AB 5 Independent Contractor Law

Industry Carveouts Impractical; Workers Need Flexible, Holistic Approach

AB (Gonzalez; D-San Diego) was signed by Governor Gavin Newsom on September 18, 2019. The bill codified the California Supreme Court decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles (Dynamex)*, and extended the application of *Dynamex* to several additional California employment laws while creating industry-specific exemptions. Upon signing the bill, Governor Newsom, as well as its author and the proponents (mainly labor unions), indicated there was more work to be done on this issue and that additional legislation would be expected in 2020.

There was indeed some additional legislation in 2020 to address AB 5 — AB 2257 (Gonzalez; D-San Diego), which added even more exemptions and made some clarifications to the business-to-business exemption. In 2021, no further exemptions were approved, leaving those industries that did not receive an exemption questioning how to comply with the rigid ABC test created by the *Dynamex* decision and AB 5.

BACKGROUND

Before *Dynamex*, California courts and state agencies had long applied what is known as the *Borello* test for determining whether a worker was an independent contractor or employee for labor and employment purposes. (*S.G. Borello & Sons, Inc. v Dept. of Industrial Relations* (1989) 48 Cal.3d 341). This flexible, multi-factor approach looked primarily at whether the hiring entity had a "right to control" the manner in which the worker performed the contracted service.

Per *Dynamex*, and now AB 5, a worker is presumed to be an employee unless the hiring entity establishes all three of the following conditions:

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.

Because of the rigidity of the ABC test — specifically factors "B" and "C" — most individuals who control their own schedule, control the projects or tasks that they take on, and control the way in which they perform the tasks or projects, will likely lose existing contracts and work opportunities. The reason is that if the worker performs work which is similar to that of the business entity retaining the worker's services and/or is not in an independent business or trade of the same work being performed, the workers will now be classified as an employee per the ABC test.

Although the *Dynamex* ruling applied only to California's Wage Orders and therefore was limited to minimum wage, overtime, and meal period and rest break liabilities, AB 5 is more expansive. Per AB 5, misclassified workers also are eligible for workers' compensation coverage, unemployment insurance, leave mandates under the Labor Code, and various other benefits. Additionally, because hundreds of thousands of workers will now be considered employees, those workers may assert their civil rights protections and potentially the ability to unionize.

2020 PUSH FOR ADDITIONAL EXEMPTIONS

AB 5 as enacted in 2019 exempted certain occupations from the ABC test, clarifying that *Borello* would apply instead. Those exemptions included, but were not limited to:

CalChamber

Agenda for California Recovery

2022 Business Issues and Legislative Guide

See the entire CalChamber 2022 Business Issues and Legislative Guide at www.calchamber.com/businessissues
Free PDF or epub available to download.

Special Thanks to the Sponsors
Of the 2022 Business Issues and Legislative Guide

Major

AUTOMOBILE CLUB • SOUTHERN CALIFORNIA • AAA

Silver

CSAA Insurance Group,
a AAA Insurer

• Persons or organizations licensed by the Department of Insurance.

• Doctors, surgeons, dentists, podiatrists, psychologists and veterinarians.

• Lawyers, architects, engineers, private investigators and accountants.

• Securities broker-dealers and investment advisers.

• Direct salespersons.

• Specified commercial fishermen.

• Specified newspaper carriers and distributors.

Other Industries

Other industries were exempted under the professional services contract exemption. For these industries, workers are exempt only if specific criteria are met. These industries include: human resources administrators; travel agents; marketers; graphic designers, grant writers, fine artists, payment processing agents, enrolled agents licensed by the U.S. Treasury, certain photographers or photojournalists, certain freelance writers, editors and newspaper cartoonists.

Other professional exemptions carry additional conditions. For example, estheticians, electrologists, manicurists, barbers and cosmetologists are exempt, but only if they set their own rates, are paid directly by clients, schedule their own appointments, and follow several other requirements more akin to independent workers than employees.

AB 5 also provided specific exemptions and requirements for a real estate licensee, repossession agency, those subcontracting in the construction industry, construction trucking industry, referral agency relationships, and a motor club exemption.

BUSINESS-TO-BUSINESS EXEMPTION

AB 5 and AB 2257 include a limited exemption for business-to-business relationships. It exempts from the ABC test "bona fide business-to-business contracting relationships" where a contractor "acting as a sole proprietor, or a business entity formed as a partnership, limited liability company, limited liability partnership or corporation contracts to provide services to another such business."

Twelve separate criteria must *all* be satisfied, including that the service provider is free from control of the contracting entity, they provide services directly to the contracting entity rather than its customers, the contractor sets its own hours and location of work, and the contractor is customarily engaged in an independent established business of the same nature as the work being performed.

The exemption is difficult to satisfy. Businesses like health care providers often contract with other businesses to provide services directly to customers or patients. A business hiring for a service realistically must have some control over the hours and location of the work — a contractor cannot just show up at midnight or not be held to any standards. Further, it is not always possible to have a contractor bring their own tools. Industries like construction or medical care necessarily utilize large and expensive machinery that are stationary. Unlike under *Borello*, where there was a balancing of factors and flexibility that took these issues into account, the rigidity of the 12 criteria usurps the joint employer analysis, allowing employees of a vendor to claim they are employees of the contracting business based on the ABC test, or even allowing the owner of a separate business to claim the owner is actually an employee of the hiring entity under the ABC test.

By February 2020, more than **30 bills** were introduced to add a myriad of exemptions to the ABC test. The result was the enactment of AB 2257, which added exemptions and made changes to the already-existing exemptions. As a result of the adoption of AB 2257, there now are 109 exemptions to the ABC test, each with unique criteria. The exemptions added by AB 2257 include:

• Recording artists, songwriters, composers, musicians, vocalists, and other music industry occupations (although there are certain limits on musicians; for example, they are not exempt if they are part of a symphony headlining in a large venue seating more than 1,500 attendees).

• Cartographers, content contributors, specialized performers, home inspectors, narrators.

• Inspectors for insurance underwriting.

• Comedians, magicians, and other similar performers.

• Manufactured housing salespersons.

• Certain animal services workers.

• Competition judges.

• Licensed landscape architects.

• Youth sports coaches.

• Wedding and event planners.

• Interpreters.

2021 LEGISLATIVE SESSION MAKES CLEAR THAT EXEMPTIONS ARE SET IN STONE

Compared to the more than 30 AB 5-related bills introduced by February 2020, only a handful were introduced in 2021. AB 231 (Nguyen; R-Fountain Valley) sought to make the exemption for licensed manicurists permanent and AB 1506 (Kalra; D-San Jose) sought to extend the exemption for newspaper carriers to

2025. Both bills eventually were condensed into a bill by the Assembly Committee on Labor and Employment, AB 1561, but the committee was willing only to extend the manicurist exemption from January 1, 2023, to January 1, 2025. In exchange for extending the newspaper carrier exemption to 2025, the bill requires every newspaper publisher or distributer to submit a report to the Labor and Workforce Development Agency detailing the number of carriers, their average wage rates, and the number of wage claims filed. SB 805 (Susan Rubio; D-Baldwin Park), which was vetoed by the Governor, would have exempted nonprofit performing arts organizations over a certain profitability margin from AB 5.

RETROACTIVITY

AB 5 itself is not retroactive (*See Myers v. Philip Morris Cos., Inc.,* 28 Cal. 4th 828, 844 (2002); *Quarry v. Doe I*, 53 Cal.4th 945, 955 (2012)), but it does provide differing retroactive and prospective applications in certain areas. AB 5 is prospective for violations of the Labor and Unemployment Insurance codes (beginning January 1, 2020) and for violations of workers' compensation (beginning July 1, 2020) (except for Labor Code violations "related to wage orders." *See* AB 5).

However, AB 5 explicitly states that the industry exemptions apply retroactively "to the maximum extent permitted by law," ensuring specific industry carveouts. The bill also states that it does not change, "but is declaratory of, existing law" with regard to the IWC Wage Orders and "violations of the Labor Code *relating* to wage orders." (*Note*: It is unclear which Labor Code sections are "related" to the wage orders. However, in a May 2019 opinion letter, the Division of Labor Standards Enforcement explained that it would be appropriate to apply the ABC test to any claim, including Labor Code violations, that rest on an employer's obligations under a wage order, including minimum wage, overtime, reporting time pay, recordkeeping violations, meal and rest periods, and others.)

On January 14, 2021, the California Supreme Court dealt a blow to employers in *Vazquez v. Jan-Pro Franchising International, Inc.*, when it held that *Dynamex* is retroactive. The court held it was retroactive because the decision did not change any "settled rule" about what test applied to the Wage Orders and doing so is not "improper or unfair" to employers. The court explicitly rejected Jan Pro's argument that *Dynamex* should not be retroactive because it and others had reasonably relied on *Borello* in determining how to classify its workers, reasoning that employers had no reasonable basis for relying on *Borello* for Wage Order claims and claiming that *Dynamex* was not a "sharp" departure from the basic approach of *Borello*.

Even if the court is technically correct that *Borello* was not a Wage Order case, the court's decision unfortunately did not reflect reality. Employers relied on the Labor Commissioner's use of *Borello* in misclassification cases for years when determining how to classify their workforce. Those employers may now face lawsuits for their good faith efforts to comply with the state's guidance. Worse, the decision opens businesses to millions of dollars of exposure that will largely go to plaintiffs' attorneys. The court's *Vazquez* opinion states *Dynamex* applies retroactively to all cases "not yet final" as of April 30, 2018. Most claims for unpaid wages under the California Labor Code carry a three-year statute of limitations that can be extended to four years as long as the plaintiff also includes a claim under California's Unfair Competition Law — not to mention the penalties that can be added to those claims under both the Labor Code and the Private Attorneys General Act. A business that relied in good faith on *Borello* can now be liable for not following the ABC test before the *Dynamex* decision was ever issued.

COURT CASES POSE CHALLENGES FOR EMPLOYERS

In 2020, 58% of voters passed Proposition 22, which enacted a hybrid model of independent contractors and employees for app-based drivers. The proposition provided workers with flexibility to select their own schedule, work for other companies, and determine their own assignments while guaranteeing a minimum wage and providing health care subsidies, among other benefits.

Opponents of the proposition sued, arguing the initiative is unconstitutional. The plaintiffs filed their lawsuit in Alameda County, which has a reputation as a pro-plaintiff court. In August 2021, the judge held that Proposition 22 was unconstitutional. The three primary reasons for the ruling were that by exempting the workers from the workers' compensation system, the measure prevents state lawmakers from implementing a workers' compensation system for the workers; the amendment procedures provided for in the initiative unconstitutionally limited the Legislature's power to pass related legislation that does not constitute an "amendment"; and that it violated the "single subject" rule by which initiatives must abide. The appeals process will take several months, and observers expect the losing side to take the issue back up to the California Supreme Court, so this case likely will not be resolved until late 2022 or possibly 2023.

A similar blow was dealt to the trucking industry by the federal U.S. Ninth Circuit Court of Appeals in April 2021. Several years ago, a trial court granted a preliminary injunction blocking the state from enforcing AB 5 against motor carriers. The state appealed, taking the issue to the Ninth Circuit. The appeals court reversed the trial court ruling, holding that AB 5 was not preempted by the Federal Aviation Administration Authorization Act. The California Trucking Association filed a petition asking the U.S. Supreme Court to review the case. The Supreme Court recently invited the Solicitor General to file a brief in the case. It has not yet determined whether it will hear the case.

CALCHAMBER POSITION

While the California Chamber of Commerce appreciates the recognition in AB 5 that the *Dynamex* decision is not one-size-fits-all and agrees that there must be some exemptions, the law's industry carveout approach is unfair and impractical. That is made evident by the fact that there now are more than 100 one-off exemptions. Carveouts should be available for workers who meet certain criteria, such as the ability to set their own schedules, choose whether to take assignments, and negotiate their own rates. Flexibility is necessary to recover from the financial devastation of COVID-19, and as demonstrated by voters with Proposition 22, the current workforce values flexibility. What's needed is a more flexible and holistic approach to applying *Dynamex* that reflects today's modern workforce.

Staff Contact
Ashley Hoffman
Policy Advocate

ashley.hoffman@calchamber.com
January 2022