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Independent Contractor and Exempt Status Questions Under California Law

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Classification of Independent Workers

Legal Framework in the U.S.

- Businesses are subject to federal, state, and local laws
- The risks associated with engaging independent contractors are greater in some jurisdictions than others
- The tests used to determine independent contractor status vary by jurisdiction, and by statute
 - Control
 - Integration / usual course of business
 - Entrepreneurial Activity

Generally, most exposure from independent contractor misclassification stems from wage and hour litigation (including class and collective actions), and government audits (e.g., unemployment insurance tax assessments)

California's Classification of Independent Workers Through December 31, 2019

- Various tests were applied depending on the situation to determine whether an individual was an employee or an independent contractor for purposes of:
 - Wage and hour laws.
 - Worker's Compensation
 - Unemployment Insurance
 - The Fair Employment and Housing Act (FEHA)
- The same individual could be deemed an employee in one context and an independent contractor in another.
- The “economic realities” test set out in *S.G. Borello & Sons, Inc. v. Dep't of Indus. Relations* (Borello) (1989) 48 Cal. 3d 341 was used for nearly all worker classification determinations.

California's Classification of Independent Workers Through December 31, 2019

- Borello is referred to as a “multifactor” test because it requires consideration of all potentially relevant facts – no single factor controls the determination. For example, where the employer does not control the work details, an employer-employee relationship may be found if
 - (1) the employer retains control over the operation as a whole
 - (2) the worker's duties are an integral part of the operation
 - (3) the nature of the work makes detailed control unnecessary. (*Yellow Cab Cooperative, Inc. v. Workers' Compensation Appeals Board* (1991) 226 Cal.App.3d 1288.)

California's Classification of Independent Workers

The Borello Test

- The worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer
 - The work is a regular or integral part of the employer's business
 - The employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work
 - The worker has invested in the business, such as in the equipment or materials required by their task
 - the service provided requires a special skill
 - the kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision
- The worker's opportunity for profit or loss depending on their managerial skill
 - The length of time for which the services are to be performed
 - The degree of permanence of the working relationship
 - The method of payment, whether by time or by the job. The worker hires their own employees
 - the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract
 - Whether or not the worker and the potential employer believe they are creating an employer-employee relationship

California's Classification of Independent Workers

Dynamex and the ABC Test

- The California Supreme Court first adopted the ABC test in *Dynamex Operations West, Inc. v. Superior Court* (2018) 4 Cal.5th 903.
- Under the ABC test, a worker is considered an employee and not an independent contractor, unless the hiring entity satisfies all three of the following conditions:
 - The worker 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;
 - The worker performs work that is outside the usual course of the hiring entity's business; and
 - The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.



California's Classification of Independent Workers

Application of the ABC Test – Part A

- The hiring entity must establish that the worker is free of such control to satisfy part A of the ABC test. (Dynamex, 4 Cal.5th at 958.)
- A worker who is subject, either as a matter of contractual right or in actual practice, to the type and degree of control a business typically exercises over employees would be considered an employee. (Id.)
- Depending on the nature of the work and overall arrangement between the parties, a business need not control the precise manner or details of the work in order to be found to have maintained the necessary control that an employer ordinarily possesses over its employees. (Id.)

Part A: Is the worker free from the control and direction of the hiring entity in the performance of the work, both under the contract for the performance of the work and in fact?

California's Classification of Independent Workers

Application of the ABC Test – Part B

- The hiring entity must establish that the worker performs work that is outside the usual course of its business in order to satisfy part B of the ABC test. (Dynamex, 4 Cal.5th at 959.)
- Contracted workers who provide services in a role comparable to that of an existing employee will likely be viewed as working in the usual course of the hiring entity's business. (Id.)
- Examples where services are not part of the hiring entity's usual course of business:
 - When a retail store hires an outside plumber to repair a leak in a bathroom on its premises.
 - When a retail store hires an outside electrician to install a new electrical line. (Id.)
- Examples where services are part of the hiring entity's usual course of business:
 - 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.
 - When a bakery hires cake decorators to work on a regular basis on its custom-designed cakes. (Id. at 959-960.)

Part B: Does the worker perform work that is outside the usual course of the hiring entity's business?

California's Classification of Independent Workers

Application of the ABC Test – Part C

- The hiring entity must prove that the worker is customarily and currently engaged in an independently established trade, occupation, or business. (*Dynamex*, 4 Cal.5th at 963.)
- The hiring entity cannot unilaterally determine a worker's status simply by assigning the worker the label "independent contractor" or by requiring the worker, as a condition of hiring, to enter into a contract that designates the worker an independent contractor. (*Id.* at 962.)
- Part C requires that the independent business operation actually be in existence at the time the work is performed. The fact that it could come into existence in the future is not sufficient. (See *Garcia v. Border Transportation Group, LLC* (2018) 28 Cal.App.5th 558, 574.)
- An individual who independently has made the decision to go into business generally takes the usual steps to establish and promote that independent business.
- If an individual's work relies on a single employer, Part C is not met. For example, Part C was not satisfied where a taxi driver was required to hold a municipal permit that may only be used while that driver is employed by a specific taxi company. (See *Garcia*, 28 Cal.App.5th at 575.)

Part C: Is the worker customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity?

California's Classification of Independent Workers

Dynamex and Its Amendments

- The law was amended numerous times to carve out occupations and professions that will remain subject to the *Borello* test. These include:
 - "among others, licensed insurance agents, certain licensed health care professionals, registered securities broker-dealers or investment advisers, direct sales salespersons, real estate licensees, commercial fishermen, workers providing licensed barber or cosmetology services, and others performing work under a contract for professional services, with another business entity, or pursuant to a subcontract in the construction industry."
- Other exemptions include licensed practicing lawyers, architects, engineers, private investigators and accountants.

California's Classification of Independent Workers

Dynamex and Its Amendments

- To further complicate matters, the law adds criteria to qualify for an exemption to the ABC test for a whole host of categories. For those working under a contract for professional services in marketing, HR administration, graphic design, fine art, photography, photojournalism, freelance writing, grant writing and editing, among others, six factors have been added:
 1. The individual must maintain a business location (which may include a personal residence) that is separate from the hiring entity;
 2. If the work is performed for more than six months after the law goes into effect, the individual must have a business license;
 3. The individual must be able to set or negotiate their own rates;
 4. The individual must be able to set their own hours;
 5. The individual must be customarily engaged in the same type of work performed under contract with another hiring entity or hold themselves out to potential customers for such work; and
 6. The individual must customarily and regularly exercise discretion and judgment.

California's Classification of Independent Workers

Dynamex and the "Suffer or Permit to Work" Definition

- The California Supreme Court held that the Wage Orders' "suffer or permit to work" definition of employer and employs:
 - Must be interpreted broadly to treat workers as employees to protect all workers who would ordinarily be viewed as working in the hiring entity's business.
 - Cannot be interpreted literally in a way to include those traditionally viewed as genuine independent contractors who are working only in their own independent business (for example, independent plumbers or electricians).

California's Classification of Independent Workers

Back to Borello

- Despite recent changes to California statutory and common law, the Borello Economic Realities Test continues to be used in worker classification under various statutory exceptions. Again, under this test, the primary consideration is whether the employer has control or the right to control the manner and means by which the work is performed, not only the scope of the work itself (*Borello*, 48 Cal. 3d at 350-55).

Can you name the
secondary factors
previously discussed?



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Classification Beginning January 1, 2020

- On September 18, 2019, California's governor signed A.B. 5 into law which codifies the ABC test, while adding numerous exceptions where the Borello test would typically apply. Additionally, if a court determines that the ABC test cannot be applied in a particular context based on grounds other than an express exception in the Labor Code, Unemployment Insurance Code, or IWC wage orders, worker classification will be governed by the standard set out by the California Supreme Court in Borello (A.B. 5; Cal. Lab. Code § 2750.3(a)(3); 48 Cal. 3d at 350-55.
- Under A.B. 5, a person providing labor or services for remuneration in California is considered an employee rather than an independent contractor for most purposes unless the hiring entity demonstrates the person falls within a specific exemption or satisfies the ABC test and Dynamex.
- The application of the ABC test and Dynamex take effect:
 - **January 1, 2020** for purposes of:
 - the California Labor Code; and
 - the Unemployment Insurance Code. (Cal. Lab. Code § 2750.3(i)(3).)
 - **July 1, 2020** for workers' compensation purposes (Cal. Lab. Code § 3351(i)).

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Retroactivity

- ◆ Additionally, A.B. 5 is effective retroactively for:
 - ◆ Wage orders and violations of the Labor Code "relating to" wage orders when applying the ABC test and Dynamex.
 - ◆ The application of the exceptions specified in proposed Labor Code Section 2750.3(b) to (h) to existing claims and actions to the maximum extent permitted by law when it would relieve an employer from liability. (Cal. Lab. Code § 2750.3(i)(1), (2).)
- ◆ But it is unclear:
 - ◆ Whether this exception will only apply to claims that have already been filed or those that may have arisen but have not yet been filed.
 - ◆ What "the maximum extent permitted by law" means.

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Is Dynamex, Itself, Retroactive?

- The question facing the California Supreme Court is whether the ABC Test should apply to contractor relationships before April 30, 2018 (and thus before the ABC Test was adopted by the California Supreme Court).
- Soon after AB 5 was passed, the Ninth Circuit Court of Appeals certified the question to the California Supreme Court in *Vazquez v. Jan-Pro Franchising International, Inc.*, 939 F.3d 1045 (9th Cir. Sept. 24, 2019).
- In May, the Ninth Circuit found that the ABC Test should be applied retroactively. The hiring entity asked the court to reconsider the question and on September 26, the court certified the question to California's high court, which finally decided to hear the issue on November 20, 2019.
- Respondent's Answer is due on April 27, 2020. The court has yet to schedule oral argument.

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Statutory Exceptions

Excluded occupations
Contracts for “professional services”
Bona fide business service providers if criteria met
Service providers for referral agencies if criteria met
Service providers under a contract with motor club

Subcontractor in construction industry if criteria met

Real estate licensee

Licensed repossession agent

Borello Test

Borello test and Cal. Lab. Code
§ 2750.5

Cal. Bus. & Prof. Code § 10032(b)

Cal. Bus. & Prof. Code § 7500.2

AB5

Statutory Exceptions

- First, certain occupations are expressly excluded from the ABC test's application. The Borello test applies to these occupations to determine when a worker must be classified as an employee:
 - A person or organization who is licensed by California's Department of Insurance as:
 - a production agency (insurance brokers, insurance agents, and other insurance licensees); a surplus line broker; or a life and disability insurance analyst.
 - Subject to a collective bargaining agreement, a California licensed:
 - physician; surgeon; dentist; podiatrist; psychologist; veterinarian; **lawyer**; architect; engineer; private investigator; or accountant.
 - Securities broker-dealer, investment adviser, or their agents and representatives that:
 - are registered with the Securities and Exchange Commission; are registered with the Financial Industry Regulatory Authority; or are licensed under specific provisions of California's Corporations Code.

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Statutory Exceptions Continued

- First, certain occupations are expressly excluded from the ABC test's application. The Borello test applies to these occupations to determine when a worker must be classified as an employee:
 - A direct sales salesperson (Cal. Unemp. Ins. Code § 650).
 - A commercial fisher working on an American vessel, with this exception set to expire on January 1, 2023 unless further extended by the state Legislature (Cal. Unemp. Ins. Code § 125.5).
 - A newspaper distributor working under contract with a newspaper publisher and a newspaper carrier working under contract with either a newspaper publisher or distributor, with this exception set to expire January 1, 2021 unless further extended by the state legislature. (A.B. 5; Cal. Lab. Code § 2750.3(b).)

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Statutory Exceptions Continued

- Second, Borello is the controlling test for contracts for limited "professional services" between a hiring entity and the individual providing those services, if the hiring entity demonstrates these six criteria:
 1. The individual maintains a business location, which may include the individual's residence, that is separate from the hiring entity, although the individual may choose to perform services at the hiring entity's location.
 2. If work is performed more than six months after January 1, 2020, the individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession.
 3. The individual has the ability to set or negotiate their own rates for the services performed.
 4. The individual has the ability to set their own hours, outside of project completion dates and reasonable business hours.
 5. The individual:
 - is customarily engaged in the same type of work performed under contract with another hiring entity; or holds themselves out to other potential customers as available to perform the same type of work.
 6. The individual customarily and regularly exercises discretion and independent judgment in the performance of the services.
(A.B. 5; Cal. Lab. Code § 2750.3(c)(1).)

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Statutory Exceptions Continued

Professional services, in this second category of exception, is defined to include only the following:

- ❖ Marketing, subject to certain requirements.
- ❖ Administration of human resources, subject to certain requirements.
- ❖ Travel agent services provided by limited individuals.
- ❖ Graphic design.
- ❖ Grant writer.
- ❖ Fine artist.
- ❖ Services by an enrolled agent licensed by the US Department of Treasury to practice before the Internal Revenue Service.
- ❖ Payment processing agent through an independent sales organization.
- ❖ With certain exceptions, services by a still photographer or photojournalist who does not license content submissions to the putative employer more than 35 times per year.
- ❖ Services by certain freelance writers, editors, or newspaper cartoonists.
- ❖ Services provided by a licensed esthetician, electrologist, manicurist (until January 1, 2022), barber, or cosmetologist if the individual satisfies certain requirements, including, but not limited to:
 - setting their own rates and schedule;
 - maintaining their own business license; and
 - issuing a Form 1099 if they rent space to perform services from the hiring entity.

(A.B. 5; Cal. Lab. Code § 2750.3(c)(2)(B).)

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Statutory Exceptions Continued

- Third, for certain professions subject to the Business and Professions Code, independent contractor classification is determined as follows:
 - For a real estate licensee, Cal. Bus. & Prof. Code § 10032(b) primarily governs, but if that section is not applicable, then by Borello, the Workers' Compensation Act, or the Unemployment Insurance Code, depending on the purpose.
 - For a licensed repossession agency that is free from the control and direction of the hiring entity both under contract and in fact, Cal. Bus. & Prof. Code § 7500.2 governs.

(A.B. 5; Cal. Lab. Code § 2750.3(d).)

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Statutory Exceptions Continued

- ◆ Fourth, the Borello test governs in determining independent contractor status for these exceptions:
 - ◆ Bona fide business-to-business contracting relationships where the business service provider is a business entity, not an individual, that meets 12 criteria, including, but not limited to:
 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

AB5

Statutory Exceptions Continued

- ◆ Fourth, the Borello test governs in determining independent contractor status for these exceptions:
 - ◆ Bona fide business-to-business contracting relationships where the business service provider is a business entity, not an individual, that meets 12 criteria, including, but not limited to:
 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 Contractors State License Board (CSLB) is required, pursuant to Chapter 9 (commencing with Section 7000) of Division 3 of the Business and Professions Code



**Let me take a moment to talk
about the difference between
independent contractors and
employees**

2 Types of Employees: Exempt & Non-Exempt

Q: The difference?

A: Non-exempt employees get overtime, breaks, and more.



The Anatomy of an Exempt Employee

The “right” kind of work

Time spent performing the right kind of work

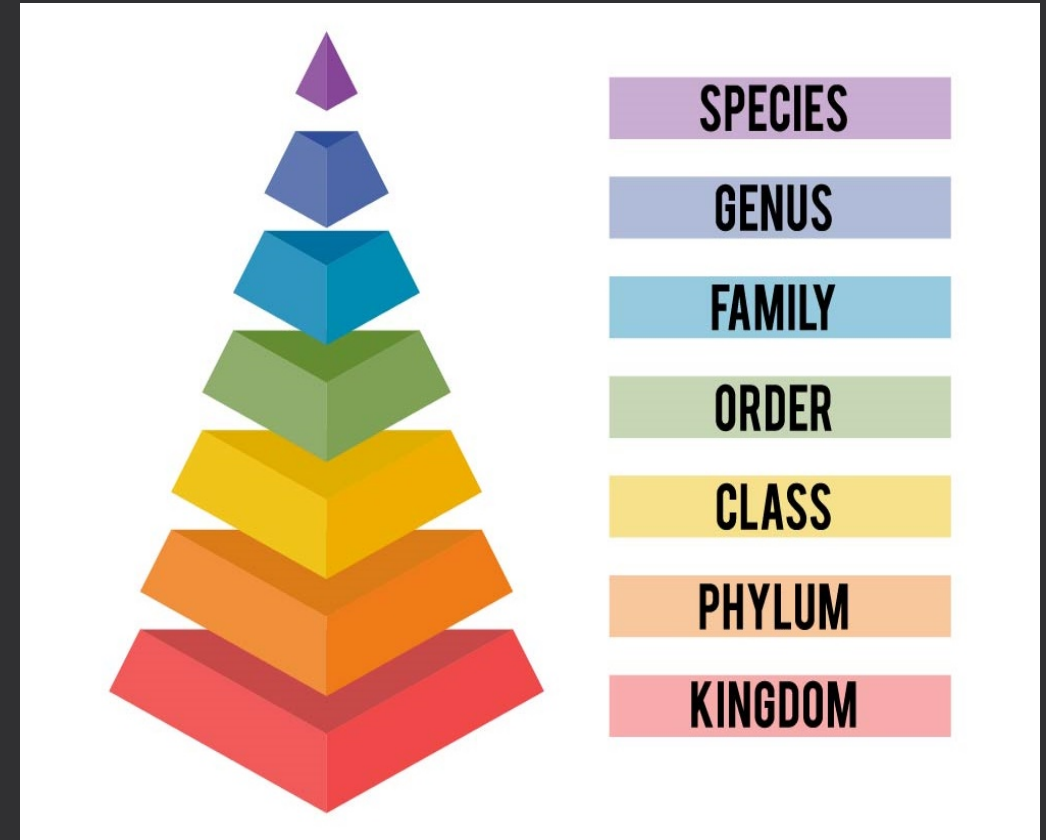
Compensation floor

Where the work is done (sometimes)



Partial Taxonomy of Exempt Employees

- White Collar
 - Administrative Exemption
 - Executive Exemption
 - Professional Exemption
- Sales
 - Inside Sales Exemption
 - Outside Sales Exemption
- Miscellaneous
 - Computer Professional Exemption



White Collar Administrative Exemption

- Comp: 2x California minimum wage.
 - 2020 Comp: \$49,920 (25 or less employees) or \$54,080 (26 or more employees)
 - Must spend more than 50% of time doing:
 - Office or non-manual work related to the employer's management or general business operations (e.g., tax, finance, HR, legal compliance)
 - Must involve exercise of discretion and independent judgment . . .
 - With respect to significant matters in the employer's business or operations (i.e., head of party planning committee doesn't count, and beware of the "production worker" precedent)

E.g.: Directors, Program Managers and Coordinators, and Office Administrators

White Collar Executive Exemption

- Comp: 2x California minimum wage.
 - 2020 Comp: \$49,920 (25 or less employees) or \$54,080 (26 or more employees)
- Must spend more than 50% of time doing:
 - An enterprise-management role
 - Supervises two or more employees
 - Authority to hire and fire other employees

E.g.: Presidents, Vice Presidents, Executive Directors and Directors



White Collar Professional Exemption

- Comp: 2x California minimum wage.
 - 2020 Comp: \$49,920 (25 or less employees) or \$54,080 (26 or more employees)
- Must spend more than 50% of time doing:
 - Work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction
- E.g.: Attorneys, Physicians, Professors





White Collar Professional Exemption

Primary Job Includes:

- Application of system analysis techniques and procedures, including consulting with users to determine software and/or functional specs
- Design development, documentation, analysis, creation, testing or modification of computer systems or programs including prototypes based on design specs
- Highly skilled and proficient in programming

But Not If:

- Trainee or entry level position
- Not enough skill to work independently
- Computer manufacture or repair
- Drafter / designer dependent on computer software, but not involved in analysis or programming
- Writer re: promotional materials
- Creates imagery for television or theatrical