

Legal Analysis of SB 459 (Corbett)

June 15, 2011

SB 459 proposes to add to the Labor Code yet another layer of penalties for California businesses. This bill purports to penalize *only* those employers (and their advisors) who “*willfully misclassify*” workers. Yet the bill fails to give employers (or courts) so much as a *hint* of what constitutes a “willful” misclassification. What conduct should an employer or court look to as evidence of, or a defense to, an alleged “willful misclassification”?

The bill’s failure in this regard is particularly onerous for employers (and courts) and patently unfair. A simple review of the relevant case law on misclassification of workers reveals exceptionally complex and conflicting case law defining and attempting to determine who is an “employee” as opposed to an independent contractor. A determination of whether a worker is properly classified as an independent contractor must be done on a case-by-case basis and is based on slippery and easily manipulated “factors”¹.

SB 459 will impose severe financial penalties on employers without advising them, in advance, what conduct will subject them to such penalties, or what conduct may be relied upon in defense of an allegation of willfulness. California employers are entitled to know the rules before they act, and SB 459 subjects them (arguably *ex post facto*) to penalties *for conduct which isn’t defined and available defenses aren’t provided. Equally troubling is the fact that Courts will be called on to determine – without guidance – whether an employer acted “willfully”*.

Unlike SB 459, other California labor codes address how an employer can avoid a statutory penalty. See, e.g., Labor Code § 203 which provides that penalties may be avoided if the employer can show that a good-faith dispute existed concerning whether any wages were due. A “good-faith” dispute means that the employer’s defense, based on law or fact, if successful, would preclude any recovery on part of the employee. (Title 8 California Code of Regulations § 13520)

Also unlike SB 459, Federal labor law concerning the misclassification of workers at least gives employers (and courts) *guidance* concerning what constitutes a “willful” misclassification. By way of example, under the Fair Labor Standards Act (“FLSA”) an employer can be assessed penalties (called “liquidated damages” under FLSA) only if the employer is unable to prove “good faith” or “reasonable grounds”. See 29 U.S.C. § 260, which provides that a Court (not the jury or fact finder) is given “the discretion not to award liquidated damages to a prevailing plaintiff if ‘the employer shows to the satisfaction of the court that the act or omission giving rise to such action was in good faith and that he had reasonable grounds for believing that his act or omission was not a violation of the’ FLSA. See, e.g., *Elwell v. University Hosp. Home Care Services*, 276 F.3d 832, 840 (6th Cir. 2002) (quoting 29 U.S.C. § 260).

¹ Federal Courts have recognized that the test for determining whether a worker is properly classified as a contractor “is a *loose formulation*, leaving the determination of employment status to *case-by-case resolution* based on the *totality of the circumstances*.” *Lilly v. BTM Corp.*, 958 F.2d 746, 750 (6th Cir. 1992); “No one [factor] is controlling, nor is the list complete”; *U.S. v. Silk*, 331 U.S. 704, 716 (1947); *Martin v. Selker Brothers, Inc.*, 949 F.2d 1286, 1293 (3d Cir. 1991) (“there is no single test to determine whether a person is an independent contractor”); and *Dole v. Snell*, 875 F.2d 802, 805(10th Cir. 1989) (test factors are “simply analytical tools, their weight, number and composition are variable”).

Also unlike SB 459, Federal tax law gives guidance to employers who misclassify workers as contractors. Section 530 of the Revenue Act of 1978 (26 USC Sec. 3401) was enacted to prevent penalties from being imposed against employers who in good faith misclassified its employees as independent contractors. Under Section 530, an employer who can show a “reasonable basis” for its classification of a worker as an independent contractor may not be penalized². Section 530 provides three specifically defined “reasonable bases” the proof of which protects an employer from being penalized. Section 530 provides as follows:

...Taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer’s treatment of such individual for such period was in reasonable reliance on any of the following:

- (A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;
- (B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment for employment tax purposes of the individuals holding positions substantially similar to the position held by this individual; or
- (C) a long standing recognized practice of a significant segment of the industry in which such individual was engaged.

In comparison, SB 459 provides no guidance whatsoever on the issue of “willfulness”. If SB 459’s goal is to target “bad actors” that misclassify workers, it would be imminently proper to include, consistent with federal labor and tax laws, well defined exemptions from penalties for employers who act in good faith and reasonably. Including well defined evidence of good faith and reasonableness serves to fairly let employers know what they need to do to avoid being penalized, and at the same time appraises courts of the evidence they are to consider in determining whether an employer acted “willfully” in a misclassification of a worker.

It should be recommended that SB459 be amended to include the following provisions -- all based on long standing federal law concerning the misclassification of workers.

PROPOSED LANGUAGE

An employer can be assessed penalties for “willfulness” only if the employer is unable to prove “good faith” or “reasonable grounds”. A Court (not the jury or fact finder) has the discretion not to award penalties under this section to a prevailing plaintiff if the employer shows to the satisfaction of the court that the misclassification was in good faith and that it had reasonable grounds supporting its decision to classify the worker as an independent contractor.

Good faith and reasonable grounds shall include, but are not limited to, an employer presenting proofs that it reasonably relied on any of the following:

² Moreover, Section 530 provides that the term “reasonable” is to be “construed liberally in favor of the taxpayer” [employer]. See, *Boles Trucking, Inc. v United States*, 77 F.3d 236, 239 (8th Cir. 1996), citing H.R. Rep. No. 95-1748 at 5 (1978).

- (1) judicial precedent, rulings or past audits in which there was no award or assessment attributable to the misclassification of this category of worker, or
- (2) a long standing, widely recognized practice of a significant segment of the industry in which the misclassified individual was engaged;
- (3) a fair and reasonable assessment of the facts and law concerning the workers' classification.