Published on *The National Law Review* https://natlawreview.com

California's New "ABC Test" For Independent Contractors Is Anything But Elementary

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On April 30, the California Supreme Court adopted in Dynamex Operations West, Inc. v. Superior Court the so-called "ABC test" to determine whether individuals are employees or independent contractors for purposes of determining the applicability of California's Wage Orders. The Wage Orders govern important employment issues including California's unique daily overtime regimen and its requirements for mandatory meal and rest periods – fodder for thousands of lawsuits across the state. The *Dynamex* decision rejected utilizing a detailed multi-factored test originally articulated by the California Supreme Court in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal. 3d 341 (1989). In its place, California's high court adopted the ABC Test, under which employing entities have the burden to satisfy. While media attention in the aftermath of *Dynamex* focused on its impact on the gig economy, the following examination of the factors highlights how this decision could have far-reaching implications for much more traditional and established business models, including the insurance and real estate industries, both of which extensively utilize independent contractors.

Part A – Is the worker free from control and direction under the contract and in fact?

The California Supreme Court cited three out-of-state cases to illustrate this factor. A 2007 Vermont Supreme Court case concluded individuals contracted to knit clothes at home were employees because the company provided the patterns, instructed that "the product is to be knit, not crocheted, and how it is to be knit." *Dynamex* at 69, quoting *Fleece on Earth v. Dep't of Emple. & Training*, 923 A.2d 594 (Vt. 2007). The California high court also cited a 2002 Washington case holding truck drivers were not independent contractors where the "hiring entity required [the] driver to keep [the] truck clean, to obtain the company's permission before transporting passengers, to go to the company's dispatch center to obtain assignments not scheduled in advance, and could terminate the driver's services for tardiness, failure to contact the dispatch unit, or any violation of the company's written policy." *Id*., quoting *Western Ports v. Employment Sec. Dept.*, 41 P.3d 510 (Wash. 2002). The only good news in *Dynamex* under part "A" of the ABC test was the Court's citation to *Great N. Constr., Inc. v. Dept. of Labor*, 161 A.3d 1207 (Vt. 2016) which held that a worker who specialized in historic restorations was an independent contractor, noting that in addition to setting his own schedule like the knitters in *Fleece on Earth*, he worked without supervision, purchased his materials himself on his own business credit card, and had declined an offer of employment because he

wanted to control his activities.

The cases the Supreme Court chose to cite emphasize the importance of revisiting agreements with independent contractors. The status of individuals who literally or figuratively follow a pattern dictated by the hiring entity is in jeopardy. Likewise, exercising too much control as the truck drivers' employers did in the Washington case will undermine independent contractor status. California is showing a strong preference that independent contractors have their own business and substantial unsupervised independence.

Part B – Does the worker perform work outside the usual course of the hiring entity?

Outcomes regarding this part of the ABC test may be the most difficult to predict, as the descriptions by the *Dynamex* Court are all over the field. For example, initially the decision explains the goal of this part is to capture as employees "*all* individuals who can reasonably be viewed as working '*in the [hiring entity's] business*" (emphasis in original). *Dynamex*, at 69-70. This general statement would be most troubling to insurers and real estate agencies, which depend on independent contractors who act exclusively as sales agents for those companies. The *Dynamex* Court also described this factor as capturing "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*" (emphasis added). *Id.* In industries like real estate and insurance, where for many decades realtors and brokers have been independent contractors, an appeal to "tradition" is attractive for employing entities. Unfortunately, California's high court provided little instruction on this point, so it may be some time and many lawsuits before this issue is clarified.

The cases cited in *Dynamex* offer little guidance. The Court cited at-home seamstresses, cake decorators, and lumber harvesters as examples of employees. It contrasts those to a plumber hired to fix a leaky bathroom at a retail store. It also distinguished the Vermont historic restoration specialist on the basis that historic restorations were not part of the employing entities' general commercial or residential work. In contrast, entertainers at a resort, which advertised live performances, should have been employees, as were art instructors at a museum.

It would be nice to think that California's courts would at least follow the U.S. District Court of Massachusetts, which applied the ABC test and still found in favor of independent contractor status in 2015 in *Ruggiero v. American United Life Insurance Co.*, 137 F. Supp.3d 104 (D. Mass. 2015). In that case, American United Life Insurance argued its business involved drafting policy language, obtaining regulatory approval of policies, and investing premiums; it did not sell policies. The Massachusetts court agreed the company had not artificially attempted to deconstruct its business as some delivery companies had but rather, it had made a legitimate business decision to outsource sales of its policies. It is worth noting not only was Mr. Ruggiero permitted to sell competitors' policies, most of his sales were for others.

While a win for the employer, *Ruggiero* should sound cautionary notes for hiring entities that seek exclusive arrangements with sales brokers. Also, entities which utilize a mix of employee sales personnel and independent contractors will no doubt find themselves at risk.

Part C – Is the worker customarily engaged in an independently established trade or business?

The final prong of the ABC test requires the hiring entity to prove the "individual *independently* has made the decision to go into business for himself or herself." *Dynamex*, at 74 (emphasis supplied). The Court made a point of observing that merely permitting individuals to work for others is insufficient evidence that the workers actually customarily engaged in an independent trade or business. Hiring entities failed part C when they could not prove the workers had independent business cards, phones, locations, advertisements, licenses, etc.

ABC Test Applied to Real Estate Brokers

On its face, the ABC test could represent a particular challenge for realtors because, by statute they are required to work under the supervision of a licensed broker. Faced with this question in 2015, the Massachusetts Supreme Judicial Court sided with employing entities, noting that the relevant real estate laws permitted sales persons to affiliate with a broker as an employee or as an independent contractor and the more specific statute governing the employment of real estate agents trumped the more general employment law. *Monell v. Boston Pads, LLC*, 471 Mass. 566 (2015). Presented with the same issue in 2013, a Southern California trial court denying a demurrer reached the opposite conclusion holding that California law permits a worker to be classified as an independent contractor for some purposes, but not all. The case settled. The door is certainly open to much more litigation.

With so much uncertainty in the wake of *Dynamex,* businesses in long-established industries which rely on independent contractors as part of their models should consider opportunities to resolve these ambiguities through legislative action. Otherwise, hiring entities should consult with counsel regarding terms of service, policies and procedures, and internal processes to verify the identity and activities of independent contractors to minimize the risk of suits. Hiring entities should also consider using arbitration agreements as a tool to manage litigation risk, although this too can be complicated in the event an individual brings claims under California's Labor Code Private Attorneys' General Act.

National Law Review, Volume VIII, Number 158