



Federal Court Provides Roadmap For Misclassification Success – Sort Of

RULING IN FAVOR OF INDEPENDENT CONTRACTOR STATUS PROVIDES BOOST TO GIG ECONOMY

Insights

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A federal appeals court in New York handed a massive victory to a car service enterprise yesterday, ruling that a group of workers seeking to collect overtime payments were not actually employees and were properly characterized as independent contractors (*Saleem v. Corporate Transportation Group, Ltd.*). In issuing the ruling, the 2nd Circuit Court of Appeals provided what may superficially appear to provide a roadmap for technology businesses that digitally connect workers with consumers to understand, and avoid, misclassification risk. Upon a closer inspection, however, that roadmap may not always help such businesses arrive safely at their destinations...

Black-Car Service Enters Gig Economy, Gets Hit With Misclassification Suit

Corporate Transportation Group and its affiliate companies (CTG) run a black-car service in the New York City area. They provide administrative support services for the 700 or so black cars that transport clients in and around the city – operating dispatch bases and providing billing, bookkeeping, accounting, and various other services to keep the business moving. The drivers themselves have three main ways of getting business: they can wait in high-traffic areas and pick up riders, make prearrangements with customers who want rides at specific times, or access CTG's propriety dispatch service that operates through a digital app connecting riders with available drivers.

CTG classified participating drivers as independent contractors, and required them to sign an agreement that acknowledged they were “not an employee or agent” of the company “but merely a subscriber to the services offered” by CTG. This did not stop a group of drivers from filing a class action lawsuit against CTG seeking unpaid overtime pay pursuant to the federal Fair Labor Standards Act (FLSA) and New York state wage and hour law.

To prevail in their lawsuit, the drivers would need to prove they were actually employees and not independent contractors, so the outcome of the case essentially hinged on this critical, threshold determination. A federal district court ruled in favor of CTG in September 2014, setting up an appeal to the 2nd Circuit Court of Appeals, which hears all federal appeals arising from New York, Connecticut, and Vermont. Yesterday, at long last, the court issued its ruling, a 42-page decision in favor of the company.

Court Establishes A 3-Step Plan For Success

The court first noted that any independent contractor misclassification dispute arising under the FLSA must be examined under an “economic realities” test. Such a test looks to the realities of the business relationship and ignores technical concepts, focusing primarily on whether CTG exercised “control” over the drivers to such a degree as to create an employment relationship.

The court concluded that, “even when the historical facts and relevant factors are viewed in the light most favorable to [the drivers], and despite the broad sweep of the FLSA’s definition of ‘employee,’ the record here does not permit the conclusion that [the drivers] were employees, but instead establishes that they were in business for themselves.”

They found the following three factors to be crucial to its decision:

1. The Drivers Had Entrepreneurial Opportunities Not Available to Employees

First, the court pointed out the drivers were permitted to work for direct competitors, and, in its calculus, “a company relinquishes control over its workers when it permits them to work for competitors.” It noted the drivers’ ability to earn income through work for others made them less economically dependent on CTG, thereby limiting any indicia of an employment relationship (*i.e.*, the economic reality of the relationship was not one of the drivers’ complete dependence on CTG).

The first lesson: employers that allow affiliated individuals to have broad entrepreneurial opportunities, even for competitive businesses, are much more likely to defeat a misclassification claim.

2. The Drivers Made A Heavy Investment In Their Business

Second, the court noted the drivers invested heavily in their own driving businesses. “Large capital expenditures,” the court said, “are highly relevant to determining whether an individual is an employee or an independent contractor,” as opposed to negligible items or simply providing the labor itself.

In this case, the drivers first had to purchase a franchise to be eligible to work in CTG’s system, which ran in the tens of thousands of dollars. Then, they had to acquire their own vehicle, at similar, substantial cost. On top of these one-time expenses, drivers were solely responsible for the costs of fuel, repair costs, maintenance fees, licensing, registration, and insurance, not to mention tolls, parking, and tickets. Some drivers even invested more heavily in their own businesses through their own advertising.

The next lesson, then: to the extent possible, technology and other sharing businesses should require any workers utilizing the company’s platform to invest in the workers’ own business through the purchase of tools, equipment, licensing, transportation, and similar items. You can provide the tools (like apps) that can help a worker unleash the scale and productivity of their own business, but you should not become the equivalent of an investor or partner or bank for the

workers' independent businesses. The more heavily invested the worker is, and less reliant on your company, the better your chance of winning a worker classification battle.

3. **The Drivers Maintained A High Level Of Flexibility**

Third, the court pointed to the many ways in which the drivers dictated their own fortunes, free of control from CTG. They chose how much to work or whether to work at all, and were not required to notify CTG when they took days (or weeks) off. The schedules were entirely of the drivers' own making. There was no incentive structure in place to reward drivers for operating at certain times, dates, or locations. In fact, drivers could decide when and where to drive free of any control of CTG, and could turn down requests for rides at any time.

It might go without saying when describing a sharing economy business model, but to the greatest extent feasible independent workers should be free to pick and choose the work they do (or reject). Not only will this help attract the most qualified or dedicated workers to perform tasks on a given platform – gig workers routinely indicate they most crave the freedom afforded them by this kind of work – but it will also be an absolute key to prevailing against legal challenges regarding worker classification.

Court Also Provides Warnings To Other Businesses

The victory for CTG, however, is not necessarily a victory for gig companies everywhere. While it is certainly a positive ruling for those operating in the sharing economy, the court's decision signals certain caveats.

The court found a number of factors cited by the drivers as tending to establish an employment relationship: the drivers were required to follow a rulebook, with violations (such as harassing customers, submitting fraudulent paperwork, not following recommended dress code, keeping a dirty car, etc.) leading to penalties, suspensions, or a termination of the contractor agreement; rates were set by CTG; and the dispatch system was controlled by CTG. Although these factors all pointed to some level of control by CTG, the court ultimately concluded that such factors did not "alter the picture," and the court concluded that the majority of factors led to its independent contractor determination.

All of the above would, at least, seem to offer relatively clear guidance to employers in the gig economy. So of course, the court went on to issue words of warning to businesses that might rely on the ruling in an overly broad manner, characterizing the scope of the ruling as providing "the narrow compass of our decision," lest other businesses believe the ruling was a free pass to exercise a similar level of control over their gig workers without fear of misclassification exposure. The 2nd Circuit panel made clear that its ruling was based on the fact-specific "totality of the circumstances" comprising the relationship between CTG and the drivers in this specific case. "In a different case, and with a different record, an entity that exercised similar control over clients, fees, and rules enforcement in ways analogous to CTG ***might well constitute an employer within the meaning of the FLSA.***"

Conclusion: What Does This Case Mean For Businesses?

In other words, the court said that you can't necessarily rely on a few factors here or there that might be similar to the facts in the CTG case when trying to predict potential liability for misclassification exposure. Instead, you need to weigh all the factors that are taken into account, both in favor of control and against a showing of control, when self-auditing your own business and determining the nature of the relationships your business establishes with workers.

Despite some uncertainty, the *Saleem* ruling is a welcome development for employers. When coupled with a similar recent ruling in favor of Uber from a California state court, sharing economy companies now have a growing body of law upon which to rely when establishing their business practices and defending misclassification challenges.

This is a rapidly evolving area of the law, and courts across the country to continue to grapple with complex issues. It is made especially difficult by the fact that courts are left to analyze these 21st century cases using 20th century law. To stay up to speed on the latest developments, we encourage you to regularly visit our [Gig Economy Blog](#).

For more information, contact any member of our [Gig Economy Practice Group](#), or your regular Fisher Phillips attorney.

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