

Classification of Independent Contractors Subject to Challenge in New Jersey, Following Supreme Court's Adoption of "ABC Test"

Legal Alert

February 5, 2015

Kenneth R. Gilberg, Michael D. Homans

Employers in New Jersey will need to review their "independent contractor" relationships to ensure such workers do not now qualify as employees with entitlements to overtime pay and benefits, based on a recent decision by the Supreme Court of New Jersey.

In *Sam Hargrove, et al. v. Sleepy's, LLC*, the Supreme Court – which is New Jersey's highest authority on state law issues – clarified the tests for determining independent contractor status in New Jersey for wage payment and wage and hour matters.

The case involved three truck drivers who delivered mattresses purchased from Sleepy's. The company had classified the drivers as independent contractors, but the drivers claimed they were employees who had been misclassified in an effort to avoid payroll taxes, and costs and benefits that would be due to employees.

The Supreme Court held that the "ABC test," derived from the New Jersey Unemployment Compensation Act, governs whether a worker is an employee or independent contractor for purposes of resolving wage payment or wage and hour claims. Under the ABC test, an individual is presumed to be an employee unless an employer can show that:

- A. Such individual has been and will continue to be **free from control or direction** over the performance of such service, both under his contract of service and in fact; and
- B. Such service is **either outside the usual course of the business** for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and
- C. Such individual is customarily engaged in an **independently established** trade, occupation, profession or business.

Employer's Burden of Proof

Importantly, the ABC test requires the employer to prove that all three requirements are met in order to establish an independent contractor relationship.

Continued

The ABC test differs substantially from the IRS's twenty-factor test, or the "Economic Realities" test used by the U.S. Department of Labor ("DOL"). Other agencies and states utilize the common law, "Right to Control" test or a hybrid of the various tests. For all of these tests, the agencies or courts look at a variety of factors and no one criteria is controlling, although the right to control the worker or how the work is performed is often the most important factor.

The *Sleepy's* decision is just the latest challenge to employers, in and out of New Jersey, in determining whether a worker is properly classified as an independent contractor. The issue is important because of the wide range of liability that arises from misclassification, including exposure to wage and hour class actions, and liability to state and federal taxing authorities for payroll taxes. Over the past several years the IRS, the U.S. Department of Labor, and various state and local governments have expanded their efforts to go after employers the government alleges has misclassified workers in order to avoid paying taxes, wages and benefits. Additionally, there has been a tidal wave of class action lawsuits concerning this issue resulting in staggering damage awards and settlements, not to mention legal fees. Not only do these cases involve wage payment and wage hour violations, they also include violations of many employment laws, such as worker's compensation, family leave and ERISA.

All of this makes it increasingly important that employers ensure they are properly classifying their workers, and, most crucially, that workers classified as independent contractors truly meet the applicable test (which is now the ABC test in New Jersey).

Action Items

Going forward, employers should consider the following five issues:

1. Can the employer meet the ABC test with regard to all New Jersey workers classified as independent contractors?
2. Has the employer analyzed independent contractor issues under other standards applied by the IRS, DOL and other states?
3. Is the employer paying required overtime, employee benefits and payroll taxes for workers who qualify as employees?
4. Has the employer considered adopting mandatory and binding alternative dispute resolution provisions in its employment and independent contractor agreements to avoid the unpredictability of court litigation, class actions and runaway jury verdicts on these issues?
5. Has the employer considered a "wage and hour audit" by counsel to determine its compliance with applicable employment laws, including the ABC test?

If an employer does have concerns relating to independent contractors as a result of the *Sleepy's* decision, now is the time to take action to address those issues. Flaster Greenberg's Labor and Employment Group has extensive experience in this area of the law, and stands ready to assist clients, as needed. Please contact Ken Gilberg, Michael Homans, Adam Gersh, or any Labor and Employment Group member.