



AB5 IS LAW. NOW WHAT?

Proactive planning is key to navigating a post-AB5 world.

On September 18, 2019, California governor Gavin Newsom signed into law a contentious piece of legislation — AB5 — that could potentially reclassify millions of independent contractors as employees and dramatically reshape the future of independent workforces in California and beyond.

As its nickname, the “gig worker bill”, suggests much of the discussion around AB5 has focused on its effects on the Ubers and Lyfts of the world. But it is actually far, far bigger than that, with the potential to touch nearly all companies in California — and even some outside of California — that use independent contractors (see below for some notable industry exemptions).

While the immediacy is most keenly felt in California, if “as California goes, so goes the nation” holds true then the door is wide open for other states to follow suit and enact similar laws that make it ever more difficult to classify workers as independent contractors (ICs). In addition, because of how the law is written, its reach may even extend to companies outside of California if those companies contract with independent contractors who cross into California — even on a limited basis.

The state of panic has been palpable, but before the dread of restructuring an entire workforce sets in, there are some proactive steps that can be taken to function in a post-AB5 economy.

WHAT DOES AB5 DO?

AB5 codifies the landmark April 2018 decision in the Dynamex case. With this decision, California’s Supreme Court determined that the rigorous, three-pronged “ABC Test” must be used to determine worker classification in wage-order claims.

Under the ABC Test a worker is presumed to be an employee — and the burden to demonstrate their independent contractor status is placed squarely on the shoulders of the hiring company. To do this successfully a company must demonstrate (the emphasis is on “demonstrate” - as scrupulous documentation is critical) that the worker satisfies all 3 criteria of the test (1 or 2 doesn’t cut it).

A worker can only be classified as an independent contractor if:

- (a) the worker is free from control and direction in the performance of services; and
- (b) the worker is performing work outside the usual course of the business of the hiring company; and
- (c) the worker is customarily engaged in an independently established trade, occupation, or business.

This definition of an independent contractor is much narrower than that of the multi-factor Borello test—the standard previously used in California, which made it far easier to classify workers as independent contractors.

AB5 makes the ABC Test the law in California, but it also expands its application beyond wage-order claims to all provisions under the state Labor and Unemployment Insurance codes.

HOW WILL AB5 BE ENFORCED?

This is really the (multi-) billion-dollar question, one that will take some time to be answered as there is a significant gap between what a law dictates and how it is interpreted by the courts.

A variety of California agencies oversee worker classification as it pertains to claims made by individuals. However, those individual claims can trigger larger agency audits of hiring companies' classification practices—and those audits will now look to the ABC Test to determine improper classification.

We can almost certainly expect to see enforcement duked out in some lengthy legal battles. AB5 enables the California attorney general, city attorneys, and local prosecutors to sue companies over violations. If this occurs it would require a judge's order to force companies to reclassify their workers, and large entities with deep pockets like Uber and Lyft would likely fight their cases for years. In addition, expect years of lobbying efforts for industry-related exemptions at the legislative level.

This is where the issue of interpretation comes into play, in the wake of the Dynamex ruling, so far the Supreme Court of California has yet to apply all 3 prongs of the ABC test in any single case. The point here is that the interpretation of AB5 will be just as critical as the legislation itself. And right now, that interpretation is an unknown.

Certainly, compliantly structuring, implementing and documenting independent contractor relationships will be more challenging under the ABC Test, but it is possible that courts will interpret AB5 in a way that permits some companies to classify workers as ICs.

WHO IS EXEMPTED FROM AB5—AND WHO ISN'T?

Prior to its passage, AB5 was the subject of major lobbying efforts on both sides of the issue. The result is that over 50 professions or types of businesses are exempted from the bill. Exemptions include doctors, dentists, insurance agents, lawyers, accounts, real estate agents, hairstylists, and a variety of creative professionals.

However, AB5 also exempts business-to-business contractors that meet 12 specific requirements and referral agencies that meet 10 specific requirements. This keeps the door open for establishing a sound business-to-business relationship between hiring companies/ referral agencies and independent contractors, but also requires a deliberately planned strategy to achieve compliance with all of the various requirements.

To be clear, exemption from AB5 does not mean that workers can automatically be classified as independent contractors by virtue of waving some kind of classification magic wand. Rather, it means the former Borello test will be used to determine their classification for both wage-order and non-wage-order claims. So structuring, implementing and documenting the independent contractor arrangement to comply with the multi-factor test is crucial for exempt businesses.

ARE THERE IMPLICATIONS OUTSIDE CALIFORNIA?

Very likely, yes. In recent years, 20 states have already implemented the ABC Test in one form or another, although primarily in relation to unemployment insurance or workers' compensation claims. The passage of AB5 could certainly hasten the ABC Test trend and expand it not only to other states but to other claim types. Because California's economy is larger than any other US state, legal and political developments there tend to have a ripple effect both across other states and at the federal level.

Since it is certainly possible similar bills will begin to pop up elsewhere, businesses operating outside of California should be proactive in shoring up the appropriate independent contractor processes and relationships now. Though it will take some time for any new legislation to actually be passed, that legislation could be applied retroactively so the sooner a company's ducks are in a row, the better.

IS IT TIME TO START PANICKING YET?

Planning, not panic, will be the most helpful here. There's no doubt that AB5 will have a meaningful impact, both inside and outside California. But again, how the law will be interpreted and applied remains to be seen. Certainly, fear of non-compliance is justified, but there are some proactive steps to take.

If you operate in California, it's a good idea to start acting now. If you operate outside of California, you have more time, but taking the necessary steps now could save you some sleepless nights later.


WHAT ARE THE STEPS MY COMPANY CAN TAKE?

- 1) Get the right legal counsel. First things first, consult an attorney that specializes in independent contractor and employment law. Seek out a specialist that has a full grasp of the nuances and who understands the possibilities for structuring the independent contractor relationship.
- 2) Assess your risk. Under guidance from your counsel, conduct an audit of your independent contractor management processes. A comprehensive audit would take a wide view to include:
 - engagement guidelines
 - contractual terms
 - IC incorporation requirements
 - rate negotiations
 - documentation processes
 - work structure and level of control
 - staff and IC interactions

Every touchpoint with an independent contractor is relevant here to help you understand what is and isn't compliant.

- 3) Leverage technology. The right technology can help you structure your business's relationship with independent contractors to minimize risk. You'll want a platform and managed service provider that can help you with the risk assessment in step 2 but also provide guidance on and implement best practices specific to your industry, independent contractor relationship model, and changing regulations. It's critical that this solution also includes comprehensive documentation of your company's relationship with the IC at every stage of the IC lifecycle.
- 4) Create separation. Establishing an arm's length, business-to-business relationship with independent contractors is one of the most important steps you can take to stay compliant, no matter what state you're in. AB5 specifically exempts business-to-business contractors from the ABC Test as long as they meet a set of 12 criteria—all of which demonstrate that the contractor operates as their own business entity.

Implementing technology can act as the intermediary between you and the independent contractor to support a business-to-business model while also providing the necessary tools for the contractor to establish themselves as a separate business.



Get in touch at sales@oforce.com to learn more about how technology can help support the independent contractor model.

THE AB5 BUSINESS-TO-BUSINESS EXEMPTION: 12 KEY CRITERIA

California's AB5 specifically exempts business-to-business contracting relationships from the ABC Test as long as the independent contractor meets all 12 criteria below. Even if your company doesn't operate in California, establishing a true business-to-business relationship is critical to reduce the risk of misclassification.

The criteria below may seem overwhelming, but Openforce's tools and services are designed to help you meet them by implementing best practices and documenting them across the entire independent contractor lifecycle.

AB5 states that the ABC Test and the holding in Dynamex "do not apply to a bona fide business-to-business contracting relationship, as defined below, under the following conditions:

If a business entity formed as a sole proprietorship, partnership, limited liability company, limited liability partnership, or corporation ("business service provider") contracts to provide services to another such business ("contracting business"), the determination of employee or independent contractor status of the business services provider shall be governed by Borello, if the contracting business demonstrates that all of the following criteria are satisfied:

- 1) The business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.
- 2) The business service provider is providing services directly to the contracting business rather than to customers of the contracting business.
- 3) The contract with the business service provider is in writing.
- 4) If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- 5) The business service provider maintains a business location that is separate from the business or work location of the contracting business.
- 6) The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.
- 7) The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.
- 8) The business service provider advertises and holds itself out to the public as available to provide the same or similar services.
- 9) The business service provider provides its own tools, vehicles, and equipment to perform the services.
- 10) The business service provider can negotiate its own rates.
- 11) Consistent with the nature of the work, the business service provider can set its own hours and location of work.
- 12) The business service provider is not performing the type of work for which a license from the Contractor's State License Board is required, pursuant to Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code.

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