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California Courts Cast Considerable Doubt on Continued Use of "Independent Contractors"

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California Courts Cast Considerable Doubt on Continued Use of "Independent Contractors"

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Agenda

1. Background on independent contractor misclassification
2. CA Supreme Court's 2018 *Dynamex* decision
3. Ninth Circuit's 5/2/19 *Vazquez* decision
4. Practical guidance for employers and companies

Background

- With increasing prevalence of “gig economy” workers in the state, the legal developments potentially impact a wide variety of companies and contractors throughout California.
- 2018 Bureau of Labor Statistics Economic report 79% of independent contractors prefer their current work situation to traditional employment.
- A 2017 survey revealed that most full-time workers who left their jobs made more money as a freelancer within a year.

Background

- Legal tests for independent contractor relationship
- Case law developments – *Vizcaino v. Microsoft* (2002), *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*
- Agency interpretations – EDD, Workers' Compensation, DLSE, DOL, EEOC, DFEH
- Statistics on use of independent contractors
- Statistics on misclassification lawsuits
- Examples of potential damages and exposure (government, class actions, statutory penalties, attorney's fees and costs, etc.)

The *Dynamex* Decision -- *Dynamex Ops. West Inc. v. Superior Court*, 4 Cal. 5th 903 (2018):

- The Supreme Court of California held that there is a presumption that all workers are employees, and that a business classifying a worker as an independent contractor bears the burden of establishing that such a classification is proper under a new test called the "ABC test."
- The Court rejected the longstanding multi-factor test in California (*Borello*) on the basis that it afforded the hiring business a "greater opportunity to evade its fundamental responsibilities under a wage and hour law" due to its ambiguities.
- In setting forth a simpler three-factor test, the Court stated its objective was "to create a simpler, clearer test for determining whether the worker is an employee or an independent contractor."

The New "ABC Test"

- Under this new ABC test, the hiring business bears the burden of proving each of the following factors to support its independent contractor classification:
  - (A) 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) the worker performs work that is outside the usual course of the hiring entity's business; and
  - (C) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.

By contrast, FLSA six factor "economic dependence" test:

- (1) the nature and degree of control,
- (2) permanence of the work,
- (3) the worker's investment in facilities, equipment or helpers,
- (4) the amount of skill required,
- (5) opportunity for profit or loss, and
- (6) level of integration into the employer's business.

- The six factors are not exclusive – the presence or absence of one factor is not determinative – contrast the ABC test.
- No presumption that the worker is an employee – the burden of proof isn't on the employer as it is in the ABC test.

Implications of *Dynamex* and the ABC Test

- The second factor of the new ABC test severely restricts businesses from hiring workers as independent contractors because it precludes the hiring of a contractor in any "***role comparable to that of an employee***."
  - To illustrate the meaning of the second factor, the Court provided two examples:
    - A retailer that contracts with an outside plumber or electrician to perform such plumbing or electrical services would not be seen as providing services "comparable" to an employee.
    - A clothing manufacturer that contracts with a work-at-home seamstress to make dresses from cloth and patterns supplied by the company (and later sold by the company) would be seen as providing services "comparable" to an employee.

Implications of *Dynamex* and the *ABC* Test

- Only the first example would satisfy the new ABC test for independent contractors.
- *Dynamex* makes it much more difficult for California employers to have independent contractors – especially if they perform work that employees also perform or sometimes perform.

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Vazquez v. Jan-Pro Franchising – May 2, 2019:

- 5/2/19: *Vazquez v. Jan-Pro Franchising Int'l, Inc.*, the Ninth Circuit Court of Appeals determined that *Dynamex* applies ***retroactively***.
- Ninth Circuit applied a default rule that judicial decisions apply retroactively, and that retroactive application of *Dynamex* did not violate constitutional due process.

Vazquez v. Jan-Pro Franchising – May 2, 2019:

- *Vazquez* does not bind state courts, and employers may still argue that *Dynamex* does not apply in some circumstances (e.g., if a claim does not arise under the wage orders or if the defendant is an alleged joint employer).
- In applying *Dynamex* retroactively, the Ninth Circuit noted the "default rule" that judicial decisions have retroactive effect, and reasoned that *Dynamex* did not fall into an exception under California law for decisions that "change[] a settled rule on which the parties below have relied." *Vazquez*, slip op. at 23.

Vazquez v. Jan-Pro Franchising – May 2, 2019:

- The Ninth Circuit also found persuasive that the Supreme Court of California summarily denied the defendant's petition for review in *Dynamex*, which "strongly suggested that the usual retroactive application, rather than the exception, should apply to its newly announced rule." *Id.* at 24.
- The Ninth Circuit also reasoned that due process challenges to legislation "adjusting the burdens and benefits of economic life" are subject to rational basis review, and concluded that challenges to judicial rules must be given even greater deference. Slip. op. at 27.
- The Ninth Circuit thus reasoned that applying *Dynamex* retroactively served the remedial purposes of the wage orders, and therefore was "neither arbitrary nor irrational." *Id.* at 27-28.

Possible CA Supreme Court Review?

- 7/22/19: Ninth Circuit issued an order granting a petition for panel rehearing, withdrawing its decision in *Vazquez*, and stating that it would certify the question of whether *Dynamex* applies retroactively to the California Supreme Court.
- CA Supreme Court review is discretionary.

Possible CA Supreme Court Review?

- California employers must be prepared to argue the ABC test and now must consider its ***retroactive application***.
- California employers must comply with the ABC test going forward.

Other Developments

- CA Senate Bill 238 to Reverse *Dynamex*
- Shannon Grove, CA Senate Republican Leader, Senate District 16 in Kern, Tulare and San Bernardino Counties
  - "Californians in all types of industries are affected, including barbers and hairstylists, farmers, educators, health care professionals, construction workers, and artists."
  - "Many college students work between classes to help pay their bills. Unfortunately, the *Dynamex* decision will disproportionately affect them and other younger workers."

Other Developments

- "Instead of interpreting the law, the California Supreme Court simply re-wrote it. Creating laws is a job given to the California Legislature, which is why good policy is necessary to fix this bad court decision."
- "Our economy and workforce are transforming, especially in California. We cannot restrict workplace flexibility with bad court rulings. Instead, we need to ensure Californians have the opportunity to choose the terms on which they work."

- Other legislation
  - 5/29/19: By a 55-11 vote, the state Assembly passed AB 5, a bill that would codify the California's Supreme Court's decision in *Dynamex*.

Practical Guidance

- "Audit": Based on *Dynamex* and *Vasquez*, California businesses that classify workers as independent contractors should immediately review — with qualified counsel — any contractor classification under the "ABC test" to determine whether the classification complies with California law and evaluate the risk of any future classifications.
- Any business that misclassifies an independent contractor is potentially liable for a host of individual and class action wage and hour claims including claims for unpaid wages (minimum wage, overtime, double time), meal and rest period premium pay, penalties and premiums under the California Labor Code, and unpaid benefits.
- Businesses should also consult their tax counsel regarding the potential tax consequences for misclassifying independent contractors.

Thank you for attending!

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