Ellen Aldridge
Nonprofits Insurance Alliance Group

Changes to Independent Contractor Classification in California

While businesses have traditionally subcontracted certain tasks to independent contractors, the on-demand or "gig" economy has seen this practice skyrocket with the business models used by Uber, Lyft, GrubHub, TaskRabbit and many other tech companies. To a limited extent, nonprofits also depend on independent contractors to perform functions where regular staff do not have the expertise, or for temporary or limited projects.

There is little risk when subcontracting is done through a business, such as hiring a temporary worker through a staffing agency where the worker is the employee of that agency. But when a nonprofit is hiring an individual worker to perform tasks that falls within the scope of the nonprofit's mission, the classification of independent contractor just became much more risky due to the recent California Supreme Court decision in Dynamex Operations West, Inc. v. Superior Court of Los Angeles.

In its lengthy decision, the Supreme Court analyzed the basic public policy objective of the California Wage Orders, which were adopted to establish minimum wage, overtime, and meal and rest breaks for non-exempt employees. The court noted that these laws ensure responsible employers are not hurt by competitors realizing the potentially substantial economic benefits of substandard employment practices (such as non-compliance with minimum wage, overtime, meal and rest breaks, insurance benefits, etc.), that could result in a "race to the bottom."

After analyzing the definition of "employee" under the Wage Orders, as well as the existing multi-pronged independent contractor test and legal tests used by other jurisdictions, the Court determined that a simplified "ABC" test should be used to evaluate whether a worker is classified as an independent contractor for purposes of California Wage Orders.

So how does this simplified test work? The ABC test presumptively considers all workers to be employees, and permits workers to be classified as independent contractors ONLY IF the hiring business demonstrates that the worker in question satisfies all three of the following conditions:

That 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 the work and in fact;
That the worker performs work that is outside the usual course of the hiring entity's business; and
That the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

So if the worker meets conditions A and C, but not B, because they are not working outside the usual course of the hiring employer's business, then the worker must be classified as an employee.

The most difficult prongs of the test to meet for most workers will be prongs B and C, so nonprofits analyzing worker classification should likely start with their mission statement and purpose. If an employee is working to further that mission, then under condition B, that worker is likely an employee and no further analysis is necessary.

Going on to condition C, by way of example, while a plumber or an IT technician are not likely to fall within the mission of a social services nonprofit, whether they are in an independently established trade, occupation or business will need further examination. A licensed plumber in a separate business clearly is, but an IT technician may or may not be. Condition A, who directs and controls the worker in the performance of their work, will always require a case-by-case evaluation.

Finally, remember that this Supreme Court case involved the definition of "employee" for purposes of the California Wage Orders. Different employment laws have different definitions of "employee," so it is possible that a worker may properly be classified as an employee with reference to one law but not another. Nevertheless, once a worker is classified as an employee for Wage Order purposes, they likely should be similarly classified for all other compliance purposes.

Nonprofits that have workers classified as independent contractors now or over the past three years (the applicable statute of limitations on wage claims) should re-evaluate that classification under this narrowed definition to assess whether there is potential liability for wages or penalties for the work performed.