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PERSPECTIVE

Unanswered questions after employee classification ruling

By Gina Roccanova

On April 30, the California Supreme Court dramatically narrowed the scope of who can qualify as an independent contractor under the state's wage orders. The new test for determining who is an employee — known as the "ABC Test" — is indeed almost as simple as A-B-C, but it is a standard many employers will find impossible to meet. The 82-page ruling has the potential to disrupt many business practices of employers.

Dynamex v. Superior Court, 2018 DJDAR 3856, involved a delivery driver who sued on behalf of himself and a putative class of similarly situated individual drivers who worked only for Dynamex as independent contractors. The plaintiff claimed that Dynamex violated the applicable California wage order and the Labor Code by classifying drivers as independent contractors and failing to reimburse them for necessary expenses incurred in the course of their work.

What the Court Decided

In deciding whether to certify the putative class, the lower courts had to determine what definition of "employer" should apply.

The defendant urged the court to use the multi-factor test set forth by the California Supreme Court in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal. 3d 341 (1989), which focused on the degree of control that the recipient of the contractor's services exercises over the manner in which the work is performed, and also required consideration of numerous other factors including, among others, the degree to which the contractor is engaged in an independent business and bears the risk of profit or loss; the nature and degree of skill required to perform the services; the intention of the parties; the duration of the relationship and whether it can be terminated at will; and how the contractor is paid.

The plaintiff, on the other hand, relying on a more recent case decided in the context of a claim of joint employment, urged the court to find an employment relationship any time a purported employer would "suffer or permit" someone to work. That definition would mean that any person performing services for the company would have to be characterized as an employee.

In resolving this dispute, the court took into consideration the "continuing serious problem of worker misclassification as independent contractors" and the "fundamental purposes" of the wage and hour laws, and adopted the "suffer or permit to work" standard. Central to this analysis is the understanding that wage and hour protections "were adopted in recognition of the fact that individual workers generally possess less bargaining power than a hiring business and that workers' fundamental need to earn income for their families' survival may lead them to accept work for substandard wages or working conditions."

The court recognized, however, that the "suffer or permit to work" standard should not encompass "traditional independent contractors" such as an outside plumber who repairs a leak or an accountant who provides annual tax preparation services. Drawing from other jurisdictions, the court adopted a three-part test for determining whether the "suffer or permit to work" test has been met. Under that standard, an employment relationship exists unless the purported employer can prove all of the following:

A. That it does not control or direct the manner in which the work is performed;

B. That the work is "outside the usual course" of its business; and

C. That the worker "is customarily engaged in an independently established trade, occupation, or business" in the same line of work performed.

What It Means for California Businesses

So-called "gig economy" businesses whose economic model depends on having most of its workforce operate as independent contractors will have the hardest time adjusting to the new standard. However, the *Dynamex* decision has the potential to impact any organization that uses the services of independent contractors.

There are economic disadvantages to classifying workers as employees, including employers' payroll taxes, workers' compensation premiums, and benefits requirements. And as the court pointed out in *Dynamex*, companies that classify much of their workforce as contractors may have a competitive advantage over those that have the same work performed by employees. Entities that use contract labor should look first at the "B" factor — i.e., whether the services provided are part of the entity's core business. Individuals who fall into that category cannot be independent contractors, regardless of whether the other two factors are present.

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The simplicity of the ABC test is something of a double-edged sword. On the one hand, it may make the distinctions between independent contractors and employees clearer for employers, and thus easier to stay on the right side of the law. On the other hand, it is likely to make it easier for plaintiffs to certify a class in litigation, since there is less opportunity for variation among three factors than there would be under continued application of *Borello*.

Some Unanswered Questions

The case left some interesting questions undecided. First, the court explicitly left open the possibility that different standards could apply to the question of who is an employee under other statutory provisions. The lower court had applied the *Borello* test in determining whether the Dynamex drivers were employees under Labor Code Section 2802, which requires employers to reimburse employees for reasonable expenses they incur in the course of their employment. The plaintiff did not challenge that part of the decision on appeal, and the Supreme Court let it stand. That may be a distinction without a difference, because the definition of "employee" under the wage orders is broadly applicable. However, it does leave open the possibility of different outcomes through different enforcement mechanisms. For example, an EDD audit, applying the multi-factor economic realities test, may conclude that an organization has correctly classified a service provider as a contractor, but a suit under the wage orders by the same purported contractor could lead to the opposite result.

Another, perhaps far more significant question, is whether organizations can sidestep the *Dynamex* analysis by contracting with service providers who have formed limited liability companies or other types of corporate entities, either alone or in groups. It is unclear whether a court would pierce the corporate veil of, say, a single-member LLC that consists of one individual driving for a single delivery company like Dynamex. However, a plaintiff claiming that a defendant entity forced the plaintiff to form an LLC for the sole purpose of circumventing the wage orders could well convince a court to disregard the corporate form.

In the meanwhile, any entity that uses contract labor would be well advised to take a closer look at those relationships.

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