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Legal Analysis: How Businesses and Public Agencies Can Adhere to AB 5

New California Law Creates Legal Test for Determining Who is an “Employee”

In the wake of Assembly Bill 5, employers will need to exercise additional care when determining whether to hire workers as employees or as independent contractors. Using the below analysis of the controversial new California law, employers should re-examine their current and future relationships with independent contractors.

AB 5 and *Dynamex*

[AB 5](#) adopts a new legal standard for determining whether a worker is an employee or an independent contractor for Labor Code and Unemployment Insurance Code purposes. The law places the burden on the employer to establish that a worker is not an employee.

It also expands the California Supreme Court’s 2018 decision in [Dynamex Operations West, Inc. v. Superior Court of Los Angeles](#). In that critical decision, the Court adopted a broad test known as the “ABC” test to determine whether a worker is an independent contractor or an employee for Wage Orders purposes (e.g., minimum wages, maximum hours, meal and rest breaks, etc.)

Following AB 5’s passage, unless an exception applies, *Dynamex*’s ABC test will be used to determine whether a worker in California is an “employee” not just for Wage Orders purposes, but also for Labor Code and Unemployment Insurance Code requirements. AB 5 takes effect Jan. 1.

The ABC Test

Under the ABC test, a worker is presumed to be an employee of the hiring entity *unless* the hiring entity can show that *all* of the following conditions are satisfied:

- A. The person 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.
- B. The person performs work that is outside the usual course of the hiring entity’s business.
- C. The person is customarily engaged in an independently established trade, occupation or business of the same nature as that involved in the work performed, per California Labor Code section 2750.3(A)–(C).

Exceptions

While AB 5 expanded the ABC test’s application, it also provides a long list of occupations and hiring relationships exempt from the ABC test’s reach. However, it is important to remember that an exception in the law does not mean that these occupations/hiring relationships are always independent contractors. Rather, an exception’s application simply means that the old test will be used to determine a worker’s status (read more about the “*Borello* test” below). As stated in Labor Code section 2750.3 (and subject to additional limitations, conditions and exceptions), AB

5 generally exempts the following occupations and hiring relationships from ABC test application:

- Licensed insurance professionals
- Physicians, surgeons, dentists, podiatrists, psychologists and veterinarians
- Lawyers, architects, engineers, private investigators and accountants
- Securities brokers and investment advisors
- Direct salespersons
- Commercial fishermen

In addition, AB 5 provides that the ABC test is not applicable to contracts for “professional services” and the determination of a worker status is governed by the *Borrello* test if the following factors are satisfied:

- A. The individual maintains a business location, which may include the individual’s residence, that is separate from the hiring entity. Nothing in this subdivision prohibits an individual from choosing to perform services at the hiring entity’s location.
- B. If work is performed more than 6 months after the effective date of this section, the individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession.
- C. The individual has the ability to set or negotiate his or her own rates for the services performed.
- D. Outside of project completion dates and reasonable business hours, the individual has the ability to set his or her own hours.
- E. The individual is customarily engaged in the same type of work performed under contract with another hiring entity or holds themselves out to other potential customers as available to perform the same type of work.
- F. The individual customarily and regularly exercises discretion and independent judgment in the performance of the services.

Professional services are limited under AB 5, and include the following fields:

- Marketing
- Administration of human resources
- Travel agent services
- Graphic design
- Grant writing
- Fine art
- Enrolled agents licensed by the Internal Revenue Service
- Payment processing agents
- Services provided by a still photographer or photojournalist
- Freelance writing

Further, the ABC test is not applicable to bona fide business-to-business contracting relationships under the following conditions:

- A. The business service provider is 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.
- B. The business service provider is providing services directly to the contracting business rather than to its customers.
- C. The contract with the business service provider is in writing.
- D. If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- E. The business service provider maintains a business location that is separate from the business or work location of the contracting business.
- F. The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.
- G. The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.
- H. The business service provider advertises and holds itself out to the public as available to provide the same or similar services.
- I. The business service provider provides its own tools, vehicles and equipment to perform the services.
- J. The business service provider can negotiate its own rates.
- K. Consistent with the nature of the work, the business service provider can set its own hours and location of work.
- L. The business service provider is not performing the type of work for which a license from the Contractor's State License Board is required under Business and Professions Code, Division 3, Chapter 9, beginning with section 7000.

Additionally, subject to specific limitations, relationships between a contractor and an individual performing work under a subcontract in the construction industry are not covered by the ABC test. As noted, distinct limitations and conditions apply to each exception provided above.

For nearly all of these exceptions, AB 5 provides that the California Supreme Court's longstanding multi-factor test from *S.G. Borello & Sons, Inc. v. Department of Industrial Relations* will determine whether an AB 5 exempted worker is an employee or independent contractor in a given scenario. Under *Borello*, the principal test of an employment relationship is

“whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired.” *Borello* also recognized the additional factors of:

- Whether the worker is engaged in a distinct occupation or business;
- 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;
- The skill required in the occupation;
- Whether the principal or the worker supplies the instrumentalities, tools and place of work;
- The length of time for which the services are to be performed;
- The method of payment, whether by the time or by the job;
- Whether the work is part of the principal’s regular business;
- Whether the principal has the right to discharge at will, without cause and
- Whether the parties believe they are creating an employment relationship.

The individual *Borello* factors cannot be applied mechanically as separate tests. Rather, all of the factors must be assessed as a whole to determine employment status. Thus, workers in AB 5’s exempted categories may still be determined to be “employees” of a hiring entity, depending on the specific facts.

Under the ABC test, any failure to establish one of the factors results in a determination that the worker is an employee, while the *Borello* test looks at the factors collectively.

Implications for Employers

There is uncertainty whether, and if so, which, AB 5 provisions may apply retroactively. That said, it is known for certain that AB 5 will apply to all work performed on or after Jan. 1. While the ABC test is similar to the *Borello* test previously applied by courts, the ABC test is broadly worded and untested in California courts. Specifically, the second prong, known as the “B” prong, may be particularly concerning for businesses: if the work that an independent contractor performs is part of the work that the business entity performs, that independent contractor will be reclassified as an employee under the ABC test. As stated above, the failure to establish any one of the three criteria under the ABC test would result in a determination of status as an employee. Businesses should examine all of their independent contractor relationships in light of this new test.

For public agencies, the B prong, likewise, presents an unknown: it is not clear what the usual course of work is for most public agencies. Therefore, an examination of agencies’ functions and the functions they are contracting out is recommended.

For information on how AB 5 may impact your business or agency, please contact the authors of this Legal Alert listed at the right in the firm’s [Labor & Employment](#) practice group or your [BB&K attorney](#).

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