

When ABC Is Not As Easy As 1-2-3: New California Law Codifies “ABC Test” For Independent Contractors While Creating Exceptions For Certain Industries And Business Relationships

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On September 18, California Governor Gavin Newsom signed Assembly Bill 5 (AB 5), which adds Section 2750.3 to the California Labor Code. This new law, which was highly anticipated and has far reaching implications for California businesses, becomes effective on January 1, 2020. It codifies that portion of the landmark 2018 California Supreme Court decision, *Dynamex Operations West v. Superior Court*, which held that an individual is presumed to be an employee unless the hiring entity can satisfy all three of the following elements, commonly referred to as the “ABC Test”:

- A. The person must be 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 must perform work that is outside the usual course of the hiring entity’s business.
- C. The person must be customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

The ABC Test, which was intended to reduce the common practice of misclassifying employees as independent contractors, has largely replaced the prior, less rigorous “common law” independent contractor test detailed in *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (“*Borello*”). Unlike the ABC Test, in which all three prongs must be satisfied, the *Borello* test evaluates multiple factors, with the principle consideration being whether “the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired.” *Borello* does not require that all of the factors, which also include considerations such as the worker’s skill and length of service, are met in order to establish independent contractor status.

Certain Industries May Be Exempt From The ABC Test

While many legal commentators predicted that *Dynamex* would be the demise of independent contractors in California, AB 5 limits the application of the ABC Test by specifically identifying a number of industries that are exempt from the ABC Test if the *Borello* factors and certain other statutory requirements are met.

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Those industries in which hiring companies may be permitted to classify workers as contractors without their workers satisfying the ABC Test (but only if the less rigorous *Borello* test is satisfied) include, **but are not limited to**:

- Certain licensed professionals (physicians, surgeons, dentists, podiatrists, psychologists, veterinarians, lawyers, architects, engineers, private investigators, accountants, and real estate licensees) and other professionals who are registered securities broker-dealers or investment advisers or their agents and representatives; or direct sales salespersons (per Section 650 of the Unemployment Insurance Code);
- Commercial fishermen;
- Workers performing repossession services for repossession agencies;
- Certain “Professional Services” including some (but not all) fine artists, professionals in marketing and human resources, travel agents, graphic design, grant writing, payment processing agents through independent sales organizations, enrolled agents who are licensed by the United States Department of the Treasury, some still photographers or photojournalists and some freelance writers, editors, or newspaper cartoonists;
- Services provided by some licensed estheticians, licensed electrologists, licensed manicurists, licensed barbers, or licensed cosmetologists;
- Certain referral agency relationships with specific types of service providers (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, and yard cleanup); and
- Some relationships in the construction industry.

The ABC Test Does Not Apply To Certain Business-To-Business Relationships

AB 5 further provides that the *Borello* test, and not the ABC Test, may still apply to certain business-to-business relationships where one business (the “Contracting Business”) has a written contract to receive services from workers employed by another business (the “Business Service Provider”). To fall within this exception, the Contracting Business must satisfy twelve criteria enumerated in the statute, including requirements that the Business Service Provider maintains a business location that is separate from the business or work location of the contracting business, has a business license, and contracts with other businesses (other than the Contracting Business) to provide the same or similar services.

All of AB 5’s statutory exemptions can be found in the full text of the statute [here](#).

AB 5’s Intent Is To Protect Workers In The “Gig Economy”

According to its legislative history, AB 5 was enacted in large part to respond to California’s loss of revenue in light of the burgeoning “gig economy” in certain industries. In its September 10, 2019 Analysis, the State Assembly noted that the law was intended to address “some of the highest misclassification rates in the economy’s growth industries, including home care, janitorial, trucking, construction, hospitality, security and the app-based ‘on demand’ sector.” Moreover, in its July 18, 2019 Analysis, the State Senate Committee on Labor, Public Employment and Retirement noted that “heightened scrutiny” for misclassification of independent contractors was needed in industries “where there are low barriers to entry and there are significant numbers of employees.” Using electricians, attorneys and janitors as examples, the Committee explained why the greater protection of the ABC Test was not intended or

needed equally for all professions and industries: “Between the finite number of professionals and strict barriers to entry, attorneys and electricians are able to control their working conditions free from coercion and intimidation. Taken together, this places the hypothetical electrician in a different market stratum than the hypothetical janitor.”

What’s Next?

The new law is far from clear, and the Legislature has indicated that it may be amended further in 2020. As stated in the Senate’s published September 9, 2019, analysis of the bill, “As with any complex legislation, it is the norm that future clean-up legislation is necessary to sand down the rough edges and diminish the unseemly gap between the written word of legislation and the hazy hieroglyphics of every day California. AB 5 is no exception.” State government agencies, such as the Franchise Tax Board and the Employment Development Department, may also issue their own guidance. Meanwhile, companies that have misclassified their workers are advised to take immediate remedial action. Penalties for companies found to have intentionally misclassified their workers are significant, ranging from \$10,000 to \$25,000 per worker, along with back wages, penalties for missed meals and rest breaks, and other statutory and civil penalties.

We encourage you to reach out to a member of our Employment Law Group with any questions or concerns.

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