

The Evolution of Independent Contractor/Employee Law

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Do you contract Independent Contractors?

- Misclassifying a worker as an independent contractor can be costly.
- Issues related to misclassification:
 - Missed overtime / Rest and Meal period violations;
 - Proper recording of time;
 - Not filing appropriate federal and state tax forms;
 - Not providing the worker with appropriate protections under OSHA.

The Beginning

The “Borello Test”

S.G. Borello & Sons v. Dept. of Industrial Relations, (1989) 48 Cal.3D 341

- In *Borello* the Court analyzed whether a worker was an independent contractor or employee and issued a multifactor test.
- BUT - The most significant factor is whether the person to whom service is rendered (the employer or principal) has control or the right to control the worker both as to the work done and the manner and means in which the work is performed.

SECONDARY “BORELLO FACTORS” TO THE TEST

- Whether the person performing services is **engaged in an occupation or business distinct** from that of the principal;
- Whether or not the **work** is a **part of the regular business of the principal or alleged employer**;
- Whether the **principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work**;

SECONDARY “BORELLO FACTORS” TO THE TEST

- The alleged employee's investment in the equipment or materials required by his or her task or his or her employment of helpers;
- Whether the service rendered requires a **special skill**;
- 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;

SECONDARY “BORELLO FACTORS” TO THE TEST

- The alleged employee's opportunity for profit or loss depending on his or her managerial skill;
- The length of time for which the services are to be performed;
- The degree of permanence of the working relationship;

SECONDARY “BORELLO FACTORS” TO THE TEST

- The **method of payment**, whether by time or by the job; and
- Whether or not the **parties believe they are creating an employer-employee relationship** may have some bearing on the question, but is not determinative since this is a question of law based on objective tests.

“BORELLO FACTORS”: EMPLOYEE V. INDEPENDENT CONTRACTOR

- Primary Factor: Right to control work;
- Secondary Factors:
 - Whether occupation is distinct from principal
 - Whether the principal supplies instrumentalities, tools and place for doing work;
 - Whether service rendered requires a special skill;
 - Method of payment;
 - Whether the parties believe they are engaged in an employee/employer relationship

DYNAMEX

In 2018, the Supreme Court case by the name of Dynamex threw a monkey wrench in **BORELLO TEST** and changed the test which determines whether a worker is an independent contractor or employee.

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DYNAMEX – THREE PRONGED “ABC” TEST

- The court ruled that companies **must use a three-pronged test** in determining whether to classify workers as employees or independent contractors. **This test assumes that workers are employees unless the company demonstrates that they are independent contractors.**

DYNAMEX – THE TEST

- Under the ABC Test a worker is presumed to be an employee and the **burden to demonstrate** their independent contractor status is placed squarely on the shoulders of the hiring company.
- To do this successfully a company must demonstrate that the worker satisfies **all 3 criteria** of the test (1 or 2 doesn't cut it).

DYNAMEX – THE TEST

- A worker can only be classified as an independent contractor if:
 - A. the worker is **free from control and direction** in the performance of services; and
 - B. the worker is **performing work outside the usual course of the business** of the hiring company; and
 - C. the worker is **customarily engaged in an independently established trade, occupation, or business.**

DYNAMEX – THE “A” PRONG OF THE TEST

- Looks at the right of control rather than the exercise of control.
- To a large extent, this is the control aspect of the **Borello Test**. In this sense, it is not particularly new or different from what already existed.

DYNAMEX – THE “B” PRONG OF THE TEST

- One must show that the worker’s job is **independent, separate and distinct** from the company’s business, and not a regular or continuous part of the business.

Example: Retail store hires a plumber to repair leak (Plumber = IC)

Example: Bakery hires cake decorators to work on a regular basis on its custom-designed cakes (Cake Decorator = EE).

DYNAMEX – THE “B” PRONG OF THE TEST

- The Court described this prong as addressing “workers whose roles are most clearly comparable to those of employees than that of independent contractors.”

DYNAMEX – THE “C” PRONG OF THE TEST

- The worker is **customarily engaged in an independent business**, not that he or she could have become so engaged.
- What this means is that the employee is already engaged in the type of business for which he was contracted for.

DYNAMEX: THE “ABC” TEST

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 - A. the worker is **free from control and direction** in the performance of services; and
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THE EVOLUTION CONTINUES

AB-5 Codifies the “ABC” Test

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AB-5: CODIFIED THE “ABC” TEST

- The law went into effect January 1, 2020.
- AB 5 both **expanded and contracted** the reach of the ABC test (Under *Dynamex*).
- **On the one hand**, AB 5 expanded its reach by applying the ABC test to all California Labor Code, Unemployment Insurance Code, and wage order claims.
- **On the other hand**, AB 5 significantly reduced the number of California workers subject to the ABC test by exempting a long list of occupations and types of service providers.

AB-2257 EXEMPTS MORE CALIFORNIA WORKERS FROM THE ABC TEST

SIGNIFICANT PUSH BACK TO AB-5

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AB-2257: SIGNIFICANT PUSH BACK TO AB-5

- AB 5 faced concerted pushback from many industries and professions.
- AB-2257 created more carve out of exceptions to AB-5.

AB-2257: SIGNIFICANT PUSH BACK TO AB-5

- In all, there are now 109 categories of workers exempted from the ABC test in California under AB-2257.
- Notably **absent from the new exemptions** were the California **trucking industry**, the **gig economy companies** despite significant lobbying efforts.

AB-2257: EXEMPT FROM AB-5 “ABC” TEST

- It's important to keep in mind that a worker is not automatically exempt because the **Borello Test** applies to these exempt professions.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

For the “business-to-business” exemption to apply, there are a number of conditions that must be met:

1. The “business service provider” (i.e., contractor) **must be free from the control** and direction of the “contracting business entity” in connection with the performance of the work, both under the contract for the performance of the work and in fact.
2. The business service provider **must be providing services directly to the contracting business**, rather than to customers of the contracting business.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

3. All independent contractor relationships must be formalized in a **written contract document**.

4. The business service provider **has all required business licenses or business tax registration**.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

5. The business service provider maintains a business location that is separate from the business or work location of the contracting business.

What this means for the business: The “business-to-business” exemption will not apply for any contractor with the same location or address as the contracting business.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

6. The business service provider is **customarily engaged in an independently established business** of the same nature as that involved in the work performed.

What this means for businesses: A contractor will only qualify for the “business-to-business” exemption if the work he or she is performing is the same work he or she usually performs in the course of his or her business.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

7. The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the contracting business.

What this means for businesses: The “business-to-business” exemption will not apply if the contractor’s only customer is the contracting business. Contracting businesses seeking to satisfy the exemption will want to ensure—at the outset of the contracting relationship—that the contractor has other customers and sources of revenue.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

8. The business service provider advertises and holds itself out to the public as available to provide the same or similar services.

What this means for businesses: To qualify for the “business-to-business” exemption, contracts should be between legitimate, full-scale businesses. Where possible, avoid contracting with a single individual or “fly-by-night” operations. Contracting businesses should consider requiring contractors to submit business cards or other marketing materials establishing that the contractor holds itself out to the public as available to provide the services for which it is being engaged.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

9. The business service provider provides its own tools, vehicles, and equipment to perform the services.

What this means for businesses: Where a contractor cannot supply its own tools, vehicles, equipment, and other instrumentalities used to perform the work, the “business-to-business” exemption will not apply.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

9. The business service provider provides its own tools, vehicles, and equipment to perform the services.

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AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

10. The contractor can negotiate its own rates.

What this means for businesses: The legislative history of AB 5 indicates: “[I]f a company does not permit its ‘independent contractors’ to set their own rates, or only permits rate setting in a narrow band, such claims of independent contractor status should be met with skepticism.” Analysis, Senate Cmte. on Labor (Jul. 10, 2019), p. 9. To satisfy the rate negotiation requirement, contracting businesses will need to provide evidence of rate negotiation or unique contract terms. This might take the form of differing rates and other terms in contracts with differing contractors for the same or similar jobs. Records of negotiation (e.g., emails or contract drafts) could also serve as proof. Businesses that simply set rates for contractors on a “take-it-or-leave-it” basis will have a difficult time satisfying this criterion.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

11. The contractor can set its own hours and location of work.

What this means for businesses: It is unlikely that this requirement would prevent a contracting business from setting deadlines for completion of an overarching job or project.

12. The “business-to-business” exemption does not apply to an individual worker (as opposed to a business entity) who performs labor or services for a contracting business.

What this means for businesses: Contracting businesses seeking to satisfy the exemption should contract **only with a contractor formally registered as a business** entity (as a corporation, LLC, partnership, or sole proprietorship) with the California Secretary of State or other equivalent state business registry. Contracts with individual persons will not satisfy the “business-to-business” exemption.

AB-2257: EXEMPT FROM THE “ABC” TEST – BUSINESS TO BUSINESS

- No magic wand.
- Exemption from AB-5 does not mean that workers can automatically be classified as independent contractors by virtue of waving some kind of classification magic wand. Rather, it means the former Borello Test will be used to determine their classification. So structuring and documenting the independent contractor arrangement to comply with the multi-factor test is crucial for exempt businesses.

AB-2257: EXEMPT FROM THE “ABC” TEST – THE ENTERTAINMENT/MUSIC INDUSTRY EXEMPTIONS

- AB 2257 creates several new entertainment industry exemptions from the ABC test, largely focused on the California music industry.
- Some positions are generally exempt from the ABC test, including, but not limited to: (1) recording artists; (2) songwriters, lyricists, composers, and proofers; (3) managers of recording artists; (4) record producers and directors; (5) musical engineers, mixers, and musicians engaged in the creation of sound recordings; (6) vocalists; and (7) independent radio promoters.

AB-2257: EXEMPT FROM THE “ABC” TEST – THE ENTERTAINMENT/MUSIC INDUSTRY EXEMPTIONS

- Where musicians or performers are engaged in a one-time live performance, they are generally exempt from application of the ABC test.

AB-2257: EXEMPT FROM THE “ABC” TEST – OTHER EXEMPTIONS AND CLARIFICATIONS

OTHER EXEMPTIONS INCLUDE:

- Persons who provide “underwriting inspections, premium audits, risk management, or loss control work for the insurance and financial services industries”;
- **Home inspectors**, a category added to the exemption for specified occupations governed by the Business and Professions Code;
- Individual **performance artists**, manufactured housing salespersons, **competition judges**, and individuals engaged in international exchange visitor programs; and
- Data aggregators and the individuals providing feedback to the data aggregators, subject to specified conditions.

AB-2257: EXEMPT FROM THE “ABC” TEST – KEY TAKEAWAY

- AB 2257 presents progress in clarifying and amending AB 5.
- Although the ABC test may not apply as broadly as it originally did under AB 5, employers may want to keep in mind that the *Borello Test* is still controlling.

EFFECTIVE DATE AND JURISDICTION OF LAW

EFFECTIVE DATE AND JURISDICTION OF LAW

- The law went into effect January 1, 2020.
- AB-5 has **jurisdiction over California residents** as well as any **employees required to perform significant services in California**, regardless of their home state.
- However, California companies could employ residents of other states to perform services outside of California and not be restricted by AB-5.
 - For instance, a company producing a film in Georgia would not be limited by AB 5 in hiring Georgia residents as independent contractors. Instead, Georgia law would apply.

Proposition 22

The evolution continues.

PROPOSITION – 22 AND THE “ABC” TEST

- Before Proposition 22, **gig companies were subject to the three-part “ABC test”** which made it harder for them to classify their drivers as contractors who aren’t entitled to wage, unemployment, discrimination, and other benefits reserved for employees.
- So, if a worker is found to be misclassified while the ABC test applied to the gig companies, that worker will be **owed wages or other employment-related benefits**.

PROPOSITION – 22: THE NEW TEST

- Proposition 22 specifically classifies drivers for app-based transportation and delivery companies as independent contractors, unless it sets drivers' hours, requires acceptance of specific ride or delivery requests, or restricts working for other companies.

PROPOSITION – 22: IN PRACTICE

- This means that to be covered by Prop 22's provisions, even an app-based company cannot tell the drivers how much or when to work, cannot require them to accept any particular passengers or delivery, cannot restrict them from also driving through another app-based company, and cannot prevent them from working any other job.

California Courts Say “ABC TEST” IS RETROACTIVE

Vazquez v. Jan Pro Franchising International Inc.

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California Courts Say “ABC TEST” IS RETROACTIVE

- The California Supreme Court ruled that the state’s rigid “ABC test” for determining if workers are employees or independent contractors applies retroactively, making businesses potentially liable for lawsuits filed years before the standard existed.

California Courts Say “ABC TEST” IS RETROACTIVE - WHAT THIS MEANS

- Based on the relevant statute of limitations, the court’s finding only affects those cases involving allegations of a violation of the wage orders, which are already making their way through the legal system, and similar cases filed within the next year or so.

California Courts Say “ABC TEST” IS RETROACTIVE - WHAT THIS MEANS

- Again in practice, *Vasquez* materially impacts only a limited number of cases that were either (1) pending at the time *Dynamex* was decided; or (2) involve *pre-Dynamex* conduct where the statute of limitations has not yet run.

What to do about AB-5

It is now more clear than ever that companies should carefully examine their contractor classifications to ensure compliance with the ABC test

What to do about AB-5

- You will want to Conduct an audit of your independent contractor management processes. Every touchpoint with an independent contractor is relevant here to help you understand what is and isn't compliant. A comprehensive audit would take a wide view to include:
 - engagement guidelines
 - contractual terms
 - IC incorporation requirements
 - rate negotiations
 - documentation processes
 - work structure and level of control
 - staff and IC interactions

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