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LIFE AFTER AB-5:

"NO CHICKEN LITTLE, THE SKY IS NOT FALLING"

Last month, Governor Gavin Newsom signed AB-5 into law, now codified as Labor Code §2750.3. Section 2750.3 governs the classification of independent contractor employment status (vs "employee") in California. The new Labor Code section expressly adopts the California Supreme Court's 80-plus-page *Dynamex* decision.[1]

Ever since the *Dynamex* ruling (and its codification in AB-5 (Labor Code §2750.3)) many in the business community have lamented the proverbial "death of small business and independent contracting in California." Nonsense. While some business in California will be heavily hit, and may need to re-structure their operations[2], most will adapt to—and operate in compliance with —the new law. These businesses will not only survive, but thrive, although operating costs may be higher.

But what individuals, businesses, and corporations cannot do is "stick one's head in the sand," and ignore the new rules of the road. Independent contractors still exist in California, and can still be used extensively in business. However, businesses must: (A) understand the new employee classification laws and how they may apply to their operational structures; and (B) be proactive in addressing their potential issues, and not simply wait for a costly enforcement action.

THE NEW LEGAL CONSTRUCT

Everyone is an Employee and not an Independent Contractor. Ok – that's an exaggeration. However, New Labor Code §2750.3(a)(1) provides, in pertinent part:

"… 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 …"

What does that mean? It means that the starting position and analysis by the EDD and FTB, per statute, is that everyone paid by a company[3] for his/her services/labor is an employee and not an independent contractor, with all of the employee rules, regulations, statutes, and code requirements applied, including withholding, wage/hour

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[1] *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (2018) 4 Cal.5th 90.

[2] Most notably business operating in the "gig" economy like Uber. The *Dynamex* case involved drivers for an on-line food delivery service.

[3] This means any business, in any form, whether sole proprietorship (individual), partnership, corporation, LLC, trust or other organization.

(including minimum wage), benefits, sick pay, training, safety, and similar applicable "employee" classification requirements.

That is, of course, "unless" the hiring company "demonstrates" (meaning that the hiring company has the burden of proof to show) ALL THREE prongs of the following 3-prong test:

(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." §2750.3(a)(1)(A).

This means the hiring company must show that the services are being performed under a written contract providing for the independence of the contractor, AND that the services were actually performed by the contractor independent of the company's control or direction. In most cases, this could easily be shown.

(B) "The person performs work that is outside the usual course of the hiring entity's business." §2750.3(a)(1)(B). This is the rub for most businesses, and we anticipate that it will likely be the source of most litigation under Section 2750.3. Are a company's contract administrative professionals rendering services outside the "usual course" of the company's business? Probably. Does a company's independent contractor commissioned salesperson satisfy this prong – probably not. If the independent contractor renders the service which the company offers to the public, it will definitely not satisfy this prong. This is a determination that must necessarily be made on a case-by-case basis, and should be made with the assistance of qualified HR and legal professionals.

(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." §2750.3(a)(1)(C). Basically, it's the company's burden to prove that the contractor regularly offers his/her business services to other companies. If a company's "independent contractor" only works for that company (e.g., a "captive" outside salesperson) this prong will most definitely not be satisfied.

Finally, there are a number of exceptions to the application of this new construct, with respect to which the pre-*Dynamex* classification determinations (*S. G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal.3d 341) apply. Some of these exceptions are absolute and others require some showing of proof on the part of the hiring company.

Some of these "absolute" exceptions include: licensed attorneys, doctors, accountants, engineers, architects, and real estate salespersons. An example of an exception that requires a showing of proof by the hiring company is a "professional services" contract (a defined term) that requires a showing of six separate indicia of an independent contractor. There is also a B2B exception that requires a showing of proof.

HOW THE PRUDENT COMPANY PROCEEDS

An adverse determination of the classification of a company's independent contractors as employees can be devastating for the company. It has been known to put more than one company out-of-business. The assessment can include the amounts for unpaid employment tax, unpaid withholdings, interest and a 30% penalty on the unpaid

withholding amounts. Multiply this by a company's number of independent contractors, account for an eventual audit by the IRS, throw in the personal liability of the responsible person at the company for the unpaid withholdings, interest and penalties, and this can be the perfect storm to derail a once-thriving business.

As a result, it is highly recommended that any business that uses independent contractors to any significant extent have their business structure and operations reviewed by qualified HR and/or legal professionals.

Even if the HR/legal professionals determine that the company can continue to classify its service providers as independent contractors, it is prudent for the company to have all of the required documentation to prove such classification.

Those documents require a written agreement with the contractor that includes all of the terms necessary under prior law (i.e., *Borello* requirements). In addition, this new written IC agreement should contain all of the items necessary to "prove" the classification under Section 2750.3. In particular, the agreement should contain: (a) representations and warranties from the contractor as to the matters showing proper classification as a contractor; (b) documents attached to the agreement in support of those representations and warranties; and (c) possibly even an insured indemnification by the contractor for an adverse ruling by the EDD, FTD, or otherwise. It is important to obtain all of these things from the contractor at the time of contracting for the mere fact that the contractor may be nowhere to be found, or become uncooperative, when the EDD/FTD comes around for their audit.

If a company determines that some, or all, of a company's independent contractors should be re-classified as employees under Section 2750.3, the company does not simply have to throw up its hands and take everyone in as an employee. There are various strategies, from the very basic to the rather sophisticated, that can be used to address these issues depending upon the specific factual situation presented.

Your qualified HR and legal professionals will have the guidance necessary to help you navigate the employment arena now made a bit more complex by the *Dynamex* decision and the requirements of Section 2750.3. The worst decision for a business is to do nothing, ignore the new laws, and wait for the inevitable enforcement action.

Chicken Little, the sky is not falling. But it might if you do not adapt to the new employment laws in California.