

APPLICATION OF AB 5 AND OTHER EMPLOYMENT LAWS TO MUTUAL WATER COMPANY DIRECTORS

by
James D. Ciampa and Andrew D. Turner
LAGERLOF, LLP

Last year, California enacted AB 5, to put into statute, at Labor Code Section 2750.3, the ABC test applied by the California Supreme Court in its 2018 decision in *Dynamex Operations West v. Superior Court*. AB 5 has created a variety of problems across various business sectors in California. There currently are numerous bills pending in the Legislature seeking to modify AB 5, including one that seeks to repeal it. However, for the time being, AB 5 is the law in California and employers, including mutual water companies, must comply with it.

Under AB 5, every worker is presumed to be an employee unless the employer can meet all three of the following conditions:

(A) The worker is free from the control and direction of the hiring entity in connection with the performance of the work, both under the contract for the performance of the 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 that involved in the work performed.

If any of those three conditions are not met, then the worker will be classified as an employee.

In its legislative findings, AB 5 describes the burdens imposed by classification as employee (payment of payroll taxes, workers compensation insurance premiums, Social Security, unemployment insurance and disability insurance premiums) and the benefits employees receive from classification as an employee (minimum wages, overtime compensation, paid sick leave, paid family leave, workers compensation coverage for work-related injuries and unemployment insurance). Thus, there are ramifications, sometimes very significant, that result from classification as an employee as opposed to classification as an independent contractor.

The distinction between employees and independent contractors generally applies across three areas of law: (1) wage and hour requirements (for example, application of minimum wage and payment of overtime, and now the requirement to provide paid sick leave), (2) workers compensation, and (3) unemployment insurance.

With respect to mutual water companies, a particular area of concern is the application of AB 5 to mutual water company directors. In general, a corporation's directors are not "employees" and instead have a unique legal status. Directors oftentimes serve as volunteers and are not compensated at all, or in other instances are paid for their service as a director through a monthly stipend. In addition, in small mutual water companies, directors may also provide services to their company. AB 5 does not list corporate directors among the categories of exemptions from employee status under that law. Thus, it is not clear from the language of AB 5 how it would apply to directors. We must therefore review the status of mutual water company directors under each of the three areas mentioned above.

1. Wage and Hour Laws.

There is no specific definition of "employee" in the wage and hour statutes that expressly refers to corporate directors. Thus, we must interpret legislative intent on that issue. In that regard, AB 5, in subdivision (a)(2) of Labor Code 2750.3, specifies that notwithstanding the adoption of the ABC test for determining employee status, existing exceptions concerning employee status set forth in the Labor Code, Unemployment Insurance Code and Industrial Welfare Commission wage orders will remain preserved for the purposes set forth in those codes and orders. As further discussed below in Section 3, below, Unemployment Insurance Code Section 622 provides that a corporate director is not an "employee" of a corporation with respect to services performed in the capacity as a director (i.e., attending meeting and making policy); but note that this definition does not apply to any operational services a director may perform. Thus, an argument can be made by applying Section 622 under that exemption in AB 5 that the wage and hour laws are not intended to apply to mutual water company directors for their director-related services.

For most mutual water companies, we do not believe standard wage and hour issues are a concern, as directors who act only in the director roles are not working overtime hours and do not take paid sick leave. However, if your company uses directors to perform services for the company, you should ensure the directors are paid minimum wage, take any required meal breaks and are paid proper overtime wages if they work more than eight hours in day or over 40 hours in a week. You also will be required to provide those directors with paid sick leave as required by the Paid Sick Leave law (i.e., the Healthy Workplace, Healthy Family Act of 2014, Labor Code Sections 245-249).

With respect to reporting for income tax purposes, some companies pay their directors as independent contractors and issue a Form 1099 to the directors at the end of the year, while others pay their directors wages and make deductions and then issue a Form W-2 at the end of the year. We are not aware of any mutual water company being held responsible for improper tax reporting of compensation paid to their directors under either form. However, you should consult with your accountant or tax advisor on that issue to ensure you are comfortable with the form of reporting your company is making. If you are not certain as to how to best

proceed, you should err on the side of caution and report any wages paid to a director on a Form W-2, with applicable withholding.

2. Workers Compensation.

Labor Code Section 3351 defines “employee” for workers compensation purposes and includes corporate officers and directors as employees “while rendering actual service for the corporation for pay.” Section 3351 makes a reference to three exceptions set forth in Labor Code Section 3352(a)(16), (18) and (19), but those exceptions will not apply in usual mutual water company settings. Thus, for purposes of the workers compensation law, and so long as they receive any form of compensation, mutual water company directors are employees who must be covered under a company’s workers compensation policy.

3. Unemployment Insurance.

As mentioned above, the Unemployment Insurance Code, in Section 622, states that the term “employee” does not include a director of a corporation or association performing services in his or her capacity as a director. “Services in his or her capacity as a director” includes either:

(1) Presence at meetings of the board of directors, even though no further service is performed at the meeting.

(2) Services customarily performed by directors in attending meetings of the board of directors such as prescribing, regulating, and guiding the policies and administration of the corporation or association.

Subdivision (c) of that statute then states that “services in his or her capacity as a director” does not include services performed by a director in addition to, or other than those described above. For example, services performed for the company, such as advisory, appraisal, auditing, credit, examining, executive, loan or similar committees are not “services in his or her capacity as a director.” As applied specifically to mutual water companies, such services would include operation, maintenance and bookkeeping. Thus, if a director provides such services, they would not fall under the exception from required unemployment insurance payments.

CONCLUSION: AB 5 is not clear with respect to its coverage of mutual water company directors relative to the employee or independent contractor classification. An argument can be made that a director who only attends board of director meetings and makes policy is not an “employee” pursuant to Unemployment Insurance Code Section 622. However, that exemption is lost if the director performs managerial or operational services for the company. If the director is considered an employee for wage and hour laws, a company must ensure proper wages are paid and that paid sick leave is made available, and that the wages are properly reported to tax agencies.

For workers compensation purposes, a mutual water company director will need to be covered under a company’s workers compensation policy if the director

is receiving any pay. With respect to unemployment insurance and application of the wage and hour laws, the same test applies to both.

California's employment laws are constantly changing and can be very complex. If you are not certain you are properly classifying your company's directors or any other employee, you should promptly contact your legal counsel for advice.