California *Dynamex* Decision Demonstrates Need for Harmonization

A recent decision by the Supreme Court of California – adopting a difficult-to-satisfy statutory "ABC" test to determine an individual's status, as an employee or independent contractor, for purposes of certain "wage orders" issued by California's Industrial Welfare Commission – demonstrates an urgent need for harmonizing the definition of "employee" for purposes of federal and state laws.

The company in *Dynamex Operations W. v. Superior L.A. Cty.*, 2018 Cal. LEXIS 3152 (Apr. 30, 2018), offered courier and delivery services. According to the findings in the case, the company treated drivers as employees until 2004, when it converted the drivers to independent contractors. The Court's decision concerned the appropriate test for determining an individual's status in the context of an effort by the company to decertify a class-action lawsuit. The Court made no substantive decision concerning the drivers' status.

The wage order at issue in *Dynamex* imposes obligations relating to minimum wages, maximum hours, and working conditions for California employees.[1] Section 2 of the wage order contains the following definitions:

> (E) "Employ" means to engage, suffer, or permit to work.
> (F) "Employee" means any person employed by an employer.
> (G) "Employer" means any person as defined in Section 18 of the Labor Code, who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours, or working conditions of any person.

The Court adopted an "ABC" test for determining "employee" status for purposes of the wage order, which presumptively considers all workers to be employees, and permits workers to be classified as independent contractors only if the hiring business demonstrates that the worker in question satisfies <u>each</u> of 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; <u>and</u>

(B) that the worker performs work that is outside the usual course of the hiring entity's business; <u>and</u>

(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 for the hiring entity.

[1] This wage order applies to the transportation industry, but the Court noted that 15 other wage orders impose similar duties on employers operating in other industries in California. A list of California wage orders is available at: <u>https://www.dir.ca.gov/iwc/wageorderindustries.htm.</u>

The "ABC" test the Court adopted is the version used in Massachusetts, which is arguably the narrowest.[2] Other versions of the test, for example, permit the "B" factor to be satisfied by showing that the worker performs a service that is either (i) outside the usual course of the business for which the service is performed or (ii) outside of all the places of business of the enterprise for which the service is performed.

The Court's Rationale

The Court's adoption of an "ABC" test resulted from its application of a *statutory purpose* interpretative standard for defining the term "employee." Under this standard, according to the Court, a court focuses on the intended scope and purpose of a particular statute and seeks to determine a classification (employee or independent contractor) that best effectuates the underlying legislative intent and objective of the statutory scheme at issue. The Court acknowledged that this interpretative standard leads to the possibility of an individual having a different status for purposes of different statutes, because of the different purposes for which different statutes have been enacted.

An example under federal law the Court referenced – as confirming the appropriateness of establishing a distinct test for the term "employee" that provides broader coverage of workers for purposes of wage and hour laws – is the Fair Labor Standards Act ("FLSA").

Applying its *statutory purpose* interpretative standard to California's wage orders, the Court found that the wage orders have three fundamental purposes. First, they are primarily to

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[2] The following describes the Court's explanation of each of the three factors of the test it adopted.

A Factor: Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact? The Court explained that a worker who is subject, either as a matter of contractual right or in actual practice, to the type and degree of control a business typically exercises over employees under the common law test, would not satisfy this factor. Also, depending on the nature of the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control.

B Factor: Does the worker perform work that is outside the usual course of the hiring entity's business? This factor is intended to bring within the "employee" category all individuals who are reasonably viewed as providing services to the business in a role comparable to that of an employee, rather than in a role comparable to that of a traditional independent contractor. The Court explained that workers whose roles are most clearly comparable to those of employees include individuals whose services are provided within the usual course of the business of the entity for which the work is performed and thus who would ordinarily be viewed by others as working in the hiring entity's business and not as working, instead, in the worker's own independent business.

The Court reasoned that if the wage order's obligations could be avoided for workers who provide services in a role comparable to employees but who are willing to forgo the wage order's protections, other workers who provide similar services and are intended to be protected under the suffer or permit to work standard would frequently find themselves displaced by those willing to decline such coverage.

C Factor: Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity? The Court interpreted this factor as intending to identify an individual who independently has made the decision to go into business for himself or herself, 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. The fact that a company has not prohibited or prevented a worker from engaging in such a business is not sufficient to satisfy this factor; rather, a hiring entity will need to prove that the worker is customarily engaged in an independently established trade, occupation, or business.

benefit the workers, by enabling them to provide at least minimally for themselves and their families and to accord them a modicum of dignity and self-respect.

Second, they are to protect companies that in good faith comply with a wage order's obligations against competitors in the same industry or line of business that resort to cost saving worker classifications that fail to provide the required minimum protections to similarly situated workers. A wage order is intended to create a "level playing field" among competing businesses in the same industry and prevent the type of "race to the bottom" that occurs when businesses implement new structures or policies that result in substandard wages and unhealthy conditions.

Third, they are to benefit the public at large, because the public will often be left to assume responsibility for the ill effects to workers and their families resulting from substandard wages or unhealthy and unsafe working conditions.

While acknowledging that a multifactor test — such as the economic realities test — that considers all potentially relevant factual distinctions in different employment arrangements on a case-by-case, totality-of the-circumstances, basis has its advantages, the Court observed that such a test also has significant disadvantages, particularly when applied in the wage and hour context. First, such a test makes it difficult for a company or a worker to determine in advance how a particular category of workers will be classified. Second, it affords a hiring business greater opportunity to evade its responsibilities under a wage and hour law by dividing its work force into disparate categories and varying the working conditions of individual workers within such categories with an eye to the many circumstances that may be relevant under the multifactor test.

To minimize these disadvantages, the Court explained that a number of jurisdictions have adopted an "ABC" test, which it characterized as simpler and more structured. The Court described the "ABC" test it adopted as a test that will provide greater clarity and consistency, and less opportunity for manipulation, than a test that requires the consideration and weighing of a significant number of disparate factors on a case-by-case basis.

Importantly, the decision does not appear to affect the test used to determine an individual's status for purposes of other California statutes, such as unemployment or California's Labor Code. The Court acknowledged the possibility of an individual qualifying as an independent contractor for one purpose (e.g., California unemployment) but not another (e.g., a California wage order).

Commentary

- This appears to be the first time a court has judicially adopted an "ABC" test in a jurisdiction in which no statutory version of the test exists. In other jurisdictions, the test is a statutory creation.

- The version of the "ABC" test that the Court adopted in *Dynamex* can be difficult to satisfy for any type of business. While the Court claims that the "ABC" test offers simplicity, clarity and consistency, the test accomplishes this by imposing criteria for creating an independent-contractor relationship that are so difficult to satisfy in certain industries that the default "employee" status becomes the norm for those industries. For individuals who provide certain

types of services in such industries, the "ABC" test functions less as a "test" than as a provision creating statutory employee status.

  - Furthermore, because the "B" factor is often the subject of metaphysical inquiry,[3] and the "C" factor involves facts a client company has no business need to know, and commonly does not know,[4] these criteria inject substantial structural uncertainty into any independent-contractor determination – even in industries for which the test conceivably could be satisfied. An unfortunate consequence is that client companies sometimes refuse to do business with independent contractors in these jurisdictions to avoid this risk.

  - The Court's adoption of an "ABC" test in this specific context arguably represents a policy action taken by the Court that is highly discriminatory against legitimate independent contractors.

- A practical compliance dilemma the new test creates is that if a company doing business with independent contractors were to conclude that it cannot satisfy the test and then modify its business practices to achieve compliance with an applicable wage order, the actions taken to achieve compliance could jeopardize the independent-contractor status of the affected individuals for purposes of other applicable laws.[5]

- The Court's analysis reflects an overly simplistic view of the worker-classification decision, by suggesting that a company's classification of individuals as independent contractors is motivated principally by the resulting cost savings. The analysis ignores the reality that a company commonly elects to engage independent contractors to perform a function for strictly business reasons, e.g., because of sporadic and unpredictable demand for the function, because

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[3] One example is the different determinations courts have made as to whether a services referral agency is in the business of facilitating the matching of independent contractors with client opportunities or is in the business of providing the type of services offered by the independent contractors who engage the agency to gain access to client opportunities. *Compare State of Nevada Department of Employment v. Reliable Health Care Services of Southern Nevada, Inc.*, 983 P.2d. 414 (Nev. 1999) (determining an agency/broker that refers respiratory technicians to clients to be in the business of brokering workers, and the technicians to be in the different business of providing client care), *with Home Care Professionals of Arkansas, Inc., v. Williams*, 2007 Ark. App. LEXIS 339 (Ark. App. 2006) (determining a registry that refers caregivers who provide home care to be in the business of providing home care).

[4] This is illustrated by the examples the Court offered of how the factor could be satisfied, such as, 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. The Court also explained that the fact that a company has not prohibited or prevented a worker from engaging in such a business is not sufficient to satisfy this factor; rather, a hiring entity will need to prove that the worker is customarily engaged in an independently established trade, occupation, or business. While a client company might have information to ascertain whether an independent contractor is incorporated, it has no business need to know, and generally would not know, about the other facts without expending significant efforts and unless the independent contractor is willing to cooperate, by providing the client company with copies of advertisements and keeping the client company informed throughout the contractual relationship of the other business-related activities in which the contractor is engaged.

[5] For example, if a company were to require an individual to take specified breaks or reimburse the individual for out-of-pocked expenses incurred, those actions would weigh in favor of employment under a common-law test. A related compliance dilemma is the near impossibility of ensuring compliance with a wage order in industries in which individuals are engaged on a sporadic basis throughout the country to perform specific projects of short duration for a fixed project fee. Finally, in many cases, an independent contractor is compensated well above corresponding employees, but due to the nature of the independent-contractor relationship the prescriptive requirements of a wage order will not be satisfied.

of the need for specialized skills or expertise, or because the function is best managed, from an efficiency perspective, by being structured on a project-fee or commission basis that relies on contractors' entrepreneurial ingenuity to achieve optimal outcomes. In these cases, the cost-savings attributable to taxes and/or benefits are seldom a consideration. Moreover, some businesses are created for the sole purpose of creating an efficient marketplace that facilitates the ability of independent contractors and potential clients to find and do business with each other. The relationships created by these businesses are not indicative of a "race to the bottom." Rather, these are win-win relationships that increase efficiency for client companies and empower legitimate independent contractors to easily and quickly find client opportunities.[6]

  - Somewhat ironically – assuming that the Court's interpretation of the wage order is intended to benefit workers – the Court's adoption of this extremely narrow test for establishing independent-contractor relationships, coupled with its explicit objective of ensuring a "level playing field" among competitors, could lead to an acceleration of companies replacing employees with technology. The Court's analysis arguably would prohibit a company from replacing employees with a more competitive labor model that utilizes independent contractors; but it would not prevent a company from replacing those same employees with a technological substitute.

- An inherent flaw in the *statutory purpose* interpretative standard the Court applied in adopting the "ABC" test is that, as the Court itself recognized, it leads to a patchwork of different tests for purposes of different statutes. This creates unproductive uncertainty for independent contractors and client companies that are seeking to do business with each other.

- Another defect in the *statutory purpose* interpretative standard is that it disregards the definition given the term "employee" in the wage order. The apparent purpose of this term is to define the scope of coverage of the wage order. The Court's analysis supplanted the scope of coverage defined in the wage order with the Court's own judicially created scope of coverage based on its assessment of who should be covered in order to best effectuate the underlying legislative intent and objective of the wage order. This contradicts a principle of statutory construction that the Court, itself, expressed in *Wells v. One2One Learning Found.*, 141 P.3d 225, 248 (2006),[7] that "interpretations which render any part of a statute superfluous are to be avoided." The Court's analysis violates this principle by rendering the part of the wage order defining the term "employee" superfluous, as the Court completely disregarded that definition and replaced it with an "ABC" test contained in a Massachusetts statute.

- The decision offers a compelling rationale for harmonizing the definition of "employee" for purposes of all federal and state statutes along the lines of a common-law test. A harmonized

[6] The decision arguably calcifies the labor models in California. If a company employs individuals to perform a certain function, the decision suggests that it could not modify its business model to outsource the function to independent contractors. It is not clear under the Court's analysis whether a company that outsourced such a function to an incorporated third-party vendor would be responsible for ensuring that the vendor's employees were paid and treated in accordance with an applicable wage order.

[7] In support of this principle, the Court cited *In re Young*, 32 Cal.4th 900, 907 (2004); *Hunt v. Superior Court*, 987 P.2d 705 (1999); and *People v. Aguilar*, 16 Cal.4th 1023, 1030 (1997).

statutory definition would protect against courts adopting different tests for purposes of different statutes.

- The Court's reference to the FLSA as a justification for creating inconsistent definitions for the term "employee" illustrates how the continued use of the outlier "economic realities" test for purposes of the FLSA is not only problematic for the FLSA, itself, but its use also apparently encourages courts to adopt increasingly disparate tests for the term "employee" for other purposes.

- A solution to this problem is offered by H.R. 3825, the *Harmonization of Coverage Act of 2017*, introduced on September 25, 2017, by Representatives Diane Black (R-TN) and Elise Stefanik (R-NY). This bill would harmonize the definition of "employee" for purposes of federal statutes by amending the FLSA to statutorily adopt a common-law test for the term "employee." This would conform the FLSA to the more recent U.S. Supreme Court decisions[8] that have adopted a "common-law" definition for the term "employee" for purposes of a statute that defines the term with a definition that is circular, which is precisely how the term is defined in the wage order at issue in *Dynamex.*

- To learn more about the Coalition's efforts in pursuit of harmonization, see http://www.iecoalition.org/.

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[8] The U.S. Supreme Court, in *Cmty. for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989); *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992); and *Clackamas Gastroenterology Assocs., P.C. v. Wells*, 538 U.S. 440 (2003), held that for purposes of federal statutes that do not define the term "employee," or define the term with a circular definition, the term is to be defined by a common-law right of control test.