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CALIFORNIA AFTER DYNAMEX: WORKER CLASSIFICATION BY FAVOR, FOLLY AND FAUX PAS

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INTRODUCTION

Work is changing. The types of employment available in the modern economy, and the very nature of labor itself, are evolving at the pace of technological progress. Yet, the framework through which organizations classify and understand their workers remains inflexible and seemingly incapable of adaptation. In recent years, high-profile court decisions and attendant legislative efforts have added to this tension by seeking to define both how Americans work and how the law categorizes that work.

No decision has been higher profile than *Dynamex v. Superior Court of Los Angeles* and no piece of legislation more significant than California Assembly Bill 5, introduced by Asm. Lorena Gonzalez-Fletcher (D-San Diego). As conceived of at the date of publication, AB 5 would cement the Golden State's post-*Dynamex* posture on worker classification for years to come—and for the worse. Not only would it ossify an outmoded, restrictive and outcome-dispositive classification test, it would do so while giving special treatment to groups based not on principle but raw political clout. Accordingly, it is vital to understand how this suddenly dire worker classification situation came to be, its implications and the threat it represents nationally, particularly if other jurisdictions hope to avoid following California's current direction.

BACKGROUND

The California Supreme Court's 2018 ruling in *Dynamex v. Superior Court of Los Angeles*,[1] and a subsequent legislative effort to codify its rigid "ABC test" for employment classification, appear tailor-made to subvert the employment arrangements that make the "gig economy"—championed by firms like Lyft, Handy and Postmates—possible by narrowing the legal definition of "independent contractor." While touted as a victory for workers, a misplaced preference for full-time employment arrangements will ultimately hurt businesses and workers alike.

Notably, the *Dynamex* decision took the first step in that direction in a case that pre-dates the "gig economy's" very existence. In fact, the genesis of this saga can be traced back to 2004. That year, a courier service named Dynamex that had traditionally classified its workers as employees for wage-and-hour purposes, reclassified its drivers as independent contractors. In response, the drivers banded together and undertook a class action complaint against Dynamex. They alleged that they were still employees under the state's labor and unfair competition codes and under various wage orders. After years of wrangling through the state's courts, the California Supreme Court ruled unanimously against Dynamex, holding that the drivers were employees.[2]

THE LAW

The *Dynamex* ruling established a starting presumption that workers are employees, not independent contractors. The decision holds that, in order to demonstrate that a worker is a contractor, a firm must establish that the worker: A) is not being directed by the hirer in the performance of their job; B) is doing work outside the scope of the company's typical business and; C) has made an affirmative decision to go into business for himself. If a firm fails to demonstrate any one of the "ABC" elements, the test deems the worker in question is an employee, and not an independent contractor.[3]

The ABC test departs from the worker classification regime California had applied for years, known as the "*Borello* standard."[4] Under *Borello*, the principal factors in the classification of a worker were the "means and manner" of the employer's control, or the extent to which an independent contractor could direct his own behavior. By utilizing a multi-factor balancing test, the *Borello* standard followed a flexible, holistic approach to worker classification.

By contrast, the ABC test takes a rigid approach, imposing three mandatory elements that firms must satisfy to ensure that workers are not employees. In fact, the *Dynamex* opinion goes further, recommending an order of operations in analysis—starting with element B or C—which is virtually outcome dispositive.[5]

1.

For instance, element B of the test allows courts to define a company's typical business and its scope for purposes of the test. In *Dynamex*, the California Supreme Court found it "quite clear" that the work provided by the delivery drivers—delivering packages—could be within the scope of Dynamex's typical business as a courier service, which in the court's view, meant it was appropriate to resolve the case on a class action basis.[6] Because each element of the ABC Test is outcome dispositive, the court stated that "part B of the ABC test is sufficient in itself" to pass the test (although the court did go on to provide "guidance" by analyzing element C nevertheless).[7] The court's analysis highlights the enormous amount of judicial discretion—based on just one prong of one test—that the ABC test allows over the employment practices of private businesses.

Thus, although employer control is still ultimately at the heart of the question of whether a worker is an employee or a contractor, the ABC test myopically focuses on elements that are only part of the story. Of course, the scope of a company's business and a worker's decision to work for himself, elements "B" and "C" of the test, have some bearing on an employer's level of control, but these factors ought to inform a holistic understanding of that worker's status rather than determine it outright.

LEGISLATIVE DEVELOPMENTS

In the wake of *Dynamex*, Asm. Lorena Gonzalez-Fletcher introduced AB 5,[8] which now sits in the state's Senate. If signed into law, AB 5 would codify the ABC test into statute, redefining what it means to be an independent contractor in California. Consequently, many workers formerly considered independent contractors would now qualify as employees.

The bill borrows its stated goal from the court in *Dynamex:* namely, the reduction of "harm to misclassified workers" and "loss to the state of [...] payment of payroll taxes, payment of premiums for workers' compensation, Social Security, unemployment, and disability insurance."[9] In its own words, the bill aims to extend labor protections at the expense of employers—and to the profit of the state. Unfortunately, those laudatory goals, pursued in this manner, will undermine worker flexibility and threaten California's economy.

This threat is exemplified by the fact that, if construed to its logical extent, the language of the ABC test would ensnare occupations such as emergency room doctors, real estate agents, insurance agents, truck drivers, hairdressers and freelance journalists. These industries have traditionally operated via independent-contractor arrangements, but given the breadth of the test, if the law is applied in a manner consistent with the *Dynamex* ruling, workers in these sectors would be forced to reclassify as full-scale employees.[10]

Because of this reality, California lawmakers have started hedging by suggesting that certain industries and workers will ultimately be exempted from the reach of AB 5. In legislative hearings, legislators and witnesses have argued that the state labor code's so-called "Professional Exemption" would allow doctors, engineers and even artists to be exempted from the ABC test.[11]

For her part, Asm. Gonzalez-Fletcher has publicly acknowledged that state lawmakers are "meeting w[ith] countless industries"[12] that are interested in exemptions and that "[e]verybody is lobbying for an exemption."[13] State labor leaders have similarly claimed that "conversations" are needed about exempting certain industries from the ABC test's ambit, including insurance agents and freelance journalists.[14] Unsurprisingly, given this rhetoric, the latest version of AB 5 includes specific exemptions for an ever-expanding list of industries, including dentists, doctors, real estate agents, insurance agents, private investigators and a litany of additional businesses with little to nothing in common.[15]

The harm from this type of government-by-exemption dynamic is significant. By openly discussing—and practically encouraging—ongoing lobbying efforts by industries to secure exemptions, citizens and voters are likely to conclude that politicians are picking winners and losers based on which industries have the most political clout. Likewise,

for those industries that are denied exemptions, the entire legislation will come across as a targeted effort to undermine their business models. And, for those concerned about the power of special interests in politics, the AB 5 approach to the "ABC test" is nothing short of a nightmarish feverdream—the risk of which threatens to spread throughout the country with each passing day.

CLASSIFICATION POLICY

Employers exercise less control over independent contractors and the reality is that contractors like it that way. Traditionally, contractors dictate their own schedules and may pursue work with multiple firms. Consequently, contractor positions are popular: one survey found that 88 percent of freelancers would not trade their current arrangements for traditional work,[16] and a recent survey by the federal government concluded that "fewer than 1 in 10 independent contractors would prefer a traditional work arrangement."[17] And yet, through AB 5, the California government intends to forcibly transform contractors into employees, stripping thousands of workers of their treasured flexibility.

As opposed to contractors, employees create higher costs for employers due to onerous regulatory requirements. To retain employees, companies must pay taxes on payroll, Social Security and unemployment insurance. As a result, independent contractors cost only 66 cents on the dollar for every hour worked by a full-time employee.[18] Thus, even a small shift in the number of independent contractors would have a massive effect on California's economy: a study by one of the authors of this brief concluded that, conservatively, the framework advanced by AB 5 would cost California businesses anywhere from $1,300,944,074 to $6,504,720,371 annually.[19]

Ironically, the majority of these costs would fall upon the shoulders of workers marginally attached to the labor force, reaching beyond the "gig" firms targeted by the bill. AB 5 will render certain business models unviable outright, forcing workers out of jobs. Further, companies that choose to retain workers will reduce pay to cover increased outlays for converted contractors. Overall, this means that AB 5 will likely lead to fewer and lower paying jobs in California.[20]

To make matters worse, in *Vazquez v. Jan-Pro Franchising International, Inc.*,[21] the U.S. Court of Appeals for the Ninth Circuit held that the ABC test can apply retroactively. A subsequent panel of that court has since sought clarification[22] from the California Supreme Court about whether, under that ruling, plaintiffs may seek compensation for "misclassification" that predates the legislation.[23] But, the prospect of a retroactive ABC test presents a legal and financial nightmare for employers, as well as raising questions of due process.

BETTER POLICY OUTCOMES

Various politicians and organizations have proposed alternative frameworks for worker classification, including portable benefits, third-way status and safe harbor.[24] None of these policy alternatives are mutually exclusive of one another, making California well positioned to act as a lodestar for a national compromise model.

The first alternative is a portable-benefits model involving worker-controlled benefits exchanges. The model aims to create entities to provide access on the open market to benefits ordinarily purchased at the workplace. Portable benefits help both workers and employers: workers receive access to competitively priced, non-cash benefits without the inflexibility of full-time employment, while firms gain new tools to attract and retain the best talent.[25]

The second, complementary alternative is a third-way status for flexible workers, which would create a new legal category in between full-scale employees and independent contractors. The specifics of a U.S. third-way status are still up for debate. However, a proposal offered by Sen. Mark Warner (D-Va.) would codify an existing standard that embraces a portable-benefits model, while other third-way proposals evaluate the connection between a contractor and a given firm to determine the level of obligation owed.[26]

In a similar vein, lawmakers in New York introduced the "Dependent Worker Act,"[27] which would classify workers in the gig economy as "dependent workers," extending to them the right to unionize, collectively bargain with employers and bring wage-theft claims. The Act defines a "dependent worker" as an individual who provides personal services to a consumer through a private sector third-party.[28]

The third alternative is to establish a safe harbor concerning the classification of independent contractors.[29] Such an approach would base worker classification on objective criteria like whether the independent party is tied to a single job provider, where the work takes place and whether a written agreement exists expressing the intent.[30] This approach improves certainty for both workers and firms, and access to the harbor could be linked to participation in a flexible benefits system or adaptation of a third-way status.

A CALIFORNIA MODEL

In the context of the Golden State's deep-blue politics, not all of the alternatives outlined above are palatable in their purest form. Mindful of these realities, a "California Model" should – at the least – embrace the following:

2. Protection of worker flexibility – most importantly, the state legislature should abrogate, or at least reformulate, "Part B" of the "ABC Test" concerning a

job's correlation with a firm's core business. In doing so, workers will retain control of their schedules, the tools of their labor, and the number, nature and quality of other work arrangements they undertake. Naturally, this also means ensuring that all rules are only applied prospectively.

3. Benefits – because of classification effects, independent contractors are not able to enjoy the same range of non-cash benefits associated with full-time employment. A California Model need not adopt a full-bore portable benefits system to fix this. The legislature should deem specific non-cash benefits incidental for classification purposes, thereby allowing firms to offer independent contractors opportunities they lack today.

4. Wages – California was among the first states to raise, state-wide, its minimum wage to $15.[31] While, as a matter of policy, the advisability of that development remains in question, consistent concerns about the compensation that independent contractors receive is doing much to drive support for AB 5. With that in mind, a California Model that includes a wage guarantee should seek to act only as a floor and not a ceiling for workers.

A California Model fit for adoption by other jurisdictions could be better, but it should do no worse than the elements outlined above.

CONCLUSION

The truly noxious part of AB 5 is that its proponents claim that it exists to help workers, even though it restricts their freedom, diminishes their economic opportunity and flatly undermines their own employment preferences. Worse yet, it does so while lavishing preferential treatment on particularly well-heeled industries.

For that reason, it is alarming that ABC Test legislation is spreading. States like Washington and Oregon have similar pending legislation,[32] and a group of Democrats in Congress recently inserted the ABC Test into a pro-labor bill called the Protecting the Right to Organize Act of 2019 (PRO Act).[33] Moreover, worker classification has gained traction on the 2020 campaign trail, with presidential candidates like Bernie Sanders supporting legislative efforts to re-define independent-contractor status.[34]

However, rather than accepting *Dynamex* as the prevailing rule for worker classification, legislators must create a framework that maintains flexibility, contains costs and provides workers with needed benefits. Alternatives that would accomplish these goals already exist and, in spite of its current posture, California is actually well positioned to develop and spread an improved model of its own. In any event, labor classification must move away from the false binary of employees versus independent contractors advanced by AB 5.

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