NJ Supreme Court Addresses Worker Classification and Independent Contractor Status Under ABC Test

Client Alert

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On August 2, 2022, the New Jersey Supreme Court handed down its decision in *East Bay Drywall, LLC v. Dept. of Labor and Workforce Development*, providing important insight into the classification of independent contractors by holding that sixteen alleged subcontractors of East Bay Drywall, LLC were, in fact, employees and not independent contractors under New Jersey's ABC test.

The ABC Test

The ABC test is a three-pronged analysis which "analyzes whether the individuals are under the direction and control of the employer, whether the work is outside of the usual course of business for which such service was performed, and finally, whether such individual is customarily engaged in an independently established trade, occupation, profession or business."

The three prongs are:

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

All three prongs must be satisfied for a worker to be considered an independent contractor and the party challenging the classification has the burden to establish all three prongs of the ABC test. Classification under the ABC test is critical to employers because they have greater responsibilities to employees as opposed to independent contractors.

Case Background and Court Rulings

In *East Bay*, at issue was whether this drywall installation business owed back payments to the Unemployment Compensation and Temporary Disability Benefit funds, an obligation that is only triggered for employees, not independent contractors. Employees, in contrast to independent contractors, are also eligible to collect unemployment benefits if they are discharged and otherwise qualify.

East Bay had been subject to a routine audit conducted by the Department of Labor and Workforce Development to determine what payments, if any, were owed by East Bay to the Unemployment Compensation and Temporary Disability Benefit funds. The entities at issue were hired by East Bay to complete drywall installation, taping, and finishing on a per-job basis. In the previous procedural history of the case, the auditor had found that all sixteen workers/entities were employees. Following an evidentiary administrative law hearing, the Commissioner of the Department of Labor and Workforce Development also concluded that the individuals performing services on behalf of all sixteen entities at issue were employees.

The Appellate Division, in reviewing the Commissioner's decision, agreed that the individuals performing services for five of the entities were employees, but determined that those working for the remaining eleven entities were independent contractors.

The Supreme Court, in reinstating the Commissioner's findings that all sixteen workers/entities were employees, focused on the evidence necessary to meet Prong C of the ABC test - proof that an alleged subcontractor operates as an independent business entity. Since the Supreme Court determined that the evidence was insufficient to meet Prong C for all the disputed entities, it did not analyze Prong A or Prong B.

In East Bay's appeal to the Supreme Court, it offered what it considered the "best evidence" supporting Prong C - its principal's testimony in the administrative law hearing that he "believed the subcontractors worked for other contractors, that sometimes a subcontractor would leave the job before it was completed, and that the subcontractors were free to accept or decline work." Easy Bay also provided certificates of insurance and business entity registration information for "most" of the disputed entities.

The Supreme Court found this evidence to be insufficient to meet Prong C and demonstrate independence, as follows:

- Evidence that the entities could refuse to accept or complete work was of “limited” “probative value” because “even a bona-fide independent contractor is not free from the pressure to accept a job.”
- Although certificates of insurance and business registration information could be useful evidence, the documents submitted here were lacking. Most of the insurance certificates submitted were only for one year of the audit period. The business registrations almost uniformly indicated a sole individual in the ownership structure (rather than a complex ownership structure) and almost all the registrations were revoked prior to the audit due to a failure to file the required reports for at least two consecutive years. The Supreme Court also noted that a business registration standing on its own is not dispositive, as “a business may be duly registered but entirely dependent upon one contractor.”

The Supreme Court reiterated that in order to determine whether an entity is truly an independent business entity, consideration of the Prong C factors set forth in the cases *Carpet Remnant Warehouse, Inc. v. Dept. of Labor*, *Gilchrist v. Division of Employment Security*, and *Trauma Nurses, Inc. v. Dept. of Labor* is appropriate, including:

- Will the business, trade, occupation, or profession "clearly continue" despite termination of the challenged relationship
- Is the entity "stable and lasting" and can it survive the termination of the relationship?
- Would the worker "join the ranks of the unemployed" if the relationship terminated?

In analyzing these factors, relevant evidence would include whether the entities (1) maintained independent business locations, (2) advertised, or (3) had employees. None of the East Bay entities provided information sufficient to demonstrate their independence.

Given East Bay's failure to meet Prong C for each of the sixteen entities, the Supreme Court concluded that each entity is properly classified as an employee. The Supreme Court warned against "a business practice that requires workers to assume the appearance of an independent business entity - a company in name only...", as it could be interpreted as a type of "subterfuge" to avoid an employer's responsibilities to remit fund contributions under state employee protection statutes. This business practice could be especially damaging in the construction context, where workers may not be as familiar with the ABC test and thus, "particularly vulnerable to the manipulation of the laws intended to protect all employees." It also cuts against the public policy of the Unemployment Compensation Law, which provides that "economic insecurity due to unemployment is a serious menace to the health, morals, and welfare of the people of this state."

Key Takeaways for Employers

Employers should be cognizant of the examples of sufficient and insufficient evidence to meet the Prong C considerations set forth in the *East Bay* decision. As this case makes clear, employer testimony is insufficient on its own, as is incomplete and outdated documentary evidence. Employers in the construction industry should be particularly mindful of the ABC test, as the Supreme Court's concluding remarks specifically note the "vulnerability" of those workers.

In view of the *East Bay* decision, it would be prudent for employers to review all the relevant facts and circumstances concerning the workers it has classified as independent contractors to assure that they can sufficiently meet the burdens of Prong C and demonstrate that such classification is appropriate.

It is important to note, however, that the ABC test is used to determine whether a worker is an employee or independent contractor for purposes of the New Jersey Wage and Hour and Wage Payment Laws. Also, courts have consistently held that the purposes of the Unemployment Compensation Laws in New Jersey make it appropriate for a more expansive definition of "employee" to be used than under the common law "right to control" test. Thus, it is possible for workers to be classified as employees under the ABC test as they were in *East Bay* but still be classified as independent contractors for other purposes.

Please contact **Irene Hsieh**, the author of this Alert, with questions about this case or to discuss your specific circumstances.

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