



Effective July 1, 2020, New California Labor Code Changes the Test for Whether a Worker Is an Employee or Independent Contractor for Workers' Compensation Purposes

On April 30, 2018, the California Supreme Court broke ground when it changed an almost 30-year old test applied to determine employment status for wage orders in the case of *Dynamex Operations West v. Superior Court of Los Angeles* (2018) 4 Cal. 5th 903 (“*Dynamex*”).

Seven months later, the California legislature began its efforts to expand the *Dynamex* decision to other areas, including workers' compensation, paid leave, disability benefits, healthcare subsidies, and the unemployment insurance code.

After several iterations, Governor Gavin Newsom signed the final draft of Assembly Bill 5 (“AB 5”) on September 18, 2019. AB 5 adds new section 2750.3 to the Labor Code and amends section 3351 of the Labor Code making the “new” ABC Test adopted in the *Dynamex* decision applicable to most occupations/industries *for workers' compensation purposes effective July 1, 2020*. The new Labor Code section applies to work performed after January 1, 2020, making it effective for areas *other than workers' compensation laws* on January 1, 2020 (i.e. unemployment, disability benefits, etc.).

AB 5 starts with an express legislative finding that misclassification of workers as independent contractors rather than employees, has resulted in workers losing significant workplace protections. The legislature continues with a finding that both the federal and state governments lose a significant amount of social security payments and payroll taxes due to misclassification of workers as independent contractors. The legislature also expressed that misclassification of employees has been a significant factor in the erosion of the middle class and rise in income inequality in California.

Before *Dynamex* and AB 5, California Had *Borello*

California has a number of different “tests” used to determine whether an individual is an employee or an independent contractor, depending on the applicable statute or regulation. The California’s workers’ compensation system is governed by the California Labor Code. Under Labor Code section 3357, any person rendering services for another is presumed to be an employee unless the person is expressly excluded from the definition of employee by Labor Code sections 3352 or 3352.94 or the hiring entity can meet its burden to show that the worker is an independent contractor. The definition of “employee” for workers’ compensation purposes can be found at Labor Code section 3351.

For the past 30 years, California has used the multifactor balancing test created in 1989 by the California Supreme Court in order to determine who qualifies as an “employee” under Labor Code section 3351. *S.G. Borello & Sons, Inc. v. Department of Industrial Relations* (1989) 48 Cal.3d. 341 (“*Borello*”).

Under *Borello*, a balancing test of the following factors is used to determine employment status of the worker:

- whether the hiring entity has the right to control the manner and means of accomplishing the result desired;
- the right to discharge at will, without cause;
- whether the worker is engaged in a distinct occupation or business;
- the kind of occupation and the skill required in the particular occupation;
- who supplies the instrumentalities, tools and the place of work for the person doing the work;
- the length of time for which services are to be performed;
- the method of payment;
- whether or not the work is part of the hiring entity’s regular business;
- and whether or not the parties believe they are creating an employer-employee relationship.

Under the *Borello* test, California courts apply and “balance” these factors in order to determine whether the relationship is more heavily weighted toward “employee” or “independent contractor” status.

“New” ABC Test created by *Dynamex* and Assembly Bill 5

In *Dynamex*, the California Supreme Court held that for purposes of the California wage order laws *only*, a test called the “ABC Test” is to be used, rather than the *Borello* test, to determine whether a worker who is paid for services is an employee or independent contractor. With the passage of AB 5, the ABC Test was formally incorporated into the Labor Code as section 2750.3, providing that the ABC Test would be used to determine employment status of workers in most industries.

Pursuant to the “ABC Test,” a hired individual is presumed an employee, and the burden lies entirely on the hiring party to rebut that presumption by showing that *all three of the following factors are present* in the working relationship:

- 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.

As a result, if the employer cannot make a showing that the worker satisfies each of the ABC criteria, the worker is deemed to be an employee and not an independent contractor.

Notably, the California Supreme Court emphasized in both the *Borello* and *Dynamex* cases that as set forth in Labor Code sections 3357 and 5705, the burden remains on the one seeking to avoid workers’

compensation liability to show that the worker is an independent contractor rather than an employee. As a result, regardless of which test applies, the burden remains on the entity or person seeking to avoid liability to prove independent contractor status.

Exemptions from the ABC Test

What makes the new Labor Code section 2750.3 somewhat complex, however, is that Labor Code section 2750.3 (b) expressly includes a description (i.e. list) of dozens of occupations that are *conditionally exempt* from the use of the ABC Test for determining if the worker is an employee or independent contractor. For those occupations that meet certain criteria, the ABC Test is not to be applied and the multifactor *Borello* test continues to be used in determining employee or independent contractor status.

As a result, for some occupations such as insurance agents, physicians, architects, and accountants, to name only a few—the multifactor *Borello* test still applies. If the occupation or industry is not expressly listed in Labor Code section 2750.3 as conditionally exempt from the ABC Test, then the ABC Test will apply to determine employment status.

The analysis as to whether the ABC Test or *Borello* test applies becomes a little more lengthy for certain industries such as professional services, business-to-business contracting relationships, referral agencies, and construction trucking, to name only a few, where the industry will only qualify for an “exemption” from the ABC Test if certain criteria listed in Labor Code section 2750.3 are first met. In other words, if certain licensing is not obtained, or other express criteria are not met (as defined in section 2750.3), then the ABC Test will still apply even though the occupation or industry is on the list of exemptions. In that situation, the hiring entity will not qualify for “exemption” status.

To provide an example of how this works, if an employer were to be in the business of graphic design, then the employer would be in the “professional services” industry as defined by Labor Code section 2750.3(c)(1). As a result, in order to qualify for an “exemption” (have *Borello* apply rather than the ABC Test), the employer would first need to satisfy the six criteria listed at Labor Code section 2750.3(c)(1)(A)-(F). If the employer cannot meet all six criteria, then the ABC Test would be the applicable test to determine employment status as the employer would not qualify for the exemption.

Moreover, there are a handful of industries, including construction trucking, commercial fishermen, manicurists, and newspaper distributors, that have an expiration date of their exemption status. For example, the construction trucking industry will only qualify for an exemption until January 1, 2022, at which point the ABC Test will apply.

Notably, the legislature included a “catch-all” provision which states that when a court rules that the three-part ABC Test cannot be applied to a particular context, then the employment status determination would be governed by the test in *Borello*.

Applicable to Workers' Compensation on July 1, 2020

Assembly Bill 5 also amended Labor Code section 3351 by adding subdivision (i), making Labor Code section 2750.3 applicable for workers' compensation purposes on July 1, 2020. Labor Code section 3351 now reads (in relevant part):

'Employee' means every person in the service of an employer under any appointment or contract of hire or apprenticeship, express or implied, oral or written, whether lawfully or unlawfully employed, and includes:

(i) Beginning on July 1, 2020, any individual who is an employee pursuant to Section 2750.3. This subdivision shall not apply retroactively.

As a result, Assembly Bill 5 will be effective in all other areas, such as the unemployment insurance code or disability benefits, for example, on January 1, 2020. The ABC Test is, of course, already the applicable test for wage orders, because of the Dynamex decision issued by the California Supreme Court.

Finally, Assembly Bill 5 also amended the definition of "employer" in Unemployment Insurance Code section 606.5 in regards to "temporary services employer" and "leasing employer" and amended the definition of "employee" in Unemployment Insurance Code section 621(b) to require use of the ABC Test to determine if workers who are paid wages or salary are employees or independent contractors for purposes of determining eligibility for unemployment benefits.

From an enforcement standpoint, Labor Code section 2750.3 now enables the California Attorney General, city attorneys, and local prosecutors to sue companies for mis-classification of workers as independent contractors. See Labor Code § 2750.3(j).

State Fund is monitoring all legal and legislative developments in this area. We are aware that lawsuits have been filed since September by other parties wishing to change elements of the new law, and related 2020 ballot initiatives have been proposed. Additional materials and information will be forthcoming and provided on State Fund's broker page.

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