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California Legislature Passes Bill Redefining Independent Contractor Test

Update

- California Assembly Bill 5, which goes into effect on January 1, 2020, was signed into law by California governor Gavin Newsom on September 18, 2019.

The Bottom Line

- The new California bill is intended to curb the misclassification of independent contractors, makes it more difficult to establish independent contractor status and significantly impacts gig economy companies, which rely on independent contractors. Other states may soon follow California's lead: Similar bills are making their way through legislatures in Oregon and Washington, and a coalition of labor groups is pushing similar legislation in New York.
- Employers in California should assess, ahead of the legislation's January 1, 2020 effective date, their classification scheme. Any analysis should take into account whether the classification passes legal muster, the cost of reclassification and the risk of engaging independent contractors. Employers should also consider alternative arrangements as well as arbitration and class action waivers to potentially minimize liability.

On September 10, 2019, California legislators passed a landmark bill toughening the state's employment classification test for independent contractors. The closely watched legislation, which will go into effect on **January 1, 2020**, now awaits the expected signature of Governor Gavin Newsom.

If it becomes law, the legislation will make it more difficult for employers to classify workers as contractors, potentially turning thousands of workers currently classified as contractors into statutory employees and entitling them to all the benefits and protections of employment.

The New California Bill

The bill essentially codifies the California Supreme Court's 2018 *Dynamex Operations v. Superior Court of Los Angeles* (*Dynamex*) decision, which imposed a strict three-prong test to determine if workers are eligible for classification as independent contractors. Before *Dynamex*, California had long applied the common law test adopted by the California Supreme Court in its 1989 *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (*Borello*) decision.

Under *Borello*, employment was determined according to a highly flexible analysis involving numerous factors, focusing primarily on whether the employer had the right to control the manner and means of the alleged employee's work.

The ABC Test

The Court in *Dynamex* adopted a new "ABC test" for purposes of the California Wage Orders (a series of industry-specific regulations published by the California Industrial Welfare Commission).

The ABC test begins by presuming a worker is an employee, and places the burden on the employer to prove each of three factors to overcome the presumption. The worker is properly classified as an independent contractor only if the employer shows all of the following:

1. That the worker 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. That the worker performs work that is outside the usual course of the hiring entity's business; and
3. That the worker is customarily engaged in an independently established trade, occupation or business of the same nature as the work performed.

The new legislation expressly adopts the ABC test set forth in *Dynamex*, and expands the scope of the test, which will now distinguish employees from contractors not only for purposes of the Wage Orders, but for the California Labor Code and the Unemployment Insurance Code as well.

Exceptions to the Bill

The bill includes a number of exceptions for certain workers and situations, including insurance brokers, doctors, securities broker-dealers, investment advisors, direct sales salespersons, real estate licensees, hairstylists and construction subcontractors, among others. Where an exception applies, employers must only satisfy the *Borello* test to classify workers as independent contractors.

In addition, the legislation establishes an additional deterrent for employers by explicitly allowing cities and the state's attorney general to sue non-compliant companies. Historically, if a worker thought they had been misclassified as a contractor, they would have to fight the classification themselves, a difficult prospect for most individuals, particularly those subject to contractual class action waivers.

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