Impacts of Eliminating Independent Contractor Status for California App-Based Rideshare and Delivery Drivers

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About the Author

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Executive Summary

In September 2019, the Governor signed AB 5, which makes it more difficult for companies to classify workers as independent contractors. Many legal observers believe that the measure will require app-based platform companies, such as Uber Technologies, Lyft Inc., and DoorDash to treat rideshare and delivery drivers in their networks as employees instead of independent contractors. In this brief, we examine the impacts of this shift. Our main conclusion is that a change to employee status will have enormous negative consequences for app-based industry drivers, as well as the services they currently provide to millions of Californians each year. Specifically:

- Despite the proponents' claims to the contrary, economic realities would require app-based platform companies to curtail or eliminate the flexibility currently afforded to drivers to choose when, where, and number of daily hours they work. Instead, drivers would be subject to fixed work hours and driving locations set by the companies.
- According to a recent survey conducted by Edelman Intelligence, the loss of flexibility that would come with employee status would be a *non-starter* for the majority of current drivers. **Almost 90 percent of drivers began driving because they needed a job where they could control their work hours**, and over two-thirds of the respondents indicated they would stop driving if they lost this flexibility. The need for flexibility is even greater due to COVID-19 limiting childcare support for parents.
- For 70 percent of drivers, income from app-based driving is supplemental to other jobs. This supplemental income, however, is extremely important – enabling them to pay bills and rent, and to build reserves for a rainy day. These additional earnings have proven especially valuable during the COVID-19 economic recession.
- According to recent estimates, the decline in driver opportunities could reach 75 to 90 percent. This is due to the fact that if drivers become employees, app-based platform company costs will rise sharply because of higher expenses for unengaged driver time, loss of driver efficiencies, higher benefit and overtime costs, additional management and overhead, and technology investments to develop new products for monitoring and controlling employees. This will lead to much higher per-trip prices, less coverage (especially in areas with less population density), reduced consumer demand, and a major loss of earning opportunities.
- The resulting decline in the industry means fewer jobs, less income, and lower tax receipts to state and local governments in California - at a time when the state has the highest unemployment since the Great Depression. The losses will be magnified by the fact that five of the six largest app-based platform companies in the U.S. are located in California. Losses of revenues and company values will impact personal income tax revenues through lower capital

gains and stock option values, which the state depends on to fund schools, healthcare, and social services. Such losses, which could range into the low-to-mid- hundreds of millions of dollars per year, will be all the more devastating over the next several years, as California struggles to deal with historically high unemployment and massive budget shortfalls.

Background

App-based ridesharing and delivery platform companies link users to drivers through smartphone applications. It is a young industry – large scale operations by Uber and Lyft began in 2012 – but it has already grown to the point where market value of the six largest companies are 50 percent larger than General Motors (GM) and Ford combined. Many factors are cited for the industry's success, including customer convenience, reduced wait times, low and relatively predictable pricing, and the effective use of technology for setting up trips, making cash payments, and optimizing travel routes.

But the core factor behind the industry's success is the *flexibility* that the current system provides for drivers to enter and leave local markets whenever and wherever they wish. This flexibility, combined with a sophisticated market-based platform for optimizing local trip-pricing and fares, helps balance the marketplace to cover demand for ridership and delivery services in multiple geographies and throughout the day. This results in higher engaged time for drivers, lower per-trip prices, and availability of services to riders and delivery customers when and where they need them.[1]

Approximately 400,000 Californians provide rides or deliveries through app-based platforms each month. Because of industry turnover, and the fact that some drivers may drive some months but not others, the number of drivers that have logged on at least once in the past year is much larger – estimated to be between 800,000 to over 1 million. These drivers earned income totaling over $6 billion in 2018. According to a 2015 survey, for weeks in which they drove, slightly over one-half of drivers using the Uber platform worked less than 16 hours per week, about 30 percent worked between 16 and 35 hours, and 15 percent worked more than 35 hours per week.[2] Five out of the six largest rideshare and delivery companies are headquartered in California. These companies have a combined market value of about $90 billion.

App-Based Drivers Are Independent Contractors

Drivers are independent contractors. They are able to decide when, where, and for how long they perform work using the network platform. They are also free to start and stop working at any time without notice. Drivers are able to choose to either work during high-

[1] As one example of the efficiencies resulting from the app-based platform model, a 2016 study published in the American Economic Review found that the fraction of working time that a driver actually spends with a rider in the back seat is roughly 40% higher for Uber than for traditional taxi markets. (Judd Cramer and Alan B. Krueger. "Disruptive Change in the Taxi Business: The Case of Uber." American Economic Review 106, 5 (May 2016), 177–82. DOI:http://dx.doi.org/10.1257/ aer.p20161002

[2] J. Hall, A Krueger. "An Analysis of the labor market for Uber's Driver-Partners in the United States." NBER Working Paper 22843, November 2016.

demand periods to maximize earnings, or during lower traffic times and places if that better suits their preferences or schedules. Drivers are also able to accept, reject, or cancel dispatch offers and to make themselves available simultaneously on multiple platforms. As discussed below, this flexibility is an extremely important feature to existing app-based drivers, as well as to the functioning of the app-based rideshare and delivery industries as a whole.

As independent contractors, drivers are not covered by state laws governing employees relating to, for example, mandatory rest and meal breaks, employer-paid disability and family leave insurance, sick-leave, health insurance, or social security contributions. They also must provide their own vehicles and must pay for their own expenses.

App-Based Drivers Could Become Employees Under AB 5

On September 18, 2019, the Governor signed AB 5, a legislative measure which codified a decision of the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles (2018).* The *Dynamex* decision affirmed that a worker is an employee *if they receive compensation from the hiring entity unless* the hiring entity satisfies a three-factor test. These factors are: (1) the worker is free from the control and direction of the hiring entity in connection with the performance of the work; (2) the worker performs work that is outside the usual course of the hiring entity's business; and (3) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

AB 5 included numerous exemptions to the *Dynamex* standard. These exemptions covered professional services and businesses referring customers to providers for specific services including, photography, event planning, moving, minor home repairs, home cleaning, and web design. AB 5 also provides special rules for working with subcontractors in the construction industry. AB 5 did not, however, provide an exemption for app-based ridesharing or delivery platform companies.

While this has yet to be determined by a court, many legal observers have concluded that ridesharing companies would fail to meet the three-pronged test codified by AB 5. If the ridesharing companies did fail the test, drivers using their platforms would become employees under the new standard and be covered by all California laws and regulations relating to meal breaks, overtime pay, sick leave, and other benefits to employees.

Industry Initiative Would Retain Current Independent Contractor Status for App-Based Drivers

Because of concerns about the impact of AB 5 the viability of the industry, the app-based platform industry has proposed an initiative (Proposition 22), that (1) retains independent contractor status for app-based drivers and (2) creates new benefits for independent workers, including:

- An earnings guarantee of 120 percent of California's minimum wage for periods in which the worker is driving.

- A health care stipend, equal to $400 per month for workers driving more than 25 hours per week, and $200 per month for those driving 15 to 25 hours per week.
- Company-provided insurance to cover medical expenses and disability to a driver that is injured while driving.
- Sexual harassment prevention policies, criminal background checks, safety training, and a prohibition against working for more than 12 hours during any 24-hour period.

Driver Attitudes About AB 5 and the Industry Initiative

In order to obtain feedback from California's app-based drivers regarding their work-related preferences, Uber Technologies, Inc. (Uber) commissioned an online survey by Edelman Intelligence, a global independent research firm.[3] The survey queried drivers about their satisfaction with the current system, the role that income derived from app-based driving plays in their lives, and their attitudes regarding their current status as independent contractors versus a potential change to employee status. The survey was conducted from May 19 to June 1, 2020.

The survey was based on a representative sample of the roughly 1 million app-based drivers in California. The final sample size was 718 drivers, and the survey had a statistical error margin of 3.7 percent. During data collection, Edelman sought a diverse set of respondents to ensure the sample reflected the industry in terms of race/ethnicity, gender, age and geographic location. This effort was aided by administrative data from the industry. Edelman also applied more than a half-dozen quality control metrics, consistent with market-research industry standards, to ensure accuracy and objectivity in the results. Given the sample size, the diversity of respondents, and the multiple quality controls, we believe the survey accurately represents the views of app-based drivers in the state. The key findings of the survey are summarized in Figure 1 and discussed below.

Figure 1
Results of App-Based Driver Survey

Main Findings
• Most drivers prefer the current system to employment.
• Flexibility provided by independent contractor status is highly valued.
• App-based driving is something most drivers do to supplement other work, but the income it provides is important.
• App-based driving has taken on greater importance during COVID-19 pandemic.
• Driving provides multiple other benefits.

[3] Edelman Intelligence, "California App-Based Driver Survey." https://www.cadriversurvey.com/

Most are satisfied with the current system and will support the industry-backed initiative. The survey found that more than four out of five respondents were satisfied with their work, and nearly three-quarters felt that app-based driving is the best option for their lifestyle. A similar three-quarters of respondents indicated that they would support the industry-sponsored initiative maintaining their independent contractor status.

Flexibility is highly valued. A consistent theme in driver responses was the critical importance of being able to work *when* they want, *where* they want and *for how long* they want. In written responses, several drivers emphasized how much they valued the ability to fit driving into their day, to take time off when needed to meet other family responsibilities, and to take advantage of high-volume work time. The independence is so important that more than two-thirds of the respondents indicated they would not continue driving with an app-based company if they had to work fixed shifts. Flexibility was particularly important to caregivers. About 80 percent of this group reported that driving with app-based companies allowed them the flexibility they needed to earn income and still meet their caregiving responsibilities.

App-based driving provides supplemental income that makes a positive difference in drivers' lives. Five in six respondents indicated that they received income from another full or part time job or from their own small business before the COVID-19 pandemic struck. Similarly, three-quarters of drivers considered income from app-based driving as supplemental, not primary. For these drivers, driving was an extra source of income, rather than a traditional job. However, the supplemental income was found to make a crucial and positive difference in many drivers' lives. About three-quarters of the respondents indicated that without the flexibility and income provided by app-based driving, they would not be able to provide for themselves and their families, set aside funds for a rainy day, or pay all their bills. About two-thirds of respondents indicated that without the app-based income, they would not be able to pay their rent or mortgage or put food on the table.

App-based driving has become even more important during the COVID-19 pandemic. Approximately one-quarter of the respondents lost their jobs during the COVID-19 pandemic. For this group, in particular, app-based driving is taking on increased importance in terms of helping individuals and families cover necessities. An even larger two-thirds of total respondents view app-based driving as replacement income for earning losses resulting from the loss of a job or a reduction in hours.

App-based driving conveys many other benefits. A clear majority of respondents indicated that app-based driving helps them feel empowered and in control of their lives, and that without app-based driving, they would not be able to spend more quality time with friends and family or pursue hobbies and interests outside of work. About 70 percent indicated that they started driving with app-based companies to have a better work-life balance. And three-quarters agreed with the statement that app-based driving has provided them with a sense of purpose and connection to their community.

In short, the survey indicates that (1) the flexibility provided by the current system is extremely important to drivers, (2) the income they are able to earn under the present system makes a major difference in their lives, and (3) *the loss of flexibility resulting from a switch to an employer-based model would simply not work for most drivers*.

Yet, such a switch is precisely what may be required by AB 5. Proponents assert that there is nothing in the language of AB 5 that would preclude app-based platform companies from continuing to allow drivers to choose when, where, and how to offer their services. However, this assertion completely ignores the economic realities facing the industry. App-based platform companies are currently able to offer this flexibility *only* because drivers are paid per-trip, rather than per-hour that they are online. The present system incentivizes workers to limit unengaged time and complete trips to earn more money. Under an employment model, where the driver is paid for all the time in the car – whether engaged or unengaged – such incentives would be removed. In fact, an employment model creates exactly the opposite incentive; drivers would be incentivized to work at times and places where demand is low, and driving is less intense. In order to align supply and demand, the only practical option available to platform companies would be to exert control over hours, shifts, and location of drivers.[4]

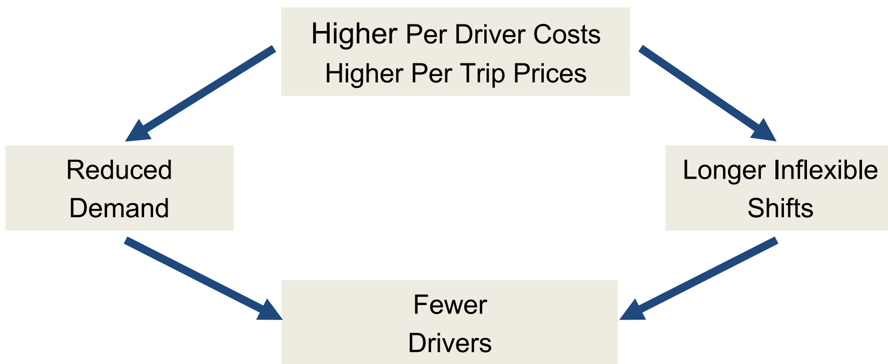
In short, transforming app-based drivers from independent contractors to employees would eliminate the most attractive feature of the current system for the majority of drivers, by removing flexibility regarding when, where, and how long they can drive.

Impact of AB 5 on Prices of Services, Customer Demand, and Industry Jobs

Beyond the negative impacts that AB 5 would have on driver flexibility, a change to an employee model would have major negative impacts on the price of services, customer demand, and industry jobs. These impacts are summarized in Figure 2 (next page) and discussed below

[4] Companies could, in theory, coax drivers to enter high-demand areas through incentives, such as higher payments. However, the incentives, above and beyond guaranteed wages and benefits, would sharply increase company costs. Given the intense competition and lack of profits already characterizing the industry, the additional costs would have to be passed along to consumers through substantially higher fares. The higher fares would, in turn sharply lower consumer demand (due to the price-sensitivity of demand for rideshare and delivery services), ultimately threatening the viability of the industry.

Figure 2
Impacts of Reclassifying App-Based Drivers
From Independent Contractors to Employees



The switch of drivers to employee status will sharply raise costs for app-based platform companies. They will be paying for the time that drivers are unengaged (that is, not carrying passengers or delivering goods); the amount of unengaged time per driver will likely increase due to the removal of pricing incentives; the company will be making additional payments for employee benefits and overtime; and it will incur both additional one-time and ongoing management-related overhead costs.

These costs will be passed along to customers. The industry is extremely competitive. Companies have yet to earn profits and simply have no room to absorb the type of major cost increases that AB 5 would entail. Consequently, the additional costs will necessarily be passed along to customers in the form of higher per-trip and per-delivery prices.

Number of trips and opportunities for work will shrink. Recent empirical studies have found that demand for app-based ridesharing and delivery services is price-elastic.[5] This means that higher prices will result in large declines in the number of rides and deliveries. Beyond this, under an employee model, app-based companies will be under pressure to consolidate the number of employees on payroll in order to minimize overhead and benefit costs. As a result, companies will require longer shifts, thereby further reducing the number of employees required.

Potential Magnitude of Impacts

The exact size of the job and pricing impacts would depend on multiple factors, including consumer-price sensitivity in California markets, and the extent to which a change to an employee model will reduce efficiencies. However, two recent estimates, using conservative and simplifying assumptions, provide illustrations of the potential magnitudes of these impacts (see Figure 3).

[5] Recent price elasticity estimates for the taxi and ride-sharing industries range from -0.8 to -2.5, suggesting that a 10% increase in price, applied industry-wide, will reduce demand by between 8 percent and 25 percent. (See, for example, Castillo, Knoepfle, Weyl, "Surge Prices Solves the Wild Goose Chase," July 2017, and N. Buchholz, "Spatial Equilibrium Search Frictions, and Dynamic Efficiency in the Taxi Industry", December 9, 2019.)

Figure 3
Recent Estimates of the Impact of a Shift to an Employee Model

Estimate Prepared By:	Coverage of Estimate	Published Results/Findings
Uber Technologies	California drivers active on the Uber platform in the most recent quarter.	• Up to 110% increase in trip prices. • 23% to 59% reduction in trips. • 76% reduction in drivers (due to reduced trips and consolidation of remaining workforce).
Berkeley Research Group	All California App-based drivers that logged on in the past year.	• 80% to 90% reduction in workforce.

Uber analysis. One impact estimate was made by Uber, which accounts for about one half of the combined app-based rideshare and delivery market in California. Based on internal data, Uber calculated that prices would need to increase 25 percent to 111 percent to cover the additional employee costs, depending on current market conditions, minimum wages, and other regulations in local regions throughout the state.[6] This implies that a trip that costs $10 today would cost as much as $21 under AB 5. The increase in price would result in a reduction in trips of between 23 percent and 59 percent, with less dense cities and rural areas experiencing the largest percentage losses. Assuming that the company would hire full-time workers, the number of active drivers in a three-month period would decline from 209,000 to 51,000, a 76 percent decrease.

Berkeley research group (BRG) analysis. Using a similar methodology, but applying the study to *all* drivers that logged onto app-based platforms in the past year, the Berkeley Research Group found that making drivers employees instead of independent contractors would trigger a loss of 80-90 percent of available work opportunities in California, a reduction of more than 900,000 jobs.[7]

Again, the precise mixture of impacts of a mandated shift to an employee model on prices, rides, and work opportunities is uncertain and will depend on factors such as the degree of price sensitivity of customers in different markets. However, the inescapable conclusion is that an employer model will result in higher prices and fewer trip options for customers, and fewer jobs available for app-based drivers. In lower-density areas, people that depend on ridesharing and delivery services will lose access to the services altogether, and consumers in other areas will face longer wait times and higher costs.

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[6] "Analysis on Impacts of Driver Reclassification, "Alison Stein, Economist at Uber, May 28, 2020 https://medium.com/uber-under-the-hood/analysis-on-impacts-of-driver-reclassification-2f2639a7f902
[7] "New Economic Analysis: 900,000 App-Based Drivers Would Lose Work in California if Forced to be Classified as Employees," Protect App-Based Drivers and Services, Press Release, May 18, 2020.

Effects on Broader California Economy and State/Local Government Revenues

In addition to the $6 billion earned by the up-to one million drivers that logged onto an app-based network last year, app-based platform companies headquartered in California employ thousands of workers, many of them in high-paying management and technical occupations, whose earnings and, potentially, jobs would be at risk if the industry were required to move to an employee-based model. Although these are national, and in some cases, global companies, their consolidated operations and outlook would be adversely affected because (1) California is a major market for app-based services, and (2) the state is a bellwether in terms of market and regulatory trends.

The negative impacts on California state revenues, in particular, would be substantial. This is because app-based platform companies, like many companies in California's high-tech sector, rely on stock-based compensation such as stock options, stock appreciation rights (SARs), and restricted stock units (RSUs) for many of their high-level management and technical employees.[8]

These awards generate billions of dollars of income each year, which under California's progressive personal income tax, are taxed at high marginal rates. Because the value of these awards is tied to company share prices, they are at risk if the change to an employee-based model in California were to negatively affect the companies' share prices. Such a decline would result in large reductions in revenues to the state's General Fund, which supports healthcare, social services, and schools throughout California. The magnitude of revenue declines is difficult to pinpoint, but could range in the low-to-mid hundreds of millions of dollars per year.

Conclusion

A change to employee status would have major negative impacts on the app-based industry drivers and the services they provide to millions of Californians each year. By eliminating the flexibility and market-based incentives that exist in the current economic model for the app-based driving industry, the shift to employee status would undermine the very factors that have led to the major adoption of these services in California and around the world. The result is a loss of the income and flexibility that app-driving currently provides to millions of Californians each year. It also means higher prices and less coverage for customers that rely on these services, especially in less-populated areas of the state. And it will mean higher unemployment, lower income, and lower tax revenues to the state and local governments in California.

[8] As one example, in its 2019 Annual Report, Uber Technologies, Inc indicates that it had 26.9 million stock options and SRUs, and 84.7 million in RSUs outstanding as of December 31, 2019.