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The ABC Test: Corporate America Gets What it Needs, Not What it Wants

Michael P. Maslanka*

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I. INTRODUCTION

The handwringing and pearl clutching by Corporate America accompanying the advent of the ABC test¹ is overly dramatic, factually unfounded, and—candidly—misplaced. The clamor comes from all business sectors, especially those companies seeking to capitalize on the emerging “gig economy.”²

This Article argues that the ABC test is a boon to all companies, not a drawback. Why is this so? Because the test—in contrast to the current buffet of options—provides certainty for employers in determining whether a worker is an independent contractor. In advocating this position, the Article discusses the business and legal environments in which companies operate in actuality, not theory; explores the imagined benefits but actual detriments to Corporate America in a business environment with and without the ABC test; explains further why the ABC test is, in fact, and in operation, a benefit to corporations; and concludes with suggestions for further development and refinement of the ABC test in order to enhance the certainty that it already provides.

II. THE BUSINESS NEED FOR LEGAL CERTAINTY

From a 30,000-foot perspective, all companies prosper from certainty and suffer from uncertainty. A purely legal analysis is, therefore, a disservice to any proper analysis. Let’s start then with the business need for certainty.

At its most evident, a legitimate business succeeds amidst a stable economic environment, a structured political order, and a cohesive culture tied together by shared values. Substantial business scholarship is devoted to how businesses can thrive in uncertain times. The prescription, especially in a fluctuating regulatory/legal environment, is straightforward: Be adaptable. “No one action, by itself, can dispel a heavy cloud of uncertainty But if [business] organizations can get out of their defensive crouch and assume a more aggressive stance, they have a better chance of maintaining their balance and shaping their future.”³

1. The test is discussed in detailed *infra*, but its essence is that a worker is presumed to be an employee unless the employer proves three elements (in some jurisdictions two); it is a throwback—pre-gig-economy—to the days when an independent contractor actually meant that the worker owned and operated their own business. *Dynamex Operations W. v. Superior Court*, 4 Cal. 5th 903, 955 (2018).

2. My words are written from the perspective of a lawyer who, while currently a law professor, represented companies for thirty-four years. Heresy? Not really for those who fully understand how companies operate in fact and prosper in reality.

3. Will Jackson-Moore et al., *How to Succeed in Uncertain Times*, STRATEGY+BUSINESS, Summer 2020, at 52, 64–65.

But such certainty is not always a given. A business must take the obstacle of uncertainty and leverage it into the value of certainty. By way of example, car makers must evolve their operations ahead of changing standards for emissions, pollution levels, and safety. “Those that have been most forward-thinking in doing so will find that they are most resilient to the changing environment.”⁴

As with business, so too with the law. A company that is held hostage to conventional legal thinking, that is beholden to the status quo, and that is an uncritical defender of what appears beneficial, does a disservice to its bottom line and, therefore, ultimately to its owners and shareholders.

A. The Legal Need for Certainty

Certainty is imperative for a successful business to operate in a stable environment. Justice Antonin Scalia sums up well the need for legal certainty: “[A]nother obvious advantage of establishing as soon as possible [clear and definite rules]: predictability. Even in simpler times, uncertainty has been regarded as incompatible with the Rule of Law. Rudimentary justice requires that those subject to the law must have a means of knowing what it prescribes.”⁵

This sentiment finds voice from the late Max Weber at the intersection of the law and capitalism in *Economy and Society*: “Capitalistic Enterprise . . . cannot do without legal security.”⁶ The manifestations of this viewpoint were equally well summarized, albeit ultimately criticized, by Professor Ofer Raban:

If an entrepreneur is to build a factory on a piece of land, she needs to be secure in her ownership of the land; she needs to know that the contracts she signs with the contractors are enforceable; she needs to know what taxes she will be asked to pay; in short, she needs to know where she stands vis-à-vis her expected costs and expected income.⁷

Here is a simple re-formulation: The greater the number of legal variables, the less likely a company will seek growth opportunities, embark upon plans for expansion, or take calculated risks. Therefore, an uncertain legal environment breeds litigation distraction, paralyzes corporate management from their normal bias towards positive action, and inhibits an entrepreneurial mindset.

4. *Id.* at 63.

5. Antonin Scalia, *The Rule of Law as a Law of Rules*, 56 U. CHI. L. REV. 1175, 1179 (1989).

6. MAX WEBER, *ECONOMY AND SOCIETY* 883 (Guenther Roth & Claus Wittich eds., Univ. of Cal. Press 1973).

7. Ofer Raban, *The Fallacy of Legal Certainty: Why Vague Legal Standards May Be Better for Capitalism and Liberalism*, 19 B.U. PUB. INT. L.J. 19, 175 (2009).

III. TRADITIONAL MODES OF INDEPENDENT CONTRACTOR ANALYSIS: THE PURPORTED BENEFITS V. THE REAL COSTS

The wisdom of the ABC test plays out against this backdrop of the twin—and interrelated needs—of business and legal certainty. Do the traditional modes of analysis in determining independent contractor status serve these vital needs? In a word: No. The traditional forms of analysis are unwieldy, covering several variants, including the right to control test *and* the economic realities test *and* the IRS test *and* various state statutes *and* amalgamations of some or all of these tests.⁸

Nonetheless, Corporate America clings to these sundry and often conflicting models. To understand its misguided loyalty and its hostility to the ABC test, we must first understand that Corporate America pledges its fealty to the former because of its belief that numerous business benefits are conferred by their use of independent contractors.

The flaw in its analysis is two-fold: it rests upon the ephemeral nature of the “benefits” it believes are derived from a finding of independent contractor status and outright ignores the detriments flowing from the misclassification of workers who are, in reality, employees.

A. Imagined “Benefits”

1. Flexibility

An employer can use an independent contractor to plug in a worker when needed and pull the independent contractor out when the need evaporates. The rise of staffing companies attests to this advantage.

2. No Payable Monetary Benefits

True enough, the Fair Labor Standards Act is inapplicable to an independent contractor. Thus, an employer is not required to pay minimum wage or overtime. Moreover, employee benefit plans, including group health insurance and 401(k) plans, only cover employees, not independent contractors, and need not be accounted for under the Affordable Care Act.

3. No Employment-related Claims

An independent contractor lacks the requisite status to assert a claim for a breach of the implied covenant of good faith and dealing or statutory claims for unlawful discrimination.

8. This bewildering forest of tests are summarized in an excellent chart form in Kerri Keohane & David Schap, *Employee Misclassification and Related Claims*, 27 J. LEGAL ECON. 63, 68–69 (2021).

4. No Taxes

The earnings of an independent contractor are reported to the IRS, but they are on a Form 1099, not a Form W-2. Thus, an employer is not required to withhold taxes or make Social Security and Medicare contributions.

B. Actual Detriments

The most prominent detriment—and the one generating the most significant financial exposure to a company—are class action/opt-in lawsuits alleging misclassification of workers as independent contractors.

Incorrect classification of an employee inevitably leads to litigation. The “benefits” described above are temporal, but the results from a successful misclassification lawsuit—especially a class-wide one—are permanent: imagined financial savings wiped out, lost minimum wages and overtime plus liquidated damages (an automatic doubling of these) imperiling the continued financial viability of the company, and substantial damages flowing from the failure to provide ERISA fringe benefits to misclassified workers that they would otherwise be entitled to receive.⁹

The numbers are dramatic, with one study finding that misclassification is the number one source of corporate exposure to damages:

- \$1.2 billion wage and hour settlements in 2018
- \$2.7 billion for the top 10 settlements in 2017 in wage and hour lawsuits
- 99.8% win-rate for claims brought by the Department of Labor
- 33% of midsize companies being fined and penalized¹⁰

The danger of misclassification is very real. It is a ticking time bomb of liability that will only become a more prominent danger to corporate America. The numbers do not lie. In 2000, the Department of Labor found that one in three businesses misclassified at least one worker.¹¹ State audits corroborate this federal

9. See *Vizcaino v. Microsoft Corp.*, 142 F. Supp. 2d 1299 (W.D. Wash. 2001); John Pearce & Jonathan Silva, *The Future of Independent Contractors and Their Status as Non-Employees: Moving on From a Common Law Standard*, 14 HASTINGS BUS. L.J. 1, 16 n.80 (2018).

10. Kyle Torti, *Independent Contractor Misclassification Is a High-Risk Game*, NEXTSOURCE (Dec. 17, 2019), <https://www.nextsource.com/2019/12/17/independent-contractor-misclassification-is-a-high-risk-game> (on file with the *University of the Pacific Law Review*).

11. Caroline Fredrickson, *Op-Ed: Is Your Uber Driver an Independent Contractor or an Employee? It Makes a Difference*, L.A. TIMES (June 5, 2015), <https://www.latimes.com/opinion/op-ed/la-oe-fredrickson-are-uber-drivers-independent-contractors-or-employees-20150605-story.html> (on file with the *University of the Pacific Law Review*).

finding. In 2012, there were an estimated 700,000 misclassified workers in New York State; 250,000 in Massachusetts; 370,000 in Illinois; 450,000 in Ohio; 580,000 in Pennsylvania; and 214,000 in Virginia.¹²

While some misclassifications could result from malicious exploitation, many more are likely the result of the confusion on *how, in a principled and consistent manner*, to define who is an independent contractor. Companies are left to make their best guess. Layer on top of this the inherent factual nature of the inquiry whether a worker is an independent contractor and summary judgment virtually disappears as a tool to weed out lawsuits; it is simply easier—and more appropriate—for a court to decide that there is a material issue of fact that must be resolved by a jury.

As Professors Pearce and Silva perceptively and concretely observe:

[t]he analysis [of determining independent contractor status] often involves a combination of objective and subjective judgments with no clear direction about the weight each factor should be given. Because there is no clear guidance on how judges should weigh the factors and because of the sometimes-subjective nature of the analysis, the answer to a question of worker classification depends heavily on the individual interpretations by the people conducting the analysis. This makes it difficult for employees and employees to determine how they should define their relationship
. . . .¹³

Bottom line: any monetary savings are more than wiped out through a settlement or a loss in class-action litigation. The savings are akin to a visit to a Las Vegas casino. While one may bingo out, there is a greater likelihood one will not or will leave poorer than when walking in. Uncertainty prevails.

There is also a secondary detriment to Corporate America. Companies that properly classify workers are at a competitive disadvantage over those who do not. One perceptive piece of scholarship cuts to the heart of the matter:

The power of the Internal Revenue Service’s 1099 form for any individual worker is vast: when an employer uses a 1099 form to file a payment, it categorizes the worker as an “independent contractor” rather than as an “employee” [entitled to a variety of protections] . . . the stakes are clear and high . . . businesses that play by the rules compete with businesses taking unfair advantages to their bottom lines by skirting taxes . . . State and

12. AFL-CIO DEP’T FOR PROF’L EMP’S., *THE MISCLASSIFICATION OF EMPLOYEES AS INDEPENDENT CONTRACTORS* (June 2016).

13. John Pearce & Jonathan Silva, *The Future of Independent Contractors and Their Status as Non-Employees: Moving on from a Common Law Standard*, 14 HASTINGS BUS. L.J. 1, 17–18 (2018).

local governments and their constituents are divested of millions of dollars in lost payments to unemployment insurance funds, payroll taxes, and workers' compensation funds.¹⁴

Moreover, these very same tax dollars build the business infrastructure of public transportation and communal communications. Fixing a public pothole on the highway leading to a store can be just as important as any other business-related need.

IV. THE ABC TEST SATISFIES THE BUSINESS AND LEGAL NEEDS FOR CERTAINTY

In contrast to the uncertainty inherent in the existing tests, as well as the inconsistent competing results from different tests (the IRS test could find a worker is an employee while the control test could find the same worker an independent contractor), the ABC test provides a unified model of clarity; in other words, a worker is an independent contractor only if all three of the following conditions are satisfied:

(A) The worker has been and will continue to be free from control or direction over the performance of the services for which the worker was retained under both any written agreement and in actuality;

(B) The service provided by the worker is outside the reason for the existence of the company retaining the service; and

(C) The worker makes a living performing this service; that is, the worker customarily engages in independently providing this service to others.

A common-sense translation is very much a “back to the future” scenario; that is, an independent contractor is actually a person who owns and operates their own business—building a shed when a company needs one, or repairing an HVAC system when a company does not have that type of internal resource, or running a consultancy business or, acting as an accounts payable outsourcing resource, or acting as a broker in the exchange of buying and selling goods.

By way of example as to this last category, Etsy, Inc. is an online marketplace for individuals to buy and sell goods. Etsy reports that it has 7.5 million active sellers as of September 30, 2021, up 2.6 million from the same time period in 2019.¹⁵ The common thread is, however, that these are stand-alone businesses,

14. 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, 54–55 (2015).

15. Josh Mitchell & Kathryn Dill, *Workers Quit Jobs in Drove to Become Their Own Bosses—Seeking Flexibility, Employees Are Discovering Their Inner Entrepreneur*, WALL STREET J., (Nov. 30, 2021),

much like independent contractor status was imagined in the 1970s and 1980s. The application of the ABC test assures the return to this model. The test presumes regular employment, with the employer being required—to bestow safely the independent contractor designation upon the person—to prove that all three criteria are satisfied. The consequence of applying the test is startling: certainty is injected into corporate decision making, misclassification risk is squeezed out, and a business can operate within established and universally understood parameters. No more guessing. And, as the *Wall Street Journal* reports, these are exactly the types of businesses that workers, who are, as a result of the pandemic, leaving employment and establishing their own entities, are setting up.¹⁶ In short, Corporate America can act with certainty in its worker designations, freeing itself to concentrate on what it ideally does best—make money by making good products and providing useful services, and not by misclassification gymnastics.

Refinement of the ABC test to provide greater certainty in murky circumstances is possible. What about situations in which a business becomes wholly dependent upon one customer? We see this situation in *Thibault v. Bellsouth Telecommunications, Inc.*, in which a business that erected and repaired cell towers had a large telecommunications company as its sole customer for three months after Hurricane Katrina.¹⁷ In short, the cell phone repair company owner thought he became an employee of Bellsouth Telecommunications, Inc., and sought overtime as an employee.¹⁸ The appeals court affirmed a judgment for the defendant after lengthy litigation.¹⁹ This could have been avoided by adopting the Canadian concept of a “dependent contractor.” The court, in this case, could have deemed the business such a contractor because it made most, if not all, its revenue from one client as a dependent contractor; in which, the business owner is more akin to an employee than to a stand-alone business and therefore should enjoy the benefits of being an employee.²⁰

V. CONCLUSION: CERTAINTY IS THE FUTURE AND THE FUTURE IS CERTAIN

Nothing is as powerful as an idea whose time has come. “Thirty-eight states have adopted some form of the ABC test.”²¹ The ABC test’s clarity recommends itself to Corporate America, and its tax-generating power endears it to state legislatures. Corporate America, including the proponents of a gig business, should

<https://www.wsj.com/articles/workers-quit-jobs-in-droves-to-become-their-own-bosses-11638199199> (on file with the *University of the Pacific Law Review*).

16. See *id.*; Deknatel & Hoff-Downing, *supra* note 14, at 70.

17. 612 F.3d 843, 849 (5th Cir. 2010).

18. *Id.* at 844.

19. *Id.* at 851.

20. See Pearce & Silva, *supra* note 13, at 30–34.

21. *Id.* at 27.

welcome its arrival, not fight its inevitability. As with most things in the law and in life that are fought tooth and nail, adoption won't really hurt a business that follows the old school of making money. The ABC test will prove to be a benefit, even if an unexpected one.

* * *