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LABOR AND EMPLOYMENT

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Risky Business: Compliance with Independent Contractor Classification Rules Just Got Even More Complicated in California and Beyond

By M. Christine Carty and Scott J. Wenner

BACKGROUND

Due to the enormous range and complexity of different state and federal laws governing workers, businesses of all sizes and in all industries often are challenged to accurately classify workers as employees or independent contractors. The confusing patchwork of laws continues to increase in complexity, as reflected by the latest developments in California and New York.

In particular, businesses with workers in California, including those headquartered in other states or overseas, must now prepare to comply with new standards for independent contractors recently adopted in Assembly Bill 5. In New York, legislators introduced the "Dependent Worker Act" in June 2019 to protect so-called "gig workers," such as Uber and Lyft drivers, by giving them the right to unionize under New York law. Although the New York proposed legislation failed, giving "gig workers" unionization rights continues to be discussed both in California and New York. **These developments emphasize the need for businesses to monitor actively the classification rules applicable to their workforce in all locations.**

NEW RULES FOR BUSINESSES WITH WORKERS IN CALIFORNIA

On September 18, 2019, California Governor Newsom signed into law controversial legislation, Assembly Bill 5, imposing new, more stringent standards on the classification of workers. As a result, classifying workers as independent contractors in California will be far more restrictive after January 1, 2020. The new law has the potential for far-reaching impact as the California Chamber of Commerce estimates that there are 3.5 million workers in California who are "misclassified" as independent contractors.

Assembly Bill 5, known as A.B. 5, transforms the test for classifying workers in California by imposing a presumption that all workers are employees and requiring that, to be classified as an independent contractor, a worker must satisfy a three-part test, called the ABC Test. Massachusetts was the first state to statutorily impose an almost identical ABC Test for wage and hour purposes. The California version of the ABC Test requires that the worker (1) be independent from the control and direction of the hiring entity in fact, (2) perform services outside the usual course of the hiring entity's business and (3) customarily engage in an independent business or trade of the same type as the worker supplies to the hiring entity. Unlike the "control test" standard for determining whether contractors are independent, which focuses on the amount of control the hiring entity exerts over the contractors, the California ABC Test includes two new and challenging requirements: proving that the contractors' services are ancillary to the main or usual business of the hiring entity and that the contractors' services are "customarily" provided to other businesses.

IMPACT OF A.B. 5

In California, improper classification of workers as independent contractors, rather than employees, may

result in liability for overtime wages, business expenses and myriad other costs, compounded by substantial penalties for violations of the Wage Orders of the California Industrial Welfare Commission ("Wage Orders") and related sections of the California Labor Code. The Wage Orders and the Labor Code together impose exacting requirements regarding, for example, employee meal and rest breaks, minimum wage and overtime, frequency of wage payments, wage statements and reimbursement of business expenses. Claims for civil penalties arising from violations of the Wage Orders and Labor Code provisions also can be brought on behalf of other workers under the California Private Attorney General Act ("PAGA"), which may result in additional monetary liability.

A.B. 5 both codified and extended the ABC Test first articulated by the California Supreme Court in a 2018 decision, *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, a case interpreting the Wage Orders governing truck drivers. A.B. 5 expressly made the *Dynamex* ABC Test applicable to all entities and industries covered by the Wage Orders. It also extended the application of the ABC Test to the Unemployment Insurance Code to interpret the definition of employees for unemployment purposes. Previously, the Unemployment Insurance Code applied a control test to determine if a worker was an employee for unemployment purposes.

EXEMPTIONS ALLOWED IN A.B. 5

As a testament to the broad impact of A.B. 5, while the bill was pending before the California legislature, it was the subject of heavy lobbying by numerous industry groups to insert exemptions into the legislation. As widely reported, many industries or professions were unsuccessful in obtaining exemptions, including "gig economy" companies like Lyft and Uber. The exemptions that were inserted into A.B. 5 are very specific, the standards precise, and some are time-limited, such as those applying to the fishing and construction industries.

A.B. 5 contains exemptions from the ABC Test for certain professions, contracts for "professional services" and business to business relationships. Examples of professionals that are exempt are certain licensed health care professionals, registered insurance agents, lawyers, architects, engineers, accountants, private investigators, broker dealers and investment advisors. "Direct sales" salespeople also are exempt as long as they fit within a narrow definition in the California Unemployment Insurance Code. The "professional services" and business to business exemptions require satisfaction of multi-part tests set out in A.B. 5. Examples of professional services subject to possible exemption are graphic artists, travel agents, human resources administrators and marketing professionals.

But an exemption is not a walk off home run. Qualifying for an exemption under A.B. 5 does not automatically guarantee classification of workers in the exempt categories as independent contractors. Rather, A.B. 5 expressly states that workers in the exempt categories are subject to an extensive multi-part control test articulated in another California Supreme Court decision, *Borello & Sons, Inc. v. Dep't of Industrial Relations*, in considering if they are independent contractors. Nonetheless, the *Borello* test is generally considered to allow a broader range of workers to be treated as independent contractors than the ABC Test.

EFFECTIVE DATES OF A.B. 5

Although A.B. 5 becomes effective on January 1, 2020, the statute expressly urges and authorizes courts to apply the ABC Test to pending cases and announces that in enacting A.B. 5 the Legislature was not creating new law but, instead, was confirming existing law, in the form of the application of the *Dynamex* ruling. As a result, entities that have been classifying workers as independent contractors cannot rely on January 1, 2020 as a bright line compliance date to avoid potential liability for improper classification under *Dynamex*. Instead, employers appear to have a risk of liability for misclassification under the ABC Test from **May 1, 2018,** the date of the *Dynamex* decision, going forward, especially where the misclassification places the entity in violation of obligations imposed by the **Wage Orders**, such as overtime, minimum wages, business expense reimbursement, meal and rest periods and recordkeeping. However, liability for misclassification under the ABC Test for purposes of the **Unemployment Insurance Code** appears to be triggered by the **January 1, 2020** effective date.

TAKEAWAYS FOR BUSINESSES

Entities with workers in California who are classified as independent contractors should consider reviewing the status of these workers under A.B. 5 to determine if they continue to be properly classified. This includes businesses headquartered in other states and overseas. In addition, we recommend keeping a close eye on possible legislative developments in California, New York and other states to create a new category of workers between common law employees and independent contractors. Additional exemptions to A.B. 5 also may be enacted in California.

More broadly, the new California classification standards highlight the changing landscape for businesses regarding classification rules and the importance of monitoring this issue. Business leaders not yet subject to the new rules in California or Massachusetts may find it beneficial to proactively audit their workforce for compliance with both state and federal rules for the classification of independent contractors and consider making changes in their agreements or practices to conform to the current court and regulatory interpretations. ◆

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