California Supreme Court Announces New, Stricter Test For Evaluating The Independent Contractor Relationship

In the landmark decision *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, No. S222732 (Cal. Sup. Ct. Apr. 30, 2018), the California Supreme Court unanimously announced a new test for determining whether a worker is an employee or an independent contractor. The new standard makes it significantly more difficult for employers to prove that an independent contractor relationship exists.

For the past 30 years, Court have looked to the "*Borello* test" for determining whether a worker was an independent contractor under the Industrial Welfare and Wage Orders. The long-standing *Borello* test took a multi-factor approach that looked first and foremost at whether the employer had a "right to control" the "manner and means" by which the worker performed the work. The Borello test also considered eight other "secondary" factors, including the degree of skill required to perform the work, whether the worker supplies his or her own tools and equipment, and the place where the work was performed.

With its decision in *Dynamex*, however, the California Supreme Court has created a significantly more rigorous three-part test called the "ABC Test." Under the ABC Test, a worker may be considered an independent contractor only if all three prongs of the test are met.

Part A

The first prong of the three part test is essentially the old *Borello* test. Independent contractors must be 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. In other words, the hiring entity must be prepared to prove not only that there is an independent contractor agreement containing "magic language" that the worker maintains control over the performance of the work, but also that, in actuality, the worker really does have such control on a day-to-day basis.

Part B

The second prong of the ABC Test is whether the worker performs work that is outside the usual course of the hiring entity's business. This prong presents perhaps the most marked change from the old *Borello* test. To shed practical light on this second prong, the Court provided specific examples. A plumber or electrician hired by a retail store to repair a leak, or install an electrical line, could be an independent contractor, because he or she is doing work that falls outside the retail store's "usual course of business." By contrast, a seamstress working from home to make dresses for a clothing manufacturer may *not* qualify for independent contractor status, since the seamstress is doing work that is within the hiring entity's "usual business operations."

Part C

The third prong of the ABC Test looks at whether the worker is "customarily engaged" in an independently established business of the "same nature" as the work performed for the hiring entity. Thus, the plumber brought in to repair a leak at a retail store must also provide plumbing services elsewhere in order to be considered an independent contractor under Part C. Importantly, the Court noted that it is not enough that the hiring entity has not prohibited the worker from providing services elsewhere – the mere lack of an "exclusivity" agreement does not automatically pass part C of the test. Rather, the Court suggested that an examination under Part C of the test look to whether the worker has made the independent decision "to go into business for himself or herself" – as evidenced, for example, by incorporating, being independently licensed, and/or publicly advertising his or her services.

The *Dynamex* Court concluded that it would be the hiring entity's burden to prove that each of the three parts of the

test were met, in order for a worker to be properly classified as an independent contractor. Where the hiring entity cannot prove one or more parts of the test, the hiring entity faces significant liability for misclassifying its workers as independent contractors. Misclassification carries statutory penalties of $5,000 to $15,000 *for each* "willful" violation, and can also expose the hiring company to liability for back wages, penalties, and additional fines as well.

While *Dynamex* should certainly serve as a wake-up call to all employers in California, it should be noted that the Court expressly limited its holding to issues raised under Industrial Welfare Commission Wage Orders – i.e., overtime, minimum wage, meal periods and rest breaks, etc. It remains unclear for the moment whether the ABC Test will be adopted in other contexts, such as tax withholdings, worker's compensation insurance, or unemployment insurance. However, it would not be at all surprising for California agencies and courts to begin adopting the ABC test in other areas, so cautious businesses may want to view *Dynamex* as a clear indication of which way the winds are blowing.

In light of *Dynamex*, businesses would be wise to conduct a careful re-evaluation of their independent contractor classifications under the ABC Test. This is particularly true for companies that hire low-level independent contracts who, if reclassified as employees, would be non-exempt from wage and hour laws. Among other things, businesses should consider whether those workers classified as independent contractors are performing work that is within their "usual course of business" under Part B of the test, in which case reclassification may be necessary. Moreover, hiring entities should consider whether they have sufficient evidence that those workers deemed independent contracts are independently conducting and promoting their own businesses beyond the four walls of the hiring entity's business.

Nelson Hardiman's Labor and Employment team is here to answer your questions!

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