Memo To: Alexsei Demo US, Attorneys Alexsei
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Regarding:

Issue

What is the test for determining whether a worker is an employee or an independent contractor for the purpose of the obligations imposed by California's wage orders?

Conclusion

The "ABC test" is used to determine whether a worker is an employee or an independent contractor for the purpose of the obligations imposed by California's wage orders. Under the ABC test, a worker is considered an independent contractor and not an employee, when the hiring entity satisfies all three of the following conditions:

> (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;
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> (B) The worker performs work that is outside the usual course of the hiring entity's business; and
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> (C) The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed. (*Dynamex Operations West Inc. v. Superior Court*)

The hiring entity has the burden to prove the worker is an independent contractor. (*Dynamex Operations West Inc. v. Superior Court*)

In order to satisfy Part A, the hiring entity must establish that the worker is not subject to the degree of control that a business typically exercises over employees. Depending on the nature of the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees. (*Dynamex Operations West Inc. v. Superior Court*)

In order to satisfy Part B, the hiring entity must establish that the worker performs work that is outside the usual course of its business. Contracted workers who provide services in a role comparable to that of an existing employee will likely be viewed as working in the usual course of the hiring entity's business. (*Dynamex Operations West Inc. v. Superior Court*)

In order to satisfy Part C, the hiring entity must prove that the worker is customarily and currently engaged in an independently established trade, occupation or business. Simply assigning the worker the label of independent contractor is not sufficient. An individual who independently made the decision to go into business generally takes certain steps to establish and promote that independent business. The independent business operation must actually be in existence at the time the work is performed. The fact that it could come into existence in the future is not sufficient. Further, if an individual's work relies on a single employer, Part C will not be satisfied. (*Dynamex Operations West Inc. v. Superior Court*; *Garcia v. Border Transportation Group LLC*)

Law

In 2019, California Assembly Bill No. 5. ("AB 5") was signed into law and became effective January 1, 2020. This law addresses the employment status of workers and establishes the test for determining whether a worker is an employee or an independent contractor. AB 5 requires the application of the "ABC test" to determine if workers in California are employees or independent contractors for the purposes of the Labor Code, the Unemployment Insurance Code, and the Industrial Welfare Commission wage orders. AB 5 states:

> [...] A person providing labor or services for remuneration shall be considered an employee rather than an independent contractor unless the hiring entity demonstrates that the person is free from the control and direction of the hiring entity in connection with the performance of the work, the person performs work that is outside the usual course of the hiring entity's business, and the person is customarily engaged in an independently established trade, occupation, or business.

In 2018, the California Supreme Court issued a decision in *Dynamex Operations West, Inc. v. Superior Court ("Dynamex")* (2018) 4 Cal.5th 903, representing a major shift in California worker classification law. In *Dynamex,* the California Supreme Court adopted the ABC test to determine whether to classify workers as employees or as independent contractors for purposes of California's wage orders. The Court set out the test at 916-917:

> For the reasons explained hereafter, we conclude that in determining whether, under the suffer or permit to work definition, a worker is properly considered the type of independent contractor to whom the wage order does not apply, it is appropriate to look to a standard, commonly referred to as the "ABC" test, that is utilized in other jurisdictions in a variety of contexts to distinguish employees from independent contractors. Under this test, a worker is properly considered an independent contractor to whom a wage order does not apply only if the hiring entity establishes: (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.

Part 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

In order to satisfy Part A, the hiring entity must establish that the worker is not subject to the degree of control that a business typically exercises over employees. Depending on the nature of

the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees. The Court explained at 958:

> First, as our decision in *Martinez* makes clear (*Martinez*, *supra*, 49 Cal.4th at p. 58, 109 Cal.Rptr.3d 514, 231 P.3d 259), the suffer or permit to work definition was intended to be broader and more inclusive than the common law test, under which a worker's freedom from the control of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact, was the principal factor in establishing that a worker was an independent contractor rather than an employee. Accordingly, because a worker who is subject, either as a matter of contractual right or in actual practice, to the type and degree of control a business typically exercises over employees would be considered an employee under the common law test, such a worker would, a fortiori, also properly be treated as an employee for purposes of the suffer or permit to work standard. Further, as under *Borello*, *supra*, 48 Cal.3d at pages 353-354, 356-357, 256 Cal.Rptr. 543, 769 P.2d 399, depending on the nature of the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees, but does not possess over a genuine independent contractor. The hiring entity must establish that the worker is free of such control to satisfy part A of the test.

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

The Court explained at 959 that in order to satisfy Part B, the hiring entity must establish that the worker performs work that is outside the usual course of its business. Contracted workers who provide services in a role comparable to that of an existing employee will likely be viewed as working in the usual course of the hiring entity’s business:

> Second, independent of the question of control, the child labor antecedents of the suffer or permit to work language demonstrate that one principal objective of the suffer or permit to work standard is to bring within the "employee" category all

> individuals who can reasonably be viewed as working "*in the [hiring entity's] business*" (see *Martinez*, *supra*, 49 Cal.4th at p. 69, 109 Cal.Rptr.3d 514, 231 P.3d 259, italics added), that is, all individuals who are reasonably viewed as providing services to the business in a role comparable to that of an employee, rather than in a role comparable to that of a traditional independent contractor. (*Accord Rutherford Food*, *supra*, 331 U.S. at p. 729, 67 S.Ct. 1473 [under FLSA, label put on relationship by hiring business is not controlling and inquiry instead focuses on whether "the work done, in essence, follows the usual path of an employee"].) Workers whose roles are most clearly comparable to those of employees include individuals whose services are provided within the usual course of the business of the entity for which the work is performed and thus who would ordinarily be viewed by others as working in the hiring entity's business and not as working, instead, in the worker's own independent business.

Part C: The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

In order to satisfy Part C, the hiring entity must prove that the worker is customarily and currently engaged in an independently established trade, occupation or business. Simply assigning the worker the label of independent contractor is not sufficient. An individual who independently made the decision to go into business generally takes certain steps to establish and promote that independent business. The California Supreme Court explained at 961-963:

> Third, as the situations that gave rise to the suffer or permit to work language disclose, the suffer or permit to work standard, by expansively defining who is an employer, is intended to preclude a business from evading the prohibitions or responsibilities embodied in the relevant wage orders directly or indirectly—through indifference, negligence, intentional subterfuge, or misclassification. It is well established, under all of the varied standards that have been utilized for distinguishing employees and independent contractors, that a business cannot unilaterally determine a worker's status simply by assigning the worker the label "independent contractor" or by requiring the worker, as a condition of hiring, to enter into a contract that designates the worker an independent contractor. (See,

e.g., *Borello*, *supra*, 48 Cal.3d at pp. 349, 358-359, 256 Cal.Rptr. 543, 769 P.2d 399 ; *Rutherford Food*, *supra*, 331 U.S. at p. 729, 67 S.Ct. 1473.) This restriction on a hiring business's unilateral authority has particular force and effect under the wage orders' broad suffer or permit to work standard.

As a matter of common usage, the term "independent contractor," when applied to an individual worker, ordinarily has been understood to refer to an individual who independently has made the decision to go into business for himself or herself. (See, e.g., *Borello*, *supra*, 48 Cal.3d at p. 354, 256 Cal.Rptr. 543, 769 P.2d 399 [describing independent contractor as a worker who "has independently chosen the burdens and benefits of self-employment"].) Such an individual generally takes the usual steps to establish and promote his or her independent business—for example, through incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like. When a worker has not independently decided to engage in an independently established business but instead is simply designated an independent contractor by the unilateral action of a hiring entity, there is a substantial risk that the hiring business is attempting to evade the demands of an applicable wage order through misclassification. A company that labels as independent contractors a class of workers who are not engaged in an independently established business in order to enable the company to obtain the economic advantages that flow from avoiding the financial obligations that a wage order imposes on employers unquestionably violates the fundamental purposes of the wage order. The fact that a company has not prohibited or prevented a worker from engaging in such a business is not sufficient to establish that the worker has independently made the decision to go into business for himself or herself. Accordingly, in order to satisfy part C of the ABC test, the hiring entity must prove that the worker is customarily engaged in an independently established trade, occupation, or business.

In *Garcia v. Border Transportation Group LLC*, (2018) 28 Cal.App.5th 558, the Court of Appeal for the Fourth Appellate Division further expanded on the requirements of Part C of the test at 574-575. Part C requires that the independent business operation actually be in existence at the

time the work is performed. The fact that it could come into existence in the future is not sufficient. Further, if an individual's work relies on a single employer, Part C will not be satisfied:

> The Massachusetts test is simply not the formulation of part C articulated in *Dynamex*. Defendants are correct that the wording of the ABC test adopted in *Dynamex* tracks a Massachusetts statute. (*Dynamex*, supra, 4 Cal.5th at p. 956, fn. 23, 232 Cal.Rptr.3d 1, 416 P.3d 1.) The Supreme Court explained that it followed Massachusetts in omitting certain language from part B of the ABC test given "contemporary work practices[ ] in which many employees telecommute." (*Ibid.*) Notwithstanding this parallel, *Dynamex* makes clear that California follows the version of part C that requires an existing, not potential, showing of independent business operation. (*Id.* at p. 962, fn. 30, 232 Cal.Rptr.3d 1, 416 P.3d 1.) Had the *Dynamex* court viewed *Sebago* as persuasive in this particular context, one would expect it to be cited in footnote 30, which only makes its absence more significant.
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> [...]
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> Turning to the record in our case, pursuant to municipal regulations Garcia obtained a driver's permit that was "limited such that it may be used by the driver only while employed by a specified taxi company." (Calexico Mun. Code, ch. 5.80, § 5.80.140.) If Garcia were to switch companies, he would need a new permit bearing the new company's name. (*Id.*, § 5.80.160.) Accordingly, there is at best limited evidence he was even capable of providing services to a different taxi company under the Sebago framework. With BTG owning 30 of 45 available taxi permits, and municipal regulations conditioning issuance of new permits on public demand for additional service, the facts of this case differ from Sebago , which involved drivers in metropolitan Boston who could "lease taxicabs and medallions from whomever they wish" on a day-to-day basis. (*Sebago*, *supra*, 28 N.E.3d at p. 1153 ; Calexico Mun. Code, ch. 5.80, § 5.80.050(A).) Even if the Sebago framework applied, the nature of the business arguably compels Garcia "to depend on a single employer for the continuation of [his] services." (*Sebago*, at p. 1153.)

> Under the more stringent part C framework adopted by the California Supreme Court in *Dynamex*, the result is obvious. *Dynamex* requires more than mere capability to engage in an independent business. Defendants presented no evidence in their moving papers that Garcia in fact provided services for other entities or otherwise established a business "independent" of his relationship with BTG. (See *Kirby*, *supra*, 176 A.3d at pp. 1187-1188 [certain factors besides performing similar work for third parties may also be relevant to part C].) Rather, they rely on the *Sebago* formulation and suggest Garcia was "free to offer his services as an entrepreneur to anyone he chose."

Before *Dynamex*, California courts relied on the multifactor "*Borello* test" established by the California Supreme Court in *S.G. Borello & Sons Inc. v. Dept. of Industrial Relations*, (1989) 48 Cal.3d 341 to determine whether a worker should be classified as an employee or independent contractor. The *Borello* test, which was used prior to the implementation of the ABC test mandated by AB 5, relied upon multiple factors to distinguish between employees and independent contractors. The *Borello* test still applies in certain employment scenarios, such as workers with exempt status. That test includes whether the potential employer has all necessary control over the manner and means of accomplishing the result desired, although such control need not be direct, actually exercised, or detailed. This additional *Borello* factor, which is not dispositive, must be considered along with several other factors, as explained by the Court at 350-351:

> Much 20th-century legislation for the protection of "employees" has adopted the "independent contractor" distinction as an express or implied limitation on coverage. The Act plainly states the exclusion of "independent contractors" and inserts the common law "control-of-work" test in the statutory definition. The cases extend these principles to other "employee" legislation as well. (3a) Following common law tradition, California decisions applying such statutes uniformly declare that "[t]he principal test of an employment relationship is whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired. . . ." (*Tieberg*, *supra*, 2 Cal. 3d at p. 946 [unemployment insurance]; see also, e.g., *Isenberg v. California Emp. Stab. Com.*

(1947) 30 Cal.2d 34, 39 [180 P.2d 11] [same; drawing direct analogy to workers' compensation law]; *Perguica v. Ind. Acc. Com.* (1947) 29 Cal.2d 857, 859-861 [179 P.2d 812] [workers' compensation]; *Empire Star Mines Co. v. Cal. Emp. Com.* (1946) 28 Cal.2d 33, 43-44 [168 P.2d 686] [unemployment insurance].)

However, the courts have long recognized that the "control" test, applied rigidly and in isolation, is often of little use in evaluating the infinite variety of service arrangements. While conceding that the right to control work details is the "most important" or "most significant" consideration, the authorities also endorse several "secondary" indicia of the nature of a service relationship.

Thus, we have noted that "[s]trong evidence in support of an employment relationship is the right to discharge at will, without cause. [Citations.]" (Tieberg, supra, 2 Cal.3d at p. 949, quoting Empire Star Mines, supra, 28 Cal.2d at p. 43.) Additional factors have been derived principally from the Restatement Second of Agency. These include (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; and (h) whether or not the parties believe they are creating the relationship of employer-employee. (Tieberg, supra, at p. 949; Empire Star Mines, supra, 28 Cal.2d at pp. 43-44; see Rest.2d Agency, § 220.) (4a) "Generally, . . . the individual factors cannot be applied mechanically as separate tests; they are intertwined and their weight depends often on particular combinations." (Germann, supra, 123 Cal.App.3d at p. 783.)

In *Vazquez v. Jan-Pro Franchising Internat.*, Inc. (2021) 10 Cal.5th 944, the California Supreme Court ruled that its decision in *Dynamex* applies retroactively to all cases not yet final as of the date *Dynamex* issued on April 30, 2018, which means that nearly all cases that were not final as

of that date will be governed by the ABC test (at 19):

> In answer to the question posed by the Ninth Circuit, we conclude that our decision in *Dynamex* applies retroactively to all nonfinal cases that predate the effective date of the *Dynamex* decision.

Authorities

Garcia v. Border Transportation Group LLC, (2018) 28 Cal.App.5th 558

Vazquez v. Jan-Pro Franchising Internat., Inc. , (2021) 10 Cal.5th 944

S.G. Borello & Sons Inc. v. Dept. of Industrial Relations, (1989) 48 Cal.3d 341

Dynamex Operations West Inc. v. Superior Court, (2018) 4 Cal.5th 903

AB 5, 2019 California Assembly Bill No. 5