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PERSPECTIVE

Ax employee/contractor dichotomy?

By Peter Hering

An archaic legal dichotomy recently has been making national headlines, including the following: "California Says Uber Driver is Employee, Not a Contractor" (New York Times, June 17, 2015); "Do Uber Drivers Really Want to Be Full-Time Employees?" (Wall Street Journal, July 9, 2015); and "Clinton says she'd 'crack down' on independent contractor abuse. Obama already has." (Washington Post, July 15, 2015).

What explains the renewed interest in a centuries-old dichotomy that distinguishes employees from independent contractors? First, the rise of the "sharing economy" spearheaded by Uber and Airbnb has led to the emergence of new kinds of relationships between businesses and individuals, which challenge the continuing validity of the dichotomy. Second, government agencies, including the United States Department of Labor, California's Division of Labor Standards Enforcement, and California's Employment Development Department are aggressively classifying most individuals as employees rather than independent contractors.

While originally developed in the context of third-party tort liability, the dichotomy has consequences far beyond third-party liability in the 21st century. In today's era of online marketplaces and shared services, one must question the continued use of this dichotomy.

First, the employee/independent contractor dichotomy presents businesses and individuals with an all-or-nothing proposition that unnecessarily restricts their freedom to structure their relationship. If the individual is classified as an employee, the employer must pay and withhold payroll taxes, provide workers' compensation insurance and certain health benefits, and comply with various wage and hour laws and other Labor Code provisions. The business also has to supervise the employee to avoid potential third party liability.

On the flipside, an individual who is an independent contractor usually enjoys considerable freedom, including the abilities to run his or her own business, to negotiate compensation, and to work as much or as little as the individual wants, often without direct supervision from an employer.

But what if a business and an individual would like to enter into an arrangement that provides some of the benefits of an employment relationship while enjoying some of the freedoms an independent contractor relationship provides? The current dichotomy and the legal consequences that flow from the classification as one or the other do not give parties this option. In fact, parties are not really free to negotiate how they want to characterize their relationship because the parties' intent is nearly irrelevant to determining whether an individual is an employee or an independent contractor.

Second, there is no single test to determine how a relationship between a business and an individual should be classified. In fact, an individual may be classified as an employee by one agency in one situation and as an independent contractor by another agency in another situation. There are so many different tests to evaluate the relationship between a business and an individual that the parties rarely feel confident that the decision to classify the individual as an independent contractor will be upheld when challenged.

For example, under California's common law test, courts ask whether the business has the "right to control" the details of the individual's work. *Ayala v. Antelope Valley Newspapers Inc.,* 59 Cal. 4th 522, 533 (2014). California courts and agencies also look to a list of 11 secondary indicia to evaluate the relationship. See Division of Labor Standards Enforcement 2002 Enforcement Policies & Interpretations Manual Section 28.3.2.1. On the other hand, in a wage and hour claim brought under California's Wage Orders, a court may apply a different test and find an employment relationship if the business (1) exercised control over the individual's hours, wages, or working conditions; (2) suffered or permitted the individual to work; or (3) engaged the individual in a common law employment relationship. *Martinez v. Combs*, 49 Cal. 4th 35 (2010).

The New York Times
An Uber driver crosses the Brooklyn Bridge.

In contrast, under federal law, the DOL considers control over the individual to be a "trivial" factor when applying its six-factor "economic realities" test. Department of Labor, Wage and Hour Division, Administrative Interpretation No. 2015-1 (July 15, 2015). And the Internal Revenue Service uses 20 factors to determine an individual's classification. See Joint Committee on Taxation, Present Law and Background Relating to Worker Classification for Federal Tax Purposes (JCX-26-07), May 7, 2007.

Regardless of whether one uses six factors, 11 secondary indicia, or 20 factors, most relationships between businesses and individuals are complex and rarely have every factor pointing in one direction.

In today's economy, alternative work arrangements (e.g., offering personal transportation services through the use of Uber's marketplace app), exist somewhere in the space between the control of a traditional employment relationship and the independence of an independent contractor relationship. The rigid employee/independent contractor dichotomy, which dates from two centuries past, has lost its usefulness and must be updated to account for the realities of today's modern day economy.

A better solution would be to develop intermediate categories that allow businesses and individuals to tailor their relationship to their needs and desires by choosing a category on the spectrum between employees and independent contractors without risking subsequent reclassification and unforeseen liability. For example, the Uber driver who uses an online marketplace may share some characteristics of an employee, of an independent contractor, and of a mobile app user. Rather than forcing individuals into all-or-nothing categories that don't fit, the law should create new intermediate categories on the spectrum between employee and independent contractor with varying levels of safeguards in place to protect individuals from exploitation depending on the nature of the relationship (e.g., guarantees of minimum compensation, access to workers' compensation insurance, health insurance, unemployment insurance, or minimum work place safety standards) while providing the freedom the individual and business desire in defining their relationship.

One thing is clear: The all-or-nothing approach is not working. We must have a dialogue regarding a move away from the all-or-nothing approach and towards defining more 21st century-appropriate categories.

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