

# Effects of AB5: Employee vs. Independent Contractor

---

HON. ROBERT RASSP, PWCJ LOS ANGELES DISTRICT OFFICE

HON. ERIC LEDGER, WCJ OAKLAND DISTRICT OFFICE

# Disclaimer

---

The opinions expressed by Judges Rassp and Ledger in the following presentation are solely those of the speakers. Judges Rassp and Ledger do not speak for or espouse any opinion of the Workers' Compensation Appeals Board, Department of Industrial Relations, the State of California, or any other entity.

# Overview

---

What we will cover:

- A Brief History of the Definition of Employment
- *Dynamex Operations West, Inc. v. The Superior Court of Los Angeles County.* (4 Cal. 5th 903 [83 Cal. Comp. Cases 817].)
- AB 5
- How Does the ABC Test Work?
- Overview of Labor Code Section 2750.3

# Overview

---

- As of July 1, 2020 will California suddenly have 1,000,000 more employees?
- AB 5 will impact:
  - Employers/Hirers
  - Insurance companies
  - Claims administrators
  - Attorneys
  - Claims professionals
  - Workers' Compensation Judges

# Employee / Independent Contractor

---

Labor Code 3357 defines an employee:

- Any person rendering service for another, other than as an independent contractor, or unless expressly excluded herein, is presumed to be an employee.

Labor Code 3353 defines an independent contractor as follows:

- “Independent contractor” means any person who renders service for a specified recompense for a specified result, under the control of his principal as to the result of his work only and not as to the means by which such result is accomplished.

Prior to AB5, the most prominent case interpreting these sections was *S.G. Borello & Sons, Inc. v. Department of Industrial Relations*, 48 Cal. 3d 341

- Provided factors to consider in weighing a finding of employment based on the scope and purposes of statutes that address classification of employee v. independent contractor
- Was directly on point for workers’ compensation – interpreting Labor Code sections 3353 and 3357

# Borello Factors\*

(“statutory purpose” test of employment)

---

- (1) right to discharge at will, without cause;
- (2) whether the one performing the services is engaged in a distinct occupation or business;
- (3) 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;
- (4) the skill required in the particular occupation;
- (5) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work;
- (6) the length of time for which the services are to be performed;
- (7) method of payment, whether by the time or by the job;
- (8) whether or not the work is part of the regular business of the principal; and
- (9) whether or not the parties believe they are creating the relationship of employer-employee.

\**S.G. Borello & Sons, Inc. v. Dep't. of Industrial Relations* (1989) 48 Cal. 3d 341, at 351.

# *Martinez et. al. v. Combs et. al. (2010)*

## 49 Cal. 4<sup>th</sup> 35

---

Issue: common law definition of employment vs. IWC Wage Order definitions

Facts:

- Workers sue employer for unpaid minimum wage – employer owns strawberry farms – employer gets bankruptcy relief
- Workers then sue two of the produce merchants to whom strawberries were sold
- Question – are the merchants employers?

Holding: NO

- “In actions under section 1194 to recover unpaid minimum wages, the IWC's wage orders do generally define the employment relationship, and thus who may be liable. An examination of the wage orders' language, history and place in the context of California wage law, moreover, makes clear that those orders do not incorporate the federal definition of employment.”

# *Martinez, (con't)*

---

Martinez explains the common law definition of employment, the ICW work order definition, and the interplay between the two.

- Great history of the law of employment discussed

Plaintiff's primary argument was that the "suffer or permit to work" language was broad enough to encompass the purchasers of the strawberries:

- "[T]he concept of downstream benefit as a sufficient basis for liability appears nowhere in the wage order's definition of 'employ' or in the decisions interpreting the child labor statutes from which the IWC borrowed the definition." (*Martinez, supra*, at 70.)
- "Suffer or permit to work" comes from child labor where minor children were sent to work by their parent or parents in order for the family to financially survive



# Dynamex

---

*Dynamex Operations West, Inc. v. The Superior Court of Los Angeles County.* (4 Cal. 5th 903 [83 Cal.Comp.Cases 817].)

Interprets “suffer of permit work” language in 8 CCR 11090 to presume employment and places burden upon the employer to show that the worker was an independent contractor.

## ABC Test:

- (A) 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; and
- (B) that the worker performs work that is outside the usual course of the hiring entity's business; and
- (C) that the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed.
  - *Dynamex*, at 957-958.

# *Curry v. Equilon Enterprises, LLC* (2018)

23 Cal. App. 5<sup>th</sup> 289

---

## Facts:

- Shell Oil (dba Equilon Enterprises LLC) owned 365 service stations in California.
- In 2003, changed business model from direct operations to leased operations.
- Class action lawsuit for wage and hour filed against Shell.
- Shell argued they were not an employer – the leasees were the employers.
- Class argued they were employees of Shell per *Dynamex*

## Holding:

- *Dynamex* holding does not apply to joint employment situations:
  - In conclusion, the “ABC” test set forth in *Dynamex* is directed toward the issue of whether employees were misclassified as independent contractors. Placing the burden on the alleged employer to prove that the worker is not an employee is meant to serve policy goals that are not relevant in the joint employment context. Therefore, it does not appear that the Supreme Court intended for the “ABC” test to be applied in joint employment cases. However, see potentially contrary opinion in *Vazquez v. Jan-Pro Franchising International Inc.* (9<sup>th</sup> Cir. 2019) 923 F. 3d 575 and 939 F. 3d 1050 which indicates the ABC test may apply to a joint employment analysis in certain contexts.

# *Dynamex* Summary

---

- Applied only to wage orders definition of the Industrial Welfare Commission and violations of the Labor Code relating to wage orders (based on the suffer or permit to work standard in wage orders)
- There was a somewhat open question of how far the case law would apply to EDD and Workers' Compensation cases
- Up until the enactment of AB 5, the WCAB encouraged WCJs to use the *Borello* factors and not the ABC test of *Dynamex* (See, e.g. *Moorehouse v. Alisal Guest Ranch* (2019) 2019 Cal. Wrk. Comp. P.D. LEXIS 328; *Perkins v. Knox* (2018) 2018 Cal. Wrk. Comp. P.D. LEXIS 490)
- However that question was resolved by AB 5.
- May apply to minors under 16 – (See Labor Code sections, 1290 and 1297)

# AB 5: Legislative Rationale

---

- Intent of AB 5 is to codify the *Dynamex* decision
- Applies in claims involving the:
  - Labor Code
  - Unemployment Insurance Code
  - Wage orders of the Industrial Welfare Commission
- If a court rules that the ABC test does not apply then the determination of employee-independent contract status shall be determined under the *Borello* factors.

# AB 5

- Codifies the holding in Dynamex with some exceptions.
- Adds section 2750.3 to the Labor Code, amends section 3351, and amends sections 606.5 and 621 to the Unemployment Insurance Code.
- Labor Code Section 2750.3 applies to workers' compensation cases beginning July 1, 2020 while Section 2750.3 applies to the rest of the Labor Code, UI Code, and IWC Wage Orders beginning on January 1, 2020
- Section 3351(i) refers to Labor Code Section 2750.3 for specific determinations of employment for workers' compensation purposes

# AB 5

---

- Labor Code Section 2750.3 for specific determinations of employment for workers' compensation purposes
  - Presumption that all workers are employees
  - Provides the ABC test to determine if a worker is an independent contractor (the answer to A, B, and C all have to be “yes” for there to be a determination that the worker is an independent contractor)
  - If the ABC test is statutorily excluded from a worker's classification then the *Borello* factors analysis occurs, or another specified applicable standard applies (e.g. Business and Professions Code standard for real estate licensees)
  - AB 5 maintains any exceptions to the terms “employee,” “employer,” “employ,” or “independent contractor,” and any extensions of employer status or liability. See Labor Code Section 2750.3(a)(2).

# AB 5 – Effective Dates

---

- For wage order claims, *Dynamex* is already in place and AB 5 merely codifies the holding.
- For all other Labor Code purposes not related to workers' compensation insurance, AB 5's effective date is January 1, 2020.
  - E.G. AB 5 is effective with respect to the Unemployment Insurance Code on January 1, 2020
- For purposes of defining an employee under workers' compensation insurance, effective date is July 1, 2020 for dates of injury on or after 7/1/2020.

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- If the answer is “Yes” to each prong of the ABC Test of Section 2750.3(a) then the worker is an independent contractor and is not an employee of the hirer, unless there is an expressed exception listed elsewhere in the statute.
- “A” = “Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?”
  - If the answer is “yes” to prong A, then the first part of the ABC Test means the worker is an independent contractor
  - The burden of proof is on the hiring entity to establish that the worker is free of such control in the performance of the work



# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- “A” = “Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?”
  - A worker who is subject by contract or actual practice to control a business typically exercises over employees is considered an employee
  - Depending on the nature of the work and overall arrangement between the parties a business need not control the precise manner or detail of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees.

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- “B” = “Does the worker free perform work that is outside the usual course of the hiring entity’s business? See *Dynamex*, 4 Cal. 5<sup>th</sup> 959-960
  - The hiring entity has the burden of proving that the worker performs work that is outside the usual course of its business
  - Contracted workers who perform services like that of an existing employee will likely be viewed as working in the usual course of the hiring entity’s business
  - Examples of services that are part of the hiring entity’s business:
    - A clothing manufacturer hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company that will be sold by the company.
    - A bakery hires a cake decorator to work on a regular basis on custom-designed cakes

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- “B” = “Does the worker free perform work that is outside the usual course of the hiring entity’s business? See *Dynamex*, 4 Cal. 5<sup>th</sup> 959-960
  - The hiring entity has the burden of proving that the worker performs work that is outside the usual course of its business
  - Contracted workers who perform services like that of an existing employee will likely be viewed as working in the usual course of the hiring entity’s business
  - Examples of services that are NOT part of the hiring entity’s business:
    - When a retail store hires an outside plumber to repair a leak in a bathroom on its premises
    - When a retail store hires an outside electrician to install a new electrical line

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- “C” = “Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity? See *Dynamex*, at 4 Cal. 5<sup>th</sup> 962-963
  - The hiring entity cannot simply call the worker an “independent contractor” or by requiring, as a condition of hiring, the worker to sign an agreement that they are an independent contractor
  - The independent business operation has to actually be in existence at the time the work is performed (See *Garcia v. Border Transportation Group* (2018) 28 Cal. App. 5<sup>th</sup> 558, 574).
  - A person who independently decides to go into business takes steps to establish and promote the business (incorporation, licensure, advertisements, routinely offers to provide services of the business to the public or potential customers)
  - If an individual’s work relies on a single employer, Part C is not met, e.g. Part C not established for a taxi driver who had to get a municipal license that could only be used while the driver was employed by a specific taxi company. See *Garcia, supra*.

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- More specific definitions of employment or independent contractor provisions in the Labor Code, IWC wage orders, or Unemployment Insurance Code remain in effect
- Where a court determines the ABC test cannot apply for a reason other than an express exception, the Borello test will apply.
  - For example, if a court were to determine in a case that the ABC test is preempted by an applicable federal law, the Borello test would be used.

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- The Borello test applies instead of the ABC Test for:
  - Licensed insurance agents and brokers\*
  - Licensed physicians, surgeons, dentists, podiatrists, psychologists, or veterinarians
  - Licensed attorneys, architects, engineers, private investigators, and accountants
  - Some registered security brokers-dealers or investment advisers or their agents and representatives
  - Some direct salespersons
  - Certain licensed commercial fishermen (only through 12/31/22 unless extended by the legislature)
  - Certain newspaper distributors or carriers (only through 12/31/20 unless extended by the legislature)

\*2750.3 A person or organization who is licensed by the Department of Insurance pursuant to Chapter 5 (commencing with Section 1621), Chapter 6 (commencing with Section 1760), or Chapter 8 (commencing with Section 1831) of Part 2 of Division 1 of the Insurance Code.

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- Additional requirements are met in order to use the *Borello* test and not the ABC test for:
  - Contracts for marketing, human resources administration, travel agents, graphic designers, grant writers, fine artists, enrolled agents to practice before the IRS, payment processing agents, still photographers/photojournalists, freelance writers, editors, newspaper cartoonists, licensed barbers, cosmetologists, electrologists’ estheticians, manicurists (through 12/31/20 only)
  - Certain subcontracts in the construction industry including trucking (conditions through 12/31/21 only) *Borello* and Labor Code Section 2750.5 list requirements
  - AB 5 maintained the burden on the hiring entity to prove independent contractor status of a worker

# AB 5 – The “ABC Test” in Labor Code Section 2750.3

---

- Additional requirements are met in order to use the Borello test and not the ABC test for:
  - Service providers who are referred to customers through referral agencies to provide: graphic design, photography, tutoring, event planning, home repair, moving, home cleaning, errands, furniture assembly, animal services, dog walking, dog grooming, web design, picture hanging, pool cleaning or yard cleanup.
  - For these occupations the Borello test is used to determine if the worker is an employee of the referral agency
  - Business and Professions Code Section 10032(b) determines status for real estate licensees; if that section does not apply then ABC test applies after 7/1/2020 for workers' comp purposes; B&P Code Section 7500.2 for some repossession agencies
  - You are cautioned to review all of AB 5 to see if there are any exceptions



# AB 5 – *Res Judicata*?

---

- EDD, CUIAB, WCAB, OSHAB, and the Labor Commissioner's Office may issue determination as to employment or independent contractor status between a worker and a hirer
- Is a final determination or decision issued by one sub-agency binding on another sub-agency as to that finding of employment or independent contractor?
- The ultimate solution may be administrative or by appellate decision

# AB 5: HYPOTHETICAL

---

- If a worker signs a written agreement stating that they are an independent contractor, the hirer does not provide payroll deductions or withholding for taxes, or social security, or SDI for the worker and the end of the year gives the worker a IRS Form 1099 rather than a W-2 does this make the worker an independent contractor?
- No!! These factors do not determine employment status
- See Labor Code Section 226.8 that prohibits willful misclassification of individuals as independent contractors



# AB 5 Excepted Professions (con't)

---

Statutory Exceptions:

**General catch-all provision:**

(3) If a court of law rules that the three-part test in paragraph (1) cannot be applied to a particular context based on grounds other than an express exception to employment status as provided under paragraph (2), then the determination of employee or independent contractor status in that context shall instead be governed by the California Supreme Court's decision in *S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal.3d 341 (Borello).

# AB 5 Excepted Professions (con't)

---

(1) A person or organization who is licensed by the Department of Insurance pursuant to Chapter 5 (commencing with Section 1621), Chapter 6 (commencing with Section 1760), or Chapter 8 (commencing with Section 1831) of Part 2 of Division 1 of the Insurance Code.

- AKA – **an insurance agent or broker**

(2) A **physician and surgeon, dentist, podiatrist, psychologist, or veterinarian** licensed by the State of California pursuant to Division 2 (commencing with Section 500) of the Business and Professions Code, performing professional or medical services provided to or by a health care entity, including an entity organized as a sole proprietorship, partnership, or professional corporation as defined in Section 13401 of the Corporations Code. Nothing in this subdivision shall apply to the employment settings currently or potentially governed by collective bargaining agreements for the licensees identified in this paragraph.

# AB 5 Excepted Professions (con't)

---

(3) An individual who holds an active license from the State of California and is practicing one of the following recognized professions: **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 Securities and Exchange Commission or the Financial Industry Regulatory Authority or licensed by the State of California under Chapter 2 (commencing with Section 25210) or Chapter 3 (commencing with Section 25230) of Division 1 of Part 3 of Title 4 of the Corporations Code.

(5) A **direct sales salesperson** as described in Section 650 of the Unemployment Insurance Code, so long as the conditions for exclusion from employment under that section are met.

(6) A **commercial fisherman** working on an American vessel as defined in subparagraph (A) below.

# AB 5 Excepted Professions (con't)

---

(c) (1) Subdivision (a) and the holding in *Dynamex* do not apply to a **contract for “professional services”** as defined below, and instead the determination of whether the individual is an employee or independent contractor shall be governed by *Borello* if the hiring entity demonstrates that all of the following factors are satisfied:

- SPECIFIC CRITERIA OF CONTRACT MUST BE MET

Covers the following “professional services”:

Marketing

Administrator of human resources

Travel Agents

Graphic Designers

Grant Writers

Fine Artists

Tax Return Preparers

Payment Processing Agent

# AB 5 Excepted Professions (con't)

---

“Professional services” (con't):

Still photographers and Photojournalists (not working on motion pictures)

Freelance writer

Editor

Newspaper cartoonist

Licensed esthetician

Licensed electrologist

Licensed manicurist

Licensed barber

Licensed cosmetologist



# AB 5 – Further Exemptions

---

(1) 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”), the determination of employee or independent contractor status of the business services provider shall be governed by Borello, if the contracting business demonstrates that all of the following criteria are satisfied:

- THEREAFTER FOLLOWS A LIST OF REQUIREMENTS TO ENSURE THE BUSINESS TO BUSINESS CONTRACT IS BONA-FIDE

# AB 5 - Subcontractors

---

Construction Subcontractors:

Labor Code 2750.3(f)

- Subdivision (a) and the holding in *Dynamex* do not apply to the relationship between a contractor and an individual performing work pursuant to a **subcontract in the construction industry**, and instead the determination of whether the individual is an employee of the contractor shall be governed by Section 2750.5 and by Borello, if the contractor demonstrates that all the following criteria are satisfied:
- THEREAFTER FOLLOWS A LIST OF REQUIREMENTS TO ENSURE THE SUB-CONTRACT IS BONA-FIDE

# AB 5 – Motor Club Exception

---

(h) Subdivision (a) and the holding in *Dynamex* do not apply to the relationship between a motor club holding a certificate of authority issued pursuant to Chapter 2 (commencing with Section 12160) of Part 5 of Division 2 of the Insurance Code 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 and, instead, the determination whether such an individual is an employee of the motor club shall be governed by *Borello*, if the motor club demonstrates that the third party is a separate and independent business from the motor club.

# AB 5 - Enforcement

---

(j) **In addition to any other remedies available**, an action for injunctive relief to prevent the continued misclassification of employees as independent contractors may be prosecuted against the putative employer in a court of competent jurisdiction by the Attorney General or by a city attorney of a city having a population in excess of 750,000, or by a city attorney in a city and county or, with the consent of the district attorney, by a city prosecutor in a city having a full-time city prosecutor in the name of the people of the State of California upon their own complaint or upon the complaint of a board, officer, person, corporation, or association.

# AB 5 – Tidbits

---

- EDD: Can make employment determination through an employment tax audit, UI, or SDI claim. For work before 1/1/2020, see Unemployment Ins. Code Section 621(b) which requires EDD to use the *Borello* factors test
- Franchise Tax Board has guidance on AB 5 for purpose of income tax for independent contractors or employees at:  
<https://www.ftb.ca.gov/file/business/industries/worker-classification-and-ab-5-faq.html>.
- A worker can be considered an employee under CA law but not under federal law due to different criteria
- *LWDA has also posted guidance on AB 5, which is available at*  
<https://www.labor.ca.gov/employmentstatus/>.

Questions????

---