

# HOLLRAH LLC

WASHINGTON, DC

## MEMORANDUM

### **BY EMAIL**

TO: Clients and Friends

FROM: Russell A. Hollrah

DATE: September 25, 2019

RE: California AB 5

---

On September 18, 2019, California's Governor Gavin Newsom signed into law Assembly Bill 5, which launched California into a grand experiment that significantly restricts an individual's right to work in that state as an independent contractor.<sup>1</sup>

AB 5 codified and expanded the application of a new three-factor "ABC" test that the California Supreme Court created in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles*, 4 Cal.5th 903 (2018) ("*Dynamex*"). *Dynamex* held that an "ABC" test is to be used for purposes of one of three alternative tests that courts use to determine an individual's status, as an employee or independent contractor, for purposes of California wage orders.<sup>2</sup>

The "ABC" test adopted in *Dynamex* replaced a common-law test that courts had used for nearly 30 years to determine an individual's status, in accordance with the California Supreme Court decision in *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal.3d 341 (1989).<sup>3</sup>

---

<sup>1</sup> AB 5, Section 1(e).

<sup>2</sup> AB 5, Section 1(f). AB 5 makes clear the legislature's intent that the "ABC" test being imposed with respect to a California wage order applies only with respect to the "suffer or permit" definition but does not affect the other two alternative definitions that apply. In *Dynamex*, the Court explained that the phrase "to employ" for purposes of the wage order, has three alternative definitions. It means: (1) to exercise control over the wages, hours or working conditions, *or* (2) to suffer or permit to work, *or* (3) to engage, thereby creating a common law employment relationship. The new "ABC" test announced in *Dynamex* pertains only to the second definition.

<sup>3</sup> The *Borello* test for determining worker status is a multi-factor test, the principal factor of which is "whether the person to whom services is rendered has the right to control the manner and means of accomplishing the result desired." *Dynamex*, 4 Cal.5th 903, 922.

## I. The New ‘ABC’ Test and its Seven Statutory Exemptions

AB 5 added new Labor Code section 2750.3, which provides that for purposes of California’s Labor Code, its Unemployment Insurance Code, and the wage orders of its Industrial Welfare Commission, a person providing labor or services for remuneration shall be considered an employee rather than an independent contractor unless the hiring entity satisfies a new “ABC” test.<sup>4</sup> AB 5 also adopts an “ABC” test for purposes of California workers’ compensation.<sup>5</sup>

The new “ABC” test is satisfied if the hiring entity demonstrates that all of the following conditions are satisfied:<sup>6</sup>

**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.<sup>7</sup>

If a hiring entity fails to establish any one of these three conditions with respect to an individual, the individual will be deemed an employee.<sup>8</sup>

AB 5 exempts from the new “ABC” test the following seven (7) categories of business relationships:

1. Specified Occupations
2. Contracts for Professional Services
3. Certain Licensed Service Providers
4. Bona Fide Business-to-Business Contracting Relationships
5. Subcontracts in the Construction Industry
6. Certain Referral Agencies
7. Motor Clubs

---

<sup>4</sup> AB 5, Section 2, which creates new Labor Code section 2750.3. The codification of the “ABC” test is contained in new Labor Code section 2750.3(a)(1).

<sup>5</sup> AB 5, Section 3.

<sup>6</sup> New Labor Code section 2750.3(a)(1).

<sup>7</sup> In *Dynamex*, the Court explained that the fact that *a company has not prohibited or prevented* a worker from engaging in such a business, or that the worker *could have* engaged in such a business, is not sufficient to establish that the worker has independently made the decision to go into business for himself or herself. Rather, to satisfy the “C” factor, a company must prove that the worker *actually is* customarily engaged in an independently established trade, occupation, or business. *Dynamex*, 4 Cal.5th 903, 962-63. The Court’s analysis of the “C” factor in *Dynamex* was followed in *Garcia v. Border Transp. Grp., LLC*, 239 Cal. Rptr. 3d 360 (2018).

<sup>8</sup> New Labor Code section 2750.3(a)(3) provides that if a court rules that the “ABC” test cannot be applied to a particular context, then the *Borello* test shall be applied. This provision appears intended to address the possibility of a court holding the “ABC” test preempted, as applied to a particular context. Some courts have held that all or part of the “ABC” test is preempted by the Federal Aviation Administration Authorization Act of 1994 (“FAAAA”), 49 U.S.C. § 14501(c), as applied to motor carriers. E.g., *Alvarez v. XPO Logistics Cartage LLC*, 2018 U.S. Dist. LEXIS 208110 (C.D. Cal. Nov. 15, 2018); *Sanchez v. Lasership, Inc.*, 2013 U.S. Dist. LEXIS 49174 (E.D. Va. Apr. 3, 2013); *Schwann v. FedEx Ground Package Sys.*, 2016 U.S. App. LEXIS 3050 (1st Cir. Mass. 2016).

For four of these exemptions, a relationship needs to satisfy a *statutory conjunctive test* in order to qualify for the exemption. The *statutory conjunctive tests* are slightly different for each exemption. But they all include a restated version of the “A” and “C” factors. In substance, these exemptions replace the “B” factor of the “ABC” test with a multifactor conjunctive test. For some relationships, the test under the exemption could be more difficult to satisfy than the “ABC” test.

The new law also provides that any existing statutory provisions in the affected laws that treat certain types of individuals as statutory employees, or as statutory independent contractors, remain in force.<sup>9</sup>

The requirements for each of exemption categories are outlined below.

## 1. **Specified Occupations**

The six occupations listed below are exempt from both the new “ABC” test and the holding in *Dynamex*.<sup>10</sup> Instead, the status of these individuals is governed by the *Borello* test.<sup>11</sup>

1. A California-licensed **Insurance agent** (person or organization).
2. A California-licensed **physician and surgeon, dentist, podiatrist, psychologist, or veterinarian** performing professional or medical services provided to or by a health care entity (subject to an exception for collective bargaining agreements).
3. A California **licensed lawyer, architect, engineer, private investigator, or accountant**.
4. A **securities broker-dealer or investment adviser** or their agents and representatives that are registered with the SEC or FINRA.
5. A **direct sales salesperson** satisfying Section 650 of the Unemployment Insurance Code.
6. A **commercial fisherman** working on an American vessel and meeting specified requirements, subject to special rules for purposes of the Unemployment Insurance Code (will expire on January 1, 2023, unless extended by the Legislature).

## 2. **Contracts for Professional Services**

Contracts for professional services, as defined below, are exempt from both the new “ABC” test and the holding in *Dynamex*, provided that the hiring party satisfies a statutory conjunctive test set forth below.<sup>12</sup> If this exemption applies, the status of the individual is governed by the *Borello* test<sup>13</sup> (i.e., a restated version of the “A” factor).

For purposes of this exemption, the term “professional services” is limited to a specific list of qualifying services, i.e., services that meet any of the following:<sup>14</sup>

1. **Marketing**, provided that the contracted work is original and creative in character and the result of which depends primarily on the invention, imagination, or talent of the employee or work that is an essential part of or necessarily incident to any of the contracted work.

---

<sup>9</sup> New Labor Code section 2750.3(a)(2).

<sup>10</sup> New Labor Code section 2750.3(b).

<sup>11</sup> For a summary explanation of the *Borello* test, see above note 3.

<sup>12</sup> New Labor Code section 2750.3(c).

<sup>13</sup> For a summary explanation of the *Borello* test, see above note 3.

<sup>14</sup> New Labor Code section 2750.3(c)(2)(B).

*General Information – Not Legal Advice*

2. **Administrator of human resources**, provided that the contracted work is predominantly intellectual and varied in character and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.
3. **Travel agent** services that satisfy specified criteria.
4. **Graphic design**.
5. **Grant writer**.
6. **Fine artist**.
7. Services provided by an **enrolled agent** licensed by the United States Department of the Treasury to practice before the Internal Revenue Service.
8. **Payment processing agent** through an independent sales organization.
9. Services provided by a **still photographer or photojournalist** who does not license content submissions to the putative employer more than 35 times per year,<sup>15</sup> except that this exemption does not apply to work on motion pictures, which includes, but is not limited to, projects produced for theatrical, television, internet streaming for any device, commercial productions, broadcast news, music videos, and live shows, whether distributed live or recorded for later broadcast, regardless of the distribution platform.
10. Services provided by a **freelance writer, editor, or newspaper cartoonist** who does not provide content submissions to the putative employer more than 35 times per year.<sup>16</sup>
11. Services provided by a **licensed esthetician, licensed electrologist, licensed manicurist, licensed barber, or licensed cosmetologist** who satisfy specified criteria<sup>17</sup> (will *expire* with respect to licensed manicurists on January 1, 2022).

The statutory conjunctive test for professional services is satisfied if the hiring entity demonstrates that all of the following factors are satisfied:<sup>18</sup>

(A) The individual maintains a business location, which may include the individual's residence, that is separate from the hiring entity. Nothing in this subdivision prohibits an individual from choosing to perform services at the location of the hiring entity.

---

<sup>15</sup> New Labor Code section 2750.3(c)(2)(B)(ix) defines a "submission" for purposes of this category of professional services to mean one or more items or forms of content produced by a still photographer or photojournalist that: (I) pertains to a specific event or specific subject; (II) is provided for in a contract that defines the scope of the work; and (III) is accepted by and licensed to the publication or stock photography company and published or posted.

<sup>16</sup> New Labor Code section 2750.3(c)(2)(B)(x) defines a "submission" for purposes of this category of professional services to mean one or more items or forms of content by a freelance journalist that: (I) pertains to a specific event or topic; (II) is provided for in a contract that defines the scope of the work; (III) is accepted by the publication or company and published or posted for sale. New Labor Code section 2750.3(c)(2)(B)(x) also provides that items of content produced on a recurring basis related to a general topic shall be considered separate submissions for purposes of calculating the 35 times per year.

<sup>17</sup> The specified criteria are satisfied if the individual:

- (i) Sets their own rates, processes their own payments, and is paid directly by clients.
- (ii) Sets their own hours of work and has sole discretion to decide the number of clients and which clients for whom they will provide services.
- (iii) Has their own book of business and schedules their own appointments.
- (iv) Maintains their own business license for the services offered to clients.
- (v) If the individual is performing services at the location of the hiring entity, then the individual issues a Form 1099 to the salon or business owner from which they rent their business space.

<sup>18</sup> New Labor Code section 2750.3(c)(1).

(B) If work is performed more than six months after the effective date of this section, the individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession.

(C) The individual has the ability to set or negotiate their own rates for the services performed.

(D) Outside of project completion dates and reasonable business hours, the individual has the ability to set the individual's own hours.

(E) The individual is customarily engaged in the same type of work performed under contract with another hiring entity or holds themselves out to other potential customers as available to perform the same type of work. **(i.e., a restated version of the “C” factor)**

(F) The individual customarily and regularly exercises discretion and independent judgment in the performance of the services. **(i.e., a restated version of the “A” factor)**

For purposes of this exemption, an “individual” includes an individual providing services through a sole proprietorship or other business entity.<sup>19</sup>

### **3. Certain Licensed Service Providers**

The following types of licensed service providers are exempt from both the new “ABC” test and the holding in *Dynamex*.<sup>20</sup>

1. A **real estate licensee**, licensed by California's Business and Professions Code, for whom the determination of worker status is governed by subdivision (b) of Section 10032 of the Business and Professions Code. If that section is not applicable, then this determination shall be governed as follows:
  - (A) for purposes of unemployment insurance by Section 650 of the Unemployment Insurance Code;
  - (B) for purposes of workers compensation by Section 3200 et seq.; and
  - (C) for all other purposes in the Labor Code by *Borello*. The statutorily imposed duties of a responsible broker under Section 10015.1 of the Business and Professions Code are not factors to be considered under the *Borello* test.
2. A **repossession agency**, licensed by California's Business and Professions Code, for whom the determination of worker status is governed by Section 7500.2 of the Business and Professions Code, if the repossession agency is free from the control and direction of the hiring person or entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

### **4. Bona Fide Business-to-Business Contracting Relationships**

If a business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation (“*business service provider*”) contracts to provide services to another such business (“*contracting business*”), such relationship will be exempt from both the new “ABC” test and the holding in *Dynamex*, provided that the *contracting business*

---

<sup>19</sup> New Labor Code section 2750.3(c)(2)(A).

<sup>20</sup> New Labor Code section 2750.3(d).

demonstrates that a statutory conjunctive test set forth below is satisfied.<sup>21</sup> If this exemption applies, the status of the *business services provider* shall be governed by the *Borello* test<sup>22</sup> (**i.e., a restated version of the “A” factor**).

The statutory conjunctive test for a bona fide business-to-business contracting relationship is satisfied if the *contracting business* demonstrates that all of the following factors are satisfied:<sup>23</sup>

- (A) The business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact. (**i.e., a restated version of the “A” factor**)
- (B) The business service provider is providing services directly to the contracting business rather than to customers of the contracting business.
- (C) The contract with the business service provider is in writing.
- (D) If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- (E) The business service provider maintains a business location that is separate from the business or work location of the contracting business.
- (F) The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed. (**i.e., a restated version of the “C” factor**)
- (G) The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity. (**i.e., a restated version of the “C” factor**)
- (H) The business service provider advertises and holds itself out to the public as available to provide the same or similar services.
- (I) The business service provider provides its own tools, vehicles, and equipment to perform the services.
- (J) The business service provider can negotiate its own rates.
- (K) Consistent with the nature of the work, the business service provider can set its own hours and location of work.
- (L) The business service provider is not performing the type of work for which a license from the Contractor’s State License Board is required, pursuant to Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code.

This exemption is not applicable to an “individual worker,” as opposed to a business entity, who performs labor or services for a *contracting business*.<sup>24</sup> It is not clear how to reconcile this exception with the general terms of this exemption (set forth above) which explicitly state that the exemption applies to a sole proprietorship who provides services for a *contracting business*. The

---

<sup>21</sup> New Labor Code section 2750.3(e).

<sup>22</sup> For a summary explanation of the *Borello* test, see above note 3.

<sup>23</sup> New Labor Code section 2750.3(e)(1).

<sup>24</sup> New Labor Code section 2750.3(e)(2).

new law offers no guidance for determining when an “individual worker” who operates a sole proprietorship would be ineligible for this exemption on account of being an “individual worker.”

The new law also indicates that the exemption does not apply in determining the status of an individual working for a *business service provider* (as opposed to working for a *contracting business*).<sup>25</sup>

Finally, the new law<sup>26</sup> states that this exemption for a bona fide business-to-business contracting relationship does not alter or supersede any existing rights under Section 2810.3, which pertains to “labor contractors.”<sup>27</sup>

## 5. Subcontracts in the Construction Industry

The relationship between a contractor and an individual performing work pursuant to a subcontract in the construction industry is exempt from both the new “ABC” test and the holding in *Dynamex*, provided that the contractor satisfies a statutory conjunctive test set forth below.<sup>28</sup> If this exemption applies, the status of the individual is governed by Labor Code section 2750.5 and by the *Borello* test<sup>29</sup> (**i.e., a restated version of the “A” factor**).

The statutory conjunctive test for the relationship between a contractor and an individual performing work pursuant to a subcontract in the construction industry is satisfied if the contractor demonstrates that all of the following factors are satisfied.<sup>30</sup>

- (1) The subcontract is in writing.
- (2) The subcontractor is licensed by the Contractors State License Board and the work is within the scope of that license.
- (3) If the subcontractor is domiciled in a jurisdiction that requires the subcontractor to have a business license or business tax registration, the subcontractor has the required business license or business tax registration.
- (4) The subcontractor maintains a business location that is separate from the business or work location of the contractor.
- (5) The subcontractor has the authority to hire and to fire other persons to provide or to assist in providing the services.
- (6) The subcontractor assumes financial responsibility for errors or omissions in labor or services as evidenced by insurance, legally authorized indemnity obligations, performance bonds, or warranties relating to the labor or services being provided.
- (7) The subcontractor is customarily engaged in an independently established business of the same nature as that involved in the work performed. (**i.e., a restated version of the “C” factor**)

---

<sup>25</sup> New Labor Code section 2750.3(e)(3).

<sup>26</sup> New Labor Code section 2750.3(e)(4).

<sup>27</sup> A labor contractor is defined in Cal. Labor Code section 2810.3(a)(3) to mean, subject to certain exceptions, an individual or entity that supplies, either with or without a contract, a client employer with workers to perform labor within the client employer’s usual course of business

<sup>28</sup> New Labor Code section 2750.3(f).

<sup>29</sup> For a summary explanation of the *Borello* test, see above note 3.

<sup>30</sup> *Id.*

(8) (A) Paragraph (2) shall not apply to a subcontractor providing construction trucking services for which a contractor’s license is not required by Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code, provided that all of the following criteria are satisfied:

- (i) The subcontractor is a business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation.
- (ii) For work performed after January 1, 2020, the subcontractor is registered with the Department of Industrial Relations as a public works contractor pursuant to Section 1725.5, regardless of whether the subcontract involves public work.
- (iii) The subcontractor utilizes its own employees to perform the construction trucking services, unless the subcontractor is a sole proprietor who operates their own truck to perform the entire subcontract and holds a valid motor carrier permit issued by the Department of Motor Vehicles.
- (iv) The subcontractor negotiates and contracts with, and is compensated directly by, the licensed contractor.

(B) For work performed after January 1, 2020, any business entity that provides construction trucking services to a licensed contractor utilizing more than one truck shall be deemed the employer for all drivers of those trucks.

(C) For purposes of this paragraph, “construction trucking services” mean hauling and trucking services provided in the construction industry pursuant to a contract with a licensed contractor utilizing vehicles that require a commercial driver’s license to operate or have a gross vehicle weight rating of 26,001 or more pounds.

(D) This paragraph shall only apply to work performed before January 1, 2022.

(E) Nothing in this paragraph prohibits an individual who owns their truck from working as an employee of a trucking company and utilizing that truck in the scope of that employment. An individual employee providing their own truck for use by an employer trucking company shall be reimbursed by the trucking company for the reasonable expense incurred for the use of the employee owned truck.

## 6. Certain Referral Agencies

If a business entity formed as a sole proprietor, partnership, limited liability company, limited liability partnership, or corporation (“*service provider*”)<sup>31</sup> provides services to clients<sup>32</sup> through a referral agency, such relationship will be exempt from both the new “ABC” test and the holding in *Dynamex*, provided that the *referral agency* demonstrates that a statutory conjunctive test set forth below is satisfied.<sup>33</sup> If this exemption applies, the status of the *service provider* shall be governed by the *Borello* test<sup>34</sup> (**i.e., a restated version of the “A” factor**).

---

<sup>31</sup> For purposes of this exemption, the term “service provider” is defined to mean “a person or business who agrees to the referral agency’s contract and uses the referral agency to connect with clients.” New Labor Code section 2750.3(g)(2)(E).

<sup>32</sup> For purposes of this exemption, the term “client” is defined to mean “a person or business that engages a service contractor through a referral agency.” New Labor Code section 2750.3(g)(2)(B).

<sup>33</sup> New Labor Code section 2750.3(g).

<sup>34</sup> For a summary explanation of the *Borello* test, see above note 3.



*General Information – Not Legal Advice*

The scope of this exemption is limited by the statutory definition given the term *referral agency*, which is defined as a business that connects clients with *service providers* that provide the following types of services:<sup>35</sup>

- **graphic design**
- **photography**
- **tutoring**
- **event planning**
- **minor home repair**
- **moving**
- **home cleaning**
- **errands**
- **furniture assembly**
- **animal services**
- **dog walking**
- **dog grooming**
- **web design**
- **picture hanging**
- **pool cleaning**
- **yard cleanup**

The statutory conjunctive test for a *service provider* who provides services to clients through a *referral agency* is satisfied if the *referral agency* demonstrates that all of the following factors are satisfied.<sup>36</sup>

- (A) The service provider is free from the control and direction of the referral agency in connection with the performance of the work for the client, both as a matter of contract and in fact. **(i.e., a restated version of the “A” factor)**
- (B) If the work for the client is performed in a jurisdiction that requires the service provider to have a business license or business tax registration, the service provider has the required business license or business tax registration.
- (C) If the work for the client requires the service provider to hold a state contractor’s license pursuant to Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code, the service provider has the required contractor’s license.
- (D) The service provider delivers services to the client under service provider’s name, rather than under the name of the referral agency.
- (E) The service provider provides its own tools and supplies to perform the services.
- (F) The service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed for the client. **(i.e., a restated version of the “C” factor)**
- (G) The service provider maintains a clientele without any restrictions from the referral agency and the service provider is free to seek work elsewhere, including through a competing agency. **(i.e., a restated version of the “C” factor)**

---

<sup>35</sup> New Labor Code section 2750.3(g)(2)(C).

<sup>36</sup> New Labor Code section 2750.3(g)(1).

(H) The service provider sets its own hours and terms of work and is free to accept or reject clients and contracts.

(I) The service provider sets its own rates for services performed, without deduction by the referral agency.

(J) The service provider is not penalized in any form for rejecting clients or contracts. This subparagraph does not apply if the service provider accepts a client or contract and then fails to fulfill any of its contractual obligations.

This exemption is not applicable to an “individual worker,” as opposed to a business entity, who performs services for a client through a referral agency.<sup>37</sup> This creates the same conflict as discussed above with respect to a bona fide business-to-business contracting relationship. It is not clear how to reconcile this exception with the general terms of this exemption (set forth above) which explicitly state that the exemption applies to a sole proprietorship who provides services to clients through a referral agency. The new law offers no guidance for determining when an “individual worker” who operates a sole proprietorship would be ineligible for this exemption on account of being an “individual worker.”

## **7. Motor Clubs**

The seventh, and final, category of exemptions exempts from both the new “ABC” test and the holding in *Dynamex* the relationship between a motor club holding a specified certificate of authority and an individual performing services pursuant to a contract between the motor club and a third party to provide motor club services utilizing the employees and vehicles of the third party.<sup>38</sup> Instead, the status of such individual relative to the motor club shall be governed by *Borello*,<sup>39</sup> provided that the motor club demonstrates that the third party is a separate and independent business from the motor club.

## **II. AB 5 Provisions Relating to Workers’ Compensation**

AB 5 amended the workers’ compensation provisions to adopt the new “ABC” test and its corresponding seven statutory exemptions (discussed above) for determining an individual’s status, as an employee or independent contractor.<sup>40</sup>

## **III. AB 5 Provisions Relating to Unemployment**

AB 5 amended the Unemployment Insurance Code to provide:<sup>41</sup>

Any individual providing labor or services for remuneration has the status of an employee rather than an independent contractor unless the hiring entity demonstrates all of the following conditions:

---

<sup>37</sup> New Labor Code section 2750.3(g)(3).

<sup>38</sup> New Labor Code section 2750.3(h).

<sup>39</sup> For a summary explanation of the *Borello* test, see above note 3.

<sup>40</sup> AB 5 section 3.

<sup>41</sup> AB 5 sections 4 and 5.

- (1) The individual 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.
- (2) The individual performs work that is outside the usual course of the hiring entity’s business.
- (3) The individual is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

These changes to the Unemployment Insurance Code differ from the changes AB 5 made to the workers’ compensation provisions. These changes codify the “ABC” test as part of the Unemployment Insurance Code. By contrast, the workers’ compensation provisions were amended to incorporate New Labor Code section 2750.3, which also includes the seven statutory exemptions. Accordingly, it is not clear whether the seven statutory exemptions (discussed above) apply for purposes of unemployment.

#### **IV. Enhanced Enforcement Provisions**

AB 5 also amended California’s Labor Code to authorize a new right of action for injunctive relief to “prevent the continued misclassification of employees as independent contractors.”<sup>42</sup> The new law permits such a lawsuit to be prosecuted against a putative employer by the Attorney General, by certain city attorneys and by certain city prosecutors. These actions can be predicated on their own complaint or upon the complaint of a board, officer, person, corporation, or association.

#### **V. Effective Dates**

The effective date for each California law affected by AB 5 is discussed below.

##### **(A) Labor Code**

For purposes of California’s Labor Code, the new “ABC” test, together with its statutory exemptions, applies to work performed on or after January 1, 2020.<sup>43</sup>

##### **(B) Wage Orders**

For purposes of California wage orders, the *Dynamex* decision, which adopted an “ABC” test for purposes of one of the three alternative tests for purposes of a California wage order, is effective as of the date of that decision, which is April 30, 2018. Whether the *Dynamex* decision also applies on a retroactive basis, is an open issue at this time.

AB5 provides that the “ABC” test being codified is to be treated as a clarification of existing law with respect to California wage orders (and to violations of the Labor Code relating to such wage orders),<sup>44</sup> and that the seven statutory exemptions from the new “ABC” test

---

<sup>42</sup> New Labor Code section 2750.3(h).

<sup>43</sup> New Labor Code section 2750.3(i)(3).

<sup>44</sup> New Labor Code section 2750.3(i)(1).

(discussed above) are to be applied retroactively to the maximum extent permitted by law.<sup>45</sup> The apparent intent of this provision is for the statutory exemptions to apply to the same extent that the *Dynamex* decision applies, to the extent permitted by law.

**(C) Workers' Compensation**

For purposes of worker's compensation, the new "ABC" test, together with its statutory exemptions, is effective July 1, 2020.<sup>46</sup>

**(D) Unemployment**

For purposes of California's Unemployment Insurance Code, the effective date is ambiguous. AB 5 amends the California Labor Code to provide that the codified "ABC" test, together with its statutory exemptions, is to be applied for purposes of the Labor Code, the Unemployment Insurance Code, and wage orders, and that these provisions apply to work performed on or after January 1, 2020.<sup>47</sup>

However, AB 5 also amends the California Unemployment Insurance Code, itself, to statutorily adopt the new "ABC" test for determining worker status, with no stated effective date.

It follows that the effective date for the changes to the Unemployment Insurance Code could be either January 1, 2020, or the date the amendments to the Unemployment Insurance Code are deemed effective.

**VI. Comments**

AB 5 appears to represent a radical social experiment based on a belief that individuals are treated as independent contractors because that is how a business chooses to treat them, and not because individuals choose to operate as independent entrepreneurs. Unfortunately, those individuals who actually do choose to operate as independent entrepreneurs will suffer as a consequence of AB 5, because they likely will find it increasingly difficult to find companies willing to do business with them in California.

The "ABC" test that will soon be the pervasive test for purposes of California employment laws is a fundamentally flawed test. The "A" factor of this test is the traditional common-law test. The "ABC" test essentially treats as employees those individuals who qualify as independent contractors under the traditional common-law test but do not also satisfy the additional "B" and "C" factors.

The "B" factor is satisfied by showing that "the person performs work that is outside the usual course of the hiring entity's business." This factor operates to prevent an independent contractor from performing services for a client that are within the course of the client's business. For many client companies, the application of this factor requires a metaphysical analysis to divine

---

<sup>45</sup> New Labor Code section 2750.3(i)(2).

<sup>46</sup> AB 5 section 3.

<sup>47</sup> New Labor Code section 2750.3(i)(3).

*General Information – Not Legal Advice*

the contours of its business. Not surprisingly, this factor has given rise to much litigation and different interpretations in the different jurisdictions that apply an “ABC” test.

For example, consider an individual who is a Ph.D. economist and for the past five years has been operating a freelance business of providing economic consulting services out of leased office space. This individual advertises the services widely and has a large number of clients. The “B” factor of an “ABC” test would cause this individual to be treated as an employee of a client if the client happened to also be in the business of providing economic consulting services.

The “C” factor is satisfied by showing that “the person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.” This factor operates to deny independent-contractor status to an individual who does not take the actions that the government believes are indicative of the individual actually operating a business.

For example, consider a recent college graduate with a computer science degree who lives at home and has chosen to offer coding skills to clients on a freelance basis. A friend who just started a new technology business that is thriving would like to contract with the individual, as the individual’s first client, to complete a complex coding project with an estimated duration of three months for a project fee of \$45,000. The “C” factor of an “ABC” test would cause this individual to be treated as employee of the friend’s business, because the individual has no other clients and has not taken any other actions that the government deems to be indicative of operating a business.

While the foregoing examples illustrate how an “ABC” test can operate to deny independent-contractor status to an otherwise legitimate independent entrepreneur, the test is not impossible to satisfy. There are actions a client company can take to strengthen its ability to satisfy this test relative to independent contractors.

For example, a company can carefully define its business to mitigate the risk that the independent contractors it engages would be deemed to provide a service within the course of its business. In addition, we have developed a tool, at [www.certifiedse.com](http://www.certifiedse.com), that legitimate independent contractors can use to show potential clients the actions they have taken to establish their independent business.

The seven statutory exemptions that AB 5 contains arguably mitigate the harshness of the bill, but several of these exemptions are available only if a statutory conjunctive test is satisfied. In some cases, the test for establishing an independent-contractor relationship under an exemption can be more difficult to satisfy than the “ABC” test, itself.

It remains to be seen whether this California experiment will have a net positive or negative impact on the lives of those who provide services in California. While the bill likely will result in more individuals being treated as employees (in some cases against the will of the individual), it

*General Information – Not Legal Advice*

also will discourage independent entrepreneurship, which is harmful to the economy.<sup>48</sup>

\* \* \*

If you have any questions or comments regarding the foregoing, please let us know.

**The foregoing is intended solely as general information and may not be considered tax or legal advice; nor can it be used or relied upon for the purpose of (i) avoiding penalties under any taxing statute or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. You should not take any action based upon any information contained herein without first consulting legal counsel familiar with your particular circumstances.**

---

<sup>48</sup> A 2010 study by Ph.D. economist Jeffrey A. Eisenach found that “[p]olicy changes that curtail independent contracting ... would result in higher unemployment, slower economic growth and reduced economic welfare.” The study also noted that curtailing independent contracting would (i) reduce job creation and small business formation, (ii) reduce competition and increase prices, (iii) create sector specific disruptions, and (iv) produce a less flexible and dynamic work force. The study observed that “one of the most powerful economic explanations for the widespread use of independent contractor relationships is the well-documented fact that independent contractors *prefer* their jobs to an employment arrangement” (emphasis added). Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy*, NAVIGANT ECONOMICS (December 2010) available at: <http://www.naviganteconomics.com/docs/Role%20of%20Independent%20Contractors%20December%202010%20Final.pdf>.