



Independent Contractor Rules Rewritten In California

Insights

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The California legislature today approved a controversial new law that will reshape the way businesses across the state classify workers. While supporters of the bill have emphasized its impact on independent contractors, the bill also severely impacts legal obligations governing businesses that hire other businesses. In short, the law will make it much more difficult for many companies to treat workers in California as independent contractors, and more difficult for businesses to hire smaller, entrepreneurial businesses. The governor has already promised to sign the law into effect; once he does, hundreds of thousands of workers across the state will be entitled to increased pay, benefits, and employment law protections – not to mention the possibility of organizing into labor unions. Many businesses, especially those in the gig economy, will need to radically restructure their operations or transform these workers into employees in order to comply with the law. What do you need to know about today's developments?

Background

The ground started to shift under the feet of many California businesses back in April 2018, when the California Supreme Court issued an unprecedented ruling that undermined its own previous decisions and adopted what is known as the ABC test for determining independent contractor status. Prior to this decision, employers used a flexible multi-factor balancing test to determine whether a worker was a contractor or employee. But under the now infamous *Dynamex* ruling, a worker is considered an employee under the state Wage Orders unless the hiring entity establishes all three of these prongs:

1. the worker is **free from the control and direction** of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact;
2. the worker performs work that is **outside the usual course** of the hiring entity's business; and
3. 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 decision not only expanded the definition of "employee" under the California Wage Orders, it also imposed an affirmative burden on companies to prove that independent contractors are being properly classified. Questions remained, however, about the scope of the ruling, the applicability of it to various state laws, the retroactivity of the ruling, and various other matters. For much of the past year-and-a-half, California businesses using contract labor were unsure of where they stood.

California Legislature Replaces Mild Confusion With Sweeping New Law

Enter the state legislature – and organized labor. From the very first day of California's legislative session, worker advocates and labor unions sought to codify and then expand the *Dynamex* decision to establish the ABC test as the undisputed law of the land. The state Assembly passed AB 5 in May 2019, and after a few months of final negotiations and deliberations, the state Senate voted to approve a slightly revised measure. Today, the Assembly put the final stamp of approval on the ultimate version of the bill, which Governor Newsom has already promised to sign into effect.

Starting January 1, 2020 – but with retroactive effect as of that date – the bar will be raised to unprecedented heights. Businesses, except for those lucky enough to secure an exemption from the state legislature, will have to comply with the ABC test or face a raft of legal problems. While the *Dynamex* ruling applied only to California's Wage Orders and therefore was limited to minimum wage, overtime, and meal and rest break liability, AB 5 goes several steps beyond. Those workers considered misclassified under the new state law will also be eligible for workers' compensation coverage, unemployment insurance, various benefits, paid sick days, and state family leave.

Moreover, because hundreds of thousands of workers will now be considered employees, they will also argue they are covered by state civil rights laws, including the most common discrimination and harassment protections. Last, but certainly not least, those workers considered employees and not contractors may now have the ability to organize themselves into labor unions, depending on how federal labor law is read in concert with the new state law, which is something that businesses with a contractor workforce have never had to worry about before.

If there is a silver lining, its that AB 5 does limit the ABC test to a certain extent and provides an exempted list of workers who are not affected by its reach. This list includes:

- doctors, dentists, and veterinarians;
- lawyers, architects, engineers, private investigators, and accountants;
- securities broker-dealers and investment advisers;
- human resources administrators;
- travel agents;
- marketers, graphic designers, grant writers, fine artists, certain photographers or photojournalists, and certain freelance writers and editors; and

There are also several classifications of exemptions that carry certain conditions. For example:

- Commercial fishermen are exempt from all requirements except from unemployment insurance;
- 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; and

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- Salespersons are exempt, but their pay must be based on actual sales as opposed to wholesale purchases or referrals.

While it is possible that other exemptions will be carved out of the statute in future legislative sessions, it is time for California businesses to adjust to the new normal and begin AB 5 compliance efforts right away.

Even Business-to-Business Arrangements Are Affected

Although much of the publicity surrounding AB 5 has focused on businesses that hire independent contractors, the bill's reach is far more extensive. Businesses may find themselves liable to the employees of their vendors, even if those vendors are large, established businesses. This is because a vendor's employees may be able to claim they are also employees of the "contracting business" under the ABC test unless the contracting business can satisfy 12 different requirements outlined in the law.

Among those, the business retaining a vendor must now prove that any vendor they hire actually provides the same or similar business services to other clients, *and* the vendor must provide services directly to the business, not to the business's customers. The bill even requires, among other things, that the vendor advertise its services to the public.

What Do Businesses Do Now?

This new law represents a shift for California independent contractor law and businesses. Those doing business in the state must now carefully analyze their relationships with their business vendors to ensure compliance. Misclassification of such workers can result in significant legal exposure when it comes to wage and hour liability, benefits coverage, workers' compensation laws, unemployment compensation, and a whole host of other legal issues.

Further, those who will soon be categorized as employees will be entitled to protection under state civil rights laws, including those barring discrimination, harassment, and retaliation. Finally, they may be entitled to form into labor unions, depending on how federal labor law is interpreted, which means that organized labor will be eager to capitalize on the new wave of eligible workers who could be added to their ranks. Expect to see organizing drives increase in California in the early part of 2020 and beyond.

All businesses that retain contract labor and do not fall into the above exemptions will need to make some tough decisions. Should you restructure your operations to ensure you are on the right side of the ABC test, or should you restructure your working relationships to classify your workers as employees? Each decision carries with it a number of technical and legal issues that can only be dealt with on a business-by-business basis; there is no one-size-fits-all answer.

We recommend you get in touch with your California counsel as soon as possible to begin work on your compliance strategy. For more information, contact your regular Fisher Phillips attorney or one of the attorneys in any of our California offices:

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