



Insight

Assessing The Consequences of Worker Reclassification in California

ISABEL SOTO | AUGUST 26, 2020

Executive Summary

- The California Superior Court has ruled that Uber and Lyft are not exempt from the worker classification requirements of Assembly Bill 5 (AB5), leading to the two companies considering halting all operations in the state, which would affect up to 1 million drivers.
- Platform-based gig work has seen rising wages and the potential for future access to benefits, but AB5 and the COVID-19 pandemic have halted many of the private sector changes and the increase in earnings.
- Due to the limits it places on worker freedom and the rising costs on employers, AB5 has several opponents and could be amended to exempt platform-based workers through a November vote on Proposition 22.

Introduction

On August 10, the California Superior Court issued an injunction requiring Uber and Lyft to classify their drivers as full employees. This latest measure and the added costs involved could mean a temporary shutdown of these two companies in that state. The additional regulatory burden on Uber and Lyft, coupled with the drop in revenues as a result of the pandemic, will reduce opportunities for individuals to supplement or replace lost wages by eliminating the jobs these companies create.

The injunction comes despite efforts by Uber and Lyft to exempt themselves from the demands of Assembly Bill 5 (AB5), which went into effect January 1, 2020. AB5 codified the “ABC” test, which is used to determine whether a worker is a full employee or independent contractor. Previous [American Action Forum research](#) has shown that this measure could likely lead to massive reclassification, which is costly to employers, hurts small businesses, and significantly limits worker freedom. The COVID-19 pandemic further exacerbates these problems as Uber and Lyft have seen plummeting revenues and rising costs.

On August 20, Lyft announced it would suspend rideshare operations in California. Uber had planned to take a similar course of action. In response, an appeals court is now allowing the companies to [continue operating](#) as independent contractors as they work toward compliance with new classification or continue to fight the order. But in the immediate term there will likely be continued revenue loss for Uber, Lyft, and their drivers, because of both the pandemic and regulatory uncertainty. Other states making similar changes, as New York is considering, could lead to a significant restructuring of platform-based “gig work” if not a complete shuttering of these businesses.

California and AB5

In August 2019, AB5 began making its way through the California legislature. With a chance of being signed into law, platform-based gig companies prepared to mount a defense of their business model. In late August, Uber, Lyft, DoorDash, and others pledged \$90 million toward a ballot initiative to push back against massive worker reclassification.

On September 18, 2019, California Governor Gavin Newsom signed the controversial bill, which would significantly narrow the definition of independent contractor and lead to a large number of independent workers becoming full employees. AB5 took effect January 2020.

Then came the layoffs and the frantic exemptions. Alternative workers of all stripes began seeing the consequences of the new rule. Fortunately, some industries were spared because they were able to mount a costly but effective campaign against reclassification. Realtors and truckers are two such occupations that were granted exemptions, but others have seen and continue to see layoffs and rising costs. Among those affected are local news media, translators, and cleaning staff. In [February 2020](#), after enactment, Assemblyman Kevin Kiley proposed a suspension of AB5 in order to provide clarity and make room for corrective legislation. That motion was rejected.

To date over \$110 million has been spent by platform-based companies fighting AB5 by promoting Proposition 22. This ballot proposition would exempt app-based companies from complying with AB5. That ruling and efforts to repeal AB5 are [supported by](#) many California legislators, as well as a number of independent worker organizations, the California Hispanic Chamber of Commerce, and civil rights group the National Action Network.

Workers Affected

The exact scope of individuals who work as part of the gig economy is unclear. The latest Bureau of Labor Statistics data place it at 10.1 percent of the labor force, while a study done by the [Federal Reserve](#) estimates that just over 30 percent of individuals earn some money in the gig economy. It is important to note that only a small fraction of those involved in the gig economy rely on it as a primary source of income. When asked, only [9 percent](#) of adults in the gig economy responded that they perform gig activities as a primary source of income. Lyft and Uber make up a large portion of the ride hailing and general ground transportation market. Out of the three segments of reimbursed ground transportation—rentals, taxis, and ride hailing—Uber and Lyft made up [72.5 percent](#) of the market in 2018. It's [estimated](#) that between 400,000 and [1 million](#) Californians work for Uber and Lyft platforms; there are an additional 1.5 million freelancers working in the state who could likely be affected by AB5.

The recent change in California could affect the hundreds of thousands of drivers in California who use the flexible nature of these gigs to supplement their regular income. A majority of all independent contractors (9 out of 10) [prefer](#) their alternative arrangement over a traditional job. The alternative work model allows workers to set their own schedules and take ownership of their work and time in a way that does not happen in traditional employment situations.

If not amended or repealed, AB5 will continue to lead to a reduction in the number of jobs that offer flexible alternatives. Along with many of those jobs disappearing, employer costs will increase, likely accelerating layoffs.

The Reality of Reclassification

The justification for such a drastic measure is that alternative/independent workers are often deprived of the benefits that full employees are granted by virtue of their status. The logic follows that the best way to help workers would be to make more of them full employees. Unfortunately, that is simply not the case. While many workers would benefit from access to benefits, becoming employees would also mean sacrificing the freedom and flexibility to set their own schedule. The flaws with having benefits tied to employment is outside the scope of this paper but is certainly worth exploring as gig work becomes [more popular](#).

In addition to benefits, there are claims that gig workers are locked into low-wage jobs when many gig workers have actually seen wages rise. Prior to the pandemic, for example, the state of driver earnings was improving. According to the [2020 RIDES Driver Earnings Survey](#), prior to the pandemic, Uber drivers on average saw their wages grow nearly 32 percent in the last year and a half. Additionally, it's been reported that Uber and other platform-based companies were offering more incentives and bonuses to workers. The combined increase in pay, in addition to incentives, bonuses, and tips, meant that average hourly earnings in early 2020 were around \$19 an hour, up from 2018's average of \$15 an hour. The pandemic, however, led to a huge drop in demand, eliminating much of the growth that has happened over the past year.

COVID-19 Challenges

On top of the challenges that alternative work has faced in California, the pandemic makes the situation even more taxing on drivers that have seen their earnings from the platforms drop as demand falls because of social distancing guidelines. In a recent [survey](#), the majority of drivers reported an 80 percent drop in earnings in the month of March alone. In some cases, drivers can transition into delivery gigs to recoup some of their drop in earnings. This kind of movement between gigs, however, would be far more difficult if workers are classified as full employees and consequently would need to follow a far more rigid schedule.

Not only does the pandemic affect driver earnings, but it by extension affects Uber and Lyft. While those in favor of massive reclassification would paint these companies as extremely successful multimillion-dollar operations, the reality is that these companies aren't profitable, and the demand drop isn't helping.

Looking Forward

Given how wide reaching and harmful AB5 could be, there are understandably several workers, interest groups, and employers who are opposed to the legislation. There is a chance that AB5 is either repealed or modified in a way that offers exemptions to platform-based companies such as Uber and Lyft. California Assemblyman Kevin Kiley has been a vocal opponent of AB5 since its introduction and has been the leading voice in repealing AB5. On August 24 a vote occurred on Kiley's [floor amendment](#) which would have repealed AB5. The California legislature rejected the amendment. Even with the failure to repeal, Uber and Lyft could still be exempt from the requirements of AB5 come November. Proposition 22 would allow Californians to vote on the alternative work versus traditional employment question and alternative work and traditional employment exempting platform-based workers from the reclassification that AB5 requires. Proposition 22, should it pass, is expected to exempt over 1 million app-based workers from AB5, but it would do more than just roll back the reclassification. Under [Proposition 22](#), platform-based gig workers would see a pay raise. The proposition would guarantee they receive 120 percent of minimum wage, sliding scale health care subsidies for drivers working over 15 hours, and accident/injury insurance.

Even with the Proposition 22 ballot measure and additional pushback, Uber and Lyft have indicated that they are considering other options should they lose this legal battle. One option is transitioning to a [franchise model](#), making it more likely (but not guaranteed) that they are exempt from the requirements of AB5.

Despite the problems and conflict that AB5 has brought to California workers, New York and New Jersey are considering passing a similar measure. As in California, the policies in these states would seek to provide workers with greater protections, but they would decrease the flexibility and supplemental earning that gig workers currently enjoy.

Conclusion

California's AB5 continues to limit worker freedom and is leading to layoffs in the state. Massive reclassification coupled with the devastating effects of the COVID-19 pandemic only exacerbate rising costs for employers and limit opportunities for workers to supplement their income. Without repeal or significant amendments, AB5 could affect over 1 million app-based workers and lead to additional costs for employers, limited worker freedom, and mass layoffs. Proposition 22 could be a reasonable compromise between those seeking to increase driver pay and benefits and those wanting to retain the flexibility that alternative work provides.