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FAQs for Employers Following the Passage of California's New Law on Independent Contractor Misclassification

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On September 18, 2019, Governor Gavin Newsom signed into law Assembly Bill 5, which clarifies when workers should be considered "employees" under the California Labor Code and the California Unemployment Insurance Code, thereby entitling them to the protections afforded by those laws. The bill codifies the standard set out in last year's California Supreme Court decision, *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, which narrowed the circumstances under which a worker can properly be classified as an independent contractor. Specifically, under the new law, in order for a worker to properly be classified an independent contractor, the hiring entity has the burden of establishing the following three elements (commonly referred to as the "ABC" test):

(A) The person 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 person performs work that is outside the usual course of the hiring entity's business;
(C) The person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

Most of the provisions of AB 5 become effective on January 1, 2020. Below are some answers to frequently asked questions to help employers navigate this significant development.

1. **Is the law under AB 5 any different than the *Dynamex* ruling?** Under *Dynamex*, the "ABC" test was limited to the resolution of the employee or independent contractor question in claims arising under California's Wage Orders—for example, claims for failure to pay minimum wage, overtime, or failure to provide adequate meal and rest periods.
   AB 5 codifies the decision in the *Dynamex* case and expands the application of the "ABC" test not only for purposes of the Wage Orders, but also the Labor Code and Unemployment Insurance Code as well. This means that the "ABC" test will apply to more claims, including failure to reimburse necessary business expenses, failure to

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provide accurate and complete wage statements, claims for waiting time penalties under Labor Code section 203, potential recovery of Private Attorney General Act (PAGA) penalties, and failure to provide workers' compensation insurance. AB 5 also empowers the California Attorney General and specified local prosecuting agencies to pursue injunctions against putative employers suspected of misclassifying their workers.

2. **Are there any exceptions to the application of the new standard in AB 5?** AB 5 provides an exemption for a number of industries and occupations, subject to licensing and other requirements, including:
   a. Insurance brokers
   b. Physicians, surgeons, dentists, podiatrists, psychologists or veterinarians
   c. Lawyers, architects, engineers, private investigators and accountants
   d. Registered securities broker-dealer or investment adviser and their agents and representatives
   e. Direct sales salespersons (if they meet certain factors)
   f. Commercial fishermen working on an American vessel (until January 1, 2023)
   g. Contracts for "professional services" such as marketing, human resources administration, travel agents, graphic designers, grant writers, fine artists (if they meet certain factors)
   h. Photographers, photojournalists, freelance writers, editors, or newspaper cartoonists (if they meet certain factors)
   i. Licensed estheticians, electrologists, manicurists (until January 1, 2022), barbers, or cosmetologists (if they meet certain factors)
   j. Real estate agents
   k. Licensed repossession agencies
   l. Bona fide business-to-business contracting relationships (under certain conditions)
   m. Construction subcontractors (for work performed after January 1, 2020, under certain conditions)
   n. Construction trucking services (until January 1, 2022)
   o. Tutors (if they meet certain factors)
   p. Motor club services

For these occupations, the determination of employee or independent contractor status will be governed by the more flexible, multi-factor test outlined in the California Supreme Court's decision in *S. G. Borello & Sons, Inc. v. Department of Industrial Relations*.

3. **What effect does AB 5 have on an employer's obligation to provide workers' compensation insurance?** The California Labor Code, at sections 3200 *et. seq.*, requires employers to have workers' compensation insurance covering their employees. AB 5 amends section 3351 of the Labor Code so that, for the purposes of determining the obligation to provide workers' compensation coverage, the "ABC" test governs. Accordingly, workers who fall within the "ABC" test (and are not covered by an exception), should be covered by workers' compensation insurance. Note that the narrowed definition of employee does not become effective until July 1, 2020 (with respect to the workers' compensation provisions specifically).
4. **Will AB 5 affect an employer's obligation to pay payroll taxes?** The Unemployment Insurance Code imposes obligations on employers to pay certain amounts of Unemployment Insurance Tax and Employment Training Tax for its employees. Because AB 5 changes the definition of "employee" in the Unemployment Insurance Code, employers will have to pay these payroll taxes for

workers who meet the definition of “employee” under the new test.

5. **Does AB 5 affect how much employers will have to withhold from employees' paychecks?** The Unemployment Insurance Code also imposes obligations on employers to withhold a portion of employees’ wages for State Disability Insurance and for California personal income tax. Accordingly, employers will have to make these withholdings for workers who meet the definition of “employee” under the new test.
6. **Does AB 5 affect an employer’s obligation to provide health insurance?** Prior to AB 5, neither the California Labor Code nor the Unemployment Insurance Code imposed an obligation to provide health insurance to employees. The amendments to these statutes pursuant to AB 5 do not add a requirement to provide health insurance to employees. The federal Affordable Care Act sets up a system whereby “large” employers must either provide health insurance to a certain percentage of their employees, or pay specified penalties. We have not yet seen any developments indicating whether the change in the definition of “employee” under California law will affect the determination of whether a worker is considered an “employee” under the federal ACA. However, we are monitoring this issue closely.
   Note, however, that some jurisdictions in California, such as San Francisco, require certain employers to satisfy health care spending requirements for employees. The amount of required spending is often based on the number of the employer’s employees, with small employers potentially exempt from the requirement. AB 5 could have an impact on how these requirements apply to employers.
7. **Can employers continue to pay workers who were formerly classified as independent contractors on a piece rate or project basis?** AB 5 does not impact an employer’s ability to pay workers on a piece rate basis. In order to properly do so, however, the employer must satisfy all requirements for paying employees by the piece or unit produced. Namely, among other things, the employer must pay the employee not less than the applicable minimum wage for all hours worked in the payroll period, compensate employees for rest and recovery periods and for other nonproductive time separate from any piece-rate compensation, and ensure that piece-rate workers are paid overtime for hours worked in excess of eight in a day or forty in a week.
8. **What effect does AB 5 have on employers who hire temporary workers through a staffing agency?** AB 5 does not have a direct effect on employers who hire temporary workers through a staffing agency, assuming the staffing agency categorizes those workers as employees of the staffing agency, and not independent contractors. If the staffing agency categorized those workers as independent contractors, and placed the workers at the contracting company’s site, arguably working subject to the control of the contracting company, there is a risk that the workers could make a claim of misclassification based on the “ABC” test against both the staffing agency and the contracting company. We recommend companies retaining temporary workers through a staffing agency confirm that the staffing agency classifies the workers placed as employees, unless they clearly meet the definition of an independent contractor.

The decision as to whether to reclassify workers, and the changes to payroll and other benefits that may come along with it, continues to be nuanced. If you have independent contractors within your workforce, contact your Dorsey employment attorney for guidance.