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California Supreme Court Holds Independent Contractor Misclassification Claims Can Be Determined by Common Proof – But Only in Certain Circumstances

By Alison Hightower

In its first employment-related class certification decision since its seminal ruling in *Duran v. U.S. Bank*,[1] the California Supreme Court, in a fragmented opinion, reversed the denial of class certification for a group of newspaper delivery carriers who alleged they were employees misclassified as independent contractors. In *Ayala v. Antelope Valley Newspapers, Inc.*,[2] the California high court held that the trial court improperly focused its analysis on variations in how the carriers did their jobs rather than whether the newspaper retained the right to control the method and manner of how they performed their duties through its standard written contracts with the carriers.

The newspaper distributed its papers using individuals retained through a preprinted standard form contract that spelled out, among other things, the newspaper's control over what, when, and how the carriers would perform their jobs, and its right to terminate the contract without cause on 30 days' notice. Four carriers sued on a behalf of a putative class of all carriers, claiming they were misclassified as independent contractors rather than employees. The plaintiffs also asserted claims for unpaid overtime, unlawful deductions, failure to provide breaks, and failure to reimburse for business expenses. In seeking certification of this class, the named plaintiff alleged that the central question—whether the newspaper carriers were "employees" vs. "independent contractors"—could be established by common proof, and pointed to the standard contract as that common proof. The newspaper opposed certification, relying on testimony from carriers highlighting individual variations in how carriers performed their work. The newspaper argued that even if the carriers were employees, the action contained unmanageable individualized issues.

The trial court denied certification. It agreed with the newspaper that "'heavily individualized inquiries' into [the newspaper's] control over the carriers' work" would predominate. A class action was not superior, therefore, to individual lawsuits by each carrier to resolve those individual issues. The court of appeals reversed on the grounds that a common critical question could be resolved on a classwide basis—"how much right does [the newspaper] have to control what its carriers do?"[3]

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1 *See* Kevin Lily, *California Supreme Court Stabilizes the Law in California Misclassification Class Action Cases*, Littler ASAP (Jun. 2, 2014).

2 No. S206874 (Cal. Jun. 30 2014).

3 The appellate court did not disturb the trial court's ruling denying certification of plaintiffs' claims that the newspaper failed to provide meal and rest breaks and denied them overtime pay.

On appeal to the California Supreme Court, the Justices applied California's standards governing class certification, which differ from the standards under Rule 23 of the Federal Rules of Civil Procedure.

If a class is certified, as few as one court-approved "class representative" can testify as to his or her experience and the defendant's actions, and if he or she prevails, hundreds and even thousands of individuals who supposedly are "similarly situated," may be entitled to collect damages without ever stepping into the courtroom. While class actions have the potential to save the courts significant time and effort by resolving claims *en masse*, the state supreme court recently overturned a trial court class judgment because the trial court had violated the employer's due process by, among other things, depriving it of the opportunity to prove that the court-approved class representative was not in fact similar to all members of the certified class. That appellate decision in *Duran v. US Bank*, however, was issued after a full trial—a rarity in class cases, since most settle.

Denial of Class Certification Reversed

Since class certification is not a final judgment, appellate reversals of certification decisions are unusual, particularly because the standard on appeal is "abuse of discretion," the most stringent standard an appellant can be required to meet to prevail on appeal. Thus, even if the appellate court would have made a different ruling, it cannot reverse a grant or denial of certification unless the lower court "abused its discretion" by, for example, relying on erroneous legal assumptions.

In *Ayala*, five of the seven California Supreme Court justices took the rare step of agreeing that the trial court had abused its discretion by denying class certification. A majority of the court found that whether the newspaper's carriers are "employees" rather than "independent contractors" under the common law test was susceptible to proof on a classwide basis.

In so holding, the majority focused on the standard, written contract the newspaper signed with its carriers. The court stated, "[s]ignificantly, what matters under the common law is not how much control a hirer **exercises**, but how much control the hirer retains the **right** to exercise."[4] According to the high court, the trial court focused on the variations in the degree to which the newspaper exercised its control, rather than on the underlying **right** to exercise control. That right was given by its form contract, to which the trial court "afforded only cursory attention…."[5] Variation in the extent to which the newspaper carrier exercised its right to control individual carriers "does not necessarily demonstrate that the hirer could not, if it chose, monitor or control the work of all its hires equally."[6] Describing the legal right of control as "likely the crux of the case's merits," the court opined that to resolve class certification, the trial court should focus on whether the right to control could be resolved on common proof.

The "difficulties with the [trial] court's ruling on class certification," the court held, "thus lie not in the answers given, but with the questions asked." Although the trial court might have reached the right conclusion, since it applied the wrong legal assumptions about the relevant questions, the decision "cannot stand," and the trial court was directed to reconsider.

The right to control has certainly been long recognized as an important factor in determining independent contractor analysis, but the common law and other tests look to other factors as well. Who provides the place of work and the tools and instrumentalities? Is the contractor engaged in a distinct business or occupation? Can the contractor be terminated with or without cause? How long will the services be performed? Can the worker make a profit based on his/her efforts and management skills? Do the parties believe that they have an employment or a contractual relationship?

The California Supreme Court majority instructed that at the class certification stage, these secondary factors should first be assessed to determine which, if any, of the factors are material to the analysis, cautioning that "courts assessing these secondary factors should take care to correctly identify the relevant considerations." Next, the trial court must determine whether the relevant factors can be tried based on common proof. Finally, the trial court must weigh the relevant issues to determine whether those susceptible to common proof predominate. In *Ayala*, the majority concluded, the trial court erred because it simply "recited secondary factor variations it found without doing the necessary weighing or considering materiality."

4 Slip op. at 8, emphasis in original.

5 *Id.* at 11.

6 *Id.* at 13.

Strong Criticisms from Justice Chin

In an unusual concurring opinion, Justice Ming Chin agreed that the trial court's ruling had to be reversed, but strongly questioned the analysis of the majority of the court. According to Justice Chin, the trial court in fact did focus principally on the newspaper's "right to control" the carriers by considering the written contract, as well as by examining how the newspaper actually exercised control over the process, the carriers as a group, and particular carriers. Justice Chin agreed that the form contract and delivery instructions showed some commonality in proof regarding the newspaper's right to control, and thus the trial court's finding that there was "no commonality" "reflects insufficient consideration of the common proof plaintiffs submitted."[7]

But while Justice Chin agreed with the reversal of the trial court's decision, he found many of the numerous criticisms the majority levels at the trial court's ruling to be off the mark.[8] Perhaps most importantly, Justice Chin criticized the majority opinion as retreating from—or misstating—the common law test as established by *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*.[9] In *Borello*, the California Supreme Court "stressed that the right to control test 'is not necessarily the decisive test,'" and that "'[t]he nature of the work, and the overall arrangement between the parties, must be examined' in addition to the right to control."[10] Thus, Justice Chin concluded, "in considering the parties' actual course of conduct in addition to the contracts, the trial court here simply did what *Borello* **required** it to do."[11] Going further, Justice Chin noted that given this precedent, "the majority errs in stating that 'how much control a hirer **exercises**' does not 'matter(),' and that the only thing that 'matters' is 'how much control the hirer retains the **right** to exercise' and whether 'there were variations in' [the newspaper's] 'underlying right to exercise' control over its carriers."[12]

Justice Chin also noted that the trial and appellate courts did not limit themselves to the common law test for determining employment status. Both considered some of the factors under the federal Fair Labor Standards Act, adopted by *Borello*, to distinguish contractors from employees, such as whether the carriers use helpers or substitutes, and whether they can take action to increase their profits.[13]

The California Supreme Court ruling does not end the *Ayala* litigation. The court sent the class certification ruling back to the Los Angeles Superior Court for reconsideration in light of its ruling. That court will have to decide—presumably with new briefing and argument—whether to certify the class. Assuming it does, the merits of the dispute still will need to be resolved, possibly by a trial.[14] Class certification does not resolve whether the carriers in fact should have been treated as "employees." Many court decisions support the consideration of numerous factors to evaluate whether workers are misclassified, with no one factor being controlling. The California Supreme Court did not jettison this precedent in *Ayala*, but only noted that on the record before it, the trial court did not properly weigh the evidence to determine if common proof could resolve the plaintiffs' claims.

California Businesses Retaining Contractors Can Reduce Their Exposure

For other class actions in the pipeline or yet to be brought, plaintiffs' counsel no doubt will argue that the California Supreme Court decision supports class certification, at least when there is a standard form contract that uniformly specifies that the business has the right to control the workers' manner and means of performing the work. But the plaintiff still will have to prove that the standard contract shows a common **illegal** policy in order to certify a class on that basis.[15] Contracts that do not retain the right to control the worker will not evidence the

7 *Id* at 7.

8 *Id.* at 9.

9 48 Cal. 3d 341 (1989).

10 Slip op. at 9.

11 *Id.* at 10, emphasis in original.

12 *Id* at 11, citations omitted, emphasis in original.

13 Other factors considered under *Borello* and the federal "economic realities" test are: (1) the worker's investment in equipment or materials required for his/her tasks; whether the service rendered requires a special skill; the degree of permanence of the working relationship, and whether the service rendered is an integral part of the alleged employer's business. *Borello*, 48 Cal. 3d at 355.

14 Entities can win these cases at trial and on appeal, such as in *Cristler v. Express Messenger*, 171 Cal. App. 4th 72 (2009) (appellate court affirmed jury's finding that delivery drivers were properly classified as independent contractors).

15 *See* Julie Dunne and Alison Hightower, *California Supreme Court Clarifies Employer Meal & Rest Period Duties*, Littler ASAP (Apr. 12, 2012).

requisite illegal common practice that is the basis for certifying a class. The workers instead will have to show a common illegal systematic practice, which is more difficult to do.

Businesses can reduce the risk of class certification by reviewing their contracts with their contractors and eliminating provisions that allow the business the right to control their workers' methods and means of accomplishing the tasks at hand or otherwise support an employment relationship.

In addition to the risk of class certification, a merits finding that workers have been misclassified as independent contractors can result in significant penalties and backpay awards under California law. Under California Labor Code section 226.8,[16] the state courts and certain California agencies have the power to punish "willful" misclassification with fines of not less than $5,000 and up to $15,000 per "violation." Further, if the entity is found to have engaged in a "pattern or practice" of misclassifying "employees" as "independent contractors," those fines can be ratcheted up to a minimum of $10,000 per violation, with a cap of $25,000 per violation. An audit triggered by an independent contractor seeking unemployment benefits could lead to imposition of the fines authorized by this new Labor Code section as well as other penalties for failing to make all required payments for payroll taxes, social security and workers compensation insurance. Moreover, federal labor and tax law impose their own significant consequences for misclassification.

To reduce risks of liability businesses should also review contracts with an eye towards the other factors that are considered in evaluating the independent contractor status. For instance, businesses should evaluate the risk of deducting any expenses from payments made to contractors. Unlike employees, independent contractors are generally expected to supply the tools, instrumentalities and the place of work. Many businesses charge contractors for the use of these items. But if those contractors are found to have been willfully misclassified "employees," then California law imposes penalties for charging those persons a fee, or making "any deduction from compensation for any purpose," such as to compensate for "goods, materials, space rental, services, government licenses, repairs, equipment maintenance, or fines arising from the individual's employment…." These penalties are in addition to the potential liability for reasonable and necessary expenses themselves, if the worker was misclassified, under Labor Code section 2802.

In addition, businesses using independent contractors should consider auditing the actual practices in the field for utilizing these workers, even when the contract supports the classification. While the contract terms may assist in avoiding class certification, the entity may not be immunized from liability by a contract if the conditions "on the ground" reflect an employment relationship.

The *Ayala* decision highlights the ongoing battle over classification of independent contractors, particularly in litigious California, which is not likely to end anytime soon. Entities retaining contractors should be vigilant to ensure that they are in compliance with California law, and particularly should be sure their contracts are consistent with the classification of these workers.

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16 California Labor Code section 226.8.