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New Law Ups Penalties for Independent Contractor Misclassifications

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SACRAMENTO — Defense counsel are warning that legislation signed into law Sunday by Gov. Jerry Brown could provide the plaintiff bar with new incentives to launch workplace litigation.

New [provisions](#) in the state Labor Code will explicitly prohibit "willful" misclassification of employees as independent contractors. Violators face civil penalties of up to \$15,000 for each instance of mislabeling a worker. Employers who demonstrate "a pattern or practice" of misclassifying workers could be fined up to \$25,000.

Those new, hefty levies would be added to whatever penalties and fees the employer already faces for failing to pay proper wages, payroll taxes, workers compensation costs and other mandated worker expenses.

"You start multiplying those potential penalties over a decent sized independent contractor workforce and the numbers get pretty large," said Daryl Landy, an employment partner in the Palo Alto office of Morgan, Lewis & Bockius.

The new law also prohibits employers from charging misclassified workers for space, equipment or other items that employees are not required to purchase. Paid consultants — with the exception of lawyers or in-house advisers, such as personnel managers — can also be held liable for recommending employers improperly declare workers independent contractors so they can avoid taxes and other costs.

Finally, the new law includes a so-called scarlett letter provision requiring violators to post a notice on their website alerting visitors that the company violated the Labor Code and has changed its business practices to avoid more violations.

For years, labor groups have sought an additional hammer to go after companies who rely on large numbers of non-employee workers. Somewhere between 10 percent and 30 percent of employers nationwide misclassify workers, according to a review of states' records by the National Employment Law Project. Audits by the state Employment Development Department in 2008 found 64,539 misidentified employees and resulted in employer assessments of almost \$194 million.

"We've seen an astronomical increase in the number of workers misclassified as independent contractors as a way to save employers money and avoid worker protections," said Peter Rukin, name partner at San Francisco's Rukin Hyland Doria & Tindall who handles plaintiff misclassification cases.

With tax revenues tanking in the sour economy, state and federal treasuries are giving new scrutiny to potential misclassifications. The U.S. Government Accountability Office concluded in 2006 that the improper use of independent contractors cost the country \$2.7 billion in Social Security, unemployment and income taxes.

Republican Gov. Arnold Schwarzenegger blocked any attempt to levy new penalties against companies that improperly used contractors, arguing that existing penalties were sufficient. But labor groups have found a new ally in Brown, a Democrat who, despite vetoing employment lawyers' top-priority bills, signed the new Labor Code provisions into law without comment.

As with other labor code violations, the penalties can be sought by either the labor commissioner or through private action.

Defense attorneys who spoke with *The Recorder* haven't advised their clients to cut ties altogether with independent contractors. They are recommending that companies take a fresh look at how they classify workers.

The problem, said attorney Scott Witlin, a partner in the Los Angeles office of Barnes & Thornburg, is that no single standard exists for determining who is and isn't an independent contractor.

"You have all these different jobs in this diverse economy, everything from Silicon Valley to Hollywood, and the lines are not very easy to see," Witlin said.

Even the state Department of Industrial Relations [concedes on its website](#) that "there is no set definition of the term 'independent contractor' for all purposes" and that two state agencies may come to different conclusions about a worker's status because they use different tests.

"The impact of this new law is really going to depend on how 'willful misclassification' is interpreted," said Paul Cowie, a senior associate with Sheppard Mullin Richter & Hampton's labor and employment group.

Senate Bill 459 says employers who "voluntarily and knowingly" label workers as independent contractors have willfully broken the law. But defense attorneys point out that courts have defined "willfully" differently, even within the Labor Code itself. They say the courts are likely to shape the word's definition in this case, too.

Rukin said he doesn't expect the increased penalties to unleash a new "parade of horrors" on defense attorneys or their corporate clients.

"These cases were being brought anyway," he said. "I don't think it's going to be a game changer because in most cases there's a liability already," he said.

The new law takes effect Jan. 1.

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