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The ABCs of AB 5

Can Anyone Be an Independent Contractor in California Anymore?

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Presentation to Arts Orange County

Michael E. Olsen, Associate, Employment and Labor
Manatt, Phelps & Phillips, LLP
714.338.2747
molsen@manatt.com



Today's Discussion

- How did *Dynamex* set the footprint for AB 5?
- Who is an independent contractor under AB 5?
- What occupations are exempt from the "ABC" test, and under what conditions?
- What does the future hold for AB 5 and possible amendments?
- What steps should employers take to be in compliance with AB 5?

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Borello: The Economic Reality Test

▪ *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal. 3d 341 (1989) uses common law "control" test, then considers the remedial purpose of the statute along with the following secondary factors:

1. Whether the person performing services is engaged in an occupation or business distinct from that of the principal;
2. Whether or not the work is a part of the regular business of the principal or alleged employer;
3. Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
4. The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers;
5. Whether the service rendered requires a special skill;

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Borello: The Economic Reality Test (cont'd)

6. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
7. The alleged employee's opportunity for profit or loss depending on his or her managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job; and
11. Whether or not the parties believe they are creating an employer-employee relationship may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

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Dynamex: Shift in Independent Contractor Law

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- April 2018: California Supreme Court changed the test to define employees in *Dynamex Operations W. v. Superior Court*, 4 Cal. 5th 903 (2018).
- Court abandoned *Borello* test for the ABC test.
 - Only applied to the IWC Wage Orders.



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ABC Test: When in Doubt, a Worker Is an Employee

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- Workers are presumed to be employees unless:

A

Worker is free from control and direction in connection with the performance of the service;

B

Service is performed outside the usual course of business of the employer; and

C

Worker is customarily engaged in an independently established trade, occupation, profession or business of the same nature as the service performed.

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Can *Dynamex*'s ABC Test Be Applied Retroactively?

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- Ninth Circuit first said "yes" and then punted the issue to the California Supreme Court.
 - No answer from the CA Supreme Court yet.
 - California law generally favors retroactivity.
- But does this matter in light of AB 5?



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Why Does *Dynamex* Matter After AB 5?

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- AB 5 codifies the ABC test articulated in *Dynamex* and expands it.
- The ABC test now defines the term "employee" throughout the California Labor Code, not just the IWC Wage Orders.
- Additionally, the test now extends to workers' compensation, unemployment insurance, paid sick leave, and paid family leave.
- AB 5 did not change the determination of whether one is an employee under federal law or under provisions of the California Fair Employment and Housing Act or statutes outside of the Labor Code providing for leave (e.g., California Family Rights Act).

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AB 5 Basic Provisions

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- Cal. Lab. Code § 2750.3(a)(1): Workers are employees unless all of the following are met:

A

Individual is free from the control and direction of the hiring entity;

B

Work is performed outside the usual course of the hiring entity's business; and

C

Individual regularly and customarily engages in the trade, occupation, or business.

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AB 5 Effective Date and Retroactivity

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- Cal. Lab. Code § 2750.3(i)
 - AB 5 retroactively applies as to IWC Wage Orders and "violations of the Labor Code relating to wage orders."
 - AB 5 retroactively applies to the exceptions.
 - If an employer would be relieved of liability under Cal. Lab. Code § 2750.3(b)-(h), then those subdivisions will apply retroactively.
- January 1, 2020: Unemployment Ins. Code and all other provisions of the Labor Code
- July 1, 2020: Workers' Compensation



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Industry-Focused Exceptions

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- Cal. Lab. Code § 2750.3(b): If an exception applies, use the *Borello* test to determine if an individual is an independent contractor or an employee.



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Statutorily Categorized Exceptions

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- Cal. Lab. Code § 2750.3(b)
 - Licensed insurance agents, brokers, and analysts
 - Certain licensed healthcare professionals
 - Securities broker-dealers, investment advisors
 - Direct sales salespersons
 - Other licensed professionals (*i.e.*, lawyer, architect, engineer, private investigator, or accountant)

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Professional Services Exception

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- Cal. Lab. Code § 2750.3(c)
 - AB 5 gives an exemption to contracts for “professional services.”
 - Contracts for professional services will also be governed by the *Borello* test if certain criteria are met.



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Professional Services Definition

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- Cal. Lab. Code § 2750.3(c)(2)(B)
- Professional services include (i)-(xi)
 - Marketing
 - Administration of human resources
 - Travel agent services
 - Graphic design
 - Grant writer
 - Fine artist
 - Payment processing agent through an independent sales organization



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Professional Services Exception Factors

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- Cal. Lab. Code § 2750.3(c)(1)
- Hiring entity can seek “Professional Services” exception if:
 1. Individual maintains separate place of business from hiring entity
 2. Individual has licenses or permits if the work is performed for longer than 6 months
 3. Individual can set and negotiate their own rate
 4. Individual sets their own hours
 5. Individual is customarily engaged in the type of work performed under contract with other hiring entities or holds themselves out to other clients as available to perform work
 6. Individual exercises discretion and independent judgment in the performance of services

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Business-to-Business Service Providers

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- Cal. Lab. Code § 2750.3(e)
- Exception for a business service provider that provides services directly to the contracting business if the **contracting business** shows all of the following for the provider:

1. Free from control and direction	6. The contract is in writing
2. Provides services directly to the contracting business	7. Contracts with other businesses and maintains a clientele
3. Maintains a separate business location	8. Advertises
4. Customarily engaged in an independently established business of the same nature as the work performed	9. Provides its own tools and equipment
5. Negotiates its own rates	10. Sets its own hours and location of work

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Referral Agency Exception

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- Cal. Lab. Code § 2750.3(g) – ABC test does not apply to relationship between a referral agency and a service provider.
- Referral agency is a business that connects clients [i.e. persons or businesses] with service providers that provide:
 - graphic design, photography, web design
 - tutor
 - event planning
 - minor home repair, picture hanging, pool cleaning, or yard cleanup
 - moving, home cleaning, errands
 - furniture assembly
 - animal services [pet boarding or day care] dog walking, and dog grooming

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Referral Agency Exception (continued)

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- **Referral agency** must ensure the service provider meets the following:

1. Free from control and direction of agency	6. The contract is in writing
2. Has all required business licenses or tax registration, or contractor's license if applicable	7. Maintains a clientele
3. Delivers services under its own name, not referral agency's	8. Advertises
4. Customarily engaged in an independently established business of the same nature as the work performed	9. Provides its own tools and equipment
5. Sets its own rates without deduction by agency	10. Sets its own hours and free to accept or reject clients

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Miscellaneous Exceptions

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- § 2750.3(b)(6): Commercial Fishermen (until January 1, 2023)
- § 2750.3(b)(7): A newspaper distributor or carrier working under contract with a newspaper publisher or distributor (effective until Jan 1, 2021) (added by AB 170)
- § 2750.3(c)(2)(B)(xi): Cosmetology/Esthetician Services (until January 1, 2022)
- Cal. Lab. Code § 2750.3(c)(2)(B): Freelance journalism exception
- § 2750.3(d): Real Estate Licensee and Repossession Agency
- § 2750.3(f): Construction Subcontractors
- § 2750.3(h): Contracts between a certified motor club and an individual performing professional services, and between the motor club and a third party to provide motor club services utilizing the employees and vehicles of the third party

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Court-Recognized Exception

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- The legislature created an express exception:
 - If a court rules that the three-part test above cannot be applied to a particular context based on grounds other than an express exception contained in the bill.
 - Cal. Lab. Code § 2750.3(a)(3).



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Lorena Gonzalez Twitter Backlash

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Randy Dotinga, Freelance Writer @rdotinga · Oct 19
 Replying to @yashar @LorenaSGonzalez and 2 others
 I was a leader of coalition of journalism groups that negotiated over #AB5. Gonzales would not give us a blanket exemption and offered a cap of 25 submissions per client per year. We & the state newspaper industry trade group asked for 52. She choose 35. We did not "ok" this.

26 81 463

JO @JO_LYF · Oct 20
 Replying to @LorenaSGonzalez
 This labor bill is forcing contractors who choose to contract, typically for flexibility and pay to be underpaid employees.

1 3 11

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Lorena Gonzalez Twitter Backlash (cont'd)

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Shaun Newton @shaunnewton · Oct 20
 Replying to @LorenaSGonzalez
 You do realize that there is no "one size fits all" option. Especially in this case. You wanted to make your mark, and a lot of us get that. But you need to take a cold hard look at #AB5 again. Consider a compromise of raising freelancers' story counts to 90 a year.

2 3 27

PixelPush @SusanVickiOver · Oct 20
 Agree with no "one size fits all" but there shouldn't be any cap at all! This also impacts freelance photographers, voice over artists etc. We might do hundreds of projects for multiple clients every year. Are we employees for all of them?

2 1 33

[[Jessica S.]] @onemorejess3 · Oct 20
 No cap, for sure. Writers may end up doing very short blurbs of 100 words each, for example, and you could blow through 90 of those in a month or less. Caps don't help at all.

4 1 15

Shaun Newton @shaunnewton · Oct 20
 Understood but know that @LorenaSGonzalez is prob looking for a compromise in lieu of a major overhaul of #AB5. That doesn't mean that we shouldn't work hard to try and change things.

1 2

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Lorena Gonzalez Twitter Backlash (cont'd)

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Lorena @LorenaSGonzalez · Oct 20
 To be clear: #AB5 was a broad labor bill codifying a test created for CA by our Supreme Court. It was not (nor was the decision) about any one profession. Any reference to specific professions was by request of those industries to provide clarification and flexibility. 1/

It wasn't a decision or a bill solely aimed at the gig economy. Although there is a massive misclassification in the gig economy, it certainly isn't a bill aimed at freelancers. The exemptions provided added more flexibility than the decision for writers/photographers, not less. 2/

We spent over a year meeting with hundreds of industries, working Californians, unions, worker groups, and academia/researchers. Not writing the bill would have meant the ABC test would apply to every single employment situation, without flexibility. 3/

It was passed (by over 3/3 of both houses) and signed by the Governor in September. The law is set to go into effect on 1/1/20, and no changes can be made before then. In reality, the ABC test has been California law since April 2018 because of Dynamex. 4/

I know that this law, like all laws, is imperfect. I obviously do not want to ruin anyone's current situation. We will continue to meet with folks & monitor implementation in the beginning of the year. There will be a part 2 of the bill. We said this last year. 5/

For example, we were hopeful that language could be worked out for the music industry, between the industry and the coalition of entertainment unions. We committed to writing that in once it is finalized. We also are working on rural healthcare providers, and a few others. 6/

I will continue to work with freelancers, the industry & unions that represent writers to see if there are further changes that should be made, especially for digital quick jobs. But, this won't get resolved just on twitter. And it can't happen before January. 7/

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Potential Legislative Fixes

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- Music industry exception
 - Revive proposed music industry exception.
 - Negotiate with labor unions to introduce new amendment.
 - Use business-to-business exception? What about "work for hire" problem?



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Potential Legislative Fixes (cont'd)

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- Other exceptions or issues anticipated to be addressed:
 - Franchise relationships
 - Clarification on business-to-business service provider exemption
- Further exceptions from AB 5 may be forthcoming, including exceptions for writers and producers.
- It is unclear whether the California legislature will make any future exemptions retroactive.

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The Building Blocks of Compliance for Employers

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Step 1: Apply the ABC Test

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- Every business in California using independent contractors should conduct an analysis of those contractors to determine if they are appropriately classified, and whether any exceptions apply.
- Conduct the analysis with assistance of counsel to protect it under the attorney-client privilege.



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Step 2: Analyze the Costs of Conversion

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- Costs of conversion will include factors such as:
 - Rates of pay
 - Benefits
 - Workers' compensation insurance
 - EPL coverage
 - Overhead costs
 - Potential litigation and penalties (retroactive liability or retroactive payments)
- Are there benefits?



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Step 3: Compare the Penalties of Not Converting

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- Workers who are misclassified may bring an action to recover unpaid wages for up to 4 years following the end of their employment.
- Workers may recover for:
 - unpaid and underpaid wages including overtime and double time;
 - missed meal and rest periods and unpaid premiums;
 - wage statement violations, including a penalty for failure to issue a wage statement; and
 - unreimbursed business expenses.



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Step 3: Compare the Penalties of Not Converting (cont'd)

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- Existing law (Labor Code § 226.8) penalizes employer in the amount of:
 - \$5,000 to \$15,000 per employee for willful misclassification
 - \$10,000 to \$25,000 per employee if there is a “pattern or practice” of willful misclassification
- Penalties under Private Attorneys General Act (PAGA)
- Tax penalties with IRS and California
 - Failure to withhold and pay payroll taxes is subject to fine and is a misdemeanor punishable by up to one year in jail in California
- Individual liability issues



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Step 3: Compare the Penalties of Not Converting (cont'd)

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- *Fogarty v. Scripps NP Operations LLC*, Ventura County Superior Court, March 22, 2019, 2019 WL 2298922, \$2,250,000 class action settlement on behalf of 1,400 newspaper delivery workers who were allegedly misclassified as independent contractors.
- *Lin v. Beverly Hill Hotel Corporation*, Los Angeles Superior Court, May 25, 2018, 2018 WL 3584244, \$915,000 class action settlement on behalf of 55 massage therapists and estheticians who were allegedly misclassified.
- *Diaz v. Absolute West LLC*, Los Angeles Superior Court, May 11, 2019, \$600,000, on behalf of 238 truck drivers allegedly misclassified.



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Step 4: Tackle the Implementation

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- Messaging
 - Internal messaging: What message should you be sending to those you are reclassifying?
 - External messaging: How will you message changes to business, workers, and the public?
- Maximize opportunities for flexibility
 - Part-time schedules
 - Telecommuting
- Retroactivity considerations
 - Back pay vs. risk of future litigation



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Step 5: Consider Lobbying, Litigation or Relocation

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- Fight
 - Consider lobbying as an option while the legislature continues to consider exceptions to AB 5
 - Consider legal challenges to the law (“court-recognized exception”)
 - Marshall PR and corporate communication resources
- Flight
 - Can some independent contractor work be relocated to different states?
 - Can it be outsourced?

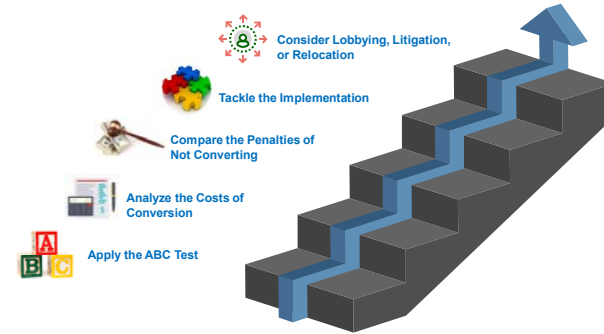


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Summary of Steps and Key Takeaways

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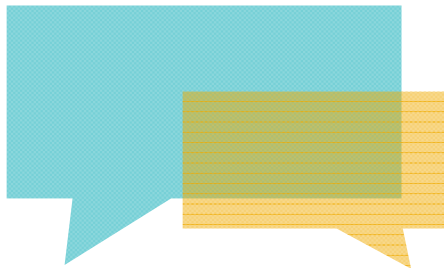


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Q&A

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Follow-Up Contact Information

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Michael E. Olsen
Associate
Employment and Labor
Costa Mesa: 714.338.2747
molsen@manatt.com

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