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How to Follow the New California Law that Penalizes Businesses for Misclassifying Employees

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I wanted to start this New Year by highlighting new legislation in California that affects litigation or business. As always, some new laws are quintessentially Californian, like one that dress codes cannot discriminate against transgendered and cross-dressers. I'll make sure to put that in my employee handbook. I also was happy to see that it is no longer legal to carry a loaded *unconcealed* handgun, making one of those laws that I really cannot believe was legal through 2011.

However, one of the most interesting and controversial laws taking effect in 2012 involves greatly increased penalties for the willful misclassification of employees as independent contractors. I litigated quite a few class actions and individual cases involving these issues as a plaintiff attorney, and now I'm viewing the issue as a business owner who uses both employees and contract workers. Since most everyone in the litigation graphics field works with independent contractors, and a large number of law firms do as well, I want to focus on some key issues raised by the new law.

S.B. 459 will appear as Sections 226.8 and 2753 of the California Labor Code, and it:

- Prohibits the willful misclassification of employees as independent contractors.
- Prohibits charging a misclassified contract worker for any item that would be illegal if he or she were an employee.
- Provides the Labor and Workforce Development Agency the authority to levy penalties from $5,000 to $25,000 per violation as well as requiring reporting to the Contractor's Licensing Board.
- Provides for joint and several liability for any person (who is not a lawyer) from advising an employer to misclassify a worker.
- Section 226.8 requires offenders to post a mandatory notice on their website, or in an area accessible to all employees, for one year.

First, a little bit of background: I understand and support this law, having spent several years litigating wage and hour class actions and cases that arose primarily out of the misclassification of employees. The violation of the classification of employees as independent contractors was (and is) especially rampant in the construction industry. The primary reason I saw employers

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intentionally misclassify employees was the high cost of workers' compensation coverage that could run over 30 percent of the wages per employee. By calling them independent contractors, and not covering them as required by law, the employer did not incur this cost—and the worker was entirely out of luck if injured. Even employers who were sued for misclassification and settled with full payment of all money due generally would continue misclassification afterward, since it was still cheaper than treating the workers as employees.

Enter S.B. 459. This law pointedly does not change any substantive law on whether a person is an independent contractor or not. Under the law, any worker starts off with a presumption of being an employee and not an independent contractor. (Labor Code Section 3357.) Secondly, if the worker is doing work that requires a license in California, they cannot be an independent contractor as a matter of law unless they personally have such a license. (Labor Code Section 2750.5) Assuming a license is not needed or is actually possessed by the worker, a multi-factor test is used to see if they are an employee or independent contractor, which involves primarily whether the worker has a distinct business from the employer, provides their own equipment, has special skills, whether they are paid by contract or the hour, etc.

However, out of all of these the factors, one that is often easiest to apply is whether the worker has any "clients" other than the employer. In the vast majority of the cases I saw, the answer was no. In other words, the only "client" of the "independent contractor" was the employer—so the worker typically should have been classified as an employee, not as an independent contractor. As a helpful warning to anyone who hires contractors, if the worker has no other employer than you, then I'd talk to an attorney about whether they are really a contract worker or not.

In law firms, I cannot tell you how may times I would hear attorneys happily tell me they would treat their legal assistants as contract workers to avoid the costs of employment. Unless those legal assistants have a real business, and work for others as well, this risk is not worth taking.

In the litigation support field, the use of contractors is the norm rather than the exception. In the graphics field, almost every company utilizes contractors on a regular basis for both regular and overflow work, but generally those same contractors are working for numerous different companies, providing all their own equipment and are quite skilled at what they do. But, as mentioned above, if you're the business owner and the contractor only works for you, then watch out.

Under S.B. 459, however, just having misclassified an employee as an independent contractor is not enough to trigger the enhanced penalties. Rather, there must be proof of a willful violation. In an article by Scott J. Wenner of Schnader Harrison Segal & Lewis LLP, "Assault on Independent Contractor Misclassification Continues: California Legislature Passes and Sends Aggressive New Legislation to Governor Brown for Signature," Mr. Wenner posits that by applying common law

concepts of a "knowing" violation, the standard for penalty will be brought down to a "should have known" standard. I happen to believe this is not correct and that violations will require evidence of a knowing and willful intent to misclassify, but Mr. Wenner's concern is valid, and it's better to be safe than sorry; i.e., err on the side of caution when classifying a worker as an independent contractor.

If the Labor and Workforce Development Agency finds a knowing and *willful* violation, the penalties are potentially quite harsh as stated above. In particular, the law gives broad authority to reach third parties that counsel employers on how to violate the law, and applies the penalties against successor companies, and owners. This last rule empowers the agency to go after intentional offenders who try to hide behind corporate shells, or create new businesses to avoid fines.

However, to me, the most interesting part of the legislation is that "scarlet letter" aspect of the violation requiring the employer to "display prominently on its Internet Web site" a notice of the violation. This penalty is something that I have never seen before, and it is quite a severe punishment.

Morgan Smith is the owner of Cogent Legal, a litigation graphics firm based in the San Francisco Bay Area that develops clear and compelling visual presentations for attorneys to use in mediation or trial. Services include animations, 2D and 3D graphics, medical illustrations, PowerPoint or Keynote presentations, interactive timelines, videos, strategic consulting and trial support. Cogent Legal integrates the legal expertise of a successful trial attorney with the creative and technical talent of a design firm.