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The New ABCs of Misclassification in California

In the ever-evolving landscape of California employment law, the California Supreme Court has issued a lengthy opinion laying new ground over who qualifies as an employee and who qualifies as an independent contractor and broadening the scope of who may qualify as an employee. In *Dynamex Operations West Inc. v. Superior Court of Los Angeles County*, S222732 (4/30/2018), the court addressed one of the significant unanswered questions in California employment law: what standard applies when determining if an individual should be classified as an independent contractor or an employee under California wage and hour law?

Dynamex and the Decision to Reclassify Its Drivers

Before the court was an appeal by Dynamex Operations West Inc., a package and document delivery business, of the denial of its motion to decertify a class of delivery drivers who work for it and had brought suit. In 2004, Dynamex changed its business model and switched its drivers from employees to independent contractors. Two individual drivers sued Dynamex, arguing that it had misclassified them, and a class of similarly situated drivers, as independent contractors and not employees. The plaintiffs claimed that they performed the same tasks both before and after the classification change and that Dynamex had failed to comply with the requirements of the California Labor Code and wage orders for drivers such as themselves. California has a somewhat unique amalgam of statutes, common law, and administrative orders that govern the employment relationship, including a series of "wage orders" issued by the Industrial Welfare Commission (IWC). The court reviewed the California wage order that applies to the transportation industry and focused on the following three relevant definitions to guide its analysis: (1) "'Employ' means to engage, suffer, or permit to work"; (2) "'Employee' means any person employed by an employer"; and (3) "'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 wage, hours, or working conditions of any person." (The court noted that there is no definition of "independent contractor" in the wage order.)

After litigation that took the initial matter up on appeal and then back to the trial court, the trial court certified a class of drivers and found that common legal and factual issues predominated over individual issues. In doing so, the trial court relied on the court's 2010 decision in *Martinez v. Combs* and its interpretation of the applicable California wage order. The court there concluded that the three alternative definitions of "employ" and "employer" found in the wage order meant that "to employ" means to (1) exercise control over the wages, hours, or working conditions; (2) to suffer or permit to work; or (3) to engage, thereby creating a common law employment relationship. Dynamex

in turn had argued that the court's 1989 decision in *S.G. Borello & Sons Inc. v. Department of Industrial Relations*, with its multifactor approach to determining employment status, was the appropriate standard to apply and that the trial court had erred in certifying the underlying class action under the wage order definitions of "employ" and "employer" found in *Martinez*. The court of appeal upheld the trial court's class certification order and concluded that, of the dueling standards, the definitions contained in *Martinez* applied.

The California Supreme Court Decision

The California Supreme Court agreed with the court of appeal that the "suffer or permit to work" definition of employ contained in the wage order may be relied on in making the independent contractor/employee determination. The court held that it is appropriate to look to the commonly referred to "ABC" standard to distinguish employees from independent contractors. That standard holds that a worker can be properly classified as an independent contractor only if all three of the following elements are met:

> (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 such 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 for the hiring entity.

The court spent a considerable amount of its decision reviewing the background of the relevant prior decisions in this area analyzing *Borello, Martinez*, and *Ayala v. Antelope Valley Newspapers Inc.* (2014) at length and ultimately settled on an employee-friendly interpretation of these cases. It found that in contrast to more recent cases applying the traditional common-law test to determine who is an employee, under *Borello* resolution of this question required an examination of the history and fundamental purpose of the statute at issue. The court explained that "*Borello* calls for application of a *statutory purpose* standard that considers the control of details and other potentially relevant factors identified in prior California and out-of-state cases in order to determine which classification (employee or independent contractor) best effectuates the underlying legislative intent and objective of the statutory scheme at issue."

The court also noted that in the nearly 30 years since *Borello*, the California legislature had failed to demonstrate any disagreement with the statutory purpose standard for classifying workers adopted by Borello. The court similarly summarized the *Martinez* decision and focused on its recognition that the IWC wage orders include a definition of "employ" and its conclusion that, under the IWC's definition, "to employ" has the three alternative definitions based on the wage order's definitions. The court found particularly significant that *Martinez* emphasized "the importance of *not* limiting the meaning and scope of 'employment' to only the common law definition" where "ignoring the rest of the IWC's broad regulatory definition would substantially impair the commission's authority and the effectiveness of its wage orders." *Martinez* concluded that "to employ" is: "(a) to exercise control over the wages, hours or working conditions, *or* (b) to suffer or permit to work, *or* (c) to engage, thereby creating a common law employment relationship."

After analyzing the origin and history of the suffer or permit to work standard identified in *Martinez*, the court rejected Dynamex's argument that such a standard only applied when determining whether an entity is a joint employer. The court found that there was no basis to limit the scope of the suffer or permit to work standard to the joint employment context where *Martinez* had explicitly acknowledged that the IWC had broad authority to define employment and was not circumscribed by common law definitions. The court also summarized its more recent decision in *Ayala*, a misclassification action in which the trial court had denied class certification because the Borello test applied. In that matter, the court concluded that it could resolve the case by applying the common-law test found in Borello because the plaintiffs had proceeded on the sole basis that *Borello* applied. The court pointed out that "we leave for another

day the question of what application, if any, the wage order tests for employee status might have to wage and hour claims such as these, and confine ourselves to considering whether plaintiffs' theory that they are employees under the common law definition is one susceptible of proof on a classwide basis." The court uses *Dynamex* to address that issue.

The *Dynamex* court then holds that the suffer or permit to work standard properly applies to the question of whether a worker should be considered an employee or independent contractor and that the trial court class certification order should be upheld. Reviewing a number of post-Martinez decisions, the court concludes that those decisions do not support the contention that the suffer or permit to work standard is not applicable to the employee/independent contractor determination. The court does concede that the wage orders, when applied literally, do not distinguish between individual workers who are properly considered employees and those who are traditionally viewed as independent contractors, such as plumbers and electricians. Nonetheless, the court concludes that, given the remedial purpose of California wage orders, the wage orders must be construed broadly, "in a manner that serves its remedial purposes … as our decision in *Martinez* recognized, the suffer or permit to work standard must be interpreted and applied broadly to include within the covered 'employee' category *all* individual workers who can reasonably be viewed as '*working in the [hiring entity's] business*.'"

The Court Concludes in Favor of Finding an Employment Relationship

The court concludes that it is appropriate to place the burden on the employer to establish that the worker is an independent contractor who was not intended to be included within the wage order's coverage. Significantly, the court held that in order to meet this burden, the employer must establish each of the three factors in the ABC test. The court emphasized that in order to establish that a worker is an independent contractor under the ABC standard, the employer must establish all three factors. The court ultimately concluded that under a proper interpretation of the suffer or permit to work standard, the trial court's determination that there was sufficient commonality of interest to support certification was correct and that the alleged violations of the wage order provisions should be litigated classwide.

Takeaways

- The California Supreme Court has reemphasized its position in favor of finding an employment relationship and has indeed placed the burden on employers to prove otherwise when it comes to complying with California's wage orders.
- The opinion reaffirms that notwithstanding the existence of written agreements with workers that identify them as independent contractors, the courts will look past the agreements to determine if there is an employment relationship in fact.
- The reliance on the ABC standard provides some further clarity for California employers but leaves some questions unanswered.
- The issue of employment reimbursements is left unaddressed by the court and leaves open the possibility that different tests may be used to determine that issue.
- Employers will need to revisit their policies and agreements and look to the functional day-to-day operation of its independent contractors, especially if they are a group who discharge similar duties as employees.

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If you have any questions or would like additional information please contact your Alston & Bird attorney or any of the following:

ATLANTA

Alexandra Garrison Barnett
404.881.7190
alex.barnett@alston.com

Ashley D. Brightwell
404.881.7767
ashley.brightwell@alston.com

Lisa H. Cassilly
404.881.7945
lisa.cassilly@alston.com

Brett E. Coburn
404.881.4990
brett.coburn@alston.com

Clare H. Draper IV
404.881.7191
clare.draper@alston.com

R. Steve Ensor
404.881.7448
steve.ensor@alston.com

Kimberly L. Fogarty
404.881.4502
kim.fogarty@alston.com

Kristen Fox
404.881.4284
kristen.fox@alston.com

Kandis Wood Jackson
404.881.7969
kandis.jackson@alston.com

Eleanor deGolian Kasper
404.881.7186
eleanor.kasper@alston.com

J. Thomas Kilpatrick
404.881.7819
tom.kilpatrick@alston.com

Isabella Lee
404.881.7163
isabella.lee@alston.com

Christopher C. Marquardt
404.881.7827
chris.marquardt@alston.com

Charles H. Morgan
404.881.7187
charlie.morgan@alston.com

Christiane Nolton
404.881.7165
christiane.nolton@alston.com

Glenn G. Patton
404.881.7785
glenn.patton@alston.com

Anna Saraie
404.881.4483
anna.saraie@alston.com

Brooks Suttle
404.881.7551
brooks.suttle@alston.com

LOS ANGELES

Martha S. Doty
213.576.1145
martha.doty@alston.com

James R. Evans, Jr.
213.576.1146
james.evans@alston.com

Jesse M. Jauregui
213.576.1157
jesse.jauregui@alston.com

Ian Wright
213.576.1015
ian.wright@alston.com

WASHINGTON, D.C.

Emily Seymour Costin
202.239.3695
emily.costin@alston.com

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WWW.ALSTON.COM