

Client Alert

O'TOOLE SCRIVO

A LIMITED LIABILITY COMPANY

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Independent Contractor or Employee?

New Jersey Supreme Court Addresses Worker Classification and the Role of the Department of Labor

On August 2, the New Jersey Supreme Court in *East Bay Drywall, LLC v. Department of Labor & Workforce Development* issued its first opinion in over thirty years applying the ABC Test in New Jersey, raising important considerations – with far-reaching implications – when a company evaluates whether to classify someone (or another legal entity as it may be) as an employee or an independent contractor.

Background on New Jersey's ABC Test

New Jersey's ABC Test is used to determine the proper classification of workers under certain laws. While the ABC Test is not used in all situations – for example, it is not used under New Jersey's Law Against Discrimination, Workers' Compensation Law, or Conscientious Employee Protection Act – it is used to determine a company's minimum wage and overtime, unemployment, and sick leave obligations, among others.

Under the ABC Test, an individual paid for services rendered is presumed to be an employee unless the hiring company can establish all three prongs of the test:

- Prong A – that the worker is “free from control or direction over the performance of such service”;
- Prong B – that the service is performed “outside the usual course” or “outside of all of the places of business” of the entity for which the service is performed; and
- Prong C – that the worker is “customarily engaged in an independently established trade, occupation, profession, or business.”

The worker must be classified as an employee if even one prong is missing. While this inquiry is fact sensitive, New Jersey has a long-standing presumption in favor of employment status.



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East Bay Drywall

In *East Bay Drywall*, the Department of Labor (“Department”) conducted an audit to determine whether East Bay Drywall had misclassified some of its employees as independent contractors and, if so, whether the company owed additional contributions to the State’s unemployment and disability benefit funds. Since at least 2013, East Bay’s business model was to bid on drywall projects and then retain subcontractors to perform the work. As was typical, each subcontractor was free to accept or decline a particular job, and the evidence established that some had even left mid-installation. Although East Bay provided them with the construction materials, each subcontractor was responsible for providing their own tools, determining the appropriate number of workers for each project, and ensuring those workers had transportation to the worksite. The subcontractors performed the work for which they were retained independently and without direction from East Bay. The principal of East Bay confirmed that, before retaining a subcontractor, he required the subcontractor to provide a certificate of liability insurance and tax identification number.

The Department’s auditor found that four individuals and twelve business entities should have been classified as employees. Following a hearing, the Administrative Law Judge (“ALJ”) reversed in part and affirmed in part, finding only three of the four individuals should have been classified as employees. The ALJ found that all twelve of the business entities were properly classified as independent contractors. The Department Commissioner reversed the ALJ, finding all sixteen individuals and business entities should have been classified as employees of East Bay. The Commissioner found the workers failed all three prongs of the ABC Test, but the focus remained on Prong C. According to the Commissioner, there was insufficient evidence to prove that the workers had any commercial existence independent of their relationship with East Bay. For example, while East Bay’s principal testified that some of the workers also took jobs unrelated to East Bay, he offered no proof.

The Commissioner’s ruling was appealed to the Appellate Division and, finally, to the Supreme Court. The Supreme Court upheld the Commissioner’s ruling – finding it neither “arbitrary, capricious, or unreasonable” – deferring to the Commissioner’s determination that the workers should have been classified as employees. Focusing on the

Commissioner’s analysis of Prong C of the ABC Test, the Supreme Court acknowledged that East Bay had presented evidence that could provide an indicia of an independently established business for certain of the subcontractors – namely, the establishment of a business entity, the procurement of insurance, and the ability to accept or decline specific projects. While acknowledging that that evidence could be probative to the analysis under Prong C, it specifically noted the possibility that such evidence may simply establish that “the entities were a business name only.” The Court then emphasized the importance of going beyond a superficial analysis of an entity’s independently established business, reverting to an analysis of the “hallmarks of independence.” That analysis requires a far more in-depth review of a particular contractor’s business and evaluates the following considerations:

The duration and strength of the business, the number of customers and their respective volume of business, the number of customers and their respective volume of business, [] the number of employees; [and] . . . the amount of remuneration each [worker] received from [the company] compared to that received from others for the same services.

The Court found that, because the record did not contain evidence to establish the hallmarks of independence, the Commissioner’s decision was not arbitrary or capricious, and the Court deferred to his findings.

Classification Considerations After *East Bay*

The *East Bay* case reinforces a common theme in New Jersey employment law: a strong presumption in favor of classifying workers as employees instead of independent contractors. But *East Bay* stands for much more. When evaluating whether to classify a worker as an independent contractor, it is insufficient, without more, that the worker has established an independent business entity. Instead, with the blessing of the Supreme Court, this Department appears to require a much more in-depth analysis to confirm that such independence is not “in name only” but exists in practice. Of course, the practical implications of this decision could and likely will have far-reaching effects. Therefore, companies should be mindful of all the facts and circumstances surrounding a worker’s business before classifying the worker as an independent contractor to ensure it meets the heightened requirements of Prong C of the ABC Test.

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