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AB5 Update: California Legislature Seeks Shake-Up of Gig Economy; Any Impact of CA Independent Contractor Laws on Franchisors Remains Unclear

On Sept. 18, California Gov. Gavin Newsom signed Assembly Bill 5 (AB5) into law. AB5, effective Jan. 1, 2020, seeks to codify and clarify a California Supreme Court case (*Dynamex Operations West, Inc. v. Superior Court of Los Angeles*), which dramatically changed the standard for determining whether workers in California should be classified as employees or as independent contractors. Specifically, the *Dynamex* court held there is a presumption that workers are employees, and placed the burden on an entity classifying an individual as an independent contractor to prove that such a classification is proper under a three-part "ABC" test. Under the ABC test, to establish that a worker is in fact an independent contractor, a hiring entity must prove: (A) the worker is free from the control and direction of the hirer in connection with the performance of the work, both under the contract for the performance of such work and in fact; (B) the worker performs work that is outside the usual course of the hiring entity's business, *and* (C) the worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity. Suffice to say, it will be difficult for a hiring entity to meet each of these standards. Notably, AB5 also codifies application of the ABC test beyond the obligations set forth in the California Wage Orders – applying it also to the California Labor Code and Unemployment Insurance Code.

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Although much of the public debate surrounding AB5 has centered around the "gig economy" (such as ridesharing companies), whether AB5 impacts more traditional business relationships, such as franchisee-franchisor relationships, remains up for debate.

While the bill's sponsor, Assemblywoman Lorena Gonzalez, issued a "legislative intent" memo stating that AB5 "is not intended to replace, alter or change joint employer liability between two businesses," the actual language of AB5 is arguably less clear. As a non-exhaustive example, application in the franchise business context of Section 2(e) of the bill, which addresses certain "business-to-business contracting relationships," is subject to interpretation. The lack of clear language within AB5 carving out the franchise business model is likely to be exploited by the California plaintiffs' bar. In addition, whether a California-based franchisee is actually an employee of the franchisor under the ABC test as codified in AB5 will undoubtedly become a hotly litigated issue.

In the meantime, given the impact AB5 clearly would have on large portions of the California economy, already there are constituents considering how to put a stop to it, including the potential use of a referendum and/or ballot initiative, either to prevent the law from going into effect or changing it entirely. Now that AB5 is has been signed by Gov. Newsom, opponents of the legislation may seek to qualify the measure for a referendum whereby voters would be given the opportunity to uphold or repeal the law (sometimes called the "people's veto"). A ballot initiative, while similar, is the more traditional manner by which proposed laws are submitted by petition. The key differences are that (1) a referendum seeks to vote on an enacted law, while the ballot initiative seeks to set forth a new law, and (2) with a referendum, unlike a ballot initiative, AB5 would be "stayed" (unenforceable) until the referendum is decided.

Given that there are currently more questions than answers available concerning the interpretation and ultimate application of AB5, franchisors should consider carefully their options as litigants and the courts grapple with this new law.

Stay tuned.

Authors

This GT Alert was prepared by **Mark D. Kemple**, **David W. Oppenheim**, **Ashley Farrell Pickett**, and **Michael Wertheim**. Questions about this information can be directed to:

- Mark D. Kemple | +1 310.586.7864 | kemplem@gtlaw.com
- David W. Oppenheim | +1 973.443.3263 | oppenheimd@gtlaw.com
- Ashley Farrell Pickett | +1 310.586.7708 | farrellpicketta@gtlaw.com
- Michael Wertheim | +1 310.586.7832 | wertheimm@gtlaw.com
- Or your Greenberg Traurig attorney

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