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New Jersey Raises the Stakes for Independent Contractor Use By Adopting Worker Classification Regulations

Independent contractor status in New Jersey is about to face even greater scrutiny. Effective October 1, new regulations from the New Jersey Department of Labor and Workforce Development will codify the interpretation of the "ABC test" for classifying workers as either employees or independent contractors under several New Jersey laws, including the Unemployment Compensation Law, Wage and Hour Law, and Wage Payment Law. For businesses that rely on independent contractors, the message is clear: The classification must hold up under the substance of the relationship, not just the title in an agreement or how the worker is paid.

What is the ABC test?

Although the ABC test itself is not new, the regulations are significant for New Jersey businesses as they convert decades of case law and agency enforcement positions into a detailed regulatory framework. The regulations make the existing test more concrete and, in many respects, more difficult for businesses to satisfy without careful documentation and well-structured independent contractor relationships. Simply calling a worker an independent contractor, issuing a Form 1099, or entering into an independent contractor agreement will not be enough to make a worker an independent contractor. Under the ABC test, a worker who performs services for pay is presumed to be an employee unless a business can prove all three prongs of the test:

- A. The worker is free from control or direction over the performance of the services.
- B. The services are either outside the usual course of the business or performed outside all its places of business.
- C. The worker is customarily engaged in an independently established trade, occupation, profession, or business.

Failure to satisfy any one prong means the worker is treated as an employee.

Prong A

To satisfy Prong A, a business must show both that it does not actually exercise control or direction over the work performed and that it does not reserve the right to control or direct the work. The following nine nonexhaustive factors will be assessed:

1. Whether the individual is required to work any set hours or jobs,
2. Whether the putative employer has the right to control the details and means by which the services are performed,
3. Whether the services must be rendered by the individual personally,
4. Whether the putative employer negotiates for and acquires the services performed by the individual,
5. Whether the individual's rate of pay is fixed by the putative employer,
6. Whether the individual bears any risk of loss for services performed,
7. Whether the individual is required to be on call, on standby, or otherwise available to perform services at set times determined by the putative employer, even if the individual does not actually perform services at such times,

8. Whether the putative employer limits the individual's performance of services for other parties, such as by limiting the individual's geographic area or potential clientele, and
9. Whether the putative employer provides training to the individual.

Prong B

Under Prong B, when determining whether the services performed are outside the usual course or place of an entity's business, a reviewing court or agency will examine whether the worker's services are part of what the business usually does, not just how it describes its business. They conduct a case-by-case analysis looking at the activities the business engages in as well as the location where the services are being performed. Locations that are outside of the business's physical plant may be among its places of business if they are where it conducts an integral part of its business. However, the regulations state that if an individual works remotely from his/her personal residence, that will not be considered the business's place of business.

Prong C

Prong C contemplates whether the worker is customarily engaged in an independently established business. Relevant factors include whether the worker has multiple customers, invests in his/her own tools or business infrastructure, sets his/her own rates, advertises his/her services, and earns meaningful income from sources other than the business at issue. Under this prong, the Department of Labor makes clear that formalities such as the existence of an independent contractor agreement or issuance of a Form 1099 alone will not be sufficient to establish independent contractor status. Nor is it sufficient for an individual to be free to work for others; rather, the individual must actually perform services for others and receive remuneration for such services during the relevant period.

The Significance of Employee vs. Independent Contractor Status

The distinction between employee and independent contractor status is crucial. Employees are generally entitled to wage and hour protections, overtime pay when applicable, wage payment protections, unemployment coverage, temporary disability and family leave insurance coverage, earned sick leave, and other statutory rights. Independent contractors, by contrast, are generally treated as separate businesses that are responsible for their own taxes, insurance, benefits, expenses, and business risk.

Misclassification can carry substantial consequences. If workers classified as independent contractors are later found to be employees, a business may face claims for unpaid wages, overtime, earned sick leave, unpaid payroll contributions, unemployment and temporary disability contributions, interest, civil penalties, liquidated damages, and attorney fees. The Department of Labor may also assess separate misclassification penalties, including penalties on a per-worker basis. In more serious cases, the Department of Labor may issue a stop-work order requiring the business to cease operations at the location where the violation exists, creating potential operational disruption in addition to monetary loss.

Bottom Line

New Jersey's ABC test remains one of the most demanding worker classification standards in the country and the new regulations provide a clearer roadmap to enforce it. Given this, businesses should use the time before the rules become operative on October 1 to review their independent contractor relationships to determine whether they can satisfy all three prongs of the ABC test and avoid the severe consequences of getting it wrong.

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