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# Is This the End of Independent Contractors in California?

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Employers classifying workers in California as independent contractors face grave new concerns based on Assembly Bill 5, signed into law by Governor Newsom on Wednesday, September 18. In its breadth and the risk to which it subjects employers, AB 5 easily eclipses last year's state Supreme Court decision in *Dynamex*. AB 5 goes into effect in only slightly more than three months, on January 1, 2020. Given the magnitude of the new law, employers must now begin to understand AB 5, evaluate their risk and take appropriate compliance and self-protective action.

## Who are Considered Employees under AB 5?

Aside from a list of workers specifically excluded from AB 5, as of January 1, the law defines all workers as employees for Labor Code and Unemployment Insurance Code purposes *unless the employer can prove* all three of the following factors (the ABC Test), that the worker:

A. is "*free from control* of the hiring entity" in the performance of his or her work;

B. performs "*work that is outside the usual course* of the hiring entity's business;" and

C. is engaged in an independently established trade, occupation or business.

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Under AB 5, employers bear the burden of proving that workers satisfy the "ABC Test" and workers must satisfy all three parts to qualify as independent contractors. AB 5 sets the new test for employees vs. independent contractors regardless of the size of the employer.

Satisfying Part B – that individuals perform "work that is outside the normal course" of the enterprise's regular course of business — will prove difficult for most businesses. Of particular importance in Southern California, the ABC test contained in AB 5 would result in individuals involved in production for TV, internet streaming, film, music videos, live theater and commercial productions being considered employees. This presumption runs contrary to the entertainment industry's wide-scale treatment of production workers as contractors.

## The Consequences of AB 5 Far Exceed those of Dynamex

While the ABC Test was first articulated last year by the California Supreme Court in the *Dynamex* decision, the adoption of AB 5 carries far greater consequence for employers than that ruling. *Dynamex* held that the ABC Test applied under only the California Wage Orders, a set of important, but limited quasi-administrative rules. In contrast, AB 5 imposes the ABC Test for all purposes under the California Labor Code and the California Unemployment Insurance Code.

By incorporating the three-part test throughout the Labor Code, AB 5 will subject employers to all of the obligations found in the Labor Code to all workers, unless the employer satisfies the ABC Test or qualifies for one of the exemptions. The Labor Code – consisting of copious laws – imposes liability on employers for, among others, violations of the minimum wage, overtime and paid sick leave laws, failure to reimburse business expenses, failure to pay all wages and other sums owing at the time of termination, and retaliation.

AB 5, unlike the *Dynamex* decision, also carries greater permanence. While a future California Supreme Court could have theoretically reconsidered *Dynamex*, the ABC Test is now statutory law embodied within the Labor Code, and far less subject to future judicial change.

Another significant distinction from last year's state Supreme Court decision, AB 5 equips the state and cities to sue employers for alleged misclassification of workers as independent contractors. This part of AB 5 creates a means for government entities to circumvent arbitration and class action waiver agreements signed by contractors. AB 5 authorizes government officials to sue employers for injunctive relief in cases of alleged misclassification, unencumbered by arbitration agreements to which they are not parties.

**Exceptions Set Out in AB 5**

AB 5 sets out a list of workers excluded from the ABC Test including:

- licensed insurance agents;
- physicians, dentists, podiatrists, psychologists and veterinarians;
- licensed attorneys, architects, engineers, private investigators and accountants;
- direct sale salespersons as described in Section 650 of the Unemployment Insurance Code;
- commercial fishermen;
- individuals performing services in marketing, human resources, travel agent, graphic design, grant writing, fine art, photography and freelance writing under certain circumstances;
- licensed cosmetologists, barbers, manicurists and estheticians;
- licensed real estate agents;
- business-to-business relationships under certain circumstances;

- individuals working for a construction contractor pursuant to a subcontract under certain circumstances;
- individuals working in referral agencies connecting clients with specified service providers including event planning, moving, home cleaning, dog walking, and pool cleaning.

Where workers fall within one of the exceptions provided by AB 5, various other standards apply for making the employee versus independent contractor distinction.

## Recommended Actions for Employers

For many businesses, the total cost of reclassifying a worker from contractor to employee – taking into account additional taxes, healthcare coverage, 401k or pension contributions, workers' compensation insurance, unemployment insurance contributions – will increase the cost of doing business substantially. In some instances, the cost of complying with AB 5 may threaten the viability of an enterprise's current business model. On the other hand, potential liability for failing to comply with AB 5 is significant.

Employers should begin to work through their individual decision-making process in light of AB 5. Each employer should make its own assessment of the total cost of complying with AB 5 and the risk the employer is willing to undertake absent full compliance. Employers have only a little more than three months to conduct their analysis, make decisions and implement those decisions before the January 1 effective date. Interestingly, an uptick in large-scale misclassification actions already has occurred simply from the passage of AB 5 by the California Legislature.

Employers also should review their employment practices liability insurance (EPLI) with respect to at least three key questions: (1) does the EPLI coverage include the carrier's payment of attorney's fees and costs incurred to defend the employer in wage and

hour lawsuits, as many EPLI policies exclude such coverage; (2) is the dollar sum provided for carrier-paid defense of wage and hour actions, if provided, sufficient; and, (3) is the employer's self-insured retention or deductible under the policy appropriate or too high.

Finally, employers also should determine whether they have in place an arbitration and class action waiver agreement signed by contractors and employees, and enforceable under the most recent state and federal case law. Despite the right of state and cities to bring actions for injunctive relief beginning on January 1, employers are well advised to continue to take all reasonable actions to protect themselves with respect to direct clams by their contractors and employees.

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