

AB 5 and the New “ABC” Test for California Employee and Independent Contractor Classifications

Insights

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On September 18, 2019, California Governor Gavin Newsom signed into law Assembly Bill 5 (“AB 5”), which will bring sweeping changes to the manner in which workers in California are classified as either independent contractors or employees when the new law goes into effect on January 1, 2020. AB 5 generally follows the “ABC” test that the California Supreme Court adopted in its 2018 ruling in *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* (“*Dynamex*”), with certain notable exceptions for a small number of specific occupations and industries.

The California Supreme Court’s 2018 ruling in *Dynamex* significantly broadened the definition of “employee” for purposes of applying the California’s Industrial Welfare Commission (“IWC”) wage orders to California workers. Under *Dynamex*, in any dispute regarding a California wage order (such as a dispute related to an individual’s right to overtime pay or meal and rest periods), the employer has the burden of proving that the worker in question is an independent contractor and not an employee of the employer, and therefore that the wage order does not apply. To meet this burden, employers must satisfy all three of the elements in the “ABC” test that was first established by the California Supreme Court in *Dynamex*. To satisfy the new ABC test, an employer must prove each of the following elements:

- the worker is free from the control and direction of the employer in connection with the performance of the work, both under the contract for the performance of such work and in actually performing the work;

- the worker performs work that is outside the usual course of the employer's business; and
- the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the employer.

The *Dynamex* ruling overturned the “Borello” test for many workers, which had been established by the California Supreme Court nearly 30 years ago to determine whether a worker is an independent contractor or employee (*S.G. Borello & Sons, Inc. v. Department of Industrial Relations* (“Borello”)). The *Borello* test includes several different factors but it primarily focuses on whether the employer has the right to direct and control the worker regarding the manner and means of performing the work.

In *Dynamex*, the California Supreme Court made clear that the broadened employee definition and the new ABC test was applicable to wage orders, but the court did not address other potential applications of the new ABC test, such as to claims for employee benefits like unemployment and workers' compensation or reimbursement of business expense, leaving employers uncertain of the scope of the ABC test and the future of the *Borello* test.

In an attempt to provide some clarity to employers with workers in California, the California legislature passed AB 5 on September 11, 2019. As a result of the passage of AB 5, effective January 1, 2020, the ABC test will apply to several California employment laws beyond wage orders, unless the worker is engaged in an occupation or an industry that is specifically exempted in the language of AB 5.

Under AB 5, the ABC test will apply to determine worker classification for purposes of the California Labor Code (including the requirement to reimburse workers for business expenses) and workers' compensation and unemployment insurance benefits. In addition, AB 5 allows California's Attorney General and the city and county attorneys in large cities (those with populations exceeding 750,000, which are currently San Francisco, San Jose, Los Angeles and San Diego) to prosecute employers believed to have misclassified employees and sue employers for injunctive relief to discontinue such practices. In addition, AB 5 applies the ABC test to business-to-business arrangements, potentially creating liability for employers to the employees of vendors that employers contract with, if such employees are able to effectively establish they are also employees of the contracting employer.

Although AB 5 replaces the *Borello* test for the purpose of classifying workers in most occupations and industries in California, AB 5 creates certain specific exemptions

from the ABC test in select occupations and industries where the *Borello* test will continue to be used to determine if a worker is an employee or independent contractor. The occupations and industries that AB 5 exempts from the ABC test include, among others, registered securities broker-dealers or investment advisers, direct sales salespersons, graphic designers, and service providers performing work for another business pursuant to a contract for certain professional services.

Additionally, certain professionals are exempt from the ABC test if the professional holds a license from the state of California to practice the specified profession in California and practices in such profession, including law, accounting and engineering. The preceding list does not include all of the professions and occupations that are of exempt from the ABC test, and the list of exemptions is likely to change with more lobbying and legislative efforts (and possibly at least one voter proposition related to app-based drivers) in 2020 and beyond.

It is important for employers to remember that unless a worker or business is included in one of the specific exemptions from the ABC test, employers must look most critically at any such worker or business that:

- provides services of a type that an employee might otherwise be performing for the employer such that these services may not fall “outside the usual course” of the employer’s business; and
- does not customarily and independently provide the same type of services to businesses other than the employer.

If either of these two elements is not satisfied in the ABC test, the worker must be classified as an employee and may not be properly classified as an independent contractor.

It is important to remember that even in most instances where an occupation or industry is exempt from the ABC test, AB 5 confirms that the *Borello* test still applies to determining whether such exempted individual or service provider may be properly classified as independent contractors.

Finally, AB 5 does not apply only to worker classifications as of January 1, 2020 but also retroactively applies to certain worker classifications occurring prior to January 1, 2020. According to the new law, AB 5 applies retroactively to California wage orders and violations of the California Labor Code relating to wage orders. Additionally, all of the exemptions contained in AB 5 apply retroactively. On November 20, 2019, the California Supreme Court announced that it would review and decide whether the *Dynamex* case that it handed down in 2018 would be applied retroactively and that

case and its impact on worker classifications in California deserves close attention in 2020.

Beginning on January 1, 2020, the ABC test will be applied to millions of workers in California to determine if such workers are employees who would be covered by a significant number of California wage, hour and other employment laws such as workers' compensation and unemployment insurance benefits.

To prepare for AB 5, employers should identify any current independent contractors who may need to be reclassified as employees and the proper steps to do so, such as providing such workers with employment offer letters and enrolling such individuals in any applicable employee benefit programs, including workers compensation insurance. Please contact your Gunderson Dettmer employment law attorney to discuss any questions you may have regarding this new law.

Related People

Gregory S. Lemmer
PARTNER EMERITUS
P +1 650 321 2400

Sharon J. Hendricks
PARTNER
P +1 650 463 5252

Chelsea D. Raiten
OF COUNSEL
P +1 212 430 4245

Claudia B. Renert
OF COUNSEL
P +1 650 463 5207

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