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When will California's trucking industry feel the effects of AB5?

Uncertainty remains as truckers grapple with compliance with employee classification law and questions of enforcement



John Kingston • Wednesday, July 13, 2022 7 minutes read



California's trucking sector is looking at numerous ways to keep in compliance with AB5, but is doing so without specifics on what's right and wrong. (Photo: Jim Allen/FreightWaves)

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Less than two weeks after the Supreme Court refused to review an appellate court decision and in the process allowed AB5 to become the law of the land in California, it's still unclear what the effects will be, but legal experts say there are steps already being taken or planned.

Meanwhile, drivers are set Wednesday with [a work stoppage called](#) among drayage drivers protesting AB5 set for the ports of Long Beach and Los Angeles.

"While [California] AB5 is likely to restrict capacity in the state, there could be some delay between the rule's implementation and actual enforcement," the transportation research team at Morgan Stanley, led by Ravi Shanker, said in a recent report. It added that some of the companies that Morgan Stanley covers believe it could be a year before an impact from AB5 is seen in the trucking sector.

But the truckers that Morgan Stanley tracks are larger publicly traded firms. The Morgan Stanley report noted that those companies generally have strong compliance operations, which are better equipped to keep them out of trouble.

"Smaller carriers and brokers are less likely to have the same robust processes," the report said. "However, they do have the benefit of being more 'under the radar' than larger peers and therefore a less likely target for initial enforcement."

More precise about when the effects of AB5 might begin to kick in was Greg Feary, a partner with the trucking-focused Scopelitis law firm. Feary told FreightWaves that in the absence of any sort of big action taken by the state, AB5 would "start to bite" in October.

Feary did not suggest any specific actions that would be taken that month. He also was not specific when asked whether some companies already are taking steps to comply with the law. "Yes, a few are doing so now," he said.

Marc Blubaugh, head of the transportation group at the Benesch law firm, already has seen at least one company packing up in California. "The day after the decision, I spoke with a small motor carrier that elected to wind up its operations in California," Blubaugh wrote in an email to FreightWaves. "It was a

relatively new entrant and was thinking of exiting the market even before the decision was issued, but the cert denial (by the Supreme Court) was the proverbial straw that broke the camel's back."

AB5 is a law that went into effect statewide at the start of 2020. It is viewed as significantly restricting the ability of a worker to be classified as an independent contractor, and does so by utilizing the ABC test to define IC status. A California Trucking Association lawsuit led to an injunction that kept AB5 out of the state's trucking sector since the start of 2020. An appellate court reversal of the injunction was upheld by the Supreme Court in late June, opening the door to AB5 enforcement in trucking.

There is nothing specific in AB5 that says a company cannot take certain actions or must perform specific activities. Converting [the text of the law](#) to a PDF results in a document of just 12 pages, and many of those pages are either recapping the findings of the 2018 decision in a civil case known as Dynamex from which the ABC test was drawn, or spelling out the long list of professions that are exempt from the law.

As several observers of AB5 in California trucking have said, what is going to need to occur would be enforcement actions taken by the state against trucking companies. As those cases are adjudicated, a body of law and precedents will develop. Those precedents then will provide both guidance to companies trying to stay in compliance with the law and a legal foundation for further enforcement. And that is going to take time.

On Tuesday, the state's labor commissioner, Lilia Garcia-Brower, appeared to fire the first shot that her agency is ready to enforce AB5 in the state's trucking business.

The Dynamex case from 2018 came out of a lawsuit against a delivery company by that name that had changed the status of its workers from employee to independent contractor. The ABC test at the heart of the decision included the

B prong, which says a true independent contractor “performs work that is outside the usual course of the hiring entity’s business.” That is the core difficulty for the trucking industry, as trucking companies hire independent owner-operators for a significant portion — or in some cases 100% — of their work.

That would cover independent contractors who are on lease to a trucking company and who are operating under the company’s motor carrier authority.

In his email to FreightWaves, Feary raised the prospect of the “brokerage model” as being a likely solution to a company continuing to operate while using independent contractors. But those contractors would no longer have the same status; they would have their own authority.

“If the owner-operator is willing to become a motor carrier, the company he/it used to haul for would be willing to broker freight to he/it as a motor carrier,” Feary wrote. “That then would probably provide a reasonable basis to believe both the B2B exemption could be met or if not, the ABC test could be met.”

The [business-to-business exception](#) is a 12-point test that would enable the hiring of an independent contractor. All 12 points need to be met for a company invoking the B2B exception to be in compliance with AB5.

The issues with the B2B exception

But Feary said there is a significant problem with the B2B exception, and it would be particularly notable for those independent contractors who had been on lease but now step out with their own authority. The question is: Can they cut the leash?

Two points in the B2B exception say the “business service provider” — the independent contractor — “is customarily engaged in an independently established business of the same nature as that involved in the work performed” and the provider “actually contracts with other businesses to

provide the same or similar services and maintains a clientele without restrictions from the hiring entity.”

“Can that owner-operator hold itself out to the public to provide its services?” Feary asked. “If the public is the shipping public, he would need MC authority.”

Blubaugh also was critical of the B2B option. “I would not say it is getting a lot of interest,” he said in his email.

The complexity of the test and the fact that a score on the 12 points in the test needs to be 100 is scaring some people off, Blubaugh said. He also noted that the fallback to AB5 in the B2B exception is the Borello test, a legal precedent that also is seen as leaning toward classifying workers as employees rather than independent contractors, much like AB5.

In another view of AB5 from a Wall Street analyst, the transportation research team led by [Amit Mehrotra](#) at Deutsche Bank, like Morgan Stanley, focused on the impact of AB5 on the publicly traded carriers that Deutsche follows.

In the report, Mehrotra said Werner Enterprises ([NASDAQ: WERN](#)) several years ago stopped utilizing owner-operators based in California, primarily because of the uncertainty regarding AB5. The report also said it believes Knight Swift ([NYSE: KNX](#)) “has already moved away from having any owner-operators in [California] or any other states that could prove problematic.”

There is an option for some segments: Turn independent contractors into employees. Blubaugh said he has seen some evidence of that. Some companies “are confident that they can still run a profitable operation after converting to employees,” he wrote. “For example, one client with whom I spoke is active in the heavy-haul/specialized carriage sector, which commands sufficiently attractive rates from shippers to justify an employee model. The same would not necessarily be true in other sectors like drayage.”

“Motor carriers have been anticipating something like this. I feel like they have been preparing, setting up brokerages and encouraging people to get their own authority. But there is still uncertainty.”

The target appears clear: Drayage

The Deutsche report emphasized what most people in California believe: The drayage sector is the key target of AB5. "There are also clear implications for companies that rely on drayage capacity off the West Coast," the Deutsche report said.

"Motor carriers have been anticipating something like this," Matt Schrap, CEO of the Harbor Trucking Association, the drayage company trade group, said in an interview with FreightWaves. "I feel like they have been preparing, setting up brokerages and encouraging people to get their own authority. But there is still uncertainty. They haven't had legal tests applied to them."

The reference to obtaining authority comes out of the fact that many drayage drivers are operating under a "transportation service lease" with a company. It is not a classic lease-back deal that is prevalent in much of the industry among owner-operators; Schrap said those have mostly disappeared in California under the weight of misclassification litigation launched by the state over the years.

Schrap said drivers working under that arrangement are known as 1099 employees, a reference to the tax form they receive from the company granting the lease. It's the opposite for a full-time employee, who receives a W-2 form.

Getting their own authority

The transportation service lease does allow the driver to be independent and operate under the federal motor carrier authority of the company granting the lease. The upside for AB5 compliance is that it may enable the driver to receive freight under the brokerage operation of the carrier he/she formerly worked for, particularly if that company can keep its brokerage and trucking operations separate. That may enable the driver to be legally hired under the terms of the B2B exception.

The drawback? Schrap said the cost of getting authority is conservatively estimated at \$20,000, with acquiring insurance a major part of the cost.

Politically in California, the Republican delegation to the Legislature wrote Gov. Gavin Newsom last week to urge him to “take any means within your authority” to delay the implementation of AB5 or exempt the trucking industry.

Newsom signed AB5 into law in 2019, and the list of exemptions to the law is enormous. It grew even larger after a second exemption bill was approved by the California Legislature and signed by Newsom in September 2020.

“Without immediate action, we can expect a devastating reduction in our driver workforce especially among minority-operated businesses,” the letter signed by numerous Republican legislators said.

The letter led to AB5 sponsor Lorena Gonzalez [posting a Twitter thread](#) that commenced with a statement by the former assemblywoman that “it’s time [trucking companies] act in accordance to basic labor laws: Treat operators as actual businesses or employ them.”

Gonzalez left the Legislature in January to become head of the California Labor Federation.

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