



by Tamara M. Kurtzman

# DECONSTRUCTING *Dynamex*

The landmark decision in *Dynamex* overturns a 30-year test for determining whether a worker is an employee or an independent contractor

## AMERICA'S

concept of the workplace has been evolving for decades. From automation obviating many traditional manufacturing jobs to the advent of flexible work schedules, the ability to work from home, and increased informality of many office settings, the workplace of today looks very different from the traditional brick-and-mortar locations of generations past.

The latest evolution of the American workplace is the ever-expanding, on-demand “gig” economy—freelance workers paid for discrete tasks or projects rather than receiving a traditional salary or hourly wage. It is estimated that more than 16 million people are now working in “contingent” or “alternative work arrangements” in the United States, and the number is growing.<sup>1</sup> At the center of this expanding gig economy, the issue of employment misclassification—treating employees as independent contractors—has become a recurring theme inside and outside the courtroom.

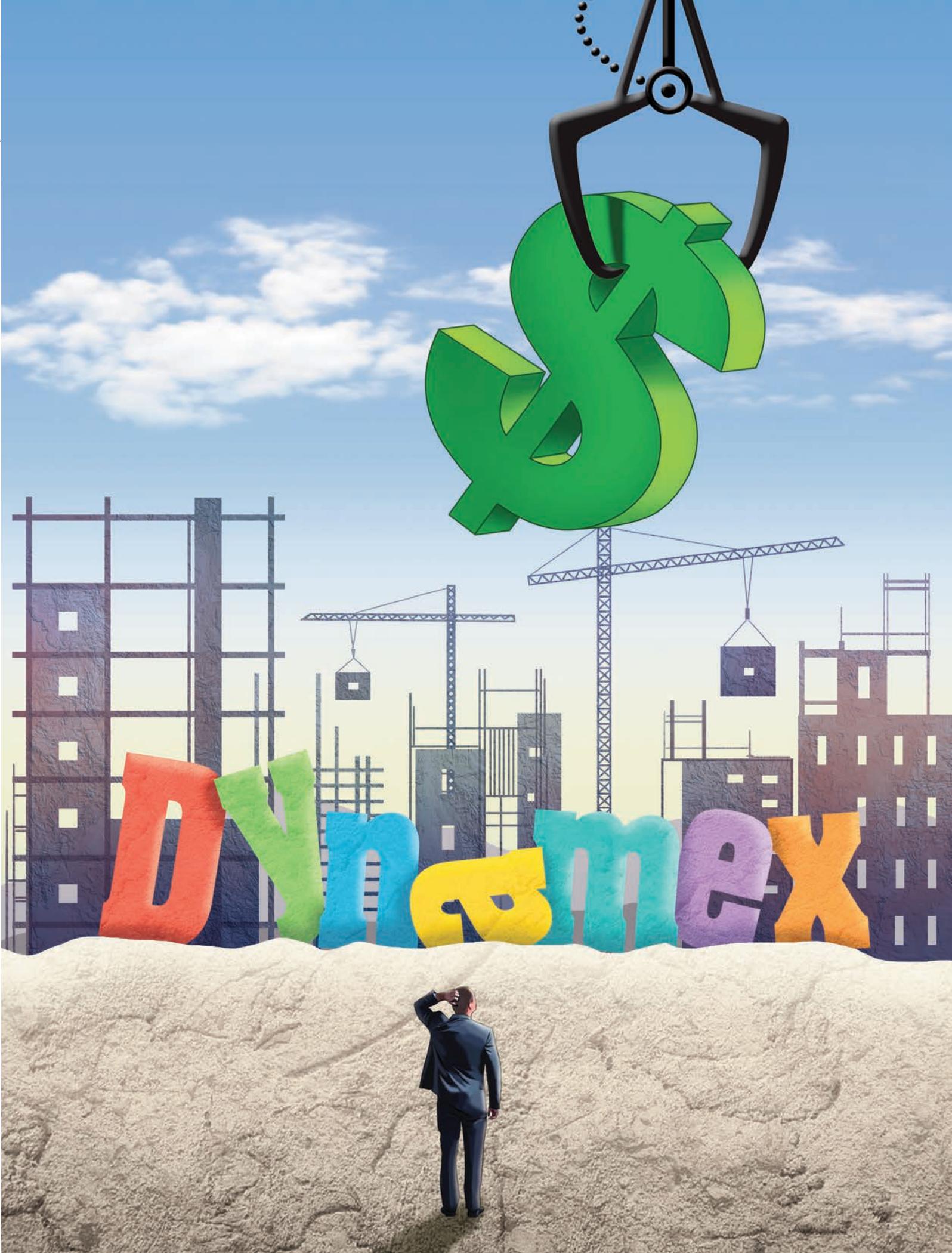
In April, the intersection of the right to

contract for services and the state’s interest in protecting workers from those contracts dramatically shifted with the California Supreme Court’s decision in *Dynamex Operations West Inc. v. The Superior Court of Los Angeles County*.<sup>2</sup> This far-reaching decision, which overturns nearly three decades of precedent, significantly expands the definition of employee under the California Wage Orders and positions the burden squarely on employers to prove that independent contractors are being properly classified.

With the rise of the gig economy and the 2017 Tax Cuts and Jobs Act,<sup>3</sup> the stakes have never been higher for employers and workers alike regarding the distinction between independent contractors and employees. For employees, the recently enacted Tax Cuts and Jobs Act has eliminated the ability to deduct unreimbursed

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work-related expenses as miscellaneous deductions on their personal tax returns. Previously, employees were permitted to deduct these unreimbursed work-related expenses subject to certain income limits. Thus, for workers who incur significant work-related expenses, classification as an employee may result in meaningful tax repercussions. On the other hand, while independent contractors may initially see larger take-home incomes, not being classified as an employee typically means the loss of key employee benefits, worker's compensation protection, protection from laws governing the employer-employee relationship (including minimum wage and maximum work-week rules), and higher tax liability.

### Employee Benefits

For businesses, employees often represent an increased cost of more than 30 percent in the form of vacation time, worker's compensation coverage, payroll taxes, and other benefits typically not given to independent contractors.<sup>4</sup> Businesses are also liable for certain types of acts committed by employees in the course of their employment and must adhere to strict requirements relating to non-discrimination, discipline, and termination. The Patient Protection and Affordable Care Act<sup>5</sup> (ACA) has also played an incentivizing factor in many employers' preference for independent contractors. Specifically, under the employer mandate of the ACA, businesses with more than 50 full-time employees are required to provide health coverage for those employees or face significant penalties. This requirement does not, however, apply to independent contractors. Simply put, employees cost employers far more than independent contractors do.

Despite the many financial incentives for any employer not to classify workers as employees, misclassification also poses significant risk. Employers who misclassify workers as independent contractors become liable for taxes that should have been withheld. Likewise, criminal,<sup>6</sup> civil,<sup>7</sup> and administrative<sup>8</sup> penalties may be imposed on employers who fail to abide by applicable labor laws and wage orders. Notwithstanding these severe ramifications, however, the proliferation of the on-demand economy has resulted in the distinction between employees and independent contractors becoming increasingly difficult to determine. For example, in February 2018, GrubHub, a food delivery service, was found to have properly classified a delivery driver as an independent contractor rather than an employee under California law.<sup>9</sup> On-demand ride services such as Uber and

Lyft also have found themselves constantly at the forefront of debate over the employment classification of their drivers. Exacerbating this difficulty, employment classification continues to be an ever-evolving area of law driven by a complex, yet decisive, distinction between those workers providing services as employees and those acting as independent contractors.

For nearly 30 years, the *Borello* test—a multifactor test enumerated by the California Supreme Court in 1989—served as the seminal guide for determining whether a worker was an independent contractor or employee.<sup>10</sup> In *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, an agricultural grower challenged a penalty imposed by the California Labor Commission for failure to secure workers' compensation coverage for their harvester employees. The grower argued that the Labor Commission had improperly imposed the penalty at issue as the harvesters were “share farmers” and thus independent contractors, not employees. Siding with the Labor Commission, however, the California Supreme Court ultimately concluded that the harvesters were indeed employees. The court reached this determination after evaluating a number of factors including: 1) whether the grower had a “right to control” the manner and means of the work completed; 2) the grower's right to discharge the workers; 3) whether the workers were engaged in a distinct occupation or business; 4) the nature of the work performed; 5) the skill required in the particular occupation; 6) whether the grower or the harvesters supplies the instrumentalities, tools, and the place of work; 7) the length of time for which the services were to be performed; 8) method of payment; 9) whether the work was part of the regular business of the grower; and 10) whether the parties believed they were creating an employer-employee relationship.<sup>11</sup>

### Right to Control

Analyzing these various factors, the court identified the right to control as the most significant element in determining employment status. Further, the court found that in the instant case, the grower had indeed maintained “pervasive control” over the operation through, among other activities, selecting the produce to be farmed, obtaining a buyer for the crops, cultivating the land throughout the growing cycle, and transporting the harvested crops to market.<sup>12</sup> As such, the court concluded that the harvesters were indeed employees and, in doing so, gave life to a multifactor test emphasizing the manner in which work is

performed as the determinative analysis of employment status in California.

In 2008, the California Supreme Court further clarified the employment landscape in *Martinez v. Combs*.<sup>13</sup> Unlike *Borello*, the *Martinez* case did not concern the issue of worker classification as an employee or independent contractor. Rather, *Martinez* arose in the context of the defendants' argument that they were not employers under California law and, as such, focused on the meaning of the terms “employ” and “employer” as used in the context of California wage orders.

### Defining Terms

In *Martinez*, seasonal strawberry harvesters brought suit against their direct employer and also their employer's distributors to recover unpaid minimum wages under the California Labor Code. The distributors initially obtained summary judgment under the theory that they were not employers under the definition of the applicable Industrial Welfare Commission wage orders. On appeal, the California Court of Appeal affirmed the grant of summary judgment, employing the “economic realities” test of the Fair Labor Standards Act<sup>14</sup> to find that the distributors had not exercised sufficient control over the harvesters to constitute employment. On further appeal, however, the California Supreme Court rejected the federal economic realities test as a means of defining employment status and held instead that that the Industrial Welfare Commission's definition did, in fact, apply.<sup>15</sup> Specifically, the supreme court held that wage orders embody three alternative definitions of “employ”: 1) the exercise of control over wages, hours, or working conditions; or 2) suffering or permitting the work; or 3) creating a common law employment relationship through engagement.<sup>16</sup> Focusing on whether the distributors at issue had suffered or permitted the harvesters' work, the court ultimately found that they had not and, therefore, were not liable as employers. However, the court made clear that its newly endorsed expansive definition of “employ” might not foreclose liability in other cases in which a typical employer-employee relationship was not present.<sup>17</sup>

Four years after *Martinez*, the California Supreme Court once again found itself presented with the question of employment classification in *Ayala v. Antelope Valley Newspapers, Inc.*<sup>18</sup> In *Ayala*, newspaper carriers filed a wage-and-hour action against the *Antelope Valley Press* alleging that the newspaper had misclassified them as independent contractors rather than as employees. The trial court initially denied

# MCLE Test No. 281

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1. In California, minimum wage laws generally apply equally to employees and independent contractors.  
True.  
False.
2. The court in *Dynamex Operations v. Superior Court of Los Angeles County* expressly held that its new “ABC” test is applicable to establishing employment status under the California Fair Employment and Housing Act.  
True.  
False.
3. The ABC test classifies workers who perform tasks consistent with the employer’s usual course of business as employees.  
True.  
False.
4. Employers who misclassify workers as independent contractors are liable for employment taxes that should have been withheld.  
True.  
False.
5. The so-called *Borello* test presently remains the standard for determining employment status for purposes of employers’ workers’ compensation insurance requirements.  
True.  
False.
6. No presumption is made under the *Dynamex ABC* test as to a worker’s employment status unless that worker can first establish the employer has violated a California wage order.  
True.  
False.
7. In *Martinez v. Combs*, the California Supreme Court adopted an “economic reality” test as the standard for defining employment status.  
True.  
False.
8. The first element of the ABC test—being free of the control and direction of the employer—is largely a reiteration of the common law *Borello* test.  
True.  
False.
9. The ABC test was adopted by the *Dynamex* court in an attempt to simplify employment classification determinations.  
True.  
False.
10. Workers may be classified as independent contractors rather than employees so long as they consent to such classification at the time of their employment.  
True.  
False.
11. *Dynamex* further expands the broad definitions of “employ” and “employer” set forth in *Martinez*.  
True.  
False.
12. An employer’s “usual course of business” for purposes of analysis under the *Dynamex ABC* test is determined exclusively by statute.  
True.  
False.
13. Agricultural harvesters, delivery drivers, and electricians are all cited by the *Dynamex* court as examples of workers likely engaged in a sufficiently independent trade so as to justify independent contractor status.  
True.  
False.
14. A worker can be simultaneously classified as an employee under California law but as an independent contractor under federal law.  
True.  
False.
15. With respect to determining an employer’s degree of control over a worker, only actual control is determinative.  
True.  
False.
16. The *Dynamex* court’s adoption of the ABC standard is modeled after a substantially similar Massachusetts test.  
True.  
False.
17. The fact that a worker has taken steps to incorporate his or her own business supports a likelihood that the third element of the ABC test can be met.  
True.  
False.
18. The ABC test does not alter the definition of independent contractor under federal law.  
True.  
False.
19. California’s courts are generally reluctant to classify workers as employees rather than as independent contractors.  
True.  
False.
20. In the aftermath of *Dynamex*, exempt workers in California are the most likely group to require reclassification.  
True.  
False.

## MCLE Answer Sheet #281



### DECONSTRUCTING DYNAMEX

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the plaintiffs' motion to certify the action as a class action on the ground that under the *Borello* standard, common issues did not predominate on the question of whether the plaintiffs were independent contractors. On appeal, however, the court of appeal disagreed in part, and reversed the trial court's finding that employee status could not be established without "heavily individualized inquiries."<sup>19</sup>

On review, the California Supreme Court limited its analysis solely to the common law test and affirmed the ruling of the court of appeal that *Borello* did not preclude class certification in the instant case. Specifically, the supreme court opined that by focusing on variations in how the newspaper exercised control over its carriers rather than on the newspaper's right to control the work itself, the trial court had "lost sight" of whether the scope of the newspaper's right of control was sufficient to permit class-wide assessment.<sup>20</sup> Notably, while the court in *Ayala* did find the *Borello* standard to be the proper test in evaluating the class certification issues presented in that case, the court did not address whether in a class action alleging misclassification of employees, a class may be certified based on the definitions of "employ" and "employer" as construed in *Martinez*, or whether the *Borello* test represented the only standard for distinguishing between employees and independent contractors in this setting. Indeed, this question would go unanswered for roughly four more years until 2018, when the court would take it up in *Dynamex*.

### The *Dynamex* Decision

On April 30, 2018, the California Supreme Court once again dramatically changed the course of California's employment landscape through its decision in *Dynamex*. In *Dynamex*, parcel delivery drivers brought suit against their employer, claiming that they were being incorrectly classified as independent contractors rather than employees. As a result of this misclassification, the drivers claimed that *Dynamex* violated provisions of a California Industrial Welfare Commission Wage Order as well as various sections of the Labor Code.

After litigation in which the trial court's order denying class certification was reversed by the court of appeal, the trial court ultimately certified a class of delivery drivers. The trial court, however, rejected *Dynamex*'s contention that in the wage order context, as in most other contexts, the *Borello* test is the sole standard for distinguishing employees from independent contractors and, instead, based its certification order on the expansive definition

of "employ" set forth in *Martinez*. *Dynamex* subsequently challenged the class certification, asserting that the *Martinez* definitions of "employ" and "employer" were inapplicable to the issue of whether the drivers were employees or independent contractors; rather, *Dynamex* argued that those definitions are relevant only to the distinct joint employer question that was directly addressed in *Martinez*.

The court of appeal rejected *Dynamex*'s contention and concluded that the wage order definitions discussed in *Martinez* are indeed applicable to the employee or independent contractor question for purposes of wage orders. The court of appeal, however, also concluded that with respect to those causes of action that are not governed by wage orders, the *Borello* test was the applicable standard for determining whether a worker is properly considered an employee or an independent contractor. *Dynamex* then appealed to the California Supreme Court.

Ultimately, the issue that came before the California Supreme Court was whether the definitions of "employ" and "employer" discussed in *Martinez* were applicable to the question of whether a worker is properly classified as an employee or an independent contractor for purposes of wage orders. In determining that the trial court had not abused its discretion in certifying the class, the court held that the broadest possible interpretation of these definitions should apply, and thereafter adopted a new ABC test closely modeled after Massachusetts' own version of this standard.<sup>21</sup>

As a starting point, the new *Dynamex* ABC test presumes that all workers are employees unless the employer is affirmatively able to prove otherwise. Importantly, the burden of demonstrating independent contractor status falls squarely on the business, not the worker. Specifically, a business must meet a three-pronged test to establish independent contractor status: 1) The company must not be able to control or direct what the worker does, either by contract or in actual practice; 2) the worker must perform tasks outside of the hiring entity's usual course of business; and 3) the worker must be engaged in an independently established trade, occupation, or business.<sup>22</sup>

The first element—being free of the control and direction of the employer—is in many respects quite similar to the common law *Borello* test. Under *Borello* as well as the newly articulated ABC test, a worker who is either by contract or by practice subject to the type and degree of control a business typically exercises over employees is likewise considered an employee. In order

to meet this part of the test, workers must be free from the employer's right of control; actual exercise of that control is, however, not necessary.<sup>23</sup>

### Departure from *Borello*

While the first prong of the ABC test is familiar, the subsequent two elements represent a prominent departure from *Borello*. The test's second prong—performance of tasks outside of the employer's usual course of business—seeks to exclude from independent contractor status those workers who are providing services in a role comparable to that of an employee. To satisfy this second element, an employer must demonstrate that the worker's job is separate and distinct from the employer's ordinary course of business, and not a regular or continuous part of that business.<sup>24</sup> Under prong B, almost any worker who engages in the same business as its employer will be classified as an employee.

In an attempt to lend clarity to this second element, the court provides examples of workers it considers to be independent contractors as opposed to employees. The court said plumbers and electricians who provide their services to a retail store would not be considered performing work within the store's usual course of business. As such, the court concludes that these workers could properly be classified as independent contractors.<sup>25</sup> On the other hand, the court cites the example of a work-at-home seamstresses hired by a clothing manufacturer to make dresses from materials supplied by the company and that will thereafter be sold by the company as someone who would likely be considered an employee.<sup>26</sup>

These simplistic examples notwithstanding, the court provides little practical analysis of how an enterprise's "usual course of business" is actually to be determined. Although the court offers the example of a retail store that engages a plumber to repair a leak or an electrician to install a new line, nowhere does the court define the usual course of business of a retail store other than simply concluding in a cursory fashion that the services of the plumber and electrician are not part of the store's usual course of business.<sup>27</sup> Practitioners and courts are thus left to navigate a wide range of statutes and case law in an attempt to define the scope of an employers' business. For example, California Labor Code Section 2810.3 defines "usual course of business" as "the regular and customary work of a business, performed within or upon the premises or worksite of the client employer" while Section 3355 defines "course of trade, business, profession, or

occupation” to be “all services tending toward the preservation, maintenance, or operation of the business, business premises, or business property of the employer.” Indeed, the question of what constitutes the usual course of business will undoubtedly be the subject of future litigation.

The third and final prong of the new *Dynamex* test seeks to identify those workers that have taken steps to create their own businesses. To that end, this C prong requires independent contractors to be “customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.”<sup>28</sup> Workers who have independently made the decision to go into business for themselves are likely to be found as satisfying this third prong. If, on the other hand, they are “simply designated as an independent contractor by the unilateral action of a hiring entity,”<sup>29</sup> it is likely that they will be found to be employees.

Notably, prong C represents the most problematic of the three prongs to decipher. While the court cites plumbers and electricians as basic examples of possible independently established trades, it remains unclear how many gig economy workers—e.g., dog walkers, web developers, or stylists—would fit into this model. A related but similarly unaddressed issue is the status of loan-out corporations under prong C. A loan-out company is a business entity in which an individual is typically the sole owner and the employee who furnishes his or her personal services to outside parties.

This arrangement is especially prevalent in the entertainment industry although loan-out agreements do occasionally appear in other industries such as real estate. Because loan-out companies often consist of a single individual, these businesses often do not engage in the same level of enterprise formalities as do other corporations. For example, loan-out companies may not advertise or otherwise actively promote the business.

Yet, the *Dynamex* court explains that the C prong of the ABC test is generally provable by evidence that the worker in question has taken “the usual steps to establish and promote his or her independent business—for example, through incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like.”<sup>30</sup> Especially in the case of loan-out companies and other small businesses, the question of what activities are truly necessary to constitute “usual steps to establish and promote” the business are critical

threshold questions that remain unanswered by *Dynamex*.

Similarly, while the court, by its language, suggests that an independent contractor must already be engaged in his or her own business to meet the third prong of this new test, it is unclear exactly how established that business must be to qualify. After all, every business has a first client. The C prong’s narrow language nevertheless suggests that initial customers may potentially face misclassification liability if the

mission. Thus, *Dynamex* does not alter the definition of independent contractor under federal law and, because at present the *Dynamex* test applies only to wage orders, this means that generally only nonexempt employees are impacted for the time being. As to determining employee status for purposes of workers’ compensation, unemployment compensation, or reimbursement of expenses under the provisions of the labor and unemployment codes, it appears that, at least for now, the



contractor fails to attract subsequent clients. If this is so, the chilling effect of this decision on small businesses and entrepreneurship as a whole may prove highly significant.

Taken as a whole, under the new *Dynamex* standard, employers may not engage an individual as an independent contractor unless that worker has established an independent business to provide services that are unrelated to the employer’s own course of business. Although the court professes that its adoption of the ABC test will “create a simpler, clearer test for determining whether the worker is an employee or an independent contractor,”<sup>31</sup> in many respects the 82-page opinion has created more questions than answers.

All is not lost for employers, however. Importantly, the court did limit applicability of the ABC test in *Dynamex* to determining whether workers should be classified as employees or independent contractors for purposes of California wage orders promulgated by the Industrial Welfare Com-

mon law *Borello* test remains applicable. How long this may stay the case, however, remains to be seen. For example, while *Dynamex* does not presently expressly apply to the California Fair Employment and Housing Act (FEHA), like wage orders, the FEHA is remedial legislation that consistently receives broad interpretation by courts in this state. As such, it is easy to imagine the *Dynamex* ABC test being applied in the future to the FEHA and other remedial statutes as the standard for determining employment status. Thus, in the future it is increasingly likely that individuals may be independent contractors under state law but not for federal purposes such as Social Security and payroll taxes.

Of course, while many of these distinctions are relevant in the context of litigation, from a practical standpoint, businesses cannot realistically choose to classify a worker as an independent contractor for some purposes and as an employee for other purposes. When deciding to categorize a

worker as an employee or independent contractor, the ABC test is thus ultimately determinative in California despite its proscribed narrow scope. Moreover, the Supreme Court's reasoning in *Dynamex* appears driven, in large part, by the court's apparent preference for traditional full-time employment arrangements as a means of extending maximum legal protections to workers whenever possible. The result—whether intended or not—of the court's approach in *Dynamex* is that the cost of doing business in California just increased for numerous businesses. Moreover, given the court's strong recent endorsement of this protectionism, it is likely that in time the *Dynamex* test may also be utilized in determining how workers are classified in other contexts as well. Irrespective of whether *Dynamex* remains limited to wage orders, it is clear that this decision will have a lasting impact on business in California and that many, if not most, employers will need to re-examine their use of independent contractors to determine whether reclassification is necessary. ■

<sup>1</sup> Press release, U.S. Dep't of Labor, Bureau of Labor Statistics, Contingent and Alternative Employment Arrangements Summary, (June 7, 2018), available at <https://www.bls.gov>.

<sup>2</sup> *Dynamex Operations W. v. Superior Ct.*, 4 Cal. 5th 903 (2018).

<sup>3</sup> Tax Cuts and Jobs Act, H.R. 1, 115th Cong., Pub. L. No. 115-97 (2017).

<sup>4</sup> Press release, U.S. Dep't of Labor, Bureau of Labor Statistics, Employer Costs for Employee Compensation, (March 8, 2018), available at <https://www.bls.gov>.

<sup>5</sup> Patient Protection and Affordable Care Act, 111th Cong., Pub. L. 111-48 (2010).

<sup>6</sup> LAB. CODE §1199 (misdemeanor punishable by a monetary fine, imprisonment, or by both, for failing to pay at least minimum wage or requiring employee to work in manner prohibited by the Industrial Welfare Commission).

<sup>7</sup> LAB. CODE §1193.6a (Department of Industrial Relations may commence and prosecute a civil action to recover unpaid minimum wages or unpaid overtime compensation owing to any employee); LAB. CODE §1194a (employee receiving less than minimum wage or legal overtime compensation has right to recover in a civil action any unpaid balance, with interest, reasonable attorney's fees, and costs of suit); LAB. CODE §1194.2 (in action to recover wages because of payment less than the minimum wage, employee shall be entitled to recover liquidated damages in an amount equal to the wages unlawfully unpaid plus interest).

<sup>8</sup> LAB. CODE §1193.5 (Department of Industrial Relations may investigate and ascertain wages, hours, and working conditions of all employees in the state and may supervise payment of unpaid minimum wages or unpaid overtime compensation owing to any employee).

<sup>9</sup> *Lawson v. GrubHub, Inc.* 302 F. Supp. 3d 1071 (N.D. Cal. 2018). Notably, however, because this case was decided prior to the decision in *Dynamex*,

the court's analysis followed *Borello*.

<sup>10</sup> *S.G. Borello & Sons, Inc. v. Department of Indus. Relations*, 48 Cal. 3d 341 (1989).

<sup>11</sup> *Id.* at 351.

<sup>12</sup> *Id.* at 356.

<sup>13</sup> *Martinez v. Combs*, 49 Cal. 4th 35, 64 (2010).

<sup>14</sup> 29 U.S.C. §203(g), (e). See *Tony & Susan Alamo Found. v. Secretary of Labor*, 471 U.S. 290, 301 (1985).

<sup>15</sup> *Martinez*, 49 Cal. 4th at 66.

<sup>16</sup> *Martinez v. Combs*, 75 Cal. Comp. Cases 430, 452, 2010 Cal. Wrk. Comp. LEXIS 83, \*60, 49 Cal. 4th 35, 231 P.3d 259, 109 Cal. Rptr. 3d 514 (Cal. May 20, 2010).

<sup>17</sup> "A proprietor who knows that persons are working in his or her business without having been formally hired, or while being paid less than the minimum wage, clearly suffers or permits that work by failing to prevent it, while having the power to do so." *Id.* at 457.

<sup>18</sup> *Ayala v. Antelope Valley Newspapers, Inc.*, 59 Cal. 4th 522 (2014).

<sup>19</sup> *Id.* at 544.

<sup>20</sup> *Id.* at 534.

<sup>21</sup> *Dynamex Operations W. v. Superior Ct.*, 4 Cal. 5th 903, 956-57.

<sup>22</sup> *Id.*

<sup>23</sup> *Id.* at 935, 958.

<sup>24</sup> *Id.* at 958-62.

<sup>25</sup> *Id.* at 959.

<sup>26</sup> *Id.* at 959, 960.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 917.

<sup>29</sup> *Id.* at 962.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 950 n.20.

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