



SCHOOL & COLLEGE LEGAL SERVICES  
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5350 Skylane Boulevard  
Santa Rosa, CA 95403

Tel: (707) 524-2690  
Fax: (707) 578-0517  
santarosa@scsocal.org  
www.scsocal.org

General Counsel  
Carl D. Corbin

Attorneys  
Ellie R. Austin  
Monica D. Batanero  
Sarah Hirschfeld-Sussman  
Nancy L. Klein  
Damara L. Moore  
Jennifer E. Nix  
Steven P. Reiner  
Loren W. Soukup  
Erin E. Stagg  
Frank Zotter, Jr.

Of Counsel  
Robert J. Henry  
Margaret M. Merchat  
Patrick C. Wilson

LEGAL UPDATE

August 22, 2018

To: Superintendents, Member School Districts (K-12)  
From: Loren W. Soukup <sup>LS</sup>  
Senior Associate General Counsel  
Subject: New Test for Classification of Independent Contractors  
Memo No. 17-2018

The California Supreme Court issued a decision on April 30, 2018 in the case of *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903, which created a new “ABC” test for classifying independent contractors. The case involved a wage order class action lawsuit filed against a courier and delivery service company, Dynamex, which had converted all of its courier drivers from employees to independent contractors to save on costs.

The Supreme Court threw out the previous six-factor independent contractor test set forth under *S.G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 49 Cal.3d 341, as it applied to California Wage Orders, and adopted the new “ABC” test.

Under the new “ABC” test, a worker is presumed to be an employee and the employer has the burden to establish that all of the following three conditions apply in order to classify a worker as an independent contractor:

A) 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. Example: Construction company was able to establish that worker was free of the company’s control and direction where the worker set his own schedule, worked without supervision, purchased all materials used on his own credit card, and had declined an offer of employment proffered by the company because the worker wanted control over his own activities<sup>1</sup>;

<sup>1</sup> *Great N. Construction, Inc. v. Department of Labor* (Vt. 2016) 161 A.3d 1207.



B) The worker performs work that is outside the usual course of the hiring entity's business. Example: Retail store hires an outside plumber to repair a leak in a bathroom on its premises or hires an outside electrician to install a new electrical line<sup>2</sup>; and

C) The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed by the hiring entity. Example: Same-day pickup and delivery service did not establish that bicycle courier was engaged in an independently established business as there was no evidence that courier "held himself out as an independent businessman performing courier services for any community of potential customers" or that he "has his own clientele, utilized his own business cards or invoices, advertised his services or maintained a separate place of business and telephone listing."<sup>3</sup>

If an employer cannot establish all three factors, the worker will be deemed an employee, not an independent contractor.

While it is unclear whether this decision will apply to claims not arising from a California Wage Order, failure to meet the new legal test could result in back pay and fines for failure to pay federal Social Security and payroll taxes, unemployment insurance, workers compensation benefits, and for violation of various federal and state statutes and regulations governing retirement, wages, and hours. As such, we recommend that educational agencies reevaluate their current independent contractor relationships to ensure compliance with the "ABC" standard.

Please contact our office with questions regarding this Legal Update or any other legal matter.

*The information in this Legal Update is provided as a summary of law and is not intended as legal advice. Application of the law may vary depending on the particular facts and circumstances at issue. We, therefore, recommend that you consult legal counsel to advise you on how the law applies to your specific situation.*

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<sup>2</sup> *Enforcing Fair Labor Standards in the Modern American Sweatshop* (1999) 46 UCLA L. Rev. 983.

<sup>3</sup> *Boston Bicycle Couriers v. Deputy Dir. Of the Civ. Of Empl. & Training* (2002) 56 Mass.App.Ct. 473.

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## Independent Contractors

On April 30, 2018, in the *Dynamex Operations West, Inc. v. The Superior Court of Los Angeles County*, the California Supreme Court established stricter tests for an employer to ensure that employees are not misclassified as independent contractors, and thereby, not receiving benefits to which employees are entitled and not generating employment taxes.

The 1989 California Supreme Court ruling originally defined workers as contractors by applying these tests:

- Is the work an integral part of the local educational agency (LEA)?
- Does the worker's managerial skill affect the profit or loss opportunity for the contractor?
- How does the worker's investment compare to the LEA investment?
- Does the work require special skill and initiative?
- Is the relationship between the contractor and the district permanent or indefinite?
- What is the nature and degree of the district's control?

In *Dynamex Operations West, Inc.*, the California Supreme Court established the ABC test in which a worker is presumed to be an employee unless the employer can show that:

- A. The worker is free from 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;
- B. The worker performs work that is outside the usual course of the hiring entity's business ("independent, separate, and distinct business from that of the employer"), regardless of where the work occurs; and
- C. 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.

The new ABC test applies only to Industrial Welfare Commission Wage Orders. The Court's opinion did not include a ruling about whether the test would also apply to other wage and hour laws. The new California Supreme Court ruling makes it significantly more challenging for entities to classify workers as independent contractors rather than employees. LEAs should review their independent contractor relationships to determine if any of their workers should be reclassified.

—*Jamie Metcalf and Kathleen Spencer*

posted 05/11/2018

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## Constricted Independent Contractor ABC Test Limited to Wage Order Claims

In *Dynamex Operations West, Inc. v. The Superior Court of Los Angeles County*, the Court clarified the standard for determining whether workers in California should be classified as employees or as independent contractors using the "ABC" test for purposes of the wage orders adopted by the California Industrial Welfare Commission (see "Independent Contractors," in the May 18, 2018, *Fiscal Report*). However, the Court did not address whether the ABC test applies to non-wage order claims.

In addressing non-wage order claims, a California Supreme Court recently opined in *Jesus Cuittlahuae Garcia v. Border Transportation Group, LLC, et al.* that employers can continue to rely on *S.G. Borello & Sons, Inc. v. Department of Industrial Relations (Borello)*. In the *Borello* case, the Court established the following factors to be considered that are non-wage related:

- The worker's investment in tools used
- The method of payment
- The degree of permanence of the relationship
- The parties' intention as to determining whether a worker is properly classified as an employee or an independent contractor

Though employers have more flexibility in the *Borello* case in addressing non-wage related claims, they are still required to meet all three parts of the ABC test in determining whether their workers are classified as employees or independent contractors or face substantial financial liability. Local Educational Agencies should continue to review their independent contractor relationships to determine if any of their workers should be reclassified.

—Charlene Quilao

posted 11/15/2018