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Understanding Dynamex: The Public Employer Perspective

INTRODUCTION

In *Dynamex Operations West, Inc. v. Superior Court*,[1] the California Supreme Court established a new test for determining whether a worker should be classified as an employee or independent contractor under California's wage orders. The wage orders regulate issues such as minimum wage, overtime compensation, and meal and rest periods. The Court rejected the flexible, multifactor *Borello* common law test that has been used to resolve worker classification issues in contexts such as pension, workers compensation, unemployment insurance and other employment rights for decades.[2] Instead, the Court adopted a strict three-prong ABC test that places the burden on the employer to establish a worker is properly classified as an independent contractor and not entitled to the protections of the wage orders. Notably, under the ABC test, a worker who performs services that are part of the employer's "usual course of business" is protected under the wage orders as an employee.

Dynamex is part of a growing trend of case law and statutory regulations to address perceived worker misclassification abuses. In response, California public employers should review their current contractual relationships under the ABC test and also seize the opportunity to review all contractual relationships to ensure compliance with other key regulations, including CalPERS membership requirements.

THE DYNAMEX CASE

Dynamex is a nationwide package and document delivery company. After Dynamex restructured its operations and reclassified all of its drivers as independent contractors to generate cost savings, two of its drivers filed a class action. They alleged that the company misclassified its drivers as independent contractors instead of employees, under the wage order governing the transportation industry and the California Labor Code.[3]

California wage orders protect employees, not independent contractors. To address plaintiffs' claims, the Court had to determine the applicable standard and test for evaluating their status as employees or independent contractors. Dynamex argued for the application of the *Borello* common law standard. That test is a

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flexible, multifactor approach that focuses primarily on whether the hiring entity has a "right to control" the manner and means by which the worker performs the contracted service.[4] The *Borello* test has been used to make independent contractor determinations in a wide variety of contexts for over thirty years.[5] The plaintiffs argued that in addition to using the *Borello* test, the Court should apply two additional tests, including the standard known as "to suffer or permit to work." That standard is much broader and is intended to protect relationships beyond the reach of the common law.[6]

The *Dynamex* court adopted the *"suffer or permit"* standard.[7] Under that standard, if an employer requires or allows employees to work, they are employed and the time spent is probably hours worked. The Court adopted this standard to provide workers with the broadest possible protections so that "workers are provided at least the minimal wages and working conditions that are necessary to enable them to obtain a subsistence standard of living and to protect the workers' health and welfare."[8] The Court also sought to remove employers' economic incentives to misclassify workers to avoid costs associated with paying payroll taxes, etc. for employees.[9]

THE ABC TEST

After adopting the "suffer or permit to work" standard, the Court next had to establish a workable test to govern the determination.[10] The Court adopted the ABC test as enacted by the state of Massachusetts, after concluding it is the most structured, provides the broadest coverage, and removes the possibility for manipulation to which the more flexible tests such as the *Borello* common law are susceptible.[11]

Under the ABC test, the hiring entity – not the worker – must establish that a worker is an independent contractor under the wage order. To properly classify the worker as an independent contractor, the hiring entity must prove *each* of the following three conditions:

(a) that 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 the work and in fact; *and*,

(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 that involved in the work performed.[12]

Applying the ABC Test

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- **Part A *"free from the control and direction"***

Part A requires the hiring entity to establish that the worker is free from the direction and control of the hirer in performance of the work, both under contract and in fact. This requirement appears to closely mirror the *Borello* test, with the focus on whether the hiring entity retained or exercised the "right to control" the manner and means by which the workers perform the services.

- **Part B *"work that is outside the usual course of…business"***

Part B has raised the most concerns for employers. Courts must consider the usual course of business for which the worker has been retained and assess the worker's role in the overall operation. If the worker performs a function that is directly tied to the heart of the operation, the service will be deemed to constitute a regular and integrated portion of the employer's business. This factor would thus weigh in favor of a finding of employee status.

To explain this prong of the test under the ABC test, the Court provided examples of fairly straightforward transactions. For example, the Court explained that when a retail store hires a plumber to a repair a leak, the services are not within the retail store's usual operation. Conversely, when a bakery hires cake decorators to work on custom designed cakes on a regular basis the workers are part of the bakery's usual operations.[13]

The use of independent contractors to perform any service that is part of the public agency's usual course of business carries a high degree of risk of misclassification. To pass muster under this general guidance, a public agency must clearly establish the contract for service is one that is unrelated to the agency's usual course of business. The agency can do so by identifying the specialized nature of the service, its purpose and anticipated duration. If the service is ongoing and relates to a core function, a literal application of the ABC test may result in the classification of the worker as an employee. To avoid a misclassification determination, the agency will need to establish its independent authority to contract for the service and challenge any interpretation of the prong that is inconsistent with such authority.[14] Alternatively, the agency may consider contracting for the service through a third party contract.[15]

- **Part C *"independently established trade, occupation, or business"***

This inquiry focuses on the usual or customary trade, occupation, profession, or business of the person retained to perform services for the employer. The employer must show that the worker is engaged in

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an enterprise that exists and can continue to exist upon termination of the relationship. In other words, the worker must be well-established in a business for his or herself, as evidenced by incorporation, licensure, advertisements, own office, business card, and offers to provide services to many potential customers.

THE POTENTIAL IMPACT OF DYNAMEX ON CALIFORNIA'S PUBLIC AGENCIES

The *Dynamex* decision leaves many important questions unanswered.

Does the ABC Test Apply to Joint Employment Relationships?

The *Dynamex* Court did not address whether the ABC test applies in the context of a joint employment relationship. Such relationships are common in the public sector. They arise when an employer uses staffing agencies, management companies and consulting firms to supply workers to perform specific services. The worker is subject to the control of both the outside firm and the public agency: the outside firm is responsible for all of the administrative functions, including payment of salary, benefits and payroll taxes, and both entities are responsible for ensuring the worker receives proper employment protections.[16] In a positive development, in *Curry v. Equilon Enterprises,* an appellate court recently found that the ABC test does not apply in the joint employment context because "taxes are being paid and the worker has employment protections."[17]

Following *Curry*, public agencies may be able to contract out functions that are part of their core business, so long as they do so with a third party entity that serves as the primary employer, rather than contracting directly with the individuals.[18] Such contractual arrangements ensure the worker receives the protections of California's labor and employment laws and that the appropriate payroll taxes are paid. By clearly articulating the primary employer's responsibilities towards the workers in the contracts, employers may be able to reduce the risk of misclassification under the "usual course of business" prong of the ABC test.

Does the ABC Test Apply Beyond the Wage Order Context?

Another question is whether the ABC test is limited to the wage order context. The *Dynamex* court expressly limited its application of the ABC test to the analysis of the "suffer or permit to work test" under the wage orders.[19] The decision does not change the definition of independent contractor under federal law, which governs who is an employee for purposes of Social Security and payroll taxes. Indeed, the *Dynamex* court specifically recognized that a worker may qualify as an employee under one statute but not another.[20] Thus, *Dynamex* contemplates that workers who qualify as independent contractors under the *Borello* common law test under a scheme such

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as Unemployment Insurance, Workers' Compensation, or CalPERS regulations, may not be considered independent contractors for the purposes of **wage order** violations.[21]

While it appears the *Dynamex* decision does not change the definition of employee outside of the wage and hour context, it is uncertain as to how lower courts and administrative agencies interpret *Dynamex* and its application in other contexts. Final resolution may need to come from the legislature, not the courts.

Does *Dynamex* Have Retroactive Application?

The *Dynamex* court did not address the issue of whether the decision applies retroactively. Employers maintain that the ABC test is a new mandatory test that should not be applied retroactively as it would violate due process. Courts and administrative agencies have followed the *Borello* multifactor test for more than three decades and businesses and public agencies have relied on the *Borello* common law standard in structuring their business and service models. On the other hand, employee advocates assert that the decision merely clarified existing law and therefore should apply retroactively.

On June 20, 2018, the California Supreme Court unanimously denied a petition for rehearing solely on the issue of whether the Court's adoption of the ABC test should apply retroactively. One trial court presented with the issue of retroactivity has already ruled in favor of the employee.[22] Also on June 20, 2018, the California Chamber of Commerce, and multiple business organizations petitioned to have the Administration and Legislature "postpone or suspend the application of the *Dynamex* decision until all parties impacted by the decision can work together to develop a balanced test for determining independent contractor versus employee status that reflects the needs of California's economy and the workforce."[23] It is notable that every other state that has adopted the ABC test has done so through *legislative action*, not a judicial decision. Given the current California legislature's pro-employee posture, it is unclear as to whether legislative action would favor employers.

How Do California Wage Orders Apply to California Public Agencies?

While the *Dynamex* decision has been perceived as a direct blow to the "gig economy" and a direct attack on new business models that are based on independent contractor relationship that have driven the growth of companies such as *Uber, Lyft,* and *Grub-Hub,* the direct impact on California public agencies may be more limited. That is because not all of the wage order provisions apply to public agencies.[24] For example, the Wage Order that is most applicable for public sector employees is Wage Order 4.[25] It addresses wages, hours and working conditions in "Professional Technical, Clerical,

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Mechanical and Similar Occupations." Wage Order 4 specifies that the following provisions do not apply to public agencies: daily overtime and double pay; meal and rest periods; reporting time pay; and, uniforms and equipment among others. Daily overtime, meal and rest breaks and failure to comply with reporting provisions are among the most common claims in wage and hour litigation.[26]

RESPONDING TO *DYNAMEX*

While some important questions remain unresolved, California employers should anticipate a renewed general focus on worker misclassification issues. To minimize the risk of employee misclassification under the wage orders and other employment laws, employers would be wise to review of all of its contingent worker relationships in order to (1) proactively identify potential compliance issues; (2) modify contracting practices to minimize potential risks; (3) implement effective control and monitoring mechanisms; and, (4) establish a record of good faith compliance efforts.

Unfortunately, the *Dynamex* decision leaves many unanswered questions. Given the significant impact of the decision on California employers, pressure for legislative action will likely continue to grow. At the same time, lower courts and enforcement agencies will continue to consider the application of the ABC test in a variety of contexts in future misclassification proceedings. Thus, employers must pay close attention to judicial and administrative determinations, as well as legislative developments to keep abreast of this developing area of law.

[1] *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903 (*Dynamex*).

[2] *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal.3d 341 (*Borello*), *see also, infra,* fn 21.

[3] Industrial Welfare Commission Wage Order 9, Cal. Code Regs., Tit. 8, § 11090, et. seq.

[4] To assist in the determination, the test also sets out a series of "secondary factors" to consider which include: whether the worker is engaged in a distinct occupation or business; whether the work is usually done under supervision; the skill required in the particular occupation; who supplies the instrumentalities, tools and location of work; the duration of the services; the method of payment; whether or not the work is part of the regular business of the hiring entity; and, the intent of the parties. *Id.* at 351.

[5] *Messenger Courier Assoc. v. California Unempl. Ins. Appeals Bd.*

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(2009) 175 Cal.App.4th 1074, 1092 (unemployment insurance benefits); *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal.3d 943, 512 (unemployment insurance); *McFarland v. Voorheis-Trindle* (1959) 52 Cal.2d 698 (workers' compensation); *Metropolitan Water Dist. v. Superior Court* (Cargill) (2004) 32 Cal.4th 491 (CalPERS benefits).

[6] *Id.* at 69.

[7] *Id.* at pp. 916, 943 (emphasis added).

[8] *Id.* at p. 952.

[9] *Id.* at p. 952.

[10] *Id.* at p. 946.

[11] *Id.* at pp. 954-955, 957, fn. 23.

[12] *Id.* at pp. 956, 964.

[13] *Id.* at pp. 959-960.

[14] Unlike *private* businesses, public agencies have the express authority to contract for specialized services, regardless of whether they relate to a core function. Gov. Code § 53060 provides, "[t]he legislative body of any public or municipal corporation or district may contract with and employ any persons for the furnishing to the corporation or district special services and advice in financial, economic, accounting, engineering, legal, or administrative matters if such persons are specially trained, experienced and competent to perform the special services required." *See also* Gov. Code § 37103. Public agencies should aggressively argue for an interpretation of Prong B that does not conflict with their express authority to contract for special services and advice.

[15] *See infra,* fn. 18.

[16] *In-Home Supportive Services v. Workers' Compensation Appeals Board* (1984) 152 Cal.App.3d 720, 732. *See also Cargill*, *supra*, 32 Cal.4th at p. 506.

[17] *Curry v. Equilon Enterprises, LLC* (2018) 23 Cal.App.5th 289, 313-314 (*Curry*).

[18] Note, however, that employees of third parties must be enrolled in CalPERS if they qualify as the City's employees under the common law control test. *Cargill, supra.*

[19] *Dynamex, supra,* 3 Cal.5th at p. 916

[20] *Dynamex, supra,* 4 Cal.5th at p. 948.

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[21] The Court has recognized that control over how services are performed, the primary factor in the common law control test, remains "an important, perhaps even the principal, test for the existence of a common law relationship." *Martinez, supra,* 49 Cal. 4th at p. 50, fn 16, p. 76. (*See, e.g.*, *Metropolitan Water Dist. v. Superior Court*, *supra*, 32 Cal. 4th 491, 512][pension law]; *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal. 3d 943, 946 [unemployment insurance]; and, *McFarland v. Voorheis–Trindle Co.* (1959) 52 Cal. 2d 698, 704 [workers' compensation].)

[22] *Johnson vs. VCG-IS, LLC, et al.* Case No. 30-2015-00802813-UC-CR-CXC (July 18, 2018).

[23] *See,* https://advocacy.calchamber.com/2018/07/30/coalition-builds-support-for-independent-workers/.

[24] *See, e.g.,* Clear As Mud: California Wage and Hour Laws in the Public Sector, The Authority, CalJPIA, Issue 50, April 2016.

[25] 8 Cal. Code Regs. § 11040(1)(B).

[26] However, the Wage Order also specifies that provisions relating to determining whether an employee is exempt or non-exempt, minimum wage, and various definitions that impact rate of pay **do** apply to public agencies. Those provisions include: the test for exempt/non-exempt status; definitions for key terms, including "hours worked" and "primarily" which are key in evaluating an employee's entitlement to payment at an overtime rate under California law; minimum wage; meals and lodging; and, penalties.

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