

## NEW CALIFORNIA LAW IMPOSES ADJUSTED RULES FOR INDEPENDENT CONTRACTOR CLASSIFICATION

Jim Anderson, The Vision Council's General Counsel, [janderson@haspc.com](mailto:janderson@haspc.com)

Recently the California Legislature passed a major law that substantially changed the way company's doing business in California will determine if workers are independent contractors (ICs) or employees. The law – Assembly Bill 5 (AB 5) – was signed into law by California Governor Gavin Newsom on Sept. 18, 2019.

AB 5 states that in California, "...a person providing labor or services for remuneration shall be considered an employee rather than an independent contractor unless the hiring entity demonstrates 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."

### Background

AB 5 is a codification of the California Supreme Court's 2018 decision in *Dynamex Operations West, Inc. V. Superior Court*. Dynamex is a nationwide delivery company and the plaintiffs are delivery drivers who had been classified as ICs by their employer. The court found that Dyanamex had misclassified the workers as ICs and in the course of arriving at their decision did a major review and analysis of the California independent contractor rules. The court concluded that California law defining independent contractors was complex and hard to understand and often lead to the misclassification of workers by employers. The Court found that this misclassification often resulted in significant economic harm to workers and adopted the "ABC Test" which it noted is used in several jurisdictions because it is easier to apply and results in fewer misclassifications.

The California Legislature codified the Courts version of the ABC test in AB 5 and integrated it into the California Labor Code. The Legislature also carved out a significant number of exemptions and a major legislative battle was waged unsuccessful by app related businesses, like Uber and Lyft, in attempt to convince the legislature to grant them an exemption. However, there is an exemption for direct salespersons. The Vision Council examined this exemption to determine if it applied to the optical industry, and the result is explored, below.

The legislature and the California governor echoed the conclusion of the court in their announcement of the passage of the bill stating that the ABC test was designed to eliminate harmful misclassification of workers as independent contractors. Governor Newsome and some legislators also stated that that misclassification of workers as ICs is one of the reasons for the decline of middle-class income.

## Guidance from the Dynamex Decision Regarding Application of the ABC Test

The Dynamex decision provides some helpful guidance regarding the application of the ABC test, which is set forth below.

### **Test Part 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.**

The court stated: "A worker who is subject, either as a matter of contractual right or in actual practice, to the type and degree of control a business typically exercises over employees would be considered to be an employee. The hiring entity must establish that the worker is free of such control to satisfy part A of the test."

### **Test Part B: The person performs work that is outside the usual course of the hiring entity's business.**

The court stated that ICs would not be: "Workers whose roles are most clearly comparable to those of employees...or individuals whose services are provided within the usual course of the business of the entity for which the work is performed and...who would ordinarily be viewed by others as working in the hiring entity's business and not as working...in the worker's own independent business" Further, the Court stated, "workers who are part of the company's usual course of business would be classified as employees."

For example, in the Dynamex case the company is a delivery company. The plaintiffs are delivery personnel. Prior to 2004, delivery drivers had been employees and in 2004 were re- classified as ICs. The drivers used their own vehicles and for the most part set their own hours. However, the court found that the delivery drivers were acting in the "usual course" of the company's business and that their classification of ICs did not meet the requirements of part B of the ABC test.

### **Test Part 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.**

The Dynamex analysis to determine if the worker is an IC is whether the worker "*independently* has made the decision to go into business for himself or herself," and, "generally takes the usual steps to establish and promote his or her independent business – for example, through incorporation, licensure, advertisements, routine offerings to provide services of the independent business to the public or to a number of potential customers, and the like."

## Direct Salesperson Exemption

One of the several categories exempt from the ABC rules is, "a direct sales salesperson as described in Section 650 of the Unemployment Insurance Code (UIC), so long as the conditions for exclusion from employment under that section are met."

When the law was first published, The Vision Council questioned whether this exemption may be applicable to some members. The Vision Council conducted research and sought additional advice from California Employment attorneys. The conclusion is that under the California law, a direct salesperson is one who sells directly to consumer and not to a retail or wholesale establishment. The relevant part of UIC Section 650 states that to be classified as a direct salesperson it must be shown that:

- a. The individual is...engaged in the trade or business of primarily inperson demonstration and sales presentation of consumer products, including services or other intangibles, in the home or *sales to any buyer on a buy-sell basis, a defined commission basis, or any similar basis, for resale by the buyer or any other person in the home or otherwise than from a retail or wholesale establishment*

## Additional Important Points

California Labor Code § 226.8 provides that it is unlawful for any employers to willfully misclassify workers as independent contractors and civil penalties, ranging from \$5,000 to \$25,000 will be assessed for each violation. These penalties will be assessed in addition to the already substantial amount of other penalties that are assessed by the Labor Board and the Employment Development Department (EDD). It has not yet been established whether “one violation” refers to one investigation or whether the new penalty is assessed on a worker-by-worker basis.

To make misclassification even more dangerous, a significant effect of the integration of the California Labor Code into AB 5 is that the Labor Code allows victims to apply for a claim to a portion of the AB 5 civil penalties under the Labor Code Private Attorneys General Act (PAGA). PAGA allows private individuals to bring suit in their own behalf and allows them to collect 25 percent of the penalties and it also provides for payment of the petitioner’s attorney’s fees by the employer. AB 5 PAGA suits could represent a significant risk of exposure for California employers because they could be mass litigation matters, like class actions. In the Dynamex case for example, two drivers filed the case as representatives of the class consisting of all Dynamex drivers who were classified as ICs. But, unlike class actions, PAGA actions cannot be compelled to arbitration and the civil penalties that theoretically can be recovered under PAGA add up quickly. With the addition of attorney’s fees, these suits could result in major expenditures.

It is important to note, the law takes effect on Jan. 1, 2020.

## What You Should Do

If your company has workers who are working in California as ICs, look carefully at the ABC rules. Ask for legal advice to see if you comply, keeping in mind that these rules are much stricter than the current rules and a misclassification ruling could be expensive. In making your business decisions you should be aware that other states either have adopted or are considering adopting the ABC rule.

Keep in mind the ABC rules are different than the IRS rules. So, if you have IC representatives in California that comply with the IRS rules, they may not comply with the ABC rule. Keep your eye on what other industries are doing, especially the gig economies. They are still trying to get an exemption by a ballot initiative, but business reporters following this issue don’t expect that the companies will get a lot of sympathy from the voters as long as the workers continue to push their desire to be employees. If the businesses don’t get the ballot initiative, they may try to come up with some novel ways to comply with AB 5, which if approved may offer some guidance to our industry.

Questions regarding this issue can be directed to Jim Anderson, The Vision Council’s general counsel, at [janderson@haspc.com](mailto:janderson@haspc.com).