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FENTON & KELLER
Attorneys at Law

NAVIGATING AB5 AND EMPLOYMENT LAW FOR THE ARTS

FENTON & KELLER
Sara Boyns, Esq.
January 24, 2020

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NAVIGATING AB5 AND EMPLOYMENT LAW FOR THE ARTS

January 24, 2020

What is AB5?

On April 30, 2018, the California Supreme Court issued its opinion in *Dynamex Operations West Inc. v. Superior Court*, which retroactively changed the test for determining whether an individual is an employee or independent contractor within the state of California. The Court adopted the “ABC Test,” under which workers are presumed to be employees unless all three of the following conditions 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.

AB 5 was signed to codify the *Dynamex* decision.¹ AB 5 lists several exemptions to the ABC Test; if a worker falls into one of these exemptions, the ABC Test does not apply and instead, the old *Borello* test applies to determine if a worker is an employee or an independent contractor.

Borello Test

The California Supreme Court established the Borello test in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* in 1989. This test relies upon multiple factors to make the determination of whether a worker is properly classified, including whether the potential employer has 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 other factors, which include:

1. Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;
2. Whether the work is a regular or integral part of the employer’s business;

¹ Several lawsuits have been filed challenging AB5. On December 30, 2019 Uber and Postmates filed suit in federal court asserting the law violates the equal protection and due process clauses of the Constitution. Freelance journalists and photographers filed suit in December 2019 alleging AB5 unconstitutionally restricts free speech, free press and equal protection. The California Trucking Association also filed a lawsuit in November 2019.

3. Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work;
4. Whether the worker has invested in the business, such as in the equipment or materials required by their task;
5. Whether the service provided requires a special skill;
6. The kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision;
7. The worker's opportunity for profit or loss depending on their managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job;
11. Whether the worker hires their own employees;
12. Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and
13. 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).

How Does AB5 Affect Musicians, Artists, and Other Arts Professionals?

- 1) You may be an employee; you may be an employer; you may be both. The statutory default is to define all workers as employees. It is up to the hirer to prove that a worker is correctly classified as an independent contractor.
 - a) Examine the ABC Factors to see if you (or the person you are hiring) meet all 3; if not the worker is likely an employee.
 - i) Factors B and C are the most difficult for businesses to prove.
 - **Factor B-** The service provided has to be “outside the usual course” of the hirer’s business.
 - (a) The statute does not provide guidance on how “the usual course of business” is defined. For example, does the hirer’s mission statement define its usual business? Does the service have to generate revenue for it to be a part of the usual course of business?
 - (b) Without guidance regarding how to define what is within a business’s “usual course of business,” this factor will be determined on a case by case basis.

- **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.
 - (a) The statute does not define “customarily” and does not state if the worker merely needs to hold themselves out as available to perform services for others; or if the worker actually has to perform the same services for others. It also does not state whether the worker has to form a business entity to meet this requirement.

2) I can’t prove all three ABC factors; now what do I do?

a) AB5 contains many exemptions. If an exemption applies to you or the person you are hiring, then the classification of the worker may be determined by the less stringent *Borello* test. A common misunderstanding is that if an exemption applies the worker is automatically an independent contractor- ***this is not the case***. The worker still needs to fit the requirements of the *Borello* test in order to be properly classified as an independent contractor.

b) Exemptions that may apply:

i) Professional Services Exemption- may apply to:

- Fine Artists
 - The term “fine artists” is not defined in the statute.²
- Photographers
- Graphic Designers
- Freelance writers

*See the attached Professional Services Checklist to see if you meet the 6 requirements to qualify for this exemption.

ii) Business to Business Exemption – 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

² It remains to be seen how the Legislature, enforcement agencies, and courts will define this term. The Federal Bureau of Labor Statistics defines a fine artist as one who “...uses a variety of materials and techniques to create art for sale and exhibition.” For purposes of determining exemptions from certain wage and hour laws, the California Industrial Welfare Commission Wage Orders define an employee working in a “learned or artistic profession” as performing work that is original and creative in character in a recognized field of artistic endeavor that depends primarily on the invention, imagination, or talent of the employee or work that is an essential part of or necessarily incident to any of the above work; and that is predominantly intellectual and varied in character and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(“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. *See the attached business to business exemption checklist.

- The requirement that is most difficult to satisfy for many businesses is the one that requires that the services are provided to the contracting business’s business, not the customers of that business. So in most arts settings, the performers or artists will be providing services to the audience (“customers”), not directly to the hiring business, and the business-to-business exemption will not apply.

* If an exemption applies be sure to have a written agreement in place with each independent contractor so you can show your good faith determination that you meet the factors of the exemption. California Labor Code 226.8 (effective January 2012) states it is unlawful to “willfully” misclassify an individual as an independent contractor.

I Can’t Meet the ABC Test and None of The Exemptions Apply- What are My Options?

1. Convert all or some workers to employee status- The safest approach is to convert all workers to employees. Set up or add workers to payroll, workers compensation insurance, provide sick leave and other benefits, provide sexual harassment prevention training, and comply with all other obligations of an employer in California.

2. Hire through a hiring agency or third party. This does not eliminate all risk due to joint employer liability. However, it can minimize liability with proper practices and safeguards in place.

3. Continue to classify workers as independent contractors and see how it plays out this year. “Clean up” legislation (AB 1850) is pending this legislative session that may provide additional exemptions and clarification. Important legislative deadlines: February 21, 2020 is the last day for bills to be introduced. AB 1850 is sure to be amended and other bills may be introduced to address AB5. August 21, 2020 is the last day to amend bills, and August 30 is the last day for each house to pass bills. September 30 is the last day for the Governor to sign or veto bills.

Risk Assessment- Should I Worry About This?

1. Employers

- a. Risk 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
- b. 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

2. Employees

- a. IRS or Franchise Tax Board audits and potential liability for taxes, interest, and penalties
- b. Did you know that any business that provides Form 1099-MISC for services received from an independent contractor must provide the contractor's earnings and location information to the Employment Development Department? The report must be completed within 20 days of paying \$600 or more to the contractor. This reporting requirement only applies to those who are doing business as an individual or sole proprietorship. According to the EDD the information provided to the EDD will be used to help to locate parents who are delinquent in their child support obligations. Could they use that information for audit purposes or to pursue misclassification claims?

AB 5 – PROFESSIONAL SERVICES INDEPENDENT CONTRACTOR CHECKLIST

January 2, 2020

Dynamex/AB 5

On April 30, 2018, the California Supreme Court issued its opinion in *Dynamex Operations West Inc. v. Superior Court*, which retroactively changed the test for determining whether an individual is an employee or independent contractor within the state of California. The Court adopted the “ABC Test,” under which workers are presumed to be employees unless all three of the following conditions 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.

AB 5 was signed to codify the *Dynamex* decision.¹ AB 5 lists several exemptions to the ABC Test; if a worker falls into one of these exemptions, the ABC Test does not apply and instead, the old *Borello* rule would apply.

Professional Services Exception² to the ABC Test

The ABC Test does not apply to a contract for “professional services” as defined below. “Professional services” means services that meet any of the following:

- ☐ Marketing, provided that the contracted work is **original and creative** in character and the result of which depends primarily on the invention, imagination, or talent of the employee or work that is an essential part of or necessarily incident to any of the contracted work.
- ☐ Administrator of human resources, provided that the contracted work is predominantly intellectual and varied in character and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

¹ Several lawsuits have been filed challenging AB5. On December 30, 2019 Uber and Postmates filed suit in federal court asserting the law violates the equal protection and due process clauses of the Constitution. Freelance journalists and photographers filed suit in December 2019 alleging AB5 unconstitutionally restricts free speech, free press and equal protection. The California Trucking Association also filed a lawsuit in November 2019.

² Labor Code 2750.3 (c)

- ☐ Travel agent services (as defined)³
- ☐ Graphic design.
- ☐ Grant writer.
- ☐ Fine artist.
- ☐ Services provided by an enrolled agent who is licensed by the United States Department of the Treasury to practice before the Internal Revenue Service.
- ☐ Payment processing agent through an independent sales organization.
- ☐ Services provided by a still photographer or photojournalist who do not license content submissions to the putative employer more than **35 times per year**.
 - This clause is not applicable to an individual who works on motion pictures, which includes, but is not limited to, projects produced for theatrical, television, **internet streaming for any device**, commercial productions, broadcast news, music videos, and live shows, whether distributed live or recorded for later broadcast, regardless of the distribution platform.
 - For purposes of this clause a “submission” is one or more items or forms of content produced by a still photographer or photojournalist that:
 - pertains to a specific event or specific subject;
 - is provided for in a contract that defines the scope of the work; and
 - is accepted by and licensed to the publication or stock photography company and published or posted.
- ☐ Services provided by a freelance writer, editor, or newspaper cartoonist who does not provide content submissions to the putative employer more than **35 times per year**. Items of content produced on a recurring basis related to a general topic shall be considered separate submissions for purposes of calculating the 35 times per year.
 - For purposes of this clause, a “submission” is one or more items or forms of content by a freelance journalist that:
 - pertains to a specific event or topic;
 - is provided for in a contract that defines the scope of the work;
 - is accepted by the publication or company and published or posted for sale.
- ☐ Services provided by a licensed esthetician, licensed electrologist, licensed manicurist, licensed barber, or licensed cosmetologist provided that the individual:

³ A person regulated by the Attorney General under Article 2.6 (commencing with Section 17550) of Chapter 1 of Part 3 of Division 7 of the Business and Professions Code, or (II) an individual who is a seller of travel within the meaning of subdivision (a) of Section 17550.1 of the Business and Professions Code and who is exempt from the registration under subdivision (g) of Section 17550.20 of the Business and Professions Code.

- Sets their own rates, processes their own payments, and is paid directly by clients.
- Sets their own hours of work and has sole discretion to decide the number of clients and which clients for whom they will provide services.
- Has their own book of business and schedules their own appointments.
- Maintains their own business license for the services offered to clients.
- If the individual is performing services at the location of the hiring entity, then the individual issues a Form 1099 to the salon or business owner from which they rent their business space.
- This exception shall become inoperative with respect to licensed manicurists on January 1, 2022.

If there is a contract for “professional services” as defined above, the *Borello* test will apply to determine if the worker is an employee of independent contractor only if the hiring entity demonstrates that all of the following criteria are satisfied:

- ☐ The individual maintains a business location, which may include the individual’s residence, that is separate from the hiring entity, or may be at the location of the hiring entity.
- ☐ If work is performed after June 1, 2010, the individual has a business license, in addition to any required professional licenses or permits for the individual to practice in their profession.
- ☐ The individual has the ability to set or negotiate their own rates for the services performed.
- ☐ Outside of project completion dates and reasonable business hours, the individual has the ability to set the individual’s own hours.
- ☐ The individual is customarily engaged in the same type of work performed under contract with another hiring entity or holds themselves out to other potential customers as available to perform the same type of work.
- ☐ The individual customarily and regularly exercises discretion and independent judgment in the performance of the services.
 - An “individual” includes an individual providing services through a sole proprietorship or other business entity.
- ☐ This subdivision shall become inoperative, with respect to licensed manicurists, on January 1, 2022.

If the worker and the work meet the definition of “professional services” and all of the above criteria are met, then the ABC Test does not apply, and instead the *Borello* Test below must be followed to determine if the worker is an independent contractor or employee.

Borello Test

The California Supreme Court established the Borello test in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* in 1989. This test relies upon multiple factors to make the determination of whether a worker is properly classified, including whether the potential employer has 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 other factors, which include:

1. Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;
2. Whether the work is a regular or integral part of the employer's business;
3. Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work;
4. Whether the worker has invested in the business, such as in the equipment or materials required by their task;
5. Whether the service provided requires a special skill;
6. The kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision;
7. The worker's opportunity for profit or loss depending on their managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job;
11. Whether the worker hires their own employees;
12. Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and
13. 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).

AB 5 – BUSINESS TO BUSINESS INDEPENDENT CONTRACTOR ANALYSIS

January 2, 2020

Dynamex/AB 5

On April 30, 2018, the California Supreme Court issued its opinion in *Dynamex Operations West Inc. v. Superior Court*, which retroactively changed the test for determining whether an individual is an employee or independent contractor within the state of California. The Court adopted the “ABC Test,” under which workers are presumed to be employees unless all three of the following conditions are met:

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AB 5 was signed to codify the *Dynamex* decision¹. AB 5 lists several exemptions to the ABC Test; if a worker falls into one of these exemptions, the ABC Test does not apply and instead, the old *Borello* rule would apply.

Business to Business Exemption² to the ABC Test

The ABC Test does not apply to 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 contracting business demonstrates that all of the following criteria are satisfied:

- ☐ There is a written contract between the business service provider and the contracting business.
- ☐ The business service provider is free from the control and direction of the contracting business entity in connection with the performance of the work, both under the contract for the performance of the work and in fact.

¹ Several lawsuits have been filed challenging AB5. On December 30, 2019 Uber and Postmates filed suit in federal court asserting the law violates the equal protection and due process clauses of the Constitution. Freelance journalists and photographers filed suit in December 2019 alleging AB5 unconstitutionally restricts free speech, free press and equal protection. The California Trucking Association also filed a lawsuit in November 2019.

² Labor Code 2750.3(e)

- ☐ The business service provider is providing services directly to the contracting business rather than to customers of the contracting business.
- ☐ If the work is performed in a jurisdiction that requires the business service provider to have a business license or business tax registration, the business service provider has the required business license or business tax registration.
- ☐ The business service provider maintains a business location that is separate from the business or work location of the contracting business.
- ☐ The business service provider is customarily engaged in an independently established business of the same nature as that involved in the work performed.
- ☐ The business service provider actually contracts with other businesses to provide the same or similar services and maintains a clientele without restrictions from the hiring entity.
- ☐ The business service provider advertises and holds itself out to the public as available to provide the same or similar services.
- ☐ The business service provider provides its own tools, vehicles, and equipment to perform the services.
- ☐ The business service provider can negotiate its own rates.
- ☐ Consistent with the nature of the work, the business service provider can set its own hours and location of work.
- ☐ The business service provider is not performing the type of work for which a license from the Contractor's State License Board is required.

The business to business "exception" does not apply to an individual worker, as opposed to a business entity, who performs labor or services for a contracting business.

If all of the above criteria are met, then the ABC Test does not apply, and instead the *Borello* Test below must be followed.

The determination of whether an individual working for a business service provider is an employee or independent contractor of the business service provider is governed by the ABC test.

This subdivision does not alter or supersede any existing rights under Section 2810.3 (dealing with contracts or agreements for labor or services with a construction, farm labor, garment, janitorial, security guard, or warehouse contractor.)

Borello Test

The California Supreme Court established the Borello test in *S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations* in 1989. This test relies upon multiple factors to make the determination of whether a worker is properly classified, including whether the potential employer has 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 other factors, which include:

1. Whether the worker performing services holds themselves out as being engaged in an occupation or business distinct from that of the employer;
2. Whether the work is a regular or integral part of the employer's business;
3. Whether the employer or the worker supplies the instrumentalities, tools, and the place for the worker doing the work;
4. Whether the worker has invested in the business, such as in the equipment or materials required by their task;
5. Whether the service provided requires a special skill;
6. The kind of occupation, and whether the work is usually done under the direction of the employer or by a specialist without supervision;
7. The worker's opportunity for profit or loss depending on their managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job;
11. Whether the worker hires their own employees;
12. Whether the employer has a right to fire at will or whether a termination gives rise to an action for breach of contract; and
13. 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).