

Buchalter

CLIENT ALERT

September 2019

By: Dawn M. Knepper

AB 5 – The Legislature’s Solution to Solving Your Questions on Proper Use of Independent Contractors

The long-awaited legislation that is intended to provide clarification on the use of independent contractors for businesses in California has now been signed into law. Assembly Bill (“AB”) 5 codifies, clarifies, and grants exemptions to the 2018 decision by the California Supreme Court known as *Dynamex*. AB 5’s requirements will come into effect for the most part in short order, on January 1, 2020. While the framework of AB 5 is quite lengthy and complicated, here is an overview.

Review of *Dynamex*

As a reminder, in April 2018, the California Supreme Court issued its decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, (2018) 4 Cal. 5th 903 (“*Dynamex*”), which expressly rejected the application of the long-standing multi-factor control test that had been promulgated by another decision from the same Court in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal. 3d 341 (“*Borello*”). *Dynamex* reiterated the presumption that a worker who performs work for a hirer is an employee, specifically for purposes of claims for wages and benefits arising under the Wage Orders issued by the Industrial Welfare Commission (“IWC”). In *Dynamex*, the Court laid out a 3-part test, commonly known as the “ABC” test, to establish that a worker is an independent contractor.

While the decision in *Dynamex* provided direction for application of the Wage Orders, which largely affects businesses in application of requirements for minimum wage, overtime and meal and rest breaks, it left open questions for the test to be used to determine whether a worker is an independent contractor in other contexts. In particular, *Dynamex* did not address the classification test to be used in the context of unemployment and disability insurance for workers, and other parts of the labor code (e.g. reimbursement of workers’ business expenses).

In the wake of the *Dynamex* decision, many businesses were left wondering whether they should reclassify its workers, many of whom had been functioning as independent contractors for a long time, to employee status. Questions left open by the decision included the need to reclassify when some of these workers are high-level professionals who would otherwise be exempt under the Wage Orders from overtime and meal and rest break requirements. Other questions included the requirement to reclassify the workers despite those same workers’ opposition to depart from the independent contractor model they preferred. In some instances, workers provided their services to multiple businesses, and reclassifying them would make them employees of multiple employers. Most critically, many businesses and workers were left frustrated with the guidance from *Dynamex* on the ABC test, and specifically part B, which called into question the manner of determining what is “the usual course of the hiring entity’s business.”

The California legislature set out to address these questions and others. Heavy lobbying resulted in the creation of a series of intricate exemptions to the ABC test, and while your worker may possibly

meet one of these exemptions, AB5 still sets out the requirement to assess the amount of control that is asserted over the worker with a reversion back to the *Borello* test.

Codification of the ABC Test

AB 5 begins with a delineation of the legislature's concern that misclassified workers are losing significant workplace protections, the unfairness for employers who must compete with companies that misclassify, and the loss to the state in needed revenue.

To address these concerns, the new law reiterates the presumption that a person providing labor or services for remuneration is an employee rather than an independent contractor, unless the employer satisfies all three components of the ABC test:

- a) The person 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 person performs work that is outside the usual course of the hiring entity's business.
- c) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

The ABC test now generally applies for purposes of the Labor Code, as well as the Unemployment Insurance Code, and for the Wage Orders of the IWC, unless an exemption applies. Many employers will unfortunately still be left wrestling with the question of determining what work is included as the "usual course" of their business, and it is expected that more direction will come from litigation, specifically on part B of the test.

Overview of the Exemptions – Don't Forget *Borello* Still Applies!

As a result of the lobbying efforts, a variety of exemptions have been extended from application of the ABC test, including: specific occupations such as licensed professionals like physicians, lawyers, accountants, investment advisors, direct sales salesperson, and commercial fishermen; certain contracts for professional services such as travel agents, photographers, freelance writers, licensed barbers and cosmetologists; specified real estate licensees; bona-fide business-to-business contracting relationships; particular subcontracting relationships in the construction industry; defined referral relationships; and even certain motor club relationships!

To the extent an employer believes that an exemption to the ABC test may apply, the assessment of the exemption's application may require analyzing other statutory provisions. For example, while a physician may be expressly identified, to be exempt they have to be licensed by the State of California pursuant to specific terms of the Business and Professions Code, and for a particular entity pursuant to the Corporations Code.

Moreover, with respect to certain exemptions, the worker may have to meet certain conditions. As an example, barbers, cosmetologists, and manicurists are only exempt if they set their own rates, are paid directly by clients and schedule their own appointments. Thus, a careful assessment of the applicability of the exemption is required.

Additionally, even if the worker meets the criteria of the exemption, in order to be legally classified as an independent contractor, the worker must satisfy all of the *Borello* requirements.

The test adopted in *Borello* is known as the “multi-factor” or “economic realities” test, and the most significant factor to be considered is whether the person to whom service is rendered (the employer or principal) has control or the right to control the worker both as to the work done and the manner and means in which it is performed. Additional factors that may be considered depending on the issue involved are: whether the person performing services is engaged in an occupation or business distinct from that of the principal; who supplies the instrumentalities, tools, and place for the work; if a special skill is involved; the amount of supervision required; the method of payment; etc. Again, the initial presumption is that the worker is an employee.

When Does AB 5 Come into Effect?

Beginning on January 1, 2020, the ABC test will apply for purposes of the Unemployment Insurance Code and all other provisions of the Labor Code not “relating to the wage orders.” Beginning on July 1, 2020, *Dynamex* and the ABC test will apply for purposes of workers’ compensation.

Also noteworthy, to the extent that an employer is currently facing a claim for misclassification and application of the exemptions would relieve it from liability, the new law applies retroactively.

Moreover, employers who took the conservative route and reclassified their workers to meet the requirements of the *Dynamex* holding may be disappointed to learn that AB 5 built in a prohibition from reclassifying a possibly exempt worker back to independent contractor status. Specifically, the new law prohibits an employer from “reclassify[ing] an individual who was an employee on January 1, 2019, to an independent contractor due to this measure’s enactment.” How this is to be interpreted and enforced remains to be determined.

What is Next?

As of now, the exemptions in AB 5 leave out large sectors of the economy that will be subjected to meeting the ABC test in AB 5 unless further action comes to pass.

Enforcement will come from many directions, including the typical claims by state agencies and private causes of action. Additionally, AB 5 specifically provides for an action for injunctive relief to prevent continued misclassification by the Attorney General or a city attorney in certain jurisdictions.

What is certain is this complicated framework will be subject to additional challenges and scrutiny from all directions.



Dawn M. Knepper is a Shareholder in Buchalter’s Labor & Employment Practice Group. She can be reached at dknepper@buchalter.com or (949) 224-6258.

This alert is published as a service to our clients and friends. The material contained here is provided for informational purposes only and is not intended to constitute advertising, solicitation or legal advice. The views expressed herein are solely those of the authors and do not necessarily reflect the views of Buchalter or its clients. For more information, visit www.buchalter.com.