

Morgan Lewis

The PRO Act's Changes to 'Independent Contractor' Status: Unraveling the US Economy

Philip A. Miscimarra¹

Harry I. Johnson, III²

April 20, 2021

The Protecting the Right to Organize Act, or PRO Act (H.R. 842, S. 420), would make extensive changes in US labor laws, including the PRO Act's reformulation of "independent contractor" status. This is not a mere technical redefinition: it would substantially unravel and change large segments of the US economy and adversely affect millions of service providers who currently view themselves as independent contractors governed by their own entrepreneurial decisions. If this aspect of the PRO Act is adopted, nearly all companies – nonunion and union – would need to reconsider whether and how their work gets done, especially in relation to temporary or contingent employees, casual workers, self-employed service providers, freelance professionals, and a vast number of other small businesses and contractors.

Regarding these issues and related PRO Act provisions – and as described more fully in the remainder of this paper – the following points warrant careful consideration:

- *Extremely Narrow Definition.* The PRO Act's three-part test would eliminate "independent contractor" status for everyone who provides services deemed part of a company's "usual" business, *or* is subject to the employer's "control and direction," *or* is not associated with an independent "trade, occupation, profession, or business."
- *Nonunion and Unionized Businesses Affected.* This restrictive "independent contractor" definition – though part of the National Labor Relations Act (NLRA) – would affect employers whose employees are *nonunion* as well as employers that are unionized.
- *Uncertainty, Burdens and Litigation.* The PRO Act creates a new "misclassification" violation making it illegal for an employer to "communicate" that its employees are independent contractors if this classification is found to be incorrect. This will result in increased litigation and more expansive damages (based on the PRO Act's other amendments), including potential three-track litigation which could be initiated in different situations by nonunion or unionized employees before the National Labor Relations Board (NLRB), the Department of Labor (DOL), and the courts.
- *Unintended Adverse Consequences.* The PRO Act's treatment of "independent contractor" status, if enacted, will profoundly affect all types of employment and service providers, while substantially changing long-established business models. These changes would also disregard objections by the contractors themselves who often value their independence. Modifying these arrangements is likely to cause substantial dislocation and adversely affect many people working in a large number of occupations.

¹ Philip A. Miscimarra is a partner at Morgan, Lewis & Bockius LLP, and former Chairman of the National Labor Relations Board. He is also a Senior Fellow at the Center for Human Resources at the University of Pennsylvania's Wharton School.

² Harry I. Johnson, III is a partner at Morgan, Lewis & Bockius LLP, and a former Board Member on the National Labor Relations Board. He co-chairs the Morgan Lewis labor-management relations practice.

- I. **Background.** The PRO Act was introduced by Representative Bobby Scott (D-VA) in the US House of Representatives and Senator Patty Murray (D-WA) in the US Senate, and it makes numerous changes in the NLRA.
- A. One of the bill's provisions changes the definition of "employee" in the NLRA, which *excludes* independent contractors. However, the PRO Act would adopt a very narrow three-part definition of "independent contractor," which is also called the "ABC" test (because there are three subparts – A, B, and C).
 - B. The PRO Act's ABC test would change Section 2(3) of the NLRA to state: "An individual performing any service shall be considered an employee (except as provided in the previous sentence) and *not* an independent contractor, unless
 - (A) the individual is *free from control and direction* in connection with the performance of the service, both under the contract for the performance of service and in fact;
 - (B) the service is performed *outside the usual course of the business* of the employer; and
 - (C) the individual is customarily engaged in an *independently established trade, occupation, profession, or business* of the same nature as that involved in the service performed." (emphasis added)³
 - C. In effect, the PRO Act would *eliminate* "independent contractor" status – regardless of how the contractor and the employer define the relationship – where the work is *either* (a) part of a company's "usual" business, *or* (b) subject to the employer's "control and direction," *or* (c) not associated with an independent "trade, occupation, profession, or business."
 - D. Only Massachusetts and California have adopted the PRO Act's strict version of the ABC test to determine employee status for claims that have a private right of action, such as minimum wage and overtime laws. California adopted at least 48 industry and occupation exemptions to it, because it caused so many broad economic effects. The majority of states use either the "right to control" test or the "economic realities" test to determine if a worker is an employee for wage and hour purposes. Those tests do not presume employee status, and instead allow a more holistic view of numerous factors to determine whether workers are economically dependent on the employer or in business for themselves. Many business models and independent contractor arrangements across the economy have been structured based on these traditional standards.
 - E. Although the PRO Act's ABC test would be part of the NLRA – and the PRO Act does not directly change wage-hour contractor status under the Fair Labor Standards Act or antidiscrimination laws – this change would still affect all kinds of employers even if *all* employees are nonunion,⁴ and innumerable arrangements involving temporary or

³ H.R. 842, Section 101(b).

⁴ The NLRA applies to all employers and employees regardless of whether the employees are nonunion or union-represented. However, the NLRA does *not* apply to governmental employers, nor does it apply to railroads or airlines (whose employees are subject to a separate statute, the Railway Labor Act).

contingent employees, casual workers, self-employed service providers, freelance professionals, and a vast number of small businesses.

- II. *Large numbers of independent contractors will be deemed “employees” under the PRO Act’s ABC test.*** The PRO Act’s reformulated definition of “independent contractor” status means that every independent contractor will be found to be an “employee” unless *each* element in the three-part test is satisfied.
- A. As indicated above, this means the PRO Act *eliminates* “independent contractor” status – regardless of how the contractor and the employer define the relationship – where the service provided is *either* (a) part of a company’s “usual” business, *or* (b) subject to the employer’s “control and direction,” *or* (c) not associated with an independent “trade, occupation, profession, or business.”
 - B. At present, many work and service arrangements involve independent contractors who would be considered “employees” under the PRO Act, based on one or more of the PRO Act’s three requirements.
- III. *The PRO Act greatly expands liability for NLRA violations.*** The PRO Act would create a new type of NLRA violation, which would arise whenever an employer communicates to service providers that they are independent contractors if litigation produces a finding (under the ABC test) that the individuals should be considered employees.⁵
- A. Thus, under the PRO Act, any time an employer classifies a worker, consultant, or other service provider as an independent contractor, the employer will potentially violate federal law, because one factor associated with “independent contractor” status *requires* the employer to indicate that the individual is a contractor rather than an employee, and the PRO Act will cause many if not most independent contractors to be deemed “employees.” Challenges to “independent contractor” status could be raised by workers or service providers themselves (even if they are nonunion) or by third parties or outside organizations.
 - B. Because the PRO Act would also expand both the scope of remedies and the avenues to challenge allegedly impermissible conduct under the law, the PRO Act’s “misclassification” violation – combined with the PRO Act’s redefinition and narrowing of “independent contractor” status – will produce substantial litigation and related burdens and uncertainty:
 - 1. **Three-Track Litigation and Expanded Damages.** The bill would substantially increase litigation over claimed misclassification violations (and other alleged NLRA violations) by creating multiple different litigation tracks – which could often be pursued at the same time – including NLRB proceedings, district court lawsuits, and new “whistleblower” claims handled by the DOL. Available NLRA remedies – currently involving employee reinstatement and back wages and benefits in most cases, and potential injunctive relief – would be expanded to include front pay,

⁵ *Id.* Section 104(1) (it shall be an unfair labor practice for an employer “to communicate or misrepresent to an employee under section 2(3) [the ABC test] that such employee is excluded from the definition of employee under section 2(3).”).

consequential damages, compensatory damages, liquidated (double) damages, attorney fees, and possibly class or collective actions.

2. **Unintentional Violations.** At present, innumerable business arrangements – involving temporary and contingent workers, freelance professionals, self-employed consultants, and others – involve independent contractor status. If the PRO Act becomes law, merely continuing these existing lawful arrangements would become violations of federal law, with the risk of substantial penalties and damages, even though *no change* has occurred in the relationship, and nobody understands the arrangement has become unlawful. Even when participants believe their “independent contractor” status passes muster under the PRO Act’s ABC test, experience shows these determinations may be challenged successfully in litigation. Alternatively, employers and contractors – under the PRO Act – must extinguish and convert their existing “contractor” relationships into “employer-employee” relationships. In many cases, one or both participants will decide that an “employer-employee” relationship is objectionable, impractical or infeasible, which will cause substantial disruption and dislocation, and adversely affect many people working in a large number of occupations.
3. **Limiting Choice.** Reclassifying service providers as employees, who have traditionally operated as independent contractors restricts the ability of the service provider, the business, and/or the employer to structure and establish the terms of their service provider arrangements. This would also eliminate many arrangements that already exist – and new opportunities – for people to own and operate their own businesses or franchises or other independent work arrangements. As the California experiment with the ABC test has demonstrated, this would be despite the preference of many service providers to remain independent and avoid employee status.
4. **Increasing Risk.** The bill creates new cause of action – which would become a separate ULP under the NLRA – making it illegal for employer to “communicate” that employees are an independent contractor if this classification is found to be incorrect. This type of “misclassification” violation could result in substantially expanded legal claims under the NLRA, with multitrack litigation and expanded damages.

IV. *The PRO Act creates a private cause of action, enhanced remedies, and encourages litigation.* The NLRA’s enforcement mechanism is currently through unfair labor practice charges, which are administered by the NLRB. Violations of the NLRA are generally addressed through equitable and/or monetary remedies (i.e., reinstatement, backpay, back benefits and injunctive relief). The PRO Act materially changes this enforcement mechanism and remedial scheme in significant ways that, combined with the new ABC test standards, place “independent contractor” status under a substantial legal threat. This may place “independent contractors” essentially in endangered status as an option for many business relationships.

- A. First, the bill creates a private right of action for employees – who may be nonunion or union-represented – to pursue a separate “civil action” in federal district court, after 60 days following the filing of certain unfair labor practice charges, unless the NLRB has first initiated its own injunction proceedings in federal court. Thus, in many cases,

alleged violations will result in proceedings before the NLRB *and* individual claims pursued in federal district courts.

- B. Second, in all cases involving alleged NLRA violations, in addition to traditional remedies (reinstatement, backpay, back benefits, and injunctive relief), the bill greatly expands the damages available to employees (again, even if they are nonunion) from the Board, the courts, or both.
 - 1. The PRO Act adds significant monetary remedies, including back pay without reduction for interim earnings (e.g., unemployment or earnings from a new job), front pay, and liquidated damages equal to twice the amount of other damages awarded;
 - 2. It creates a new “civil penalty” for every NLRA violation, up to \$50,000 each, which could be doubled where the employer committed certain other violations in the prior five years;
 - 3. It enhances the Board’s power to seek an injunction in federal court to reinstate terminated employees during the course of any litigation over their terminations;
 - 4. It provides for the recovery of attorney fees, and even punitive damages, in private district court lawsuits based on NLRA violations; and
 - 5. It includes civil penalties for noncompliance with Board orders, enforceable by civil action in federal district court, up to \$10,000 for each violation, and – in the case of any final Board order – *every day* of noncompliance is deemed a “separate offense.”
 - C. Third, the PRO Act imposes potential *personal liability on directors and officers*, to the extent they are found to have “directed or committed” the violation, or “established a policy that led to such a violation,” or “had actual or constructive knowledge of and the authority to prevent the violation and failed to prevent the violation.”
 - D. Fourth, the PRO Act also bars employers from entering into arbitration agreements with employees and applicants requiring individual arbitration of any legal claims instead of class/collective actions in court litigation.
 - E. Fifth, the bill creates new “whistleblower protection” rights in amendments to a different existing statute – the Labor Management Reporting and Disclosure Act – that can result in proceedings before the DOL (and possibly federal district courts) if an employer allegedly discriminates or terminates any applicant or employee based on their role in providing information to an agency or union about labor-management reporting violations.
- V. ***The California experience with the ABC test reveals its problems and limitations.*** California’s adoption of the strict ABC test illustrates the test’s significant shortcomings, unintended consequences and enormous costs. California’s implementation of the ABC test in Assembly Bill 5 (AB-5) illustrates its numerous problems.
- A. Upon adoption of the ABC test, California businesses had to stop using the services of independent contractors who did not clearly and overwhelmingly meet the test, resulting in a backlash from many businesses and independent contractors across many economic sectors.

- B. California subsequently amended AB-5 several times to exempt at least 48 industries and occupations, and the backlash also resulted in a ballot initiative that has now carved out gig transportation workers. This process was costly, confusing, and time-consuming.
- C. Implementing the ABC test through the PRO Act, combined with the private cause of action and enhanced remedies, would have the same impact across the nation because it is not the applicable test used in most states to determine whether a worker is properly classified as an independent contractor.
- D. Amending the bill to limit federal preemption of state classification tests would not limit its reach, because independent contractors in any state could assert the misclassification violation because the NLRA is a federal law, regardless of which test the state applies under its own wage and hour and other employment laws.

VI. Conclusion

The PRO Act's much more restrictive treatment of "independent contractor" status will apply to nonunion employers and unionized employers throughout the country. The PRO Act's reformulation of "independent contractor" status will also limit and eliminate innumerable existing contractor relationships that will profoundly affect how business is done in our complex US economy, affecting large number of temporary or contingent employees, casual workers, self-employed service providers, freelance professionals, and other small businesses and contractors.

The PRO Act's adoption is likely to mean that many businesses and service providers who currently maintain a lawful contractor relationship will violate federal law merely by continuing the arrangement, which may result in substantial litigation and potential liabilities, even though none of the participants wanted the relationship to change and nobody may understand that the arrangement is unlawful.

The PRO Act is likely to produce significant litigation over "independent contractor" status and alleged "misclassification" violations. This risk is made greater by the PRO Act's other changes – providing for three-track litigation (involving the NLRB, the federal courts, and the DOL) and expanded damages (potentially including front pay, consequential damages, compensatory damages, liquidated damages, and attorneys' fees) – and will result in substantial uncertainty, burdens, and potential liabilities.

To the extent the PRO Act causes employers and contractors to extinguish and convert their existing "contractor" relationships into "employer-employee" relationships, it is likely – in many cases – that one or both participants will decide that an "employer-employee" relationship is objectionable, impractical, or infeasible, which will cause substantial disruption and dislocation, including many cases where the contractor's services will no longer be used. These consequences – even though not intended by supporters and sponsors of the legislation – will adversely affect large numbers of people in numerous occupations throughout the United States.⁶

⁶ **NO LEGAL, TAX, OR COMPLIANCE ADVICE.** This paper and the information it describes is general in nature, it reflects matters as of the date set forth under the title and is subject to change. Such information is provided for convenience and informational purposes only and should not be considered legal, tax, or compliance advice. © 2021 Morgan, Lewis & Bockius LLP. All Rights Reserved.