THE NEXT CHAPTER IN EMPLOYEE MISCLASSIFICATION

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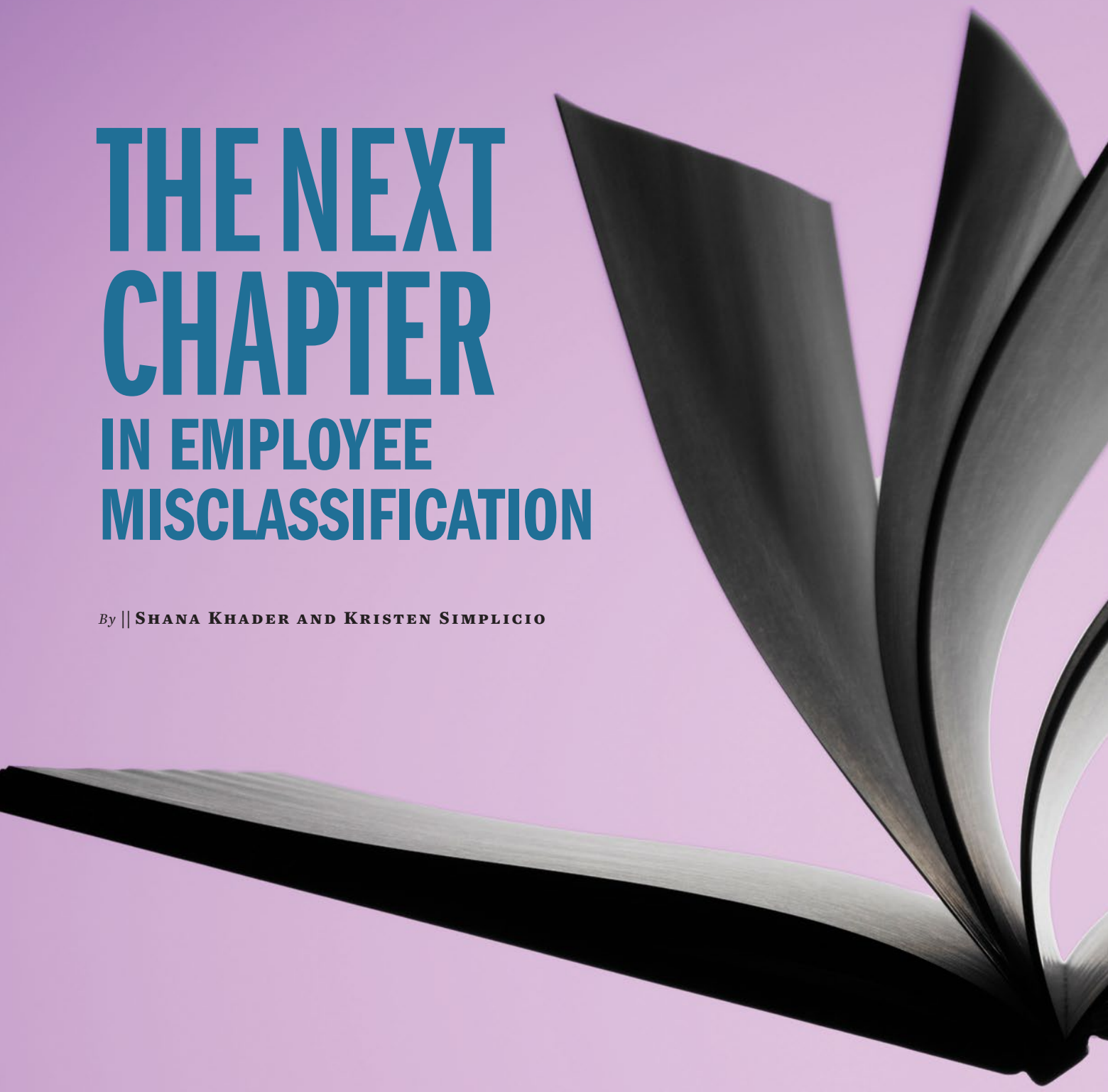

Technological advances have brought new employee misclassification issues. Here's how this affects workers in the multi-level marketing industry.

Employee misclassification certainly isn't new, but its face continues to evolve. Early decisions guiding the interpretation of the Fair Labor Standards Act assessed whether beef boners on a slaughterhouse production line were employees (they were)[1]; whether "newsboys" who worked full time selling newspapers on the street were employees (they were, too)[2]; and whether coal shovelers who brought their own picks and shovels to work were employees (they were, but the drivers who brought their own trucks and helpers were not).[3]

And while misclassification undoubtedly continues to run rampant in industries employing the more manual types of labor that gave rise to those early cases, technological advances have pushed questions of employee classification into new arenas: most publicly, to app-based workers. But what about companies operating in the $40 billion multi-level marketing (MLM) industry[4]—which has transformed beyond home parties and now relies extensively on "independent contractors" who mostly sell products to friends, family, and their social media networks?

With one in every 13 Americans joining an MLM organization in their lifetimes and so few earning money from these endeavors,[5] it's worth considering how we got here. Decades ago, workers in the nascent MLM industry bore a resemblance to door-to-door salespeople—for both, in-home, personalized demonstrations were the key to convincing skeptics to buy novel products.[6] While this work was viewed as "independent" under the common law, today laws are more protective of workers.[7] Home parties are becoming a relic of the past,[8] and so should our assumptions about these workers' legal status.

TESTS AND UNDERLYING PRINCIPLES

For the most part, the inquiry under both state and federal law is one of "economic reality," essentially seeking to answer the questions: Who does the worker work for? And is the worker economically dependent on the employer for work or are they really in business for themselves?[9] This is a multifactor inquiry, riddled with gray areas.

At least a few states have adopted versions of the more stringent "ABC test," which places the burden on the hiring entity to show that the worker is free from its control, performs work outside the usual course of its business, and is customarily engaged in an independently established trade.[10]

If the hiring entity cannot demonstrate all three of these elements, then the worker is presumed to be its employee. Because the ABC test is clearer and more worker-friendly than the economic reality test, it should not be a surprise that ABC jurisdictions like California have given rise to misclassification litigation on behalf of app-based workers.

Before discussing how misclassification principles apply to modern workers, it is worth reminding ourselves what is at stake when we talk about employee misclassification. First, there is the right to be paid for time worked—including the floors set by law for minimum wage and overtime. Many jurisdictions provide employees with important rights to paid sick and parental leave, unemployment benefits, workers' compensation, and protection from discrimination and sexual harassment.

In addition, employers are subject to payroll taxes that go toward funding Social Security, Medicare, and state and federal unemployment insurance programs. Taken together, these protections—at least in theory—are designed to provide some stability for working people in the United States. Employers that misclassify their employees as contractors deprive these workers of benefits and deprive state and federal safety net programs of crucial funds.

THE MISCLASSIFICATION STATE OF PLAY

In recent years, app-based gig workers—particularly drivers for Instacart, Postmates, and Uber—have been subject to litigation for potential employee misclassification. Undergirding these cases is a sense that workers can work *a lot* and still earn *very little*, particularly when accounting for expenses such as car maintenance, mileage, and the cost of smartphones.

In *James v. Uber Technologies*, for example, the named plaintiff claimed that some weeks he earned as little as $3.90 per hour after accounting for expenses.[11] And in San Diego's lawsuit

against Instacart, the government alleged that Instacart's payment formula did not account for workers' time spent waiting for orders, miles driven to the store, or necessary equipment such as insulated bags, violating California's minimum wage and overtime laws.[12]

App-based workers and their advocates, including government enforcement agencies, have achieved significant victories. These include a $100 million settlement in a private lawsuit against Doordash[13] and a $100 million settlement in New Jersey's misclassification suit against Uber, in which the state demanded the payment of back taxes.[14] But despite these settlements, the status of the workers remains largely unadjudicated, including in jurisdictions with the most robust worker protections.

The prevalence of forced arbitration agreements in workers' contracts has made it harder for workers to fight misclassification. However, mass arbitration is one interim tool to wield until a more permanent solution to forced arbitration can be achieved.[15]

With mass arbitration, hundreds or thousands of workers can file individual arbitrations, which can prompt not only individual relief but also broader resolution.[16] This fight will certainly rage on not only in the courts and arbitral forums but also through legislative advocacy and continued worker organizing.

THE MULTI-LEVEL MARKETING INDUSTRY

Meanwhile, technological advances continue to lead to new misclassification issues. One example is the enormous MLM industry, in which companies use workers whom they classify as independent contractors to sell their products to friends, family members, and—increasingly—their social media networks.

During the COVID-19 pandemic, MLM recruitment soared—particularly recruitment of women, who make up 74% of MLM participants.[17] But despite the continued allure of these companies, one study found that 99% of MLM participants end up *losing* money.[18] And they share more with gig or app-based workers than may initially meet the eye.

Like app-based workers, companies recruit their MLM salesforce through promises of "flexibility" and shimmering (but vague) representations about earning potential, bonuses, and building their own businesses.[19] Despite touting this flexibility, both app-based and MLM companies can exert significant direction over how the work is performed—one of the hallmarks of employee status under the more amorphous economic realities test and the clearer ABC test.[20]

As alleged in *James v. Uber Technologies*, Uber sets (and can change) its drivers' pay rates, closely monitors their performance, determines and enforces certain quality standards, and requires that drivers use its app to control their work flow.[21] In *Rimler v. Postmates*, the plaintiffs alleged similar facts, including that Postmates unilaterally set couriers' pay, assessed their performance based on customer feedback, and disciplined workers based on this feedback.[22]

Many MLM companies operate in the same way—exerting control over workers while classifying them as independent contractors. In a case filed against health, beauty, and home products MLM company Amway in 2020 for wage violations, the plaintiff alleged that Amway controlled sellers' work through stringent "Rules of Conduct," governing where and how products could be sold and dictating product messaging, among other things.[23]

Similarly, in *Lyons v. The Beachbody Company*, filed in May 2023, the plaintiff alleges that while working as a "coach" for fitness-based MLM company Beachbody, the company maintained strict control over the product pricing (and therefore her earning potential), controlled messaging around the products she sold, handled fulfillment and shipping of orders, provided extensive training, and required use of its app and website to perform her sales work.[24]

At the same time, like app-based drivers, MLM sellers are required to pay myriad business expenses out of their own pockets: In the *Beachbody* case, the plaintiff alleges that workers were expected to purchase sample products and pay for internet service and that they were required to incur a monthly service fee just to remain enrolled in the selling program.[25] And yet, like app-based drivers, the financial rewards may never come: Despite spending time, energy, and money, the plaintiff alleges that coaches may make little or no money at all. All the while, because coaches promote Beachbody's products on their social media, the plaintiff alleges that Beachbody benefits from what is essentially free online marketing, watching its products and promotions trend on social media and its bottom line grow.

In addition to alleging that they were misclassified as independent contractors, plaintiffs in these types of cases may also allege violations of state labor laws, such as wage-and-hour laws and laws related to meals and breaks.

THE OUTDATED 'DIRECT SELLER' EXEMPTION

For years, MLM companies have largely shielded themselves from liability based on "direct sales" exemptions under state law. MLM companies allege that these exemptions, lobbied for heavily by the Direct Selling Association

(an MLM lobbying group), establish independent contractor status for MLM workers.[26] But it's time to look closely at these exemptions—because with technological advances changing how work is conducted, the wording of these statutes is largely outdated. And because the federal Fair Labor Standards Act does not contain any direct selling exemption, possible changes to its notoriously worker-unfriendly test for misclassification may offer another path forward as well.[27]

A different federal law—the Tax Code—defines "direct sellers" broadly and treats them as independent contractors for tax purposes only.[28] Many direct sales exemptions to state labor codes contain similar language,[29] but there are variations. In California, the exemption is limited to those who are engaged in the business of "primarily inperson demonstration and sales."[30] Oregon has a similar modification.[31]

The exemptions under these state statutes, however, may not reach modern practices.[32] There is a real question as to whether any of these statutes, written decades ago for Tupperware® party hosts, can encompass the reality of modern-day MLM sales, where workers increasingly sell online to consumers rather than in person—especially since the onset of COVID-19.

Indeed, in 2018, after analyzing the legislative history and its extensive consideration of Tupperware parties, the Oregon Supreme Court strictly interpreted the language of its state's direct sales statute to find the sellers were not independent contractors, and in a concurring opinion, one justice provided further elaboration on the differences between the industry today and at the time of the bill's passage.[33]

KEY TAKEAWAYS

How *Beachbody* and other lawsuits against MLM companies play out

remains to be seen, but one thing is for sure: There are millions of workers in the U.S. who are losing money working for these companies, while the industry is as successful as ever. And we, as workers' rights advocates, need to revisit some of our assumptions about the industry to best help its workers. Here are some suggestions for representing workers in this area.

Give careful attention to laws in the relevant jurisdiction on direct sellers. If there is a codified direct sales exemption, does its language suggest a narrow application to home parties? What protections does the jurisdiction give to workers in analogous contexts, such as gig workers, and those in telemarketing and lead generation?

Review the worker's 'independent contractor' agreement for signs of control. Does it limit the worker's ability to set their own prices, exercise discretion in advertising, or sell through channels other than the company's website? These are all signs of control and reduced opportunity to exercise discretion.

Consider time spent developing social media posts and the commensurate value to the company. Do not discount this work in evaluating lost wages. Creating TikTok videos and catchy Instagram stories can be time-consuming work that delivers huge benefits to the MLM company, even when the worker does not see any commissionable sales. Their work creating social media posts and hashtags may be coordinated by the MLM company to drive exposure, brand awareness, and website visits.

And a review of the MLM company's privacy policy may reveal the ways in which the company is capturing data and using that data for its own benefit. For example, the MLM company may retain the rights to track and display advertising to its website visitors, allowing the MLM company to continue to target potential leads with advertising—resulting in potential sales—long after the worker's efforts initially directed them to the website.

Find ways to challenge forced arbitration agreements. Forced arbitration agreements are one-sided and may be unenforceable. You may be able to challenge them on the grounds that they do not reach actors that could be liable (such as company directors)[34]; have formation problems[35]; or contain language barring the enforcement of statutory rights.[36]

Because arbitration typically does not provide for rights to appeal, the possibility of enormous statutory penalties and significant public injunctive relief may dissuade defendants from arbitrating disputes. Likewise, because arbitration costs can be significant for the defending company, the possibility of mass

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arbitration might persuade the MLM companies to stay in court.[37]

When forced arbitration cannot be avoided, review the forum's rules. While forced arbitration agreements may be silent or call for commercial rules, the forum may have special fee schedules and practices for misclassification cases. For example, the American Arbitration Association's Commercial Rules call for the use of the "Employment Fee Schedule" in misclassification cases, which requires the defending company to pay most of the arbitration costs, whereas costs are typically split under the Commercial Rules.[38]

MLM work arrangements are often designed to undervalue workers' contributions—just as gig workers in the app-based economy. But it does not have to be that way. By looking to the hard-fought litigation wins on behalf of gig workers and revisiting our assumptions about MLM companies, advocates have a real opportunity to help the workers who have built the MLM industry get the recognition, protection, and compensation they deserve.


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Notes

1. *See Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947).
2. *See N.L.R.B. v. Hearst Publ'ns, Inc.*, 322 U.S. 111 (1944) (interpreting the National Labor Relations Act).
3. *See United States v. Silk*, 331 U.S. 704 (1947) (interpreting the Social Security Act).
4. According to the Direct Selling Association, an MLM lobbying group, MLM companies generated $40.1 billion dollars of revenue in 2020. Direct Selling Ass'n, *Direct Selling Association Releases Data Showing Record High Sales, Sellers, and Customers in the U.S. in 2020*, May 26, 2021, https://tinyurl.com/3tb7up48.
5. *See* Marguerite DeLiema et al., *AARP Study of Multilevel Marketing: Profiling Participants and Their Experiences in Direct Sales*, AARP, Aug. 2018, https://tinyurl.com/ycvwxan9/.
6. *See generally* Kat Eschner, *The Story of Brownie Wise, the Ingenious Marketer Behind the Tupperware Party,* Smithsonian Mag., Apr. 2018, https://tinyurl.com/2adedj2a.
7. *Compare Electrolux Corp. v. Danaher*, 23 A.2d 135, 139 (Conn. 1941) (finding door-to-door sales workers to be free from hiring entity's control under common law) *with Kirby of Norwich v. Adm'r, Unemployment Comp. Act,* 176 A.3d 1180, 1184 (Conn. 2018) (finding door-to-door sales worker to be an employee under state's ABC statute).
8. *See* Abby Vesoulis & Eliana Dockterman, *Pandemic Schemes: How Multilevel Marketing Distributors Are Using the Internet—and the Coronavirus—to Grow Their Businesses*, Time, Jul. 9, 2020, https://time.com/5864712/multilevel-marketing-schemes-coronavirus/. One MLM company candidly told investors about how its workers deliver "significant value" to the company by helping new products and programs "become a trending term on social media." *The Beachbody Company, Inc. (BODY) CEO Carl Daikeler on Q1 2022 Earnings Call Transcript*, Seeking Alpha, May 9, 2022, https://seekingalpha.com/article/4509407-beachbody-company-inc-body-ceo-carl-daikeler-on-q1-2022-earnings-call-transcript.
9. *See generally* Mark Burton, *Reversing Employee Misclassification,* Trial, Sept. 2021, at 18.
10. *See, e.g., Dynamex Operations W., Inc. v. Super. Ct. of L.A. Cnty.*, 416 P.3d 1, 35 (Cal. 2018). Other jurisdictions that have adopted some version of the ABC test for wage-and-hour protections include Connecticut, Massachusetts, Nebraska, New Jersey, and Vermont. Other states apply it only in limited areas, such as construction, or only to analyze unemployment insurance eligibility but not for other wage-and-hour laws. A survey of state laws appears at the appendix in Jon O. Shimabukuro, *Worker Classification: Employee Status Under the National Labor Relations Act, the Fair Labor Standards Act, and the ABC Test*, Cong. Rsch. Serv., Apr. 20, 2021, https://crsreports.congress.gov/product/pdf/R/R46765/1.
11. Amended Consolidated Class Action Complaint ¶ 43, *James v. Uber Techs., Inc.*, No. 19-cv-06462 (N.D. Cal. July 14, 2020).
12. Complaint ¶¶ 28–29, *People v. Maplebear, Inc.*, No. 37-2019-00048731 (Cal. Super. Ct. Sept. 13, 2019).
13. Class Action Settlement Agreement & Release, *Marko et al. v. Doordash, Inc.*, No. BC659841 (Cal. Super. Ct. July 9, 2021).
14. Cade Metz, *Uber Agrees to Pay N.J. $100 Million in Dispute Over Drivers' Employment Status*, N.Y. Times, Sept. 12, 2022, https://www.nytimes.com/2022/09/12/technology/uber-new-jersey-settlement.html.
15. In California, for example, another tool is its unique Private Attorneys General Act (PAGA), which provides workers the right to pursue wage-and-hour violations on behalf of the state. For more on how courts have interpreted PAGA, see *Viking River Cruises, Inc. v. Moriana*, 142 S. Ct. 1906 (2022); *Adolph v. Uber Techs., Inc.*, 532 P.3d 682 (Cal. 2023). Another tool in California is its arbitration fee statutes imposing stiff penalties on businesses that default on arbitration payments beyond 30 days of their due date, including waiver of the right to compel arbitration. Cal. Civ. Proc. Code §§1281.97, 1281.98, & 1281.99.
16. *See* Andrew Wallender, *Uber Settles 'Majority' of Arbitrations for at Least $146M*, Bloomberg Law, May 9, 2019, https://news.bloomberglaw.com/daily-labor-report/uber-sees-wage-suits-dropped-including-12-501-arbitration-claims.
17. *See generally* Vesoulis & Dockterman, *supra* note 8; Bridget Read, *Hey Hun! In Women's Joblessness, Multi-level Marketers Saw Opportunity*, N.Y. Mag.: The Cut, Feb. 3, 2021, https://www.thecut.com/2021/02/pandemic-unemployment-multi-level-marketing.html.
18. Emily Stewart, *$5 Jewelry and an MLM Conference Gone Wrong*, Vox, Sept. 23, 2021, https://www.vox.com/the-goods/22688317/mlm-covid-19-pandemic-recruiting-sales-paparazzi.
19. For examples of language that companies use to make these promises, see Uber, *Drive*, https://www.uber.com/us/en/drive; Handy, *Be a Professional With Angi Services*, https://www.handy.com/apply; Scentsy, *Join Scentsy*, https://scentsy.com/join; Rodan and Fields, *Become a Rodan and Fields Consultant*, https://www.rodanandfields.com/en-us/enrollment/become-a-rodan-and-fields-consultant; LuLaRoe, *Join LuLaRoe*, https://www.lularoe.com/join-lularoe.
20. *See generally* Burton, *Reversing Employee Misclassification*, *supra* note 9.

21. Amended Consolidated Class Action Complaint, ¶ 33–38, *James v. Uber Techs., Inc.*, *supra* note 11.
22. Second Amended Class Action and PAGA Complaint ¶¶ 25–27, *Rimler v. Postmates, Inc.*, No. CGC-18-567868 (Cal. Super. Ct. July 15, 2021).
23. First Amended Complaint ¶¶ 55–67, *Orage v. Amway Corp.*, No. RG20049773 (Cal. Super. Ct. Dec. 23, 2020). The *Amway* suit, brought under California's PAGA, was eventually forced into arbitration. But the California Supreme Court's recent decision in *Adolph* raises a question of whether such a result could be avoided in future PAGA cases. *See* 532 P.3d 682.
24. *See generally* Class Action Complaint, *Lyons v. The Beachbody Co.*, No. 23STCV11459 (Cal. Super. Ct. May 22, 2023).
25. *Id.*
26. *See* Jessica Burch, *The Pyramid Problem: Regulating Direct Sales at the Edges of Labor and Consumption, 1972–1982*, chapter from a forthcoming book, available at https://labor.history.ucsb.edu/sites/secure.lsit.ucsb.edu.hist.d7_labor/files/sitefiles/Burch_Pyramid%20Problem_100418_UCSB%20.pdf, at 27–28.
27. FLSA's misclassification rules are not as worker friendly as many state laws, and it remains to be seen whether the Biden administration will be successful in efforts to change that. *See* Rachel M. Cohen, *The Coming Fight Over the Gig Economy, Explained*, Vox, Oct. 12, 2022, https://www.vox.com/policy-and-politics/2022/10/12/23398727/biden-worker-misclassification-independent-contractor-labor.
28. 26 U.S.C. §3508(b)(2)(A)(ii).
29. *See, e.g.*, Fla. Stat. §443.1216(13)(u); Tex. Lab. Code §201.070(2).
30. Cal. Unemp. Ins. Code §650.
31. Or. Rev. Stat. §657.087.
32. For example, the laws identified in footnotes 29–31 codify exemptions for sellers who are compensated on a "buy-sell basis" or "deposit-commission basis," terms defined at 26 U.S.C. §6041A(b)(2)(A) & (B). MLM workers paid under other commission models may not fall under this exemption.
33. *See ACN Opportunity, LLC v. Emp. Dep't*, 418 P.3d 719, 729, 731–33 (Or. 2018).
34. *See, e.g.*, *Doe v. Trump Corp.*, 6 F.4th 400, 410 (2d Cir. 2021) (upholding decision to refuse to allow non-signatories to enforce arbitration agreement under equitable estoppel theory).
35. *See, e.g., Cullinane v. Uber Techs., Inc.*, 893 F.3d 53, 64 (1st Cir. 2018) (finding no agreement to arbitrate was formed where notice of terms was inconspicuous).
36. *See, e.g.*, *McGill v. Citibank, N.A.*, 393 P.3d 85 (Cal. 2017) (finding arbitration agreement waiving right to seek public injunctive relief to be unenforceable).
37. Alison Frankel, *Uber Loses Appeal to Block $92 Million in Mass Arbitration Fees,* Reuters, Apr. 18, 2022, https://www.reuters.com/legal/litigation/uber-loses-appeal-block-92-million-mass-arbitration-fees-2022-04-18/.
38. *See* Am. Arbitration Ass'n, *Commercial Arbitration Rules and Mediation Procedures*, Sept. 1, 2022, at 10, https://www.adr.org/sites/default/files/Commercial_Rules_Web.pdf.