Mounting Pressure on the Use of Owner-Operators

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GUEST WRITERS

Motor carriers have faced more than their fair share of challenges in recent years, including driver shortages, increasing fuel prices, and a myriad of other issues spurred by the COVID-19 pandemic. Now, one of the most significant threats to the trucking industry is the issue of employee misclassification involving owner-operators. Should an owner-operator be found to have been misclassified as an independent contractor instead of an employee, the motor carrier can be subject to a wide range of legal claims. Class action attorneys have targeted motor carriers on these types of issues given the potential for significant attorney fee awards should they prevail on misclassification claims.

Increasing scrutiny of the misclassification issue is occurring at the state and federal level and is involving both legislative and regulatory initiatives. Two of the most noteworthy efforts, California Assembly Bill 5 ("AB5"), passed in 2019, and the U.S. Department of Labor's ("DOL") recent push to redefine the term "independent contractor." Motor carriers that utilize owner-operators are wise to stay abreast of these legal developments and prepare for potential changes by evaluating the ways in which they classify and utilize owner-operators.

Key State Legislative Developments: California's Assembly Bill 5

State legislatures are increasing their focus on owner-operator relationships. Laws such as AB5, make it more difficult for companies to use owner-operators.

Under AB5, the relationship between truckers and their carriers, brokers, and even shippers will now be governed by the "ABC" test in California to determine whether the trucker is an employee or an independent contractor. The California Supreme Court first recognized the test in Dynamex Operations West, Inc. v. Superior Court (2018) 4 Cal.5th 903. The Dynamex ruling established a presumption that all workers are employees unless the employer can prove otherwise. Now, in order to be considered an independent contractor under the law, the below three prongs must be satisfied:

A. The worker is free from the control and direction of the hiring entity;

B. The worker performs work that is outside the usual course of the hiring entity's business; AND

C. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

AB5 and similar legislation can fundamentally change the way trucking companies do business across the country. Carriers may have to reclassify their formerly independent drivers to employees, or they will have to drastically change the way the two parties do business in order to avoid claims of misclassification. Independent drivers will have less flexibility in choosing their work, and companies will be required to provide benefits and certain wages to their newly-recognized employees. Many experts believe the legislation will increase labor costs, thereby creating additional costs for consumers.

It is important to recognize that AB5 does not directly ban owner-operators, but the legislation does make it much more difficult for trucking companies to utilize them without incurring sizable legal risk to use them. Other states, such as Illinois, New Jersey, Washington, and New York, have considered similar legislation, and there

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is fear that many other jurisdictions will attempt to implement these types of changes.

The Biden Administration's Efforts

Additionally, the Biden administration has identified employee misclassification as a key objective. President Joe Biden has vowed to be "the most pro-union president you've ever seen." Shortly after President Biden took office, the Department of Labor attempted to reverse a new definition of "independent contractor" that the Labor Department published in January 2021, the final days of the Trump Administration; however, courts held that the Biden administration did not allow for enough time for public comment. The DOL is again working on rewriting the definition.

Most recently, a DOL proposed rule would make it more difficult for companies to classify workers as independent contractors under the Fair Labor Standards Act ("FLSA"), a change that is expected to shake up many industries that rely on gig workers or owner-operators, including the trucking industry. The proposal would require that workers be considered employees when they are "economically dependent" on a company. This will ensure that the employees are entitled to more benefits and legal protections than if the workers were identified as independent contractors, such as minimum wage and workers' compensation benefits.

Worker dependency would be determined by the "economic realities test," which is made up of six factors: the extent to which the work performed is an integral part of the hiring entity's business; the worker's opportunity for profit or for loss; the nature and extent of the worker's investment in his or her business; whether the work performed requires special skills or education; the permanency of the relationship between both parties; and the degree of control exercised by the employer. While several of the factors could potentially present problems to employers,

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the test appears to be less restrictive than the ABC test mentioned above.

Independent Contractors in Maryland

Under general Maryland law, courts determine whether a worker is an independent contractor or employee based upon several criteria, including: (1) who has the right to control and direct the work; (2) who has the right to select and/or discharge the worker that will perform the work; (3) how wages are paid; (4) whether the work is part of the employer's regular business; and (6) the intention of the parties when entering into the relationship.

Two specific areas of law, involving workers' compensation and unemployment insurance, have their own statutes and corresponding regulations that more clearly

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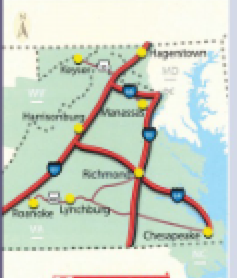

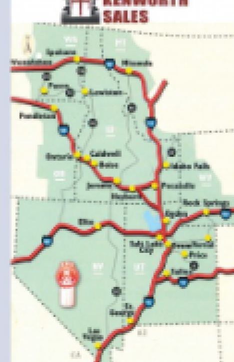

delineate the factors that the respective agencies will rely upon when determining whether an owner-operator is an employee for purposes of their respective benefits. Motor carriers are strongly encouraged to ensure that their equipment leases and/or transportation service agreements comply with those specific statutes in order to lessen their exposure to workers' compensation and unemployment benefits.

Practical Considerations

Motor carriers must keep a keen eye on these legal developments while continuing to evaluate their use of owner-operators. Below are some of the ways that some motor carriers are preparing for changes to the legal landscape:

1. Updating Owner-Operator Agreements

While the Federal Motor Carrier Safety Act ("FMCSA") imposes many requirements on motor carriers wishing to utilize owner-operators as part of their business models, the FMCSA still allows some flexibility in the use of owner-operators. As a result, motor carriers have choices in how they can draft these types of agreements. By carefully exercising their discretion in what optional provisions to include or exclude, motor carriers can help limit their exposure in misclassification claims.

2. Initiating a Brokerage Arm

A second option that some motor carriers are gravitating towards is to open a brokerage entity to govern their relationships with their owner-operators. This brokerage-type relationship will likely pass the "B" prong of the above test because brokers are technically outside of the course of the hiring entity's and independent driver's business.

There are additional costs in establishing a broker arm, but this is may be a viable option for some. Many carriers now see the broker model as an option to avoid hiring full-time employee drivers if legislative measures chip away at, or eliminate altogether, the traditional owner-operator model.

MANY OWNER-OPERATOR DRIVERS, ESPECIALLY IN CALIFORNIA, ARE ALREADY BEGINNING TO ESTABLISH THEMSELVES AS LIMITED LIABILITY COMPANIES. THE DRIVERS CAN THEN RECEIVE LOADS FROM THE TRUCKING COMPANIES' BROKERAGE DIVISIONS.

Two events must occur in order to make the brokerage model sufficient:

a. The licensed motor carrier must establish a brokerage operation.
b. Owner-operators must secure operating licenses as Licensed Motor Carriers (LMCs).

Many owner-operator drivers, especially in California, are already beginning to establish themselves as limited liability companies. The drivers can then receive loads from the trucking companies' brokerage divisions. However, it can be a lot of work and money for an independent driver to file as a business entity such as a limited liability company and may not be a feasible option for every owner-operator.

3. Two check system

Another potential solution to stricter legislation surrounding owner-operators is for carriers to pay their drivers using a two-check system. Two-check systems have been around for years, although they're not commonly used. Under this system, the driver is not classified as an independent contractor, but, rather, is an actual employee of the motor carrier; however, the driver also has an agreement to rent his or her equipment to the motor carrier. The first check is for the employee's wages and the second is for the equipment rental.

There are potential areas of concern with this system if implemented improperly. For example, some motor carriers believe that they can pay the driver minimum wage and put the rest of the money toward the truck's rental. The Internal Revenue Service may view this as shielding income, which can lead to legal ramifications. Another issue is that a two-check system does not usually provide the flexibility that

both motor carriers and owner-operators seek.

Certainly, there is no fail-safe method to eliminate legal risk altogether when utilizing any independent contractors, much less owner-operators which pose different legal challenges. Having said that, motor carriers that pay attention to these legal developments and act quickly can dramatically reduce their legal exposure and help avoid being targeted by class-action lawyers and governmental auditors.

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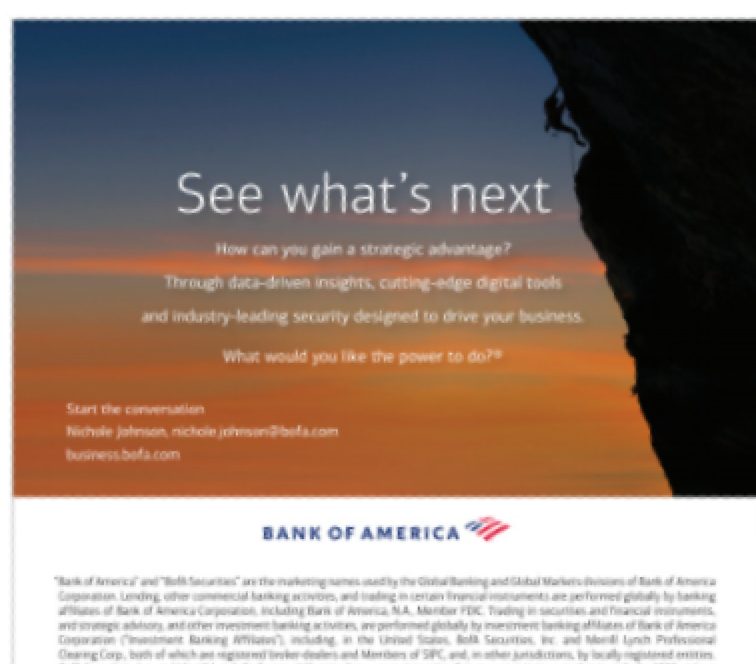

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