



Decision in Sleepy's Case a Wake Up Call for Employers Using Independent Contractors

Client Advisories

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On January 14, 2015, the New Jersey Supreme Court issued a decision which confirms the New Jersey Department of Labor's position that the very restrictive "ABC" test for independent contractor status must be used in resolving claims under the New Jersey wage and hour laws. Hargrove v. Sleepy's, LLC, NJ Sup. Ct., (A-70-12)(Jan. 14, 2015) (<http://www.judiciary.state.nj.us/opinions/supreme/A-70-12HargrovevSleepys.pdf>). This case should serve as another wake up call to New Jersey employers that classifying workers as independent contractors, rather than as employees, is disfavored under the law and will be subject to close scrutiny by state agencies and courts. As New Jersey employers get ready to supply IRS Form 1099s to those workers paid as independent contractors last calendar year, they should review each of these relationships to determine if they meet the high standard of the "ABC" test.

The Hargrove case got to the New Jersey Supreme Court by way of the United States Court of Appeals for the Third Circuit, which essentially asked the New Jersey Supreme Court for its position on this issue of New Jersey law. The plaintiffs in the underlying case delivered mattresses ordered by customers of the defendant, Sleepy's, LLC. The plaintiffs asserted that Sleepy's misclassified them as independent contractors, as opposed to employees, and that this misclassification caused them to lose money and benefits which they would have received had they been classified as employees. Although plaintiffs had signed an "Independent Driver Agreement," they claimed that this was just a ruse to avoid paying them properly, and that this failure violated New Jersey's wage and hour laws.

Originally, the federal trial court dismissed the lawsuit on summary judgment, applying the independent contractor test used for determining employee status under the Employee Retirement Income Security Act (ERISA) to determine that the plaintiffs were independent contractors. The plaintiffs then appealed to the Third Circuit, arguing that the trial court had erred, and that the proper test for determining employment status under the New Jersey Wage Payment Law was the "ABC" test set forth in the New Jersey Unemployment Insurance Law. Sleepy's argued that because the ABC test wasn't referenced under either the Wage Payment Law or the

Wage and Hour Law, the ABC test wasn't proper, and that the Court should apply the "economic realities" test used with respect to federal Fair Labor Standards Act (FLSA) cases. Various groups representing employer and employee interests submitted amicus briefs in this case urging the Supreme Court to adopt one or another of the many tests currently used to determine whether an employment relationship exists.

The Court determined that the same test should be used to determine the nature of an employment relationship under both the New Jersey Wage Payment Law and the New Jersey Wage and Hour Law, and that the standard adopted by the New Jersey Department of Labor, the "ABC" test, would be used to make employment status determinations under both laws.

The "ABC" test, set forth at N.J.S.A. 43:21-19(i)(6)(A)-(C), presumes an individual is an employee unless the employer can make certain showings regarding the individual employed, including:

(A) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and

(B) Such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and

(C) Such individual is customarily engaged in an independently established trade, occupation, profession or business.

It should be noted that "[T]he failure to satisfy any one of the three criteria results in an 'employment' classification." Carpet Remnant Warehouse, Inc. v. N.J. Dep't of Labor, 125 N.J. 567, 581 (1991). This is critical, because not only does the employer have the burden of proof, but the employer must satisfy each element of the test separately - the ABC test is not a three factor "balancing test" where a strong showing as to two factors can "make up" for failing the third.

Hargrove illustrates a very important fact for employers to consider when choosing to classify an employee as an independent contractor. There are a variety of different tests used to determine employment status which are used by courts and agencies under the various laws that cover the employer-employee relationship, and the results can be different depending on the test applied. Employers often rely on an analysis of a single test (and even that analysis is often only cursory) to support their decision to classify an individual as an independent contractor. Avoiding liability requires that employers understand and apply the most restrictive test applicable to their situation.

The "ABC" test is one of the most stringent tests for employment status - the most likely to yield a conclusion that a particular worker is not an independent contractor, but rather an employee. Part C of the test bears special mention here, as it is one where employers often make mistakes. It is not enough that a worker holds himself out as independent contractor, or even forms a corporation to demonstrate his independence - part C requires "an enterprise that exists and can continue to exist independently of and apart from the particular service relationship. The enterprise must be one that is stable and lasting -- one that will survive the termination



of the relationship.” Gilchrist v. Div. of Emp’tSec., 48 N.J. Super. 147, 158 (App. Div. 1957). Part C of the “ABC” test is only satisfied when an individual has a profession that will actually survive the termination of the challenged relationship. This means that satisfying part C is extremely difficult or even impossible where, as a factual matter, a worker is doing all or most of his or her work for a single company - even if this is result of the worker’s choice and not either an explicit or implicit requirement of the work..

Every employer that uses independent contractors would do well to consider each of those relationships and whether it meets the ABC test. The misclassification of employees as independent contractors can lead to a cascade of liabilities, including for unpaid minimum wage and overtime, unpaid unemployment contributions, failure to provide Workers’ Compensation coverage, and failure to make proper tax withholdings. While individually expensive, the liabilities can become insurmountable when compounded across multiple workers. The attorneys of Archer’s Labor and Employment Department are available to help you navigate this maze.If you have any questions about this advisory or other labor and employment matter, please contact any member of the **Labor and Employment Department** of Archer in Haddonfield, N.J., at (856) 795-2121; in Philadelphia, Pa., at (215) 963-3300; in Princeton, N.J., at (609) 580-3700; in Hackensack, N.J., at (201) 342-6000; or in Wilmington, Del., at (302) 777-4350.

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