possible the same individuals could be considered independent contractors by one state and employees by another (this is essentially what happened in *Narayan*).

At its core, there must be relinquishment of at least some level of control to ensure independent contractor status. For these reasons, it may be worth reconsidering the terms of some relationships, as unwelcome as change can be within some business organizations. Through the taking of preventive measures like these, in-house counsel can significantly reduce risk.

Further Reading

1 Biz Carson, "Why There's A Good Chance Your Uber Driver Is New," Business Insider (October 2015).

2 On Uber generally, see https://help.uber.com.

3 Litigation was filed August 16, 2013 in the US District Court, Northern District of California, O'Connor v. Uber Technologies, Inc., Case No. C-13-3826 EMC.

4 Eric Levenson, "Driver Files Federal Lawsuit Against Uber on Behalf of All Massachusetts Drivers," (June 2016).

5 Drivers allege Uber advertised to customers that gratuities were included in the fare, and that drivers did not receive the total proceeds of the gratuities.

6 California enacted the Private Attorneys General Act of 2004 to create a cause of action under which aggrieved employees may file lawsuits to recover civil penalties for Labor Code violations otherwise recoverable by the state.

7 Judge Edward M. Chen, "Order Denying Defendant Uber Technologies, Inc.'s Motion for Summary Judgment," 23:12-24:2, 30:28-31:1, *O'Connor v. Uber Technologies, Inc.*, Case No. C-13-3826 EMC (March 11, 2015).

8 California Labor Commissioner, "Order, Decision Or Award of The Labor Commissioner," *Berwick v. Uber Technologies, Inc.*, Case No. 11-46739 (June 3, 2015); See also Steve Hargreaves, "Uber Driver Is, In Fact, An Employee," CNN (June 2015).

9 Judge C. DeSilvestore, “Decision,” California Unemployment Insurance Appeals Board, Case No. 5371509 (November 18, 2014); See also Heather Somerville, “Former Uber Driver Was An Employee, Rules California Department,” Reuters (September 2015).

10 Judge Michelle Burrows, “Decision And Notice of Decision,” Unemployment Insurance Appeals Board, Case No. 016-23858 (June 9, 2017). See also Matthew Flamm, “In Another Blow to Uber, Judge Rules That Drivers Are Employees,” Crain’s New York Business (June 2017).

11 Commissioner Brad Avakian, “The Employment Status of Uber Drivers,” Advisory Opinion of the Commissioner of the Bureau of Labor and Industries of the State of Oregon (October 14, 2015). See also Elliot Njus, “Uber Drivers Are Employees, Labor Commissioner Says,” The Oregonian (October 2015).

12 Litigation was filed June 22, 2017 in the Los Angeles County Superior Court, *James v. Kalanick*, Case No. BC666055.

13 See, for example, *Kubinec v. Top Cab Dispatch, Inc.*, 2014 WL 3817016; *Millsap v. Fed. Express Corp.* (1991) 227 Cal.App.3d 425; and *Rabanal v. Ride Share Port Mgmt. LLC*, 2013 WL 6020340 (unpublished).

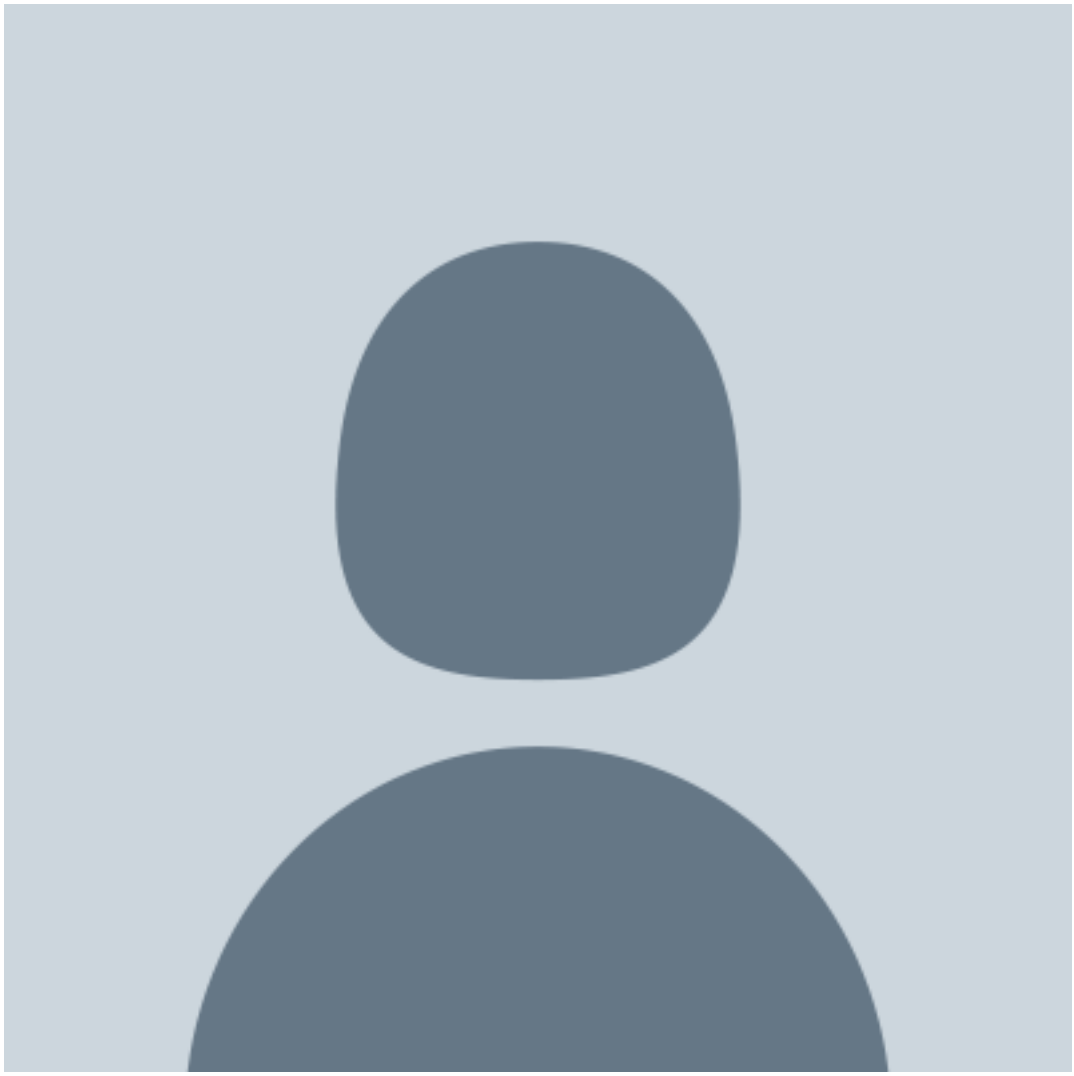
14 For a discusson of Uber/driver contentions see generally Judge Edward M. Chen, “Order Denying Defendant Uber Technologies, Inc.’s Motion for Summary Judgment,” *O’Connor v. Uber Technologies, Inc.*, Case No. C-13-3826 EMC (March 11, 2015).

15 If it is unclear whether a worker is an employee or an independent contractor, Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding, can be filed with the IRS. The form may be filed by either the business or the worker. The IRS will review the facts and circumstances and officially determine the worker’s status. It can take at least six months to get a determination.

16 See, for example, the following California cases: *Ayala v. Antelope Valley Newspapers* (2014) 59 Cal.4th 522, 535 [In cases where there is a written contract, analysis of the right to control without full examination of the contract is virtually impossible]; *Grant v. Woods* (1977) 71 Cal.App.3d 647, 653 [“Written agreements are of probative significance” in evaluating the extent of a hirer’s right to control.]; and *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943, 952 [written agreements are a “significant factor” in assessing the right to control].

17 In addition to local case law, multiple government agencies promulgate rules regarding the classification of workers as employees or independent contractors, such as state departments of labor, unemployment compensation boards, workers compensation insurance boards, and other tax departments. The Internal Revenue Service (IRS) and the US Department of Labor also promulgate federal rules.

Christian Graham



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