Legal Update Article

California's 'ABC' Test for Independent Contractor Analysis to be Applied Retroactively

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May 7, 2019

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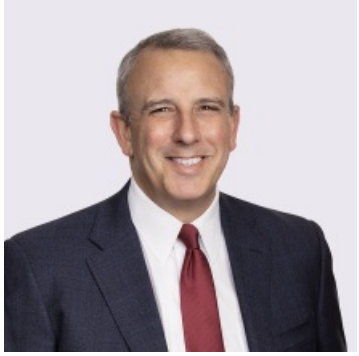

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California employers were dealt another setback in responding to claims of misclassification of independent contractor status for violations of the Industrial Welfare Commission Wage Orders (IWC Wage Orders). Noting California's "basic legal tradition" that "judicial decisions are given retroactive effect," the U.S. Court of Appeals for the Ninth Circuit has held that the state's recently adopted "ABC" test, used in the employee-versus-independent contractor analysis in cases involving IWC Wage Orders, must be applied retroactively. *Vazquez v. Jan-Pro Franchising Int'l, Inc.*, 2019 U.S. App. LEXIS 13237 (9th Cir. May 2, 2019).

In so holding, the Court of Appeals reversed the grant of summary judgment to an international janitorial franchising company in a class action lawsuit brought by several franchisees claiming that they are in fact employees of the franchising company.

Almost exactly a year earlier, the California Supreme Court, in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles County,* 416 P.3d 1 (Cal. 2018), broadened the definition of "employee" in the context of the IWC Wage Orders when undertaking the employee-versus-independent contractor analysis, by adopting what commonly is known as the ABC test. Under that standard, to establish that an individual is in fact an independent contractor, an employer must prove that:

A: The work is free from the control and direction of the company in connection with the performance of the work, both under the contract for performance of the work and in fact;

B: The worker performs work that is outside the usual course of the company's business; and

C: The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

The standard set forth in *Dynamex* presumes that workers are employees subject to the requirements of the IWC Wage Orders and clearly places the burden on the employer to prove all three elements of the ABC test to establish independent contractor status.

Background

The underlying claims in *Vazquez* have been meandering through various courts for more than a decade, with the case's history providing a law school primer on such topics as *res judicata* and the "law of the case," legal terms that essentially stand for the proposition that "this already has been decided." In short, Jan-Pro, a Georgia corporation and "master owner" of its trademarked name and janitorial business model, sells the rights to use that name to "master franchisors" who, in turn, sell business plans to "unit franchisees" who provide the actual janitorial services. In 2008, franchisee Giovanni Depianti brought a class action against Jan-Pro in Massachusetts federal court, claiming

that he and other franchisees were in fact employees of Jan-Pro and not independent contractors. Ultimately, Depianti's claims were dismissed, while the claims of three California plaintiffs, including Gerardo Vazquez, were severed and transferred to the U.S. District Court for the Northern District of California.

Vazquez then asserted class claims on behalf of similarly situated California franchisees. In May 2017, the district court, relying on California law then in place, concluded that the plaintiffs could not establish a material issue of fact as to their claim that they were employees and not independent contractors. The plaintiffs appealed and, while the matter was pending on appeal, the California Supreme Court decided *Dynamex*, overturning existing law. It held that the ABC test now applied to Industrial Wage Orders claims. Although the California Supreme Court was asked to explicitly hold that the *Dynamex* decision applied only prospectively, it refused to do so.

The *Vazquez* Decision

In light of the intervening change in the law brought about by *Dynamex*, the Ninth Circuit asked the parties in *Vazquez* to supplement their briefing on appeal to address whether the ABC test should be retroactively applied to the case at hand. Understandably claiming that it should not, Jan-Pro first asserted, under alternate theories, that the case already had been decided in light of prior decisions by the First Circuit Court of Appeals, the federal district court in Massachusetts, and the highest state courts in both Massachusetts and Georgia. Rejecting these arguments, the Ninth Circuit held that those prior decisions expressly applied only to the claims of Depianti and not the California plaintiffs. On the contrary, noted the Ninth Circuit, the Massachusetts federal court "severed Plaintiffs' claims so that they could represent their own interests. Binding Plaintiffs to the final decision in Massachusetts would therefore foreclose their claims without having provided them an adequate opportunity to litigate them."

As to retroactivity, the Court of Appeals first noted, citing well-established law, that "as in the federal system, appellate courts in California apply intervening state supreme court rules retroactively when reviewing cases, even if the judgment in the trial court was entered prior to the ruling from the California Supreme Court." Although an exception to the rule of retroactivity may apply "when a judicial decision changes a settled rule on which the parties below have relied," the Ninth Circuit was unwilling to accept the employer's "conceptually problematic" argument that that matter should be remanded to allow the trial court to determine how much Jan-Pro relied on pre-*Dynamex* law, as doing so could lead to the inconsistent application of the retroactivity doctrine.

Moreover, the California Supreme Court's refusal to expressly hold that *Dynamex* applied only prospectively, while not a ruling on the merits, nonetheless tacitly suggested that the usual standard of retroactivity would apply. Furthermore, at least three California lower courts, including an intermediate court of appeal, already had held that *Dynamex* was to be applied retroactively, and "[a]n intermediate state appellate court decision is a datum for ascertaining state law which is not to be disregarded by a federal court unless it is convinced by other persuasive data that the highest court of the state would decide otherwise." Thus, concluded the Ninth Circuit, "[g]iven the strong presumption of retroactivity, the emphasis in *Dynamex* on its holding as a clarification rather than as a departure from established law, and the lack of any indication that California courts are likely to hold that *Dynamex* applies only prospectively, we see no basis to do so either."

Finally, rejecting the employer's (and an *amicus* party's) implication that applying *Dynamex* retroactively was inconsistent with constitutional due process, the Court of Appeals noted that "[a]s to caselaw involving civil (and purely economic) liability, the Supreme Court has made clear that legislative acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality." To this end, "[e]ven more deference is owed to judicial common-law developments, which by their nature must operate retroactively on the parties in the case." Concluding that applying *Dynamex* retroactively would be neither arbitrary nor irrational (and therefore not unconstitutional), the Ninth Circuit stated that its decision "ensure[s] that the California Supreme Court's concerns are respected," that is, that the "[plaintiff-employees] can provide for themselves and their families [and] retroactivity protects the [relevant] industry as a whole, putting [the employer] on equal footing with other industry participants who treated those providing services for them as employees for purposes of California's wage order laws prior to *Dynamex*."

The Takeaway

Even had it been applied only prospectively, *Dynamex* has had, and will continue to have, a significant impact on companies throughout California that rely on workforce configurations using independent contractors. Thus, the Ninth Circuit's determination that the ABC test should apply retroactively will result only in greater repercussions for businesses using a franchise model or independent contractor model.

If not already underway, California employers who routinely enter into independent contractor arrangements with individuals should promptly and carefully review the status of those workers. With statutes of limitation as long as four years for wage claims under California state law when also pleading a violation of the Business & Professional Code and now retroactive application of the independent contractor test, such review is all the more critical.

If you have any questions about the *Vazquez* or *Dynamex* decisions, the employee-versus-independent contractor analysis, or any other wage and hour issue, please consult the Jackson Lewis attorney(s) with whom you regularly work.