Updates on AB5 – Navigating Employment Law for the Arts

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You may be an employee; you may be an employer; you may be both.

AB 5 defines all workers as employees. It is up to the hirer to prove that a worker is correctly classified as an independent contractor.

The classification analysis is complicated already, and as Julie will explain, pending legislation will complicate it even more.

- For 29 years we followed the Borello test in classifying workers;
- In 2018 the California Supreme Court decided Dynamex Operations West, Inc. v. Superior Court of California, rejecting the Borello test and adopting the ABC test.
- In January 2020 AB 5 was enacted to codify the ABC test.
The **Borello** test is still important because if one of the AB 5 exceptions applies to a worker, the **Borello** test applies.

**Borello** is a multi factor test that balances 13 factors to determine if a worker is an employee or independent contractor, allowing flexibility for many industries and workers.

The principal factor of the **Borello** test is whether the hirer "retains all necessary control" over the job and the worker.

The other **Borello** factors are:
Worker Classification: Common Law Borello Test

Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;

Whether the work is a regular or integral part of the employer's business;

Whether the employer or the worker supplies the equipment and tools for the work, and the place for the worker doing the work;

Whether the worker has invested in the business, such as in the equipment or materials required for their task;

Whether 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;
Worker Classification: Common Law Borello Test

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;

Whether the worker hires their own employees;

Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and

Whether or not the worker and the potential employer believe they are creating an employer-employee relationship.
Worker Classification: Dynamex ABC Test

Dynamex holds that workers are presumed employees unless all three factors of the ABC test are met:

(A) The individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; and

(B) The service is performed outside the usual course of the business of the employer; and,

(C) The individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.
More About AB 5

- AB 5 codifies the *Dynamex* ABC Test and expands its application, applying it to the Labor and Unemployment Insurance Codes in addition to the Industrial Welfare Commission Wage Orders.

- As of January 1, 2020, the ABC test is the law for classifying workers as employees or independent contractors and applies *retroactively*. 
Why Does it Matter if the Worker is an Employee or an Independent Contractor?

Laws applicable to employees include:
- Minimum wage, overtime, meal and rest periods
- Harassment, discrimination and retaliation protections
- Payroll and benefits
- Leaves of absence
- Paid sick leave

Independent contractors:
- Paid pursuant to contract
- No tax withholding or payroll
- No recordkeeping obligations
Risk Assessment—Should I Worry About This?

Risks of claims by workers include:
- Unpaid overtime and minimum wage
- Meal and rest period violations
- Paystub violations
- Claims for reimbursement of business expenses
- Claims for benefits—retirement, sick leave, vacation, workers' compensation, unemployment insurance and state disability
- Waiting time penalties for violation of the California Labor Code

Risk from governmental agencies include:
- Unpaid payroll taxes, social security, federal, state and local taxes, Medicare, plus penalties and interest
- Audits by the Employment Development Department, Internal Revenue Service, Franchise Tax Board, Department of Industrial Relations and potential assessment of penalties
- Potential criminal prosecution for failure to have workers compensation insurance (Ca. Labor Code 3700.5)
- Claims by the Division of Labor Standards Enforcement for willful misclassification
Now What Do I Do?

- **Step 1: Does the worker meet the ABC test?** If so, the worker is likely an independent contractor.

- Look at the working relationship and the ABC factors- can you meet all 3?
  - Factors B and C are the most difficult to prove.

  - **Factor B**- The service provided has to be “outside the usual course” of the hirer’s business.

  - **Factor C**- The worker has to be “customarily engaged in an independently established trade, occupation, profession, or business” as the service the worker is being hired to perform.
Step 2: If the worker does not meet the ABC test, does an exception apply?

- Be sure to examine the requirements for the applicable exception(s)

- Include the exception requirements in your contract with the worker

- If an exception applies, the Borello test is used to determine if a worker is an independent contractor.
Step 3: The worker is an employee if:

- The worker does not meet all 3 ABC factors; OR
- There is no AB 5 exception; OR
- There is an exception, but the worker does not meet the Borello test.
Exceptions that may apply:

The Professional Services Exemption may apply to:

- Fine Artists
  - The term “fine artists” is not defined in the statute.
- Photographers*
- Graphic Designers
- Freelance writers*

(* subject to pending changes in AB 2257)
Lorena is a retired teacher who is hired by non-profit Wonderful, Inc. to teach knitting and sewing to children through after-school enrichment programs. Lorena teaches three 4-week sessions during the school year.

Wonderful, Inc.’s mission statement is, “to provide artistic after school-enrichment programs to children.”

Lorena does not work for any other agency or business.

Does Lorena meet the ABC test?

Is Lorena a fine artist?
Hypothetical- Lorena Professional Services Exception Requirements

- Does Lorena maintain a business location, which may include her residence, that is separate from Wonderful, Inc.?
- Does Lorena have a business license, and any required professional licenses or permits for her to practice her profession?
- Can Lorena set or negotiate her own rates for the services performed?
- Other than project completion dates and reasonable business hours, can Lorena set her own hours?
- Is Lorena customarily engaged in the same type of work performed under contract with another hiring entity, or does Lorena holds herself out to other potential customers as available to perform the same type of work?
- Does Lorena customarily and regularly exercise discretion and independent judgment in the performance of the services?
- If Lorena is a fine artist and all of the above criteria are met, then the ABC Test does not apply, and instead the Borello test must be followed to determine if Lorena is an independent contractor or employee of Wonderful, Inc.
AB 5
EXCEPTIONS: Business to Business

Business to Business Exception— requires a “bona fide business-to-business contracting relationship.” 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 Borello test will apply if the 12 requirements of the business-to-business exemption are met.

AB 2257 will clarify that an individual may conduct business as a sole proprietor.
Hypothetical- Lorena – 12 factors of the business to business exemption

- Does Lorena have a written contract with Wonderful, Inc.?
- Is Lorena free from the control and direction of Wonderful, Inc. in connection with the performance of the work, both under the contract for the performance of the work and in fact?
- Is Lorena providing services directly to Wonderful Inc. rather than to “customers” of Wonderful, Inc.?
- If Lorena works in a place that requires her to have a business license or business tax registration, does she have the required business license or business tax registration?
- Does Lorena maintain a business location that is separate from Wonderful, Inc.’s location?
- Is Lorena customarily engaged in an independently established business of the same nature as the services she is providing to Wonderful, Inc.?
AB 5
EXCEPTIONS: Business to Business

- Does Lorena have a contract with other businesses to provide the same or similar services and maintain a clientele without restrictions from Wonderful, Inc.?

- Does Lorena advertise and hold herself out to the public as available to provide the same or similar services?

- Does Lorena use her own tools, vehicles, and equipment to perform the services?

- Does Lorena negotiate her own rates, and set her own hours and location of work?

- Does Lorena perform the type of work that does not require a license from the Contractor's State License Board?

- If the answer to all of the above questions is yes, the ABC Test does not apply, and instead the Borello Test must be followed to determine if Lorena is an independent contractor or employee of Wonderful, Inc.
If the worker does not meet the ABC test and an exception does not apply consider:

- Converting all or some workers to employee status. This is the safest approach.
- Hiring through a hiring agency or third party. This does not eliminate all risk due to potential joint employer liability, but it can reduce liability with proper practices and safeguards in place.
Gov. Newsom’s 2020-2021 budget proposes $127 million in new funding and 407 new staff positions for labor and employment programs with most of the increase going to the Dept. of Industrial Relations (Labor Commissioner) and the EDD.
“Clean Up” Legislation

- Approximately 40 bills were introduced in the current Legislative session to address various aspects of AB5.
- August 21, 2020 was the last day to amend bills, and August 30 is the last day for each house to pass bills.
- AB 2257 is the only bill to advance and as Julie will discuss it is expected to pass.
- September 30 is the last day for the Governor to sign or veto bills.
Contact Your Legislators

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Don’t just complain- tell your story or the story of how you are impacted.