New ABC Test For Independent Contractors Sends California Employers Reeling

Insights
7.02.18

The "ABC test" recently adopted by the California Supreme Court in the *Dynamex Operations West, Inc. v. Superior Court* case is now touted as the best way to make the distinction between an "exploited employee" and an "entrepreneur." The court's adoption of the ABC test for determining whether an employee should be classified as an employee or independent contractor has sent shock waves to businesses which have relied in the past upon a flexible, multi-factor common law test where none of the individual factors, taken alone, are necessarily controlling.

ABC Test
A hiring entity classifying an individual as an independent contractor now bears the burden of establishing that such a classification is proper under the "ABC test." To do so, the entity must prove each of the following three factors:

(A) that 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) that the worker performs work that is **outside the usual course** of the hiring entity's business; and

(C) that the worker is **customarily engaged in an independently established trade, occupation, or business** of the same nature as the work performed.

More than 20 states already use some form of the ABC test, although for most of them the test has been used for only a particular inquiry such as unemployment insurance determinations. In California, however, the state Supreme Court specifically ruled that the ABC test should be broadly applied for inquiries under the California Wage Orders as to whether a worker is an employee or independent contractor.

Because the Wage Orders regulate the terms and conditions of employees in all industries and occupations, the new test will have far-reaching consequences. Some areas of the law remain unsettled, such as whether the ABC test should be applied to Labor Code claims not arising under a Wage Order (for example, claims for expense reimbursement under Section 2802) or to what extent state or local federal courts could find that an element of the test is preempted by federal law.

Applying The ABC Test

Many businesses have service workers who request to be paid as 1099 independent contractors. These include workers across a broad spectrum of occupations and industries, such as truck drivers, exotic dancers, contract accountants, IT workers, and even high-level managers with special skills. Among their most common reasons: avoiding income taxes or other tax relief benefits. But a worker's request to be reclassified, standing alone, won't turn the scales in an employer's favor.

In *Dynamax*, the court maintained that the public interest in social welfare does not always jive with the personal interests of workers and that, in the end, the intent of public policy in protecting workers is a central consideration in determining employee versus independent contractor status. The consequences of misclassification continue to raise complicated issues when multiple entities are involved, including joint liability upon a finding of joint employment.

Another problem made worse by the *Dynamex* case arises from the growing number of workers in the "gig economy," which depends on the use of independent contractors as a business model. Companies are now being forced to rethink whether their particular model at the heart of their business runs afoul of the ABC test and could result in misclassification liability.

In the end, businesses should think not only about their own potential liability, but the potential liability of affiliated companies benefitting jointly from the services performed. Given that the risk of misclassification presumably could be greater in such situations, vendors and business affiliates similarly should be concerned about these risks. They could impact contractual relationships including the attempt, noted by *Dynamex*, to spread the risks by various means such as indemnification agreements.

PRONG A – *"free from the control and direction of the hiring entity"*

Due to the prevalence of decisions examining "control" under the old test, it is foreseeable that many businesses will suffer losses due to misclassification under factor A of the ABC test. The fact that some workers request, or require, a 1099 arrangement generally will not help much if the other facts don't support independent contractor status. And one issue impacting this factor is whether the worker treated as an independent contractor was also the same individual doing the work when classified as an employee, which the *Dynamex* court cautioned is an example of where control is implicit.

PRONG B – *"performs work that is outside the usual course of the hiring entity's business"*

Many employers in California using independent contractors have been confronted with the reality that, given the ABC test—particularly Prong B—their business model is in trouble. The California Supreme Court reasoned that services that would ordinarily be viewed by others as falling within the hiring entity's business rather than a worker's "own independent business" render that worker an employee and not a contractor.

The examples provided by the court where a worker would satisfy this prong and be properly classified as a contractor were relatively clear cut: a retail store retaining a plumber or electrician to perform maintenance work at the facility, not a service normally provided by the retailer. As for specialized technical work within an isolated function of an employer's business, the court said these are not among the types of jobs that would typically qualify, even though these have historically fallen within a gray area. This prong of the test could create differing opinions among courts attempting to interpret the new law.

Because the Federal Aviation Administration Authorization Act (FAAAA) preempts state laws that relate "to a price, route, or service" of a motor carrier, at least in the transportation industry, employers may argue that the FAAAA preempts an overbroad application of the "B" prong. So far, however, California courts have not ruled in favor of preemption when this element was part of the larger list of factors subject to discretionary weighing. On the other hand, the 1st Circuit Court of Appeals, addressing Massachusetts' ABC test, has found preemption of the B factor on different facts, so there may be some hope on the horizon if California courts revisit this question.

PRONG C – ***"independently established trade, occupation, or business"***

Under the third prong, businesses will be required to prove that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work they are performing for the hiring entity. The court again referred to such workers as plumbers and electricians retained for limited functions or projects as those traditionally fitting into this prong. On the other hand, workers engaged to carry out a skilled function that is a normal part of a particular integrated part of a business—as opposed to someone in a separate trade, occupation, or business retained for doing a separate service outside the employment context—may nonetheless be prone to be viewed as employees no matter how skilled the work involved.

For the above reasons, organizations with independent contractors will need to examine these factors as they relate to their business. There is good reason to be very careful with regard to engaging any independent contractors going forward, especially workers who are working as single individuals ("one-person company") rather than companies who have retained a force of workers in an independent business.

Does *Dynamex* Have Retroactive Application?

There is yet another reason for concern by employers: the issue of whether the *Dynamex* decision applies retroactively. This issue could mean the difference between catastrophic liability or merely a correction going forward, as needed.

Businesses maintain that the new mandatory test adopted by the *Dynamex* decision should not apply to employers retroactively because it would violate due process. After all, businesses relied upon the older tests that balanced multiple elements for years, establishing their business model in reliance upon the more flexible factors. On the other hand, employee advocates contend that the decision merely clarified existing law and therefore should apply retroactively. This issue is currently before the California Supreme Court, and we should soon have an answer to this question

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Does *Dynamex* Apply To Joint Employment Scenarios?

There is some good news, however. One California appellate court has already limited the scope of the ABC test, ruling that the test does not apply when determining whether two businesses are joint employers of an individual already treated as an employee. Instead, the court ruled that it only applies when determining whether an individual has been correctly classified as an independent contractor. A word of caution, however: the May 18 decision in *Curry v. Equilon Enterprises, LLC* comes from a state appellate court, not the state Supreme Court, so there may be further court rulings on this topic before all is said and done.

Conclusion

Regardless of the outcome on the retroactivity and joint employment questions, businesses would be wise to carefully evaluate their independent contractor relationships with Fisher Phillips legal counsel in California to avoid liability going forward, as there are bound to be further legal decisions clarifying the application and scope of the ABC test.

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