KUTAKROCK

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The Gig Economy, Age Approximately 11, Died Monday in a San Francisco Courthouse

On August 10, 2020, a San Francisco Superior Court judge issued a temporary injunction prohibiting ride-hail app companies Uber and Lyft from classifying drivers as independent contractors rather than employees. Theoretically, the ruling will require Uber and Lyft to begin providing drivers with employee entitlements required under California law, such as paid meal and rest breaks, overtime, a minimum wage currently set at $13.00 per hour, unemployment and workers' compensation insurance, and reimbursement for mileage and other business expenses. Of course, Uber and Lyft will quickly appeal the ruling, and a state appellate court will decide over the next several weeks whether the ride-hailing companies must figure out the logistics of ensuring strict wage and hour compliance within 75,000 privately owned vehicles operated by gig workers accustomed to working on their own terms, including how much or how little they work.

The ruling and the lawsuit stem from a California law that took effect on January 1, 2020 commonly called "AB 5." AB 5 rewrote the test courts must utilize to determine whether workers are "employees" as opposed to independent contractors, for purposes of the California Labor Code, Unemployment Insurance Code, and Wage Orders of the California Industrial Welfare Commission. Under AB 5, employment status is determined utilizing an employment-friendly "ABC Test." Under the ABC Test, employment is *presumed* unless the employer can establish *all* of the following elements:

A. The worker is free from the control and direction of the hirer 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 that involved in the work performed.

After AB 5 took effect, Uber and Lyft did not change their California business models to classify drivers as employees. Four months passed, and in early May the California Attorney General and City Attorneys for Los Angeles, San Diego, and San Francisco filed a lawsuit seeking substantial damages, penalties and an injunction prohibiting Uber and Lyft from continuing to, among other things, deprive drivers of the protections of the Labor Code and Unemployment Insurance Code. The court's ruling is provisional—a preliminary injunction which, pending a final resolution of the lawsuit on its merits, requires Uber and Lyft to begin treating drivers as employees.

Uber and Lyft advanced several arguments against the preliminary injunction, including that AB 5 is unconstitutional and that each of the drivers entered an arbitration agreement that requires wage and hour disputes to be resolved through private arbitrations (more specifically, over 75,000 private arbitrations) rather than through public court proceedings. Uber and Lyft also argued that they are not transportation providers. Instead, they simply created a ride-sharing app that allows people looking for a ride somewhere to locate people interested in providing that ride. Transporting passengers, according to Uber and Lyft, is therefore outside the usual course of their business within the meaning of Prong (B) of the ABC Test.

On the merits, the San Francisco court's preliminary injunction turned exclusively upon its assessment of Prong (B). Calling the Prong (B) analysis "simple" and "obvious," the injunction held that Uber and Lyft's characterization of their businesses as a mere app creator "cannot survive even cursory examination." Because different California laws regulate Uber and Lyft as "transportation network companies," their representations about what they actually do on

a day-to-day basis—specifically, engineering, improving, and marketing a smartphone app—were entitled to no deference. Instead, Uber's attempt to tell the court how it has defined its own business for the past decade was "circular reasoning: because it regards itself as a technology company and considers only tech workers to be its 'employees,' anybody else is outside the ordinary course of its business, and therefore is not an employee." Because Uber and Lyft cannot survive as businesses without drivers, the court believed it was "common sense" that driving is Uber and Lyft's usual course of business. Uber and Lyft's arguments to the contrary were, according to the court, "frivolous."

Uber and Lyft's arguments were not "frivolous." Rather, their arguments were built upon decades of precedent from other states that have routinely held (a) a company's description of its business, particularly when not demonstrably contrived, is entitled to substantial weight, and (b) companies that match service providers with consumers do not perform the brokered or franchised service in their usual course of business. For instance, six years ago a federal court in Massachusetts held "cleaning" was not within the usual course of business of Jan-Pro, a franchisor commonly thought of as one of the world's largest janitorial companies.[1] Similar court victories for brokers, franchisors, and other matchmaking companies are numerous.[2]

Should the preliminary injunction be affirmed on appeal, a significant number of California business relationships may be jeopardized or require significant alteration. The San Francisco court refused to credit how Uber and Lyft have defined their own businesses in the real world and outside the context of litigation. The court instead focused on the extent to which the drivers' service was "indispensable" or "valuable" to Uber and Lyft's business model. It is unclear how this "indispensability" standard can exclude several business relationships that have not traditionally created an employer-employee relationship. Companies rely on all sorts of "valuable" services. For instance, a farmer's services are indispensable to a grocery store that sells milk, eggs, and vegetables. No court is likely to hold that a grocery store employs a farmer, despite the farmer's "value" and "indispensability" to its business model. Nothing in the San Francisco court's injunction explains why, for instance, every upstream worker who touches a component of a final good is not an employee of every company in the downstream distribution channel. Consequently, resolving the ABC Test has become more convoluted than any classification test that preceded it.

The California Legislature passed AB 5 with the goal of adding simplicity and certainty to the tests for whether a worker is an employee or an independent contractor. While appellate courts in the coming months may elucidate whether AB 5 can kill the gig economy in a manner that meets those purported goals, one thing is clear: AB 5 creates significant risk for any company that utilizes independent contractors in California to perform any aspect of a profit-generating function of the business.

If you wish to visit with us about the impact of AB 5, please contact a member of Kutak Rock's FLSA Litigation and Wage and Hour Defense Group, a member of the Employment Law Group, or your Kutak Rock attorney. You may also visit us at www.KutakRock.com.

[1] *See DePianti v. Jan-Pro Franchising International*, No. 08-10633, 2014 WL 4145411 (D. Mass. Aug. 22, 2014) (holding janitorial services were not within usual course of business of one of the world's largest janitorial services because "[Jan-Pro's] usual course of business was not to compete with unit franchisees for cleaning contracts . . . instead limiting its activities to creating a business model that it licenses to regional franchisees").

[2] *See State Dept. of Employment v. Reliable Health Care Services of S. Nevada, Inc.*, 983 P.2d 414, 418 (Nev. 1999) ("Reliable is a staffing company that profits from brokering workers [but] does not treat patients. Therefore, … the work of the Providers was outside the usual course of the business of Reliable as a matter of law."); *Daw's Critical Care Registry v. Department of Labor*, 42 Conn. Sup. 376, 622 A.2d 622 (1992) (per curiam) ("[T]he simple and overriding fact is that Daw's does not perform patient care but it brokers nurses."); *Trauma Nurses, Inc. v. Board of Review*, 576 A.2d 285, 292 (N.J. App. Div. 1990) ("TNI does not perform patient care. It brokers nurses.").