Schnader
ATTORNEYS AT LAW

Schnader Harrison Segal & Lewis LLP

NEW YORK PENNSYLVANIA CALIFORNIA WASHINGTON, D.C. NEW JERSEY DELAWARE

LABOR & EMPLOYMENT ALERT

SEPTEMBER 2011

Assault on Independent Contractor Misclassification Continues: California Legislature Passes and Sends Aggressive New Legislation to Governor Brown for Signature

By Scott J. Wenner

Billed as prohibiting and punishing the "willful misclassification" of employees as independent contractors, S.B. 459 would impose stiff civil penalties for each violation and even higher penalties if a "pattern" of violations is found. Both houses of the California Legislature recently passed S.B. 459 and sent it on to Governor Brown for signature. This measure joins a plethora of legislative and administrative efforts at the federal and state levels to deter and punish the misclassification of employees as independent contractors. (See recent Schnader Alert — "Senate Bill Proposes to End Misclassification of Independent Contractors".)

In addition to imposing new civil penalties, S.B. 459 also would empower the Labor Commissioner to assess damages on behalf of those misclassified; subject non-lawyer consultants to joint liability for knowingly advising an employer to classify a worker later deemed an employee as an independent contractor; and require an offending employer to post a notice on its website for one year containing specific information about its violation of the law. If signed by the Governor, its provisions will appear as new Sections 226.8 and 2753 of the Labor Code.

Unlawful Practices

S.B. 459 creates two new unlawful practices that an employer can be found to have engaged in by a court or by the California Labor and Workforce Development Agency:

(1) "Willful misclassification" of an individual as an independent contractor.

(2) Charging a willfully misclassified worker a fee, or making any deductions from compensation for any purpose that would have violated the law governing deductions from pay — Labor Code §§221 and 224 — had the worker properly been classified as an employee.

Willful Misclassification

This is the key definition in the legislation and the source of much of the controversy surrounding it. The term was redefined in the final bill as "avoiding employee status for an individual by voluntarily and knowingly misclassifying that individual as an independent contractor." The original definition of "willful" in earlier versions of the legislation was "voluntary and intentional" — a somewhat lesser standard that critics of the bill observed would readily permit employers that wholly mistakenly misclassified workers to be held liable. While legislative staff comments reportedly suggested that the amended standard appearing in the final bill might make it more difficult to find that an employer "willfully misclassified" a worker, and thereby would constrain the number of enforcement actions, this is not likely to be the case, for the reasons discussed in detail below.

Civil Penalties/Damages

On the determination by the Labor Commissioner, a court, or by the Labor and Workforce Development Agency ("Agency") that an employer or other person has engaged in an unlawful practice, the employer or person is subject to a civil penalty that can range, under the legislation, between *$5,000 and $15,000 for each violation* found, in addition to any other penalties or fines permitted by law. Moreover, if the employer or person is found to have engaged in a pattern or practice of such unlawful practices, the civil penalty which can be levied increases to a minimum of $10,000 and a maximum of $25,000 per violation. The legislation also permits the Labor Commissioner or a court to order payment of damages to anyone injured by having been willfully misclassified. The Labor Commissioner further is authorized to seek enforcement of orders issued under S.B. 459 in the courts.

(continued on page 2)

(continued from page 1)

Licensed Contractors

If the employer found in violation is a licensed contractor under the Contractors' State License Law, the Agency or court that made the determination is directed to transmit a certified copy of the determination to the Contractors' State License Board. That Board, in turn, is directed to initiate disciplinary action against a licensee within 30 days.

Public Notice

Another source of controversy is the legislation's "scarlet letter" rule. If a court or the Agency determines that the person or employer violated a prohibition of S.B. 459, it is directed to order the person or employer to display prominently *for one year* on its Internet Web site, in an area accessible to all employees and the general public, or, in the absence of an Internet Web site, to display in an area that is accessible to all employees and the general public at each location where a violation occurred, a notice *signed by an officer* that contains all of the following:

(1) That the Labor and Workforce Development Agency or a court, as applicable, has found that the person or employer has committed a serious violation of the law by engaging in the willful misclassification of employees.

(2) That the person or employer has changed its business practices in order to avoid committing further violations of this section.

(3) That any employee who believes that he or she is being misclassified as an independent contractor may contact the Labor and Workforce Development Agency. (The notice must include the mailing address, e-mail address, and telephone number of the Agency.)

(4) That the notice is being posted pursuant to a state order.

Enforcement

The legislation specifically allocates enforcement authority to the Labor Commissioner. However, as is the case with respect to other sections of the Labor Code, it permits employees to enforce their rights judicially. Thus, any employer that classifies significant numbers of workers as independent contractors must consider themselves to be at risk for class actions challenging their classification of these workers. While it does not appear at present that actions under the Private Attorneys General Act (PAGA) are authorized, that could change.

Impact on Employers

As the California Chamber of Commerce has observed, while purportedly just going after employers who *willfully misclassify* workers, "the [final] bill still falls short of adequately protecting employers that are trying to comply with the law, yet mistakenly misclassify an individual as an independent contractor." There are several reasons that the Chamber's observation is true.

First, the "knowing" standard is interpreted by the courts as including *constructive knowledge*, which in turn incorporates what the employer purportedly *should have known* — an inexact and subjective standard applied *post hoc* by a finder of fact.

Second, and compounding the first problem, the standards for determining whether a worker is properly classified as an independent contractor not only shift depending on the forum, but also are vague and subjective at best. The California Department of Industrial Relations readily admits the shifting and ambiguous nature of the term, observing that the same person may be deemed an employee under one law but an independent contractor under another. (See, e.g. http://www.dir.ca.gov/dlse/faq_independentcontractor.htm, *last visited 9/21/2011*.) To bring potentially enormous, severe and punitive sanctions against an employer based on a finding that the employer *should have known* it was not in compliance with an ambiguous standard would impose an unreasonable if not impossible burden on California employers.

Third, as a practical matter, by creating a private right of action with enormous and severe penalties at risk, the real threat is less from agency enforcement than from the "class action mills" that have been churning out the wage and hour class actions in recent years. The latter are less likely to be deterred by a slight tightening of the "willfulness" standard than is an enforcement agency with limited resources.

If Gov. Brown signs S.B. 459 over the objections of the Chamber of Commerce and other employer organizations, as many predict he will, the already increased risk borne by employers that classify workers as non-employees will be ratcheted up further still. Both potentially enormous

(continued on page 3)

(continued from page 2)

penalties and possible reputational damage from the public "shaming" the legislation mandates would dramatically increase the stakes when classifying a worker as an independent contractor. Whether or not Gov. Brown signs S.B. 459 into law, the actions already taken by federal agencies[1] — including the Department of Labor and the IRS — and by state legislatures and agencies should prompt all employers to reexamine their independent contractor relationships in a realistic way and determine whether they would withstand increased scrutiny. ◆

1. On September 19, the U.S. Department of Labor announced a memorandum of agreement signed with the IRS, as well as agreements signed with officials of Connecticut, Hawaii, Illinois, Maryland, Massachusetts, Minnesota, Missouri, Montana, New York, Utah and Washington, all promising cooperation on rooting out misclassification of workers.

For more information about our Labor and Employment Practices Group, or to speak with a member of the group at a particular Schnader office location, please contact:

Scott J. Wenner
415-364-6705; 212-973-8115
swenner@schnader.com

Michael J. Wietrzychowski
856-482-5723
mwietrzychowski@schnader.com