California Governor Gavin Newsom signed Assembly Bill 5 (A.B. 5) into law on September 18, 2019. The legislation, which generally takes effect January 1, 2020, redefines when a person performing work for a business is considered an employee for purposes of California law. A.B. 5 will significantly affect ride share platforms, known in California as Transportation Network Companies (TNCs)—including, most notably, Uber and Lyft, whose drivers are currently considered independent contractors under both California and federal law—as well as their drivers and customers. In practical terms, A.B. 5 will result in greater costs for the platforms, reduced pay for many drivers, reduced flexibility for all drivers, and higher fares for consumers—as much as 50 percent higher in some cases.

Although Uber has indicated that it does not immediately plan to reclassify its drivers as employees—maintaining that its drivers do not perform work at the core of the company’s operations—the viability of the employee status test established under A.B. 5 has been met with skepticism by many labor law experts.

Under A.B. 5, whether a worker is an employee or independent contractor under the California Labor Code is determined by a set of standards known as the “ABC test,” which the California Supreme Court adopted in 2018 with respect to California wage orders. Under the ABC test, a person performing work for a business is an independent contractor only if the hiring entity can establish each of the following factors:

(A) that the worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the work and in fact; and (B) that the worker performs work that is outside the usual course of the hiring entity's business; and (C) that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

This essay examines how A.B. 5 will affect both TNC drivers, and by extension riders, given that the law will likely result in higher fares due to TNCs treating their drivers as employees under California law. Although A.B. 5 will likely increase the total net compensation of TNC drivers in terms of median hourly earnings, at least some drivers will likely see lower

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hourly earnings and the number of drivers able to earn a living working as TNC drivers will likely decrease. TNCs will also face a strong incentive under A.B. 5 to decrease the level of flexibility they currently afford their drivers in terms of which cars they may use, how they maintain their cars, how many hours they may work, and when and where they work. As for riders, a substantial fare increase, amounting to as much as a 50 percent increase in the price of a typical trip, is all but inevitable.

**How A.B. 5 Will Affect Drivers**

*Minimum Wage.* In California, the statewide minimum wage for most employees is $12 per hour. It is set to rise to $13 in 2020. The minimum wage is higher in some California jurisdictions, such as San Francisco, where it is $15.59 per hour. As employees, California TNC drivers would be eligible for a minimum hourly wage of $13 per hour in 2020—or, in several California jurisdictions, a higher minimum wage. This minimum wage may exceed the amount that TNC drivers currently earn in average wages after expenses. A 2018 study by Lawrence Mishel of the Economic Policy Institute (EPI) found that Uber drivers nationwide earn an average of $9.21 per hour.

However, hourly pay varies considerably from driver to driver. A 2018 study that analyzed internal fare data provided by Uber found that on a single day in Los Angeles, expected driver wages had a standard deviation of over $3 per hour, which corresponded to wage variation of over 10 percent.

TNCs must pay drivers no less than minimum wage even when they are idling between fares. Therefore, requiring TNCs to pay drivers a minimum wage of $13—or more—will give them a strong economic incentive to force relatively unproductive drivers to become more productive or face termination. TNCs might allow drivers to go on the clock only after they travel to a neighborhood where demand exceeds supply. Uber and Lyft have already implemented this practice in New York City, where the city’s Taxi and Limousine Commission has imposed a pay floor for drivers based on the percentage of total driving time when vehicles are occupied by passengers.

To the extent that TNCs exercise greater discretion over where drivers must travel and when they may work, TNCs will be less likely to share windfall earnings with drivers, for completing trips in areas where fares are unusually high, known as surge pricing or prime time. Currently, TNCs share this windfall with drivers is to encourage them to flock to high-demand, low-supply areas. But if TNCs can simply dictate to drivers where they must go and when they must work, TNCs will not need to rely on economic incentives as much to motivate drivers to service high-demand areas.

*Work Hours.* The flexible nature of working for a TNC is one of the main factors attracting drivers to TNCs. Drivers are free to work an hour here and there—or spend 12 hours on the road for seven days in a row, if they so choose. The amount drivers earn depends on
demand from prospective riders, the supply of other drivers, and the fare determined by the TNC app. That will all change under A.B. 5.

In California, when an employee works over 40 hours in a week, she earns 150 percent of her regular wage for each additional hour. When an employee has worked 12 hours in a day, she earns 200 percent of her regular wage for each additional hour. And when an employee has worked six days in a row—regardless of the number of hours—she earns 150 percent of her regular wage for each hour worked on the seventh consecutive day. California law does not allow “employers to require employees to routinely work for minutes off the clock without compensation.”

As employees, drivers would become eligible for overtime pay of up to 200 percent of their regular wage, depending on how many hours a driver had worked in a single day or week. TNCs might be willing to pay overtime in some cases. However, given the large supply of drivers willing to work for minimum wage, TNCs would likely prohibit drivers from working more than 40 hours in a week, 12 hours in a day, or seven days in a row. Drivers who prefer to work a few 12-hour days each week, or a couple of hours each day for a week at a time, would suffer from reduced earning capacity under the incentive structure that TNCs would face under the California Labor Code.

TNCs would also likely change their approach to drivers who are on the road looking for a fare with the app running. Because California requires an employer to compensate employees whenever they are on the clock, a driver who is willing and able to accept a ride request would likely be considered actively working and thus entitled to minimum wage. TNCs would therefore have a strong incentive to exert greater control over drivers, who are currently allowed to travel wherever they wish, or require them to remain stationary until they accept a fare. TNCs might insist that drivers in low-demand neighborhoods travel to busier parts of town, so the TNC does not have to pay an employee to drive around without a paying customer. TNCs might also prohibit drivers who are between fares from operating two or more TNC apps simultaneously—a common practice among drivers who work with both Uber and Lyft—to minimize how long it takes to get their next passenger.

**Health Insurance.** Under the Patient Protection and Affordable Care Act, also known as Obamacare, large employers must offer employer-subsidized health insurance coverage to at least 95 percent of their employees who work 30 hours or more per week on average. Because Obamacare requires large employers to provide coverage that is affordable, a covered employee’s premium contribution cannot exceed 9.86 percent of the employee’s household income. Employees in households earning under 400 percent of the federal poverty line are eligible for additional premium assistance.

Requiring TNCs to provide affordable health insurance coverage to drivers who work 30 or more hours per week will likely result in the same outcome that the Obamacare employer mandate has produced elsewhere: an incentive to limit the number of hours that employees may work each week so that they are not considered full-time employees.
Obamacare also requires health insurance coverage provided by an employer to cover at least 60 percent of the plan’s total costs, equivalent to a “bronze” plan in the Obamacare marketplace.23 Employers who do not offer adequate coverage are subject to significant monetary penalties.24 In California, the average premium for the lowest-cost bronze health insurance plan is $296 per month in 2019, according to the Kaiser Family Foundation.25

Capping how much TNC drivers can work each week would mark a sharp contrast with the current TNC model, in which drivers enjoy considerable flexibility with respect to how much time they spend driving. Although most TNC drivers do not drive on a full-time basis, a nontrivial number of drivers do work full time. Involuntarily preventing drivers from working full-time might force such drivers to find other sources of income.

**Employee Expenses.** A California employer must cover “all necessary expenditures” an employee incurs “in direct consequence of the discharge of his or her duties.”26 Necessary expenditures include “all reasonable costs” incurred by an employee.27 An employee who drives her own car in carrying out her work duties is entitled to reimbursement from her employer.28

Each year, the IRS calculates a “standard mileage rate” that employees may use to determine the costs of operating their automobile for business use. This rate reflects gas, depreciation, licenses, fees, insurance, and repairs, among other expenses.29 For 2019, the IRS standard mileage rate is 58 cents.30

In general, a California employer must reimburse an employee who drives her car as part of the job no less than the Internal Revenue Service’s (IRS) standard mileage rate—unless the employer can show that the employee’s actual costs were lower than the IRS rate.31 The California Division of Labor Standards Enforcement maintains that the employer bears the burden of showing that an employee’s cost of operating a vehicle is less than the IRS mileage rate.32

TNCs typically require drivers to operate relatively new four-door vehicles.33 Given that a full-time TNC driver may put 35,000 miles or more on her car each year,34 drivers often opt for reliable and efficient cars such as a Toyota Camry or Kia Soul, or even hybrids such as the Toyota Prius.35 In practice, drivers usually incur expenses far lower than the IRS mileage rate of 58 cents per mile. According to a 2019 study by researchers at the MIT Center for Energy and Environmental Policy Research, TNC drivers incur 30 cents per mile in median expenses.36 (Meanwhile, 30 cents per mile is also the amount that drivers would be reimbursed by TNCs under a California legislative proposal supported by Uber as an alternative to A.B. 5.37)

If TNC drivers were treated as employees, TNCs might seek to cap driver reimbursement at a rate lower than the IRS standard rate of 58 cents per mile. Under California law, however, the TNC would bear the burden of showing that a driver’s expenses differed from the IRS rate. Therefore, TNCs would have a strong incentive to impose stricter limits on the vehicles drivers may use, while barring relatively inefficient vehicles. TNC drivers who transport
riders in an SUV or luxury car may not be allowed to continue driving, or might be required to charge a steep premium.

TNCs could also require drivers to get their cars serviced at repair shops with which the TNC has negotiated prices, obtain personal auto insurance through insurers authorized by the TNC, and even refuel their cars at pre-approved gas stations where the TNC has negotiated a bulk discount.

**Tipping.** California is one of a few states in which an employee’s tips do not count toward the employee’s minimum wage. Employees are generally entitled to keep all the tips they receive, although pooling tips among similarly situated employees is allowed in limited circumstances.

Lyft and Uber both allow riders to tip their driver using the app, with the tip added to the total amount billed to the rider’s credit card. In 2017, Lyft drivers earned $240 million in tips, or 6.67 percent of the $3.6 billion they earned in fares.

Tips from riders can materially improve TNC drivers’ earnings, yet many riders do not tip at all. Riders’ willingness to tip is highly sensitive to suggestions provided by TNC apps, which may reflect rapidly evolving social norms around tipping and TNC rides.

If TNC drivers are treated as employees and are thus entitled to minimum wage, expense reimbursement, and state-mandated benefits, riders may tip smaller amounts or refrain from tipping entirely. When the minimum wage of tipped restaurant servers increases, research indicates that patrons tend to tip smaller amounts, perhaps based on the assumption that paying their server a living wage is already baked into menu prices. Similarly, riders may be less inclined to tip if TNC drivers make a guaranteed wage of $15 or more per hour, are reimbursed for their driving expenses, and receive employer-subsidized health insurance coverage.

**Unemployment Insurance.** Unemployment insurance (UI) taxation will impose an additional cost on TNCs, with the resulting revenue for the state intended to cover the cost of paying unemployment benefits to discharged TNC drivers.

Generally, a California employee who is discharged from unemployment and is actively seeking work can collect unemployment benefits for up to 26 weeks, unless the employee was discharged due to misconduct. Most California employers must pay a state unemployment tax based on their payroll. The tax rate ranges from 3.4 to 6.2 percent of the first $7,000 paid annually to each employee.

Given the high rate of “churn” among TNC drivers, TNCs will likely pay the highest unemployment insurance tax rate permitted under law. Moreover, because TNCs to date have treated their drivers as independent contractors, they have not paid any state unemployment taxes. A sudden influx of TNC drivers as employees eligible for California unemployment benefits will create substantial new liabilities for California’s unemployment
insurance trust fund, especially if an economic downturn occurs in the first few years following the enactment of A.B. 5.

**State Disability Insurance and Paid Family Leave.** Each California employee is assessed an annual tax to fund the California State Disability Fund.\(^47\) Employers are responsible for withholding and remitting this tax.\(^48\) The 2019 tax rate is 1 percent of an employee’s taxable wages up to $118,371.\(^49\) Self-employed individuals are not required to pay state disability insurance and generally are ineligible for disability or paid family leave.\(^50\)

California employees are also eligible to take leave of up to six weeks—increasing to eight weeks in 2020—to care for a seriously ill family member or spend time with a newborn or adopted child.\(^51\) Paid family leave benefits in California are funded by the California State Disability Insurance program. The California State Disability fund pays employees who are temporarily disabled or take paid family leave a benefit equal to 60 to 70 percent of their regular wages, up to $1,252 per week.\(^52\)

As employees, TNC drivers will face a new tax equal to 1 percent of their taxable wages. In exchange, they will be eligible for disability benefits and paid family leave. For some drivers—especially drivers who are older, less healthy, expecting children, or responsible for taking care of family members—this tradeoff may be beneficial on net. These benefits may not be as useful to relatively young, healthy drivers with few familial obligations.

**Worker’s Compensation.** If TNC drivers are treated as employees, they will be eligible for workers’ compensation if they suffer injury or disability while driving, regardless of who is at fault. Requiring TNCs to pay workers’ compensation premiums based on drivers’ earnings would entail an additional cost for TNCs that will ultimately be borne, in some combination, by riders, TNC employees, and TNC shareholders.

California’s workers’ compensation system pays employees who suffer injury or disability in the course of their employment, regardless of fault.\(^53\) Every employer must either obtain a workers’ compensation insurance policy or secure a certificate of self-insurance for workers’ compensation claims.\(^54\) Premium rates vary based on the nature of work an employee performs. According to the Workers’ Compensation Insurance Rating Bureau of California, the premium rate for employees of taxicab operations in 2019 is $6.18 per $100 of payroll.\(^55\)

**Sick Leave.** A California employee who has worked more than 30 days for an employer must accrue at least one hour of paid sick leave per 30 hours worked.\(^56\) An employee who leaves her position is not eligible for payment for accrued sick leave.\(^57\)

Like nearly all California employees, TNC drivers could take sick leave if they were considered employees. A full-time TNC driver would thus be eligible to take about eight days of paid sick leave per year. The costs incurred by TNCs to pay sick drivers who are not transporting passengers or earning fare revenue will ultimately be borne by riders, TNC employees, and TNC shareholders, in some combination.
**Cost of Hiring Drivers.** Before A.B. 5, TNCs compensated drivers by sharing with them about 75 percent of the fare revenue each driver generates. EPI’s Lawrence Mishel found that Uber drivers are paid $16.55 per hour, on average, after Uber’s commission.\(^{58}\) (This figure does not include tips from passengers, which Uber passes along to drivers in their entirety.) As independent contractors, drivers are solely responsible for driving expenses, self-employment taxes, and health insurance premiums. Drivers are not eligible for workers’ compensation, paid leave, or unemployment insurance.

However, if A.B. 5 will ultimately require TNCs to treat drivers as employees, and TNCs then classify drivers as employees for purposes of federal law, the cost to TNCs of driver-employees will rise dramatically compared to the independent contractor model. A driver who costs Uber $31,776 annually as an independent contractor would cost the company $53,088 annually in exchange for driving the same number of hours, holding constant the total mileage covered.

Assuming the portion of a driver’s time spent idling between fares—currently estimated at 24 minutes per hour\(^ {59}\)—remains constant, Uber’s total driver expenses per passenger mile would rise by nearly 60 percent—from $1.38 to $2.30 per passenger mile. If Uber’s commission per passenger mile remains at $0.46 per mile, and assuming Uber raises fares to reflect 100 percent of its additional driver-related expenses, the average fare per mile would rise from $1.84 per mile ($1.38 for drivers, $0.46 for Uber) to $2.76 per mile ($2.30 for drivers, $0.46 for Uber). This amounts to a 50.3 percent increase in Uber’s average fare.

To illustrate, consider a California driver who drives full-time for a single TNC for 40 hours each week, on average, for 48 weeks per year. Given that a typical Uber driver earns $16.55 per hour (not including tips), our full-time Uber driver can expect to make about $31,776 in compensation from Uber over the course of one year as an independent contractor.

In contrast, if our driver were an employee, Uber would have to pay the employee at least the California minimum wage of $13 per hour. Assuming our driver is paid minimum wage and works the same number of hours as an employee—while taking the full 64 hours of paid sick leave for which the driver is eligible—Uber would pay our driver $25,792 in one year (1,920 hours worked plus 64 hours of paid leave at $13.00 per hour).

As an employee, our driver is also entitled to reimbursement from Uber for reasonable vehicle expenses. At the 2019 IRS standard mileage rate of $0.58 per mile, given that a typical Uber driver covers 20 miles in one hour,\(^ {60}\) Uber would owe our driver $22,272 in mileage reimbursement (1,920 hour worked times 20 miles per hour times $0.58 per mile of expenses). Uber would also owe state unemployment insurance of $448 annually (6.4 percent state UI tax times the $7,000 cap on annual wages per employee subject to UI tax). And Uber would owe about $1,594 in workers’ compensation insurance premiums, at 6.18 percent of our driver’s total wages of $25,792 per year.\(^ {61}\)

Uber would face additional expenses based on treating our driver as an employee for purposes of federal law as well. Uber would be responsible for paying 7.65 percent of the employee’s wages to fund Social Security and Medicare under the Federal Insurance
Contributions Act (in addition to withholding an equal amount from our driver's wages), amounting to $1,973 annually. And under the Patient Protection and Affordable Care Act, Uber would be required to pay a portion of our driver's health insurance premiums to ensure that the driver does not owe more than 9.86 percent of her household income in health insurance premiums. In 2019, the average premium for the lowest-cost bronze health insurance plan in California is $296 per month. Uber would thus be responsible for $1,009 of the total annual premiums of $3,552 for the driver's health insurance.

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<tr>
<td>Base pay (including paid sick leave)</td>
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<td><strong>Total annual cost of driver</strong></td>
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**Conclusion.** When A.B. 5 goes into effect on January 1, 2020, ride share services in California will incur significant new costs associated with compensating their drivers. Although median hourly compensation for TNC drivers will probably increase, not all drivers will experience a pay increase. High-performing drivers under the current compensation regime may see lower overall earnings, especially if they value take-home pay more than benefits. Drivers will also likely enjoy substantially less flexibility under A.B. 5 in terms of when they work, where they drive, and possibly even which car they operate and how they maintain it.

The price of a typical ride in a California TNC car will increase substantially, perhaps by 30 to 50 percent. A.B. 5 might also encourage consolidation among TNCs, given that the largest two companies—Uber and Lyft—have struggled to maintain positive cash flows, let alone generate a profit.

As for consumers, A.B. 5 will likely result in fewer options and higher prices. As TNCs attempt to increase fares to recoup their additional costs, consumers will take fewer TNC rides, opting instead for other modes of transportation or simply taking fewer trips.

**Notes**

2. An Act to amend Section 3351 of, and to add Section 2750.3 to, the Labor Code, and to amend Sections 606.5 and 621 of the Unemployment Insurance Code, relating to employment, and making an appropriation therefor, 2019 California Legis. Serv. Ch. 296 (A.B. 5) (September 18, 2019).
The Value of Flexible Work:


7 Ibid.


14 California Labor Code § 510(a), http://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?sectionNum=510.&lawCode=LAB.

15 Ibid.

16 Ibid.


31 *Gattuso v. Harte-Hanks Shoppers, Inc.*
32 Ibid. (“If an employer wants to pay less than this established IRS rate, the employer bears the burden of proving that the employee’s costs of operating the vehicle for work is actually less.”).
34 Mishel, p. 17.
39 National Geographic Education Blog, “To Tip, or not to Tip?” [https://blog.education.nationalgeographic.org/2015/10/23/to-tip-or-not-to-tip/](https://blog.education.nationalgeographic.org/2015/10/23/to-tip-or-not-to-tip/).
45 Ibid.
51 California Unemployment Insurance Code § 3301(a)(1).
52 California Unemployment Insurance Code § 3301(b).
55 WCIRB California, “Classification Search, Classification Code 7365,”
https://www.wcirb.com/content/taxicab-operations-2.
56 California Labor Code § 246(b),
https://leginfo.legislature.ca.gov/faces/codes_displaySection.xhtml?sectionNum=246.&lawCode=LAB.
57 California Labor Code § 246(g).
58 Mishel, p. 11.
60 Cody Cook, Rebecca Diamond, Jonathan Hall, John A. List & Paul Oyer, “The Gender Earnings Gap in the Gig Economy: Evidence from over a Million Rideshare Drivers,” p. 42, Stanford University, 2019,
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