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When Less Isn't More: An Overview of East Bay's Impact on Employee Misclassification

On August 2, the New Jersey Supreme Court issued a ruling in *East Bay Drywall, LLC v. Department of Labor & Workforce Development* that now requires companies to provide stronger evidence to satisfy their burden under the ABC Test to prove an independent contractor relationship. Specifically, the court held that corporate formation documents, such as business registrations and insurance certificates, are no longer by themselves dispositive in establishing a contractor's independence.

DOL's Audit

The court's decision stems from a routine audit performed by the New Jersey Department of Labor & Workforce Development (DOL) of East Bay Drywall, LLC (East Bay), a drywall installation business. The audit's purpose was to determine whether East Bay's drywall installers were bona fide independent contractors or employees, as defined under the ABC Test of the Unemployment Compensation Law. Under the ABC Test, workers are presumed to be employees unless the business can demonstrate the following three factors: A) the worker is free from direction and control of the employer; B) the worker's services are outside the usual course of business or performed outside the employer's place of business; and C) the worker is customarily engaged in an independently established trade, occupation, profession or business. Applying these factors, the auditor concluded that East Bay failed to satisfy the ABC Test for 16 of its installers and assessed East Bay with fines and penalties for misclassification. Of the 16 installers, four were individuals and the other 12 were registered as third-party corporate entities.

Agency Appeals

East Bay appealed the assessment to the Office of Administrative Law, which prompted an evidentiary hearing by an administrative law judge (ALJ). After hearing testimony from both sides, the ALJ affirmed the DOL's audit findings for three of the installers at issue and reversed for the remaining 13 installers. In applying the ABC Test, the ALJ concluded that 13 of the installers satisfied part C of the ABC Test because those installers each had a business entity registration, which demonstrated each could continue to operate independently after the termination of their work relationship with East Bay. However, when the matter was subsequently presented to the DOL for final agency review, the DOL's commissioner reversed the ALJ's findings for the 13 installers and agreed with the auditor that all 16 installers were employees of East Bay.

Appellate Division

East Bay appealed the final agency decision to the Appellate Division of the New Jersey Superior Court to contest the commissioner's findings. In large part, but not entirely, the Appellate Division disagreed with the commissioner and concluded that only five of the installers were employees and the other 11 were bona fide independent contractors. The Appellate Division found that East Bay satisfied the ABC Test for the 11 installers because there was minimal showing of control and direction by East Bay for purposes of part A of the test, the drywall installation was not performed in any of East Bay's physical plants for purposes of part B, and the 11 installers presented certificates of insurance, which the Appellate Division considered to be significant indicia of their independent business status for part C of the test. The other five installers, however, failed to show they actually operated as independent business entities.

Supreme Court Decision

Shortly after the Appellate Division's ruling, the DOL petitioned the New Jersey Supreme Court to grant certification for an appeal, which the court did. In its decision, the court ruled entirely in favor of the DOL, concluding that all 16 installers were employees and none were bona fide independent contractors under the ABC Test. In reaching its decision, the court did not analyze parts A or B but focused solely on part C. Specifically, the court rejected East Bay's evidence presented to support part C of the test (i.e., the owner's testimony, the installers' business registrations and the certificates of insurance), finding it insufficient to prove independence.

The court was unpersuaded by the owner's testimony that many of the installers worked for other entities because, according to the court, employees are also free to work for more than one employer. With respect to the insurance certificates, the court concluded they provided coverage for only one year of the audit period and, therefore, did not clearly establish independent operation from East Bay. Regarding the business registrations, the court found that nearly all the registrations were revoked prior to the audit period and each only listed one individual in the ownership structure. In the court's view, the evidence suggested the entities were businesses in name only rather than independent businesses operating apart from East Bay. Consistent with its decision, the court remanded the matter to the DOL to calculate the financial penalties against East Bay.

Bottom Line

The New Jersey Supreme Court's holding in *East Bay* is a huge blow to companies that rely on independent contractors for aspects of their business. Evidence and factors that were previously persuasive in proving independence under the ABC Test no longer hold the same weight. The timing of this decision is also significant given Governor Murphy's newly created Task Force on Employee Misclassification and the adoption of a series of New Jersey laws that further crack down on worker misclassification. These new laws impose heftier fines and threaten stop-work orders if businesses misclassify employees, even if the violation was unintentional. New Jersey businesses should scrutinize and evaluate their use of independent contractors and consult with legal counsel to evaluate compliance and avoid the consequences of misclassification.

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