Governor Newsom Signs AB 2257 –
More Clarifications and Exceptions to the "ABC Test" for Independent Contractor Status

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On September 4, 2020, Governor Newsom signed AB 2257, a bill that provides comprehensive clarifications and changes to the very controversial bill - AB 5 - that went into effect in January 2020 and requires the use of the "ABC Test" to determine independent contractor status for most employment laws in California. AB 2257 brings some good news to businesses in various industries who utilize independent contractors, and provides needed clarification to a number of ambiguities in the text of AB 5.

I. A Refresher on AB 5.

AB 5 is the bill that Governor Newsom signed in September 2019 addressing employment status when a hiring entity claims that the person it hired is an independent contractor. AB 5 went into effect on January 1, 2020 and requires the application of the "ABC Test" to determine if workers in California are employees or independent contractors for purposes of the Labor Code, the Unemployment Insurance Code, and the Industrial Welfare Commission (IWC) wage orders. The California Supreme Court first adopted the ABC Test in *Dynamex Operations West, Inc. v. Superior Court* [(2018) 4 Cal.5th 903] and the purpose of AB 5 was to essentially codify that test for multiple purposes under California employment law.

Under the ABC Test, a worker is presumed to be an employee and not an independent contractor, unless the hiring entity satisfies all three of the following conditions:

A. 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.

According to the *Dynamex* case, the hiring entity must establish that the worker is free of such control to satisfy part A of the ABC Test. 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. 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.

B. The worker performs work that is outside the usual course of the hiring entity's business.

According to the *Dynamex* case, 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. 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. The *Dynamex* court provided the following examples of services that 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 or when a retail store hires an outside electrician to install a new electrical line. However, examples where services are part of the hiring entity's usual course of business would include things like: 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, or when a bakery hires cake decorators to work on a regular basis on its custom-designed cakes.

C. The worker is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.

According to the *Dynamex* case, the hiring entity must prove that the worker is customarily and currently engaged in an independently established trade, occupation, or business. 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. Instead, factor 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. An individual who independently has made the decision to go into business generally takes the usual steps to establish and promote that independent business. The *Dynamex* court said that examples of the types of steps taken include things like: incorporation; licensure; advertisements; routine offerings to provide the services of the independent business to the public or to a number of potential customers; and the like. If an individual's work relies on a single employer, factor C is not met.

While AB 5 declared that the ABC Test was the test for determining independent contractor status under various California employment laws, it created a number of "exceptions" to the ABC Test if certain conditions were met which would allow the relationship to be analyzed under prior tests for independent contractor status. These exceptions included for example, the "specific industry" exception; the "business-to-business" exception; the "referral agency" exception; and the "professional services" exception.

II. AB 2257 Does Not Provide Any Industry or Business with the Right to Classify Individuals as Independent Contractors.

Before providing a summary of the changes and clarifications made by AB 2257, it is important to address a recurring misstatement in news articles and other posts about the Bill. A number of news articles make statements like: "*AB 2257 provides parties engaged in a business-to-business relationship [or a referral agency] with the right to circumvent the restrictions of AB 5 and continue to classify individuals as independent contractors consistent with industry practice and established business models.*" This is not correct. The law before the passage of AB 5 and the adoption of the "ABC Test" always required that a hiring principal/business establish that the person hired to perform services meets the applicable test for independent contractor status. As such, independent contractor status has never been an election that the parties can just make, and AB 2257 doesn't grant parties the right to do so.

AB 2257 does make certain changes to AB 5 and adds additional industries to certain exceptions under AB 5. However, if an exception applies, this merely means that rather than the "ABC Test" applying when analyzing whether a person is properly classified as an independent contractor under certain California employment statutes, the long-established "multi-factor" *Borello* Test applies. This test comes from the California Supreme Court decision in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* [(1989) 48 Cal.3d 341] and relies upon multiple factors to make the determination of independent contractor status, including whether the potential employer has all necessary control over the manner and means of accomplishing the result desired, although such control need not be direct, actually exercised or detailed. This factor, which is not dispositive, must be considered along with various other factors outlined by the *Borello* court, including:

- 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 instrumentalities, tools, 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 by 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;
- 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 (this may be relevant, but the legal determination of employment status is not based on whether the parties believe they have an employer-employee relationship).

The *Borello* Test is referred to as a "multifactor" test because it requires consideration of all potentially relevant factors – no single factor controls the determination. Courts have emphasized different factors in the multifactor test depending on the circumstances of a given relationship. Therefore, unlike the all-or-nothing "ABC Test" which requires all factors be met to establish independent contractor status, the *Borello* Test provides for a more "totality of the circumstances" analysis that can support an argument that a person is properly classified as an independent contractor.

III. A Summary of the Main Takeaways from AB 2257.

1. Business-to-Business Exception.

AB 5 provided that the ABC Test and the holding in the *Dynamex* case do not apply to a bona fide business-to-business contracting relationship if the twelve itemized requirements for this exception are met. AB 2257 made a number of modifications to the requirements to provide clarification and, to some extent, make them less restrictive. The business-to-business exception will be codified in Labor Code section 2776. Some examples of the modifications include:

- The second requirement for the business-to-business exception is that the business service provider (e.g. purported independent contractor) provide the services directly to the contracting business, rather than the contracting business' customers. AB 2257 modified this requirement to read as follows:

  (2) The business service provider is providing services directly to the contracting business rather than to customers of the contracting business. This subparagraph does not apply if the business service provider's employees are solely performing the services under the contract under the name of the business service provider and the business service provider regularly contracts with other businesses.

- The seventh requirement under the business-to-business exception required that the business service provider contract with other businesses to provide the same or similar services and maintain clientele without restrictions from the hiring entity. AB 2257 modified this requirement to state that the business service provider "*can*" contract with

other businesses. Thus, the business service provider does not have to in fact contract with other businesses to meet the requirement.

AB 2257 also made clear that when two bona fide businesses are contracting with one another under the conditions set forth in the business-to-business exception, the determination of whether an individual worker (who is not acting as a sole proprietor or formed as a business entity), is an employee or independent contractor of the business service provider or contracting business will be governed by the "ABC Test."

2. <u>Referral Agency Exception</u>.

AB 5 provided that the ABC Test and the holding in the *Dynamex* case do not apply to the relationship between a "referral agency" and a service provider if the itemized requirements for the exception are met. AB 2257 made a number of modifications to the requirements, and also added a number of industries/services that referral agencies can refer clients to. The referral agency exception will be codified in Labor Code section 2777. Some examples of the modifications include:

- The second requirement in the referral agency exception was revised to clarify that if the work [by the service provider] for the client is performed in a jurisdiction that requires the service provider to have a business license or business tax registration in order to provide the services under the contract, the service provider shall certify to the referral agency that they have the required business license or business tax registration. The referral agency is required to keep the certifications for a period of at least three years. The following definitions were also included:

  (A) "Business license" includes a license, tax certificate, fee, or equivalent payment that is required or collected by a local jurisdiction annually, or on some other fixed cycle, as a condition of providing services in the local jurisdiction.

  (B) "Local jurisdiction" means a city, county, or city and county, including charter cities.

- A new requirement was added (number 4), that provides that if there is an applicable professional licensure, permit, certification, or registration administered or recognized by the state available for the type of work being performed for the client, the service provider shall certify to the referral agency that they have the appropriate professional licensure, permit, certification, or registration. The referral agency is required to keep the certifications for a period of at least three years.

- The requirement (now number 5) that the service provider deliver services to the client under the service provider's name "rather than the name of the referral agency," was changed slightly to state that the service provider delivers services to the client under the service provider's name, "*without being required to deliver the services under the name of the referral agency.*"

- The requirement (now number 8) that the service provider [actually] maintains a clientele without any restriction from the referral agency, was revised to provide that "*the referral agency does not restrict the service provider from maintaining a clientele and the service provider is free to seek work elsewhere, including through a competing referral agency.*"

- The requirement that the service provider "set its own rates for services performed, without deduction by the referral agency" was modified to read (as requirement numbers 9 and 10) that "*(9) The service provider sets their own hours and terms of work or negotiates their hours and terms of work directly with the client." a*nd "*(10) Without deduction by the referral agency, the service provider sets their own rates, negotiates their rates with the client through the referral agency, negotiates rates directly with the client, or is free to accept or reject rates set by the client."*

- Requirement number 11 was added to provide that *"the service provider is free to accept or reject clients and contracts, without being penalized in any form by the referral agency. This paragraph does not apply if the service provider accepts a client or contract and then fails to fulfill any of its contractual obligations.*"

AB 2257 also included a number of definitions relevant to the referral agency exception, including expansion of what type of services are, and are not, recognized under the referral agency scheme.

- "Client" means: a person who utilizes a referral agency to contract for services from a service provider, or a business that utilizes a referral agency to contract for services from a service provider that are otherwise not provided on a regular basis by employees at the client's business location, or to contract for services that are outside of the client's usual course of business. The definition states expressly that it is the responsibility of a business that utilizes a referral agency to contract for services, to meet the conditions outlined in this definition.

- "Referral agency" means: a business that provides clients with referrals for service providers to provide services under a contract, with the exception of services in certain high hazard industries. AB 2257 expanded the type of services that are recognized as under the referral agency exception. They include, but are not limited to, "*graphic design, web design, photography, tutoring, consulting, youth sports coaching, caddying, wedding or event planning, services provided by wedding and event vendors, minor home repair, moving, errands, furniture assembly, animal services, dog walking, dog grooming, picture hanging, pool cleaning, yard cleanup, and interpreting services.*"

- AB 2257 expressly provides that "*referrals for services do not include services provided in an industry designated by the Division of Occupational Safety and Health or the Department of Industrial Relations as a high hazard industry pursuant to subparagraph (A) of paragraph (3) of subdivision (e) of Section 6401.7 of the Labor Code or referrals for businesses that provide janitorial, delivery, courier, transportation, trucking, agricultural labor, retail, logging, in-home care, or construction services other than minor home repair.*"

AB 2257 goes on to provide further definitions related to some of the new industries recognized under the referral agency exception, for example "interpreting services" and "consulting."

> *"(7) "Interpreting services" means:*
>
> *(A) Services provided by a certified or registered interpreter in a language with an available certification or registration through the Judicial Council of California, State Personnel Board, or any other agency or department in the State of California, or*

through a testing organization, agency, or educational institution approved or recognized by the state, or through the Registry of Interpreters for the Deaf, Certification Commission for Healthcare Interpreters, National Board of Certification for Medical Interpreters, International Association of Conference Interpreters, United States Department of State, or the Administrative Office of the United States Courts.

(B) Services provided by an interpreter in a language without an available certification through the entities listed in subparagraph (A).

(8) "Consulting" means providing substantive insight, information, advice, opinions, or analysis that requires the exercise of discretion and independent judgment and is based on an individual's knowledge or expertise of a particular subject matter or field of study."

3. <u>Professional Services Exception</u>.

AB 5 provided that the ABC Test and the holding in the *Dynamex* case do not apply to a contract for "professional services" if the hiring entity can demonstrate that certain itemized requirements for the exception are satisfied. AB 2257 made a number of modifications to the requirements, and also added some definitions relevant to the exception. The professional services exception will be codified in Labor Code section 2778. Some examples of the modifications include:

- One of the most important modifications made to the professional services exception was the elimination of the controversial per-year cap on submission of work by freelance writers and photographers. AB 5 provided that if a freelance photographer, photojournalist, or writer made more than 35 submissions to the same publisher in a year, they could not qualify under the professional services exception. AB 2257 has deleted the 35 per-year cap and added language that requires the following to be shown: *that the individual providing the services is not directly replacing an employee who performed the same work at the same volume for the hiring entity; the individual does not primarily perform the work at the hiring entity's business location; and the individual is not restricted from working for more than one hiring entity.*

- AB 2257 also adds new professions now recognized under the professional services exception (if all of the requirements of the exception are met). For example:

  - A specialized performer hired by a performing arts company or organization to teach a master class for no more than one week. "Master class" means a specialized course for limited duration that is not regularly offered by the hiring entity and is taught by an expert in a recognized field of artistic endeavor who does not work for the hiring entity to teach on a regular basis.
  - Services provided by an appraiser.
  - Registered professional and licensed foresters.
  - A home inspector.

- AB 2257 also provides a definition for the term "fine artist" which was undefined in AB 5. A "fine artist" means "*an individual who creates works of art to be appreciated primarily or solely for their imaginative, aesthetic, or intellectual content, including drawings, paintings, sculptures, mosaics, works of calligraphy, works of graphic art, crafts, or mixed media.*"

4. Single Engagement Event Exception.

AB 2257 includes a new exception for single engagement events which will be codified in Labor Code section 2779. The ABC Test and the holding in the *Dynamex* case will not apply to the relationship between two individuals wherein each individual is acting as a sole proprietor or separate business entity formed as a partnership, limited liability company, limited liability partnership, or corporation performing work pursuant to a contract for purposes of providing services at the location of a single-engagement event provided the itemized requirements outlined in section 2779 are met. A "single-engagement event" means a stand-alone non-recurring event in a single location, or a series of events in the same location no more than once a week.

The requirements for this exception are similar to the requirements in other exceptions – e.g. there is no right of control, the service provider can negotiate their rate of pay; there is a written contract, the service provider maintains their own business location (which may be a personal residence); the service provider provides their own tools and equipment; if a business license is required, the service provider has one; the service provider can contract with others and maintain their own clientele; and the service provider holds themselves out to the public to provide similar services.

As in the case of a referral agency, "services" under the single event exception do not include services provided in an industry designated by the Division of Occupational Safety and Health or the Department of Industrial Relations as a high hazard industry.

5. Music and Recording Industry Exception.

AB 2257 includes a new exception for occupations in the music and recording industry which will be codified in Labor Code section 2780. The ABC Test and the holding in the *Dynamex* case will not apply to certain occupations in connection with creating, marketing, promoting, or distributing sound recordings or musical compositions. The occupations included in the exception include:

(A) Recording artists, subject to the below.

(B) Songwriters, lyricists, composers, and proofers.

(C) Managers of recording artists.

(D) Record producers and directors.

(E) Musical engineers and mixers engaged in the creation of sound recordings.

(F) Musicians engaged in the creation of sound recordings, subject to the below.

(G) Vocalists, subject to the below.

(H) Photographers working on recording photo shoots, album covers, and other press and publicity purposes.

(I) Independent radio promoters.

(J) Any other individual engaged to render any creative, production, marketing, or independent music publicist services related primarily to the creation, marketing, promotion, or distribution of sound recordings or musical compositions.

Certain occupations, however, are expressly excluded from the music and recording exception. They include:

- Film and television unit production crews, as such term is commonly used in the film and television industries, working on live or recorded performances for audiovisual works, including still photographers and cinematographers; and

- Publicists who are not independent music publicists.

Also AB 2257 provides that recording artists, musicians, and vocalists shall not be precluded from organizing under applicable provisions of labor law, or otherwise exercising rights granted to employees under the National Labor Relations Act. Also, musicians and vocalists who are not royalty-based participants in the work created during any specific engagement shall be treated as employees solely for purposes of receiving minimum and overtime wages for hours worked during the engagement, as well as any damages and penalties due to the failure to receive minimum or overtime wages. However, in all events, and notwithstanding the prior language in Section 2780, the terms and conditions of any current or future collective bargaining agreements or contractual agreements between the applicable labor unions and respective employers shall govern the determination of employment status.

6. <u>Single-Engagement Live Performance Exception</u>.

AB 2257 (and Labor Code section 2780) also provide a new exception that the ABC Test and the holding in the *Dynamex* case do not apply to a musician or musical group for the purpose of a single-engagement live performance event, and instead the determination of employee or independent contractor status shall be governed by the *Borello* Test, unless one of the following conditions is met:

(A) The musical group is performing as a symphony orchestra, the musical group is performing at a theme park or amusement park, or a musician is performing in a musical theater production.

(B) The musical group is an event headliner for a performance taking place in a venue location with more than 1,500 attendees.

(C) The musical group is performing at a festival that sells more than 18,000 tickets per day.

Below are definitions relevant to the single-engagement live performance exception:

- "Event headliner" means the musical group that appears most prominently in an event program, advertisement, or on a marquee.

- "Festival" means a single day or multiday event in a single venue location that occurs once a year, featuring performances by various musical groups.

- "Musical group" means a solo artist, band, or a group of musicians who perform under a distinct name.

- "Musical theater production" means a form of theatrical performance that combines songs, spoken dialogue, acting, and dance.

- "Musician" means an individual performing instrumental, electronic, or vocal music in a live setting.

- "Single-engagement live performance event" means a stand-alone musical performance in a single venue location, or a series of performances in the same venue location no more than once a week. This does not include performances that are part of a tour or series of live performances at various locations.

- "Venue location" means an indoor or outdoor location used primarily as a space to hold a concert or musical performance. "Venue location" includes, but is not limited to, a restaurant, bar, or brewery that regularly offers live musical entertainment.

7. <u>Individual Performance Artist Exception</u>.

AB 2257 (and Labor Code section 2780) also provide a new exception that the ABC Test and the holding in the *Dynamex* case do not apply to an individual performance artist performing material that is their original work and creative in character and the result of which depends primarily on the individual's invention, imagination, or talent, provided all of the following conditions are satisfied:

(A) The individual is free from the control and direction of the hiring entity in connection with the performance of the work, both as a matter of contract and in fact. This includes, and is not limited to, the right for the performer to exercise artistic control over all elements of the performance.

(B) The individual retains the rights to their intellectual property that was created in connection with the performance.

(C) Consistent with the nature of the work, the individual sets their terms of work and has the ability to set or negotiate their rates.

(D) The individual is free to accept or reject each individual performance engagement without being penalized in any form by the hiring entity.

An "individual performance artist" shall include, but is not limited to, an individual performing comedy, improvisation, stage magic, illusion, mime, spoken word, storytelling, or puppetry. However, the exception does not apply to an individual participating in a theatrical production, or a musician or musical group. Again, AB 2257 provides that notwithstanding the language of the exception, in all events, the terms and conditions of any current or future collective bargaining agreements or contractual agreements between the applicable labor unions and respective employer shall govern the determination of employment status.

8. <u>Data Aggregator Exception</u>.

AB 2257 includes a new exception for the data aggregator industry which will be codified in Labor Code section 2782. The ABC Test and the holding in the *Dynamex* case will not apply to the relationship

between a data aggregator and an individual providing feedback to the data aggregator under the following conditions:

(A) The individual is free from control and direction from the data aggregator with respect to the substance and content of the feedback.

(B) Any consideration paid for the feedback provided, if prorated to an hourly basis, is an amount equivalent to or greater than the minimum wage.

(C) The nature of the feedback requested requires the individual providing feedback to the data aggregator to exercise independent judgment and discretion.

(D) The individual has the ability to reject feedback requests, without being penalized in any form by the data aggregator.

"Data aggregator" is a business, research institution, or organization that requests and gathers feedback on user interface, products, services, people, concepts, ideas, offerings, or experiences from individuals willing to provide it. "Minimum wage" is local or state minimum wage, whichever is greater.

9. <u>Specified Occupations Exception</u>.

AB 2257 modified the specified occupations exception from AB 5 (now codified in Labor Code section 2783) to both clarify the exception and add additional occupations. Below are the main changes:

- In addition to individuals and organizations licensed by the California Department of Insurance, the exception also covers "*a person who provides underwriting inspections, premium audits, risk management, or loss control work for the insurance and financial service industries.*"

- The following occupations were added to the exception:

  - Landscape architects.

  - Manufactured housing salesperson, subject to the Health and Safety Code and applicable regulations.

  - A newspaper distributor working under contract with a newspaper publisher and a newspaper carrier working under contract either with a newspaper publisher or newspaper distributor. [***NOTE***: This subdivision shall become inoperative on January 1, 2021, unless extended by the Legislature.]

  - An individual who is engaged by an international exchange visitor program that has obtained and maintains full official designation by the United States Department of State.

  - A competition judge with a specialized skill set or expertise providing services that require the exercise of discretion and independent judgment to an organization for the purposes of determining the outcome or enforcing the rules

of a competition. This includes, but is not limited to, an amateur umpire or referee.

10. Enforcement.

Finally, AB 2257 modified the enforcement provision of AB 5 (Labor Code section 2786) to provide that, in addition to the State Attorney General and city attorneys, local district attorneys can also prosecute misclassification cases against putative employers.

IV. Conclusion

AB 2257 contains an urgency clause that states that "[*t]his act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the California Constitution and shall go into immediate effect*." Thus, AB 2257 became effective upon Governor Newsom's signature. Those businesses impacted by the original requirements outlined in AB 5 and/or the changes contained in AB 2257 should consult with their employment counsel to evaluate their classification of workers as independent contractors so as to ensure they are in compliance with California law.

The attorneys in Weintraub Tobin's Labor & Employment Department have years of experience counseling employers on the use of independent contractors. Feel free to reach out to one of them for assistance.