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Car Crash: California's Imbroglio With Uber and Lyft Will Have Lasting Effects on Gig Economy

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Texas Lawyer

California's AB-5 showdown is on "pause" for now as a California appeals court extended the length of time Uber and Lyft will have to comply with an order requiring both ride-hailing companies to reclassify their drivers as employees.

State officials claim in their lawsuit that Uber and Lyft are violating a new state labor law, AB-5, by neglecting to pay expenses such as payroll taxes and unemployment insurance for their workers. Executives from both ride-hailing companies responded to the charges last week saying they would have to suspend service in the state in order to comply with the preliminary injunction. Meanwhile, both companies have said they will continue operating in the state as a result of the extended stay.

Texas Lawyer spoke recently to William Finegan, a shareholder and leader of the labor and employment practice group at the law firm of Munsch Hardt, about the monumental impact the case will have for the gig economy, workers, as well as California and Texas.

How did California and Texas take such divergent paths in determining workforce classifications for ride-hailing employees?

William Finegan: A decade ago, states had suffered declines in tax revenues. A method to address the issue was for state taxing and employment agencies to focus on the employee/contractor status issue by challenging whether workers were employees rather than contractors. This is particularly true in states with a state income tax. The revenue stream on such taxes is much more consistent and assured if an employer is making deductions from employee pay, rather than relying on a contractor to self-pay the taxes. It is not a significant issue in states like Texas, where there is no income tax. Hence, the basic issue of worker status is not as pressing in states without an income tax.

Beyond the state revenue issue (the most significant driver), there is also a concern that contractors, unlike employees, are not eligible for a range of benefits such as workers' compensation coverage, health care, retirement, vacation, sick leave, EEO protections, etc.

California led the charge on the worker classification challenge. First, the California state courts introduced the stringent so-called ABC test (setting forth the standard to determine worker status), making it very difficult to prove contractor status; a burden then placed on the company rather than the plaintiff or state. Next, the California Legislature passed AB-5, codifying the standard into law. This bill was signed into law by Gov. Gavin Newsom in September 2019 to be effective on Jan. 1, 2020. Since its signing, troubling responses have begun to appear, from companies cutting contractors or leaving the state, to rumors that venture capital firms are suspect of future investments due to the law's impact. It's true and the ultimate impact is still in the making.

Other states that have adopted the ABC test include Vermont, Massachusetts and New Jersey.

What's going to happen?

States and cities with more progressive political views tend to support a broader net in defining what it means to be an employee. The ultimate breadth and depth of the impact of the new standard is currently unknown.

If Uber and Lyft pull out of California, what will be the impact to the California economy?

Uber and Lyft are only the headlines on this issue. There are a host of companies that provide gig platforms which link workers with ultimate customers. The companies do not have any traditional interaction with the workers, other than via the application offered which links the worker (i.e., the service provider; drivers taking people places) to the service user (i.e., rider). If the worker is considered an employee, then all of the aforementioned accoutrements of employment (benefits) will be a cost that must be passed along to the worker (lower pay) or to the service user (higher fares).

How will that impact Texas?

Companies offering application-based services will not be as likely to start their businesses in states which treat all workers as employees.

What's at stake for employers and gig employees?

Higher costs for employers and less jobs for employees.

What else can you say about the situation in California?

Companies are moving to Texas from California. Likewise, mobile employees are relocating to Texas and other states from California. Many companies make the intentional decision not to do business in California, primarily because of its employment laws and the likelihood of employment litigation. The draw of 40 million people in a beautiful part of the country is a big enticement. The pain of high taxes, incredible regulations, litigation and the state's general treatment of employer's is a deterrent. Time may not be kind to California.

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Primary Contacts



William Finegan

Dallas
214.855.7501
bfinegan@munsch.com

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