Dynamex and the Future of Independent Contractors (and Perhaps Freedom of Contract) in California

The case's impact for established business using an independent contractor model and entrepreneurs contemplating creation of service businesses is significant though, at this point, hard to measure.

By James M. Nelson | May 22, 2018 | The Recorder

The California Supreme Court's ***Dynamex v. Superior Court*** decision on April 30 was **a game changer**. The impact for established business using an independent contractor model and indeed those solo entrepreneurs contemplating creation of service businesses is significant though incapable of full measurement. This is an evolving story and Dynamex has requested a rehearing.

The Complexity of the Employee Status Issue

The case began as *Lee v. Dynamex* and the question was whether a group of individuals who agreed to provide delivery driving services as independent contractors were misclassified and should have been compensated as employees. That question exists at the intersection of personal liberty to contract and the state's interest in protecting workers in lopsided economic power situations from making deals bad enough that there is an impact to society justifying the state in forbidding the deal. Paragraph two of the decision reveals that the court viewed independent contractor status as a threat to workers' rights. On the other hand, consider the ride app driver who in many instances has employment and benefits from another real job and is simply looking to increase income. The 1099 issued him for his driving income

assures he will pay income taxes but does he really derive benefit from adding to his Medicare tax and Social Security tax or state disability Insurance load? That presents a constitutional and perhaps a philosophical question.

What *Dynamex* tried to address is a question the courts have struggled with for years. Is there a test to determine the difference between an employee and an independent contractor that enables both businesses and the courts to be able to know the difference with some certainty? *Dynamex* actually involved whether there was a way to make these determinations on a classwide basis for groups of workers under the wage orders.

'Borrello'

This is not uncharted territory for the California Supreme Court and that brings us to *S.G. Borello & Sons v. Director of Dept. of Industrial Relations*, 48 Ca.3d 341, (1989). There, the court developed a test based on the workers compensation statute. The resulting test became known as a "common law" test but it was comprised of a number of pieces that came from different sources. Nonetheless, the "lore" is that *Borello* articulated a common law test applicable to many Labor Code provisions.

California employment law issues are not principally common law driven. In addition to the ample number of statutes, the California Legislature of the last millennia created an agency called the Industrial Welfare Commission whose original mission was to develop standards for the labor of women and minors. Those standards were expanded to all workers over the decades.[1] IWC was not specific about which workers were covered by the wage orders or which entities owed obligations.

'Martinez'

This failing was noted by the California Supreme Court in *Martinez v. Combs*, 49 Cal.4th 35 (2010). That case involved the extension of wage orders beyond the directly contracting parties. Like *Borello*, *Martinez* involved agricultural field labor and probed who was obliged to satisfy the obligation to pay minimum wages to the workers. Noting the absence of useful IWC or statutory definitions, the court fashioned a two-part test. First, the obligation fell upon anyone who suffered or permitted the worker to perform services and thereby had the right to hire, fire, set wages and direct the method manner and timing of the performance of services. Second, the obligation fell on those who had the right to control the details of the work which was defined to include wages, hours and working conditions. That helped on joint employer issues but had its limits.

'Dynamex'

This brings us, to *Dynamex*. It was about delivery drivers with written agreements affirming independent contractor status. The dual questions were (a) can the "suffer or permit to work" analysis be resolved on a class action basis and if so (b) what is the test? The court adopted California's version of the "ABC" test to define when a business had suffered or permitted an individual to work under the first part of the *Martinez* test.

That test begins with a presumption that all service providers to businesses are employees unless the business proves otherwise. As articulated, the service provider has no voice in this process. The business must establish all of the following factors:

1. The worker is free [2] from control of the method, manner and means by which the services are provided both per the contract and as a factual matter;

2. The service being provided is not part of the company's regular [3] business;

3. The service provided is customarily provided by an independently established trade [4], occupation or business of the same kind as the service being provided.

The court achieved greater certainty under the Wage Orders but at what cost to progress and entrepreneurship? That certainty comes with some consequences and raises more areas of complexity and uncertainty.

Complexities of a post-'Dynamex' World

What we know from the lengthy decision is the court views its ABC test to be a construction of the wage orders not of the Labor Code or the common-law definition of employee under California law. The wage orders govern minimum wage and have some impact on overtime. They do not however address employee status for workers' compensation, unemployment compensation or reimbursement of expenses under or the provisions of the labor and unemployment codes.

The *Dynamex* ABC test is also very different from the common-law definition generally applicable under federal employment law and employee benefits law in particular after *Nationwide Mutual Insurance v. Darden*, 503 U.S. 318 (1992).

Exploring just how complicated this can get can be illustrated with a brief thought experiment. Let's assume Robert Darden of the federal case was a present California insurance agent who fails the "B" part of the ABC test. He probably is a *Dynamex* employee for overtime, minimum wage and exempt status purposes under the wage orders, but he probably is not a *Borello* employee for expense reimbursement purposes or unemployment tax purposes. He's probably not a *Darden* employee and thus ineligible to participate in employee benefit plans, but what do you do with him when performing nondiscrimination testing on the tax side of the 401(k) plan? When it becomes payday, do you withhold personal state income tax but not deduct for SDI, FICA, FUTA and Medicare taxes? Then, at year-end, do you issue a federal 1099 and a state W-2? There are answers to these questions, or will be, but rest assured this will be messy.

The question unanswered is whether when the founders created the Ninth Amendment limitation on government power over the people and the 14th Amendment extended that limitation to the states is this sort of restriction over the people's freedom to contract (however well-intended) what they had in mind?

ENDNOTES

[1] Note that the original justification for the wage orders was that women and minors needed extra protection adult males did not. When discrimination based on sex became unlawful the health and safety premise for the original protection became suspect but expanding coverage has not been constitutionally challenged thus far.

[2] How "free" remains an open concern much like the old control test. If I point to a pile of wood and direct a worker to build a birdhouse is that too much direction for the worker to be "free?"

[3] What are the parameters of a "regular" business? If I sell heavy things is delivery a part of it or something I can contract out to a logistics company? I need inventory to sell; is storing it now a regular part of the business?

[4] Once long haul trucking was performed only by employee drivers, whereas now most of it is by owner operators; has it been long enough? What do we do with new innovation where the service did not exist customarily as was the case with app developers and software designers not all that long ago?

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