NEW PENALTIES FOR MISCLASSIFYING WORKERS AS INDEPENDENT CONTRACTORS

David Goldman is a partner at Wendel, Rosen, Black & Dean LLP where he counsels clients in complying with federal, state and local employment laws and defends employers in wage and hour regulation disputes as well as wrongful termination and discrimination claims. David provides advice regarding competitive business practice issues and prepares employment agreements and handbooks for clients.

Email: dgoldman@wendel.com
Phone: 510.834.6600

Despite the urging of the California Chamber of Commerce and other business and employer groups, Governor Brown nevertheless signed into law Senate Bill 459 ("SB 459"), which imposes new penalties for misclassifying workers as independent contractors. Businesses often use independent contractors to perform finite projects, particularly when current staff does not have the requisite skills and experience or, for that matter, time to handle a work project or assignment. Additionally, in today's uncertain business climate, businesses are reluctant to add staff until a steady growth in business activity occurs. All these circumstances lead businesses to consider hiring workers without any long-term commitments or contributions for employment related costs, such as payroll taxes, workers' compensation insurance, health insurance benefits and the like.

In light of perceived abuses by employers, governmental agencies have announced their intentions to undertake increased scrutiny of employers who use independent contractors to perform services that their employees can or do perform. Clearly, given tax shortfalls resulting from the stagnant economy, government agencies are looking for new sources of revenues, including from businesses who may be avoiding payroll and other employment taxes.

In conjunction with these concerns, the California Legislature enacted SB 459. Effective on January 1, 2012, SB 459 imposes civil penalties of not less than $5,000, nor more than $15,000, for each "willful misclassification" of a worker and penalties increase to not less than $10,000, nor more than $25,000, for each violation when the employer engages in a "pattern or practice" of such misclassifications.

The Labor Commissioner has now been specifically empowered to determine if a worker has been misclassified as an independent contractor and can impose civil penalties and other disciplinary action against the employer, but also against its owners, successor corporation, or related business entity *under certain circumstances*.

The most troubling aspect of this new law is the absence of clear guidance establishing when a worker is or is not an independent contractor. SB 459 provides not a test, but a definition of "willful misclassification," a term that is described as avoiding employee status for an individual by "voluntarily and knowingly" misclassifying that individual as an independent contractor. What *that* means is not identified in SB 459.

Different governmental agencies have adopted their own standards for determining when a worker is or is not an independent contractor. All the standards used, whether they are utilized by the Employment Development Department (right to control test), the Division of Labor Standards Enforcement (multi-factors test), the Fair Labor Standards Act (economic reality test), or the IRS test (behavioral control, financial control and parties relationship tests), require an examination of the surrounding work circumstances and then application of a subjective test to determine whether a worker is an employee or not. Consequently, government agencies can and do reach

different results whether a particular worker is considered to be an employee or an independent contractor.

One thing is sure; employer classifications of workers as independent contractors are going to be tested and employers will be compelled to defend their determinations either in civil court or before the Labor Commissioner. New uncertainty has been created by SB 459, along with substantial financial consequences for employers who misclassify workers as independent contractors instead of as employees.

In addition to employers and possibly related entities and their owners who may be liable for violation of SB 459, any person who "for money or other valuable consideration" knowingly advises an employer to treat an individual as an independent contractor to avoid employee status will be "jointly and severally" liable. New Labor Code §2753. Employees who give such advice to his or her employer (for example, HR representatives and attorneys advising employers), however, will be exempt from such "joint and several" liability.

Other consequences are provided by SB 459 if the Labor Commissioner/Labor and Workforce Development Agency ("LWDA") or a Court determines a violation has occurred. The employer (or "person") responsible for the misclassification will be ordered to display on its Internet website or in an area prominently accessible to all employees and the general public at each location if no Internet website exists, a notice of their wrongdoing ("I Have Been Bad" notices). These notices must adhere to the following rules:

1. The LWDA/Court found the identified person or employer committed a serious violation of law and willfully misclassified employees.
2. The person or employer has now changed its business practices.
3. Employees should contact LWDA if they believe they have also been misclassified and LWDA contact information must be provided.
4. That the notice has been posted pursuant to a State order.
5. An officer is required to sign the notice.
6. The notice must be posted for one year.

What Should Employers Do?

Unfortunately, SB 459 does not provide any real guidance to employers regarding how to classify workers as either employees or independent contractors. No "bright line" test to guide employers exists and increased enforcement is likely following the enactment of SB 459.

Employers who are using independent contractors or who are considering using independent contractors must reexamine whether legal and factual support exists for the independent contractor classification given to workers. Among the factors employers should consider:

1. Does the company have the right to control the means and the manner of the work performed? (How to do the work; when the work should be performed.)
2. Has the worker been hired to perform a specific project with a short-term end date, or is the engagement opened-ended?
3. Does the worker have his/her own business name and address? Taxpayer identification number? Business License?
4. Is the worker free to seek other work or does the worker work full-time for the company and is dependent on it for income?
5. Is the work to be performed at the company's premises or does the worker determine where to perform services?
6. Can the worker delegate work to others or subcontract all or a portion of the work?
7. Does the worker have specialized skills that do not need supervision by others? Does the worker perform services independent of company supervision?
8. Is compensation paid in a lump sum or in progress payments for the proportion of work completed, or is the worker paid by the hour, week or month, which suggests employment relationship?
9. Is there a written agreement detailing the respective responsibilities of the company and the worker?
10. Does the company have a right to discharge the worker at any time? (There is no greater right to control a worker than the right to unilaterally decide to end the working relationship.)

Attorneys who represent employees and government agencies will be using SB 459 to seek expanded civil penalties for "willful misclassification" of workers. Now is the time for your business to take a second look at its existing relationship with its independent contractors to determine if potential financial exposure exists under existing law, and whether it may be further exposed to the substantial civil and other penalties that will be imposed by SB 459.

Simply stated; conduct staff audits now. Don't wait until a lawsuit is brought and risk the substantial financial consequences if a worker has been misclassified as an independent contractor.