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Easy as ABC!

UNDERSTANDING WHO IS AN EMPLOYEE IN THE WAKE OF *DYNAMEX* AND AB 5

In his September 18, 2019 letter to the Members of the California Assembly accompanying his signature on AB 5, Governor Newsom stated: "The hollowing out of our middle-class has been 40 years in the making and the need to create lasting economic security for our workforce demands action. Assembly Bill 5 is an important step."

The largest part of most businesses' budget is labor. Because of this, businesses will try to find ways to save labor costs. Starting largely in the 1990s, many employers relied on overtime exemptions to abusive degrees. This led to a spate of California Supreme Court decisions such as *Ramirez v. Yosemite Water Co., Inc.* (1999) 20 Cal.4th 785 and *Sav-On Drugs, Inc. v. Superior Court* (2004) 34 Cal.4th 319 that helped curb the rampant misclassification of employees as exempt from overtime payment.

Employers then turned to the independent-contractor model to save labor costs. Workers in many industries, including taxi drivers and truck drivers, were forced to forgo the protections of the Labor Code. New industries sprang up relying on the classification of workers as independent contractor, mainly "gig-economy" delivery and ride-share companies like Postmates and Uber.

In 2018, the California Supreme Court stepped in to introduce the ABC test to California, joining a handful of other states whose goal it is to simplify determining independent contractor status. In *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903, California adopted the ABC test for claims under California's Industrial

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Welfare Commission's ("IWC") Wage Orders. The California Supreme Court, in a unanimous decision, ruled that an expansive definition of "employee" should be used when applying the protections afforded under the IWC Wage Orders. These protections encompass minimum wage requirements and maximum hours of work, as well as meal and rest breaks.

In 2019, the California Legislature jumped on board to broaden the test's application to the Labor Code generally. So, what is the ABC test and where do we go from here?

Understanding *Borello*

To answer those questions, let's roll the clock back to 1989, to the California Supreme Court decision *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 341. In *Borello*, the Court sought to draw a distinction between the common law definition of employment that arose in the context of vicarious liability from the remedial statutory purpose of the worker's compensation laws at issue in that specific case. (*Id*. at 350-352.)

The *Borello* decision set forth California's test for independent-contractor status for liability in employment cases, which reigned supreme for three decades. *Borello* adopted a multi-factor test, summarized as: "(1) whether the worker is engaged in a distinct occupation or business; (2) whether, considering the kind of occupation and locality, the work is usually done under the alleged employer's direction or without supervision; (3) the skill required; (4) whether the alleged employer or worker supplies the instrumentalities, tools, and place of work; (5) the length of time the services are to be performed; (6) the method of payment, whether by time or by job; (7) whether the work is part of alleged employer's regular business; and (8) whether the parties believe they are creating an employee-employer relationship." (*Futrell v. Payday California, Inc.* (2010) 190 Cal.App.4th 1419, 1434.) The general presumption under *Borello* is that the worker is an employee. (*Borello*, *supra*, 48 Cal.3d at 354.)

Understanding *Martinez*

Then a bump came along in 2010 – the California Supreme Court's decision in *Martinez v. Combs* (2010) 49 Cal.4th 35. While this case did not directly address independent contractors, arguments could be made the door was open to alter the independent contractor analysis in wage-theft cases. *Martinez* held that the IWC Wage Order's definition of employment embodies three alternative definitions: (1) to exercise control over the wages, hours or working conditions; or (2) to suffer or permit to work; or (3) to engage, thereby creating a common law employment relationship. (*Martinez,* 49 Cal.4th at 64.) A question arose: could a worker prove employment status under the "suffer or permit" definition?

Wage and hour practitioners thought that question would be answered in *Ayala v. Antelope Valley Newspapers, Inc.* (2014) 59 Cal.4th 522. However, due to the limited scope of the plaintiffs' theory in that case, the question was "left for another day." (*Id*. at 531.)

Enter *Dynamex*!

Clocking in at a healthy 42 pages, anyone practicing in the area of wage theft needs to take the time to read the *Dynamex* decision in its entirety. The opinion, written by Chief Justice Tani Cantil-Sakauye, includes a noteworthy discussion of the toll on our society when workers are misclassified as independent contractors. The Court noted the importance of the classification status, as employers:

- Pay into the Social Security fund
- Pay payroll taxes
- Pay unemployment insurance taxes
- Pay state employment taxes
- Provide worker's compensation insurance
- Must comply with state and federal statutes and regulations governing working conditions

(*Dynamex, supra*, 4 Cal.5th at 913.) "In recent years, the relevant regulatory agencies of both the federal and state governments have declared that the misclassification of workers as independent contractors rather than employees is a very serious problem, depriving federal and state governments of billions of dollars in tax revenue and millions of workers of the labor law protections to which they are entitled." (*Ibid*.)

Understanding the ABC test

In the *Dynamex* decision, determining whether a worker is an employee under the "suffer or permit" to work definition of the IWC Wage Orders, the Court adopted the ABC test used in other states. Under this test, a worker is an independent contractor only if *all three prongs* are met: "(A) 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; (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 for the hiring entity." (*Dynamex*, *supra*, 4 Cal.5th at 916-917.) Following is a discussion of each test:

Part A: Lack of control and direction

Under the "suffer or permit" standard discussed in *Martinez*, an independent contractor must be free from the control and direction of the business it performs service for. (*Dynamex*, *supra*, 4 Cal.5th at 958.) The Court also makes it clear it is the hiring entity's burden to "establish that the worker is free of such control to satisfy part A of the test." (*Ibid*.)

To illustrate this point, in a footnote, the Court discussed three cases from other jurisdictions that have adopted the ABC test in Vermont and Washington. In *Fleece on Earth v. Dept. of Emple & Training* (2007) 923 A.2d 594, the Vermont Supreme Court held the A part of the test was not satisfied where work-at-home knitters were limited to knitting sweaters based on instructions patterns provided by the company. In *Western Ports v. Employment Sec. Dept.* (2002) 110 Wash.App. 440, 41 P.3d 510, 517-520, a Washington State Court of Appeal found the hiring entity did not meet its burden

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of proof where a truck driver was required "to keep [the] truck clean, to obtain the company's permission before transporting passengers, to go to the company's dispatch center to obtain assignments not scheduled in advance, and could terminate driver's services for tardiness, failure to contact the dispatch unit, or any violation of the company's written policy." These two cases were contrasted with *Great N. Constr. Inc. v. Dept. of Labor* (Vt. 2016) 161 A.3d 1207, 1215, where a construction company met its burden of proof under part A with a worker specializing in historic reconstruction, who "set his own schedule, worked without supervision, purchased all materials he used on his own business credit card, and had declined an offer of employment proffered by the company because he wanted control over his own activities." (*Dynamex*, *supra*, 4 Cal.5th at 958, fn. 27.)

The focus of litigation on this test will then be the instructions and direction given by companies to the workers.

Part B: Outside usual course of business

Under the "suffer or permit" standard, an independent contractor must be working outside the business it performs service for. (*Dynamex*, *supra*, 4 Cal.5th at 959.) That is, the worker should be performing work that is not part of the hiring entity's business, but rather the services of the worker's own independent business. (*Ibid*.) Here, the Court illustrates this point by using the example of a plumber hired to repair a leak in a bathroom or an electrician hired to install a new electrical line in a retail store. This is contrasted with a clothing manufacturer hiring a work-at-home seamstress or a bakery hiring a cake decorator.

The Court stressed the importance of this test out of a concern that workers who are willing to forgo the IWC Wage Order protections will displace those who are not willing to do so. (*Id*. at 960.) It is also necessary to level the playing field for businesses that comply with the law by ensuring industry-wide minimum requirements to avoid a "race to the bottom" effect. (*Ibid*.)

Once again, the Court looked outside California for examples, to cases from Maine, Vermont, New Hampshire, and Connecticut. In *McPherson Timberlands v. Unemployment Ins. Comm'n* (Me. 1998) 714 A.2d 818, the Maine Supreme Court held cutting and harvesting of timber fell within the business of a timber management company. In *Appeal of Niadni, Inc.* (2014) 93 A.3d 728, the Supreme Court of New Hampshire found live entertainers to fall with the usual business of a resort that advertised and provided entertainment. In *Mattatuck Museum-Mattatuck History Soc. v. Administrator* (1996) 679 A.2d 347, 351-352, the Connecticut Supreme Court held an art instructor fell within the usual course of a museum's business where the museum regularly offered art classes. In contrast, in *Great N. Constr. Inc., supra,* 161 A.3d at 1215, the Vermont Supreme Court held specialized historic restoration work fell outside the usual scope of a construction company's business. (See, *Dynamex*, *supra*, 4 Cal.5th at 961, fn. 28.)

The focus of litigation on this test will then be how the business has traditionally characterized itself to its customers and its relationship to the type of labor performed by the worker.

Part C: Independent business

Under the "suffer or permit" standard, a business cannot force a worker to be an independent contractor. (*Dynamex*, *supra*, 4 Cal.5th at 962.) "As a matter of common usage, the term 'independent contractor,' when applied to an individual worker, ordinarily has been understood to refer to an individual who *independently* has made the decision to go into business for himself or herself." (*Ibid*.) Under part C, it is not enough that a company permits the worker to provide the same services to other companies. (*Ibid*.)

Cases from Virginia, Massachusetts, and Connecticut illustrate part C. In *Brothers Const. Co. v. Virginia Empl. Comm'n* (1998) 494 S.E.2d 478, 484, a Virginia Court of Appeal held that siding installers were not engaged in independently established businesses that were permanent, stable, and lasting where they had provided their own tools, but did not have "business cards, business licenses, business phones, or business locations," and had not "received income from any party other than" the hiring entity. In *Boston Bicycle Couriers v. Deputy Dir. Of the Div. of Empl. & Training* (2002) 778 N.E.2d 964, 971, a Massachusetts Court of Appeal held a bicycle courier had not independently established a business where there was no evidence the courier promoted his business to other clientele. In *Southwest Appraisal Grp., LLC v. Administrator* (2017) 155 A.3d 738, 741-752, the Connecticut Supreme Court found auto repair appraisers were not independent contractors where there was no evidence of work for other companies or efforts to find work with other companies. (See, *Dynamex*, *supra*, 4 Cal.5th at 963, fn. 31.)

The focus of litigation on this test will then be the timing of the creation of the worker's business and efforts to promote that business to additional potential clients.

Post-*Dynamex*

Problems remained after *Dynamex* because of its limited application to IWC Wage Orders. One of the chief problems with misclassification is that the cost of doing business is often shifted to workers. While the IWC Wage Orders require employers to provide tools and equipment, that section has not been as broadly interpreted as Labor Code section 2802, which requires reimbursement for all work-related expenses.

Understanding AB 5 means knowing its exemptions

The California Legislature then took up the cause, ultimately passing AB 5, now codified as California Labor Code section 2750.3. This new statute, in essence, applies the holding in *Dynamex* to all IWC Wage Orders, California Labor Code sections, and to the California Unemployment Insurance Code. There are, however, numerous exceptions found in California Labor Code section 2750.3(b), including:

• Persons licensed by the Department of Insurance

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• Physicians, surgeons, dentists, podiatrist, psychologists, and veterinarians
• Licensed lawyers, architects, engineers, private investigators and accountants
• Registered securities broker-dealers and investment advisors and their agents
• Direct sales salespersons
• Commercial fishermen working on "American vessels"
• Newspaper distributors, until January 1, 2021

Under California Labor Code section 2750.3(c), there is an exception for contracts for "professional services" if the hiring entity is able to demonstrate the worker has a physically separate business location, the worker has a business license, the worker has the ability to negotiate their own rates, the worker can set their own hours, the worker performs the same work for others, and the worker exercises discretion and independent judgment. "Professional services" includes:
• Marketing
• Human resources administration
• Travel agent services
• Graphic design
• Fine art
• Agents who practice before the IRS
• Payment-processing agents
• Certain still photographers and photojournalists
• Certain freelance writers, editors and newspaper cartoonists
• Certain licensed estheticians, electrologists, manicurists, barbers, and cosmetologists

Under California Labor Code section 2750.3(d), there are exceptions under the California Business and Professions Code for:
• Certain licensed real estate agents
• Certain repossession agents

Further exemptions are present where certain conditions are met, which largely track the *Borello* elements and include a written contract for:
• Bona fide "business-to-business contracting" relationships (Cal. Lab. Code, § 2750.3, subd. (e))
• Subcontractors in the construction industry (Cal. Lab. Code, § 2750.3, subd. (f))
• Referral agencies (Cal. Lab. Code, § 2750.3, subd. (g))

Under California Labor Code section 2750.3, subdivision (h), there is an exception for:
• Certain motor clubs

This law is meant to be "not a change in, but is declaratory of, existing law." (Cal. Lab. Code, § 2750.3, subd.(i).) This includes the exemptions listed above. (*Ibid*.) However, the new law only applies to work performed after January 1, 2020. So for work pre-dating the effective date of AB 5, there will continue to be a split regarding the application of the ABC test between the IWC Wage Orders and the Labor Code.

Takeaways

As you field calls from confused workers in 2020, here are some tips:
• Start by determining whether an exemption applies
• If an exemption applies, your default will be *Borello*
• If no exemption applies, look to the ABC test
• Remember all three elements of the ABC test must be met for a worker to be an independent contractor
• Invest in a nationwide legal research plan (or learn to use Google Scholar), as the California Supreme Court made it clear in *Dynamex* that cases from other jurisdictions will be useful in interpreting the ABC test
• The California Labor Commissioner has put together a wonderfully helpful FAQ section on its website summarizing the new law
• When resolving cases under this new law, include injunctive relief requiring the re-classification of the workers as employees
• Always remember: "Wage and hour laws 'are to be construed so as to promote employee protection.'" (*Mendiola v. CPS Security Solutions, Inc.* (2015) 60 Cal.4th 833, 840.)

Postscript

As we head into this new world, it is important to remember that workers have always been presumed to be employees. (*Borello, supra,* 48 Cal.3d at 354.) Independent contractor status is always the exception that applies in limited circumstances. The problem in the wage and hour context has been that the same facts could be presented to different triers of fact and different conclusions could be reached regarding employment status. Hopefully, under the ABC test, there can be new clarity for workers and for businesses.

There is still a great deal of legislative interest in this issue and we can expect new bills to be proposed during the 2020 session. Legislators will be watching settlements reached under the law, especially whether the settlements include a requirement that workers be reclassified as employees.

Companies like Lyft, Uber, and DoorDash have purportedly pledged $90 million to put an initiative on the ballot to give gig economy businesses an exemption. The concern raised by these businesses is a fiction that "flexibility" has been lost. This rallying cry ignores the power of employers to weave flexibility into any employment relationship, including flexible hours. To say that flexibility will be withdrawn is nothing short of retaliation.

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