

Date of Hearing: April 3, 2019

ASSEMBLY COMMITTEE ON LABOR AND EMPLOYMENT

Ash Kara, Chair

AB 5 (Gonzalez) – As Amended March 26, 2018

SUBJECT: Worker status: independent contractors

SUMMARY: Codifies the decision of the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) that presumes a worker is an employee unless a hiring entity satisfies a three-factor test, and exempts from the test certain insurance occupations, physicians, securities broker-dealers, and direct salespersons.

Specifically, **this bill:**

- 1) States that it is the intent of the Legislature to codify the decision of the California Supreme Court in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903, and clarify its application to state law.
- 2) Provides that for purposes of the labor code, where another definition of “employee” is not otherwise provided, and for the wage orders of the Industrial Welfare Commission (IWC), a person providing labor or services for remuneration shall be considered an employee unless the hiring entity satisfies all of the following conditions:
 - 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.
- 3) Exempts from the application of *Dynamex* and instead, applies the definition of an employee as set forth in the decision of the California Supreme Court in *S. G. Borello & Sons, Inc. v Department of Industrial Relations (Borello)* (1989) 48 Cal.3d 341, to the following occupations:
 - a) A person or organization who is licensed by the Department of Insurance pursuant to Chapter 5 (commencing with Section 1621), Chapter 6 (commencing with Section 1760), and Chapter 8 (commencing with Section 1831) of Part 2 of Division 1 of the Insurance Code.
 - b) A physician and surgeon licensed by the State of California pursuant to Division 2 (commencing with Section 500) of the Business and Professions Code, performing professional or medical services provided to or by a health care entity, including an entity organized as a sole proprietorship, partnership, or professional corporation as defined in Section 13401 of the Corporations Code.

- c) A securities broker-dealer or investment adviser or their agents and representatives that are registered with the Securities and Exchange Commission or the Financial Industry Regulatory Authority or licensed by the State of California under Chapter 2 (commencing with Section 25210) or Chapter 3 (commencing with Section 25230) of Division 1 of Part 3 of Title 4 of the Corporations Code.
 - d) A direct sales salesperson as described in Section 650 of the Unemployment Insurance Code, so long as the conditions for exclusion from employment under that section are met.
- 4) States that the above provisions are declaratory of existing law.

EXISTING LAW:

- 1) Creates a presumption that a worker who performs services for a hirer is an employee for purposes of claims for wages and benefits arising under wage orders issued by the IWC, as established in the case of *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 903.
- 2) Requires a 3-part test, commonly known as the “ABC” test, to establish that a worker is an independent contractor for the above purposes.
- 3) Establishes the Division of Labor Standards Enforcement (also known as the Labor Commissioner) within the Department of Industrial Relations, to among other things, enforce the wage orders of the IWC.

FISCAL EFFECT: Unknown

COMMENTS: The *Dynamex* decision was issued almost a year ago but debate over worker misclassification under our wage and hour laws continues to garner much attention. Worker misclassification is not a new concept. In fact, a 2000 study commissioned by the U.S. Department of Labor found that nationally between 10% and 30% of audited employers misclassified workers.¹ As our workplaces and the nature of the employee-employer relationship evolves, new opportunities for misclassification have emerged. In 2017, California’s Employment Development Department Tax Audit Program conducted 7,937 audits and investigations, resulting in assessments totaling \$249,981,712, and identified nearly *half a million* unreported employees.² Recent research also supports the prevalence of misclassification and finds some of the highest misclassification rates in the economy’s growth industries, including home care, janitorial, trucking, construction, hospitality, security, and the app-based “on demand” sector.³

¹ See the National Employment Law Project’s (NELP) Fact Sheet “Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries,” <https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries-update-2017/>.

² Employment Development Department 2018 Annual Report on Fraud Deterrence and Detection Activities, https://edd.ca.gov/About_EDD/pdf/Fraud_Deterrence_and_Detection_Activities_2018.pdf.

³ See NELP’s Fact Sheet in footnote 1.

California is not the first state to adopt the ABC test for determining employee status under its labor laws. New Jersey, Massachusetts, and Connecticut also use the ABC test to establish employment status for wage and hour laws. In fact, Massachusetts adopted the ABC test in 1990. Nearly 30 states use the test to determine employment status for purposes of unemployment insurance eligibility.

The *Dynamex* court adopted the ABC test after looking at the evolution of the employee-employer relationship historically and more specifically, the genesis of wage and hour law as a tool to remedy abuses arising from that relationship. According to the *Dynamex* court, a broad interpretation of employee status for purposes of California's wage orders "finds its justification in the fundamental purposes and necessity of the minimum wage and maximum hour legislation in which the standard has traditionally been embodied. Wage and hour statutes and wage orders were adopted in recognition of the fact that individual workers generally possess less bargaining power than a hiring business and that workers' fundamental need to earn income for their families' survival may lead them to accept work for substandard wages or working conditions. The basic objective of wage and hour legislation and wage orders is to ensure that such workers are provided at least the minimal wages and working conditions that are necessary to enable them to obtain a subsistence standard of living and to protect the workers' health and welfare."⁴

The court also addressed why the *Borello* test for employee status, arising from a workers' compensation case involving farmworkers hired to harvest cucumbers under a written "sharefarmer" agreement, was inadequate for purposes of defining an employee under the wage orders. The test set forth in *Borello* involves the principal factor of "whether the person to whom services is rendered has the right to control the manner and means of accomplishing the result desired" and also includes the following nine additional factors: "(1) right to discharge at will, without cause; (2) whether the one performing the services is engaged in a distinct occupation or business; (3) 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; (4) the skill required in the particular occupation; (5) whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work; (6) the length of time for which the services are to be performed; (7) method of payment, whether by the time or by the job; (8) whether or not the work is part of the regular business of the principal; and (9) whether or not the parties believe they are creating the relationship of employer-employee."⁵

The *Dynamex* court rejected the *Borello* test on the grounds that it is a multifactor, all circumstances standard with factors that can be given different weight depending on the case. The court expressed concerns that the multifactor test was not appropriate for wage and hour laws whose purpose is to protect workers and recognize their inherently dependent status in the employee-employer relationship.

⁴ *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 952.

⁵ *S. G. Borello & Sons, Inc. v Department of Industrial Relations* (1989) 48 Cal.3d 341.

Background on the *Dynamex* case

The State Supreme Court ruled in *Dynamex* that certain package delivery drivers were misclassified as independent contractors rather than employees under a California wage order specific to the transportation industry. In explaining the basis for its decision, the court focused on the relationship between *Dynamex*, a same-day courier and delivery service company, and its drivers who worked “on-demand.”

In finding that the on-demand drivers were employees, the court carefully reviewed and analyzed their working conditions. The court determined that the drivers were free to set their own schedule but had to tell *Dynamex* which days they intended to work. The drivers were required to obtain and pay for a cell phone so as to maintain contact with *Dynamex*. They generally made deliveries using their own vehicles but were also expected to wear *Dynamex* shirts and badges, and in some cases, attach a *Dynamex* decal to their vehicles. Drivers were mostly free to choose the sequence of their deliveries but were required to complete all assigned deliveries on the day of assignment.

Wage Orders of the IWC

The IWC, now inoperable, was established in 1913 to regulate wages, hours and working conditions in California. The commission has issued 17 wage orders over the years covering various industries in order to establish minimum wage and other protections for employees. These wage orders are enforced by the Labor Commissioner (LC). In *Dynamex*, the drivers argued that they were employees covered by Wage Order No. 9, pertaining to the transportation industry.

The IWC wage orders generally exempt three main categories of employees: administrative, executive, or professional. These exemptions largely mirror those that are carved out in the federal Fair Labor Standards Act.⁶ Employees working in these capacities are exempt from provisions such as minimum wage, overtime, meal and rest periods, and reporting time pay. An administrative employee is characterized as someone who customarily and regularly exercises discretion and independent judgment. An executive employee is characterized as someone who customarily and regularly directs the work of two or more other employees and has the authority to hire or fire employees. A professional employee is characterized as someone who is licensed or certified by the State of California and is primarily engaged in the practice of a recognized profession.

Committee Comments

The bill, in its present form, codifies and applies the ABC test to provisions of the labor code, as specified, and to the IWC’s wage orders. In the future, the author may wish to extend the application of the ABC test to provisions of the unemployment insurance code that cover critical employee benefits such as unemployment insurance and family leave programs.

⁶ See 29 CFR Part 541, “Defining and Delimiting the Exemptions for Executive, Administrative, Professional, Computer and Outside Sales Employees.” This provision is commonly known as the “white collar” exemption.

This would also create more consistency among California's various statutory definitions of "employee" and provide employees and employers greater certainty about their rights and responsibilities under the law.

Arguments in Support

According to the author, "The misclassification of workers is a clear detriment to working families, local businesses, and the state. 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. The bill will apply to provisions of the Labor Code that do not otherwise define "employee" and the wage orders of the Industrial Welfare Commission. AB 5 also clarifies...that the employment relationships for physicians, insurance agents and brokers, securities broker-dealers and investment advisors, and direct salespersons 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). 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."

Prior to *Dynamex*, workers were often in a catch-22, finding themselves treated by their hiring entity as both an employee and an independent contractor in different aspects of their job. The California Labor Federation, a sponsor of the bill, states that the ABC test "prevents the common practice in many industries of a company forcing an individual to act as an independent business while the company maintains the right to set rates, direct work, and impose discipline. It distinguishes carefully between a trucking company that has no employee drivers (misclassification) and a trucking company that contracts with a mechanic (legitimate contractor).

Bringing misclassified workers into employee status will mean more workers have a safety net when they are sick, laid off, or hurt at work. It will also significantly benefit the State. In the *Dynamex* case, the DLSE estimated that misclassification costs the state \$7 billion annually. While calling a worker a contractor is cheaper for the company, someone has to bear those costs and, in most cases, it is the taxpayer that is forced to subsidize this business model."

The ABC test also recognizes the reality of our evolving workplaces. In support, the UCLA Labor Center states, "Whereas once employers hired workers directly, many industries have turned to alternative models to retain labor and limit liability for wages, occupational safety, and taxes. Chief among these are franchising, contracting out labor to staffing agencies, and classifying workers as independent contractors. Standards, including wages, benefits, and safety, have eroded for the workforce performing the same labor under a different title. Individual workers bear the onus of determining whether they are legitimately employees or independent contractors, a status that too often results in sub-minimum wages and tax liabilities borne by poor people. All the risk shifts from employers to the workforce. Misclassification is wage theft."

A coalition of employer organizations, including the California Chamber of Commerce, is support if amended, and states, "AB 5 (Gonzalez)...exempts certain industries/professions

(doctors, insurance agents, securities brokers, and direct sellers) from the application of the *Dynamex Operations West v. Superior Court* (“*Dynamex*”) decision. While we appreciate the recognition in AB 5 that the *Dynamex* decision is not one size fits all and agree the professions identified should be exempted under AB 5, the Legislature should not stop with selecting just a few professions and not others similarly situated. Accordingly, we are seeking additional amendments that provide a more progressive and holistic approach to the application of *Dynamex* that reflects today’s modern workforce [.]”

Arguments in Opposition

The Southwest California Legislative Council, is opposed and states, “the rise of independent contractors has served to ignite large portions of the California economy, encourage entrepreneurship, and provide income for an estimated 4 million workers. Many of our members are local entrepreneurs who contract their services out to a variety of businesses, enabling them to benefit from multiple income streams. Indeed, independent contractor status has fostered the growth of the so-called ‘gig’ economy, with companies like Uber and Lyft, which enable thousands of college students, active duty military personnel and others to fill spare-time hours and generate income.”

Related Legislation

AB 71 (Melendez) of 2019 would require a determination of whether a person is an employee or an independent contractor to be based on a specific multifactor test, including whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired, and other identified factors. The measure is pending in this committee.

AB 233 (Cooley) of 2019 would provide that “employee,” for purposes of California wage orders of the Industrial Welfare Commission, the Labor Code, the Unemployment Insurance Code, the Division of Workers’ Compensation, or any other purpose related to the characterization of employees and independent contractors under statute or common law, shall not include a person or organization who is licensed by the Department of Insurance pursuant to Chapter 5 (commencing with Section 1621), Chapter 6 (commencing with Section 1760), and Chapter 8 (commencing with Section 1831) of Part 2 of Division 1, and who has entered into a written agreement with an insurer or organizational licensee, as specified. The measure is pending in the Assembly Insurance Committee.

SB 238 (Grove) of 2019 would require for purposes of claims for wages and benefits arising under wage orders, an analysis of whether the worker is economically dependent upon the hiring entity to determine whether that worker is an employee based upon the economic reality of the relationship with the hiring entity. The bill would require this analysis to be based solely upon enumerated factors that are similar to those used as a part of the Economic Realities Test in the federal Fair Labor Standards Act of 1938. The measure is pending in the Senate Rules Committee.

REGISTERED SUPPORT / OPPOSITION:

Support

AFSCME

Bet Tzedek Legal Services
California Conference Board Of The Amalgamated Transit Union
California Conference Of Machinists
California Employment Lawyers Association
California Healthy Nail Salon Collaborative
California Immigrant Policy Center
California Labor Federation (Sponsor)
California Nurses Association
California Professional Firefighters
California Rural Legal Assistance Foundation, Inc.
California Teamsters Public Affairs Council
Consumer Attorneys Of California
Direct Selling Association
Engineers And Scientists Of California Local 20
Inlandboatmen'S Union Of The Pacific
International Union Of Operating Engineers, Cal-Nevada Conference
Maintenance Cooperation Trust Fund
National Employment Law Project
Numerous Individuals
Professional & Technical Engineers, Local 21
SAG-AFTRA
SEIU California (Cosponsor)
State Building And Construction Trades Council Of Ca
UCLA Labor Center
Unite Here International Union
United Domestic Workers Of America-AFSCME Local 3930
United Food And Commercial Workers, Western States Council
Utility Workers Union Of America, Local 132
Worksafe

Support if Amended

American Trucking Associations, Inc.
Association Of Language Companies
Atkinson Andelson Loya Ruud & Romo
Calasian Chamber Of Commerce
California Ambulance Association
California Association Of Licensed Investigators
California Building Industry Association
California Chamber Of Commerce
California Coalition Of Travel Organizations
California Construction & Industrial Materials Association
California Defense Counsel
California Employment Law Council
California Forestry Association
California League Of Food Producers
California News Publishers Association
California Retailers Association
Citizens Against Lawsuit Abuse

Civil Justice Association Of California
Electronic Transactions Association
Glamsquad, Inc.
Ipsse - The Association Of Independent Workers
National Council For Languages And International Studies
Pro Small Biz Ca
Professional Independent Consultants Of America, Inc.
Rover.Com
Sacramento Regional Builders Exchange
San Gabriel Valley Economic Partnership
Silicon Valley Leadership Group
The Joint National Committee For Languages
Western States Trucking Association

Oppose

Numerous Individuals
Southwest California Legislative Council

Analysis Prepared by: Megan Lane / L. & E. /