

Wednesday, April 23, 2008

California Enforcement Agency Continues Trend to Classify Independent Contractors As Employees

Recently the California Division of Labor Standards Enforcement (“Division”) audited beauty and nail salons in 10 counties throughout Northern California. Nearly every salon audited in Sacramento County was issued a citation with assessed fines totaling \$61,000.00. What was the Division’s basis for issuing citations and assessing fines? The improper classification of workers as independent contractors.

The Division’s audit appears to be a continuation of a larger trend in California labor and employment law which has no clear end in sight. Advocates cite unfair competitive advantage, avoidance of payroll tax and employment-related benefits, and lack of labor and employment law protections as reasons supporting the recent focus on misclassified independent contractors.

How Does A Business Know Whether Workers Are Independent Contractors?

The Division has long relied upon the standard established in S.G. Borello & Sons, Inc. v. Department of Industrial Relations[1] decided by the California Supreme Court in 1989 to determine the status of independent contractors. The Borello case has been favorably cited and relied upon in two recent California appellate court decisions dealing with courier drivers who were treated as independent contractors.[2] One of these cases involved the assessment of unemployment taxes and the other involved the violation of the California Labor Code provision requiring reimbursement of business expenses. In each of these cases, the California court determined that an employment, not an independent contractor, relationship existed.

From these cases and the recent trend perpetuated by the Division, it appears that the standard established in Borello is the most reliable under California law for determining whether a worker is an employee or independent contractor.

Under this analysis, the most significant factor considered is whether the business or principal involved retains the right to control the manner and means of accomplishing the task assigned to the worker. When a principal retains the right to control, it is a strong indication that an employment relationship exists. Other considerations reviewed under California law include:

1. Whether the worker is engaged in an occupation or business distinct from that of the principal;
2. Whether or not the work performed is part of the regular business of the principal;
3. Whether the principal or the worker supplies the instrumentalities, tools, and the place for the person doing the work;
4. The worker's investment in the equipment or materials required by the task;
5. The skill required in the particular occupation;
6. The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
7. The worker's opportunity for profit or loss depending on managerial skill;
8. The length of time for which the services are to be performed;
9. The degree of permanence of the working relationship;
10. The method of payment, whether by time or by the job; and
11. Whether or not the parties believe they are creating an employment relationship.

In 1989, the Borello court noted: "The modern tendency is to find employment when the work being done is an integral part of the regular business of the employer, and when the worker, relative to the employer, does not furnish an independent business or professional service." [3] This statement has held true since Borello was decided and continues in the current trend focusing on misclassification.

What Should Businesses Do In Response to This Recent Trend?

As a result, it is prudent for all businesses that rely upon independent contractors to perform significant or integral parts of their regular operations to analyze carefully these relationships.

The beauty salon and courier industries are not unique in this regard. Each industry will be subject to the same criteria for determining whether an independent contractor relationship exists. Also, the trend establishes that written contracts purporting to characterize a relationship as an independent contractor relationship will be of little value in the analysis. There exists a presumption of employment that must be overcome by the business seeking to establish the independent contractor relationship^[4] and the factors noted above, not the written agreement, will be determinative.

Beyond the civil fines assessed by the Division, improper classification of independent contractors can result in liability for unpaid overtime compensation and business-related expenditures, premiums for missed meal and rest period, and other related compensation issues. When an unexpected employment relationship is established, the application of equal employment opportunity laws and other labor and employment laws follows which may also create significant liability. Finally, misclassified independent contractors may be entitled to pension and health insurance benefits which were withheld because of the misclassification. It seems obvious that misclassification can be devastating to a business and even an entire industry.

If you have questions regarding the classification of independent contractors, you should not hesitate to contact labor counsel to protect your business from the reach of the Division and its renewed efforts to audit and investigate misclassified workers.

For more information regarding the above, please contact **Treaver Hodson** at (916) 442-3552.

[1] 48 Cal. 3d 341 (1989).

[2] *Air Couriers International v. Employment Development Department*, 150 Cal. App. 4th Cal. App. 4th 1 (2007). 923 (2007); *Estrada v. FEDEX Ground Package System, Inc.*, 154

[3] *Borello*, 48 Cal.3d at 357.

[4] California Labor Code section 3357.