When Tech Startups Outgrow the 1099 Model: Moving Firms Out of the Kiddie Pool

ABSTRACT

The 1099 independent contractor has become the new norm for Silicon Valley startups. In the wake of the Ninth Circuit Court of Appeals decision in Alexander v. FedEx*, tech startups have been scrutinized for their financially savvy preference for 1099 contractors through both class action lawsuits and administrative proceedings. As these movers and shakers grow from humble beginnings to companies with multi-billion dollar valuations, the choice between classifying workers as traditional W-2 employees or 1099 contractors will have dramatic effects on the peer economy's labor force and tax status. This Note examines the startup worker classification dilemma, concludes that neither a strict application of the W-2 formula nor the 1099 model alone is an adequate fit for the high risk nature of startups, and proposes a regulatory solution for worker classification based on the concept of critical mass—the point at which these firms should exit the 1099 kiddie pool and start classifying workers as W-2 employees.*

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People are talking about 1099 contractors: the steam engine of the thriving, digitalized peer economy.[1] Startups like Uber, Lyft, Homejoy (home cleaning), Spoonrocket (meal delivery), TaskRabbit (errand assistance), and Shyp (package delivery) have turned the aptly coined "peer economy" (also referred to as the sharing economy) into a formidable market force.[2] Peer economy expert Denise Cheng defines the phenomenon as "a framework of online, peer-to-peer marketplaces that enable people to monetize skills and assets they already have,"[3] adding that the peer economy encompasses "verticals such as ridesharing (legalized by the California Public Utilities Commission as 'transportation network companies'), skill sharing, small-scale manufacturing, space sharing, and personal service for hire."[4] At the heart of most successful peer economy enterprises lies the no-strings-attached 1099 independent contractor, which can be viewed in contrast to the traditional W-2 employer-employee model due to its pay-as-you-go form of compensation.[5]

The 1099 contractor has garnered favor in the startup community in part because of the significant cost savings a business can enjoy when it substitutes contract labor for traditional W-2 employees.[6] Startups with independent contractors boast that workers have increased independence and flexibility to make their own timetables, working at their convenience and exercising a higher degree of autonomy than regular employees.[7] Unlike classic W-2 employees, who have access to a wide host of labor benefits and protections, contractors are left to their own devices in several areas of employment benefits.[8] For example, minimum wage compensation, overtime compensation, employer-provided health insurance, retirement benefits, workers' compensation, paid leave, and

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1. Kevin Roose, *Does Silicon Valley Have a Contract Worker Problem?*, NY MAGAZINE—DAILY INTELLIGENCER (Sept. 18, 2014, 8:42 AM), http://nymag.com/daily/intelligencer/2014/09/silicon-valleys-contract-worker-problem.html [http://perma.cc/8NM7-955G].
2. *Id.*
3. DENISE FUNG CHENG, READING BETWEEN THE LINES: BLUEPRINTS FOR A WORKER SUPPORT INFRASTRUCTURE IN THE PEER ECONOMY 25, June 2014.
4. *Id.*
5. Roose, *supra* note 1.
6. *Id.*
7. *Id.*
8. ZenPayroll, *The 1099 Economy is Real and Growing Fast*, http://www.newgeography.com/files/ZenPayroll_1099-Economy_FINAL2-72.png [http://perma.cc/2VTD-W2HR].

unemployment insurance are legally guaranteed to employees, but not to contractors.[9] Beyond health and wage protections, workers classified as employees also have the right to organize and bargain collectively as well as increased protection from discrimination based on race, gender, disability, or age.[10]

The unprecedented rise in independent contractors as a proportion of the US workforce raises questions as to the legality of such work arrangements and has given rise to various lawsuits alleging worker misclassification.[11] This widespread practice has both labor and tax law ramifications. Tech startups are especially incentivized to use the model as they scale, since they can cut costs significantly by doing so.[12] In the face of perverse incentives for tech startups to misclassify workers, can the innovation of these peer economy players be preserved while still protecting the rights and benefits of the workers who have made their success possible?

This Note seeks to examine the role of contract workers in the rising age of the peer economy, whose amorphous and fast evolving nature seems to defy both the classic W-2 model as well as the 1099 category. In many cases, the workers driving (quite literally) major tech successes like Uber and Lyft exercise greater independence than regular employees but are still intrinsically tied to a central employer who exercises varying degrees of control and coordination over them to the extent that it seems to shirk the 1099 category. Part I examines the rise of 1099 employment along with the peer economy and Affordable Care Act (ACA). Part II discusses the tax and labor law ramifications of employee misclassification. Part III looks at developing jurisprudence in the 1099 arena to provide a forecast for companies who may be misclassifying workers. Part IV analyzes varying approaches to bridging the gap between the two categories with an interest in preserving innovation. These suggestions range from free market correction to enforcing the preexisting W-2 framework to the creation of a third category, the "kiddie pool." Lastly, Part V suggests, due to the lack of a realistic choice between either the W-2 or 1099 model at the outset of the startup formation, the solution to the Silicon Valley worker conundrum may be to impose a W-2 regime on startups after they successfully scale and have a sizeable workforce or, in other words, reach a critical mass.

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9. *Id.*; *see* Fair Labor Standards Act, 29 U.S.C. §§ 206–207 (2006) (establishing minimum wage and overtime compensation for time worked after forty hours per week).

10. Richard R. Carlson, *Why the Law Still Can't Tell an Employee When It Sees One and How It Ought to Stop Trying*, 22 BERKELEY J. EMP. & LAB. L. 295, 317, 363 (2001).

11. *See* O'Connor v. Uber Tech., 58 F. Supp. 3d 989 (N.D. Cal. 2014); Cotter v. Lyft, 60 F. Supp. 3d 1059 (N.D. Cal. 2014).

12. ZenPayroll, *supra* note 8.

As the peer economy's proportion of the US economy continues to grow, the law must keep pace with technology to provide app-directed service providers with the basic social net intended by labor law and the ACA, but it should preserve technological innovation as it does so.

I. 1099 CONTRACTORS FUELING THE SHARING ECONOMY ROCKET TO THE MOON

The Great Recession has created a unique opportunity for entrepreneurs in the peer economy to capitalize on both the spirit of thriftiness in cash-strapped consumers and the large supply of workers who have been left either unemployed or underemployed.[13] Easily accessible apps that provide affordable services using skills and free time that would-be workers already possess are attractive to both workers and consumers alike. As Denise Cheng points out, "Peer economy platforms didn't unearth a new type of commerce. These economic platforms further enable socio-economic activities that were always moving toward a more visible and centralized space—activities that have trickled up and are now given [sic] the market a face."[14] Driving, domestic care, cleaning, cooking, walking dogs, and running errands—long regarded as routine tasks of living—have been commodified, and workers who perform these chores for pay in peer economy platforms are made visible as their services' market power is harnessed through the peer economy.[15] Such services have typically been the realm of marginalized workers, such as women, minorities, immigrants, and undocumented workers, and have operated below the radar of federal regulation in matters of wage and health protection of the workers.[16] Now that a central authority in the form of tech apps is both profiting from and legitimizing informal services in the eyes of the public, missteps in employee misclassification and labor violations can be more readily scrutinized.

The market power of such apps and tech developments is undeniable. Rachel Botsman, author of *What's Mine is Yours, Collaborative Consumption*, claims the peer-to-peer rental market is worth at least $26 billion and the overall sharing economy is worth

13. Cheng, *supra* note 3 at 32.

14. Denise Cheng, *The Peer Economy Will Transform Work (or At Least How We Think of It),* HARV. BUS. REV., https://hbr.org/2013/12/the-peer-economy-will-transform-work-or-at-least-how-we-think-of-it/ [https://perma.cc/5983-BG79].

15. *Id.*

16. *Id.*

$110 billion,[17] although recent developments show this projection might merely scrape the surface.[18] AirBnB, a service that allows members to rent out rooms or entire properties on a short-term basis through an online platform, has been valued at $10 billion.[19] The business is quickly becoming a rival for the hotel industry, while receiving criticism for a lack of regulation.[20] Uber, one of the main focuses of this Note, has a hefty $40 billion valuation by venture capital experts.[21] The seven-year-old company continues to expand internationally, exploiting markets in India and the Asia Pacific region.[22]

Marketed as "everyone's private driver," Uber has quickly replaced taxis in the lives of many.[23] The Uber app has managed to capture an enormous amount of riders due to its ease of use and reliability.[24] Using the app is simple—the user need only install the app, agree to terms and conditions, add a credit card, and request a ride using the phone's location services. A ride arrives on request within minutes, and Uber provides a timeline of how long the ride will take to arrive. The price of the ride is determined through a unique algorithm developed by Uber that enables "dynamic pricing" to occur.[25] Through dynamic pricing, the cost of a ride increases based on the supply of drivers on the road and the amount of riders seeking a car.[26] Uber's model is intended to incentivize drivers to get on the road when demand is high, rewarding them with accordingly higher fares.

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17. Danielle Sacks, *The Sharing Economy*, FAST COMPANY, May 2011, http://www.fastcompany.com/1747551/sharing-economy [http://perma.cc/CDX5-CPBK].

18. *Id.*

19. Roose, *supra* note 1.

20. *Id.*

21. Prior to December 2014, valuation of Uber was estimated at $18 billion; however in light of a recent round of venture capital investments in the amount of $1.2 billion, with additional wiggle room of an estimated $1.8 billion in investments, the private company's valuation soared to $40 billion. *See* Ryan Mac, *Uber Files for $1.8 Billion Round and Could Be Worth $40 Billion*, FORBES (Dec. 4, 2014), http://www.forbes.com/sites/ryanmac/2014/12/04/uber-files-for-1-8-billion-round-and-could-be-worth-40-billion/ [https://perma.cc/8K67-L3WF].

22. *Id.*

23. *See* Uber, *Uber: Everyone's Private Driver*, VIMEO (Feb. 2, 2013), https://vimeo.com/58800109 [https://perma.cc/W5HA-RF2Q].

24. JONATHAN HALL & ALAN KRUEGER, AN ANALYSIS OF THE LABOR MARKET FOR UBER'S DRIVER-PARTNERS IN THE UNITED STATES 25 (Jan. 22, 2015), https://s3.amazonaws.com/uber-static/comms/PDF/Uber_Driver-Partners_Hall_Kreuger_2015.pdf [https://perma.cc/HS9Z-DZND].

25. Will Oremus, *Surge Pricing is not Price Gouging*, SLATE (Oct. 2, 2014), http://www.slate.com/blogs/future_tense/2014/10/02/surge_pricing_is_not_price_gouging_why_uber_and_sprig_s_policies_aren_t.html [http://perma.cc/7VXV-W42W].

26. *Id.*

A recently released Uber driver data report reveals some key facts about the company's growth that have been thus far unknown to the public.[27] The company is larger than many expected. Specifically, the number of Uber drivers who gave four or more rides (therefore, more than one-time participants) in December 2014 was an astounding 162,037.[28] This number of "active" drivers has increased markedly since Uber launched its lower cost "uberX" service in 2012.[29] The report also discloses the average hourly wage for drivers before taxes and vehicle expenses are subtracted from earnings—$19.04.[30] While falling below the average hourly wage of American workers in the private sector, which was estimated at $25.09 as of September 2015,[31] this figure is well above the federal minimum wage of $7.25. Of course, depending on a given driver's expenses, looking at this high hourly wage alone could have a distortionary effect on earnings.[32]

The two major takeaways from the data released by Uber are: (1) an enormous number of people are looking to the app for employment, and (2) Uber drivers appear to be making more than minimum wage for the most part, so perhaps the market is taking care of their needs. The logic goes, Uber drivers and their passengers are free to opt out of the service entirely—using Uber is a choice. If drivers found their earnings to be insufficient, they could choose an alternative job. However, the flaw with seeing the average hourly wages in isolation is that they don't tell the whole story. While $19 is the *average* hourly wage earned by Uber drivers, an Uber driver could be on the road during a slow day/night and bring home much less— even less than minimum wage.[33] Uber drivers are dispatched by the Uber app when a customer signals that he or she needs to be picked up from a specific location.[34] While drivers are responsible for maintaining their cars and insurance policies, their work depends on

27. *See* Hall & Krueger, *supra* note 24.

28. *Id.* at 14, 17.

29. *Id.*

30. Laura Lonzetti, *5 Surprising Numbers from Uber's Driver Data Report*, FORTUNE (Jan. 22, 2015), http://fortune.com/2015/01/22/5-surprising-numbers-from-ubers-driver-data-report/ [https://perma.cc/GC96-CLVP].

31. US Dept. of Labor, Bureau of Labor Statistics, Economic News Release, Tbl. B-3 http://www.bls.gov/news.release/empsit.t19.htm [http://perma.cc/TER3-V63V].

32. US Dept. of Labor, Wage and Hour Division, http://www.dol.gov/whd/minimumwage.htm [http://perma.cc/XW7G-MV4M].

33. Uber takes 20 percent of each ride's fare.

34. Tracy Lien, *Uber and Lyft May Have to Treat Their Drivers as Employees, Judge Says*, LA TIMES (Jan. 30, 2015), http://www.latimes.com/business/technology/la-fi-tn-uber-lyft-independent-contractors-20150130-story.html [http://perma.cc/QBW5-LAHZ].

receiving directions from the app, and the tech company can terminate their contracts at its discretion.[35]

In a driver's mind, Uber may be a sole source of income, yet an Uber driver salary is far less dependable than it appears.[36] Add the lack of healthcare provided by Uber to its drivers, their inability to bargain collectively or legally protect themselves from discrimination, and the overarching lack of unemployment or retirement benefits available to them, and the employment law ramifications become clear. Professor Katherine Stone describes this trend of employment practices as an erosion of the "standard contract of employment."[37] Rather than referring to an actual contract, Stone's standard contract of employment is a set of expectations and norms about the kinds of benefits and protections that should be in place when a worker is providing a service for a principal's benefit.[38] These benefits are discarded in independent contractor relationships, where both sides are assumed to be on more even footing.[39] However, as is evident in the case of many 1099 startups, workers are not on even footing with the companies that employ them and have opted out of the "standard contract" in exchange for a well-paying job.[40] As Julia Tomasetti eloquently points out, "By virtue of its contractual designation, subordination in production becomes independence in contracting—'You agreed in writing to work under my right of control and therefore I, the employer, am not controlling your work.'"[41] While this arrangement is appropriate in many situations, as a new norm for startup employment models, it should be troubling.[42]

35. *Id.*

36. *See* Jordan Vesey, *Who Protects the Workers Powering the New Sharing Economy*, PBS NEWSHOUR (Oct. 10, 2014), http://www.pbs.org/newshour/making-sense/sharing-economy-great-consumers-cost-workers/ [http://perma.cc/3JU9-XFB9].

37. *See* Katherine V.W. Stone, *The Decline of the Standard Contract of Employment in the United States: A Socio-Regulatory Perspective*, in RETHINKING WORKPLACE REGULATION: BEYOND THE STANDARD CONTRACT OF EMPLOYMENT 58, 59 (Katherine V.W. Stone & Harry Arthurs eds., 2013).

38. *Id.*

39. Julia Tomassetti, *The Contracting/Producing Ambiguity and the Collapse of the Means/Ends Distinction in Employment*, 66 S.C. L. REV. 315, 327 (2014).

40. *See* Robert Kuttner, *The Task Rabbit Economy*, AM. PROSPECT (Oct. 10, 2013), http://prospect.org/article/task-rabbit-economy [https://perma.cc/AS4F-WXUA].

41. *See* Tomassetti, *supra* note 39.

42. *But see* Hall & Krueger, *supra* note 24 (arguing that stagnant wage growth for a large sector of the population and rising inequality cannot be definitely linked to existing data in the labor market).

II. TAX AND LABOR IMPLICATIONS OF MISCLASSIFICATION IN THE STARTUP CONTEXT

Experts estimate that startups like Uber can save an estimated 30 percent of payroll costs by having contractors instead of employees. By employing contractors, Uber gains a competitive advantage over the heavily regulated taxi and limo industries.[43] Other companies are following suit: experts estimate that between 2013 and 2014, the ratio of contract workers to full-time employees in small to medium businesses has increased, especially in metropolitan areas.[44] For instance, Illinois saw the share of contract workers increase from 7.6 percent to 12.9 percent of its total workforce, while New York's numbers increased from 9.9 percent to 12.3 percent.[45] The workforce in Orlando, Florida increased from having just 5.5 percent contract workers to a sizeable 19.5 percent, as did Austin, Texas—which jumped from 10.33 percent to a whopping 22.48 percent.[46] Data showing increases is also available for Seattle, Los Angeles, San Francisco, Dallas, Houston, and Tampa.[47] Of the entire 2014 US workforce of 156 million people sixteen and older, 10.3 million were classified as 1099 contractors.[48]

Experts point out that the increase of contract workers coincided with the initiation of the Affordable Care Act (ACA) in March 2013, which requires employers to provide certain categories of employees with health insurance.[49] Keeping with traditional views of independent contractors as being self-sufficient, 1099 contractors are not among those covered by the ACA, incentivizing more companies to adopt the 1099 labor model, or misclassify altogether.[50]

A. The Extent of Misclassification Nationally

The exact prevalence of employee misclassification is unknown but is considered to have increased in recent years.[51] In 1984, the

43. ZenPayroll, *supra* note 8.

44. Though these numbers are not limited to the sharing economy alone, they do demonstrate that the sharing economy's preferred 1099 model is experiencing steady growth. *See id.*

45. *Id.*

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*; *see* Patient Protection and Affordable Care Act, 42 U.S.C. § 18081 (2010).

50. *See* ZenPayroll, *supra* note 8.

51. NAT'L EMP'T LAW PROJECT (NELP). *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries* 4, Aug. 2014,

Internal Revenue Service (IRS) completed the last comprehensive study on rates of worker misclassification.[52] The results of the study estimated that approximately 3.4 million US workers were misclassified as 1099 contractors by their employers.[53] That level of misclassification would have resulted in approximately $1.6 billion in losses to federal revenue.[54] Current accounts of worker misclassification have been cobbled together by both federal and state audits of employers.[55] Analyzing this data, the Department of Labor (DOL) Employment and Training Administration suggests the incidence of worker misclassification has increased significantly.[56] Between 2002 and 2011, DOL audits identified more than double the average number of misclassified workers per audit.[57] In 2006 alone, the US Government Accountability Office (GAO) report on worker misclassification estimates that $2.72 billion was lost to federal revenue as a result of misclassification.[58] Another 2000 DOL study found that of firms audited in nine states, between 10 to 30 percent were misclassifying a percentage of their employees.[59]

If this pattern is replicated across the country, there are likely several million workers who are misclassified and are therefore denied legal protection to ensure they are being provided with a minimum wage, overtime wages, various employer sponsored benefits, paid leave, workers' compensation, and unemployment insurance.[60] Further, these erroneously classified workers are ineligible for Social Security and Medicare benefits unless they pay both the employer and employee shares of the payroll tax, which constitutes double the amount that traditional W-2 employees pay in payroll taxes.[61]

In 2013, the Treasury Inspector General for Tax Administration (TIGTA) released a report specifically addressing

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http://www.nelp.org/content/uploads/2015/03/IndependentContractorCosts1.pdf [http://perma.cc/D5D9-3X9U].

52. US GOV'T ACCOUNTABILITY OFFICE, GAO 09-717, EMPLOYEE MISCLASSIFICATION: IMPROVED COORDINATION, OUTREACH, AND TARGETING COULD BETTER ENSURE DETECTION AND PREVENTION 1 (2009), http://www.gao.gov/assets/300/293679.pdf [http://perma.cc/BV4Q-MF5B].

53. *Id.*

54. This represents the value of revenue loss in 1984 dollars. *See id.*

55. NELP, *supra* note 51.

56. *Id.*; *see* Tom Crowley, UI Tax Chief, US Dep't of Labor, *Worker Misclassification—An Update from Constitution Ave.* 23, http://www.naswa.org/assets/utilities/serve.cfm?gid=86824dbe-575c-4edb-9e93-444cef85c837&dsp_meta=0 [http://perma.cc/2FHK-4767].

57. NELP, *supra* note 51; *see* Crowley, *supra* note 56.

58. US GOV'T ACCOUNTABILITY OFFICE, *supra* note 52, at 1.

59. *Id.*

60. ZenPayroll, *supra* note 8.

61. *Id.*

worker misclassification.[62] In the report, TIGTA completed an audit analysis of the employment taxes paid by employers when they misclassify employees as independent contractors.[63] The audit showed that for a worker with the average annual income of $43,007, the advantage per worker for an employer to misclassify was $3,710.[64] This sum included $2,666 lost to the worker's Social Security and $624 to Medicare benefits as well as $420 in federal unemployment.[65]

In addition to federal tax revenue, revenue sources that feed into state-sponsored unemployment insurance funds, workers compensation, and overall state budgets are also impacted by misclassification.[66] Because the amount lost to state revenues must be extrapolated from individual audits of employment records, exact figures on the amount lost to state treasuries are uncertain.[67] Although these findings are not certain, experts believe the amount lost to state revenue is significant.[68] The figure likely surpasses hundreds of millions in many states.[69] For instance, the state of New York is estimated to have a 10.3 percent misclassification rate of workers.[70] In this case, the state's unemployment insurance revenue is reduced by $198 million annually.[71] Further, the New York workers' compensation fund is reduced by $1.1 million, and the state loses approximately $170 million in income tax revenue.[72]

Municipal government tax revenue is similarly stifled by misclassification.[73] Several major local governments—including San Francisco, which imposed a 1.162 percent payroll tax on businesses in 2015 with payrolls greater than $150,000—lose a substantial amount of tax revenue when employers misclassify workers as independent contractors.[74]

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62. TREASURY INSPECTOR GEN. FOR TAX ADMIN., EMPLOYERS DO NOT ALWAYS FOLLOW INTERNAL REVENUE SERVICE WORKER DETERMINATION RULINGS (2013), https://www.treasury.gov/tigta/auditreports/2013reports/201330058fr.pdf [https://perma.cc/5L4F-587Z].

63. *Id.* at 2–3.

64. *Id.*

65. *Id.*

66. NAT'L EMP'T LAW PROJECT (NELP), INDEPENDENT CONTRACTOR MISCLASSIFICATION IMPOSES HUGE COSTS ON WORKERS AND FEDERAL AND STATE TREASURIES 2, Aug. 2014.

67. *Id.*

68. *Id.*

69. *See id.* at 3.

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.* at 4.

74. *Id.*; *see* S.F. CAL., BUS. & TAX REG. CODE, art. 12-A, §§ 903.1–905A (2014); S.F. TREASURER, 2015 TAX RATES, http://sftreasurer.org/2015-tax-rates [https://perma.cc/AN4L-4DVW].

B. Cross-Agency Tax and Labor Enforcement Efforts to Combat Misclassification

Enforcement of tax and labor laws against employers at both the state and federal levels has increased since 2010 in the face of budget deficits.[75] Both the IRS and DOL pledged to combine their efforts in a "united compliance front" to combat misclassification with a 2011 "Memorandum of Understanding" signed by both the Secretary of Labor and the Commissioner of Internal Revenue. To accomplish their objectives, the parties agreed the DOL will share information from its Wage and Hour Division investigations as well as any other data that may implicate employment tax compliance issues with the IRS.[76] In return, the IRS will provide the DOL with annual reports summarizing the results of the DOL referrals.[77] While the results of this collaboration have yet to be seen, the efforts support a shift toward cracking down on misclassification at the federal level. This shift is arguably essential to any effective enforcement of labor laws. While the DOL had more than 1,500 wage and hour inspectors in 1941 to cover approximately 15.5 million workers and 360,000 employers, in 2011 only one thousand inspectors were responsible for 130 million workers active in seven million enterprises.[78]

Meanwhile, federal assistance to the states has increased to identify misclassification at the state level. To aid state enforcement efforts, Congress has allocated over $10 million to states to implement programs for identification of worker misclassification in the Consolidated Appropriations Act of 2014.[79] The Act's promises were fulfilled on September 15, 2014, when the DOL awarded nineteen states with approximately $10.2 million to fund such programs, specifically targeted to aid state unemployment insurance funds.[80] The grants, ranging from approximately $27,000 in Delaware to upwards of $1 million in Texas, will be used by state unemployment agencies to readily detect misclassification.[81]

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75. Jane P. Kwak, Note, *Employees Versus Independent Contractors: Why States Should Not Enact Statutes That Target the Construction Industry*, 39 J. LEGIS. 295, 299 (2012–13).

76. INTERNAL REVENUE SERV. & DEP'T OF LABOR, MEMORANDUM OF UNDERSTANDING BETWEEN THE INTERNAL REVENUE SERVICE AND THE DEPARTMENT OF LABOR, Sept. 19, 2011.

77. *Id.* at 2.

78. Kuttner, *supra* note 40.

79. Consolidated Appropriations Act, 113 P.L. 76, 128 STAT. 5, DIV. H, TITLE I (2014).

80. Sec'y of Labor Thomas E. Perez, Press Release: $10.2M Awarded to Fund Worker Misclassification Detection, Enforcement Activities in 19 State Unemployment Insurance Programs, Sept. 15, 2014, http://www.dol.gov/newsroom/releases/eta/eta20141708 [http://perma.cc/44LM-32P3].

81. *Id.*

As of this writing, administrative agencies in both California and Florida have determined employee status for Uber drivers in two separate adjudications. The first case involved a Miami Uber driver who applied for unemployment benefits after Uber refused to pay for repairs to his car that was damaged while transporting customers.[82] The Florida Department of Economic Opportunity found, on a case-by-case basis, that this particular driver was in fact an employee of Uber, given the extent of control the company exercised over him.[83] Therefore, his plea for unemployment insurance coverage from Uber was granted.[84] In California, the California Labor Commissioner concluded that Uber was "involved in every aspect of the operation" of the drivers, foreclosing on the capacity of an Uber driver to exercise independent discretion characteristic of an independent contractor.[85] The driver was awarded $4,152.20 in reimbursable business expenses for auto-related costs incurred while driving for Uber.[86] While these rulings are significant, this form of administrative adjudication by state agencies applies only to the individual worker who files a complaint. Such adjudications can carry persuasive weight in state courts, but they are otherwise non-binding on Uber and other 1099-powered firms.

Meanwhile, at the federal level, tax-related enforcement has taken the form of thousands of IRS audits.[87] These efforts are continuously driven by complaints from workers themselves, who can file IRS Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding* to get an official IRS opinion on whether they have the correct worker classification.[88] Of all the SS-8 requests filed for fiscal year 2008,[89] 72

82. Robert W. Wood, *Florida Says Uber Drivers Are Employees, But* FedEx*, Other Cases Promise Long Battle*, FORBES (May 26, 2015), http://www.forbes.com/sites/robertwood/2015/05/26/florida-says-uber-drivers-are-employees-but-fedex-other-cases-promise-long-battle/ [https://perma.cc/XT3S-B582]; Douglas Hanks, *For Uber, Loyal Drivers and a New Fight for Benefits*, MIAMI HERALD (May 21, 2015), http://www.miamiherald.com/news/business/article21599697.html [http://perma.cc/6FUW-72NT].

83. Hanks, *supra* note 82.

84. *Id.*

85. Berwick v. Uber, Cal. Labor Comm'r, State Case 11-46739 EK, p. 9, (Mar. 10, 2015).

86. *Id.* at 10. Applying the 2014 IRS mileage rate to compute her expenses, the Commissioner found that Uber must compensate the driver at a rate of $0.56 per mile driven during the course of her employment, a total of 6,468 miles. They also found that Uber must reimburse the driver for her toll charges. While the driver also filed for unpaid wages and minimum wage compensation, the Commissioner did not find that the plaintiff met her burden of providing sufficient evidence of her wages paid.

87. Steven Greenhouse, *U.S. Cracks Down on 'Contractors' as a Tax Dodge*, N.Y. TIMES (Feb. 18, 2010), at A1, http://www.nytimes.com/2010/02/18/business/18workers.html [https://perma.cc/6B8K-P6AX].

88. TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 62, at 3.

percent resulted in IRS determinations of employer misclassification of employees as independent contractors while 3 percent resulted in determinations that the employer was correctly classifying the worker as an independent contractor.[90]

Such determinations are time consuming and demand that tax officials apply the common law factors for deciding if an employer-employee relationship exists.[91] Developed over hundreds of years of jurisprudence, the overwhelming influence on the determination is the *respondeat superior* theory of secondary liability—holding employers responsible for the actions of employees when the employer exercises a significant degree of control over the employee.[92] The US Supreme Court clarified these common law factors in *Community for Creative Non-Violence v. Reid*, in which the Court applied the general common law of agency in the master-servant relationship to determine whether a worker qualifies as an employee:

> [W]e consider the hiring party's right to control the manner and means by which the product is accomplished. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.[93]

For purposes of the IRS, the *Reid* factors boil down to three main areas of concern.[94] They are: (1) the behavioral control of the worker by the employer, such as providing instructions or training,[95] (2) the financial control (i.e., how the worker is paid and whether he or she is reimbursed for expenses), and (3) the type of relationship between the parties, or whether the work performed is an essential part of the business.[96] At the heart of the IRS inquiry is the issue of

89. US GOV'T ACCOUNTABILITY OFFICE, *supra* note 52, at 21. The IRS estimates that approximately 90 percent of SS-8 determination requests are filed by workers while the remainder are likely from employers. *Id.* at 22.

90. The remaining 25 percent of requests were closed without further advice given. US GOV'T ACCOUNTABILITY OFFICE, *supra* note 52, at 21.

91. Kwak, *supra* note 75, at 296.

92. *Id.*

93. Cmty. for Creative Non-Violence v. Reid, 490 U.S. 730, 751–52 (1989).

94. *See* TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 62, at 3.

95. I.R.S. PUBLICATION 1779 (REV. 3-2012), INDEPENDENT CONTRACTOR OR EMPLOYEE?, https://www.irs.gov/pub/irs-pdf/p1779.pdf [http://perma.cc/G5XN-AUHH].

96. TREASURY INSPECTOR GEN. FOR TAX ADMIN., *supra* note 62, at 3. The three areas of scrutiny were viewed as a welcome departure from the previously difficult to implement twenty-factor test that the IRS abandoned in 2010. For more detail into the revised IRS

employer control. The employer-employee relationship will be found to exist according to IRS regulation if the worker "is subject to the will and control of the employer not only as to what shall be done but how it shall be done."[97] In many cases, the determination is easy to make; however, class action litigation victories for Starbucks baristas, strippers, and truck drivers show that some workers occupy an ambiguous space in which many courts are inclined to find an employee relationship exists.[98] The question ultimately hinges on whether the facts demonstrate adequate employer control.[99]

The Affordable Care Act's (ACA) employer mandate inherently influences employment practices and could be contributing to rising rates of misclassification. The *Reid* factors can also inform a reading of the ACA, which does not itself provide a clear definition of employee, despite requiring employers with fifty or more full-time employees to provide them with health insurance plans.[100] Rather than crafting its own definition of "employee," the ACA refers readers to the definition of "employee" found in the Employee Retirement Income Security Act of 1974 (ERISA).[101] This definition is no more helpful. In fact, as the Court in *Nationwide Mutual Insurance Company v. Darden* explains, "ERISA's nominal definition of 'employee' as 'any individual employed by an employer, [citation omitted] is completely circular and explains nothing.'"[102] Rather than arbitrarily decide on a new definition for employee, the Court in *Darden* remained true to the fact-dependent inquiry from *Reid* and the long-established common law of agency.[103]

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framework, see TEXAS WORKFORCE COMMISSION, ESPECIALLY FOR TEXAS EMPLOYERS, APPENDIX D: IRS INDEPENDENT CONTRACTOR TEST, http://www.twc.state.tx.us/news/efte/appx_d_irs_ic_test.html [http://perma.cc/3U4Y-Q3XY].

97. Treas. Reg. § 31.3401(c)-(1)(b).

98. *See* Katie Johnston, *Lawyer Fights for Low-Wage Workers' Rights*, BOSTON GLOBE (Dec. 23, 2012), http://www.bostonglobe.com/business/2012/12/23/lawyer-shannon-liss-riordan-fights-for-low-wage-workers-rights/knsxtjO3kMwGldhP2sjLjP/story.html [https://perma.cc/4FB6-YB5M].

99. *See id.*

100. Michael A.S. Newman, *Who is an Employee and Who is an Independent Contractor under the Employer Mandate Provisions of the Affordable Care Act (ObamaCare)?* EMP. L. OBSERVER (Feb. 27, 2013), http://www.employmentlawobserver.com/2013-02-27-who-is-an-employee-and-who-is-an-independent-contractor-under-the-employer-mandate-provisions-of-the-affordable-care-act-obamacare [http://perma.cc/J4DV-MMW5]; *see* 26 U.S.C. § 4980H(c)(2)(A) (2012).

101. Section 1551 of the ACA refers readers to Section 2791 of the Public Health Service Act (42 U.S.C. 300gg-91), which defines employee as: "the meaning given such term under section 3(6) of the Employee Retirement Income Security Act of 1974 [29 USCS § 1002(6)]."

102. Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318, 323 (1992).

103. *Id.* at 327.

Understanding the common law origins of the employee determination is therefore relevant to future adjudications involving 1099 startups. As Part III discusses, recent case law suggests the legality of current arrangements may be short-lived; however, going after misclassification on a case-by-case basis may be an inefficient way to address what has quickly become a common practice in the tech startup realm. Part IV discusses proposals for a non-litigious regulatory solution to the 1099 dilemma.

III. *ALEXANDER V. FEDEX*: WHAT THE CASE MEANS FOR APP DEVELOPERS RELYING ON 1099 CONTRACTORS

If it looks like an employee, acts like an employee, then it might be . . . In the wake of the Ninth Circuit Court of Appeals decision in *Alexander v. FedEx*, in which the Ninth Circuit held that 2,300 drivers working for FedEx were misclassified as independent contractors, tech companies using the 1099 model should be weary of fallout from both state and federal labor and tax regulators for misclassifying workers.[104] Indeed, at the time of this writing, class action lawsuits brought by workers for both Uber and Lyft are pending in the Northern District of California.[105]

The recent Ninth Circuit case is especially problematic for tech startups because of its jurisdiction over Silicon Valley and, inherently, the bulk of peer economy giants. While FedEx has won independent contractor class actions in other jurisdictions, such as the District of Columbia,[106] the Ninth Circuit's finding of misclassification in *Alexander v. FedEx* is the reigning precedent in the Ninth Circuit and applies California's stringent "right-to-control" test.[107] This right-to-control test derives from a landmark California Supreme Court case, *S.G. Borello & Sons, Inc. v. Dep't of Industrial Relations*, in which the court required a multifactor fact-intensive review that examines "whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired."[108] In *Borello*, sharefarmers contracted with cucumber

104. Alexander v. FedEx Ground Package Sys., 765 F.3d 981 (9th Cir. 2014); *see* Roose, *supra* note 1; *see also* Slayman v. FedEx Ground Package Sys., Inc., 765 F.3d 1033, 1037 (9th Cir. 2014) (finding independent contractor status for 363 FedEx workers in Oregon under Oregon's "right-to-control" test).

105. O'Connor v. Uber Tech., 58 F. Supp. 3d 989, 989 (N.D. Cal. 2014); Cotter v. Lyft, 60 F. Supp. 3d 1059, 1059 (N.D. Cal. 2014).

106. *See* FedEx Home Delivery v. National Labor Relations Board, 563 F.3d 492, 495 (D.C. Cir. 2009).

107. *See* 765 F.3d 981.

108. 769 P.2d at 404.

grower "Borello" to prepare and harvest Borello's cucumber crop.[109] The farmers, mainly migrant workers from Mexico, signed an agreement pledging to pay for all the expenses and labor to cultivate and harvest the cucumbers in an independent contractor capacity. The sharefarmers and Borello agreed they would split the gross proceeds from cucumber sales fifty/fifty, thus profits from yielding a good crop were the primary incentive in place for workers.[110] Borello argued it was profit motivating the farmers, rather than the company's supervision.[111] Ultimately, the California Division of Labor Standards Enforcement did not recognize the sharefarmers as contractors due to the degree of control Borello exercised over the production and harvest of the cucumbers grown on his property, finding Borello in violation of withholding workers' compensation coverage for the farmers.[112]

In its decision-making process, the *Borello* court looked to the purpose of the California Workers' Compensation Act, which was intended primarily for the employer to act as an insurer for injuries an employee suffers on the job, protecting the employer from additional tort liability and encouraging a safe work environment.[113] These factors, in addition to the degree of control exercised by Borello, persuaded the court to find employee status for the workers.[114] Because the migrant workers were harvesting crops planted by Borello, nurtured by Borello throughout the year, on Borrello's land, placing the harvest into bins provided by Borrello, and following commonly known cultivation and harvest practices that required no particular specialized skill that would prompt a need for supervision, the court found the degree of control exercised was "pervasive" and thus indicative of an employer-employee relationship.[115]

In contrast to the Ninth Circuit's adherence to the right-to-control test, the D.C. Circuit applies a more lenient "entrepreneurial opportunities" test.[116] Thus, in *FedEx v. NLRB*, the D.C. Circuit found FedEx drivers' ability to take on multiple routes and to contract out to third parties for delivery assistance to be indicative of an independent contractor relationship. Reviewing similar facts in *Alexander v. FedEx*, the Ninth Circuit looked to the FedEx Operating Agreement (OA) requirement that FedEx drivers

109. *Id.*
110. *Id.*
111. *Id.*
112. *Id.* at 346.
113. *Id.* at 354.
114. *Id.* at 356.
115. *Id.*
116. Alexander v. FedEx Ground Package Sys., 765 F.3d 981, 994 (9th Cir. 2014).

must receive the consent of their supervisors before engaging in these "entrepreneurial" pursuits and found it indicative of the employer control.[117] For instance, under the OA, a driver can only operate more than one vehicle if FedEx agrees and if doing so is "consistent with the capacity of the [driver's] terminal."[118] Further, drivers must be in "good standing" to assign their routes to others, and FedEx reserves the right to disapprove of any assignee who is not "acceptable to FedEx."[119] Additional criteria that led to the Ninth Circuit's employee determination was the requirement that drivers wear uniforms, follow FedEx grooming standards, drive vehicles approved by FedEx, and FedEx's direction of which packages the driver should deliver and the times they must be delivered.[120]

Alexander v. FedEx appears to be analogous to the similar "driver" class action suits faced by Lyft and Uber in the Ninth Circuit. In both cases, drivers are suing the ridesharing apps for lost tips and operating expenses, claiming they were misclassified as contractors rather than employees.[121] Though both cases are still in preliminary proceedings, Uber and Lyft will likely face application of California's "right to control" test should they reach the trial stage.[122]

At a January 2015 hearing, District Judge Edward Chen heard arguments from both the plaintiff's class action attorney, Shannon Liss-Riordan, and the defendant Uber's counsel, Morgan Lewis.[123] To avoid applying the "right to control" test, Uber denies that its drivers are providing it a service.[124] In a novel approach, the company argues that it is distinct from FedEx, because it is an intellectual property company rather than a transportation company.[125] In this vein, Uber argues that it is not providing a service to customers who use the app to find rides, rather Uber drivers are themselves customers who pay Uber a fee to license their app and must compensate Uber for each use of the app as they use it to give rides.[126]

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.* at 984.

121. O'Connor v. Uber Tech., 58 F. Supp. 3d 989 (N.D. Cal. 2014); Cotter v. Lyft, 60 F. Supp. 3d 1059 (N.D. Cal. 2014).

122. *See generally* O'Connor v. Uber Tech., No. C13-3826, Transcript of Proceedings, San Francisco, CA, Jan. 30, 2015, (If the case proceeds to trial, this is the standard that will be applied under California law), http://uberlawsuit.com/Uber%20-%20Transcript%20of%20hearing%20on%20summary%20judgment%20-%201-30-15.pdf [http://perma.cc/GHE2-VP29].

123. *Id.*

124. *Id.*

125. *Id.*

126. *Id.*

While Uber's counsel argued that the app was similar to a concierge at a hotel, who operates as a middleman between hotel guests and service providers, Judge Chen expressed preoccupation at the fact that Uber, rather than taking gratuity as guests give it, demands its 20 percent fee in exchange for app licensing services for each ride.[127] Judge Chen further expressed doubt that Uber was "getting paid" simply for selling an app, which it could accomplish in the App Store.[128] Rather, Uber is compensated for each ride procured by the app and is responsible for paying the drivers and setting the rates they can charge.[129] Judge Chen listened to Uber's counsel and admitted he was skeptical of "the idea that Uber is simply a software platform service provider and nothing else."[130] On March 11, 2015, Judge Chen denied Uber's motion for summary judgment, holding that a jury trial would be necessary to decide the mixed questions of law and fact that go into the determination of whether a worker should be classified as an employee or independent contractor under California law.[131]

Should the case proceed to trial, California's "right to control" test will be applied, and the court will examine Uber's official driver manual and the agreement between Uber and its drivers. Though this agreement labels drivers as independent contractors and not employees, the court will be bound by California "right to control" precedent in *Borello*, which dictates that "[t]he label placed by the parties on their relationship is not dispositive, and subterfuges are not countenanced."[132] Though the odds seem stacked against Uber, this case's outcome should not overshadow the overarching issue. Whether or not the plaintiffs succeed in this case, as app-directed services continue to proliferate in popularity and use, the number of workers who receive very little legal labor protection or benefits will also increase as 1099 contractors become the new norm in the peer economy.

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127. *Id.*

128. *Id.* at 15.

129. *Id.*

130. *Id.* at 3.

131. O'Connor v. Uber Tech., No. C13-3826 (N.D. Cal. March 11, 2015) (order denying defendant's motion for summary judgment), http://uberlawsuit.com/OrderDenying.pdf [http://perma.cc/DGV9-FG4B].

132. Alexander v. FedEx Ground Package Sys., 765 F.3d 981, 989 (9th Cir. 2014) (citing S.G. Borello & Sons, Inc. v. Department of Industrial Relations, 769 P.2d 399, 403 [54 Cal. Comp. Cases 80] (Cal. 1989)).

IV. THROWING A LIFESAVER INTO THE POOL: THE RANGE OF ALTERNATIVES TO INCREMENTAL JUSTICE

The legal dilemma depicted here has two main forces in contention: apps tapped into the peer economy and the people who depend on them for their livelihoods. App-directed service providers—while they have the option to be "micropreneurs,"[133] dabbling in several fields at once—may very often treat their app-directed service jobs as full-time gigs. These workers are lured to app work by promises of salaries well above minimum wage and a more flexible, relaxed schedule.[134] Yet what often happens instead is their job is not as reliable as it first appeared. When the expenses of paying for their own equipment, insurance, maintenance, and taxes are added up, contractors are left with far less than they had first imagined, in addition to being without benefits like workers' compensation, collective bargaining rights, or health insurance.[135]

On the opposite side of this conflict are the incredibly innovative and resourceful app developers who see the potential the peer economy has to offer. With each man, woman, and child in possession of a smartphone, their customer base is limitless. These developers create utility and spread resources in a way that extracts value from things and skills that people already have. In doing so, jobs are created for those who choose an alternative lifestyle to a traditional "9 to 5"—not just a few jobs, but hundreds of thousands, if not millions, of jobs in the future. But there's a catch: were these startups treating their workers as W-2 employees from the beginning, they might not have had sufficient revenue to grow substantially enough to get on their feet and prosper.

This Note proposes three solutions of varying believability to counteract this division of interests: the free market correction, the W-2 crackdown, and the temporary 1099 "kiddie pool." Each of these solutions attempts to balance both the concerns of startups and the underlying policy rationale behind labor laws. Of all three, the 1099 "kiddie pool" takes into consideration the vulnerability of new business entities to the initial low revenue and high costs of starting

133. A "micropreneur" is the name for an individual who engages in many peer economy platforms to earn a living. *See* Vesey, *supra* note 36.

134. *See id.*

135. For instance, Uber in New York claims the median driver for UberX (the lowest priced of three types of rides) earned $90,766; however, Uber drivers say that after taxes, maintenance, Uber's commission, gas, and car cleanings are deducted from earnings, their income is closer to $12 per hour. *See* Alison Griswold, *In Search of Uber's Unicorn*, SLATE (Oct. 27, 2014), http://www.slate.com/articles/business/moneybox/2014/10/uber_driver_salary_the_ride_sharing_company_says_its_drivers_make_great.html [http://perma.cc/Y8XR-WPVG].

up. Assuming the firm grows up big and strong, it then scrutinizes the firm's employment model once it reaches a critical mass.

A. Free Market Correction

One approach to the question of regulating certain new technologies is to simply "let the market sort it out." The fear is that, by over-regulating a new technology that has yet to demonstrate its full potential, the government could be precluding itself from receiving tremendous future benefits, resulting in a regulatory failure.[136] Called "inchoate technologies," inventions and innovations that are still in an early form of development, and are thus especially vulnerable to hamstringing by excessive regulation, possess a distinct protection interest.[137] Ideally, a free market correction would advance the objectives of all interested parties, with firms increasing pay and labor protections to compete for skilled workers (who would be in demand by consumers)—but therein lies the problem. For example, when skills such as driving are commodified, all drivers are nearly equally skilled (although many would beg to differ), and the competition for jobs steepens. It is not the firms that would compete for drivers, but rather drivers that would compete for firms. In that regard, firms and customers may receive higher quality drivers with better credentials, perhaps through demonstrated safe driving records and passage of background checks, but the laborers themselves are left without a bargaining chip at the free market table. Hence, we have the introduction of health and labor regulations, many of which can be seen governing the taxi industry—to the detriment of its current competitiveness with ride-sharing apps.

Of course, when the technology itself is not being regulated, but rather private actors involving third parties are the primary concern, an attempt at regulating the circumstances surrounding the inchoate technology may be justified.[138] Generally, health and safety concerns, such as those present in the case of worker misclassification, can tip the balance toward a presumption of regulation.[139]

In the case of Uber's preferred 1099 model, it is clear that the market has embraced the cheap rides Uber drivers supply. Again, the inchoate technology is the app, not the actual process of giving rides. Uber's easily accessible platform has scooped up a market share of

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136. Daniel Gervais, *The Regulation of Inchoate Technologies*, 47 HOUS. L. REV. 665, 667–70 (2010).

137. *Id.*

138. *Id.* at 702.

139. *See* Cass R. Sunstein, *Laws of Fear: Beyond the Precautionary Principle*, 151 U. PENN. L. REV. 1003, 1018 (2005).

tech savvy customers who are unsatisfied with the fares and experience of regular taxis. Further, Uber drivers, as free market participants, can opt out of their contracts at any time and are not required to work a set number of hours or days. The recently released Uber Report claims that 51 percent of Uber drivers work between one and fifteen hours per week. This would suggest that the majority of Uber drivers would not qualify for full-time employee benefits but instead work part time. These drivers are likely looking for a supplementary income in addition to another job. In contrast, approximately 20 percent or more of drivers do so full-time (in excess of thirty hours per week).[140] That is, 20 percent of Uber drivers treat it like a full-time job. Since Uber doesn't limit drivers from doing this, a fair number of workers are choosing Uber as their full-time income source. That's approximately 32,407 drivers.[141] This is where rhetoric about "micropreneurs" and stay-at-home moms goes sour: though Uber may set itself up as a principal with thousands of independent contractors, many of those contractors rely on the company for their whole livelihood. This structure inevitably raises all of the tax and labor issues this Note discussed previously. As stated by the court in *Borello*, the major reason behind having labor laws in the first place is to protect the public treasury from the externalities of workers that are better borne by their employer.[142]

Allowing Uber and other successful 1099-powered startups to continue under this model eschews all of the wage and labor protections that have been put in place at both the federal and state levels. These measures truly do have a purpose, and inflated wages for drivers can easily leave them shortsighted about their future position when the social net they thought they had vanishes beneath their feet.

B. W-2 Crackdown

The most draconian measure that could be taken to ensure that proper wage and labor standards are upheld for 1099-powered startups is to blanket enforce W-2 employee status. Depending on the results of the class action suits in the Ninth Circuit, this could become a reality, at least for transportation-style startups. While enforcing the W-2 regime would alleviate many of this Note's concerns, it could also kill the startups before they even get off the ground.

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140. Hall & Krueger, *supra* note 24 at 20, tbl. 4.

141. See previous total number of Uber drivers figure and multiply by 20 percent—the more conservative number of Uber drivers working full time.

142. *Borello*, 769 P.2d at 404.

A W-2 crackdown on so-called "inchoate technologies," which many would agree is an accurate description of many 1099 startups, could preclude the economic and social benefits that many of these startups provide. There is simply too much potential that could go unseen were a draconian measure adopted. Further, application of the common law factors on a case-by-case basis is the only way to distinguish certain startup models from others. For this reason, the 1099 "kiddie pool" discussed below could be the ideal alternative to either the free market approach or a stringent enforcement of W-2 status on fledgling companies that may possess unforeseeable future potential.

C. 1099 Kiddie Pool

The 1099 "kiddie pool" is a leniency period for app developers just getting their startup off the ground. Under this proposed legal framework, startups are free to use the 1099 contractor model during their most vulnerable time while the app tries to "catch on" with the public. For Uber, this period was arguably two years—at least for the world outside of Silicon Valley—to catch on to the app and embrace its services.[143] However long it takes the app to "catch on," what is necessary to deciding when the app should be forced to exit the "kiddie pool" is the time at which the app reaches a critical mass.

Critical mass can be measured in revenue, value of the business, or in the number of workers employed. Uber's current worker count of 162,037 appears ready to exit the "kiddie pool."[144] Its $40 billion valuation also seems mature enough to warrant an exit.[145] The last figure that can be considered here is total revenue for the company. Though Uber's yearly net profits are unknown, CEO Travis Kalanick has stated that gross revenue in San Francisco alone (one of Uber's most successful and oldest markets) was $500 million at the end of 2014.[146] These numbers can safely be considered as meeting the threshold for critical mass. Further discussion of peer firms will help narrow the approximate range of critical mass measurements that would be most precise and appropriate.

Critical mass in other employment law settings is much more conservative than Uber's numbers. The ACA, for example, pegs the requisite number of employees to warrant application of the Employer

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143. *See* Lonzetti, *supra* note 30.

144. *See* Hall & Krueger, *supra* note 24.

145. Mac, *supra* note 21.

146. Carmel DeAmicis, *Uber's Raking in Money in SF, but the Story is Complicated*, GIGAOM (Jan. 19, 2015), https://gigaom.com/2015/01/19/ubers-raking-in-money-in-sf-but-the-story-is-complicated/ [https://perma.cc/5Y7E-VG3U].

Mandate at just fifty.[147] Further, the Family Medical Leave Act (FMLA) also has a fifty-employee requirement before requiring the employer to allow employees to "take a maximum of twelve weeks unpaid leave for the birth of a child or in order to care for a seriously ill spouse, child or parent."[148] At the highest end of the spectrum, the Worker Adjustment and Retraining Notification Act (WARN) applies to employers with one hundred or more employees.[149] Though laudable, these numbers are a far cry from those needed by a firm to cross over from the "kiddie pool" to the lap pool. Finding little guidance toward a critical mass from traditional employment law, perhaps real life firm sizes are the more realistic standard from which to calibrate a critical mass.

V. LEARNING FROM THE PAST: BREAKING GROUND FOR THE KIDDIE POOL

The ideal framework for the "kiddie pool" model is a standard informed by real world practices that takes into consideration the vulnerability of startups. After all, with "fail fast, fail often" as the mantra of Silicon Valley, startups are estimated to fail 90 percent of the time.[150] In light of the inflexibility of imposing a strict W-2 regime on all startups and the discomfort this Note has toward leaving enforcement of labor laws up to the free market, the "kiddie pool," informed by current tech successes, is the closest measure available for setting a practicable critical mass to govern when firms must "level up" to the W-2 pool.

In this vein, Uber and the similarly situated Lyft provide excellent evidence of permissible upward limits for the "kiddie pool" in terms of revenue and number of workers. Both companies have expanded significantly in a short period of time and have a milieu of drivers who rely on them as a sole source of employment. The data available from both of these firms, along with other successful 1099 startups, should be compiled and analyzed to ascertain their "critical mass." This much-needed research would assist in gauging the proper

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147. Patient Protection and Affordable Care Act, 42 U.S.C. § 18001 (2010); *see* 26 U.S.C. § 4980H(c)(2)(A) (2012); CIGNA, EMPLOYER MANDATE FACT SHEET 1 (2015), http://www.cigna.com/assets/docs/about-cigna/informed-on-reform/employer-mandate-fact-sheet.pdf [https://perma.cc/D4N5-YPZD].

148. 29 U.S.C. § 2611(4)(a)(i) (2012).

149. WARN, 29 U.S.C. § 2101(a)(1) (2010) (requiring employers to give advance notice of plant closings and mass layoffs).

150. Alison Griswold, *Startups with Shorter Names Are More Likely to Succeed, Study Finds*, SLATE (Feb. 9, 2015), http://www.slate.com/blogs/moneybox/2015/02/09/startup_success_factors_short_names_and_an_office_in_silicon_valley_study.html [http://perma.cc/Q67C-992N].

time to exit the "kiddie pool." While the exact standard may be a range of quantities or a semi-arbitrarily selected quota or cap, it is clear that a metric is needed as 1099-fueled startups continue to make up a greater share of the workforce. Labor, health, and wage protections for workers should not be lost in the cracks of 1099 ambiguity. Moving firms who get too big out of the "kiddie pool" and into the W-2 pool ensures that the stunning economic growth of these firms is also socially sustainable.

VI. CONCLUSION: DIVING INTO THE DEEP END

Silicon Valley startups are the new titans of the US economy. Their shrewd use of app-based technology allows them to reach millions of customers with seemingly endless applications for their ingenuity. But what is consumed is also supplied. Workers are joining the digitalized 1099 economy at a marked pace, only they are not receiving the rights and benefits typically allotted them in a traditional employment relationship. In the interest of sustaining the social net that federal and state labor and welfare laws have strived to construct, app-based employers must be held accountable for the welfare of their workers. Though jurisprudence in this realm is still developing, adopting a new framework for addressing the future of startup employment could allow the law to keep pace with technology. This Note's proposed 1099 "kiddie pool" serves as one such framework, providing a safe haven for peer economy startups to develop, and thereafter, a safety net for the workers who make their success possible.

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