CHILD CARE LAW CENTER®

LEGAL MEMORANDUM

THE IMPACT OF THE *DYNAMEX* DECISION ON DETERMINATIONS OF EMPLOYMENT STATUS OF CALIFORNIA CHILD CARE PROVIDERS

September 17, 2018

INTRODUCTION

A recent California Supreme Court decision adopted the "ABC test" for determining whether a California worker is properly classified as an employee or an independent contractor, *Dynamex Operations West, Inc. v. Superior Court of Los Angeles,* 4 Cal.5th 903 (2018). Under this 3-part test, it will be more difficult to establish that a worker in California is an independent contractor for purposes of wage and hour laws. This lengthy, well-reasoned decision was written by Chief Justice Tani Cantil-Sakauye (appointed by former Governor Arnold Schwarzenegger), and unanimously agreed to by all the associate justices.

The *Dynamex* decision raises important questions for the child care community. It has the potential to redefine the relationships between state agencies, child care payment agencies, child care providers and parents. This memo explains the new test to determine whether a worker is an employee or independent contractor; the policy reasons supporting the adoption of that test for *all* workers when reviewing compliance with wage and hour laws, particularly those at the bottom of the wage ladder; and how different kinds of child care arrangements might be evaluated under this new test.

As we work together to resolve the issues raised by *Dynamex*, lawmakers, agencies and advocates must balance important interests. We must look for new solutions that positively impact child care providers, who have been historically underpaid, while protecting low-income parents and continuing to grow the availability of good, affordable child care.

I. The ABC Test

Under the ABC test, a worker is considered an employee for wage order purposes *unless* the business entity can show that the worker meets all of the standards below:

> (A) the worker is free from the 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; ***and***

(C) the worker is customarily engaged in an *independently* established trade, occupation, or business of the same nature as the work performed.

If the hiring entity fails to show that any of these requirements are met, then a court will determine the worker is an employee. The decision instructs the lower courts that because failing any one of the tests results in an employment relationship, if the finding is negative on B or C, there is no need to even reach what might prove to be a more difficult determination on A. While the ABC test creates a bright line rule and simplifies the process to determine whether a worker is considered an employee, it is not a radical departure from current law. The *Dynamex* decision applies the ABC test when determining whether a worker is an employee or independent contractor, adopting previous case law adopting this to determine who is a joint employer. See, *Martinez v. Combs*, 49 Cal.4th 35 (2010).[1]

II. The Overriding Purpose of California's Labor Law and Wage Orders Is to Protect the Rights of Workers.

The *Dynamex* decision adopts the ABC test, already used in some form by 22 states, to determine whether an individual worker should be categorized as an employee or independent contractor for wage order purposes.[2] In choosing to adopt the more inclusive ABC test, the Court relied on the principle of statutory construction that wage and hour laws, including the state wage order challenged in this case, are the "type of remedial legislation that must be liberally construed in a manner that serves its remedial purposes." *Dynamex*, *supra*, 4 Cal 5th at p. 953, citing *Industrial Welfare Com. v. Superior Court*, 27 Cal.3d 690, 702 (1980).

A. Wage and Hour Laws are Remedial Legislation Meant to Protect Workers

The *Dynamex* Court conducted an exhaustive review of the standards used in past California employment cases to connect this decision to prior judicial interpretations of wage and hour laws. The consistent theme was to ensure that wage and hour protections, as remedial legislation, were interpreted generously in order to protect a broad category of workers.

The Court repeatedly emphasized that the underlying statutory purpose is the touchstone for deciding whether a particular category of workers should be considered employees rather than independent contractors. In other words, California is going to choose the standard that best effectuates the underlying legislative intent and objective of protecting workers. Not only does a broad and inclusive test protect more workers, it also relieves the public of having to underwrite the costs of employee misclassification, including loss of tax revenues, and having to pay for worker's compensation and unemployment insurance. It was also unfair to the companies that acknowledged its workers as employees because it put them at a competitive disadvantage against those companies who were misclassifying workers as independent contractors. *Dynamex*, *supra*, 4 Cal. 5th at 953[3]

The Court also looked to recent employee misclassification legislation enacted by the California Legislature in response to the serious problem of misclassification of workers as independent contractors. This 2011 law imposes stiff civil penalties on those who willfully misclassify, or aid

in the misclassification of, workers as independent contractors.[4] The Court took this as additional evidence that adopting the ABC test would further the legislative purpose of protecting workers against misclassification. In so doing, it rejected two other possible tests that would have allowed for more workers to be considered independent contractors.[5] The *Dynamex* Court ultimately rejected both of these alternative tests for two reasons. First, they did not provide a clear, predictable standard that gave employers and workers advance notice of how they would be classified. Second, these multi-factor, sliding scale factors were more capable of employer manipulation.

III. The Meaning of the ABC Test

Decisions regarding whether to categorize a worker as an employee or an independent contractor are very fact-based, individualized determinations. Courts examine the specifics of the work, the degree of control retained by the worker or the business entity, how hours and schedules are set, the rate of pay, whether other clients or customers are retained by the worker, etc. These fact-based inquiries will continue under the ABC test.

Under the ABC test, a worker is presumed to be an employee unless the hiring entity proves that the worker **meets each prong** of the ABC test. Below is a description of and considerations for each factor:

Part A: Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?

The key question under what is commonly referred to as "the control test," is not whether the employer actually exercised control, but whether the employer had the right to do so. The *Dynamex* decision clarified that depending on the nature of the work and the overall arrangement of the parties, a business need not control the precise manner or details of the work in order to be found to have the necessary control to be considered an employer. It is enough that the business entity maintains "the necessary control that an employer ordinarily possesses over its employees…" *Dynamex, supra*, 4 Cal. 5th at p. 37, fn. 27, citing three detailed scenarios and describing the requisite degree of control for (1) work-at-home knitters and sewers; (2) truck drivers and (3) a worker who specialized in historic restoration. The first two were found to be employees of the hiring entity; the third was not.

The language "both under the contract…and in fact" signifies that courts should look beyond the written agreement between the parties to whether the worker is actually free of control. Thus, contracts that define the relationship as one of independent contractor are not definitive of how the reality of the situation will be assessed. If the contract is no more than an attempt to use the "independent contractor" label to avoid employer liability, the court will disregard the contract, and the actual practice of the parties will determine this factor.

Some of the relevant factors for the control test are: whether the worker must adhere to a time schedule set by the employer, the employer's unilateral ability to set the rate of pay, and whether the employer provided training to the worker. The degree of control contemplated under this first

part of the ABC test has been found in situations where employers exercise control over price, rate of pay, form of contract, acceptance of orders, terms of sale, noncompetition provisions, right to discharge, and the furnishing of customers.

Part B: Does the worker perform work that is outside the usual course of the hiring entity's business?

This test examines whether the work done is part of the regular business or services provided by the hiring entity. The example given is if a retail store hires a plumber or electrician, this is not in the store's usual course of business. In contrast, if a clothing manufacturing company hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company and they will be sold by the company, they will be considered employees, notwithstanding that the workers determine the hours that they work, are paid a piece rate, and do not work on-site.

Part C: Is the worker customarily engaged in an independently established trade, occupation or business of the same nature as the work performed for the hiring entity?

While the first two tests focus on the acts of the hiring entity, Part C focuses on the worker. If the worker has only one client, the hiring entity, then it does not have an independently established trade or business. Does the worker hold themselves out to some community of potential customers as independent tradespeople involved in a particular business or trade? Factors that might be considered include whether the worker maintains a separate business location, has employees, is free to accept outside work, may sustain profits or losses in the performance of the services at issue, and hold themselves out to the public as a separate business.

IV. Applying the ABC Test in the Child Care Arena

The Court has not ruled on how child care workers, specifically, are classified. However, we can use the Court's recent ruling to determine how the ABC test would likely be applied to various child care work situations. The brief description below is a general legal analysis. Each scenario will be determined by its specific facts and how they are applied to the ABC factors described above.

A. Child care workers employed in a Family Child Care Home or Child Care Center

Child care workers who are employed as an assistant by the operator of a family child care home (FCCH), or employed in a child care center have traditionally been considered employees of the FCCH or center and will remain employees under the ABC test.

B. Licensed Family Child Care Providers

Licensed family child care providers typically accept multiple children into their home; some, all, or none of whom may be receiving a subsidy. Applying both the degree of control and the existence of an established business, it appears that licensed family child care providers operate their own businesses and would not become employees of the parents or the state under the new

ABC test.[6]

Further, licensed family child care providers operating a large family child care home are themselves employers, hiring assistants and employing them in their homes.

C. Family Child Care Home Education Networks (FCCHENs)

Providers who are part of a FCCHEN are themselves operating family child care homes but come under increasing control and direction of both CDE and the contracting agency who acts as the FCCHEN administrator. The authorizing statute for FCCHEN's provides that "the Superintendent of Public Instruction…shall contract with entities organized under law to operate family child care home education networks that support educational objectives for children in licensed family child care homes that serve families eligible for subsidized child care." Cal. Educ. Code § 8245. Section 8245(b) then lays out the nine requirements that each participating FCCH home in a FCCHEN must meet.[7]

The CDE contract governing FCCHEN's requires the network administrator to monitor several listed requirements, including quality standards, and to conduct periodic assessments of program quality in each family child care home affiliated with the network. FCCHEN's are subject to an annual review and placement on the Environment Rating Scale (ERS), and these findings are used for the Program Self-Evaluation Annual Report.

A legitimate question is raised whether a FCCH provider that is part of a FCCHEN is "free from the 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." Questions that may be relevant to the issue of control include, who selects the children who are served by the FCCH? Who is providing the survey tools and the curriculum/instruction to be used? Who decides whether a particular FCCH provider qualifies for the enhanced reimbursement rate?

The fact that the contract repeatedly labels the FCCH as a "service provider" and the FCCHEN administrator as the contractor is not determinative. It will be instructive to review individual contracts between the participating family child care providers and the FCCHEN administrators to determine the degree of control over the performance of the work that is retained by the administrator, whether it be a local school district or a child care contractor. Taking these factors into account and depending on the individual facts, FCCHEN providers may be considered employees of CDE and/or the FCCHEN administrator under the ABC test.

Similar questions of control may arise for Early Head Start Home based child care programs, but this memo does not examine that question.

D. License Exempt/Family, Friend and Neighbor Care

Family, Friend and Neighbor or license-exempt care providers, by definition, do not have their own independent business or clientele. In fact, they are forbidden to provide care to more than one family's children other than their own. Tit. 22, Cal. Code Regs. § 102358. Thus, whether they are providing the care in their own home or in the home of the child, they are clearly employees because they do not meet the "C" part of the test.

The parent who chooses the individual to care for their child and has the power to hire and fire that child care provider is an employer, but the parent is probably not the only employer and the administering state agency is likely a joint employer (see Part V, below). CDSS uses forms that attempt to deny that the state agency has any employment relationship with the provider. The license exempt provider must sign a form saying, "I understand that I am not an employee of the County Welfare Department, Alternative Payment Program or other Payment agency." Declaration of Exemption from Trustline: CCP-1. Similarly, the form requesting payment from the county for child care states: "The county does not act as the child care provider's employer, and does not have a business relationship with the child care provider when a child care payment is paid. If I choose child care in my home, I may be considered the employer and am responsible for complying with any applicable federal and state employment-related laws." CCP-2145.[8] The stage one agency notices are incomplete as the parent should also be informed that they may be considered an employer even if the child care is provided in the license-exempt provider's home – the location of where the care takes place may not be conclusive in determining whether a child care worker is considered an employee; this was true even before the ABC test became the standard in California and is even more so now.

CDSS also requires parents to sign the CCP4 Health and Safety form acknowledging that:

- If you choose to have child care provided in your home (in-home care), you are considered the employer and are responsible for paying at least the state's minimum wage, social security tax, Medicare and state worker's compensation insurance for your provider. You may also be responsible for unemployment taxes.
- You may be required to withhold federal or state income taxes from the child care provider's earnings. The provider is responsible for reporting income and payment of any federal or state income taxes.

State law requires that almost all employees in California, which includes license-exempt child care providers, be paid at least the state minimum wage, which is currently $10.50 per hour.[9] In some cities and counties, the minimum wage is higher.[10] For license-exempt providers providing care in the home of the child, the Industrial Wage Order 15, "household occupations" would apply. Industrial Welfare Commission Order No. 15-2001, Regulating wages, hours and working conditions for Household Occupations. Although individuals who are the parent, spouse, or child of the employer are exempt from this requirement under California Law,[11] the Fair Labor Standards Act requires that employers pay all employees the federal minimum wage. Thus, technically a license-exempt provider working for his or her parent, spouse or child must earn at least the federal minimum wage of $7.25 per hour.

V. If Certain Child Care Workers are Deemed Employees, Who is the Employer?

In addition to the threshold determination of whether the individual is an independent contractor or an employee, if found to be an employee, who is their employer? This was not the question posed in the *Dynamex* case. In California, a 1983 federal court decision found that the disabled person hiring the Personal Care Attendant (PCA) *and the state agency* were joint employers in the In-Home Supportive Services (IHSS) program. *Bonnette v. California Health & Welfare*

Agency, 704 F.2d 1465 (9th Cir., 1983). Both *Bonette* and *Guerrero v. Superior Court*, 213 Cal.App.4th 912 (2013), contain good discussions of who is a joint employer in the IHSS program for purposes of federal wage claims (FLSA) and in *Guerrero*, state wage claims. These joint employer determinations have also been addressed in very fact-specific ways.

The license-exempt provider who provides care, in or out of the parent's home, is very likely to be considered an employee. The parent who chooses the provider and has the ability to hire and fire would probably be found to be *an* employer of the license-exempt provider.

However, like the IHSS workers in *Bonnette* and *Guerrero*, in subsidized care, many aspects of the work are controlled by the state agency, who sets the rate of pay, the eligibility criteria to become an approved provider, the rules governing family eligibility and service need, and the monthly documentation of attendance. In the case of CalWORKs child care for current CalWORKs parents who need child care in order to meet their obligation to participate in a Welfare-to-Work activity or employment, the state agency and county welfare departments are also mandating the hours of WTW or work that trigger the need for child care. California courts would likely be extremely reluctant to find that low-income parents who are told that they must participate in WTW or employment and can only find license-exempt care -- a friend or relative willing to accept the low reimbursement rate and irregular hours -- would now be solely financially liable for the state's failure to set the reimbursement rate at the minimum wage. Taking into account *Bonnette* and *Guerrero*, the state agency who sets these rules is very likely, at minimum, the joint employer.

The question has been raised whether the Alternative Payment Program (APP) is also a joint employer, along with the state and the parent. There is a legitimate argument that the APP's who are administering the different state child care and development contracts are acting as agents of the state for purposes of determining who is an eligible provider, who must be Trustlined, the number of approved hours, and the maximum rate of payment. It is also possible that they would be found to be a joint employer as well, sharing those elements of control with the state and the parent. *Guerrero* provides some insight into the question, where the IHSS workers were found to be employees of both the county and the public authority set up to administer the IHSS program at the county level. While the client retained the power to hire and fire, the "County and Public Authority had substantial power over the employment relationship by virtue of their control of the purse strings and their control over the type of system they implemented to deliver IHSS program services, and the public authority set up at the county level." *Guerrero, supra,* 213 Cal.App.4th at pp. 933-937.

VI. Does Dynamex Entitle Misclassified Workers to Retroactive Wage Claims?

The *Dynamex* ruling affirmed the Appeals Court's certification of a class of drivers, and did not address the period of retroactive wages. However, California workers have three years from the date of a violation to file a claim for unpaid wages and can collect overtime pay for work performed up to three years before the claim was filed. That recovery period is extended to four

years if a lawsuit is filed in court.[12] In addition, workers may recover interest and penalties on unpaid wages.

It is still too soon to know how the articulation of a new test in *Dynamex* will be applied to retroactive claims.

CONCLUSION

The *Dynamex* decision will have a broad, positive impact on workers across low-wage industries by affording them needed protections of employee wage and hour laws, unemployment insurance, and workers compensation. Reducing the rising trend of employee misclassification will also help states collect employer taxes and contributions to unemployment insurance and workers compensation funds.

The child care workforce is a relatively small component of this larger workforce trend. This decision provides an opportunity to examine our practices to ensure that we are not building a child care delivery system that exploits low-wage, vulnerable workers, who are predominantly women of color.

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[1] In *Martinez v. Combs*, a 2010 California Supreme Court decision, the Court adopted the broad IWC definition of "suffer or permit to work" in examining whether a particular entity was a "joint employer."[1] In *Dynamex*, the Court ruled that the use of this test was not limited to joint employer determinations, but was also the appropriate test for determining whether a worker was an employee or independent contractor. *Dynamex*, *supra*, 4 Cal. 5th at 944.

[2] *See, e.g.*, Alaska Stat. § 23.20.525(a)(8); Ark. Code Ann. § 11-10-210(e); Conn. Gen. Stat. § 31-222(a)(1)(B)(ii); Del. Code Ann. tit. 19, § 3302(10)(K); 820 Ill. Comp. Stat. 115/2; Mass. Gen. Laws c. 149 § 148B; Md. Code Ann., Lab. and Employ. § 8-205; Neb. Rev. Stat. § 48-604(5), § 48-1229(1); Nev. Rev. Stat. § 612.085; N.H. Rev. Stat. Ann. § 282-A:9(III); N.M. Stat. § 51-1-42(F)(5); Tenn. Code Ann. § 50-7-207(e)(1); Vt. Stat. tit. 21 § 301(6)(B), § 341(1). Other states have recognized the ABC test through court decision. *See*, e.g. *Hargrove v. Sleepy's, LLC*, 220 N.J. 289, 106 A. 3d 449 (2015).

[3] In *amici* briefs filed with the *Dynamex* Court, many organizations representing workers detailed the enormous toll that misclassification of employees as independent contractors exacts on workers, law-abiding employers, and our economy. See, e.g., National Employment Law Project, INDEPENDENT CONTRACTOR MISCLASSIFICATION IMPOSES HUGE COSTS ON WORKERS AND FEDERAL AND STATE TREASURIES, Sept. 2017 (accessed Sept. 5, 2018).

[4] Labor Code, §226.8, enacted by Stats. 2011, ch.706, § 1l; §2753, Stats. 2011, ch. 706, §2. Fines of between $5,000 and $25,000 per violation for willfully misclassifying employees as independent contractors.

[5] The *Dynamex* Court rejected the economic realities" test used to determine federal wage claims under the Fair Labor Standards Act (FLSA). That test considers a list of factors that are meant to treat as "employees those workers who, as a matter of economic reality, are economically dependent upon the hiring business, rather than realistically being in business for themselves." *Dynamex*, *supra*, 4 Cal. 5th at p. 950, fn. 20. These factors include: (1) the degree of control exercised by the employer over the workers; (2) the workers' opportunity for profit or loss and their investment in the business; (3) the degree of skill and independent initiative required to perform the work; (4) the permanence or duration of the working relationship; and (5) the extent to which the work is an integral part of the employer's business. The Court also rejected the "common law" test which contains an even longer list of factors to be considered.

[6] Some states that have Collective Bargaining Agreement (CBA's) between the state and licensed, and some license-exempt, family child care providers already use the ABC test to determine employment status. Those CBA's or state statutes explicitly provide that the family child care providers who are the represented workers in the bargaining unit are only considered state employees for purposes of collective bargaining and are not considered state or public employees for any other purpose. *See*. e.g., Mass. Gen. Laws, chapter 15D, §17(b); Conn. Gen. Statutes, Ch. 319pp § 17b-705, and 705a, "A family child care provider shall not be considered a state employee and shall be exempt from any and all provisions of the general statutes creating rights, obligations, privileges or immunities to state employees as a result of or incident to their state service."

[7]Cal. Educ. Code § 8245 (b) states that the FCHHEN's shall provide all of the following:

(1) Age and developmentally appropriate activities for children.
(2) Care and supervision of children.
(3) Parenting education.
(4) Identification of child and family social or health needs and referral of the child or the family to the appropriate social or health services.
(5) Nutrition.
(6) Training and support for the family child care home education network's family home providers and staff.
(7) Assessment of each family child care home provider to ensure that services are of high quality and are educationally and developmentally appropriate.
(8) Developmental profiles for children enrolled in the program.
(9) Parent involvement.

[8] Counties and the contractors that administer the various child care and development programs typically put a disclaimer in their contractual agreements between the contractor and the provider, or the provider and the parent. The agreement includes such language as, "The contract is between the parent and me, the County is not my employer. I am responsible for withholding my own taxes, such as Social Security, Medicare, and Income taxes from my child care earnings. Child care payments are reported to the Internal Revenue Service and the Franchise Tax Board."

[9] The California minimum wage as of January 2018 was raised to $11.00 per hour, and $10.50/hour for employers with 25 employees or less. CA Labor Code 1182.12; CA Minimum Wage Order (MW-2017).

[10] Thirty cities in California have set a minimum wage higher than the state minimum wage. For a list of cities that have adopted their own minimum wage standard, and which employers and workers to which it applies, see https://www3.swipeclock.com/blog/california-minimum-wage-across-cities-towns-2018-guide-employers/.

[11] State of California, Industrial Welfare Commission Order No. 15-2001, Regulating wages, hours and working conditions for Household Occupations, Section 1(C).

[12] The general statute of limitation on wage claims is **three years**. Cal. Code Civ. § Proc. 338. Claims for unpaid wages as restitution under the California's Unfair Competition Law (UCL) must be filed within **four years**. Cal. Bus. & Prof. Code §§ 17200, 17208.