

AB 5: Changing the Landscape for Independent Contractor Analysis

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By **Galit A. Knotz and Katherine A. Roberts** | September 19, 2019 at 04:10 PM

On Sept. 19, Gov. Gavin Newsom signed into law Assembly Bill 5 (AB 5), a sweeping new law that makes it significantly more difficult for most workers in the state to qualify as independent contractors. With the governor's approval, the California Legislature has once again enacted a law that imposes significant changes on companies without providing much of a roadmap for compliance. The law takes effect on Jan. 1, 2020.

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What AB 5 Does

AB 5 codifies the *Dynamex Operations West v. Superior Court of Los Angeles (Dynamex)* case, decided by the California Supreme Court in April 2018. In that case, the court abandoned the 20-year-old test for independent contractors set forth in *Borello & Sons v. Department of Industrial Relations (Borello)*. The *Borello* test considered many factors related to the amount of control an employer exerted over a purported independent contractor, none of which was determinative on its own.

In, *Dynamex*, the court embraced a standard that presumes workers are employees rather than independent contractors, unless the hiring entity can show that the workers meet all three prongs of the so-called "ABC test," and thus can qualify for independent contractor status. The "ABC" requirements are that:

- (A) The hiring entity does not control or direct the performance of work;
- (B) The person performs work outside the usual course of the hiring entity's business; and
- (C) The person is customarily engaged in an independently established trade, occupation or business.

If the hiring entity cannot meet the ABC test, the worker is considered an employee and thus may be eligible for a slew of rights and benefits previously unavailable to them, including minimum wage, overtime pay, and meal and rest breaks, among other protections under the Labor Code; employee

benefits such as health benefits, stock options and 401k; coverage under the employer's workers' compensation, unemployment and disability insurance; and eligibility for paid sick days and paid family leave.

Who Is Exempt From AB 5 and What Does That Mean?

AB 5 contains exemptions for a wide variety of professions, including certain health and other licensed professionals, broker-dealers, direct salespeople and commercial fishermen.

It is important to note, however, that exempt occupations are not automatically "safe" in their independent contractor status. Rather, workers in exempt occupations get the benefit of using the more lenient *Borello* standard instead of the *Dynamex* ABC test.

AB 5 also includes a list of additional exemptions that have their own factors which must be established in order for the ABC test not to apply (presumably in addition to meeting the test under *Borello*). By way of example, AB 5 exempts workers in enumerated "professional services," if the hiring entity can demonstrate that it meets all of the following factors:

- The individual maintains a business location separate from the hiring entity;
- The individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession (provided such work occurs six months after Jan. 1, 2020);
- The individual has the ability to set or negotiate their own rates for the services performed;
- Outside of project completion dates and reasonable business hours, the individual has the ability to set the individual's own hours;
- 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; and
- The individual customarily and regularly exercises discretion and independent judgment in the performance of the services.

The "professional services" exemption includes a host of jobs and industries—which themselves are subject to exceptions—including, in broad terms, marketer, human resource administrator, graphic designer, grant writer, fine artist, photojournalist, freelance writer, editor or newspaper cartoonist, licensed esthetician, licensed electrologist, licensed manicurist, licensed barber and licensed cosmetologist. As noted above, there are additional exemptions subject to their own list of factors, including for businesses that are formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation; some construction industry occupations; and "the relationship between a referral agency and a service provider" (where a "referral agency" is a business that connects clients with service providers that provide graphic design, photography, tutoring, event planning, minor home repair, moving, home cleaning, errands, furniture assembly, animal services, dog walking, dog grooming, web design, picture hanging, pool cleaning or yard cleanup).

Notably absent from all the enumerated exemptions are workers from the entertainment, ridesharing/delivery and trucking industries, among others.

Further, AB 5 allows courts to apply the more flexible *Borello* test "based on grounds other than an express exception to employment status." That test is centered on the hiring entity's control over the work at issue, including the manner in which is performed. But the bill provides no guidance on when such application would be appropriate, and thus potentially opens the door for litigation in the face of what may otherwise appear to be a law that aims to provide clarity.

Without question, AB 5 changes the landscape for companies that utilize independent contractors in California. But it also opens the door to misinterpretation, uncertainty and further litigation. Thus, the quick takeaways for employers are as follows:

- No position or industry in California is statutorily authorized to use independent contractors—thus every hiring entity must continue to review its classification. The only question is, which test applies?
- Even though AB 5 has now been signed into law, there is reason to believe that the law is still in flux. For example, the state legislature passed Assembly Bill 170 (AB 170) on Sept. 14, giving newspaper publishers until Jan. 1, 2021, to reclassify their delivery drivers from contractors to employees. Many believe this recent bill, which is considered a companion piece to AB 5, demonstrates that the full reach of AB 5 has not been finalized just yet, as many industries continue to push for more exemptions through more companion bills or emergency legislation.
- AB 5 is not likely to provide the clarity it purports to bring: several of the exemptions are unclear; the judicial mandate for circumventing the application of *Dynamex* will undoubtedly generate litigation; and several industries have openly vowed to challenge the bill through ballot initiatives.

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