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California Supreme Court raises the bar for workers to be classified as independent contractors: what employers need to know

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On Monday, April 30, 2018, the California Supreme Court issued a decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* that dramatically revises the test for determining whether workers should be classified as employees or independent contractors.

This new test has the potential to turn many workers currently classified as independent contractors into employees of their hiring entities for purposes of minimum wage, overtime, meal and rest periods and Cal-OSHA compliance. Businesses that rely heavily on contractors—especially those in the gig economy, including companies that provide ride-share, food and grocery delivery and other on-demand services—may find themselves the victims of significant new wage and hour litigation.

The Supreme Court adopted a broad, worker-friendly test

In a lengthy eighty-plus page opinion, the Supreme Court adopted the so-called "ABC test"—a rigid, worker-friendly test for determining whether workers should be classified as employees or independent contractors under the California Industrial Welfare Commission ("IWC") Wage Orders.

The ABC test *presumes* that *all* workers are employees, unless the business can demonstrate that *all* of the following factors are met: (A) the worker is free from the control and direction of the hirer in connection with the performance of the work, (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.

The burden is on the hiring entity to prove that the worker meets all three elements of the test. Failure to meet even one element will result in a finding that the worker should be classified as an employee.

Prior to *Dynamex*, California courts generally applied a multifactor "control" test that considered

the totality of the circumstances, resulting in a case-by-case determination of whether a worker was an employee or an independent contractor. The Supreme Court touted the ABC test's greater predictability and presumption of employment as being preferable to the flexibility previously afforded under the multifactor test. The Supreme Court also specifically rejected the federal economic realities test that determines employment status under the Fair Labor Standards Act. Instead, with the Supreme Court's ruling in *Dynamex*, California has adopted the Massachusetts version of the ABC test that presumes that a worker is an employee unless all three ABC factors can be proven.

The "usual course of business" factor

The Supreme Court noted that the ABC test will not transform a retail store's hiring of an outside plumber or electrician into an employee, because the services of the plumber or electrician are not part of the store's usual course of business. On the other hand, when the worker's role within a hiring entity's usual business operation aligns with the work of the employee, the worker will likely be classified as an employee.

Expect future litigation to focus on part B of the ABC test: the "usual course of the hiring entity's business" factor. In the case of *Dynamex*, the Supreme Court determined that the answer was clear because the worker was a delivery driver for a same-day courier and delivery service. Part B is of particular concern, however, to "technology companies" who provide apps aimed at facilitating interactions between independent contractors and the companies' customers. The courts will need to determine whether such businesses are technology companies or service companies.

Limitations and unanswered questions

The Supreme Court's decision is limited to the definition of "employee" under the IWC Wage Orders, which imposes obligations on employers relating to the minimum wages, maximum hours and required meal and rest breaks of California employees. In California, the Wage Orders are constitutionally-authorized, quasi-legislative regulations that have the force of law. The court left open the question of whether the ABC test should also apply to claims asserted under other laws and statutes, such as the obligation to reimburse employees for reasonable business expenses under Labor Code section 2802. It is also unclear whether the "ABC" test will apply retroactively.

What's next?

Companies, in particular those with business models that rely heavily on the use of contractors who perform work that is similar to the companies' work or industry, should move swiftly to consult with counsel.

Companies need to determine whether their contractors satisfy the ABC test. If contractors do not meet the test, companies may want to consider whether to reclassify contractors as employees.

Additionally, companies need to determine whether the workers meet the tests for the administrative, executive or professional exemptions as described in the Wage Orders. While exempt workers are still employees, they are not entitled to most of the protections afforded by the Wage Orders (including overtime, and meal and rest periods).

Ultimately, businesses need to move quickly to vault over the court's new higher bar for

independent contractor classifications. Companies that fail to evaluate their independent contractor workforce are at risk of legal exposure.

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