



## Overview

In 2018, the California Supreme Court adopted a new pro-employment standard (the “ABC Standard”) in its ruling on the *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903 (“*Dynamex*”) decision. This decision reinterprets state law to presume a worker is an employee versus an independent contractor under California wage orders and regulations.

Assembly Bill 5 (“AB5”) was passed by the California Legislature and signed by Governor Newsom, and it codifies the ABC Standard and brings increased costs, administrative duties, and legal risks for hiring parties on multiple fronts, including, but not limited to:

- Payroll taxes;
- Meals, breaks and overtime policies and enforcement and premium pay;
- Benefits;
- Leave and PTO policies, requirements and enforcement;
- Wage order violations;
- Labor Code violations and Private Attorney General Actions (“PAGA”) claims;
- Unemployment insurance; and
- Workers’ compensation coverage, claims, and premiums;

## What is the ABC Standard?

Under the ABC Standard, the worker is presumed to be an employee. To have the worker classified as an independent contractor, the hiring party must show:

- A) The worker is free, both contractually and in practice, from control and direction on how to perform a service;
- B) The worker’s service is outside the hiring party’s usual services;
- C) The worker has an independently-established trade, occupation, or business of the same nature as the work performed.

## The Prior Standard – *Borello*:

In the 30 years before *Dynamex*, the courts used a multi-factor test to determine whether workers are employees. Under *S. G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989) 48 Cal.3d 342 (“*Borello*”), the primary consideration was a company’s right to control the manner and means by which a worker performed work. *Borello* also allowed consideration of secondary factors, including the degree of skill required for the work, the method of payment, and the nature of the company’s usual business. *Borello* provided employers flexibility in how to establish an independent contractor relationship.

The adoption of the ABC Standard via *Dynamex* and AB5 removes the flexibility afforded employers under *Borello*, but *Borello* is still important because it applies when AB5 is either inapplicable or when exceptions under AB5 apply.



**Assembly Bill 5 – Codifies the “ABC Standard”:**

AB5 codifies in the Labor Code and the Unemployment Insurance Code the ABC Standard promoted by *Dynamex*. AB5’s Final Language can be found here:

<https://legiscan.com/CA/text/AB5/2019>

The ABC Standard applies unless a specified exception applies or unless a court orders it inapplicable under a certain situation. If the ABC Standard does not apply, whether by exception or by court order, then the *Borello* standard applies.

**The Effect of *Dynamex* and AB5:**

The ABC Standard entitles workers to all of the rights and benefits of employment unless the hiring party can meet ABC Standard to prove the worker is an independent contractor. These all lead to higher costs for labor and potential legal risks for hiring parties as set forth above.

The ABC Standard might also empower competitors in the construction trade to sue the hiring contractor for unfair competition and/or unlawful business practices under the Business and Professions Code by arguing that the hiring party received a competitive advantage when it avoided paying proper employee wages and benefits.

AB5 also contains a provision stating that “[n]o provision of this measure shall permit an employer to reclassify an individual who was an employee on January 1, 2019, to an independent contractor due to this measure’s enactment.” Once the hiring party calls a worker an employee, there is no going back.

Since AB5 is now codified in the Labor Code, violations may be actionable under the Labor Code Private Attorney General Act (Labor Code §§ 2698 et seq., “PAGA”), which provides an incentive to plaintiff attorneys in California to pursue employers because PAGA and the Labor Code contain attorneys’ fees provisions. AB5 also provides that claims for injunctive relief to prevent misclassification may be initiated by the Attorney General of California, or by city attorneys.

**Timing - When does AB5 apply?**

When AB5 will apply depends on what type of regulation and potential liability the employer might face. AB5 allocates retroactive and prospective liability into several parts:

1. *Dynamex* and the ABC Standard apply retroactively “with regard to wage orders of the Industrial Welfare Commission and violations of the Labor Code relating to wage orders.” (Labor Code section 2750.3(i)(3).)



2. All exceptions apply retroactively to the maximum extent permitted by law, to the extent they would relieve an employer from liability. (Labor Code section 2750.3(i)(2).)
3. On and after January 1, 2020, *Dynamex* and the ABC Standard will apply for purposes of the Unemployment Insurance Code and all other provisions of the Labor Code. (Labor Code section 2750.3(i)(1).)
4. On July 1, 2020, *Dynamex* and the ABC test will apply for purposes of workers' compensation. (Labor Code 3335(i).)

Earlier this year a published opinion held that the ABC Standard should be applied retroactively to wage orders. In *Vasquez v. Jan-Pro Franchising International, Inc.* (9th Cir. May 2, 2019) 2019 WL 1945001 the court expanded the potential liability of employers because it determined that the ABC Standard applied retroactively to wage order claims that might have existed prior to *Dynamex*.

*Vasquez* further illuminated Part B of the ABC Standard, stating that the following should be considered when determining whether the worker's service is outside the hiring party's usual services: "(i) whether the work of the employee is necessary to or merely incidental to that of the hiring entity; (ii) whether the work of the employee is continuously performed for the hiring entity; and (iii) what business the hiring entity proclaims to be in." (*Vasquez* at 49.)

Despite that *Dynamex* expressly applies only to the wage orders, AB5 states that the legislative adoption of *Dynamex* is "declaratory of existing law with regard to wage orders of the Industrial Welfare Commission and violations of the Labor Code relating to wage orders." (Labor Code section 2750.3(i)(1).)

Unfortunately, AB5 fails utterly to clarify which provisions of the California Labor Code are sufficiently "related to" the wage orders to give rise to retroactive liability. Perhaps the Legislative advocates for the construction and business communities would perform a valuable service by processing "clean up" legislation to narrow the scope of potential liability created by AB5.

#### **AB5 Exceptions:**

AB5's final language reflects lobbying by multiple industries who were successful in obtaining carve out exceptions to the ABC Standard. The exceptions include, but are not limited to, outside sales persons, as well as professionals such as physicians, engineers, architects, lawyers, private investigators, and accountants.

Of particular interest to AGC members are the exceptions for the construction industry and as a sub-exception, the trucking/hauling industry. The rest of this paper details the construction



exception, and AGC will continue preparing separate papers on the trucking and the business to business exceptions.

**AB5 Exception for the Construction Industry:**

The construction industry's exception allows businesses and individuals to default to the more flexible *Borello* test, but still must meet certain requirements. In other words, even if a hiring party meets all of the AB5 requirements, it still must be able to prove the worker is an independent contractor under the *Borello* test.

AB5 includes the construction industry exception by adding Labor Code 2750.3, subpart (f), which provides:

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:

- (1) The subcontract is in writing.
- (2) The subcontractor is licensed by the Contractors State License Board and the work is within the scope of that license.
- (3) If the subcontractor is domiciled in a jurisdiction that requires the subcontractor to have a business license or business tax registration, the subcontractor has the required business license or business tax registration.
- (4) The subcontractor maintains a business location that is separate from the business or work location of the contractor.
- (5) The subcontractor has the authority to hire and to fire other persons to provide or to assist in providing the services.
- (6) The subcontractor assumes financial responsibility for errors or omissions in labor or services as evidenced by insurance, legally authorized indemnity obligations, performance bonds, or warranties relating to the labor or services being provided.
- (7) The subcontractor is customarily engaged in an independently established business of the same nature as that involved in the work performed.

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The section 2750.3(f) requirements are one part of a “belt and suspenders” approach by the Legislature to ensure that a subcontractor to a prime contractor is a true subcontractor, and not a “captured subcontractor.”



Even when the prime contractor and the subcontractor have the mutual and individual paperwork required to meet the section 2750.3(f) requirements, if challenged, the prime contractor would have a burden to prove enough of the *Borello* factors to avoid liability.

Unfortunately, AB5 will increase the cost of construction in California because having to meet all of the section 2750.3(f) factors and the *Borello* test will open the door to a multitude of claims and expensive litigation, which, in turn, will increase risks and costs of claims and DIR enforcement actions, premiums for Employment Practices Liability Insurance, and ultimately, labor costs on projects.