



AB 5 – Stop the Misclassification of Workers

IN BRIEF

Assembly Bill 5 codifies a widely used legal standard known as the “ABC test” to determine employment status for the purposes of the California Labor and Unemployment Insurance Codes and clarifies the test’s application. In doing so, this bill seeks to end the harmful practice of worker misclassification.

BACKGROUND

In 2004, a misclassification lawsuit was filed against a package and document delivery company called Dynamex which had converted all of its delivery drivers from employees of the company to independent contractors. The company used this tactic to cut costs at the expense of its own workers. Drivers continued to perform essentially the same job, but without the protections afforded under the California Labor and Unemployment Insurance Codes and wage orders.

In April 2018, the California Supreme Court issued the landmark decision *Dynamex Operations West, Inc. v. Superior Court of Los Angeles* which unanimously ruled in favor of the drivers and based its ruling on a three part “ABC” test used to determine employment status in other states. The court found workers can only be classified as independent contractors if a hiring business can prove the following three conditions:

- (A): The worker is “free from the control and direction” of the company that hired them while they perform their work.
- (B): The worker is performing work that falls “outside the hiring entity’s usual course or type of business.”
- (C): The worker has their own independent business or trade beyond the job for which they were hired.

New Jersey, Massachusetts and Connecticut also use the ABC test to determine employment status for their wage and hour laws. Twenty-six states use the test to determine employment status for purposes of unemployment insurance eligibility.

PROBLEM

For decades, many companies have increasingly shifted toward a business model that relies on the misclassification of employees and is based on exploiting workers, lowering labor standards in the workplace, and evading state and federal taxes. Companies that misclassify their workers force them to act as an “independent business” while the employer maintains the right to set rates, direct work, and impose discipline and control upon the worker. In many cases, workers employed with these companies are performing the same work as traditional employees, but without any of the

rights or protections afforded to workers under California Labor and Unemployment Insurance Codes, such as the right to paid sick days, the right to organize to improve wages and working conditions, anti-discrimination or retaliation protections, Social Security, and access to critical worker safety-net programs like unemployment insurance and workers’ compensation. Low-wage and immigrant workers who are already highly vulnerable to exploitation are disproportionately harmed when companies deny workers their basic rights to minimum wage and overtime, and instead, choose to pass down the economic risk onto the workers and abandon their responsibilities as employers.

Companies have used the practice of misclassification to cut costs at the expense of workers and in turn, created an insurmountable challenge for working families trying to make ends meet. This exploitative business practice has proliferated in industries such as trucking, delivery, janitorial and construction for decades. The advent of app-based companies and the “gig economy” has only further accelerated the practice of misclassification and resulted in declining working conditions and increased reliance on public assistance. In California, almost half of workers who participate in the gig economy struggle with poverty¹. Further evidence suggests that the shift toward relying on contractors, coupled with larger corporations reducing the wages of low- and mid-level workers, may have accounted for as much as 20 percent of the increasing wage inequality between 1989 and 2014.² Misclassified workers must pay higher taxes because they are responsible for paying both the employer and employee share of Social Security, Medicare, and unemployment taxes. Collectively, workers across the country can lose as much as \$2.72 billion annually due to misclassification³, while businesses stand to save 15 to 30 percent on labor costs⁴ as a result.

The misclassification of workers has widespread repercussions for our economy and state’s well-being. The practice of misclassification creates unfair competition for responsible contractors and law-abiding employers who honor their lawful obligations to their employees, yet are forced to compete with other companies that use an illegal business model. Businesses misclassifying their workers undermine worker safety-net programs and leave an undue burden on law-abiding businesses in the form of annual unemployment insurance taxes and workers’ compensation premiums estimated at \$831.4 million and \$2.54 billion respectively⁵. Ultimately, when workers without protections are laid off or cannot find a job, get sick or injured on the job, or they retire, taxpayers end up bearing the costs of

¹ https://www.prii.org/research/renewed_struggle_for_the_american_dream-prii_2018_california_workers_survey/

² https://faculty.wharton.upenn.edu/wp-content/uploads/2017/02/fswe_orsgsci-v3.3.pdf

³ <https://www.gao.gov/assets/120/116521.pdf>

⁴ <https://www.nelp.org/wp-content/uploads/2015/03/1099edFactSheet2010.pdf>

⁵ <https://www.nelp.org/wp-content/uploads/On-Demand-Economy-State-Labor-Protections.pdf>

supporting them. The Division of Labor Standards Enforcement estimates that the misclassification of workers results in an estimated annual loss of \$7 billion per year in payroll tax revenue to the state, that otherwise could have supported General Fund programs for public safety, education, and public infrastructure.

SOLUTION

The misclassification of workers is a clear detriment to working families, local businesses, and the state. This harmful practice undermines the hard-fought laws passed by the Legislature that have historically positioned California as a national leader in creating the strongest worker protections in the country.

AB 5 codifies the ABC test prescribed in the Court's Dynamex ruling to help ensure that working Californians can retain all the rights and job protections afforded to employees under the California Labor Code and Unemployment Insurance Code. The bill will apply to the wage orders of the Industrial Welfare Commission, in addition to provisions of Labor and Unemployment Insurance Codes that do not otherwise define "employee". By codifying this landmark ruling, the bill creates a clear and consistent definition for employment and stands to raise the working standards for millions of workers in the state of California.

AB 5 also clarifies the test's application to provide certainty to industries that are unsure of the case's implications. Specifically, the bill clarifies that the following employment relationships will be governed by the test adopted by the California Supreme Court in the case of *S. G. Borello & Sons, Inc. v. Dept. of Industrial Relations* (1989):

- Physicians, dentists, and podiatrists
- Insurance agents and brokers
- Securities broker-dealers and investment advisors
- Direct salespersons
- Real estate licensees where B&P Code Section 10032(b) does not apply
- Repossession agents
- Hair stylists, barbers, estheticians, and electrologists who maintain their own business license and are free from direction or control of the salon from which they lease their space. This includes, but is not limited to the individual: scheduling their own appointments, being paid directly by their client, providing for their own supplies, retaining their own book of business or clients, and setting their own rates and hours for the services performed in which the rate is at least twice the minimum wage for hours worked.
- An individual contracting for a professional service given that the hiring entity can demonstrate that the individual can negotiate their rates, set their own hours, decide where to perform the services, engage in other contracts for services, maintain a business license and separate location, and regularly exercise discretion and

independent judgment in the performance of the services. This standard applies for professions that require an active license in law, architecture, engineering, veterinary medicine, private investigation, or accounting, or the possession of an advanced degree that involves specialized study in the field of marketing or the administration of human resources. This standard also applies to freelance writers who make no more than 25 contributions to any one publication for a rate equivalent to at least twice the minimum wage for hours worked and retain their intellectual property, in addition to fine artists, professional grant writers, and graphic designers.

- A business contracting with another business, given the hiring entity can demonstrate that the service provider is free from their control and direction, is customarily engaged in an independently established business, can negotiate their rates to be at least twice the minimum wage for hours worked, is providing a service to the hiring entity rather than its customers, retains the appropriate business licensure, and holds itself out to contract with other businesses.
- A contractor in the construction industry subcontracting with an individual, given that the hiring entity can demonstrate the subcontractor is free from their direction and control, is licensed by the Contractors State License Board, maintains the appropriate business licensure, has the authority to hire and fire other persons involved in providing the service, assumes financial responsibility for their services, and is customarily engaged in an independently established business.

SUPPORT

California Labor Federation (sponsor)
State Building and Construction Trades Council
SEIU State Council
California Association of Realtors
California Teamsters Public Affairs Council
UFCW Western States Council
Communications Workers of America, 9th District
American College of Emergency Physicians, CA Chapter
National Association of Insurance and Financial Advisors-CA
Securities Industry and Financial Markets Association
Direct Selling Association
Independent Insurance Agents & Brokers of California
California Association of Health Underwriters
Professional Beauty Federation of California
Greater California Livery Association
National Employment Law Project
California Nurses Association
California Professional Firefighters
California School Employees Association
California Federation of Teachers
UNITE-HERE
California IATSE Council
SAG-AFTRA
AFSCME
SEIU Local 1000
Conference Board of the Amalgamated Transit Union
California Conference of Machinists
Engineers and Scientists of CA, IFPTE Local 20
Inlandboatmen's Union of the Pacific

International Union of Operating Engineers
Professional and Technical Engineers, IFPTE Local 21
United Farmworkers Union
Utility Workers of America
Western States Council of Sheet Metal, Air, Rail &
Transportation
Entertainment Union Coalition
United Auto Workers Local 2865 and Local 5810
UPTE, CWA Local 9119
UDW/AFSCME Local 3930
Courage Campaign
Southern CA Coalition for Occupational Safety & Health
National Domestic Workers Alliance
California Healthy Nail Salon Collaborative
Asian Americans Advancing Justice California
Coalition for Humane Immigrant Rights
California Immigrant Policy Center
California Rural Legal Assistance Foundation
Labor & Employment Committee of National Lawyers Guild
Consumer Attorneys of California
California Employment Lawyers Association
Equal Rights Advocates
Legal Aid at Work
9 to 5 National Association of Working Women
California Alliance for Retired Americans
Western Center on Law and Poverty
Working Partnerships USA
Sierra Club California

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