CALIFORNIA SUPREME COURT'S DYNAMEX DECISION ALTERS INDEPENDENT CONTRACTOR LANDSCAPE

Dynamex Operations West. v. Superior Court (April 30, 2018)

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On April 30, 2018, the California Supreme Court issued a landmark decision in *Dynamex Operations West v. Superior Court*, No. S222732, in which the Court chose to essentially scrap the nearly 30-year old test for determining whether a worker is an employee or an independent contractor for claims asserted under California's Wage Orders.

In replacing the decades-old *Borello* control test, which applied multiple factors to the determination of whether a worker qualifies as an independent contractor, the Court adopted the simplified "ABC" Test applied in various other jurisdictions around the country, including Massachusetts and New Jersey.

The revised standard adopted by the Court is summarized as follows:

- The Court interpreted California's wage precedents and policy as *placing the burden on the business to prove* that a worker is an independent contractor rather than an employee, otherwise the worker will be presumed to be an employee.

- To meet its burden under the ABC Test, a business must establish each of three ABC 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.

- Under the ABC Test, the failure of a business to establish any one of the three factors means that a worker will be determined to be an employee and not an independent contractor as a matter of law.

- The Court's ruling specifically applies to claims stemming from California's Wage Orders, but the Court left open whether this test would also apply to other statutes, such as those governing claims for failure to pay workers' business expenses (Cal. Labor Code sect. 2802).

The ABC Test is undoubtedly much simpler to apply than the now- replaced *Borello* control test, under which numerous factors had to be considered for the analysis, and the importance of any one factor was to be determined by courts or agencies on a case-by case basis. (*S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 341 [*Borello*])

However, the ABC Test is far broader in its reach than the *Borello* test, purposefully so the Supreme Court stated, and will likely result in many more workers being unable to meet the requisite test to be classified as an independent contractor. This change is especially significant for California physicians, many of whom are classified as independent contractors.

Factor "A" of the ABC Test, which requires that the worker must be "free of the control of the hiring entity in the performance of the work," is more or less a restatement of part of the *Borello* control test, and can be based on a myriad of related factors evidencing control of the employer over the worker's performance of work, including whether the worker supplies his own tools or controls the specific details of his work, without interference by the hiring entity.

The second factor, requirement "B" of the ABC Test, mandates that in order to be considered an independent contractor, a worker must "perform work that is outside the *usual course of the hiring entity's business*." To illustrate the meaning of the "usual course of business," the Supreme Court gave the example that "when a retail store hires an outside plumber to repair a leak in a bathroom on its premises or hires an outside electrician to install a new electrical line, the services of the plumber or electrician are not part of the store's usual course of business and the store would not reasonably be seen as having "suffered or permitted" (the California law definition of employment) the plumber or electrician to be working as its employee.

"On the other hand," the Court said, "when a clothing manufacturing company hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company that will thereafter be sold by the company," or "when a bakery hires cake decorators to work on a regular basis on its custom- designed cakes," the workers are part of the hiring entity's *usual business operation* and the hiring business can reasonably be viewed as having suffered or permitted the

workers to provide services as employees" and not as independent contractors.

Factor "C" of the ABC Test, which requires that the workers "must be customarily engaged in an independently established trade, occupation or business of the same nature as the work performed," requires a showing that the worker has "independently made the decision to go into business for himself or herself." Such workers would be expected to have taken "the usual steps to establish and promote his or her independent business," for example through "incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like."

Misclassifying workers can have a potentially large impact on businesses, because if a worker should be classified as an employee, the business bears responsibility for paying federal social security and payroll taxes, unemployment insurance taxes and state employment taxes as well as providing workers compensation insurance. Employees, unlike independent contractors, are protected by an extensive body of laws regulating the work place, including wage and hour and discrimination laws, among many, and significant penalties exist for misclassifying employees as independent contractors, including the potential for costly tax audits by the EDD.

This decision can be expected to have a profound effect on the health care industry, where a significant number of workers, especially physicians, are classified as independent contractors.

No cases have yet interpreted the decision in the healthcare industry, so the decision's practical effect is not yet known. The broad language of the decision suggests some interim conclusions, however:

- Workers who provide services on a full-time and exclusive basis to a single entity are at risk of re-classification, and always were, even before the *Dynamex* decision.

- Workers who are individually incorporated and provide services to a number of entities may satisfy the first and third prong, but may well fail the second, at least if they provide services squarely within the entity's professional service offerings.

- Physicians who provide administrative services, e.g., as a medical director in a hospital, may still be correctly characterized as independent contractors, especially if the physician otherwise maintains a medical practice.

It is also not clear what the practical effect of re-classification would be, beyond the obvious: liability for employment taxes and unemployment and workers' compensation insurance. For example, if an emergency physician were re-classified as an employee, he or she would almost certainly be an exempt employee, so no overtime or break requirements would be applicable. Physician independent contractors who are currently compensated on an hourly or productivity-based system could continue to be compensated that way, although their employers would be required to withhold taxes. Such workers could enjoy the benefits of the workers compensation system, although it is not clear how many would do so. Finally, discrimination laws that protect employees would become applicable to such workers.

Physicians often seek independent contractor status for reasons related to the deduction of expenses or individual pension planning. If physicians are now required to be employees, these benefits may no longer be available.

Because the new standard on its face only pertains, at least at this point, to wage issues, and not expressly to workers compensation or payment of payroll taxes (which incorporate their own definitions of "employee" and "independent contractors"), and the case expressly carved out payment of employee expenses as not subsumed within the new standard, we are currently exploring legal ways to work around the new standard to allow workers and their principals to continue to define the way they would like to do business, where possible. In some cases, we are exploring whether workers and professionals may be employees for wage purposes while maintaining contractor status with respect to other issues. Such analysis must be done on a case-by-case basis.

The *Dynamex* decision will have a large impact on the way many industries conduct business, and many businesses will need to re-examine their use of independent contractors, and their current agreements, to determine whether re-classification is necessary.

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