McDermott Will & Emery

WORKER CLASSIFICATION: COMPLICATIONS BEYOND THE FRONT PAGE

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EMPLOYMENT

CALIFORNIA'S DYNAMEX ROLLS OUT THE ABC TEST AND THE *PRESUMPTION OF EMPLOYMENT*

- The burden is placed on the employer to prove IC status
- Individual is deemed an employee unless employer demonstrates prongs A, B, and C of the test:
  - (a) that the worker is free from the control and direction of the hirer in connection with the performance of the work;
  - (b) that the worker performs work that is outside the usual course of the hiring entity's business;
  - (c) that the worker is customarily engaged in an independently established trade, occupation, or business.

"C" STANDS FOR "CALIFORNIA WON'T FOLLOW MASSACHUSETTS" (ACCORDING TO CA'S FOURTH DISTRICT COURT OF APPEAL)

- Part C in Massachusetts requires a worker need only be "*capable*" of independent business operation "even if the putative employee does not actually do so"
- Part C in California will require *actual* independent business operation
- In *Garcia v. Border Transport* court decided on October 26, 2018 to split with MA:
  - a taxi driver alleged he was misclassified as an IC, *Dynamex* was applied by the Court of Appeals in driver's favor
  - Defendants failed the ABC test in part by providing no evidence of plaintiff's independent trade/occupation/business (to the contrary, taxi's permit was limited to use while working for defendant, suggesting his "business" was limited to defendant's)

FIRST, SOME “BAD” NEWS:

- Current case law suggests *Dynamex* will be applied retroactively:
- Orange County state court has ruled – in Johnson v. VCG-IS, LLC 15-802813, a case concerning the independent contractor status of exotic dancers – that *Dynamex* applied retroactively
- Separately, the Court of Appeal noted the significance of the Supreme Court denying Dynamex’s petition to clarify whether the decision applied prospectively/retroactively

“ABC” SPELLS TROUBLE… FOR CA AND OTHERS

- “As California goes, so goes the nation[‘s employment laws]”
- California became the latest state to adopt the “ABC” test in its recent *Dynamex* ruling
- *Dynamex* “ABC” test widely regarded as strictest IC test
- Over 20 states use the ABC test for various reasons (frequently for unemployment insurance qualification), but California has joined Massachusetts and New Jersey in requiring all three “ABC” prongs for IC classification

A GLIMMER OF HOPE FOR EMPLOYERS USING STAFFING COMPANIES (READ: A LOT OF YOU)

- *Dynamex* not applied to "joint employer" test in *Curry v. Equilon Enterprises, LLC*, with court stating that the policy reasons behind the "ABC" test are uniquely relevant to independent contractor misclassification scenarios
- *Martinez* is likely test in "joint employer" cases
- Supreme Court yet to rule on this

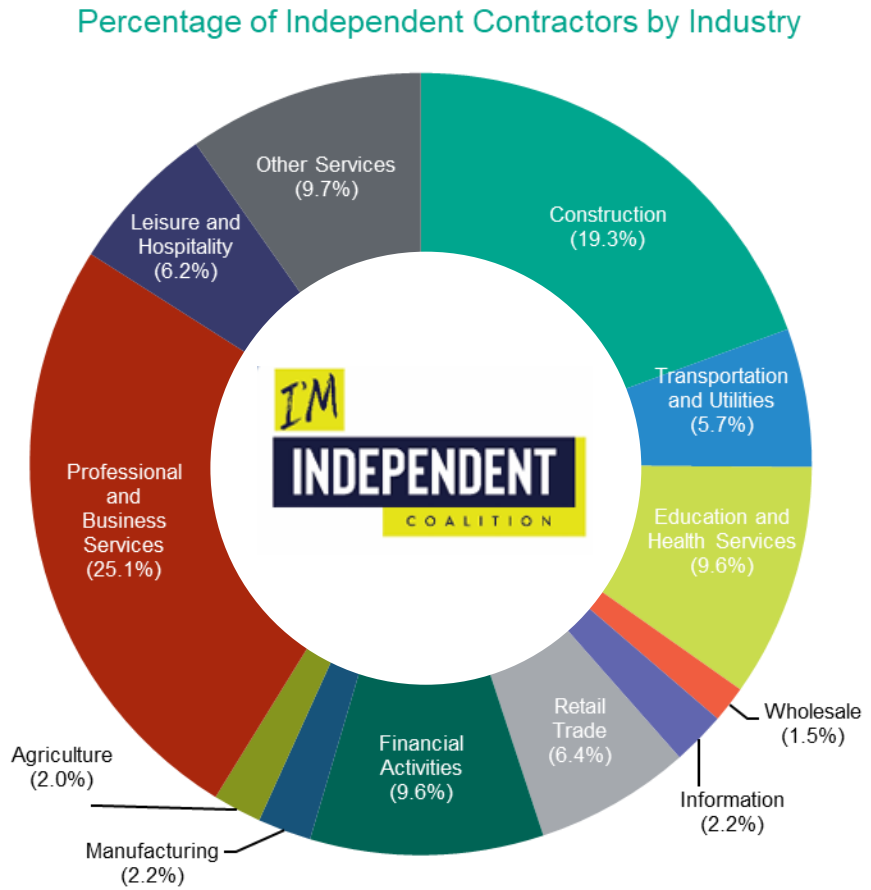
AND *BORELLO* STILL BREATHES….

- *Dynamex* restricted application of ABC test to claims arising under the IWC wage orders
- *Borello* still governs statutory penalties not based on IWC orders: claims for overtime, wrongful termination, waiting time penalties, and derivative UCL claims

AND A BREATH OF FRESH AIR FROM THE "FEDS"

- Trump's NLRB withdraws Obama-era precedent governing its definition of "employee" for more employer-friendly standard in *SuperShuttle DFW, Inc.* (involving ridesharing platform)
  - Employers relying on ICs face potentially lower unionization risk based on NLRB's new ruling
  - Only "employees" may unionize – ICs may not
  - To determine whether "employee" or IC, NLRB will use non-exhaustive 10-factor analysis with an examination of "entrepreneurial opportunity"
    - Driver's control over their own schedules was key factor
- Trump's DOL suggests a return to historical IC classification for DOL-specific issues
  - Withdrew Obama-era expansive guidance re: IC misclassification under FLSA wherein "most workers are employees"
  - Issued guidance suggesting return to "totality of circumstances" test for misclassification

IC IMPACT SPANS MULTIPLE INDUSTRIES NEW AND OLD



*Bureau of Labor Statistics, Report on Contingent and Alternative Employment Arrangements (2018)

LAWSON V. GRUBHUB: CASE TO WATCH

- Gig economy misclassification case: SF-based Grubhub driver filed wage and hour class action; winnowed down to single-plaintiff pursuing expense reimbursement claims
- Grubhub initially prevailed, but *Dynamex* may change that with appeal pending in Ninth Circuit
- Particular points to mind:
  - Plaintiff's main claim is not a wage-order claim, but is instead a business expense reimbursement claim rooted in Labor Code 2802
  - Plaintiff was also shown to have worked for multiple different "intermediaries," so this could impact analysis of Grubhub's "Part C" argument
  - Grubhub argues re: fairness of retroactive application (although their argument may be unique here because the case was litigated)

NEW WAYS FORWARD: A LESS BINARY FUTURE

- Think tank solutions?
  - Seth Harris, Deputy Secretary of Labor, and Alan Krueger, Princeton Professor of Economics and Public Affairs, have proposed an "independent worker" (IW) classification
    - Courts have called gig economy workers "square pegs" forced into one of two round holes (employee or IC)
    - New classification addresses new economy workers who work for "intermediaries" or "platforms" and can choose when and whether to work, but face constraints on how much to charge customers, etc.
- We have yet to see this considered by state legislatures, but hopeful Gov. Elect Newsom's may offer creative solutions – his campaign site addressed both the importance of gig workers in CA and worker standards; discussed implementing "portable benefits"

“INDEPENDENT WORKER” CONCEPT:

- Freedom to organize and collectively bargain
- Ability to pool
- Civil rights protections
- Tax withholding and the Federal Insurance Contributions Act
- Opt-in for workers’ compensation
- No wage and hour protections, no unemployment insurance

GAVIN, ARE YOU LISTENING?

- No groundbreaking "compromise" proffered yet. Competing bills introduced on 12/3/18:
  - Assembly Bill 5 introduced by Lorena Gonzalez Fletcher (D-SD) codifying *Dynamex*
    - As it stands, *Dynamex* only applies to Wage Orders – this could broaden that scope legislatively
  - Assembly Bill 71 introduced by Melissa Melendez (R-Lake Elsinore) effectively does the opposite, codifying state law to reflect *Borello* test
- Business advocates have been excited about Gavin Newsom's business background – we can expect this to be put to the test in 2019, particularly in light of his generally pro-tech *and* pro-labor tendencies

BEST PRACTICES: AN OUNCE OF PREVENTION

- Supplementing your workforce?
  - Review your vendor contracts carefully, especially those within "scope of business"
    - Seek duty to defend and indemnification provisions
    - Seek other specific protections (wage & hour)
- Review your vendor carefully, too
  - Request audit demonstrating use of best practices for big ticket issues
  - For smaller vendors - bond posting?
- And, maybe, avoid *Dynamex*?
  - *Curry v. Equilon* offers employers hope skirting the unforgiving ABC test; *Curry* suggests potential joint employers would arguably be analyzed under the

EMPLOYEE BENEFITS & TAX

DYNAMEX, WORKER CLASSIFICATION & EMPLOYEE BENEFIT PLANS

Does the holding in the Dynamex Case apply to employee benefit plans?

- Employee benefit plans are governed by ERISA and the Internal Revenue Code
  - In order to determine whether a person is an "employee" ERISA uses a different test than the ABC test
    - ERISA applies a 13-factor common law-based test the U.S. Supreme Court adopted in *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) ("*Darden*")
    - Factors include: the contractor's right to control when, where, and how the individual performs the job, the skill required for the job, the source of tools and instruments needed for the job, the location of the work, duration of relationship between the parties, the contractor's ability to assign additional work, individual's discretion over when and how long to work, method of payment, contractor's role in hiring and paying assistants, whether individual's work is part of the business of the contractor, whether the contractor is in business and the provision of employee benefits to the individual

DYNAMEX, WORKER CLASSIFICATION & FEDERAL TAX STATUS

Does the IRS use the same standard as ERISA when determining employee status for tax purposes?

- Case law provides that the IRS uses a 7 factor test to determine whether an individual is an "employee" and IRS guidance provides further insight into how the IRS considers the various factors
  - The IRS generally looks at factors that fall into three categories:
    - Behavioral: Does the contractor control or have the right to control what the individual does and how the individual does his or her job?
    - Financial: Are the business aspects of the individual's job controlled by the contractor? (these include things like how individual is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)
    - Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?
    - The keys are to look at the entire relationship and consider the degree or extent of the right to direct and contro
  - IRS historically has used a 20-Factor Test

ERISA RECLASSIFICATION LANGUAGE

If an individual is an "employee" under the ABC test and also satisfy the ERISA/IRS tests, do they automatically have a right to be in the employee benefit plans?

- If an individual is reclassified as an employee, that employee will be eligible to participate in the employee benefit plans of the employer if they meet the eligibility requirements under such plans
- This could lead to significant liabilities for retroactive employee benefits. However, the employee benefits community has largely already addressed this issue
  - Most prototype 401(k) plan documents – and some health plan documents in use by "self-insured" employers – contain what is commonly referred to as "Microsoft language" — under which plan eligibility will not extend retroactively to individuals who are hired as independent contractors, even if they later are classified as employees
  - The language came into common use after the Ninth Circuit ruling in *Vizcaino v. Microsoft Corp., 120 F.3d 1006 (9th Cir. 1997), cert. denied.522 U.S. 1098 (1998),* which held that long-term, "temporary" workers, hired as independent contractors, were employees for purposes of Microsoft's 401(k) and stock purchase plan

ERISA RISKS - WORKER MISCLASSIFICATION

QUALIFIED RETIREMENT PLANS - DISQUALIFICATION

- Failure to satisfy required testing – independent contractors not included in:
  - Coverage testing
  - Discrimination testing

ACA – PENALTIES

- Failure to provide coverage to 95% or more of employees
- Failure to offer minimum value to employees
  - IRS is enforcing the ACA and auditing compliance
  - This issue can be particularly troublesome under staffing agency agreements if the contract with the staffing agency does not contain specific language ensuring compliance with the ACA by the staffing agency

BENEFIT CLAIMS NOT FUNDED OR INSURED

- Employer on the hook for benefits otherwise due and owning
- Retirement Contributions
- Medical Coverage
- Incentive Plan Awards

CASE STUDY

- XYZ has 15,000 employees
- XYZ has approximately 5,000 individuals working under independent contractor agreements
  - Numerous staffing and temporary labor contracts
  - Unknown number of individual IC agreement with varying terms

POSSIBLE EMPLOYMENT PENALTIES & LIABILITIES

- Employment taxes (e.g., FICA/FUTA withholdings) and income tax withholding
  - Penalties and interest assessed against employers for missed withholdings
  - Penalties for issuance of incorrect tax reporting (i.e., Form 1099 vs. W-2)
- Worker's compensation payments
- Unemployment violations
- FLSA (overtime) – lends itself to class actions
- Entitlement of individuals to FMLA/COBRA protections and other rights under state/federal employment laws afforded to employees

POSSIBLE BENEFIT PLAN PENALTIES & LIABILITIES

- XYZ Health Plans
  - Affordable Care Act (ACA) requires offer of qualifying health insurance to at least 95% of its full-time employees
  - If enough independent contractors should be classified as full-time employees (or the current number grows in the future), significant ACA risks and penalties may apply if it causes XYZ to fall below the 95% coverage threshold
    - Potential ACA penalty each year is generally **$2,000 (as indexed for inflation) times all full-time employees (minus first 30)**
    - Example: If XYZ has 15,000 full-time employees, **potential ACA penalty each year is almost $30 million** (i.e., $2,000 times 15,000 full-time employees)
    - It only takes one misclassified individual who gets coverage through an ACA health exchange (and who qualifies for an ACA tax credit) to trigger the entire penalty!

POSSIBLE BENEFIT PLAN PENALTIES & LIABILITIES

- XYZ Pension and 401(k) Plans
  - Misclassified individuals may bring claims for retroactive benefits they would have received had they been considered employees instead
    - Individuals may bring claims for retroactive vesting and benefit accruals
    - May require company to make restorative company contributions (plus missed investment earnings)
    - In addition to the costs for the additional pension/401(k) benefits, this may lead to large penalties if the misclassifications are found upon audit by the IRS
      - Starting point for negotiation sanction amount with the IRS is a percentage of aggregate dollar amount for total adverse tax consequences to participants and company if the plan were to lose its tax-qualified status
      - For large companies, the starting IRS sanction amount could be enormous!

WAIVER

Employees can waive entitlement to benefits

- BUT may still be required to be included in total employee headcount for certain compliance testing requirements
- Waive of rights must be knowing and voluntary – determination looks to
  - Workers education and business sophistication
  - Roles of employer and employee in negotiating the waiver
  - Clarity of waiver
  - Time worker had to consider waiver
  - Whether worker had independent counsel/advisors
  - Consideration exchanges for the waiver
- Microsoft – freelancers all signed waivers but waivers were specific to their status as independent contractors not employees so were not enforced = $96M settlement

WHY NOT JUST COVER ALL WORKERS

Should an employer just treat everyone as an employee to make thing simple?

- Individuals that do not meet the ERISA/IRS test for an employee may not participate in benefits plans due to the exclusive benefit rule applicable to such plans
- Offering participation to non-employees could affect the qualified status of retirement plans
- Insured health plans may retroactively deny claims
- Having non-employees in your health plan may convert the health plan into a multiple employer welfare arrangement

BEST PRACTICES

- Review factors surrounding engagement of each independent contractor to determine whether they should be treated as employees
- Have written contracts with independent contractors clearly setting forth the parameters of the relationship
- Review employee benefit plans and policies to make sure that each plan or policy has language excluding reclassified employees from participation
- Ensure vendor agreements include
  - Indemnification
  - Insurance coverage - ACA compliance
  - Right to inspect/audit
- Review collective bargaining agreements and multiemployer welfare arrangements to determine if union/union fund applies different standards
- Conduct *privileged* self-audits of all workers on a routine basis to ensure all workers properly classified
- May use Form SS-8 to ask IRS to determine whether an individual is an employee or an independent contractor.
- Consider the Voluntary Classification Settlement Program to correct any existing classification issues.