

Client Notification Letter — AB 5

January 23rd, 2020

RE: California's New Law Assembly Bill 5 and the Impact on Worker Classification

On January 1st, 2020, Assembly Bill 5 (AB 5) will go into effect and may impact whether your workers are treated as employees or as independent contractors under California law.

On September 18, 2019, California Governor Gavin Newsom signed into law Assembly Bill 5 ("AB 5"), which establishes a three-pronged test that a business must satisfy to maintain that a worker is an independent contractor for employment purposes in the state. This bill becomes effective **January 1, 2020** and codifies a 2018 Supreme Court of California decision in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903 (*Dynamex*), which redefined the standard for determining whether a worker is an independent contractor or an employee.

The *Dynamex* case held that there is a general presumption that most workers are employees and should be classified as such, with the burden of proof on employers to classify individuals as independent contractors by using what is now referred to as the "three-pronged ABC test." The ABC test is much narrower than that of the multi-factor *Borello* test — the standard previously used in California, which had made it far easier to classify workers as independent contractors. Consequently, for many employers, AB 5 could represent a costly change and expansion of potential risks and exposures including, but not limited to, the following:

- **Wage and hour risks.** Misclassification of workers who are eligible for overtime could result in significant legal exposure for businesses.
- **Workers' compensation programs.** Beyond the fact that more individuals will now be eligible for statutory workers' compensation benefits in the event of work-related injuries, the reclassification of independent contractors will almost certainly increase the cost of insurance for many employers.

Although AB 5 is expected to face legal challenges and there remain unanswered questions, including whether *Dynamex* applies retroactively, businesses should nonetheless begin to prepare. If your business utilizes independent contractors, it is extremely important that you take the time now to understand the impact of this new law and the application of the ABC test to your company, and to take the steps to ensure appropriate compliance with this new law.

While AB 5 applies to California, lawmakers in other states have expressed interest in passing similar legislation. That means businesses not directly affected by the new law should keep an eye on its progress and consider how similar legislation elsewhere could affect their organizations.

What is the three-pronged ABC test?

Under the ABC test, for a worker to be classified as an independent contractor, an employer must first prove the following:

- A. The worker is free from the control and direction of the hiring company “in connection with the performance of the work, from both a ‘practical perspective’ as well as under the contractual agreement between the parties”;
- B. The worker performs work that is “outside the usual course of the hiring company’s business”; and
- C. 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 ABC test is a much stricter standard of proof than the *Borello* test, and, for most companies, meeting all of the above standards set forth in the ABC test will be challenging. It appears that the failure to prove any one of these three prerequisites will be sufficient to establish that the worker is an included employee, rather than an excluded independent contractor.

Who is exempt from AB 5 and who isn’t?

Prior to its passage, AB 5 was the subject of major lobbying efforts on both sides of the issue. As its nickname, the “gig worker bill” suggests, much of the discussion around AB 5 has focused on its effects on Uber and Lyft-type businesses. But the impact is considerably larger than that, with the potential to touch nearly all companies in California that use independent contractors. As it stands now, approximately 50 professions or types of businesses are exempt from the bill. Exemptions include doctors, dentists, insurance agents, lawyers, accountants, real estate agents, hairstylists, and a variety of creative professionals. In addition, AB 5 also exempts business-to-business contracts that meet specific requirements.

An exemption from AB 5 does not mean that workers can automatically be classified as independent contractors. For the vast majority of the exemptions, the bill provides that the determination of employee or independent contractor status shall be governed by the *Borello* test. Consequently, structuring and documenting the independent contractor arrangement to comply with the applicable test, which will usually be the multi-factor *Borello* test, remains crucial for exempt businesses.

Take action now!

Although AB 5 is expected to face legal challenges and there remain some unanswered questions, including whether *Dynamex* applies retroactively, businesses should begin preparations to adapt to the new law. **We strongly encourage you to consult with legal counsel experienced in employment practice matters to review your independent contractor relationships, to determine the appropriateness of these classifications, and to assist you, if necessary, if you are subject to AB 5 to determine if reclassifications may be required to mitigate potential business exposures.**

Please call me if you have any questions, or would like to discuss this further.

Sincerely,

ROBERT L. BORELLI, Certified Public Accountant