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Big Labor Law Changes on the Way for Ground Transportation Gig Workers? – *Impact of California's Prop 22 Ruling & the Proposed U.S. Department of Labor Rule*

Developments unfolding in California and at the U.S. Department of Labor ("DOL") will affect industry reliance on independent contractors as drivers. There are already varying legal standards at the federal, state, and local levels that may be used to determine whether your driver is an independent contractor or not – with significant consequences for intentionally, or even unintentionally, misclassifying a worker as an independent contractor such as civil penalties, enforcement actions, unpaid wages (including overtime), and tax contributions.

Whether your driver is an independent contractor or an employee is a weighty issue for the passenger ground transportation industry. Many in the limousine, black car, livery, and taxi industries have long relied on independent contractor-drivers and consider it the industry norm, and app-based transportation network companies have further solidified independent contractors as the status quo. But, is that about to change?

New players in the industry like Revel, Kaptyn, and Alto are embracing an employee-driver business model, providing drivers hourly wages and benefits in addition to supplying the vehicles and covering all related costs. Also, a new U.S. Labor Secretary may mean further changes for those who rely on independent contractors.

In early March, President Biden announced his nomination of Julie Su for Secretary of the Department of Labor to take the helm when current Labor Secretary Marty Walsh leaves at the end of March 2023. Before Su was appointed Deputy Labor Secretary in 2021, she held several roles in California, including serving as California Labor Commissioner and Secretary of the California Labor and Workforce Development Agency, where she was in charge of enforcing the state's labor laws, including the state's worker classification law known as A.B. 5. Su must be confirmed by a majority of the U.S. Senate, which has not set a date for Su's confirmation hearing as of this writing. Many on the business side are taking issue with Su's record in California, and it would take only two Democrats in the U.S. Senate to defeat and sink her confirmation.

A.B. 5, which took effect in January 2020, presumes workers are employees under the law. In other words, the California legislation places the burden squarely upon the employer to demonstrate that a worker is an independent contractor rather than an employee, making it harder for the drivers to be classified as independent contractors, unless the business can meet all three factors of the "ABC" test.[1] Business owners should understand that *the failure of the employer to prove even one of the three criteria results in a worker being classified as an employee, rather than as an independent contractor!*

Part B of the test, which asks "does the worker perform work that is outside the usual course of the hiring entity's business?," is the biggest hurdle for transportation network companies

[1] https://news.bloomberglaw.com/daily-labor-report/su-dol-nomination-faces-business-lobby-senate-absence-hurdles

("TNCs"), which have consistently argued that they are not transportation companies. In the immediate wake of A.B. 5, many commentators opined that the ABC test likely makes it difficult—if not impossible—for "gig economy" companies like Uber and Lyft to designate their workers as independent contractors. Commentators have pointed out that TNCs may be especially hard pressed to meet the second part of the ABC test."[2]

This article will provide an update on the implications of the latest Proposition ("Prop") 22 court ruling in California, the status and potential impact of the proposed U.S. DOL rules, the interplay between federal and state laws on this topic, the legal path forward, and how mobility companies that work with independent contractor or partner drivers in the passenger and goods delivery business can prepare for these contingencies. There will undoubtedly be more legal maneuvering and potential further challenges to not only Prop 22 and the U.S. DOL rules, but possibly to other laws that may be enacted which are similar, involving either the ABC test, or Prop 22 legislative clones in other states. While the legal challenges may continue, transportation operators should keep a close eye on these developments as the changes to business operations and labor models may need to be adjusted.

California's Proposition 22 (Mostly) Upheld (for Now)

On March 14, 2023, a California state appeals court handed a win to Uber, Lyft, and other app-based ride and delivery companies when it upheld a ballot measure that allows these types of companies to classify drivers as independent contractors instead of employees. Golden State voters approved the ballot measure known as Proposition 22 ("Prop 22") in November 2020 following the state's enactment of A.B. 5.[3] Prop 22 carves out app-based drivers for rideshare and delivery companies—but not taxis or other for-hire vehicles—from A.B. 5, while providing these drivers with certain other benefits and protections. [*See* Cal. Proposition 22, "Exempts App-Based Transportation and Delivery Companies from Providing Employee Benefits to Certain Drivers. Initiative Statute," Cal. Att'y Gen., Initiative No. 19-0026 (2020).[4]]

Shortly after Prop 22 passed, opponents—led by Service Employees International Union ("SEIU") California—challenged the measure in state court, alleging Prop 22 provisions infringe on the California State Legislature's right to enforce workers' compensation laws, and that a provision addressing collective bargaining must pass by a seven-eighths vote in the Legislature and cannot be put in an amendment. In 2021, an Alameda County Superior Court judge agreed, finding Prop 22 is "constitutionally problematic."

The first trial court that was later overruled, held that the proposition is invalid in its entirety because it intrudes on the California Legislature's exclusive authority to create workers' compensation laws and violates a specific ballot initiative rule called the "single-subject rule for initiative statutes." Also, it was held invalid to the extent that it limits the Legislature's authority to enact legislation that would not constitute an amendment to Prop 22.

[2] 128 Yale L.J. 254, 326 n.181 (2018)
[3] https://electionresults.sos.ca.gov/returns/ballot-measures
[4] https://www.oag.ca.gov/system/files/initiatives/pdfs/19-0026A1%20%28App-Based%20Drivers%29.pdf.

The state of California along with an industry organization backed by Uber and Lyft, called Protect App-Based Drivers and Services appealed the decision, arguing that the trial court was totally mistaken on all points. The appellate panel mostly agreed, ruling that the California Constitution does not give the California Legislature complete authority over workers' compensation laws or violate the single-subject rule. However, the appellate court panel left intact the lower court's ruling that a provision addressing collective bargaining cannot be put in an amendment that must pass by a seven-eighths vote in the Legislature, concluding "that the initiative's definition of what constitutes an amendment violates separation of powers principles." The appellate panel then severed the unconstitutional provisions from the rest of Prop 22, effectively removing any restrictions on the Legislature's control over collective bargaining that Prop 22 could have imposed.

Opponents of Prop 22 could challenge the decision in an appeal to the California Supreme Court. The executive director of SEIU California told Law360 "Drivers have always led this movement, and we will follow their lead as we consider all options — including seeking review from the California Supreme Court — to ensure that gig drivers and delivery workers have access to the same rights and protections afforded to other workers in California."[5]

However, the California Supreme Court is not required to hear all cases that petition for review, and typically the California Supreme Court will decide to review a decision if: (1) the case involves issues of first impression yet to be decided by the California Supreme Court; (2) the citizens of California will be substantially impacted by the result of the case and any review; or (3) the California Supreme Court Justices do not agree with the decisions of the lower courts. Although it appears that the first two factors could be met because Prop 22 is clearly a case of first impression that affects citizens of California statewide, the Justices may decline review because they simply agree that the lower court's decision of severing the unconstitutional provisions and leaving a form of Prop 22 that is constitutional and balanced, although arguably imperfect. There is a distinct possibility that the California Supreme Court will decline to review the legal challenge to Prop 22, and – if it does review the case – it will affirm the lower court's decision in order to avoid the constitutional question that has already been resolved.

The passage of Prop 22 has been seen as a significant victory for app-based companies that rely on independent contractors. Having to reclassify these gig workers as employees would pose a threat to their business model because of the added costs associated with employee-drivers.[6] While Prop 22's passage lets these ride-hailing companies avoid the costs of employing their drivers, they will still be required to offer drivers some basic job protections, including minimum earnings, healthcare subsidies, insurance to cover on-the-job injuries, and vehicle insurance.[7]

Proposition 22 Explained

[5] https://www.law360.com/articles/1585530/drivers-can-be-contractors-calif-panel-mostly-backs-prop-22?copied=1

[6] Uber Technologies, Inc., Registration Statement (Form S-1) (Apr. 11, 2019), www.sec.gov/Archives/edgar/data/1543151/000119312519103850/d647752ds1.htm#toc647752_2.

[7] *See* Proposition 22, art. 3 (compensation), art. 4 (benefits), and art. 5 (antidiscrimination and public safety).

Prop 22 classifies ride-hailing and delivery drivers as independent contractors unless the app sets drivers' hours, requires acceptance of specific ride or delivery requests, or restricts drivers from working for other companies. The proposition applies to TNCs, as well as charter-party carriers of passengers (TCPs) if the driver is transporting passengers through an online-enabled app or platform, and to couriers working for a delivery network company (DNC), such as Uber Eats, GrubHub, and Instacart.

Under Proposition 22, a TNC is defined as an organization … operating in California that provides prearranged transportation services for compensation using an online-enabled application or platform to connect passengers with drivers using a personal vehicle. A TCP means every person engaged in the transportation of persons by motor vehicle for compensation, whether in common or contract carriage, over any public highway in this state. TCPs include any person, corporation, or other entity engaged in the provision of a hired driver service when a rented motor vehicle is being operated by a hired driver. DNCs are businesses that maintain an online-enabled app or platform to facilitate on-demand delivery services.

Under Prop 22, app-based delivery and ride-hail companies are required to offer their drivers certain alternative benefits, including minimum compensation, insurance to cover on-the-job injuries, automobile accident insurance, healthcare subsidies for qualifying drivers, protection against harassment and discrimination, and mandatory contractual rights and appeal processes. Companies will be required to pay drivers at least 20% more than the minimum wage, plus 30 cents per mile to cover expenses, with the potential to earn more, and without limits on how much drivers can make.[8] Eligible drivers will receive a healthcare stipend that is consistent with employer contributions under the Affordable Care Act.[9]

Prop 22 is more than worker classification and benefits for drivers. It also criminalizes impersonation of such drivers, restricts local regulation of app-based drivers, and extends the same background checks that are required of TNC drivers to app-based delivery drivers and couriers.[10]

The measure also preempts local regulation of app-based driver compensation and gratuities; driver scheduling, leave, health care subsidies, and any other work-related stipends, subsidies, or benefits; driver licensing and insurance requirements; and driver rights with respect to a network company's termination of an app-based driver's contract.[11] By occupying these fields, this ensures that rideshare and delivery drivers and companies are not subject to a patchwork of regulations by the more than 500 cities and counties in California.

The U.S. DOL Proposed Rule

On October 13, 2022, the U.S. Department of Labor ("DOL") published a proposed rule to revise DOL's guidance on how to determine who is an employee or independent contractor under the Fair Labor Standards Act (FLSA) and, thus, not subject to the minimum wage and overtime requirements the Act applies to "employees." The goal of the Biden administration in making the

[8] Proposition 22, § 7453.
[9] *Id*. at § 7454.
[10] Proposition 22 §7458.
[11] Proposition 22, art. 7.

proposed change is to make it more difficult for employers to classify workers as independent contractors for FLSA purposes.

The newly proposed rule would establish a non-exhaustive six-factor "economic reality of the whole activity" test, in which none of the factors has predetermined weight. The six factors to be considered in determining for who qualifies as an independent contractor for FLSA purposes are: (1) opportunity for profit or loss depending on managerial skill; (2) investments by the worker and the employer; (3) degree of permanence of the work relationship; (4) nature and degree of control; (5) extent to which the work performed is an integral part of the employer's business; and (6) skill and initiative.

Additional factors may be relevant in determining whether the worker is an employee or independent contractor for purposes of the FLSA, if the factors in some way indicate whether the worker is in business for herself or himself, as opposed to being economically dependent on the employer for work.

Importantly, in the text of the discussion of the proposed rule, the DOL states: "Relatedly, the use of a personal vehicle that the worker already owns to perform work—or that the worker leases as required by the employer to perform work—is generally not an investment that is capital or entrepreneurial in nature." This would eliminate one factor that has been traditionally argued to demonstrate that a transportation driver is in business for himself as an independent contractor.

The proposed rule would rescind a 2021 DOL rule in which two core factors—control over the work and opportunity for profit or loss—carried greater weight in determining the status of independent contractors. While it had been expected that the DOL would publish a revised rule in early 2023, the shake-up in leadership at DOL might delay that time frame.

In any event, the courts remain ultimate arbiters of whether a particular individual or group of individuals are employees or independent contractors. If, however, the rule change is approved and the courts grant the new DOL rule the deference they typically do with "interpretive" rules, the weight they afford the new rule will depend in large part on the thoroughness evident in its consideration and the validity of its reasoning. Having waited nearly two years to revisit the independent contractor issue, the Biden administration presumably believes the new rule will withstand judicial scrutiny. However, even if the rule change is implemented and withstands judicial scrutiny, the change will only apply to worker classification under FLSA and will not apply to state wage laws, as discussed in the "Up Next for Transportation Business" section below.

Fair Labor Standards Act (FLSA) Requirements

The FLSA establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in federal, state, and local governments. Covered nonexempt workers are entitled to a minimum wage of not less than $7.25 per hour (the federal minimum wage). In addition, employees are entitled to overtime pay at a rate of not less than one and one-half times the regular rate of pay after 40 hours of work in a workweek (any fixed and regularly recurring period of 168 hours – seven consecutive 24-hour periods).

The FLSA covers, or applies to, all employees of "enterprises" that have at least two employees and an annual dollar volume of sales or receipts of at least $500,000. The FLSA also covers employees engaged in interstate or foreign commerce either by directly participating in the actual movement of persons or things in interstate commerce, or by doing work directly supporting the movement of goods in interstate commerce. Depending on the interplay of the applicable state, local, and federal laws, whether in harmony or not, transportation companies should understand the FLSA requirements and prepare for any reclassification claims. However, some employees are exempt from the law's overtime pay provisions.

Exemptions from FLSA

While the FLSA requires that employers pay covered employees a minimum wage as well as overtime pay, Section 213(b) exempts certain categories of employees from the Act's overtime wage requirements. Of relevance are the motor carrier exemption and the taxicab exemption, which has been applied to the limousine industry.

Section 13(b)(1) of the FLSA provides an overtime exemption for employees of motor carriers (those who provide transportation by motor vehicle for pay) if the U.S. Secretary of Transportation has the power to regulate their minimum qualifications and maximum hours of service under the Motor Carrier Act. Only drivers, drivers' helpers, or loaders who are responsible for proper loading of motor vehicles that are to be used in transportation of passengers or property in interstate commerce can be exempt from the overtime provisions of the FLSA under Section 13(b)(1).

Section 13(b)(17) of the FLSA provides a "taxicab exemption" that applies to "any driver employed by an employer engaged in the business of operating taxicabs." In 2018, the U.S. Second Circuit Court of Appeals—which covers Connecticut, New York, and Vermont—found that a limousine service qualified for the taxicab exemption, and the limousine drivers had no statutory right to overtime pay. *Munoz-Gonzalez v. D.L.C. Limousine Serv., Inc.*, 904 F.3d 208, 210 (2d Cir. 2018). In *Munoz-Gonzalez*, the court created a three-part test for defining a taxicab for the purposes of the FLSA. Under Munoz-Gonzalez, a taxicab is: "(1) a chauffeured passenger vehicle; (2) available for hire by individual members of the general public; (3) that has no fixed schedule, fixed route, or fixed termini." However, other circuit courts of appeals and federal district courts around the country have refused to exempt limousine company employers under the taxicab exemption.

Up Next for Transportation Businesses

Prop 22 will only impact app-based drivers for TNCs and delivery companies in California. While the proposed DOL rule change will impact companies across the country with respect to federal minimum and overtime wage law, it will have no direct bearing on the tests used by the states and other areas of the federal government to determine collective bargaining and unionization rights, unemployment compensation, workers' compensation, or other labor and employment laws outside the FLSA. The rules for worker classification can differ drastically under the various state laws, and must be considered on a state-by-state basis.

Transportation companies should consider that any workers' compensation and unemployment claims will not be affected by the proposed DOL rule change. As a result, the analysis for those types of claims in the company's jurisdiction will continue in the same manner. However, as the notion of employee-drivers becomes more widespread, accepted, or demanded, the administrative law judges and regulators could shift away from finding drivers as independent contractors at all levels of government and enforcement. In those cases, those companies may have causes of action to present constitutional challenges or other civil remedies depending on the applicable local, state, or federal law.

States and local governments may implement laws similar to, or less protective than, Prop 22, while other states continue to treat app-based drivers as independent contractors regardless of pressure from other states and the federal government. TNCs generally want to bring Prop 22 clones to other states and the federal government. Lyft's Chief Policy Officer stated, "I think Prop 22 has now created a structure for us to discuss with leaders in other states and Washington, potentially. We think that Prop 22 has now created a model that can be replicated and can be scaled."[12] These attempts have fallen flat in recent times. For example, the highest court in Massachusetts struck down a similar ballot initiative in total.[13]

"It wasn't, in the end, a case about whether gig workers should be employees or independent contractors, or about tort liability. It was about the power of well-funded companies to use their bazillions to get their way. In this sense, the broad-based campaign opposing the ballot initiative struck at the crux of the issue when the campaign leaders chose their name: Massachusetts Is Not For Sale. They came together: workers, unions, civil rights and immigrant rights' organizations, environmentalists, seniors, and more, to make sure that massive out-of-state companies didn't get to rewrite long-established protective workplace laws."

These legal skirmishes are setting the stage for "David versus Goliath" battles in local, state, and federal courts throughout the country, which will create a patchwork of standards for determining employment status based on the differing outcomes. The federal standards, although expected to be more protective, will only apply to interstate operators engaged in interstate commerce, while on the other hand we will see local market operators' reluctance to change business models unless required to do so at the state and local level through enforcement. For some jurisdictions, these changes will be slow to materialize – if at all because of a lack of political will and market operator reluctance.

For example, prior case law made in the Sacramento Superior Court created a hard and fast rule that shuttlebus and van operators are *per se* independent contractors, which at the time, stopped the Labor Commissioner "from considering wage claims filed by such drivers because the Sacramento Superior Court previously found the drivers were independent contractors, not employees." SuperShuttle Int'l, Inc. v. Lab. & Workforce Dev. Agency, 40 Cal. App. 5th 1058, 1061, 253 Cal. Rptr. 3d 666, 670 (2019). This case shows us the power of precedent, which likely shaped Prop 22 to be applicable only to TNC workers and not all for-hire drivers, and will play out similarly in other states – notwithstanding strong federal regulation or local enforcement of new reclassification laws.

[12] https://www.washingtonpost.com/technology/2020/11/05/uber-prop22/
[13] https://prospect.org/justice/in-massachusetts-limit-on-gig-companies-deceptions/

In New York, a bill (S2052) would implement the "ABC" test for the Empire State. However, a version of this same bill has been introduced and languished in the past two legislative sessions. Whether this legislative proposal has any traction to be enacted is yet to be seen. If passed, S2052 would classify workers as employees unless: (a) the worker is free from the control of the hiring entity; (b) the work performed is outside the hiring entity's bailiwick; and (c) the worker is "customarily engaged" in the type of work he or she is hired to do. California, New Jersey, Massachusetts, and Vermont already use the ABC test in their wage and hour laws. Twenty-six states use some version of the ABC test in their unemployment laws. Ten states, including New York, apply it broadly to labor laws within a particular sector, typically construction or landscaping.

There are a variety of different legal standards that will apply to those situations. It will be important for businesses that use independent contractors to coordinate with legal counsel to develop a workforce strategy that works best among this patchwork of obligations. Now is the time for transportation companies that use independent contractors to minimize risk. Companies should be looking at their driver agreements and worker classification practices to see how they align with current and proposed new rules. Proactive measures for compliance will be the key to success.