Assemblywoman Lorena Gonzalez, 80th Assembly District

AB 5 – Stop the Misclassification of Workers

IN BRIEF

Assembly Bill 5 codifies a widely used legal standard known as the "ABC test" to determine employment status for the purposes of the California Labor and Unemployment Insurance Codes and clarifies the test's application. In doing so, this bill seeks to end the harmful practice of worker misclassification.

BACKGROUND

In 2004, a misclassification lawsuit was filed against a package and document delivery company called Dynamex which had converted all of its delivery drivers from employees of the company to independent contractors. The company used this tactic to cut costs at the expense of its own workers. Drivers continued to perform essentially the same job, but without the protections afforded under the California Labor and Unemployment Insurance Codes and wage orders.

In April 2018, the California Supreme Court issued the landmark decision *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* which unanimously ruled in favor of the drivers and based its ruling on a three part "ABC" test used to determine employment status in other states. The court found workers can only be classified as independent contractors if a hiring business can prove the following three conditions:

> (A): The worker is "free from the control and direction" of the company that hired them while they perform their work.
>
> (B): The worker is performing work that falls "outside the hiring entity's usual course or type of business."
>
> (C): The worker has their own independent business or trade beyond the job for which they were hired.

New Jersey, Massachusetts and Connecticut also use the ABC test to determine employment status for their wage and hour laws. Twenty-six states use the test to determine employment status for purposes of unemployment insurance eligibility.

PROBLEM

For decades, many companies have increasingly shifted toward a business model that relies on the misclassification of employees and is based on exploiting workers, lowering labor standards in the workplace, and evading state and federal taxes. Companies that misclassify their workers force them to act as an "independent business" while the employer maintains the right to set rates, direct work, and impose discipline and control upon the worker. In many cases, workers employed with these companies are performing the same work as traditional employees, but without any of the rights or protections afforded to workers under California Labor and Unemployment Insurance Codes, such as the right to paid sick days, the right to organize to improve wages and working conditions, anti-discrimination or retaliation protections, Social Security, and access to critical worker safety-net programs like unemployment insurance and workers' compensation. Low-wage and immigrant workers who are already highly vulnerable to exploitation are disproportionately harmed when companies deny workers their basic rights to minimum wage and overtime, and instead, choose to pass down the economic risk onto the workers and abandon their responsibilities as employers.

Companies have used the practice of misclassification to cut costs at the expense of workers and in turn, created an insurmountable challenge for working families trying to make ends meet. This exploitative business practice has proliferated in industries such as trucking, delivery, janitorial and construction for decades. The advent of app-based companies and the "gig economy" has only further accelerated the practice of misclassification and resulted in declining working conditions and increased reliance on public assistance. In California, almost half of workers who participate in the gig economy struggle with poverty[1]. Further evidence suggests that the shift toward relying on contractors, coupled with larger corporations reducing the wages of low- and mid-level workers, may have accounted for as much as 20 percent of the increasing wage inequality between 1989 and 2014.[2] Misclassified workers must pay higher taxes because they are responsible for paying both the employer and employee share of Social Security, Medicare, and unemployment taxes. Collectively, workers across the country can lose as much as $2.72 billion annually due to misclassification[3], while businesses stand to save 15 to 30 percent on labor costs[4] as a result.

The misclassification of workers has widespread repercussions for our economy and state's well-being. The practice of misclassification creates unfair competition for responsible contractors and law-abiding employers who honor their lawful obligations to their employees, yet are forced to compete with other companies that use an illegal business model. Businesses misclassifying their workers undermine worker safety-net programs and leave an undue burden on law-abiding businesses in the form of annual unemployment insurance taxes and workers' compensation premiums estimated at $831.4 million and $2.54 billion

[1] https://www.prri.org/research/renewed_struggle_for_the_american_dream-prri_2018_california_workers_survey/
[2] https://faculty.wharton.upenn.edu/wp-content/uploads/2017/02/fswe_orgsci-v3.3.pdf
[3] https://www.gao.gov/assets/120/116521.pdf
[4] https://www.nelp.org/wp-content/uploads/2015/03/1099edFactSheet2010.pdf

respectively[5]. Ultimately, when workers without protections are laid off or cannot find a job, get sick or injured on the job, or they retire, taxpayers end up bearing the costs of supporting them. The Division of Labor Standards Enforcement estimates that the misclassification of workers results in an estimated annual loss of $7 billion per year in payroll tax revenue to the state, that otherwise could have supported General Fund programs for public safety, education, and public infrastructure.

SOLUTION

The misclassification of workers is a clear detriment to working families, local businesses, and costs taxpayers billions of dollars each year. This harmful practice undermines the hard-fought laws passed by the Legislature that have historically positioned California as a national leader in creating the strongest worker protections in the country.

AB 5 codifies the ABC test prescribed in the Court's *Dynamex* ruling to help ensure that working Californians can retain all the rights and job protections afforded to employees under the California Labor Code and Unemployment Insurance Code. The bill will apply to the wage orders of the Industrial Welfare Commission, in addition to provisions of Labor and Unemployment Insurance Codes, while preserving existing statutory exemptions and grants of employment. By codifying this landmark ruling, the bill creates a clear and consistent definition for employment and stands to raise the working standards for millions of workers in the state of California.

Contracting for Professional Services

AB 5 clarifies the test's application to provide certainty to industries that are unsure of the case's implications. Specifically, the bill clarifies that the following professions will be governed by the test adopted by the California Supreme Court in the case of *S. G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989):

- Insurance agents and brokers
- Physicians, surgeons, dentists, podiatrists, and psychologists
- Lawyers
- Architects
- Engineers
- Veterinarians
- Private investigators
- Accountants
- Securities broker-dealers and investment advisors
- Direct salespersons
- Commercial fishermen
- Real estate licensees
- Repossession agents

The bill clarifies that the employment status of the following professionals will be determined by the test adopted in *Borello,* if the hiring entity can demonstrate that the professional (1) maintains a business location separate from the hiring entity; (2) has a business license and any required professional licenses or permits; (3) has the ability to set or negotiate their own rates; (4) has the ability to set their own hours; (5) customarily engages in the same type of work performed under the contract; (6) holds themselves out to other potential customers for the same type of work; (7) exercises discretion and independent judgment:

- Marketing professionals
- Administrators of human resources
- Travel agents
- Graphic designers
- Grant writers
- Fine artists
- Enrolled agents
- Payment processing agents
- Still photographers and photojournalists, as long as the professional maintains no more than 35 accepted and licensed content submissions by a single publication or stock photography company per year.
- Freelance writers, editors, and newspaper cartoonists, as long as the professional maintains no more than 35 accepted content submissions by a single publication or company per year.
- Licensed cosmetologists, barbers, estheticians, electrologists, and manicurists as long as the professional issues the salon owner a Form 1099 if they rent their business space, processes their own payments, is paid directly by their clients, maintains sole discretion of the number of clients and which clients they service, has their own book of business, and schedules their own appointments. The provision relating to licensed manicurists will become inoperative on January 1, 2022.

Business-to-Business Contracts

The bill clarifies that a bona fide business contracting with another bona fide business is not subject to the test under *Dynamex;* instead, the determination of employment status of the business providing the service will be governed by the test under *Borello. Borello* governs if the contracting business can demonstrate that the business service provider (1) is free from control and direction from the contracting business; (2) provides services directly to the contracting business itself, instead of its customers; (3) has a written contract with the contracting business; (4) has a business license or business tax registration; (5) maintains a business location separate from the contracting business; (6) customarily engages in the same type of work performed under the contract; (7) contracts with other businesses to provide the same or similar services; (8) maintains clientele without restrictions from the hiring entity; (9) advertises and holds itself out to the public for the same or similar services; (10) provides its own tools, vehicles, and equipment; and (11) can negotiate its own rates, set hours, and location of work. The bill also clarifies that the practice

[5] https://www.nelp.org/wp-content/uploads/On-Demand-Economy-State-Labor-Protections.pdf

of a motor club contracting with third-party towing company is not subject to the test under *Dynamex*.

Subcontracting in Construction Industry

The bill clarifies that the employment status of an individual who is subcontracted by a construction contractor is determined by the test under *Borello,* if the construction contractor demonstrates that the subcontractor (1) has the subcontract is in writing; (2) is licensed by the Contractors State License Board; (3) has the appropriate business license or business tax registration; (4) maintains a business location separate from the contractor; (5) has the ability to hire and fire other individuals to provide the services; (6) assumes financial responsibility for errors in services; and (7) is customarily engaged in an independently established business of the same nature as the performed work.

Subcontracting Construction Trucking Services

In the case of construction trucking services, the subcontractor must also (1) be a business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation; (2) registered with the Department of Industrial Relations as a public works contractor; (3) utilize its own employees to perform the construction trucking services (unless the subcontractor is a sole proprietorship who operates their own truck and holds a valid motor carrier permit); (4) negotiate, contract with, and be compensated directly by the licensed contractor.

This provision, as it relates to construction trucking services, will sunset on January 1, 2022. This section also clarifies that an individual who owns their own truck may utilize that truck in the scope of their employment and accordingly, will be reimbursed for their expenses.

Referral Agency Service Contracts

The bill clarifies that business entities performing work for a client through a referral agency are not subject to the test under *Dynamex*. This work may consist of graphic design, web design, photography, tutoring, event planning, minor home repair, moving, home cleaning, errands, event planning, furniture assembly, animal services, dog walking, dog grooming, picture hanging, pool cleaning, or yard cleanup.

In order for the test under *Dynamex* to be inapplicable to a business entity providing services to a client or business through a referral agency, the agency must demonstrate that the service provider (1) is free from the control and direction of their agency; (2) has the appropriate state contractor's license, business license, or business tax registration; (3) delivers the service under their own name, instead of the agency's name; (4) provides their own tools and supplies; (5) is customarily engaged in an independently established business of the same nature as the performed work; (6) maintains their own clientele without restrictions from their agency; (7) is free to accept or reject clients and contracts without being penalized in any form; (8) has the ability to seek work elsewhere, including competing agencies; (9) sets their own hours and terms of work; and (10) sets their own rates for services without deductions from their agency.

Implementation & Enforcement

Provisions in the bill which outline criteria that professionals and business entities must adhere to in order to be subject to the test under *Borello* are retroactive. The bill also clarifies that the application of the ABC test beyond the wage orders will be applied prospectively. Worker's compensation requirements under the bill are not retroactive and will be effective July 1, 2020. Finally, AB 5 clarifies that the Attorney General and specified city attorneys can enforce the provisions of the bill by seeking injunctive relief to stop the exploitation of misclassified workers.

SUPPORT

California Labor Federation (sponsor)
State Building and Construction Trades Council
SEIU State Council
California Association of Realtors
California Teamsters Public Affairs Council
UFCW Western States Council
Communications Workers of America, 9th District
American College of Emergency Physicians, CA Chapter
National Association of Insurance and Financial Advisors-CA
Securities Industry and Financial Markets Association
Direct Selling Association
Independent Insurance Agents & Brokers of California
California Association of Health Underwriters
Sierra Club California
Greater California Livery Association
National Employment Law Project
California Nurses Association
California Professional Firefighters
California School Employees Association
California Federation of Teachers
UNITE-HERE
California IATSE Council
SAG-AFTRA
AFSCME
SEIU Local 1000
Conference Board of the Amalgamated Transit Union
California Conference of Machinists
Engineers and Scientists of CA, IFPTE Local 20
Inlandboatmen's Union of the Pacific
International Union of Operating Engineers
Professional and Technical Engineers, IFPTE Local 21
United Farmworkers Union
Utility Workers of America
Western States Council of Sheet Metal, Air, Rail & Transportation
Entertainment Union Coalition
United Auto Workers Local 2865 and Local 5810
UPTE, CWA Local 9119
UDW/AFSCME Local 3930
Courage Campaign
Southern CA Coalition for Occupational Safety & Health

National Domestic Workers Alliance
California Healthy Nail Salon Collaborative
Asian Americans Advancing Justice California
Coalition for Humane Immigrant Rights
California Immigrant Policy Center
California Rural Legal Assistance Foundation
Labor & Employment Committee of National Lawyers Guild
Consumer Attorneys of California
California Employment Lawyers Association
Equal Rights Advocates
Legal Aid at Work
9 to 5 National Association of Working Women
California Alliance for Retired Americans
Western Center on Law and Poverty
Working Partnerships USA

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