# Employment Matters

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## Employee versus Independent Contractor: The Latest

By Joel M. Grossman, Esq.

Courts have been dealing with the issue of whether a worker is considered an employee or an independent contractor for many years. The common law established specific rules, which have guided the courts for decades. *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*. Among other factors to be considered under the common law test are whether the worker or the principal supplies the tools and instrumentalities for the work, whether the worker has a separate business, whether the worker is permanent or temporary and, most important, whether the principal maintains the right to control the worker in performing his or her assigned task.

But in the new economy, the common law tests may not work as well. A good example is a driver for Lyft or Uber. On the one hand, she provides her own vehicle

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## ADR Options in Employment Trade Secret Matters

By Hon. James Epstein (Ret.)

Non-compete agreements, restrictive covenants and trade secret issues are rapidly expanding areas in employment law. They present litigation challenges that make mediation an attractive alternative for parties on both sides.

Typical scenarios for the disputes involve a departing officer, executive or employee and an employer who views the circumstances of the departure as a violation of an employment contract term. After the usual saber-rattling by the parties and/or their attorneys, often one side files for a temporary restraining order (TRO) to be heard on an expedited basis. The lawyers scramble to parse the employment agreement and investigate facts to support or oppose the imposition of the extraordinary relief sought in the TRO. Areas of concern include, first and foremost, the enforceability of the terms. These often turn on the reasonableness of the restrictions in time and scope, as well as the absence or presence of contractual consideration for the agreement.

Courts across the country continue to struggle with these issues. In Illinois, for example, recent court decisions reveal

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and fuel, and sets her own hours. If she feels like going to Brazil for a few weeks, she can do that. If her passenger wants to be driven to the airport, she can take any route she prefers; she need not ask her supervisor the preferred route. She is also free to pursue other employment. In fact, many Lyft drivers also drive for Uber, which indicates that they are pursuing their own business. Based on these facts, the drivers seem to be independent contractors.

On the other hand, the drivers are not permitted to set rates; only the company can do that. In addition, drivers are not allowed to arrange for a pickup at a designated time in the future; they can take an assignment only at the time a passenger uses his or her mobile device to hail a ride.[1] These facts tend to indicate that the drivers are under the control of the company and are therefore employees.

It is clear that the old common law rules for determining when a worker is an employee or an independent contractor are simply outdated in the new economy. Indeed, the U.S. Department of Labor's Wage and Hour Division recently issued an extensive memorandum on the issue, and it rejected the common law test. In an Administrator's Interpretation issued on July 15, 2015, by Wage and Hour Division (WHD) Administrator David Weil, he states that instead of the common law test, federal courts interpreting the Fair Labor Standards Act (FLSA) must utilize the multi-factorial economic realities test.[2]

The economic realities test focuses on "whether the worker is economically dependent on the employer or in business for him- or herself." The WHD goes on to say that using the economic realities test instead of the common law control test is consistent with the FLSA's definition of an employee as someone who is "suffered or permitted to work," as opposed to looking at the degree of control the employer has over the employee. These unusual words are simply a way of saying that the employer knowingly allows a worker to perform services for it. The WHD says that the "suffer or permit" standard is much broader than the "right to control" common law standard, so more workers would likely be deemed employees under the "suffer or permit" rule.

If one looks at workers under the economic realities test, which asks whether the worker is economically dependent on the employer, then issues such as control are clearly far less important and are certainly not definitive. As the WHD states, "In applying the economic realities factors, courts have described independent contractors as those workers with economic independence who are operating a business of their own. On the other hand, workers who are economically dependent on the employer, regardless of skill level, are employees covered by the FLSA."

Apart from federal law, new developments in state law are worth noting. For example, California enacted Labor Code section 226.8, which adds specific penalties for an employer who "willfully" misclassifies an employee as an independent contractor; namely, no less than $5,000 and no more than $15,000 per violation. If it is determined that the employer is engaged in a pattern or practice of misclassifying employees as independent contractors, the penalties go up to no less than $10,000 and no more than $25,000 per violation. In addition, if an employer misclassifies an employee as an independent contractor, the employee can sue to recover wages for missed meal and rest periods and unpaid overtime. And perhaps most dangerous of all, the IRS may come down hard on a company that it believes has falsely classified employees as independent contractors, with the possibility of that company having to pay those employees' back taxes plus penalties.

What does all this mean for a company wishing to hire a worker and needing to determine whether to classify him or her as an employee or an independent contractor? The law clearly is moving in the direction of employment status, and the penalties and risks of litigation are growing. Employers need to be more cautious than ever and err on the side of employment when at all possible. ●

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[1] *This last fact may change as part of a tentative settlement of the Lyft class action.*

[2] *WHD Administrator's Bulletin No. 2015-1, July 15, 2015.*

disagreements over whether to apply a bright-line rule for determining adequate consideration for a restrictive covenant, or whether to assess it on a case-by-case basis.

Assuming the presence of adequate consideration for the contract, judges proceed to consider whether the restrictions on the departing employee are reasonable as to time and scope. These determinations vary widely based upon the profession or industry involved, the duties of the employee, his or her access to confidential data and the prospective harm to each of the parties and the public. They also vary widely based upon the orientation of the presiding judge. One judge's view of equity may be significantly different from another's.

Following the TRO hearing, both the work and cost increase as the parties prepare for the preliminary injunction hearing and, ultimately, trial. Discovery presents specialized problems involving attempts to dig into company emails –including battles over limitations on the number of terms to be searched and forensic investigations of computer hard drives and other data storage systems– crucial matters of confidentiality, the scope of protective orders and other complicated matters.

Discovery can also lead to attempts to depose customers and later call them to testify. This area requires parties to exercise careful judgments on the impact on their vital business interests of going forward with the litigation. Putting customers on the spot can inconvenience and irritate them and harm relationships with the party.

In trade secret cases, the parties must grapple with risks of potentially exposing confidential information to competitors or customers given the imperfections of protective orders. Judges must decide


whether the trade secrets are truly secret. This often involves exposing them in the litigation and having company executives deposed on what makes them valuable or unique.

Proving prospective damages can be difficult. If part of a claim is loss of customers, would they have left anyway? Are the trade secrets the employer is seeking to protect or recover for really significant?

Mediation has significant benefits in general litigation, and even more in matters involving restrictive covenants, non-competes and trade secrets. As in all cases, a mediated solution is, by definition, one that each party can accept. The risk of a wholly intolerable result in a court decision is completely eliminated.

As always, legal costs are sharply reduced from what full discovery motion practice and trial would require. Opportunities for confidentiality and creative resolution terms exist that would not be available to a court.

Mediation provides significantly greater advantages in these complex matters. It eliminates the risk that the restrictions this employee has agreed to will be declared unreasonable and unenforceable by a judge. Correspondingly, an adverse ruling can destroy the deterrent effect on other employees considering separation in a manner that a confidential settlement with one employee may not.

Additionally, a mediated settlement can prevent the involvement of customers in litigation and the danger of exposing confidential data to them and competitors.

It is important to select neutrals who have significant experience in this type of matter. They understand the issues and are sensitive to the concerns of both sides. They can articulate the hurdles each side will face and, when asked, evaluate the strengths and weaknesses for the parties.

When the parties are in contact before a TRO is filed, they may benefit from beginning mediation immediately. If a TRO has been filed, the best time for mediation may be between the ruling and before great expense and damage are incurred preparing for the preliminary injunction hearing.

Considering whether mediation can benefit your client in these complex equitable matters is a worthwhile exercise. ●

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# Classification of Laborers in the Sharing Economy

By James Ware, U.S. District Judge (Retired)


The sharing economy is now a recognized sector of the world economy. Businesses and individuals have embraced this new economy to exchange and share privately owned goods and services. Many of these "exchanges" have grown from neighborhood cooperatives into national and international enterprises. The sharing economy covers a wide range of business models, from peer-to-peer networks like Airbnb to business-to-peer networks like Zipcar. As they have grown, many of these enterprises have developed rules that control the activities of individuals who participate in them. A healthy debate has emerged over when the amount of control over the laborers transforms the enterprise from a cooperative to an employer.

Traditionally, any person who performs labor for an enterprise is classified as either an employee or an independent contractor, depending on the level of control. If an enterprise exercises control over the details of how activities are performed, including the means and manner for performing them, an employment relationship is recognized. If control over the details of the activity rests with the laborer, as distinct from the end result only, the relationship is likely to be recognized as that of an independent contractor. Under the Fair Labor Standards Act (FLSA), the U.S. Department of Labor uses an economic realities test that focuses of "whether the worker is economically dependent on the employer or in business for him- or herself." *DOL Administrator's Interpretation No. 2015-1* (issued July 15, 2015); *S. G. Borello & Sons, Inc. v. Department of Industrial Relations*.

As Douglas J. Farmer points out in *California Employment Law: The Complete Survival Guide*, "Failure to classify a laborer correctly can result in failure to comply with a multitude of employment laws, tax laws, employee benefit plan obligations and other legal requirements." For example, the California Fair Employment and Housing Act (FEHA) prohibits discrimination in the workplace, but independent contractors are excluded from its coverage. The severe consequences for misclassification have led many companies to ask Human Resources professionals or lawyers or a neutral to conduct a periodic assessment of its practices.

The labor relationships involved in the sharing economy have introduced new classification issues. In this current economy, some enterprises do not conduct a neutral classification analysis because they do not regard themselves as being in an employment relationship. In their contracts, they describe themselves as providers of technology that facilitate peer-to-peer exchanges. Reliance on contractual definitions is dangerous because the conduct of the parties, not a written contract, defines the proper classification.

Some sharing enterprises do not define themselves as employers, because labor is not being supplied to the enterprise, but is instead supplied by one user of the technology to another user. Moreover, the meaning of "user" or "participant" can vary between modalities. In the room-sharing enterprise Airbnb, hosts and guests are both called users. In the ride-sharing enterprises Lyft and Uber, only riders are called users.

As sharing enterprises have come to see that consumers react to the quality of service, these enterprises have introduced standards of conduct that hosts or drivers have to follow. The enterprises are trying to stay on the independent contractor side of the line between enforcing standards of conduct and leaving things up to the participants.

Classification carries significant consequences for laborers. For independent contractors, there are no salary restrictions or minimum work-time rules. On the other hand, many rules and regulations protecting laborers are not applicable to them. Of course, there is always the possibility that as the enterprise becomes more economically dependent on them, the laborers can organize and together demand more from the enterprise.

The *Berwick v. Uber* administrative action and the *O'Connor v. Uber* class action presently pending before the Ninth Circuit and U.S. District Court in San Francisco, respectively, are being carefully watched by the labor-management bar because they add new insight into how classification disputes arising out of the sharing economy might be resolved. •

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# *Sandquist*: Who Decides?

**By Debby Saxe, Esq.**

Employees or former employees who have signed pre-dispute arbitration agreements as a condition of employment often file class actions against their employers in court. If the employer moves to compel arbitration in a timely manner and the agreement is found to be enforceable, the court must compel arbitration under the Federal Arbitration Act (FAA) and/or the California Arbitration Act (CAA).

Many employers file motions to compel arbitration on an individual (non-class) basis, and trial courts routinely grant such motions without seeming to realize that they present two distinct questions: (1) Is the arbitration agreement enforceable? And (2) does the arbitration agreement permit class proceedings? The second question presents its own predicate question: Does the court have authority to decide it, or is it a question for the arbitrator?

If the arbitration agreement contains a broad delegation clause, the second question is to be decided by the arbitrator. *Howsam v. Dean Witter Reynolds, Inc.* (The question whether the parties have submitted a particular dispute to arbitration, *i.e.*, the question of arbitrability, is an issue for judicial determination unless the parties clearly and unmistakably provided otherwise.) Here is an example of such a clause:

> *The Arbitrator, and not any federal, state or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement, including...any claim that all or any part of this Agreement is void or voidable.*

This kind of clause gives the arbitrator authority to decide the second question, whether or not it is considered to be a question of arbitrability, because parties clearly and unmistakably delegated that question to the arbitrator. *Rent-A-Center, West, Inc. v. Jackson.* Some courts find a clear and unmistakable intent for the arbitrator to decide such questions from the fact that an arbitration agreement references the AAA or JAMS Employment Rules, both of which say zit is up to the arbitrator to decide if class arbitration is available. *Yahoo!, Inc. v. Iversen* (incorporation by reference of the AAA Supplementary Rules constitutes clear and unmistakable agreement to have the arbitrator decide questions regarding the arbitrability of classwide claims); *Hartley v. Superior Court; Universal Protection Service, L.P. v. Superior Court.*

If the arbitration agreement does not contain a clear and unmistakable delegation of the second question to the arbitrator, *Howsam* requires a court to determine if the second question is a question of arbitrability for the court to decide or, instead, a procedural question for the arbitrator to decide. This is easier said than done.

In *Green Tree Financial Corp. v. Bazzle*, a plurality of the United States Supreme Court Justices said the question of whether an arbitration agreement permits class arbitration is a procedural question to be decided by the arbitrator, not the court. However, there was no majority opinion on that subject in *Bazzle*, and the United States Supreme Court's subsequent decisions in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.* and *Oxford Health Plans LLC v. Sutter* almost always are inapposite because the parties in *Stolt-Nielsen* had stipulated that they had reached no agreement on the subject of class arbitration and the parties in *Sutter* had stipulated that it was up to the arbitrator to decide whether or not the agreement permitted class arbitration. These are unusual circumstances. More often, the plaintiff argues that the agreement permits class arbitration, and the defendant argues that it does not; thus, the parties do not agree about whether it is up to the court or the arbitrator to decide.

The plurality in *Bazzle* (Justices Breyer, Scalia, Souter and Ginsburg) found that the question of whether an arbitration agreement permits class arbitration is a procedural question. However, the U.S. Supreme Court went out of its way in *Stolt-Nielsen* and *Sutter* to emphasize that there was no majority opinion on the subject in *Bazzle* and the federal courts of appeal are split. The Tenth Circuit has held it is a procedural question for the arbitrator (*Quilloin v. Tenet Health System*), while the Third and Sixth circuits

have concluded that it is a "gateway" issue for the court. *Opalinski v. Robert Half International, Inc.* (holding that the availability of classwide arbitration is a substantive question of arbitrability to be decided by the court); *Huffman v. The Hilltop Companies, LLC;* and *Reed-Elsevier, Inc. v. Crockett* (gateway questions are fundamental to the manner in which the parties will resolve their dispute).

The California Supreme Court is poised to provide an answer. It has granted review in several cases presenting the question, and the lead case, *Sandquist v. Lebo Automotive, Inc.*, has been fully briefed since last April. In *Sandquist*, the trial court granted a defendant's motion to compel arbitration of a putative class action on an individual (non-class) basis, and the Court of Appeal reversed, finding the trial court had no authority to decide whether or not the arbitration agreement permits class arbitration, because it is a procedural question for the arbitrator. The California Supreme Court has not yet scheduled a date for oral argument in *Sandquist*. •

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