



EMPLOYMENT LAW ALERT

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California Enacts New Law Prohibiting Willful Independent Contractor Misclassification

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When a company misclassifies a worker as an independent contractor, the consequences are severe, including back taxes, wages and benefits, and civil and criminal penalties, and can come from all sides, including individual and class action lawsuits, state and federal agency audits and enforcement actions, and even criminal prosecution. But the California legislature has decided all these sanctions are not enough. On October 9, 2011, Governor Jerry Brown signed into law Senate Bill 459, which adds two new provisions to the California Labor Code and creates additional penalties for independent contractor misclassification.

What is SB 459?

The new law adds two new sections to the California Labor Code (sections 226.8 and 2753) and applies to all employers. It creates civil penalties of between \$5,000 and \$25,000 for willful misclassifications of workers as independent contractors. These penalties are in addition to all other penalties and fines permitted by law. A "willful misclassification" is defined as "avoiding employee status for an individual by voluntarily or knowingly misclassifying that individual as an independent contractor". The new law also prohibits charging fees to or making deductions from the compensation paid to the misclassified workers if the fee or deduction would have been prohibited if the worker was an employee.

In addition to steep civil penalties for each violation, the new law requires any person or employer who willfully misclassifies a worker as a contractor to prominently display a notice on its website that states (1) it has committed a serious violation of the law by engaging in the willful misclassification of employees; (2) it has changed its business practices to avoid further violations; (3) that any employee who believes he or she is being misclassified may contact the Labor Workforce Development Agency; and (4) that the notice is being posted pursuant to a state order. The notice must be posted for one year and be signed by an officer of the company.

The California Labor Commissioner is charged with enforcement of the law, though employees may presumably bring enforcement actions on behalf of themselves and others under the Private Attorneys General Act.

[Click here](#) for the full text of SB 459 and the new Labor Code sections.



What is the difference between an independent contractor and an employee?

Independent contractors are self-employed and are not covered by employment and related tax laws or, typically, by company benefit plans. The law presumes that a worker is an employee and while there is no bright line rule for determining whether a worker is properly classified as a contractor, most tests center around three basic concepts:

- **Control:** If the company exercises enough control over the worker and the work performed (e.g. closely supervises worker, sets work hours, assigns specific tasks, provides specific direction on how and when to perform work), the worker likely should be classified as an employee.
- **Contractor's ability for profit and loss:** If the worker cannot hire assistants or subcontract out the work, uses the company's tools and/or equipment, is reimbursed for business expenses, cannot work for other companies simultaneously, and/or is paid an hourly wage or a salary as opposed to being paid by the project or job, the worker is more likely to be an employee.
- **Distinct Occupation:** If the worker is performing the same type of work as the company's employees, provides services that are integral to the company's regular business, is working on the company's premises, does not possess a specialized skill, and/or is working for the company for an extended period of time, the worker is more likely to be an employee.

What should companies do?

Companies should act fast to avoid the many potential consequences of misclassification, including those created under the new law. One preemptive measure is to conduct a privileged examination of the work forces to determine whether contractors are properly classified. If the company determines that some workers may be improperly classified, it can adjust the workers' relationship so that they are more likely independent contractors, cease the relationship, or convert the contractors to employees. Companies should also consider setting up strict requirements for hiring contractors and be vigilant in meeting those requirements. Companies may also choose to engage a third party to screen and hire its contractors, though the contract with the third party should include a strong indemnification clause to provide protection for the company in the case of alleged misclassification.