Hotel Lawyer: California limits use of independent contractors, creating significant liabilities and penalties for California hotel and restaurant employers

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As of January 1, 2020, California employers will need to comply with a new law which codifies a heightened standard of classifying an individual as an independent contractor. The new law can have significant implications for hospitality industry employers. Marta Fernandez, hotel lawyer and a partner in JMBM’s Labor & Employment department, discusses the new law and what employers can expect.

California limits use of independent contractors, creating significant liabilities and penalties for California employers

by Marta Fernandez

On September 2019, California Governor Gavin Newsom signed Assembly Bill No. 5 (AB 5) into law, regarding the classification of workers as employees or independent contractors. The new law will have far-reaching effects with respect to employee classification, tax ramifications, and corporate structuring in California.

AB 5 will become effective on January 1, 2020.

On the most basic level, the law codifies the heightened standard of classifying an individual as an independent contractor and will affect employer costs with respect to Social Security and Medicare taxes, unemployment and disability insurance, workers’ compensation costs and coverage, sick leave, minimum wage, overtime, and rest breaks and meal periods.

The new law codifies the “ABC” test for determining independent contractor status, which was adopted as the default classification test by the California Supreme Court in its 2018 decision in *Dynamex Operations West, Inc. v. Superior Court*.

How did we get here?

Before *Dynamex*, the common law test for employee classification was outlined in the 1989 case *Borello & Sons, Inc. v. Dept. of Industrial Relations*, which focuses on whether the hiring entity had the right to control certain aspects of the work being performed.

Under *Borello*, the following factors were considered:

- The right to discharge a worker at will, without cause
- Whether the worker is engaged in a distinct occupation or business
- The type of work, emphasizing whether it is usually done under direction or without supervision
The skill required for the particular occupation
• Whether worker supplies her or his own tools, materials and workspace
• The length of time the work will be performed
• Method of payment (e.g., whether by the time or by the job)
• Whether or not the work is part of the regular business of the hiring entity
• Whether or not the parties believe they are creating the relationship of employer-employee

On April 30, 2018, the California Supreme Court issued its decision in *Dynamex*, rejecting the more flexible, multifactor standard laid out in *Borello* and establishing a new test for employee-classification, often referred to as the “ABC” test.

Under the ABC test, the presumption is that the individual is an employee unless the hiring entity demonstrates that *all three* of the following conditions have been met in order for the individual to qualify as an independent contractor:

A) The individual is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract terms and in fact;

B) The individual performs work that is outside the usual course of the hiring entity’s business; and

C) The individual is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.

**Exemptions**

**Exempt occupations**

The law provides for several categories of exemptions and, for those occupations, the former test for classification as set forth in *Borello* will apply. (For a list of exemptions see California Assembly Bill No. 5, Chapter 296.)

**Estheticians, barbers, manicurists and cosmetologists**

While most exempted occupations appear not to apply directly to the hospitality industry, “estheticians, barbers, manicurists and cosmetologists” should not be overlooked by hotels and resorts offering these services.

If you have such workers at your hotel and they are classified as independent contractors, note that they will be subject to the *Borello* test only if they set their own rates, process their own payments, are paid directly by the client, set their own hours of work, determine the number of clients with their own book of business, and maintain their own license. If this criteria is not met, then their independent contractor status will be assessed under the ABC test. If the individual is performing services as your location, then the individual must also issue a Form 1099 to show they rent their business space from you.

**Business-to-Business contracts are exempt**
The new law also provides a codified exemption for business-to-business contracts. The exemption applies to contracts entered into between a primary business and a service-provider for services to be provided by the service-provider employees. Where the business-to-business contract can meet a 12-prong test, the employer status of the primary business over the service-provider employees will be assessed under Borello.

This codified exemption is relevant if a hotel outsources functions such as laundry services, pool cleaning, and landscaping to another business. Under these circumstances, whether the hotel will be treated as an employer of the service-provider’s employees will be assessed under the Borello test, if its agreement with the service-provider meets a 12-prong test, which should demonstrate a bona-fide contract between two companies. The contracting business must demonstrate that all criteria are satisfied, including that “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”. For a list of all 12 requirements, see California Assembly Bill No. 5, Chapter 296.

**Impact on Existing Law**

AB 5 writes the ABC test into the California Labor Code, including the Industrial Welfare Commission wage order and the Unemployment Insurance Code.

Beginning in July 2020, AB 5 will also impact California workers’ compensation regulations—the only part of the bill that does not apply retroactively.

Additionally, AB 5 amends the Unemployment Insurance Code to include the ABC test, and does not reference the exempted occupations still subject to the Borello test. So, even if an independent contractor falls into one of those exemptions, the ABC test may still apply for the purposes of unemployment insurance.

**Potential penalties for misclassification**

Potential penalties for misclassification can be substantial. First, for any employee that has been misclassified, the employee can file an independent cause of action for minimum wages, overtime, meal break and rest break violations. Additionally, California provides for independent civil penalties that range between $5,000 and $25,000 per misclassification. Further, the IRS can levy its own penalties depending on the extent of misclassification. Lastly, the hiring entity will also be liable for payments and penalties due to the California EDD Department for unemployment and disability benefits as well as penalties to the Workers’ Compensation fund. Additionally, any employee who prevails on a private cause of action for misclassification would be entitled to attorneys’ fees.

**What should employers do?**

California hospitality employers should audit the status of all their independent contractors to make sure they are properly classified by January 1, 2020. If you elect to classify any worker as an independent contractor, we recommend you review your decision with legal counsel.
Marta Fernandez is a partner in JMBM’s Employment and Labor Department and a senior member of JMBM’s Global Hospitality Group®. As a management labor lawyer with more than 20 years of experience, Marta specializes in representing hospitality industry clients in all aspects of labor and employment including labor-management relations such as union prevention, collective bargaining for single as well as multi-employer bargaining units, neutrality agreements and defense of unfair labor practice charges before the NLRB. She defends employers in administrative and litigation claims, such as employee claims of sexual harassment and discrimination and counsels clients in preventative strategies such as executive training, arbitration enforcement, and policies and procedures. For more information, please contact Marta Fernandez at 310.201.3534 or at mfernandez@jmbm.com.

This is Jim Butler, author of www.HotelLawBlog.com and hotel lawyer, signing off. Please contact us if you would like to discuss any issues or development that affect your hotel interests. We would like to see if our experience might help you create value or avoid unnecessary pitfalls. Who’s your hotel lawyer?

Jim Butler is a founding partner of JMBM and JMBM’s Global Hospitality Group® which provides business and legal advice to hotel owners, developers and investors. This advice covers hotel purchase, sale, development, financing, franchise, management, labor & employment, litigation, ADA, IP, EB-5 matters and many other areas.

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