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AB 5:

The Legislature's Solution to Solving Your Questions on the Proper Use of Independent Contractors

Presented By

Paul Bressan

pbressan@buchalter.com

949.244.6232

Dawn M. Knepper

dknepper@buchalter.com

949.244.6258



- Review of AB 5 including review of the ABC test of *Dynamex*, and the alternative test from *Borello*
- Analysis of the exemptions provided by AB 5
- Multi-jurisdictional issues
- Implications for specific industries
- Actions since the issuance of the decision
- Potential exposure associated with a misclassification determination
- Avoiding misclassification claims



Independent Contractors in CA – Buchalter

A Moving Target

- On September 17, 2019, Governor Newsom signed Assembly Bill (“AB”) 5 into law, which codified the ABC test enunciated in the California Supreme Court decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018)
- *Dynamex* changed the landscape on the use of an independent contractor

A Moving Target

- *Dynamex* was limited in scope to the Wage Orders issued by the Industrial Welfare Commission
 - For most businesses, that relates to meal/rest breaks, minimum wage, and overtime
- Left open questions on an employer’s obligations for other rights and benefits of employment like unemployment and disability insurance, and reimbursement of workers’ business expenses
- The *Dynamex* Court expressly rejected the use of the “multi-factor” test outlined in *S.G. Borello & Sons v. Superior Court of Los Angeles*, which focused on control by the hiring entity

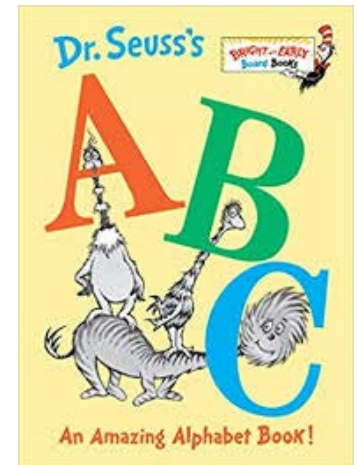


AB 5 - The Big Picture

- There is a presumption that a person providing labor or services for remuneration is an employee rather than an independent contractor
- Generally adopts the ABC test for the Labor Code (including the Worker’s Compensation Act), Unemployment Insurance Code, and for the Wage Orders of the IWC, unless an exemption applies
 - Multiple exemptions exist, may have additional statutory provisions to meet and/or conditions AND
 - The relationship with the worker must satisfy all of the *Borello* requirements



- The hiring entity has the burden to establish that a worker is an independent contractor and not an employee
- To meet this burden, the hiring entity must establish each of the three factors embodied in the ABC test:
 - 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; and
 - 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 by the worker



- Is your worker the cake decorator or the plumber?



Factor “A”

- How much control?
- What is “free from the control”?
- Actual control versus right to control
- How broad is the term “performance”?



Factor “B”

- What is the “usual course” of business?
- Who determines what that is?
- Is it enough to physically work outside of the company’s usual place of business?
 - Is that going to be required?

Factor “C”

- What is “customarily engaged”?
- Individual versus another entity
- What is meant by “independently established”?

- Does an exemption apply?
 - Specific occupations such as licensed professionals like physicians and surgeons, 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;
 - Certain motor club relationships!



under AB 5

- A physician and surgeon, dentist, podiatrist, psychologist, or veterinarian licensed by the State of California pursuant to Division 2 (commencing with Section 500) of the Business and Professions Code, performing professional or medical services provided to or by a health care entity, including an entity organized as a sole proprietorship, partnership, or professional corporation as defined in Section 13401 of the Corporations Code
- Does not apply to licensees governed by CBA

under AB 5

- An individual who holds an active license from the State of California and is practicing one of the following recognized professions: lawyer, architect, engineer, private investigator, or accountant
- A real estate licensee, if certain factors are met

under AB 5

- A direct sales salesperson as described in Section 650 of the Unemployment Insurance Code, so long as the conditions for exclusion from employment under that section are met

under AB 5

- A contract for “professional services” – including certain kinds of marketing, HR, travel agents, graphic artists, still photographers, and writers
- Also licensed esthetician, licensed electrologist, licensed manicurist, licensed barber, or licensed cosmetologist
- **Certain factors apply to each!**

under AB 5

- Additionally, the contract for “professional services” must satisfy all of these factors:
 - A. The individual maintains a business location, which may include the individual’s residence, that is separate from the hiring entity. Nothing in this subdivision prohibits an individual from choosing to perform services at the location of the hiring entity.
 - B. If work is performed more than six months after the effective date of this section, the individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession.
 - C. The individual has the ability to set or negotiate their own rates for the services performed.
 - D. Outside of project completion dates and reasonable business hours, the individual has the ability to set the individual’s own hours.
 - E. The individual is customarily engaged in the same type of work performed under contract with another hiring entity or holds themselves out to other potential customers as available to perform the same type of work.
 - F. The individual customarily and regularly exercises discretion and independent judgment in the performance of the services.

under AB 5

- Bona fide business-to-business contracting relationship
 - A business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation (“business service provider”) contracts to provide services to another such business (“contracting business”)
 - Must satisfy multiple factors

Even if an Exemption Applies, Next Consider *Borello*

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- The test adopted in *Borello* is known as the “multi-factor” or “economic realities” test
- First, 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:

1. Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
2. Whether or not the work is a part of the regular business of the principal or alleged employer;
3. Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
4. The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers;
5. Whether the service rendered requires a special skill;

6. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
7. The alleged employee's opportunity for profit or loss depending on his or her managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job; and
11. Whether or not the parties believe they are creating an employer-employee relationship may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

Additional Considerations on Buchalter

The IC Relationship

- Factors that are NOT determinative:
 - Existence of a written agreement purporting to establish an independent contractor
 - The fact that the worker is issued a 1099 form rather than a W-2



- AB 5 generally comes into effect on January 1, 2020
- The worker's compensation provisions comes into effect July 1, 2020
- To the extent an employer is currently facing a claim for misclassification and application of the exemptions would relieve it from liability, AB 5 applies retroactively
- If you reclassified, keep in mind that AB 5 does not permit an employer to reclassify an individual who was an employee on January 1, 2019, to an independent contractor due to the bill's enactment



- Businesses based in California using independent contractors located out of state
- Businesses based out of California using independent contractors located in California



Implications for specific industries

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- Challenges made by the gig economy



- Additional guidance from the CA Supreme Court is to come on retroactivity
- Filings since *Dynamex*



- Unpaid wages and overtime
 - Possible arguments for exempt status
- Liquidated damages
- Interest
- Attorneys' fees and costs
- Penalties for violation of federal and state labor laws (such as missed meal periods/rest breaks)
- Penalties for failure to pay applicable federal, state and local taxes



- Cost of litigation
- Potential PAGA claims, class actions, and audits
- Media exposure



- LC Section 226.8 makes it unlawful to willfully misclassify an individual as an independent contractor
- Stiff penalties attach to such violations
 - pattern and practice violation civil penalties of not less than \$10,000, and not more than \$25,000 for each violation
 - any other penalties or fines the law permits
- Potential individual liability – officers and directors of a company may be found personally liable for misclassification claims under LC section 558.1



Other considerations *cont'd* Buchalter

- Reclassifying a contractor as an employee may raise questions as to whether the worker was properly classified in the first instance, and in some instances result in legal action



1. Ensure that HR and decision-makers understand, through training or otherwise, how to properly classify workers
2. Review form contracts used with contractors
3. Remember, the contract's language will not ultimately determine independent contractor status
4. Take disputes with contractors seriously whether in a private action or before the EDD, DLSE, IRS, etc.

Questions?

THANK YOU!

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