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Client Alert Commentary

Latham & Watkins Benefits, Compensation & Employment Practice May 11, 2018 | Number 2319

Is a Worker an Independent Contractor or an Employee? 5 Precautions for California Employers

California Supreme Court makes the test tougher and the answer clearer under the Wage Orders, but potentially inconsistent with other laws.

Key Points:

- The Court ruled, when assessing a worker's classification as an independent contractor or employee under California's Wage Orders, the "to suffer or permit to work" definition of employ applies.
- Now, to establish that an independent contractor is appropriately classified and, therefore, ineligible for the rights and protections under California's Wage Orders, the hiring person or entity must establish each element of the "ABC" test.
- The commonly applied "*S.G. Borello*" test, a fact-intensive and more circumstantial test, does not apply to Wage Orders.

The California Supreme Court's recent ruling in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County*[1] clarified that under California's Wage Orders, which govern minimum wage, overtime pay, hours of work, and meal and rest break requirements applicable to employees only, a person is properly classified as an employee, not an independent contractor, if he or she is "suffered or permitted to work" for the hiring person or entity. On April 30, 2018 the Court also ruled that not every person providing a service is an employee. A person is not considered to meet the suffered or permitted to work standard, if the hiring person or entity establishes that the worker meets the following "ABC" test:

A. The worker is free from control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of work and in fact.

5 Precautions for California Employers

1. The burden to establish that a worker is an independent contractor, and not an employee, is on the employer.
2. Avoid engaging a person as an independent contractor to carry out a core business function or to perform services that are the same as those performed by employees.
3. If engaging a person as an independent contractor:
   - Document the relationship with the worker as an independent contractor.
   - Make certain that the worker actually controls the means and method of achieving the employer's objective.
     - Specify the outcome desired and set deadlines for major milestones and completion.
     - Avoid or minimize specifying the method, hours, and details of the work process.
   - Determine if the worker has a real business independent of providing services to the employer.
     - Avoid indefinite or long-term exclusive arrangements.
     - Determine if the worker actually markets his/her services to others.
4. Evaluate the employer's obligation with respect to workers compensation benefits, unemployment insurance taxes, and payroll taxes and withholdings, as the test to determine employment status may differ from that applicable to California's Wage Orders.
5. When in doubt, consult with counsel or satisfy the minimum wage and hour laws.

B. The worker performs work that is outside the usual course of the hiring entity's business.

C. 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. [2,3]

Thus, for California Wage Order purposes, a worker is presumed to be an employee, and the service recipient has the burden to demonstrate all three of the ABC test's factors for the worker to be properly classified as an independent contractor.[4]

What Changed?

Prior to the *Dynamex* decision, the California Supreme Court, in its 1989 decision in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations,*[5] applied a different standard for determining if workers were independent contractors for workers' compensation purposes. In that case, the Court applied the common law test to determine if a worker was an employee, holding that whether the service recipient has the right to control the manner and means of accomplishing the result sought was the key for determining whether a worker was an employee or independent contractor for purposes of workers' compensation.[6]

In determining whether the service recipient controls the manner and means, the *S.G. Borello* Court recognized a number of factors to consider, none of which were determinative, including:

(a) Whether the one performing services is engaged in a distinct occupation or business

(b) The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision

(c) The skill required in the particular occupation

(d) Whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work

(e) The length of time for which the services are to be performed

(f) The method of payment, whether by the time or by the job

(g) Whether or not the work is a part of the regular business of the principal

(h) Whether or not the parties believe they are creating the relationship of employer-employee.[7]

This standard was also applied by the California Supreme Court in *Ayala v. Antelope Valley Newspapers, Inc.*,[8] *a* 2014 decision in a wage and hour class action, and the employer in *Dynamex* argued that it was the sole applicable standard for determining if a worker was an employee or independent contractor for wage and hour purposes. However, in *Ayala*, the parties did not dispute that the common law test applied, and, subsequently, in its 2010 decision in *Martinez v. Combs*,[9] the California Supreme Court held that, under the California Wage Orders, there are three alternative definitions of "employ": "(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."[10]

The *Dynamex* Court concluded that which test is applied should be determined based on the purpose of the law in question, and that the Superior Court was correct in applying the suffer or permit to work standard to determine worker classification as to the wage order claims.[11]

The *S.G. Borello* test, given its multiple, unweighted factors, creates both greater uncertainty as to the proper classification of a worker, as well as greater flexibility for the worker and the service recipient to

tailor the situation to favor independent contractor status by, among other actions, documenting the relationship as an independent contractor relationship, limiting the use of the service recipient's equipment and facilities, and paying in a method other than an hourly wage or salary.

Under *Dynamex*, the presumption of employee status and the need to meet all three criteria — particularly the criterion that the work not be integral to the hiring entity's business — increases the difficulty for employers to tailor the arrangement to favor independent contractor status.

What Does the *Dynamex* Decision Impact?

The direct impact of the decision is that more workers now will be considered employees under California's Wage Orders. Workers classified as independent contractors who should be classified as employees under the ABC test are entitled to be paid in accordance with the California Wage Orders, including minimum wage, overtime pay, and meal and rest breaks, for non-exempt employees, unless such workers' duties and pay qualify for an exemption under the California Wage Orders. There will continue to be conflicting results in cases in which the same worker may be deemed an employee under some laws but found to be appropriately classified as an independent contractor under other laws in light of the varying tests applied.

The Court explicitly recognized that although the Fair Labor Standards Act (FLSA) also utilizes the suffer or permit to work definition for determining whether a person is an employee subject to the FLSA's protections, the federal courts have interpreted that standard in a manner similar to the *S.G. Borello* test. Consequently, it is possible for a worker to be an employee under *Dynamex's* ABC test subject to California's wage and hour rules, but an independent contractor for federal wage and hour purposes.

The Court did not clarify what standard would apply to claims under the California Labor Code, such as claims for expense reimbursement or workers' compensation benefits, that are not addressed in the Wage Orders. As a result, the *S.G. Borello* test may apply to some claims, while the ABC test applies to claims under the California Wage Orders.

What About Taxes?

The *Dynamex* decision is explicitly limited to whether workers should be classified as employees or independent contractors under the California Wage Orders, and has no direct impact on federal or state tax withholding obligations.

Conclusion

Employers who engage independent contractors in California should take caution; under *Dynamex*'s standard, their independent contractors may be deemed employees, entitled to minimum wage, overtime pay, and other benefits of California's Wage Orders.

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Endnotes

[1] 2018 WL 1999120 (Cal. Apr. 18, 2018). In *Dynamex,* the business engaged pickup and delivery drivers as independent contractors. *Id.* at *2. The case came to the California Supreme Court after the Superior Court certified a class seeking to recover under the California Wage Orders and for unreimbursed business expenses under Labor Code Section 2802. *Id.* at *2-3. Dynamex moved to decertify the class, appealed a Superior Court order denying its motion to the Court of Appeal, and sought review by the California Supreme Court of the Court of Appeal's adverse ruling. *Id.*

[2] The "ABC" test appears in a variety of versions and has been adopted by several other states for various legal purposes. The version adopted by the California Supreme Court tracks the Massachusetts version.

[3] *Id.* at *29.

[4] *Id.* at *30-34.

[5] 48 Cal. 3d 341 (1989).

[6] *Id.* at 352-57.

[7] *Id.* at 351.

[8] 59 Cal. 4th 522, 530-31 (2014). In *Ayala*, the putative class of employees had argued they were employees under the common law test; consequently, the Court did not address the question of whether the common law test, or another test, applied.

[9] 49 Cal. 4th 35, 64 (2010).

[10] *Id.* at 64.

[11] Dynamex argued that the suffer or permit to work and the exercise control over the wages, hours and working conditions definitions were only applicable for determining joint employment. The Court concluded that it did not need to consider whether the exercise control definition applied because the lower court's certification order was adequately supported by the suffer or permit to work standard. 2018 WL 1999120, at *22.