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## *With the Enactment of AB 5, Many Independent Contractors Will Become Employees*

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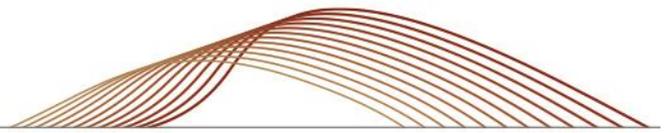
As expected, Governor Newsom has signed AB 5, which will mandate the reclassification of many independent contractors into employees under California law. AB 5 both codifies and expands the state Supreme Court's decision in [Dynamex Operations West, Inc. v. Superior Court](#), 4 Cal. 5th 903 (2018), which adopted a much simpler and more pro-employment test. But AB 5 also makes exceptions to the law for numerous occupations. Unfortunately for many gig-economy companies, those exceptions do not include them. However, AB 5 may not be the last word on the subject. Additional amendments to the law will be sought next year. Governor Newsom's signing message announces that he intends to convene a meeting of the Legislature, the labor movement and the business community to discuss further changes to the law, which could include recognizing collective-bargaining rights for gig-economy workers, perhaps in return for some relief from the law. In the meantime, leading gig-economy companies have promised a voter proposition on the November 2020 ballot to exempt their industry.

As written, AB 5 will go into effect on January 1, 2020. Here's what California companies need to know about the law.

### **Dynamex**

In [Dynamex](#), the California Supreme Court up-ended decades of jurisprudence and regulatory guidance on the criteria for when a worker should be deemed an independent contractor, rather than an employee. Previously, the prevailing authority was [S. G. Borello & Sons, Inc. v. Department of Industrial Relations](#), 48 Cal. 3d 341 (1989). Under [Borello](#), a court considered various factors in deciding whether a worker qualified as an independent contractor, with the right to control how the worker performed the work being the most important. Defendants often won the classification battle under [Borello](#). A notable example is [Lawson v. Grubhub, Inc.](#), 302 F. Supp. 3d 1071 (N.D. Cal. 2018), where Grubhub—a gig-economy company—defeated a driver's claim of misclassification under the [Borello](#) test.

However, in [Dynamex](#), the Supreme Court decided that the [Borello](#) test was not the correct standard for claims based on the California Wage Orders, which govern such employee entitlements as minimum wage, overtime wages and meal and rest periods. Instead, the court adopted the simpler and more pro-employment ABC test, which is used in a few other U.S. jurisdictions. Under the ABC test, a worker is presumed to be an employee, and to rebut that presumption the hiring entity must prove [all three](#) of the following:



- 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.
- B. The worker performs work that is outside the usual course of the hiring entity's business.
- C. The worker 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 makes it much more difficult for a company to establish a worker is an independent contractor. In particular, part B presents a difficult—perhaps insurmountable—obstacle to independent contractor status when companies use independent contractors to carry out their business.

## **AB 5**

In response to Dynamex, bills were introduced in the California Legislature to codify the decision, expand upon it, and/or overturn it. After (and in some instances despite) intense lobbying by organized labor, gig-economy companies and other interests, AB 5 prevailed, albeit with significant amendments. Governor Newsom, who reportedly was hoping for a compromise that would take into account the new world of gig-economy companies, announced his support for the bill on Labor Day, which more or less sealed the deal. After final passage by the Legislature, Governor Newsom signed the bill, which is effective on January 1, 2020, along with AB 170, which adds a limited exemption for newspaper carriers as discussed below.

AB 5 both expands and narrows the Dynamex ruling. It expands Dynamex by applying the ABC test beyond the Wage Orders to include the California Labor Code (which includes such matters as expense reimbursement, wage statements and workers' compensation) and the Unemployment Insurance Code. But it also narrows Dynamex by creating numerous exemptions from the ABC test, which are listed below. However, that does not mean workers in those exemptions are necessarily independent contractors. Their independent-contractor/employee status will be decided—for the most part—under the Borello test, which means some workers will be found to be correctly classified as independent contractors, while others will be found to be incorrectly classified and entitled to employment status and the wages and benefits that come with it.

Workers found to be misclassified as independent contractors can seek a variety of remedies, including unpaid minimum and overtime wages, premiums for missing or non-compliant meal and rest periods, reimbursement of expenses, penalties for non-compliant wage statements, civil penalties under the Labor Code Private Attorneys General Act ("PAGA") for Labor Code violations, workers' compensation benefits, unemployment insurance, paid sick leave, and family and medical leave. Injunctive relief can be sought by the Attorney General and certain city attorneys or prosecutors to prevent continued misclassification. (Private litigants also may try to sue for injunctive relief, as an Uber driver already has done in the wake of AB 5's passage.)

## **Exemptions under AB 5**

As amended before passage, the following occupations and contractual relationships are exempt from the ABC test (which means worker classification will be decided for the most part under the Borello test):



## Specific Occupations

- Licensed insurance professionals.
- Licensed physician and surgeons, dentists, podiatrists, psychologists, and veterinarians performing professional or medical services provided to or by a health-care entity.
- Licensed and practicing lawyers, architects, engineers, private investigators, and accountants.
- Registered securities broker-dealers and investment advisors.
- Direct-sales salespeople.
- Commercial fishermen working on an American vessel (until January 1, 2023, unless extended).
- Newspaper distributors working under contract with a newspaper publisher, and newspaper carriers working under contract, either with a newspaper publisher or newspaper distributor (until January 1, 2021, unless extended).

## Certain contracts for "professional services"

- All of the following conditions must be satisfied:
  - the individual providing the services maintains his/her own business location;
  - the individual has a business license (in addition to any required professional license);
  - the individual has the ability to set and negotiate rates;
  - the individual has the ability to set his or her own hours (aside from requirements regarding project completion date and reasonable business hours);
  - the individual is customarily engaged in the same type of work under contracts with others or holds himself or herself out to others as available to perform the same work; and
  - the individual customarily and regularly exercises discretion and independent judgment.
- "Professional services" include:
  - Marketing work that is original and creative and depends on the invention, imagination or talent of the individual.
  - Human-resources administrator work that is intellectual and varied in character.
  - Certain travel agent work.
  - Graphic design work.
  - Grant writer work.



- Fine artist work.
- Work by an enrolled agent licensed to practice before the IRS.
- Work by a still photographer or photojournalist (up to 35 submissions per year).
  - This section does not apply to an individual who works on motion pictures, which includes, but is not limited to, projects produced for theatrical, television, internet streaming for any device, commercial productions, broadcast news, music videos, and live shows, whether distributed live or recorded for later broadcast, regardless of the distribution platform.
- Work by a freelance writer, editor, or newspaper cartoonist (up to 35 submissions per year).
- Work by a licensed esthetician, licensed electrologist, licensed manicurist (until January 1, 2022), licensed barber, or licensed cosmetologist, provided that the individual:
  - sets his or her own rates, processes his or her own payments and is paid directly by clients;
  - sets his or her own hours of work and can choose his or her clients;
  - has his or her own book of business and schedules his or her own appointments;
  - maintains his or her own business license; and
  - when work is performed at the hiring entity's location, rents space from the hiring entity.

*Bona fide business-to-business contracting relationships, under which a "business service provider" provides services to a "contracting business," provided all of the following conditions are met:*

**[Note: This does not apply to an individual worker, as opposed to a business entity, who performs labor or services for a contracting business. But the business entity can be a sole proprietorship, partnership, LLC, LLP, or corporation.]**

- the business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact;
- the business service provider is providing services directly to the contracting business, rather than to customers of the contracting business;
- the contract with the business service provider is in writing;
- the business service provider has the required business license or business tax registration;
- the business service provider maintains a business location that is separate from the business or work location of the contracting business;



- the business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed;
- the business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity;
- the business service provider advertises and holds itself out to the public as available to provide the same or similar services;
- the business service provider provides its own tools, vehicles, and equipment to perform the services;
- the business service provider can negotiate its own rates;
- the business service provider can set its own hours and location of work; and
- the business service provider is not performing the type of work for which a license from the Contractor's State License Board is required.

AB 5 also exempts the following from the ABC test:

- Certain entities regulated by the California Business and Professions Code, such as real estate licensees and repossession agencies (their classification will be determined by the test set forth in the relevant Code section).
- Contractor/subcontractor relationships in the construction industry, subject to several conditions.
- Relationships between a service provider and a referral agency, where the 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, and where the referral agency satisfied several conditions.
- Relationship between a motor club and an individual performing services pursuant to a contract between the motor club and a third party to provide motor club services using the third party's employees and vehicles.

## ***Retroactivity***

An important and unresolved issue under Dynamex was whether the California Supreme Court's adoption of the ABC test is retroactive. A panel of the U.S. Court of Appeals for the Ninth Circuit initially held that Dynamex was retroactive, but then changed its mind and decided to refer the question to the California Supreme Court. Vazquez v. Jan-Pro Franchising Int'l, 930 F.3d 1107 (9th Cir. 2019).

AB 5 says it resolves the issue. The legislation provides that, with regard to Wage Orders and violations of the Labor Code relating to Wage Orders, it is declarative of existing law (and thus, retroactive for those purposes). Presumably, the law is not retroactive to the extent it applies the ABC test beyond the Wage Orders or violations of Labor Code provisions relating to Wage Orders. The



legislation also states that, to the extent the exceptions in the various subdivisions would relieve an employer from liability, those subdivisions “shall apply retroactively to existing claims and actions to the maximum extent permitted by law.” Nevertheless, it likely will take an appellate court decision to decide for sure the retroactive effect of AB 5 (and, for that matter, Dynamex).

## **Next Steps**

Although some insist that AB 5 will be amended again, either through new legislation or a voter proposition, the bill as is takes effect on January 1, 2020, so now is the time to act. After Dynamex was decided last year, we recommended that companies revisit their use of independent contractors to see if workers should be reclassified as employees in order to comply with the law and avoid significant liability. AB 5 makes the need for that review even more crucial.



*If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:*

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