

California Law Update

Cathy Arias and Erica Shelley Nelson

September 2006

EMPLOYER WARNING:

Business Ordered Closed Because It Misclassified Workers as Independent Contractors

On September 11, 2006, the Court of Appeals upheld a Department of Industrial Relations' (DIR) stop order and assessment of penalties against JKH Enterprises, Inc. (JKH) on the basis that JKH's drivers, who are responsible for making deliveries on JKH's behalf, should be properly classified as employees, as opposed to independent contractors, and that JKH failed to procure workers' compensation insurance.

Workers' Compensation Requirements Under California Law

Under California labor law, every employer except the State must provide worker's compensation insurance for the benefit of its employees. If an employer fails to secure the payment of compensation, a stop order closing the business will be issued and penalties assessed.

Factual Background

JKH operated a courier service business which picked up items from its customers and delivered to designated locations. JKH considered its drivers to be "independent contractors" and not "employees." Each driver acknowledged his or her status as an independent contractor in an application form. JKH's drivers used their own vehicles to make deliveries; paid for their own gas, car service and maintenance, and insurance; and used their own cell phones. Moreover, all drivers set their own schedules, chose their own driving routes, and were not supervised.

Despite this apparent independence, the DIR found that JKH's drivers should be classified as employees rather than independent contractors and issued a stop order closing JKH and assessed a \$15,000 (\$1,000 for each driver) penalty on the grounds that JKH failed to provide workers' compensation insurance to its employee drivers.

JKH challenged the DIR's decision and the Appellate Court agreed with the DIR. The Appellate Court declared that JKH's minimal control "was not considered dispositive because the work did not require a high degree of skill [and] the functions constituted the integral part of JKH's courier service business."

Critical Factors In Distinguishing Employees v. Independent Contractors For Purposes Of The California Workers' Compensation Act

In upholding the stop order and penalty, the Appellate Court reasoned that even if an employer does not exercise significant control over the details of the work, additional factors should be considered when classifying workers as employees versus independent contractors. These factors include:

- Whether there is a right to fire at will without cause;
- Whether the one performing services is engaged in a distinct occupation or business;
- The kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the principal or by a specialist without supervision;
- The skill required in the particular occupation;
- Whether the principal or the worker supplies the instrumentalities, tools, and the place of work for the person doing the work;
- The length of time for which the services are to be performed;
- The method of payment, whether by the time or by the job;
- Whether or not the work is a part of the regular business of the principal;
- Whether or not the parties believe they are creating an employer-employee relationship;
- Whether the classification of independent contractor is bona fide and not a subterfuge to avoid employee status;
- The hiree's degree of investment other than personal service in his or her own business and whether the hiree holds himself or herself out to be in business with an independent business license;
- Whether the hiree has employees;
- The hiree's opportunity for profit or loss depending on his or her managerial skill; and
- Whether the service rendered is an integral part of the alleged employer's business.

In affirming the trial court's order, that JKH's drivers are properly classified as employees, the Court of Appeals repeatedly distinguished between the legislated social policies underpinning an employer's obligation to provide workers' compensation insurance under the law versus the general torts concepts at play in the cases relied upon by JKH.

Based on this decision, employers should be particularly cautious in classifying workers as independent contractors for the purposes of decreasing the cost of doing business and increasing profits. We recommend that employers not only seek legal advice in order to assist in the handling of these issues preemptively, but also consider the above factors and the legislative social policies when determining how to classify their workers under California workers' compensation law.

Cathy Arias is the Chair of Burnham Brown's Employment Law Department and specializes in counseling and defending employers. She is also an experienced trial lawyer. Ms. Arias can be reached at 510.835.6806 or carias@burnhambrown.com.

Erica Shelley Nelson is a member of Burnham Brown's Employment Law Department and Transportation Department. Her practice focuses primarily on employment. She can be reached at 510.835.6712 or enelson@burnhambrown.com.