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Impact of AB5 on Independent Contractor Status in California: *Dynamex* becomes law, but the devil is in the details

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On September 18, 2019, California Governor Gavin Newsom signed Assembly Bill 5 ("AB5"), which modifies the California Labor Code to adopt the California Supreme Court's recent worker-friendly test for determining whether workers are properly classified as independent contractors. The bill, which was strongly backed by organized labor, seeks to adopt the more-stringent test for worker classification and provide some legislative clarity on its application across the Labor Code. But the bill is a mixed bag that also contains a panoply of exceptions and carve-outs that will provide relief for certain California businesses. As is often the case with California employment legislation, the devil is in the details.

California Supreme Court recently adopted broad, worker-friendly test

In April 2018, the California Supreme Court dramatically revised the test for whether workers should be classified as employees or independent contractors, overturning nearly 30 years of precedent. In *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, the court changed the way California businesses approach the use of independent contractors as part of their workforces, and made it more difficult for workers to maintain an independent contractor relationship with California businesses.[1]

Before *Dynamex*, the multi-factor test for whether a worker was properly classified as an independent contractor focused primarily on the level of control the business exercised over the worker. This test was adopted by the California Supreme Court in 1989 in the matter of *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*. *Dynamex* replaced this test with a three-factor "ABC" test. The ABC test is a rigid, worker-friendly test for determining whether workers are properly classified as independent contractors.

The ABC test presumes that all workers are employees, unless the business can demonstrate that all of the following factors are met: (A) The worker is free from the control and direction of the hirer

[1] See our alert, "California Supreme Court raises the bar for workers to be classified as independent contractors: what employers need to know," May 08, 2018, available here.

in connection with the performance of the work; (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 for the hiring entity. The burden is on the hiring entity to prove that the worker meets all three elements of the test. Failure to meet even one element will result in a finding that the worker should be classified as an employee.

AB5 codifies the ABC test, but only applies it to certain business relationships and industries

The text of AB5 is lengthy, but it essentially (1) adopts the *Dynamex* ABC test as the generally applicable test for California employers, and (2) specifically exempts certain occupations and business relationships from the ABC test, providing that the less-stringent *Borello* test will continue to apply to those industries under certain conditions.

Where the ABC test should apply, the legislature adopted the Supreme Court's language, setting forth the ABC test verbatim. Additionally, although *Dynamex* previously imposed the ABC test on worker classification under the California Industrial Welfare Commission ("IWC") Wage Orders, AB5 makes clear that the *Dynamex* test should apply beyond the wage orders to all provisions of the California Labor Code and the Unemployment Insurance Code.

However, if a California worker falls into one of the following categories, the business relationships will continue to be governed by the less-stringent, multi-factor *Borello* test, in certain circumstances:

1. Workers working as insurance agents, surplus line brokers, analysts, physicians, dentists, podiatrists, psychologists, veterinarians, lawyers, architects, engineers, private investigators, accountants, direct sales salespersons, securities broker-dealers, investment advisors, commercial fishermen, or certain newspaper carriers.

2. Real estate licensees and repossession agencies.

3. Contracts for professional services between a hiring entity and an individual providing professional services that meet a number of criteria. This includes, in certain circumstances, the services provided by a human resources administrator, travel agent, graphic designer, grant writer, fine artist, payment processing agent, photographer, photojournalist, freelance writer, freelance editor, freelance newspaper cartoonist, esthetician, electrologist, manicurist, barber, or cosmetologist.

4. Relationships between a contractor and an individual performing work pursuant to a subcontract in the construction industry that meet certain criteria.

5. Relationships between a referral agency and a service provider that uses the referral agency to connect with clients that meet certain criteria.

6. Motor club services.

7. Bona fide business-to-business contracting relationships that meet certain criteria, including that both the contracting business and the vendor business must be a "sole proprietorship, partnership, limited liability company, limited liability partnership, or

corporation" and not "an individual worker . . . who performs labor or services for a contracting business."

Many of these exceptions, particularly the occupational exceptions, will provide relief to some California businesses that regularly rely on "bona fide" independent contractor relationships. It must be emphasized, however, that the many of these exceptions **only apply for limited engagements or where certain additional criteria are met**. Also, the specific criteria that must be met may be different for different occupations and industries. Therefore, even businesses that fall under an exception may have to consider reviewing the structure of their relationships with independent contractors and monitoring the scope of their engagements.

Is AB5 retroactive?

In *Dynamex*, the California Supreme Court left open the question of whether ABC test should be applied retroactively. Recently, the Ninth Circuit Court of Appeals referred this question to the California Supreme Court. California businesses are still awaiting that decision.

For its part, the legislature included text in AB5 that makes *Dynamex* retroactive for IWC wage orders and violations of the Labor Code "relating to wage orders." However, it remains unclear what Labor Code violations are sufficiently related to the wage orders to invoke the retroactive application of *Dynamex*.

AB 5 further provides that:

- The *Borello* exceptions apply retroactively to the maximum extent permitted by law, to the extent that the exceptions would relieve a California business from liability.
- On January 1, 2020, *Dynamex* will apply for purposes of the Unemployment Insurance Code and all other provisions of the Labor Code.
- On July 1, 2020, *Dynamex* will apply for purposes of workers' compensation.

Additional considerations for California businesses

If one of the *Borello* exceptions does not apply, then California businesses must still be particularly wary of the second prong of the ABC test. Arguably the most-consequential factor of the ABC test, prong (B) requires that the worker perform work that is outside the usual course of the employer's business. In *Dynamex*, the Supreme Court noted that the ABC test will not transform a retail store's hiring of an outside plumber or electrician into an employee, because the services of the plumber or electrician are not part of the store's usual course of business. On the other hand, prong (B) presents much more of a challenge for companies that rely heavily on outside labor contractors whose business operations align with the work of the contractors, such as those in technology and other emerging markets (including the on-demand gig economy) and businesses that generally rely on contractors to supplement their traditional workforces.

Prong (B) has essentially forced ride-share app-based companies like Uber and Lyft to resort to adopting the argument that they could pass the ABC test because they are not cab companies, but rather are technology companies that merely provide applications that connect drivers to passengers. While this argument has not yet been fully tested through the court system, it is unclear whether California trial and appellate courts will find this logic convincing.

That said, AB5 does provide clarity and peace of mind to California business relationships that fall under one of the law's B*orello* exceptions. Freelance writers, aestheticians, and others can breathe a sigh of relief knowing that the less-stringent multi-factor control test applies, and not *Dynamex* and its devilish prong (B).

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