NOW + NEXT

EMPLOYMENT LAW ALERT | NIXON PEABODY LLP

JANUARY 15, 2021

The ABC's of worker classification in California: Recent developments impacting California employers

By Bonnie Glatzer, Mae Hau, Alicia Anderson, and Hillary Baca

Recent developments have both narrowed and significantly expanded the "ABC" test for determining whether workers in California are employees or independent contractors. The California Supreme Court ruled that the ABC test extends retroactively, thus potentially exposing thousands of California businesses to misclassification claims. However, recent legislative amendments to California's Assembly Bill 5 (AB5), which adopted the ABC test as the generally applicable test for worker classification in California, expands upon the the long list of occupations and industries that are exempt from this ABC test. The voter-approved Proposition 22 further provides an exemption from the ABC test for app-based rideshare delivery companies. These three developments, and what they mean for California businesses, are discussed below.

Unanimous California Supreme Court holds that *Dynamex* is retroactive

On January 14, 2021, the California Supreme Court ruled that its decision in *Dynamex*, which established the state's rigid "ABC" test for determining if a worker is an employee or independent contractor, applies retroactively. *See Gerardo Vazquez v. Jan-Pro Franchising International, Inc.*, S258191.

The California Supreme Court's announcement of the ABC test on April 30, 2018, in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903, requires companies to meet three specific criteria to classify workers as independent contractors for purposes of the California wage orders.[1] Under the test, a worker is generally considered to be an employee unless the putative employer can prove (a) the worker was not under its control and direction in performance of the work in question, (b) the worker's business was not in the hiring company's usual course of business, and (c) the worker was customarily engaged in an independent trade,

[1] The test to determine whether a worker is an employee or an independent contractor under the federal Fair Labor Standards Act (FLSA) may differ. On January 6, 2021, U.S. Department of Labor issued its final rule on Independent Contractor Status, effective March 8, 2021, explaining that a five-factor economic realities test governs the classification analysis under the FLSA. This test is less restrictive on employers than the ABC test, but whether it takes effect under the Biden administration remains to be seen.

occupation, or business. As a practical matter, the ABC test typically results in many more workers being classified as employees rather than independent contractors.[2]

When *Dynamex* was decided, however, the California Supreme Court left open the question of whether *Dynamex* should be applied retroactively. In the *Vazquez* case, the question came before the California Supreme Court from a referral by the federal U.S. Court of Appeals for the Ninth Circuit, where the *Vazquez* case is currently pending.

In finding that *Dynamex* applies retroactively, the California Supreme Court primarily relied on the fact that *Dynamex* addressed an issue of first impression concerning how a wage order's "suffer or permit to work" standard should apply in the employee or independent contractor context. The employer argued that an exception to the general rule of retroactivity should be recognized because it reasonably believed that the question of whether a worker should be classified as an employee or independent contractor would be resolved under the standard set forth in *S.G. Borello & Sons v. Department of Industrial Relations* (1989) 48 Cal.3d 341, which had long been considered the controlling case on worker classification. The Court, however, noted that *Borello* was decided in the context of the workers' compensation statutes and did not purport to determine who should be considered an employee for purposes of a wage order. Instead, the Court held that this question was resolved for the first time in *Dynamex*. Accordingly, the Court concluded that *Dynamex* applies retroactively because it is an authoritative judicial interpretation of language (i.e., "suffer or permit to work") and did not overrule any prior California Supreme Court decision or disapprove any prior California Court of Appeal decision.

The Court also dismissed the employer's claim that retroactivity should not apply because businesses could not reasonably have anticipated that the ABC test would govern at the time they classified workers as independent contractors rather than employees. The Court found that this argument carried little weight because the *Dynamex* decision did not change any settled rule. Moreover, the Court found that public policy and fairness concerns, such as protecting workers and benefitting businesses that comply with the wage order obligations, favor retroactive application of *Dynamex*.

Expanded exemptions to ABC test following recent amendment of AB5

There have also been some recent legislative amendments to California's AB5, which modified the California Labor Code and adopted the *Dynamex* ABC test as the generally applicable test for worker classification in California.[3] Assembly Bill 2257, which took effect on September 4, 2020, amends the language of AB5.

The original text of AB5 exempted many occupations and service providers from the ABC test and made them subject to the more flexible, multi-factor *Borello* test instead. The recently passed amendments retain the ABC test but add to the long list of occupations exempt from it, including but not limited to: performance artists, songwriters, and others involved in "creating, marketing, promoting, or distributing sound recordings or musical compositions"; other creative workers who provide services under contract, i.e., "freelance writer, translator, editor, copy editor, illustrator[,] or newspaper cartoonist"; insurance underwriting inspectors; a "manufactured housing salesperson";

---

[2] For details about *Dynamex* and the ABC test, read our alert "California Supreme Court raises the bar for workers to be classified as independent contractors: what employers need to know," (May 08, 2018).

[3] See our alert, "Impact of AB5 on Independent Contractor Status in California: *Dynamex* becomes law, but the devil is in the details," (September 27, 2019).

licensed landscape architects; real estate appraisers; and home inspectors, among others. There are currently approximately 100 different exemptions under which a worker might fall.

AB 2257 also recasts and clarifies exemptions from the ABC test that existed in AB5 for business-to-business relationships, referral agencies, and professional services. Both AB5 and the amendments in AB 2257 provide that many of the exemptions are retroactive to the extent that they would relieve employers of liability.

Proposition 22 exempts some gig workers from the ABC test

On November 3, 2020, voters in California passed Proposition 22, which creates an exemption from the ABC test for app-based rideshare and delivery drivers. Proposition 22 preserves the independent contractor status of "app-based drivers" for "network companies," so long as certain conditions are met, including the freedom to accept or reject delivery requests and the provision by the network company of certain benefits typical of an employment relationship, including minimum wage premiums for driving time (calculated at a rate of 120% of the local minimum wage), reimbursement for vehicle expenses, insurance coverage, health care subsidies, and other protections. Qualified drivers and network companies are exempt from any conflicting provisions of the California Labor Code, the Unemployment Insurance Code, and the California wage orders.

Although Proposition 22 provides an exemption from the ABC test for app-based rideshare delivery companies, the contours of the exemption it provides are quite narrow. Despite its high profile, businesses should be aware that Proposition 22 is unlikely to exempt their business from the ABC test unless they can meet the internet-based, on-demand transportation/delivery service model similar to Uber, Lyft, and Postmates. Additionally, the proposition is expected to face several legal challenges; as of the date of publication of this alert, at least one legal challenge has already been filed.

What this means:

- The *Dynamex* decision will apply retroactively to all non-final cases filed before April 30, 2018, that assert wage order violations and Labor Code violations based on wage orders.
- In addition to its effect on pending cases, thousands of California businesses will now be exposed to potential liability for relying on the *Borello* test in classifying workers as independent contractors. Liability for misclassification could extend back as far as four years. Thus, there may well be a wave of independent contractor class actions filed in response to the California Supreme Court's decision.
- Hiring entities should carefully review the exemptions under the recent amendments to AB5 to determine whether they need to apply the more rigorous ABC test or whether they can properly rely on the multifactor *Borello* test. It may be that a worker who previously fell under the ABC test is now exempt and that such exemption will apply retroactively, which will be good news for some companies who can escape the negative implications of the *Vazquez* decision.
- Proposition 22 provides relief for app-based rideshare and delivery service companies but is not the far-reaching exemption from the ABC test that many California businesses may have been hoping for.

In light of these changes, businesses with workers in California may wish to consider conducting an audit of their independent contractor workforces to assess potential liability. Businesses may

also wish to consider proactive individual settlement offers to potentially mitigate risk. Businesses should continue to consult with experienced California employment legal counsel regarding all of these issues.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- Bonnie Glatzer, 415-984-8333, bglatzer@nixonpeabody.com
- Mae Hau, 213-629-6125, mhau@nixonpeabody.com
- Alicia Anderson, 213-629-6073, acanderson@nixonpeabody.com
- Hillary Baca, 415-984-8393, hbaca@nixonpeabody.com