



AB 5 – Stop the Misclassification of Workers

IN BRIEF

Assembly Bill 5 codifies a widely used legal standard known as the “ABC test” used to determine employment status for the purposes of the California Labor Code 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 Code 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 Code, 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

¹ https://www.pri.org/research/renewed_struggle_for_the_american_dream-pri_2018_california_workers_survey/

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

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

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

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 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. The bill will apply to provisions of the Labor Code that do not otherwise define "employee" and the wage orders of the Industrial Welfare Commission. 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 employment relationships for physicians, insurance agents and brokers, securities broker-dealers and investment advisors, and direct salespersons 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). 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.

SUPPORT

California Labor Federation
AFSCME
California Conference Board of the Amalgamated Transit Union
California Conference of Machinists
California Nurses Association
California Professional Firefighters
California School Employees Association
California Professional Firefighters
California Teamsters Public Affairs Council
Communications Workers of America, 9th District
Engineers and Scientists of CA, IFPTE Local 20
Inlandboatmen's Union of the Pacific
International Union of Operating Engineers
National Domestic Workers Alliance
Professional and Technical Engineers, IFPTE Local 21
SAG-AFTRA
SEIU State Council
State Building and Construction Trades Council
UDW, AFSCME Local 3930
UFCW Western States Council
United Farmworkers Union
UNITE-HERE
Utility Workers of America
California Employment Lawyers Association
California Healthy Nail Salon Collaborative
California Immigrant Policy Center
California Rural Legal Assistance Foundation
Center on Policy Initiatives
Consumer Attorneys of California
Equal Rights Advocates
National Employment Law Project
Maintenance Cooperation Trust Fund
Warehouse Worker Resource Center
Western Center on Law and Poverty
Working Partnerships USA
Worksafe
Bet Tzedek Legal Services
California Association of Health Underwriters
Direct Selling Association
Independent Insurance Agents & Brokers of California
National Association of Insurance and Financial Advisors of California
Securities Industry and Financial Markets Association

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