The 'ABC' Test is Fundamentally Flawed and Should be Eradicated

by

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The medical ethics phrase "first do no harm" is also applicable to public policy. It is an ethical consideration to be taken seriously by any state contemplating the adoption of an "ABC" test for determining worker status.

The "ABC" test is fundamentally flawed. It creates two new categories of "statutory employees" that deny independent-contractor status to large swaths of independent entrepreneurs. It harshly infringes on the rights of those who choose to offer their services as independent entrepreneurs and poses a clear and present threat to business innovation and efficiency. According to a 2010 study by Ph.D. economist Jeffrey A. Eisenach, "[p]olicy changes that curtail independent contracting … would result in higher unemployment, slower economic growth and reduced economic welfare."[1] The study also notes that curtailing independent contracting would

(i) reduce job creation and small business formation,
(ii) reduce competition and increase prices,
(iii) create sector specific disruptions, and
(iv) produce a less flexible and dynamic work force.[2]

The study observes that "one of the most powerful economic explanations for the widespread use of independent contractor relationships is the well-documented fact that independent contractors prefer their jobs to an employment arrangement."[3] It follows that any state that adopts an "ABC" test will deny large numbers of independent entrepreneurs the right to offer their services in the manner they prefer.

Rather than expanding the application of an "ABC" test that is fundamentally flawed, states should eradicate the test by replacing it with the traditional common-law test,[4] which has survived the test of time and is adaptable to any type of work relationship.

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[1] Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy*, NAVIGANT ECONOMICS (December 2010) available at: http://www.naviganteconomics.com/docs/Role%20of%20Independent%20 Contractors%20 December%202010%20Final.pdf.
[2] *Id*.
[3] *Id*.
[4] This is precisely what occurred this year in three states, namely, Arkansas, Oklahoma, and Tennessee. Legislation was enacted in each of these states that replaced an "ABC" test with a common-law test for unemployment and related purposes. *See* Arkansas H.B. 1850 (enacted April 16, 2019); Oklahoma H.B. 1095 (enacted May 10, 2019); Tennessee H.B. 539 (enacted May 13, 2019).

I. The 'ABC' Test

There are several different iterations of the "ABC" test. The iteration that has attracted national media attention, and is now being considered for adoption by other states, is the version the Supreme Court of California adopted in *Dynamex Operations W. v. Superior L.A. Cty.*, 2018 Cal. LEXIS 3152 (Apr. 30, 2018), for purposes of California wage orders. The California legislature subsequently codified this test and expanded its application by enacting Assembly Bill 5. The California Supreme Court explained this test as:

> (1) placing the burden on the hiring entity to establish that the worker is an independent contractor who was not intended to be included within the wage order's coverage; and
> (2) requiring the hiring entity, in order to meet this burden, to establish *each* of the three factors embodied in the "ABC" test—namely
>
> (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; *and*
>
> (B) that the worker performs work that is outside the usual course of the hiring entity's business;[5] *and*
>
> (C) that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.[6]

An important aspect of this test is that it places the burden on a client to prove each of the three requirements to establish an independent-contractor relationship. If the client fails to satisfy any one of those requirements with respect to an individual, the client is deemed the individual's employer.

II. The 'ABC' Test is a Dramatic Departure from the Traditional Common-Law Test for Determining Worker Status

The predominant test currently used to determine an individual's status, as an employee or independent contractor, is the common-law right of control test.[7] This test has its origins in English

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[5] By contrast, the "B" factor in other versions of the test can be satisfied in either of two ways, i.e., by showing e*ither*: (1) that the service is either *outside the usual course of the business* for which such service is performed, or (2) that the service is performed *outside of all the places of business of the enterprise* for which such service is performed.

[6] The California Supreme Court explained that the "C" factor can be satisfied only by establishing that an individual *actually does engage* in an independently established occupation, as opposed to establishing that an individual has *the right to* do so.

[7] The two most prevalent iterations of the common-law test are the test used for purposes of the Internal Revenue Code and the test set forth in the Restatement (Second) of Agency § 220(2). For purposes of the Internal Revenue Code, The Internal Revenue Manual, 4600 Employment Tax Procedures, Exhibit 4640-1, provides that workers are generally employees if they: (1) must comply with employer's instructions about the work; (2) receive training from or at the direction of the employer; (3) provide services that are integrated into the business; (4) provide services that must be rendered personally; (5) hire, supervise, and pay assistants for the employer; (6) have a continuing working relationship with the employer; (7) must follow set hours of work; (8) work full time for an employer; (9) do their

common law[8] and has survived the test of time as a reliable determiner of worker status.

The common-law test is inherently adaptable to any type of work relationship, as it applies a multifactor analysis that turns on whether the client retains the requisite right of control over the means and methods used by the putative independent contractor in providing services. The weight to be given any specific factor depends on the specific relationship being examined.[9]

If a client is determined to retain the requisite right of control, the individual at issue is deemed an employee of the client; whereas if the client is determined *not* to retain such right of control, the individual is deemed an independent contractor.

The "ABC" test is a perversion of the common-law test. It consists of the common-law test (the "A" factor) but also takes two factors from the common-law test (the "B" and "C" factors) and makes them mandatory factors for all work relationships, without regard to whether those two factors – as applied to a specific work relationship – are *appropriately* accorded paramount weight.

III. The Characteristics of the 'ABC' Test That Make It Fundamentally Flawed

The fundamental flaw of the "ABC" test is its requirement that all work relationships satisfy its "B" and "C" factors, regardless of the appropriateness of those factors to a specific work relationship. This leads to undeniably absurd outcomes.

A. The 'B' Factor Creates a New Category of Statutory Employees Consisting of Anyone who Provides Services Within a Client's Usual Course of Business

The "B" factor operates to deny independent-contractor status to any individual who performs a type of service that is deemed to fall within the "usual course of business" of the client. The court in *Sanchez v. Lasership, Inc.*, 937 F. Supp. 2d 730, 741-42 (E.D. Va. 2013),

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work on the employer's premises; (10) must do their work in a sequence set by the employer; (11) must submit regular reports to the employer; (12) receive payments of regular amounts at set intervals; (13) receive payments for business and/or traveling expenses; (14) rely on the employer to furnish tools and materials; (15) lack a major investment in facilities used to perform the service; (16) cannot make a profit or suffer a loss from their services; (17) work for one employer at a time; (18) do not offer their services to the general public; (19) can be fired at any time by the employer; (20) may quit work at any time without incurring liability. To determine whether a worker qualifies as an independent contractor, the relationship between the worker and a business is analyzed with the aid of the twenty common-law factors. No one factor is decisive, however, the degree of importance of each depends on the occupation and factual context in which services are being performed. *American Consulting Corp. v. United States*, 454 F.2d 473, 477 (3d Cir. 1971); Rev. Rul. 87-41, 1987-1 C.B. 296. Factors which may be considered in the Restatement (Second) of Agency in determining employee status include: whether the purported employee is engaged in a distinct occupation or business; whether the work involved is usually done under an employer's direction or by an unsupervised specialist; the skill involved; who supplies the instrumentalities and place of performance; the length of employment; the method of payment (by the time or by the job); whether the work is part of the employer's regular business and/or necessary to it; and the intent of the parties creating the relationship. No single factor is determinative. E.g., *Hilton Int'l Co. v. NLRB*, 690 F.2d 318, 320-21 (2d Cir. 1982).

[8] E.g., Matthew T. Bodie PARTICIPATION AS A THEORY OF EMPLOYMENT, 89 Notre Dame L. Rev. 661, 675 (Dec. 2013), "The 'control' test is the dominant standard for employment, both nationally and internationally. The test finds its historical roots in the definition of 'servant' in English common law."

[9] See above note 7.

characterized this factor as:

> unique … [and] unlike any other statute in the country, as it is the only statute that requires independent contractors to perform services outside an entity's "usual course of business." … other independent contractor statutes only account for an employer's usual course of business as one of many factors, if at all, in determining independent-contractor status.

For example, consider an individual who owns a vehicle and decides to operate as a self-employed courier. If this individual were to contract with a courier company that has contracts with clients who need packages delivered, courts have acknowledged that it is impossible for the individual to satisfy the "B" factor and qualify as an independent contractor. The court in *Sanchez v. Lasership, Inc.*, 937 F. Supp. 2d 730, 741-42, explains this anomaly as follows:

> As applied to motor carriers …, the effect of [the "B" factor] is to bind carriers to utilize a certain type of employment relationship to carry out their operations. Specifically, [the "B" factor] commands [a motor carrier] to convert its independent contractors to employees because its independent contractors perform services within [its] course of business. In other words, [a motor carrier] which is in the business of providing package delivery services, is precluded from utilizing independent contractors also in the business of package delivery services. The "logical effect" therefore is a categorical ban on the use of independent contractors by motor carriers…. Plaintiffs readily concede that, "[the motor carrier] cannot possibly satisfy the ["B" factor] because [it] is in the delivery business, and Plaintiffs performed delivery services for [it]."

The application of the "B" factor leads to undeniably absurd outcomes outside the motor carrier/courier industry as well. For example, consider a nationally known Ph.D. economist who provides economic consulting services for a variety of different clients out of leased office space and who actively markets the consulting services to potential clients. If this economist were to provide services to an economic consulting firm, the consulting firm would be required to treat the economist as its employee under an "ABC" test, solely because the economist would be engaged to provide services that are within the usual course of the consulting firm's business. There are countless numbers of analogous examples involving different types of services that lead to the same nonsensical outcome.

To make matters worse, courts have broadly interpreted the contours of a company's "usual course of business." A recent example is provided in *Vogue v. Adm'r, Unemployment Comp. Act*, 2019 Conn. Super. LEXIS 637 (Super. Ct. Apr. 4, 2019). This case involved a retailer of body jewelry who operated out of a leased store location. The retailer believed there might be synergy by allowing a tattoo artist to also operate out of its location, so it entered into arrangements with tattoo artists to provide tattoo services to customers at its store.

The court held that the services a tattoo artist provided were within the usual course of the retailer's business. Thus, the retailer failed the "B" factor and was required to treat the tattoo artist as its employee. The court's determination was based principally on the following findings:

- the retailer offered the tattoo services on a regular and continuous basis;
- the retailer had engaged a different tattoo artist prior to the artist at issue in this case;
- in connection with the retailer engaging this tattoo artist, it had advertised for a tattoo artist and interviewed several candidates;
- the retailer's website advertised the availability of tattoo services during all open store hours; and
- the retailer advertised the tattoo services through its website and its Facebook page.

To be sure, if a company is prohibited from selecting the other business and from advertising the services the other business provides, its potential for gaining synergy from the other business is severely diminished.

As a fundamental matter, the *Vogue* decision illustrates how a company's "usual course of business," for purposes of the "B" factor, can extend beyond the type of services that the company, itself, provides, and thereby prohibit entrepreneurs from experimenting with other types of businesses that could add synergy to their own business. For example, in *Vogue*, the outcome would not have been different if the tattoo artist also offered tattoo services at a variety of different locations, including out of its own leased office space, if the tattoo artist actively marketed its services to the general public, or if the tattoo artist had other employees who assisted the artist in meeting client demand. The mandatory "B" factor renders all these other factors completely irrelevant to a determination of the tattoo artist's status relative to the retailer.

B. The 'C' Factor Creates a New Category of Statutory Employees Consisting of Anyone who Has Not Followed Government-Mandated Business Development Practices

The "C" factor is problematic because (i) it requires all independent entrepreneurs to adopt the same government-mandated business development practices, regardless of the appropriateness of those practices to any specific business; and (ii) a client has no business reason to know, and seldom knows (until too late), sufficient facts concerning an individual to ascertain whether the individual would satisfy this factor.

Courts that have considered the "C" factor have identified largely the same types of facts a client needs to demonstrate in order to meet this requirement. In *Brothers Construction Co. v. Virginia Employment Com.,* 494 S.E.2d 478, 484 (1998), the Virginia Court of Appeal concluded that a hiring entity had failed to prove that siding installers were engaged in an independently established business where – although the installers provided their own tools – no evidence was presented that the installers had:

(i) business cards;
(ii) business licenses;
(iii) business phones;
(iv) business locations; or

(v) had received income from any party other than the hiring entity.

Similarly, in *Boston Bicycle Couriers v. Deputy Director of the Division of Employment & Training*, 778 N.E.2d 964, 971 (2002),[10] a same-day pickup and delivery service was determined to fail the "C" factor relative to a bicycle courier, because it did not present evidence that the courier:

(i) held himself out as an independent businessman performing courier services;
(ii) had his own clientele;
(iii) utilized his own business cards or invoices;
(iv) advertised his services; or
(v) maintained a separate place of business and telephone listing.

As the foregoing reveals, the "C" factor requires *all* independent entrepreneurs to implement specified business development practices, notwithstanding that such practices might serve no business purpose for some individuals.

This factor leads to highly counterintuitive results. For example, it can deny independent-contractor status to a laptop entrepreneur who operates a business part-time, one client project at a time, using a personal laptop computer, out of the individual's own apartment, and who obtains clients purely by word-of-mouth referrals. Likewise, it can deny independent-contractor status to an independent entrepreneur who has one large client that provides sufficient work to keep the individual busy, with no business need to engage in any of the prescribed business development activities. In each of these cases, the independent entrepreneur would be denied independent-contractor status solely because of a failure to implement government-mandated business development practices – and without regard to any other common-law factor.

Another insidious aspect of this factor is the reality that clients generally have no business need to inquire about these matters. When a client engages an independent entrepreneur to accomplish an objective, the client's principal concern is whether the individual is capable of accomplishing the objective. The client generally is not concerned about whether the individual has business cards or maintains a website, or the extent to which the individual might also provide similar services to others. As a consequence, clients often discover whether an individual happens to have taken the prescribed business development actions when it is too late, i.e., at the time of a hearing devoted to determining whether the individual qualifies as an independent contractor.

[10] Accord, *Kirby of Norwich v. Adm'r, Unemployment Comp. Act*, 2018 Conn. LEXIS 72 (Jan. 31, 2018), in which the Supreme Court of Connecticut indicated that to satisfy the "C" factor, evidence that an individual provides services for multiple clients is one factor, but additional factors should also be considered, such as whether the individual:

(i) maintains a home office;
(ii) is independently licensed by the state;
(iii) had business cards;
(iv) has sought similar work from third parties;
(v) maintains the individual's own liability insurance; and
(vi) advertises the individual's services to third parties.

IV. Conclusion: the 'ABC' Test Should be Eradicated and Replaced with a Common-Law Test for All Purposes

The "ABC" test is antithetical to a free market society in which individuals have the right to offer their services as independent entrepreneurs or to seek work as employees. Until recently, the "ABC" test has been confined largely to state unemployment statutes. While there is no question the test has been disruptive in this narrow context, it has hitherto been confined generally to that context.

Expanding the "ABC" test beyond unemployment would be highly ill-advised. An expanded application of this test would crush independent entrepreneurship and stifle economic growth. The economic consequences to individual entrepreneurs, to business innovation, and to the economy overall could be dire. Once independent entrepreneurship is driven from the marketplace, it is unknown how quickly, *if at all*, it could be revived once the mistaken policy is reversed.

Rather than expanding the fundamentally flawed the "ABC" test beyond the confines of unemployment, states should consider eradicating the test completely, and reinstating the traditional common-law test for determining worker status for all purposes, including unemployment. The common-law test not only has survived the test of time but it is inherently adaptable to any type of business relationship, by virtue of its multifactor analysis that accords different weights to different factors, depending upon the specific relationship at issue.