

## Contractor Apocalypse: California Supreme Court Adopts Broad New Misclassification Test

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In a groundbreaking decision, the California Supreme Court adopted a new legal standard today that will make it much more difficult for businesses to classify workers as independent contractors, drastically changing the legal landscape across the state. The decision will directly affect the trucking and transportation industry because the workers involved in the case were delivery drivers, but also has the potential to affect nearly every other industry—including the emerging gig economy. Specifically, the court adopted a new standard for determining whether a company “employs” or is the “employer” for purposes of the California Wage Orders.

Under the new “ABC” test, a worker is considered an employee under the Wage Orders unless the hiring entity establishes all three of these prongs:

1. the worker is **free from the control and direction** of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;
2. the worker performs work that is **outside the usual course** of the hiring entity’s business; and
3. the worker is **customarily engaged in an independently established trade, occupation, or business** of the same nature as the work performed for the hiring entity.

This decision not only expands the definition of “employee” under the California Wage Orders, it also imposes an affirmative burden on companies to prove that independent contractors are being properly

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classified. As a result of today's decision, all California businesses with independent contractors will need to conduct a thorough evaluation of such workers to determine whether they are properly classified (*Dynamex Operations West, Inc. v. Superior Court*).

### **Background: Employee Classification In California**

Most employers are familiar with the dichotomy between employees and independent contractors. For example, if a worker is an employee, the law imposes specified obligations on the business employing the worker, such as providing workers' compensation insurance, withholding taxes from wages, and complying with wage and hour laws. Independent contractors, on the other hand, are treated as separate business entities in effect, and businesses utilizing their services are relieved of most of these kinds of obligations when it comes to their relationship.

Determining whether a worker is properly classified as an employee or an independent contractor can be difficult. In fact, today's decision cited a 1944 U.S. Supreme Court case bemoaning this difficulty, proving that this has been a long-standing concern. Making the issue even more challenging is that the standards involved may vary depending on which analytical framework is being used to evaluate the classification. In California, the common law test for identifying an employee relationship has long been resolved by examining who has the right to control the manner and means of accomplishing the work at issue.

Determining whether there is sufficient control to establish employment status depends on a myriad of factors, including but not limited to the ability to hire or fire a worker, the distinctiveness of the work, the kind of occupation and custom of the locality, the skill required in the occupation, who provides the instrumentalities in order to perform the work, the length of time that services are to be performed, the method of payment, whether the work is part of the regular business of the principal, and whether or not the parties believe they are creating an employer-employee relationship.

For purposes of enforcement of the California Wage Orders promulgated by the Industrial Welfare Commission (IWC), the definition of "employ" has been determined by examining whether a purported employer (1) exercises control over the wages, hours, or working conditions of the worker; (2) suffers or permits the worker to work; or (3) engages the worker, thereby creating a common-law employment relationship (*Martinez v. Combs*, 2010).

### **The *Dynamex Operations West* Case**

Charles Lee and Pedro Chevez were hired by Dynamex as delivery drivers to transport packages, letters and parcels to Dynamex customers. Prior to 2004, Dynamex classified its California drivers as employees, but in 2004, the company converted all drivers from employees to independent



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contractors. In 2005, several drivers filed suit alleging they performed the same tasks as contractors as they performed when they were classified as employees; as a consequence, they said, the reclassification violated California law. The plaintiffs sought to represent approximately 1,800 drivers engaged as independent contractors.

The case has been in litigation for nearly two decades, including several appeals to the California Court of Appeal. It eventually wound its way up to the California Supreme Court, which signaled that one of two courses was possible: the court would either stick with the flexible standard adopted by *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989), the seminal California case regarding classification of independent contractors, or adopt a very rigid ABC test used by several other states.

### California Supreme Court Agrees With The Workers And Adopts New “ABC” Standard

Dynamex argued that the “suffer-or-permit” standard from *Martinez* should be limited to cases involving questions of joint employment. The court rejected this argument and instead held that any test adopted should have a broad application to effectuate the purpose and objectives of the Wage Orders. But the question remained of just what exactly the standard should look like.

Dynamex argued that the flexible *Borello* standard should be retained; the court also considered an alternative “economic realities” standard put forth by many federal circuits. However, the court rejected that test as unworkable and scrapped the *Borello* standard altogether. Instead, the court charted new territory by concluding it would most consistent with the history and purpose of the suffer or permit standard in the Wage Orders to interpret state law as **placing the burden on the hiring entity** to establish that a worker is an independent contractor, **and** to establish **each** of the three factors embodied in the “ABC” test above.

### Prong A: “Free From Control And Direction”

The court first discussed the “A” prong, which is akin to the common law control standard. The court concluded that a worker who is, either by contract or by practice, subject to the type and degree of control a business typically exercises over employees should likewise be considered an employee. Accordingly, businesses must now establish that workers are free of such control to meet this part of the test. The court confirmed that a business “need not control the precise manner or details of the work” in order to be found to have maintained the necessary control sufficient to lead to a finding of employee status.

This first test should not come as too much of a surprise to businesses facing misclassification challenges. As noted above, it is akin to the common law standard with which most are already familiar. It is the B and C tests that change the game completely.



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### **Prong B: “Outside Usual Course Of Business”**

Prong “B” seeks to determine whether workers can reasonably be viewed as individuals who are providing services to the business in a role comparable to that of an employee, rather than in a role comparable to that of a traditional independent contractor. Workers whose roles are “most clearly comparable” to those of employees include workers whose “services are provided within the usual course of the business” and thus would “ordinarily be viewed by others as working in the hiring entities’ business.” Thus, this prong expands those within the definition of employee to include almost any worker who engages in the same business as the hiring entity.

The court used the example of a retailer that hires a plumber or electrician to perform maintenance at their establishment; such a worker would be hiring someone outside of the company’s business and thus would be able to demonstrate independent contractor status. On the other hand, a clothing manufacturer that hires a work-at-home seamstress, or a bakery hiring a cake decorator, would typically not be able to make such a demonstration.

### **Prong C: Customarily Engaged In Independent Trade**

The third “C” prong seeks to identify those workers that have taken steps to create their independent business. If the worker has independently made the decision to go into business for themselves, they are likely to be found as satisfying this third prong. If, on the other hand, they are “simply designated as an independent contractor by the unilateral action of a hiring entity,” there is a substantial risk they will be found to be an employee.

The good news: the court stated that a business does not necessarily have to prove that workers in question took steps such as incorporation, licensure, advertising, and the like to prove this prong. The bad news: the court also stated that the simple fact that a company does not prohibit or prevent a worker from engaging in such an independent business is insufficient to establish a worker has independently made the decision to go into business for themselves.

### **What This Means Moving Forward**

This decision is a seismic shift for California wage and hour law and class litigation. The court now imposes a burden on businesses to defend their classification of workers as independent contractors. Misclassification of such workers can result in significant legal exposure with respect to wage and hour compliance.

One benefit of the court’s decision is it provided a framework for compliance with the ABC test, but it remains to be seen how California courts will apply this new standard. It may take several years for a uniform analysis to form in the courts. In the interim, California employers should re-evaluate their classification of their workers to ensure full compliance with the law.



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