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BLOG

New Class Action Calls Into Question MLM's Independent-Contractor Classifications

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William Orage (Orage) recently filed a lawsuit against Amway Corporation (Amway) on behalf of himself and the California Workforce Labor Development Agency in Alameda County, California.[1] Amway is a multi-level-marketing (MLM) business that distributes health and beauty products through a network of Independent Business Owners (IBOs) who operate as independent contractors.[2] The Orage lawsuit alleges that Amway improperly classified Orage and other IBOs as independent contractors. Because IBOs should be classified as employees of Amway, according to Orage, the suit claims that Amway violated California law by failing to (1) pay IBOs a minimum wage, (2) provide IBOs with necessary tools and equipment to perform their jobs, and (3) maintain employment records for IBOs.[3] To determine whether the IBOs are independent contractors, the Court must evaluate whether newly amended California Assembly Bill 5's (AB5) default, strict, three-part "ABC" test applies or AB5's exception for "direct sales salespeople" requires the Court to apply the more malleable multi-factor balancing test from *S. G. Borello & Sons, Inc. v. Department of Industrial Relations.*[4]

The direct-selling industry is paying close attention to the Orage lawsuit because if Amway's IBOs are deemed employees under either standard, many other MLMs will likely see challenges to their independent-contractor classifications. To get ahead of, and reduce the risk of, such challenges, MLMs can take actions, including:

1. **Robust review of distributor policies in light of both the *Dynamex* and *Borello* standards**: Although such review will be highly fact-specific to the circumstances of each organization, MLMs should ensure that they have limited elements of control to only those that are traditional in typical distributor relationships. If an organization has controls indicative of an employer–employee relationship, the organization will likely draw scrutiny under either standard.
2. **Ensuring that distributor policies include a well-drafted, enforceable arbitration provision that contains a class-action waiver provision**: For example, MLMs must make sure their arbitration provisions are neither illusory nor unconscionable under the law of the jurisdictions in which the provisions are likely to be enforced.

Both above actions will position MLMs to (1) withstand a misclassification argument and (2) quickly defeat a misclassification argument—particularly if brought on a class basis, which is likely. MLMs often ask us to review their policies to protect their ability to withstand improper-classification challenges. Please do not hesitate to reach out to us if you would like assistance.

Read on for further details of the Amway case. We will, of course, continue to monitor the case and bring our readers the latest news as it arrives.

Legal Background

AB5 makes the "ABC" test from *Dynamex Ops. W., Inc. v. Sup. Ct. of Los Angeles*[5] the default test in California for determining whether a worker is an independent contractor or employee.[6] Under the ABC test, the employer must show that the worker is an independent contractor by establishing that: (A) 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; (B) the worker performs work that is outside the usual course of the hiring entity's business; and (C) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.[7] If the employer fails to establish any of the above three requirements, the worker is an employee.[8]

But AB5 includes an exception for, among other types of workers, "direct sales salespersons" as defined in Section 650 of California's Unemployment Insurance Code.[9] In turn, the Unemployment Insurance Code defines "direct sales salesperson" to include, among others, workers

> engaged in . . . sales to any buyer on a buy-sell basis, a deposit-commission basis, or any similar basis . . . for resale . . . or otherwise than from a retail or wholesale establishment . . . [if] [s]ubstantially all of the remuneration . . . is directly related to sales or other output . . . rather than to the number of hours worked [and if] [t]he services performed by the individual are performed pursuant to a written contract and the contract provides that the individual will not be treated as an employee with respect to those services for state tax purposes.[10]

If a worker is a "direct sales salesperson," the multi-factor balancing test from *Borello* applies instead of the ABC test.[11] The *Borello* factors include:

> [the] extent to which the employer had a right to control [the details of the service]; . . . the right to discharge at will, without cause; (a) whether the one performing services is engaged in a distinct occupation or business; (b) the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision; (c) the skill required in the particular occupation; (d) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; (e) the length of time for which the services are to be performed; (f) the method of payment, whether by the time or by the job; (g) whether or not the work is a part of the regular business of the principal; and (h) whether or not the parties believe they are creating the relationship of employer-employee.[12]

Unlike under the "ABC" test, no single factor is dispositive under *Borello*, and *Borello* is a more lenient standard that MLM companies more easily satisfy.

Orage's Lawsuit

Against this backdrop, Orage alleges that Amway improperly characterizes its IBOs as independent contractors. Although Orage's complaint does not state whether AB5 or *Borello* applies, Orage alleges that Amway "controls, directs, and determines the manner and means by which IBOs perform their jobs."[13] *Id.* ¶ 55. The Complaint cites the following provisions of Amway's "Rules of Conduct" as evidence of Amway's control over IBOs:

1. Amway's right to punish IBOs for violating the "Rules of Conduct," including by terminating them;
2. Amway's requirement that individuals become IBOs in their individual capacities rather than in a corporate capacity;
3. Amway's prohibition on IBOs transferring their Amway businesses without Amway's permission;
4. Amway's limiting online sales to personal retail websites provided by Amway;
5. Amway's prohibition on IBOs selling Amway products in retail establishments which they own or in which work;

6. Amway's prohibition on IBOs displaying or selling Amway products at events without Amway's permission;
7. Amway's prohibition on IBOs using Amway products for fundraising purposes;
8. Amway's administration of its own satisfaction guarantee on its products and Amway's requirement that IBOs provide their customers the same guarantee;
9. Amway's regulation of the materials and statements IBOs can use to sell products or sponsor new IBOs;
10. Amway's requirement that IBOs use only Amway-approved materials in marketing Amway products or opportunities to customers and prospective IBOs;
11. Amway's prohibition on husbands and wives registering as separate IBOs; and
12. Amway's non-competition and non-solicitation clauses.[14]

The above allegations are relevant under both the AB5 and *Borello* tests and significant because the cited provisions are common in many MLM distributor policies. The control expressed in many of these provisions, however, can be significantly minimized with appropriate drafting and relatively minor, non-intrusive changes to standard operating procedures. We encourage all MLM companies to analyze their policies carefully with an eye toward these provisions and others that might impose excessive control and/or non-competition/non-solicitation parameters. Such provisions should be amended or eliminated to minimize the risk of lawsuits like *Orage v. Amway*.

In *Orage*, the Court has not yet confronted the question of the IBOs' employment status but is currently considering procedural motions. As promised, we will closely monitor Orage's case.

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[1] No. RG20049773, *Orage v. Amway Corp.*, Compl. (Jan. 10, 2020).

[2] *Id.* ¶ 1.

[3] *Id.* ¶¶ 79–91.

[4] 48 Cal. 3d 341 (Cal. 1989). *See* AB5 §§ 1(a), 1(d), 2(a)(1), 2(b)(5). AB5 is available here.

[5] 4 Cal. 5th 903 (Cal. 2018).

[6] AB5 §§ 1(a), 1(d).

[7] *Id.* § 2(a)(1).

[8] *Id.*

[9] *Id.* § 2(b)(5).

[10] Cal. Unemp. Ins. Code § 650.

[11] AB5 § 2(a)(3).

[12] *Borello*, 48 Cal. 3d at 350–51.

[13] No. RG20049773, *Orage v. Amway Corp.*, Compl., ¶ 55 (Jan. 10, 2020).

[14] *Id.* ¶¶ 56–67.

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Authors

John Sanders, Jr.

Katrina Eash

William G. Fox

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