The Desperate Consequences of Flunking the "ABCs"

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What do franchisors, the trucking industry, and bakery producers have in common? At the moment, each is fighting a common enemy—the ABC test of worker status—to protect its independent contractor business model from extinction. Their battle exemplifies a significant problem with today's worker classification laws: they are ill-suited and unaccommodating to many of the contemporary business models that they regulate. This article examines the key legal and political developments that led to the current dispute and proposes a solution for saving independent contractor business models from ABC obliteration.

I. A Presumption of Employee Status

California, the nation's largest economy, is the epicenter of the battle over worker classification.[1] In 2020, the state enacted California Labor Code Section 2775, a three-part ABC test for determining if a worker is an employee or independent contractor in the eyes of the government.[2] California law

1. California is home to the largest worker population in the country, which exacerbates the problem of ill-suited worker laws. Based on pre-pandemic 2019 economic data, California far outperforms all other states in contributing to the country's economic welfare. Ryan A. Hughes, *If California Were a Country*, Bull Oak Capital (Dec. 28, 2021), https://bulloakcapital.com/blog/if-california-were-a-country.

2. California Labor Code Section 2775 codified California Assembly Bill 5 (AB 5), which was introduced into the California Assembly after the California Supreme Court's decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County*, 4 Cal. 5th 903 (2018). *Dynamex* adopted the ABC test for determining if workers should be classified as employees or independent contractors for purposes of wage orders (e.g., minimum wages and other minimum worker benefits issued by California's Industrial Welfare Commission). *Id.* at 956–57. Although *Dynamex* disclaimed that it was making new law, it is hard not to regard *Dynamex* as a seismic shift in California's labor policy by replacing a long-standing multi-factor flexible

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now presumes all workers who provide labor or services for remuneration are employees unless a "hiring entity" demonstrates that three conditions are present:

> Prong A: the person is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact;
>
> Prong B: the person performs work that is outside the usual course of the hiring entity's business; and
>
> Prong C: the person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.[3]

Testing the "ABCs" of a commercial relationship is important to a host of legal duties that attach to employers, ranging from responsibility for workers' compensation benefits to wage and hour laws, unemployment taxes, reimbursement of expenses, and vicarious liability. Firms that properly classify workers as independent contractors need not worry about these legal duties or about anti-discrimination laws, sexual harassment laws, employee bargaining rights, healthcare benefits, or family and medical leave laws. The stakes of misclassifying workers are high: on top of repaying back taxes and benefits with interest, companies face stiff civil penalties for misclassification.[4]

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standard for classifying independent contractors with an ABC test that presumes all workers are employees. AB 5 was a huge victory for organized labor, something that California's politicians wholeheartedly endorsed. *See* San Francisco Building and Construction Trades Council, State Senate Passes AB 5 (Sept. 30, 2019), https://www.sfbuildingtradescouncil.org/news/top-stories/1478-state-senate-passes-ab-5 (quoting California's Governor Gavin Newsom speech on Labor Day 2019 supporting AB 5). When Governor Newsom signed AB 5 into law a few weeks later on September 18, 2019, he lauded it for creating "pathways for more workers to form a union." *See* Signing Statement, Office of the Governor (Sept. 18, 2019), https://www.gov.ca.gov/wp-content/uploads/2019/09/AB-5-Signing-Statement-2019.pdf. No one disputes that unions were behind AB 5, which by turning more workers into employees makes it easier for unions to organize workplaces. *See* Josh Eidelson, *The Gig Economy Is Coming for Millions of American Jobs*, Bloomberg (Feb. 17, 2021), https://www.bloomberg.com/news/features/2021-02-17/gig-economy-coming-for-millions-of-u-s-jobs-after-california-s-uber-lyft-vote ("union leverage is at a nadir"); *see also* Diane Dixon, *Commentary: New Freelance Law AB5 Illustrates What's Wrong with the Democratic Super-Majority in Sacramento*, L.A. Times (Feb. 18, 2020), https://www.latimes.com/socal/daily-pilot/opinion/story/2020-02-18/commentary-freelance-law-ab5. For a more fulsome discussion of AB 5, its requirements, and background, see Anthony Marks & R. Andrew Chereck, *The ABCs of AB-5*, 41 Franchise L.J. 41 (2021).

3. Cal. Lab. Code § 2775(b)(1)(A)–(C). Like relevant authority on the topic, this article uses "hiring entity" and "hiring firm" interchangeably.

4. California Labor Code Section 2802 requires an employer to reimburse its employees for all necessary expenditures or losses incurred in discharging their employment duties, including paying them for their attorneys' fees in actions they successfully bring to enforce their rights under Section 2802. Cal. Lab. Code § 2802(a)–(c). It grants the California Labor Commissioner authority to issue citations to employers that violate reimbursement obligations. *Id.* § 2802(d). Damages for wage order violations include interest on top of back pay or benefits. *Id.* § 2802(b). In *Fleming v. Matco Tools Corp.*, 2021 WL 673445, at *14 (N.D. Cal. Feb. 21, 2021), a court rejected a franchisor's argument that the franchisee plaintiffs would be unjustly enriched if they were able to retain their profits from franchise operations and also receive reimbursement for their expenses if they were classified as employees, exposing yet another (previously

California's new ABC test upends a thirty-year-old multi-factor common law test for distinguishing employees from independent contractors articulated in 1989 by the California Supreme Court in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*.[5] The *Borello* test is far narrower in scope (meaning that it classifies fewer workers as employees) than California's new Labor Code Section 2775, which completely rewrites California worker status rules. The *Borello* test now only applies to a handful of statutory exemptions from Labor Code Section 2775.[6]

California's experience has energized other states to reconsider their own worker classification labor laws, mostly along "blue" versus "red" party lines.[7] Spurred by employee rights activists that brand misclassification "a longstanding, pervasive problem affecting millions of workers and costing government agencies billions of dollars each year," numerous ABC–type bills have been introduced or enacted since California passed its law in 2019 expanding the number of jurisdictions that presume a worker's employee status unless a hiring firm proves otherwise.[8] Even the federal government is considering legislation that would adopt an ABC test for classifying workers

unimaginable) complication of misclassification: nothing prevents a franchise or distribution relationship from simultaneously being regulated as an employment relationship.

5. *See* S.G. Borello & Sons, Inc. v. Dep't of Indus. Rels., 48 Cal. 3d 341, 351 (1989).

6. *See* Marks & Chereck, *supra* note 2, at 42–44; *see also* Littler Publications, *AB 5: The Aftermath of California's Experiment to Eliminate Independent Contractors Offers a Cautionary Tale for Other States*, JD Supra (Mar. 10, 2020), https://www.jdsupra.com/legalnews/ab-5-the-aftermath-of-california-s-40627 ("One of the key criticisms of [AB 5] was the arbitrary fashion in which some industries—often constituencies with powerful political allies—were granted exemptions from AB 5, while others were left out in the cold."). Among the many exemptions is one that applies to "business-to-business contracting relationships," but the conditions to qualify are so numerous and picky that it seems impossible that it actually covers any real-world business-to-business contracts. *See* Cal. Lab. Code § 2776. There are other exemptions for assorted professionals, artists, and random "others" as varied as manufactured housing salespersons, commercial fishers working on U.S. vessels, competition judges, and individuals performing services for a motor club. *Id.* §§ 2777–2784.

7. The politization of misclassification is indisputable. *See* Kim Kavin, *Welcome to Ms. Kavin's Neighborhood. Today's Lesson: The ABCs*, Daily Kos (Jan. 29, 2020), https://www.dailykos.com/stories/2020/1/29/1914395/-Welcome-to-Ms-Kavin-s-Neighborhood-Today-s-Lesson-The-ABCs (written before the 2020 elections, the blog identified worker misclassification as being "key to the Democratic Party's campaign plans this election year, both at the federal and state levels"); *see also* Lauren Doroghazi, *Beyond California AB 5—States Address Independent Contractors*, MultiState (Nov. 14, 2019), https://www.multistate.us/insider/2019/11/14/beyond-california-ab-5-states-address-independent-contractors (specifically referring to "blue" and "red" states in discussing recent ABC legislative efforts). At the same time—along party lines—that more states are considering enacting ABC legislation, there is an opposite push with other states passing or considering "independent contractor" laws that make it easier for businesses to retain independent contractors. *See* Max Kutner, *In Classification Debate, Some States Back Contractor Status*, Law360 (Nov. 10, 2021), https://www.law360.com/employment-authority/articles/1438848/in-classification-debate-some-states-back-contractor-status.

8. The quote is from the pro-union Economic Policy Institute's June 16, 2021, report. Lynn Rhinehart et al., *Misclassification, the ABC test, and Employee Status: The California Experience and Its Relevance to Current Policy Debates*, Econ. Pol'y Inst. (June 16, 2021), https://www.epi.org/publication/misclassification-the-abc-test-and-employee-status-the-california-experience-and-its-relevance-to-current-policy-debates. An April 20, 2021, Congressional Research Service report identified twenty states and the District of Columbia with some type of ABC test carrying a presumption of employee status. Jon O. Shimabukuro, Cong. Research Serv.,

for certain federal labor law purposes, a test that is stricter than the one the Internal Revenue Service now uses to determine independent contractor status.[9]

Like many business-to-business commercial arrangements, franchisors, trucking firms, and bakery producers have always assumed that their business models supported the independent contractor status of their commercial partners: franchisees, drivers, and distributors. The common core of each arrangement is a synergistic, economic codependency. Franchisors expand their brands by awarding licenses that allow franchisees to use the franchisor's trademarks and marketing programs in their own business as long as customers enjoy a similar experience across independently owned locations. Trucking firms depend on independent drivers to use their own rigs and trucks to haul loads for the firms' customers. Bakery producers rely on independent drivers to move inventory from production facilities and warehouses to retailers' shelves. Each "hiring firm" sets the rules of commercial engagement, but each contractor drives its own revenue and influences its own profitability.

II. Historical Perspective

State wage laws, including ABC tests, trace their roots to unemployment compensation laws written during the Great Depression, a time of

R46765, Worker Classification: Employee Status Under the National Labor Relations Act, the Fair Labor Standards Act, and the ABC Test (2021).

9. In March 2021, the U.S. House of Representatives approved the Protecting the Right to Organize Act of 2021 (PRO Act), which would amend the National Labor Relations Act (NLRA) in two significant ways. *See* Snell & Wilmer, *The PRO Act's Potential Effect on Employers*, JD Supra (Mar. 16, 2021), https://www.jdsupra.com/legalnews/the-pro-act-s-potential-effect-on-5634391. First, it would codify the joint employer standard articulated by the NLRB in *Browning-Ferris Industries, Inc.*, 362 N.L.R.B. 1599 (Aug. 27, 2015). The *Browning-Ferris* standard attaches joint employment status to a company that *indirectly controls or reserves the right to control* another company's working conditions, even when there is no evidence of actual control. Second, it would adopt a California-like ABC test to identify who is an employee for purposes of union organizing and collective bargaining. H.R. 842, 117th Cong. (1st Sess. 2021). Just like AB 5, the PRO Act is unapologetically pro-union and designed to increase union membership in the United States. *See Why the US PRO Act Matters for the Right to Unionize: Questions and Answers*, Human Rights Watch (Apr. 29, 2021), https://www.hrw.org/news/2021/04/29/why-us-pro-act-matters-right-unionize-questions-and-answers#_How_else_would (addressing how the PRO Act would strengthen unions); *see* Alan I. Model, Kevin E. Burke, Maury Baskin & Michael J. Lotito, *PRO Act Would Upend U.S. Labor Laws for Non-Union and Unionized Employers Alike*, Littler (Feb. 10, 2021), https://www.littler.com/publication-press/publication/pro-act-would-upend-us-labor-laws-non-union-and-unionized-employers. Critics of the PRO Act call it as outdated as ABC laws. *See* Kavin, *supra* note 7 ("The root of the problem with legislation like California's AB 5 and the federal PRO Act is the outdated ABC test, written in the 1930s"); *see also* Anna Deknatel & Lauren Hoff-Downing, *ABC on the Books and in the Courts: An Analysis of Recent Independent Contractor and Misclassification Statutes*, 18 U. Pa. J.L. & Soc. Change 53, 65–66 (2015) (observing that sixteen states enacted ABC legislation between 2004 and 2012, but the IRS's twenty-factor test for identifying the existence of an employer-employee relationship has remained untouched since its adoption in 1987). Kavin observes that "the ABC test is far stricter than the modern test that the Internal Revenue Service uses to determine who is a legal independent contractor." Kavin, *supra* note 7.

unprecedented unemployment when the U.S. workforce's needs and economic landscape were nothing like they are today.[10] The focus on misclassification today is largely driven by unions that frame the conversation in black-and-white terms that cast companies utilizing independent contractors as exploitive and opportunistic.[11] Unions have fought for years to shrink the growing ranks of self-employed workers by pushing ABC legislation.[12] Their efforts began gaining traction in 2000, after a report commissioned by the Department of Labor (DOL) revealed that as many as thirty percent of audited businesses misclassified their workforce under then-applicable legal tests.[13] The misclassification issue became more acute beginning in 2007 when the Great Recession collapsed state tax revenues triggering budget gaps in states across the country.[14] Since then, there has been a marked uptick in union-backed efforts to overhaul labor laws focused particularly at owner-operator programs.[15]

III. Complicating Current Events

Several attention-grabbing aftershocks have occurred since California's ABC test became law in 2020. In November 2020, "gig economy" companies, Uber, Lyft, Instacart, and DoorDash, long in the crosshairs of employee rights advocates, used their deep pockets to pass Proposition 22, a California public referendum preventing app-based drivers from being classified as

10. *See* Carpet Remnant Warehouse, Inc. v. N.J. Dep't of Lab., 593 A.2d 1177, 1183–84 (N.J. 1991) (tracing the roots of state ABC legislation to New Deal legislation).

11. The pro-union Economic Policy Institute's June 16, 2021, report links to its Twitter page where it tweets: "Most people know that unions improve wages and benefits for workers, but do you know just how beneficial they really are? Take our quiz . . . ." Rhinehart et al., *supra* note 8; *see also* Rebecca Dixon, *The Gig Is Up on 21st-Century Exploitation*, TechCrunch (Apr. 29, 2021), https://techcrunch.com/2021/04/29/the-gig-is-up-on-21st-century-exploitation (discussing misclassification and identifying app-based companies as "the face of a larger, sinister trend").

12. *See* Taylor Johnston, *The U.S. Labor Movement Is Popular, Prominent and Also Shrinking*, N.Y. Times (Jan. 25, 2022), https://www.nytimes.com/interactive/2022/01/25/business/unions-amazon-starbucks.html. This article notes that, despite their shrinking ranks, the popularity of unions is the highest it has been in decades. Unions are using their popularity to lock in political advantages. For example, the PRO Act would overturn state right-to-work laws that make it unlawful to compel employees to join or pay dues to a union as a condition of their employment. Snell & Wilmer, *supra* note 9; Model et al., *supra* note 9.

13. Deknatel & Hoff-Downing, *supra* note 9, at 55 n.10.

14. *Id.* at 57, n.12.

15. *See* Richard Reibstein, *The Past Decade of Independent Contractor Misclassification and Compliance Law*, JD Supra (Jan. 3, 2020), https://www.jdsupra.com/legalnews/the-past-decade-of-independent-24702. The term "owner-operator" includes sole proprietors, as well as contractors, that are business entities or have employees of their own. Misclassification involves a single firm as the putative employer or a worker. A hiring firm can be guilty of misclassifying a contractor even when that contractor has employees of its own (and the hiring firm would also be guilty of misclassifying the contractor's employees). *See*, *e.g.*, Alexander v. FedEx Ground Package Sys., Inc., 765 F.3d 981, 993 (9th Cir. 2014) (finding FedEx drivers were employees even though they operated through a business entity and had employees of their own). Joint employer liability, often discussed together with misclassification, is, as the term implies, a "two employer" test that evaluates if both the hiring firm and contractor employ the contractor's workers. *See Joint Employment: Overview*, Practical Law Practice Note Overview 9-523-4928 (maintained).

employees.[16] Less than a year later, these "gig" giants put a similar public initiative on the November 2022 ballot in Massachusetts, a state with a substantially similar ABC law (predating and inspiring California's version).[17] The "gig" companies' victory in California shows that the cause of "worker freedom" resonates with voters.[18] Complicating their California victory, however, on August 20, 2021, Proposition 22 was ruled unconstitutional, a decision currently on appeal.[19]

In January 2021, the California Supreme Court exacerbated the newly inked ABC test's impact on California businesses by ruling in *Vazquez v.*

16. "Gig economy" companies sold Proposition 22 to the public by committing to pay app-based drivers at least 120% of minimum wage and provide health insurance subsidies and accident subsidies. *See* Cal. Bus. & Prof. Code § 7453(d)(4)(A). Critics of Proposition 22 are quick to point out that app-based drivers in California still make subminimum wages due to fine print conditions in the public measure. *See* Brian Chen & Laura Padin, *Prop 22 Was a Failure for California's App-Based Workers. Now, It's Also Unconstitutional.*, Nat'l Emp. Law Project (Sept. 16, 2021), https://www.nelp.org/blog/prop-22-unconstitutional.

17. *See* Rebecca Bellan, *Massachusetts AG Greenlights Uber, Lyft-backed Gig Worker Ballot Initiative*, TechCrunch (Sept. 1, 2021), https://techcrunch.com/2021/09/01/massachussetts-ag-green lights-uber-lyft-backed-gig-worker-ballot-initiative. An article published in the *Harvard Political Review* says the amalgam of conditions that attach to the 2022 Massachusetts initiative would leave Massachusetts drivers with a subminimum wage should the initiative pass. Mary Cipperman, *Work À La Carte*, Harv. Pol. Rev. (Oct. 18, 2021), https://harvardpolitics.com /work-a-la-carte.

18. The Proposition 22 California victory exposes an interesting political conundrum: while legislators elected "by the people" pass state ABC laws that treat all workers as employees, their constituents are voting to protect on-demand independent contractor models from extinction. A worker's classification as an independent contractor may not preclude them from being able to collectively bargain. *See Federal Court Rules that Seattle's "Uber Ordinance" Violates Federal Antitrust Law*, Nat'l Fed'n of Indep. Bus. (May 22, 2018), https://www.nfib.com/content/legal -blog/economy/federal-court-rules-that-seattles-uber-ordinance-violates-federal-antitrust-law (discussing the Ninth Circuit's decision in *Chamber of Commerce of the United States v. City of Seattle*, 890 F.3d 769 (9th Cir. 2018), which held that a Seattle ordinance giving independent contractor drivers the right to collectively bargain was preempted by federal antitrust law). *City of Seattle* did not classify app-based drivers as protected employees under the NLRA but did rule that the Seattle ordinance giving drivers collective bargaining rights was not preempted by the NLRA. 890 F.3d at 794; *see* also Thomas W. Joo & Leticia Saucedo, *A New Paradigm: Rideshare Drivers, Collective Labor Action, And Antitrust*, 69 Buff. L. Rev. 805, 824–26 (2021). The right of independent contractors to collectively bargain is an unsettled question that is outside the scope of this article.

19. Castellanos v. State, 2021 WL 3730951, at *2 (Cal. Super. Ct. Aug. 20, 2021), *appeal filed*, Case No. A163655 (2021). The force behind *Castellanos* is the Service Employees International Union (SEIU), the same union behind numerous misclassification lawsuits over the last decade, including the "McDonald's Fight for $15" cases. *See* Ken Green, *Unionizing the Gig Economy: A Path Forward for Gig Workers* (July 6, 2021, updated Aug. 30, 2021), https://uniontrack.com/ blog/unionizing-the-gig-economy; *see also* Kate Conger & Kellen Browning, *A Judge Declared California's Gig Worker Law Unconstitutional. Now What?*, N.Y. Times (Aug. 23, 2021), https:// www.nytimes.com/2021/08/23/technology/california-gig-worker-law-explained.html (calling it "an awkward turn of events" that the California Attorney General's office, which had sued Uber and Lyft before Proposition 22's passage for misclassifying their drivers, is now defending Proposition 22 against the SEIU's constitutional challenge). At the time of this article's submission for publication, the appeal filed by the State of California and the "gig" company respondents in late September 2021 is pending. Castellanos v. State, Case No. A163355 (Cal., 1st App. Dist., Div. 4). The *Castellanos* ruling does not make app-based drivers employees in California, but does leave their status unsettled. *See* Sean King, *The End of Proposition 22?: How a California Court Is Labeling the Initiative Unconstitutional*, St. John's Lab. & Emp't Law F. (Oct. 6, 2021), https://stjclelblog.org/2021/10/the-end-of-proposition-22.

Jan-Pro Franchising International, Inc. that the test applies retroactively.[20] As a result of *Vazquez*, "relationships that were never considered or expected to be employment relationships [are] deemed employment relationships by law."[21] Suddenly franchisors, trucking firms, bakery producers, and numerous others are scrambling to save their independent contractor networks—some decades old—sparking intense lobbying for new exemptions or other strategies to avoid having their business models obliterated by California's ABC test.

Finally, the pandemic has produced what economists call the "Great Resignation," a worker shortage choking industries like technology and healthcare and challenging the country's economic recovery. The Great Resignation has particular implications for California, a hotbed for startups that depend on younger workers who comprise a material percentage of overall resignations.[22] It has spurred some employers to volunteer generous pay and employee benefits to lure workers back. It also has given unions new muscle to advance their pro-ABC legislative agendas.[23]

IV. The "B" Problem

Prong B is the most vexing element of the ABCs as it conditions independent contractor status on a worker performing work outside the usual course of the hiring entity's business.[24] This requirement is incompatible with arrangements where a hiring firm's revenue directly depends on someone else's work, which swallows nearly every independent contractor arrangement. Prong B presents an insurmountable problem not just for vertically integrated arrangements between brands and franchisees and suppliers and distributors, but also for arrangements between any two links in a supply chain. Because the ABC test is conjunctive, companies operating in states that incorporate the "usual course of business" version of Prong B cannot lawfully classify their workers as independent contractors if workers perform services that reasonably could be provided by an employee.[25] This vague

20. Vazquez v. Jan-Pro Franchising Int'l, Inc., 10 Cal. 5th 944, 948 (2021).

21. *See* Marks & Chereck, *supra* note 2, at 42.

22. *See The Great Resignation: What It Means for California Startups and Young Talent*, Jobamax (Oct. 11, 2021), https://jobamax.medium.com/the-great-resignation-what-it-means-for-california-startups-and-young-talent-2049be53ab21.

23. The Great Resignation is empowering union-backed employees to strike for better working conditions, adding clout to the workers' rights movement. On top of this, unions are gaining in popularity. A Gallup Poll conducted in August 2021 shows pro-union sentiment is at its highest level since 1965, up twenty points since 2016. Megan Brenan, *Approval of Labor Unions at Highest Point Since 1965*, Gallup (Sept. 2, 2021), https://news.gallup.com/poll/354455/approval-labor-unions-highest-point-1965.aspx.

24. While Prong B varies across states, tougher ABC laws like California's and Massachusetts's condition independent contractor status on a worker performing work outside the usual course of the hiring entity's business. Cal. Lab. Code § 2750.5; Mass. Gen. Laws ch. 149, § 148B.

25. Dynamex Operations W., Inc. v. Superior Court, 4 Cal. 5th 903, 959 (2018) (explaining Prong B to mean that workers must be classified as employees when their "services . . . would

legal standard leaves companies highly vulnerable to misclassification challenges to their independent contractor arrangements.[26]

V. Judicial Battleground

Each of the groups profiled in this article has challenged California's ABC test in the courts. First, trucking companies have twice challenged the law on constitutional grounds, although only one case remains alive. In a last-gasp plea to the U.S. Supreme Court, the California Trucking Association has asked the Court to find that the Federal Aviation Administration Authorization Act (F4A) preempts California's ABC test as it applies to motor carriers.[27] Although the association's petition remains pending, the Court refused to hear a similar constitutional preemption argument on October 4, 2021.[28]

Second, on September 21, 2021, the U.S. District Court for the Southern District of California held in *Goro v. Flowers Foods, Inc.* that bakery giant Flowers Foods, producer of Wonder Bread, Tastykake, and Dave's Killer Bread, had misclassified its distributors even though distributors use their own vehicles and employees to bring the company's bakery products to national, regional, and local accounts in their territory; decide when to work, how to staff, what routes to travel, and how much time to spend at each retail location; establish their own relationships with local store management; and exercise autonomy over other business needs like insurance.[29] Flowers Foods' consignment-based direct-store-delivery system is widely used by other bakery producers throughout the United States.[30]

ordinarily be viewed by others as working in the hiring entity's business and not as working, instead, in the worker's own independent business").

26. Prong B asks if the work being performed is *integral* to the hiring firm's usual course of business, which is an evidentiary issue unrelated to whether the worker sets prices, quality, and service levels and therefore controls its own profits and losses. Cal. Lab. Code § 2750.5. The importance of setting prices, quality, and service levels is discussed later in this article. *See infra* Part VII.

27. *See* Cal. Trucking Ass'n v. Bonta, 996 F.3d 644 (9th Cir. 2021), *petition for cert. filed* (U.S. Aug. 11, 2021) (No. 21-194).

28. Cal Cartage Transp. v. State, 217 Cal. Rptr. 3d 570 (2020), *cert. denied*, 2021 WL 4507665 (U.S. 2021) (No. 20-1453); *see also* Cheryl Miller, *SCOTUS Rejects Trucking Company's Challenge to California's Worker Classification Law*, Recorder (Oct. 4, 2021), https://www.law.com/therecorder/2021/10/04/scotus-rejects-trucking-companys-challenge-to-californias-worker-classification-law/?slreturn=20211004164154. The *Cal Cartage* case could still go back to California courts or regional federal courts.

29. Goro v. Flowers Foods, Inc., 2021 WL 4295294, at *2, *3 (S.D. Cal. Sept. 21, 2021).

30. *Id.* at *2 ("Other bakeries also use this distribution model, which was developed in the 1950s."). At some point in the last ten years, Flowers Foods must have recast its distribution program as franchises—possibly to add additional armor against misclassification claims. The strategy had initial success as the *Goro* decision mentions that, in December 2017, the California Labor Commission rejected a Flowers Foods distributor's misclassification claim finding the distributor to be a "franchisee and therefore outside of the Labor Commission jurisdiction." *Id.*, at *4. Not all bakery chains that utilize a Flowers Foods–type consignment-based distribution model are franchises. *See*, *e.g.*, Atchley v. Pepperidge Farm, Inc., 2012 WL 6057130, at *1 (E.D. Wash. Dec. 6, 2012) (rejecting a distributor's Washington Franchise Investment Protection Act claims because the distributorship did not meet the statute's "franchise" definition).

In the decision, the district court shredded Flowers Foods' arguments, one based on the alleged preemption of any one of three different federal laws, and the other based on alleged disputed facts that Flowers Foods argued entitled it to a jury trial on whether its distributors were independent contractors. The court summarily rejected all three preemption arguments because (1) the Ninth Circuit, it said, had already rejected an earlier argument that the F4A preempted California's ABC test as applied to motor carriers; and (2) Flowers Foods had failed to identify an actual conflict between the federal franchise and trademark laws and California's ABC test or a "clear and manifest" intent by Congress to preempt state labor laws justifying preemption.[31] It called Flowers Foods "disingenuous" for claiming to be in the "bakery business" while its distributors were in the transportation or delivery business.[32] According to the court, there was too much evidence that Flowers Foods' business encompassed sales, delivery, and merchandising, the very functions distributors performed whose work was necessary, not incidental, to Flowers Foods' business.

Third, on November 17, 2020, the International Franchise Association (IFA) borrowed a page out of 7-Eleven's playbook, which two months earlier had convinced a Massachusetts federal judge that the federal franchise rule preempted Massachusetts's ABC test and required dismissal of a misclassification lawsuit filed by 7-Eleven franchisees.[33] The IFA's action, which was

31. *Goro*, 2021 WL 4295294, at *9, *11 (citing Cal. Trucking Ass'n v. Bonta, 996 F.3d 644, 659 (9th Cir. 2021)).

32. *Id.* at *12. On December 3, 2021, the *Goro* court rejected Flowers Foods' motion for summary judgment on plaintiffs' state law wage claims. Goro v. Flower Foods, Inc., 2021 WL 5761694 (S.D. Cal. Dec. 3, 2021). It found "genuinely disputed material facts" as to whether the distributors operated in interstate commerce, which would have exempted Flowers Foods from California's wage laws. *Id.* at *8.

33. *See* Complaint, Int'l Franchise Ass'n v. California, Case No. 3:20-CV-02243-BAS-DEB (S.D. Cal. 2020). The Massachusetts case is *Patel v. 7-Eleven, Inc.*, 485 F. Supp. 3d 299, 307 (D. Mass. 2020) (ruling that genuine issues of fact precluded summary judgment that franchisees were employees under the Massachusetts independent contractor law ("Massachusetts ICL")), *appeal filed*, 8 F.4th 26 (1st Cir. 2021), *certifying questions to* No. SJC-13166, 2022 WL 869486 (Mass. Mar. 24, 2022). On March 24, 2022, the Massachusetts Supreme Judicial Court answered the questions certified to it by the First Circuit by ruling that there was no conflict between the Massachusetts ICL and the FTC Rule and, thus, no federal preemption. *Patel v. 7-Eleven, Inc.*, 2022 WL 869486, at *1 (Mass. Mar. 24, 2022). Specifically, the Massachusetts Supreme Judicial Court found that the "free[dom] from control" required by Prong A to establish an independent contractor relationship under the Massachusetts ICL did not conflict with the FTC Rule's "significant . . . control" over the franchisee's "method of operation," which is one of two alternatives to establish a franchise under federal law (the other alternative being significant assistance). *Id.* at *3, *6. The court explained that, although the FTC Rule and Prong A both use "control" in their respective legal tests, "significant . . . control" over a franchisee's business operations is broader than control over workplace decisions under Prong A, quoting *Goro*, which observed that "the phrase 'method of operation' in the FTC Franchise Rule is broader than the phrase 'performance of [services]' appearing in the ABC Test." *Id.* at *7 (quoting *Goro*, 2021 WL 4295294, at *10). The court dismissed arguments that its ruling would destroy the franchise business model, citing recent FRANdata and IFA reports extolling franchising's steady growth despite rulings under common law and ABC tests finding franchisees to be employees. *Id.* at *8. According to the court, applying the Massachusetts ICL test to franchise relationships would not "result in every franchisee being classified as an employee of the franchisor." *Id.* at *9. The court also noted that the "controls required under the Lanham

filed in the same court that later issued the *Goro* decision, sought to declare California's ABC test inapplicable to the franchise model on constitutional grounds based on preemption arguments similar to 7-Eleven's: (1) neither the federal franchise rule nor trademark law allow a franchisee "to be free from the control and direction of the franchisor," in direct conflict with Prong A, and (2) franchising's trademark licensing feature prevents a franchisee from operating "outside the usual course" of a franchisor's business, in direct conflict with Prong B. The thrust of the IFA's argument was that strict application of the ABC test would convert every California franchisee to an employee of the franchisor and dismantle the franchise business model:

> It cannot be the case . . . that, in qualifying as a franchisee . . . an individual necessarily becomes an employee . . . . [S]uch a ruling . . . would eviscerate the business franchise model, rendering those who are regulated by the FTC Franchise Rule criminally liable for failing to classify their franchisees as employees.[34]

After the *Goro* ruling rejected the same preemption arguments at the foundation of the IFA's case, the State of California moved to dismiss the IFA's complaint. In early 2022, the court ruled for defendants and dismissed the IFA's constitutional challenge without prejudice (and also without leave to amend), finding no justiciable dispute at the moment.[35]

These outcomes have pulled the rug out from under the feet of Flowers Foods and other bakery producers with distributors in California, trucking firms and franchisors doing business in California, and companies utilizing similar owner-operator business models still undetected by misclassification radar. Even though *Dynamex* said that it did not change existing law, until *Dynamex* no one saw the ABC test coming in a way that might topple decades-old business models (some say franchising was invented during the Middle Ages).[36] These companies are now in the unenviable position of

Act, 15 U.S.C. § 1064 (5) (A)" did not conflict with the "free[dom] from control" required by Prong A for independent contractor status. *Id.* at *7, n.16, *8. In dicta, the court reasoned that a putative franchisee carries the burden of proof on a threshold issue in every misclassification franchise case, which is to show that it performs services for the alleged employer/franchisor, a threshold that the court said is "not satisfied merely because a relationship between the parties benefits their mutual economic interests." *Id.* at *9.

34. *Patel*, 485 F. Supp. 3d at 310.

35. Int'l Franchise Ass'n v. California, 2022 WL 118415, at *7 (S.D. Cal. Jan. 12, 2022). The court did not offer the IFA leave to amend because the IFA had not asked for leave and had already amended its complaint once before. *Id.* It found the IFA's arguments about fitness for review both theoretical ("the Court is left to speculate if or how Section 2775(b)(1) might be applied to franchises") and unconvincing ("Plaintiffs have not shown a plausible basis to fear an immediate enforcement of Section 2275(b)(1) [sic] against all franchise relationships, devoid of context"). *Id.* at *6.

36. Dynamex Operations W., Inc. v. Superior Court of L.A. Cnty., 4 Cal. 5th 903, 964 (2018). *See supra* note 2 and accompanying text. By ruling the ABC test was not new law, the California Supreme Court paved the way for *Vazquez* to hold a few years later that the ABC test applies retroactively to arrangements in place before the *Dynamex* decision. Vazquez v. Jan-Pro Franchising Int'l, Inc., 10 Cal. 5th 944, 955 (2021). Labor advocates say the corporate lobby should have seen *Dynamex* coming. Caitlin Vega, *What's the Real Story on Dynamex?*, Cal. Lab. Fed'n (Aug. 13, 2018), https://calaborfed.org/whats-the-real-story-on-dynamex. For the roots of franchising, see Robert W. Emerson & Michala Meiselles, *U.S. Franchise Regulation As a Paradigm*

defending business models that rely on economic allocations that are incompatible with employment relationships or facing significant costs and penalties as employers if their luck in court does not improve.[37]

VI. Political Ping-Pong and Mismatched Legal Tests

No one benefits from the political ping-pong that labor laws have experienced in the last decade, with Obama-era policies summarily replaced by Trump-era policies, and Trump-era polices undone by Biden-era policies.[38] Swatting labor laws back and forth between extremes hinders the ability of companies and workers to plot their future and destroys the predictability of laws necessary for the free flow of interstate commerce.[39]

States with ABC laws that presume all workers are employees cling to old-fashioned ideas about work, ignore new technologies that have changed the way work is and can be performed, and disregard the modern needs of today's workforce that strongly desires flexibility.[40] The twenty-first century

for the European Union, 20 Wash. U. Glob. Stud. L. Rev. 743, 746 (2021) ("Franchising, as a concept, dates back to the thirteenth century or earlier, over four hundred years before it was first adopted as a business model.").

37. The potential implications of a misclassification ruling involving the groups profiled in this article—the trucking industry, bakery producers, and franchisors—are staggering. If required to reclassify their California network members as employees, each might owe each network member and their employees for missing wages including documented overtime and expense reimbursements with interest, plus fines, penalties, and attorneys' fees, without receiving credit for profits that a network member earned from operating their own business. *See* Kai Thordarson, *AB-5 and Drive: Worker Classification in the Gig Economy*, 17 Hastings Bus. L.J. 137, 149–50 (2021) (discussing the harsh penalties in ABC laws as a mechanism for compliance).

38. *See* Robert Nagle, *Watch the Pendulum Swing—NLRB's Acting GC Rolls Back Predecessor's Guidance Memoranda*, JD Supra (Feb. 9, 2021), https://www.jdsupra.com/legalnews/watch-the-pendulum-swing-nlrb-s-acting-6244431. As this article goes to print, the Democrat-controlled NLRB is playing politics by inviting the public to file briefs in a non-franchise NLRB case involving the independent contractor status of workers who provide makeup and hairstyle services to the Atlanta Opera, specifically on the issue of whether the NLRB should follow the independent contractor standard that the NLRB articulated in 2019 when the NLRB was Republican-controlled, return to the Obama-era independent contractor standard, or fashion a new standard. *NLRB Invites Briefs Regarding Independent Contractor Standard*, Nat'l Lab. Rels. Bd. (Dec. 27, 2021), https://www.nlrb.gov/news-outreach/news-story/nlrb-invites-briefs-regarding-independent-contractor-standard. Like all NLRB decisions, the Atlanta Opera case will be reviewed by the U.S. Court of Appeals for the D.C. Circuit, which, in the past, has strongly rebuked the NLRB for favoring politics over legal precedent and ignoring the court's prior rulings in its decisions. *See* Richard Reibstein, *Courts Unlikely to Accept a New NLRB Independent Contractor Test*, Locke Lord (Dec. 29, 2021), https://www.lockelord.com/newsandevents/publications/2021/12/courts-unlikely-to-accept-a-new-nlrb-independent-c.

39. The California Trucking Association makes these points in its petition to the U.S. Supreme Court seeking to overturn the Ninth Circuit's holding that the F4A does not preempt California's ABC test as applied to motor carriers. *See* Petition for Writ of *Certiorari* at 15–16, Cal. Trucking Ass'n v. Bonta, 996 F.3d 644 (9th Cir. 2021) (No. 21-194.)

40. *See* Andrew G. Malik, *Worker Classification and the Gig Economy*, 69 Rutgers U. L. Rev. 1729, 1747–48 n.106 (2017) (discussing 2015 statistics regarding the varied backgrounds of the 40,000 active Uber drivers at the time who chose to drive for Uber because of the platform's "flexibility and convenience"—"it fit their life well, not because it was their only option."); *see also* Rani Molla, *Service Workers Are Getting Paid More Than Ever. It's Not Enough*, Vox (Nov. 1, 2021), https://www.vox.com/recode/22748448/service-food-hotel-workers-pay-raise-resignation-jobs-wages-bene

economy is service and consumption driven and qualitatively different than the manufacturing-centric economy dominating most of the twentieth century.[41] Yet work arrangements are subject to growing orders of ABC worker classification laws rooted in New Deal–era social policies.

Although Uber and other "gig" companies are the poster children of this new economy, the complications presented by ABC laws are not confined to platform technology firms. None of the groups profiled in this article that are fighting for their business model's survival—franchisors, the trucking industry and bakery producers—is a technology or "gig" firm run by platform companies like Uber, Lyft, or DoorDash. Worker classification laws are industry-agnostic. What the groups profiled in this article have in common with their "gig" cohorts is that they produce jobs that create economic codependency between brand owners and contractors while at the same time allowing contractors significant autonomy over the manner and means of work when compared to traditional employees.[42]

Whether one calls today's new economy a sharing economy, on-demand economy, gig economy, peer economy, collaborative economy, or something else, many of the jobs being generated are attractive to workers who "value autonomous, short-term, flexible work over lifetime job security."[43]

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fits (exploring some of the existential reasons for the Great Resignation and concluding that employees left traditional hourly jobs during the pandemic not out of a desire to stop working altogether, but to secure a better work-life balance for themselves, which adds pressure on companies to change traditional work models).

41. *See* Mike Moffatt, *History of American Economic Growth in the 20th Century*, ThoughtCo (Aug. 1, 2018), https://www.thoughtco.com/us-economic-growth-in-the-20th-century-1148146; Megan Carboni, *A New Class of Worker for the Sharing Economy*, 22 Rich. J.L. & Tech. 11 (2016); Emily C. Atmore, *Killing the Goose That Laid the Golden Egg: Outdated Employment Laws Are Destroying the Gig Economy*, 102 Minn. L. Rev. 887, 907–08 (2017) ("[T]wentieth-century legislators . . . could not have conceived of a mutually beneficial business model that successfully operates on minimal operating costs, a remote technological marketplace, and international demand.").

42. Another commonality of franchising and gig arrangements is that both result in "fissured workplaces" according to proponents of "fissured workplace" labor theories, where multiple non-affiliated organizations influence worker relationships. *See* David Weil, The Fissured Workplace 8–9 (2014) (describing workplace "fissuring" as the phenomenon where large "lead businesses" no longer directly employ workers to accomplish their business goals, but instead rely on "a complicated network of smaller businesses" operating in a highly competitive environment that shrinks their profit margins, which, in turn, result in "increasingly precarious working conditions" for the workers of these lower-level small employers). Dr. Weil's book profiles different fissured workplaces including various subcontracting relationships, franchise relationships, technology arrangements, and outsourcing arrangements. *Id.* at 13, 99–121 (subcontracting relationships), 122–58 (franchise relationships); 159–81 (supply chains, outsourcing, technology).

43. *See* Kaiponanea T. Matsumura, *Breaking Down Status*, 98 Wash. U. L. Rev. 671, 701, nn.179, 185 (2021) (referring to surveys revealing how gig workers prefer independent contractor status over being an employee even without the benefits that employee status confers). Likewise, V.B. Dubai, *Wage Slave or Entrepreneur?: Contesting the Dualism of Legal Worker Identities*, 105 Calif. L. Rev. 65, 118 (2017), studied the San Francisco taxi industry and found immigrant and racial-minority taxi workers strongly preferred independent contractor status not because they misunderstood what it meant to be an employee, but because it fulfilled their personal aspirational identity to be an entrepreneur and freed them from top-down work rules even if it meant less stable income.

The twentieth century legal tests for classifying workers are not helpful in addressing these new workplace realities.[44]

It should be possible for governments to design a third worker category, a flexible contractor model with some traditional labor protections like paid sick leave and occupational accident insurance to prevent companies from abusing independent contractor status and pushing worker welfare responsibility entirely on to governments' backs. This third category must recognize a distinct class of worker who brings "services integral to the employer's business, works subject to both their own criteria and the employer's criteria, . . . performs activities autonomously . . . and . . . [is] paid based on the quality and quantity of work performed," not according to pay laws that measure work "with a clock."[45] The notion of a third worker category is not unprecedented: the United Kingdom uses three categories for classifying individuals who render services to a company.[46] Canada recognizes a third

44. *See* Atmore, *supra* note 41, at 889 (concluding that applying traditional binary employee classification tests to today's workers pushes a "square peg" through one of "two round holes" and advocates for comprehensively reforming worker classification rules so that they foster and support, not complicate, today's economic forces). The references to "square peg" and "two round holes" come from *Cotter v. Lyft, Inc.*, 60 F. Supp. 3d 1067, 1081 (N.D. Cal. 2015), a decision that rejected cross-motions for summary judgment in Lyft drivers' misclassification class action. The *Cotter* court was highly critical of the legal tests that it had to work with, saying the test "developed over the 20th Century for classifying workers isn't very helpful in addressing this 21st Century problem." *Cotter*, 60 F. Supp. 3d at 1081; *see also* Malik, *supra* note 40, at 1731 ("If a third category is not created, both courts and gig-economy companies will be forced to settle for one of the first two options–at the expense of innovation and advancement.").

45. Tad Devlin & Stacie Chiu, *Is Your Uber Driver or Lyfter an Employee or Independent Contractor and Why Does It Matter?*, Thomson Reuters (June 2017), http://www.kdvlaw.com/wp-content/uploads/2017/07/Westlaw-Shared-Economy-Is-Uber-Driver-an-Employee-or-Independent-Devlin-June-2017.pdf; *see also* Robert Sprague, *Updating Legal Norms For a Precarious Workplace*, 35 A.B.A. J. Lab. & Emp. L. 85, 85 (2020) (noting that "the legal tests used to classify whether a worker is an employee, who is afforded various workplace protections, or an independent contractor, who is not entitled to workplace protections, have not kept pace with evolving, on-demand work"). The Sprague article does not endorse a third worker category. *Id.* at 101–11. It reviews state legislative efforts to counteract ABC laws by enacting independent contractor laws that give contractors various portable employment-like benefits decoupled from any particular job or company.

46. Vinson & Elkins LLP, *A Third Approach to Classification—What Is a British "Worker,"* Lexology (June 19, 2018), https://www.lexology.com/library/detail.aspx?g=54faa142-d9e4-41c2-bf8d-673cb3397370. The United Kingdom recognizes employees, independent contractors and workers defined this way:

- **Employees** are party to a contract of employment and have the "full suite" of employment rights, including to equal pay, sick pay, holiday pay, non-discrimination, and protection from unfair dismissal;
- **Independent contractors** are party to contracts for (not necessarily personal) services, but are not employees, and do not have any of the rights that flow from a contract of employment; and
- **Workers** are in an intermediate category, in that they are party to contracts for (personal) services rather than contracts of employment, and do not have all the benefits of an employee, but do have rights to equal pay and non-discrimination.

See Miriam A. Cherry & Ana Santos Rutschman, *Gig Workers As Essential Workers: How to Correct the Gig Economy Beyond the Covid-19 Pandemic*, 35 A.B.A. J. Lab. & Emp. L. 11, 14 (2020). The UK approach distinguishes a "worker" and an "independent contractor" by asking (1) is the contract for personal services; and (2) is the company the client or customer of the individual rendering

"dependent contractor" category, Italy and Spain each recognize their own third worker category, as do South Korea, Germany, and other European Union countries.[47]

For vertically integrated business models, which include most franchises, where companies require their own workforce to discharge their contractual duties to franchisors or some other hiring firm, it should be sufficient for workers to have one W-2 employer, the party that actually hires them, supervises their performance, and decides all incidents of their employment. Efforts to hold franchisors and others similarly connected to a worker's W-2 employer liable as joint employers of that worker should be recognized for what they are: pro-union, not pro-employee.[48]

VII. Saving Independent Contractor Business Models from ABC Obliteration

Reflexively, a third worker category in the United States seems like it should be an easy solution to implement, but experiences elsewhere suggest otherwise. Critics of third worker categories in other countries say the third category adds complexity to worker classification disputes, delivers unintended consequences, and results in many more, not fewer, workers classified as employees under labor laws.[49] Based on these lessons, a third worker

services? Vinson & Elkins LLP, *supra* note 46. If the answer to (1) is yes and the answer to (2) is no, the individual is likely a worker, not an independent contractor. *Id.*; *see* Jennifer M. Leaphart, *Sharing Solutions?: An Analysis of Taxing the Sharing Economy in the United States and Europe*, 91 Tul. L. Rev. 189, 208–10 (2016) (explaining the UK system).

47. Section II of the Cherry and Rutschman article, *supra* note 46, reviews various proposals for adding a third worker class in the United States. Most proposals spotlight "on-demand" workers and the gig economy. For example, Seth D. Harris & Alan B. Krueger, *A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The "Independent Worker"* (Hamilton Project, D.C.), Dec. 2015, at 22–24, suggest creating an "independent workers" category covering workers in a "triangular relationship" between customers needing a service (e.g., a car ride or food delivery) and an intermediary, typically a technology company (e.g., Uber or Postmates). None of the third worker category proposals that this author has reviewed is broad enough to capture non-gig business arrangements like those profiled in this article. *See* discussion *infra* note 62.

48. It is obviously easier for unions to organize workers if they can bargain with the joint employer at the top of the chain—the franchisor, licensor, or supplier—than if they must bargain with each individual employer—the franchisee, licensee, or distributor—each with their own separate workforce. As a matter of public policy, however, if franchisees occupy the employer role, why do their workers need, or for that matter deserve, two W-2 employers, the franchisor and franchisee, jointly and severally? The author of this article can think of no reason except to appease unions.

49. Miriam A. Cherry & Antonio Aloisi, *"Independent Contractors" in the Gig Economy: A Comparative Approach*, 66 Am. U. L. Rev. 635, 646–50 (2017). For a discussion of the United Kingdom supreme court's dismissal of Uber's appeal of a February 2021 landmark ruling that rejected Uber's claim that drivers should be classified as contractors, finding them instead to be workers with access to a minimum wage, pension benefits, and paid holidays, see Bama Athreya, *Gig Workers Are in the Driver's Seat in Europe. Is There Hope for the US?*, Inequality.org (Dec. 13, 2021), and Natasha Lomas, *UK High Court Deals Huge Blow to Uber-Style Ride-Hailing Contracts*, TechCrunch (Dec. 6, 2021), https://techcrunch.com/2021/12/06/uk-high-court-uber-contracts-loss.

category in the United States may not be the ideal solution for the groups profiled in this article and others like them to ensure contractor status for their business models. Indeed, despite all the problems with the traditional binary model, it may prove just as challenging and equally unsatisfying to create a common set of organizational features for a third worker category that are shared by the assorted commercial arrangements scattered around the murky edges of the traditional binary divide (especially when new work models are constantly appearing).[50]

A better option for saving contractor status for the businesses profiled in this article and others like them may be to amend ABC laws to add a rebuttable presumption that a business-to-business contracting arrangement is an independent contractor relationship, not an employment relationship, when the contractor can influence its revenue by setting prices to consumers, exercises control and discretion over the means and manner of executing customer service standards, and can control its profits and losses. These are the core functions whereby a business demonstrates its independence.[51]

The idea for this legislative solution comes from an unlikely source: Professor David Weil, the Obama-era chief administrator of the Wage and Hour Division of the DOL and author of *The Fissured Workplace* and the DOL's informal guidance on joint employment under the Fair Labor Standards Act (Administrator's Interpretation No. 2016-1).[52] Dr. Weil is a foe of "fissured workplaces," which, as noted, include franchises, subcontracting, outsourcing arrangements, and digital platforms that connect consumers with workers.[53] He likely was not thinking about saving franchising or other fissured arrangements as independent contractor models when he critiqued the ABC test in a 2021 law review article. But, in that article, Dr. Weil and his coauthor, Tanya Goldman, assail the ABC test for being "over-inclusive" and not a tractable legal standard for businesses today.[54] They propose to

50. Gali Racabi, *Despite the Binary: Looking for Power Outside the Employee Status*, 95 Tul. L. Rev. 1167, 1183 (2021) ("This problem of matching legal status to a specific collection of organizational features is magnified tenfold when firms introduce new organizational structures.").

51. Tanya Goldman & David Weil, *Who's Responsible Here? Establishing Legal Responsibility in the Fissured Workplace*, 42 Berkeley J. Emp. & Lab. L. 55, 112 (2021).

52. Weil, *supra* note 42.

53. *Id.* at 66 ("Fissured workplace business models incentivize violations of our fundamental labor and employment standards."). In June 2021, President Biden nominated Dr. Weil for his old job at the DOL. Press Release, The White House, President Biden Announces Key Nominations (June 3, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/06/03/president-biden-announces-key-nominations. After his nomination failed to get out of committee, on January 4, 2022, Biden renominated Dr. Weil in this new session of Congress. Press Release, The White House, Nominations Sent to the Senate (Jan. 4, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/01/04/nominations-sent-to-the-senate-54. But on March 30, 2022, the Senate voted to deny Weil his old job. *See* Paige Smith, *Senate Turns Back David Weil as Labor's Top Wage-Hour Enforcer*, Bloomberg Law (March 30, 2022), https://news.bloomberglaw.com/daily-labor-report/senate-turns-back-david-weil-as-labors-top-wage-hour-enforcer.

54. Goldman & Weil, *supra* note 51, at 88. Goldman and Weil point out that after enacting Labor Code Section 2775, the California legislature needed to enact a mishmash of exemptions to rebalance its overbroad employee test. The random exemptions reflect "political will and

rebalance the ABC test to incorporate aspects of the economic realities analysis that highlight the specific defining attributes of an independent business entity.[55] The Goldman and Weil article observes: "[T]he core functions of a business revolve around its ability to set price, quality, and service levels." By contrast, "[a]n economic actor that lacks this capacity operates in an environment where economic returns are determined almost exclusively by the party compensating them."[56] A better test of employment status, Goldman and Weil propose, "would center on evaluating the worker's opportunities for profit or loss beyond just accepting or rejecting more work."[57] They elaborate as follows:

> Critical activities would include setting price and quality standards for goods or services provided; setting key product or service standards and characteristics; overseeing the marketing and development of products; making expansion and contraction decisions; and making decisions affecting the costs of service provision or production. The ability to directly affect profit or loss in significant ways indicates whether a party has meaningful bargaining power going beyond the decision to say "yes" or "no" to a job or gig. Incorporating those criteria into a modified ABC test would link the test back to the purposes of regulating work in the first place.[58]

Goldman and Weil offered this critique of the ABC test in opposing claims by technology firms that their business arrangements with drivers deserve independent contractor protection.[59] With dispatch, the authors say that platform companies are employers because they use technology and algorithms to control prices.[60] Consequently, they conclude, drivers have no control over their profits and the only way that drivers can derive greater return for their effort is by working more.[61]

Here is where the Goldman and Weil article exposes the possibility of defending business-to-business arrangements like those profiled in this article as independent contractor arrangements. If franchisees, distributors, and licensees control the economic drivers of their brand relationship and the means and methods for executing brand standards, then they can control

power," not adherence to legal doctrine. *Id.* at 111 ("Our main concern with the tractability of the ABC test is that if it is truly overinclusive, legislatures will continue to include carve-outs, which often reflect political will and power rather than a need to re-balance power in a working relationship.").

55. *Id.* at 111–12. To avoid confusion, this article's proposal for amending California Labor Code Section 2775 draws inspiration from ideas presented by the Goldman and Weil article, but does not adopt their third option per se, which they describe as a three-part "concentric circle framework" (only the middle circle is discussed in this article). *Id.* at 88. This article agrees with the criticism by Goldman and Weil that California Labor Code Section 2775 is over-inclusive and out of touch with modern business formats. *Id.*

56. *Id.* at 112.

57. *Id.* To avoid confusion, by "third option," Goldman and Weil are not proposing a third worker category; they are creating a new test for employee status that blends the ABC and economic realities test. *Id.* at 111–12.

58. *Id.*

59. *Id.* ("evaluating platform models' business structures").

60. *Id.* at 113.

61. *Id.*

their own profits and, according to Goldman and Weil, deserve to be classified as independent contractors, not employees. Goldman and Weil use the example of janitorial franchises where the franchisor controls an individual franchisee's pricing, customer contracts, service relationships, and even the ability to take on additional work.[62] Such an arrangement, Goldman and Weil say, lacks the defining characteristics of business independence and, therefore, should be classified as an employment relationship. But this means the converse is also true: franchises should be classified as independent contractor relationships when franchisees determine consumer prices and the means and methods for executing brand standards and control their own profits. Under the standard proposed by Goldman and Weil, franchisors would not be doomed categorically to employer status; there would be a way out of ABC purgatory if they can make this showing.[63]

Specifically, as to franchises, in most franchise programs, franchisees control their own profits through a combination of setting consumer prices and controlling overhead. In the vast majority of franchise programs, a franchisee's economic returns are not determined *almost exclusively* by the franchisor.[64] Admittedly, franchisors can and do influence consumer prices at franchisee outlets by engaging in brand marketing promoting prices at "participating locations," but franchisees may elect not to participate in these programs without jeopardizing their franchise rights. Even though some franchisors may set maximum prices when legally permissible and permitted by the parties' franchise agreement, this is not price control because franchisees remain free to charge less. Further, real-world competition is always operating to temper franchisee pricing decisions so franchisor maximum-pricing strategies should matter less. Franchisors encourage and many require their franchisees to engage in local marketing (subject to franchisor approval over trademark use) and other activities designed to drive revenue including by maintaining high levels of customer service. Although mandatory buying programs and subleasing requirements in some franchise systems may impact a franchisee's overhead, franchisees control their employee costs

62. *Id.* at 108.

63. At the moment, franchises seem stuck in ABC purgatory in California. The IFA has tried unsuccessfully to convince the union-beholden California legislature to adopt a categorical exemption from Labor Code Section 2775 for relationships that fit the franchise definition. As noted, the *Goro* decision summarily dismissed the supplier's federal franchise preemption argument, and the IFA's constitutional challenge to Labor Code Section 2775 was recently tossed. Goro v. Flowers Foods, Inc., 2021 WL 4295294, at *5 (S.D. Cal. Sept. 21, 2021). In early 2022, the California legislature took up a previously narrowly defeated union-backed proposal to create an appointed—not elected—body called the Fast Food Sector Council that would have authority to determine workplace policies across all fast-food restaurants in California and create statutory joint liability between franchisors and their California-based franchisees. Mary Vinnedge, *IFA Remains Concerned About California's FAST Act*, FranchiseWire (Jan. 20, 2022), https://www.franchisewire.com/ifa-remains-concerned-about-californias-fast-act. California continues to slam the door in the face of franchisors desperately seeking to protect their independent contractor business model. *Id.*

64. Goldman & Weil, *supra* note 51, at 112 (using the phrase "almost exclusively" to identify the defining quality of an employee).

and most if not all of the revenue drivers of their business. In sum, under the Goldman and Weil test of who qualifies for independent contractor or employee status, franchisees merit treatment as independent contractors.[65]

To ensure its predictability, an amendment to California Labor Code Section 2775 would need to identify at least two (though maybe only two)

65. At the time of this article's submission for publication, the Goldman and Weil article has been cited only once. *See* Andrew Elmore, *Regulating Mobility Limitations in the Franchise Relationship as Dependency in the Joint Employment Doctrine*, 55 U.C. Davis L. Rev. 1227 (2021). Elmore discusses joint employer liability, not misclassification, the subject of the Goldman and Weil article, which immediately strains Elmore's reliance on the Goldman and Weil thesis. *See* Goldman & Weil, *supra* note 51, at 116 n.25 ("The fissured workplace also presents an issue of joint employment, but this article focuses on . . . employees . . . misclassified as independent contractors. We recognize that these issues are intertwined but do not address matters of joint employment in this Article." [error in original text]). Elmore claims that relaxed enforcement of antitrust laws since the 1970s vis-à-vis vertical restraints (which Elmore uses as a proxy for franchise relationships) explains "the current judicial trend of presuming that franchisors do not jointly employ franchisee employees," a trend that he condemns. Elmore, *supra*, at 1241. Elmore argues for a blanket presumption that all franchisors are joint employers of their franchisees' employees based on a franchisee's operational dependence on the franchisor. *Id*. at 1268 ("The dependency of franchisees on franchisors for continued operation can also justify a presumption of joint employment . . . ."). Elmore contends that the same ABC test that presumes that franchisees are misclassified employees supports a presumption of the franchisor's joint employer status: franchising, he argues, categorically robs franchisees of their independence and renders them "dependent subordinate firms," which prevents franchisees from qualifying as an "independent trade or business," a fact necessary to satisfy Prong C of the ABC test and qualify for independent contractor status. *Id.* at 1268–70. By creating operational dependency and subjugating franchisees to subordinate status, franchisors "shape subordinate firm workplaces," which, Elmore says, justifies a presumption that all franchisors are joint employers of their franchisees' employees. *Id.* at 1268–70.

Elmore's joint employer argument is fundamentally flawed. The biggest problem with it is that Elmore completely ignores the importance of the trademark license to the franchise relationship. The trademark license has long been regarded as the cornerstone, the bedrock, of every franchise relationship. *See* Susser v. Carvel Corp., 206 F. Supp. 636, 640 (D.C.N.Y. 1962). Elmore sharply criticizes *Patterson v. Domino's Pizza, LLC*, 333 P.3d 723, 743 (Cal. 2014), in which the California Supreme Court refused to find that the trademark license at issue imposed sufficient control over the franchisee to hold the franchisor liable, as an employer would be liable, for wrongdoing committed by a franchisee's employee. *Patterson* viewed franchisees as "entrepreneurs" and regarded a franchisor's "systemwide standards and controls" as "a means of protecting the trademarked brand at great distances." *Id.* at 734. *Patterson* heralded the trademark license, saying it "benefits both parties," explaining that franchisors use the trademark license "to build and keep customer trust by ensuring consistency and uniformity in the quality of goods and services . . . ." *Id.* at 725, 733. Not only does Elmore cold-shoulder the importance of the trademark license, he ignores the role of federal trademark law in the franchise relationship, something that *Patterson* says "obligates a licensor of trademarks, such as a franchisor, to protect the integrity of its registered and unregistered marks by monitoring their use, as well as the quality of the goods and services bearing such marks." *Id.* at 734 (quoting Dean T. Fournaris, *The Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems*, 27 Franchise L.J. 224, 224 (2008)). Elmore narrows *Patterson* to the slightest of margins, confining *Patterson*'s "reasoning to employment discrimination laws that adopt vicarious liability standards." Elmore, *supra*, at 1256. Indeed, Elmore sweepingly condemns all laws that rely on the trademark license to shield franchisors from liability as joint employers. *Id.* at 1245–46. Elmore also pays no attention to what Goldman and Weil identify as the *sine qua non* of independent contractor status: the ability to set prices, quality, and service levels and ultimately profits. Goldman & Weil, *supra* note 51, at 111. Indeed, Elmore declines to frame the joint employer inquiry in economic terms as Goldman and Weil do with misclassification. *Id.* As a result, the Goldman and Weil thesis offers Elmore's flawed joint employer presumption absolutely no support.

co-existing factors for a hiring firm to earn the presumption of independent contractor status: the contractor must be able to (1) set prices (either the prices paid by consumers or by the hiring firm to the contractor); and (2) execute customer service standards on its own.[66] The amendment also should clarify that the presumption is not negated if the hiring firm (i) recommends consumer prices; (ii) engages in brand marketing featuring suggested consumer prices; (iii) sets maximum consumer prices; or (iv) articulates customer service standards without prescribing the means or methods for accomplishing them. When the contractor retains control over these two factors, the proposed amendment would presume that the contractor has economic independence and shift the burden to the plaintiff to rebut the foundational facts.[67]

This proposed amendment would not categorically exempt all franchises, nor would competitors necessarily fare the same way. The goal is to respect the essential characteristics for when a contractor is really in business for itself and overcome the roadblocks presented by California's ABC law.

66. The devil of any legislative proposal is in articulating its details so that a statute's application is predictable. The amendment proposed in this article may need additional refinement, but at least it shines a light on a path forward for the profiled business models that, up to now, have found a dead end in California. Which half of the traditional binary divide should receive the statutory presumption—employee vs. independent contractor—is a matter of public policy preference. *See* 21B Charles A. Wright & Arthur R. Miller, Federal Practice and Procedure § 5122 (2d ed. 2021). The party with the burden of proof carries the load. *Id.* § 5222.2.

67. Many states define "independent contractor," but the author of this article has not found any with a law of general application that focuses on the indices of business independence. Some state laws assign independent contractor status to workers in a specific industry (construction subcontractors (e.g., California), drivers (e.g., Louisiana), and licensed workers (e.g., Oregon)). Cal. Lab. Code § 2750.5; La. Rev. Stat. § 23:1021; Or. Rev. Stat. § 670.660(2). Many states have "marketplace contractor" statutes applicable to on-demand workers. *See* Robert Sprague, *Using the ABC Test to Classify Workers: End of the Platform-Based Business Model or Status Quo Ante?*, 11 Wm. & Mary Bus. L. Rev. 733, 746–48 (2020); Robert Sprague, *Are Airbnb Hosts Employees Misclassified as Independent Contractors?*, 59 U. Louisville L. Rev. 63, 69 (2020) (identifying states with "marketplace contractor" laws). At least one state, Indiana, uses the elaborate IRS twenty-factor test of independent contractor status. Ind. Code § 22-3-6-1(b)(7). Florida defines "independent contractor" for purposes of workers' compensation, but not generally. Fla. Stat. § 440.02(15)(d)(1)(a). Some states use a circular definition of independent contractor (e.g., Alabama, where an independent contractor is someone self-employed that does not meet the definition of employee). Ala. Code § 25-7-41(a)(2). Prior commentators have offered their own solution for fixing the over-inclusive, hodgepodge legislative approach for defining independent contractor, but their solution fixes the problem for the gig industry, not more generally. Travis Clark, *The Gig Is Up: An Analysis of the Gig-Economy and an Outdated Worker Classification System in Need of Reform*, 19 Seattle J. Soc. Just. 769, 805 (2021); Harris & Krueger, *supra* note 47, at 27.

There is another view. The California legislature should take heed of the criticism leveled at California's ABC test by two of labor's biggest supporters and add a presumption of independent contractor status, not merely an exemption, for business-to-business arrangements regardless of the industry they operate in when the contractor possesses the indices of business independence that Goldman and Weil highlight: the ability to control prices and execute customer service standards and thereby to control profitability. After all, what is the use of the current business-to-business exemption from California's ABC test if, in reality, it protects no one? *See supra* note 6. If the California legislature refuses to add a presumption of independent contractor status, the proposed amendment in this article would work as another exemption to California Labor Code Section 2775.

This proposal, moreover, may prod some business-to-business programs, including franchises, to recalibrate their business models to earn independent contractor status. In the franchise context, such prodding may curb some current franchisor practices that critics argue cannot fairly be defended in the name of protecting the franchise brand.[68] Franchisors have long justified their extensive controls over franchisee operations by claiming that they must insist on absolute uniformity of operations across businesses with different owners to protect brand goodwill.[69] This article's proposal for saving the independent contractor model may force some trademark owners to reexamine their contracts, scale back those controls not essential to brand integrity, and give franchisees, distributors, and licensees control over the economic drivers of the brand relationship as a tradeoff for retaining contractor status.[70]

A legislative solution that corrects for the ABC test's over-inclusiveness without attempting categorically to exempt franchisors, the trucking industry, bakery producers, and others like them (something the California legislature refuses to do) may be the most realistic path forward for these groups to save their business models.

VIII. Conclusion

Governments should not keep their thumb on the scale by continuing to pass laws that enshrine traditional models of employment and ignore the

68. *See* Erin Conway & Caroline Fichter, *Surviving the Tempest: Franchisees in the Brave New World of Joint Employers and $15 Now*, 35 Franchise L. J. 509, 519–20 (2016). In the context of advising franchisors how to reduce their joint employer liability risks, authors Conway and Fichter point out that the federal Lanham Act does not require a franchisor to control a mark absolutely by leaving a licensee no discretion over their day-to-day operations; it only requires a trademark owner to have "'adequate control' over the quality of goods or services offered under the mark." *Id.* at 519. These authors conclude that franchisors must strike "the right balance" if they want "to expand rapidly and build a strong brand presence across the nation (or even the world)" yet avoid liability for their franchisees' operations as a joint employer, offering that "[t]his balance will necessarily look different in different types of franchise systems." *Id.* at 519–20.

69. *See, e.g.*, David J. Kaufmann, Felicia N. Soler, Breton H. Permesly & Dale A. Cohen, *A Franchisor Is Not the Employer of Its Franchisees or Their Employees*, 34 Franchise L.J. 439, 455 (2015) ("[T]he Lanham Act not only fosters the notion of brand uniformity but requires trademark and/or service mark licensors—and every franchisor is a trademark and/or service mark licensor—to impose standards and controls upon their licensees (and every franchisee is a trademark and/or service mark licensee) to ensure that the mark in question serves its intended purpose: uniformity of goods or services of a certain type and quality, uniformity of appearance, and uniformity of operations. Critically . . . if a franchisor (as licensor) does not impose upon franchisees such standards, that franchisor's trademark (applicable to goods) or service mark (applicable to services) may be deemed abandoned as a matter of law, as it could be viewed as standing for nothing.").

70. Conway & Fichter, *supra* note 68, at 520 ("Striking this perfect balance may seem an unfair task to assign to franchisors. However, given the advantages provided to franchisors by the very nature of franchising . . . perhaps it is a natural cost of doing business in this manner.").

needs of a modern economy.[71] Based on California's experience with Proposition 22, a restless populace is looking for governments to offer a more balanced way to categorize contemporary business arrangements that allow contractors control over their own profitability. An appropriately framed classification test that recognizes the economic realities of what it means to be an independent business would supply well-respected business models a safe haven for continuing to offer opportunities to those who want to be their own boss. In the meantime, however, franchisors, the trucking industry, bakery producers, and others like them utilizing independent contractors have little choice but to do whatever they can to avoid flunking the ABCs.

71. On March 1, 2022, the UC Berkeley Labor Center released a report regarding the role of independent contracting in California's economy. *See* Annette Bernhardt et al., *Independent Contracting in California: An Analysis of Trends and Characteristics Using Tax Data*, UC Berkeley Lab. Ctr. (Mar. 1, 2022), https://laborcenter.berkeley.edu/independent-contracting-in-california. Studying tax data from 2014 to 2016 (more recent tax data was not available), researchers found that, in 2016, only nine percent of California workers earned a living solely through independent contracting, another nine percent combined a traditional W-2 job with independent contracting, and eighty-two percent earned a living through one or more W-2 jobs. *Id.* Among the more interesting findings: (1) "gig" workers represented less than two percent of all independent contracting in 2016 despite all of the attention they receive from politicians; (2) workers who relied exclusively on independent contracting for their income tended to be older, married, and lived in lower-income households and had low earnings on average compared to W-2 workers; and (3) only nineteen percent of hiring firms issued their contractors 1099 forms, which limited researchers' analysis. *Id.* Researchers avoided revealing their own bias on whether AB 5 benefits or hurts California's economy. Instead, they pressed for expanded rigorous research and urged policymakers to use scientific data, not partisan politics, to fashion laws like AB 5, noting "a chronic lack of clarity about independent contracting, affecting policymakers as well as tax authorities." *Id.*

One certainty about the politically charged topic of the future of independent contracting is that new developments will continue. After this author must put her pen down, new cases will be filed, new legislation will be introduced, and new opinions will be expressed that might shape this author's views. There will be another chapter in the saga of the risks to businesses of flunking the ABCs.