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CALIFORNIA PASSES AB5, NEGATIVELY AFFECTING HOW STAFFING FIRMS DO BUSINESS

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On September 11, 2019, California lawmakers passed AB5. In doing so, pending the Governor's signature (which is expected very shortly), the legislature made what is affectionately known as the "ABC Test" state law. If signed by the Governor as is, it is set to go into effect January 1, 2020.

Why Should California Staffing Firms be Concerned?

The ABC Test is one of the most stringent classification tests in the nation and now California staffing firms will have to comply with it in structuring independent contractor relationships with contingent workers.

What is the ABC Test?

The ABC Test is a three-part test that presumes workers are employees and requires employers to bear the burden of proving that the workers are truly independent contractors. If a staffing firm fails to satisfy any part of the ABC Test, the worker will be declared an employee and the staffing firm will be forced to pay employment tax, interest and penalties, as well as other benefits employees are entitled to receive.

What Are the Elements of The ABC Test?

The ABC test has three parts (all of which the employer must establish):

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.

With regard to Part A of the test, a staffing firm must show an absence of control or right to control (e.g. when services must be performed, if a particular person is required to perform the services, etc.). If the staffing firm exercises the same degree of control over the independent contractor as it does over an employee, an employee-employer relationship will likely be found, resulting in the employer failing Part A.

Part B will be met if the staffing firm can show the services were not performed in the employer's usual course of business or the services were performed outside of the employer's place of business (e.g. the place where integral part of the business is performed, not the location where services will be performed). The following example was provided in the Dynamex case:

> "… on the one hand, when a retail store hires an outside plumber to repair a leak in a bathroom on its premises or hires an outside electrician to install a new electrical line, the services of the plumber or electrician are not part of the store's usual course of business and the store would not reasonably be seen as having suffered or permitted the plumber or electrician to provide services to it as an employee. *See, e.g.*, Enforcing Fair Labor Standards, supra, 46 UCLA L.Rev. at p. 1159.) On the other hand, when a clothing manufacturing company hires work-at-home seamstresses to make dresses from cloth and patterns supplied by the company that will thereafter be sold by the company (cf., e.g., Silent Woman, Ltd., supra, 585 F.Supp. at pp. 450-452[1]; accord Whitaker House Co-op, supra, 366 U.S. 28[2]), or when a bakery hires cake decorators to work on a regular basis on its custom-designed cakes (cf., e.g,, Dole v. Snell (10th Cir. 1989) 875 F.2d 802, 811), the workers are part of the hiring entity's usual business operation and the hiring business can reasonably be viewed as having suffered or permitted the workers to provide services as employees. In the latter settings, the workers' role within the hiring entity's usual business operations is more like that of an employee than that of an independent contractor."

Part C requires the staffing firm to demonstrate that the contingent worker is in business for himself or herself. As the Dynamex court explained:

> "As a matter of common usage, the term "independent contractor," when applied to an individual worker, ordinarily has been understood to refer to an individual who independently has made the decision to go into business for himself or herself. (See, e.g., Borello, supra, 48 Cal.3d at p. 354[3] [describing independent contractor as a worker who "has independently chosen the burdens and benefits of self-employment"].) **Such an individual generally takes the usual steps to establish and promote his or her independent business — for example, through incorporation, licensure, advertisements, routine offerings to provide the services of the independent business to the public or to a number of potential customers, and the like.** When a worker has not independently decided to engage in an independently established business but instead is simply designated an independent contractor by the unilateral action of a hiring entity, there is a substantial risk that the hiring business is attempting to evade the demands of an applicable wage order through misclassification."

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[1] Silent Woman, Ltd. V. Donovan, 585 F.Supp. 447 (E.D. Wis. 1984).
[2] Goldberg v. Whitaker House Cooperative, Inc., 366 U.S. 28 (1961)
[3] S. G. Borello & Sons, Inc. v. Department of Industrial Relations, 48 Cal. 3d 342 (1989).

Further to this point, staffing firms must show that the independent contractor's enterprise was/is able to survive a termination of the relationship with the employer. For instance, if company X hired contractor A to perform services as an independent contractor and those services consumed a majority of contractor A's time, it is likely contractor A would be determined to be an employee as he or she had no other time to perform services elsewhere.

It is also important to note the ABC Test takes precedence over as to how the parties classify themselves. Therefore, just because the parties agree there is an independent contractor relationship when the relationship begins does not mean their agreement is correct, even in business-to-business transactions, and that they are shielded from the requirements of such test.

Notable Exceptions

As with most laws, the legislature did carve out notable exceptions, such as physicians, dentists, podiatrists, psychologists, veterinarians, securities broker-dealer, investment advisers, direct salespeople (as defined under Section 650 of the Unemployment Code), commercial fisherman, marketing professionals, administrators of human resources, travel agents, graphic designers, grant writers, fine artists, IRS enrolled agents, payment processing agents, real estate licensees, repossession agents, lawyers, accountants, engineers, tutors, event planners, home cleaning agents, dog walkers, dog groomers, web designers, hairstylists and barbers, and aestheticians, payment processing agents, repossession agents and human resources administrators. There are also exceptions for some types of business-to-business activities.

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