THE SEA CHANGE IN INDEPENDENT CONTRACTOR LAW: WHAT IT MEANS FOR YOU

BY JOHN M. POLSON, ESQ.

California Governor Gavin Newsome recently signed into law Assembly Bill 5, which adopts the "ABC test" for determining employer-employee status under the California Labor Code. The ABC test makes it more difficult to treat a service provider as an independent contractor (IC), significantly expanding liability for IC misclassification.

This is not limited to California. Other states will follow suit and create new employee rights for the growing population of gig workers and other contractors. The New York legislature is said to be considering its own version of AB 5. The same may be true in Illinois, Wisconsin, Oregon, and Washington. The ABC test is already used outside California in contexts such as unemployment insurance benefits. Meanwhile, a bill seeking to federalize the ABC test across all 50 states was introduced in Congress.

IC TESTS

Traditional IC tests focus on the hiring entity's level of control over the work. The greater the control, the more likely the worker is an employee. Traditional tests generally measure the level of control through a multifactor balancing test in which no single factor is dispositive. The ABC test, on the other hand, uses control as one of three distinct factors. All three factors must be in favor of IC status to prevail in an IC status dispute. Unlike traditional IC balancing tests, the hiring entity cannot "fail" one of the ABC factors and compensate by "winning" the others.

The big problem with the ABC test is the "B" factor, which requires proof that the worker performs work outside the usual course of the hiring entity's business. To maintain IC status, the worker cannot perform services that are essentially the same services the hiring entity provides to its customers.

For example, unless an exception applies, an IT consulting company probably cannot pay its customer-facing IT consultants as contractors under the ABC test. Likewise, a plumbing company probably cannot pay its plumbers as contractors. But the plumbing company could pay an IT consultant as an IC without a "B" factor problem because the plumbing company does not provide IT services as part of its usual course of business.

The California version of the ABC test includes exceptions for various industries and professions. If an exception applies, then the traditional IC analysis still applies, which does not include a strict "B" factor. The California version of ABC also contains a "business to business" exception; however, that exception is limited by

the fact that it requires the hiring entity to satisfy a 12-factor test.

RADICAL CHANGES TO THE GIG ECONOMY

If you are thinking this could radically change the gig economy, you are right. Many gig economy businesses will find it harder to defend the IC status of their roster of service providers under the ABC test. The same goes for other businesses relying on ICs to provide services to customers.

The impact of ABC on PEOs is two-fold:

- Risk to the PEO arising from its own misclassified contractors; and
- Risk arising from client companies using misclassified contractors.

The first risk is straightforward: If a PEO uses a contractor who should be paid as an employee under the ABC test, the PEO has liability for misclassifying that person as an IC.

The risk from client level misclassifications is murkier. A workers' compensation claim from a client's misclassified worker is a potential risk. State agencies are motivated to find coverage for workers presenting uninsured claims, as are claimant attorneys, and they may look to the PEO's insurer to cover such a claim. Client service agreement (CSA) language and insurance policy language used in tandem often offer a defense to claims presented by undisclosed workers who were misclassified as ICs. However, such cases do not always go in favor of the PEO and the carrier, and loopholes can create problems.

Other employment laws should be easier to address, such as state wage and hour laws, although there is still risk there, too. For example, a class action could be filed by misclassified ICs claiming failure to pay minimum wage. The PEO might be named in that case. Again, the PEO should have valid defenses based on CSA language; however, creative plaintiffs' lawyers can make things difficult for the PEO.

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How can PEOs mitigate the risks flowing from client misclassifications? Here are some suggestions:

- Scrutinize current and prospective client companies who rely heavily on ICs as part of their business model.
- For clients with greater-than-average IC risk, evaluate the ability of the client to manage the risk (e.g., defend litigation challenging its business model) and the ability of the client to indemnify the PEO if the PEO is dragged into the challenge.
- Avoid advising clients about the IC classification of specific individuals in the client's service or otherwise entangling the PEO in client IC misclassifications.
- Watch the law develop, both good and bad. Some clients may benefit from legal actions challenging the enforceability of ABC laws.
- Obviously, review the CSA to ensure it is state-of-the art with respect to the issue of misclassified contractors and undisclosed employees.

While there is risk involved in this area and PEOs should take steps to address the risks, this should not be viewed as a "sky is falling" situation. Other industries have far greater reasons for concern. ■

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