MEMORANDUM

TO: Interested Parties
FROM: Alida Kass, President & Chief Counsel
SUBJECT: S863
DATE: February 7, 2020

The Lame Duck session ended without legislation targeting independent contractors arriving on the governor's desk. However, the legislation has been reintroduced in the same form as it was when released from its second Senate Labor Committee meeting, now as S863.

The independent contractor coalition has been working towards a legislative solution that would clarify and update the standards by which individuals are classified as employees or contract workers. But before we can focus on solutions, we must first be clear on why legislation as introduced threatens wide range of legitimate freelance workers.

What is the Existing Standard?
There has been some confusion regarding what it means to codify existing law, and how that differs from codifying existing agency interpretation. When advocates and sponsors have claimed that the legislation would simply codify existing law, they have argued that workers currently in compliance with the law would remain in compliance under S863. The freelancers themselves have expressed concern that this codification would actually *change* the rules and rob them of their chosen livelihood.

The confusion stems from the competing interpretations that the courts and Department of Labor bring to the existing ABC test. Freelancers might comply with existing standards as reflected in the decisions of the New Jersey courts, and yet run afoul of the more restrictive interpretation of the Department of Labor. Although that DOL interpretation has been rejected by New Jersey Appellate Division and Supreme Courts, it continues to be applied in DOL adjudications.

The ABC Test
The New Jersey Unemployment Compensation Act has required individuals meet the ABC test since 1937. The ABC test is the most restrictive of the existing tests for worker classification. A minority of states use the ABC test, and several of those apply a more flexible variation. Pennsylvania is among the states requiring only the A and C prong, while other states like Virginia require A plus *either* B *or* C.

In the 2015 *Hargrove v. Sleepy's* decision, the New Jersey Supreme Court accepted the Department of Labor's 1995 regulation extending that statutory ABC test "with interpreting case law" to the Wage and Hour Law, as well as its "practice" of applying that same standard to the Wage Payment Law, holding the same ABC test would apply to all three laws. The Court's explanation cited several seminal state court decisions,

including *Carpet Remnant Warehouse, Inc. v. N.J. Dept. of Labor* and *Trauma Nurses, Inc. v. Board of Review, New Jersey Dept. of Labor.*

But the Department of Labor has persisted in applying an interpretation that is significantly more restrictive than what has been applied in the interpreting case law. The concern is that S863 would change the rules, codifying the more restrictive interpretation of the ABC test, which has been adopted in DOL adjudications, but which has been rejected by the New Jersey Appellate Division and Supreme Court.

DOL B Prong Interpretation:
According to the text of the ABC test, individuals can satisfy the B prong in two ways: if the individual's service is "outside the usual course of the business" *or* if the service is performed "outside all of the places of business." DOL interprets the second alternative to mean, essentially, that anywhere the freelance worker goes to perform a service is a "place of business" of the employer.

The New Jersey Supreme Court rejected that interpretation in *Carpet Remnant.* DOL had concluded that freelance carpet installers were at a "retailer's places of business" at "every geographical point of installation." The Court pointed out that "under that definition of 'places of business,' for a person to satisfy the B standard's second alternative would be practically impossible." Instead, the Court wrote, the phrase could refer only to those locations where the enterprise "has a physical plant or conducts an integral part of its business."

Garden State Fireworks, Inc. v. N.J. Dept. of Labor presented a scenario with remarkably analogous facts. Here, instead of a carpeting warehouse, with freelance workers signing up to install carpeting in consumers' homes, it was a fireworks warehouse, with freelance pyrotechnicians signing up to set up and conduct fireworks displays. The DOL applied the same circular logic that had been rejected in *Carpet Remnant*, this time labeling the places the worker goes to perform a service an "integral part of its business," and therefore a "place of business" of the retailer.

The Appellate Division rejected the word play as plainly inconsistent with *Carpet Remnant* – wrting that DOL's broad interpretation "*would render this required prong meaningless as the standard could never be met*." But as evidenced by a September 2019 adjudication, the DOL *continues* to apply the same rejected analysis, holding that for therapeutic foster care, the providers' own homes were "extensions" of the contracting entity's place of business.

Problem of S863:
Although the text of the B prong would not change under S863, the legislation would require that individuals establish "to the satisfaction of the Commissioner of Labor" that they meet the codified ABC test. Given the longstanding effort by DOL to limit the scope of the B prong to effectively eliminate the "place of business" defense, the concern is that this delegation language would be read as a decision by the legislature to adopt the DOL preferred interpretation over what has prevailed in court. Of course, eliminating the "place of business" defense is precisely the change that has sparked massive job losses, economic dislocation and chaos in California.

DOL C Prong Interpretation:
The C prong requires individuals be engaged in an "independently established trade, occupation, profession or business." Here, the New Jersey courts have focused on the likelihood that an individual will seek to collect unemployment benefits, should they lose the opportunity to work with a particular hiring entity.

The DOL has brought a more restrictive analysis to the test in two ways, both reflected in the two proposed changes to the test in S863.

The DOL has held individuals engaged in occupations or professions to a more restrictive standard than has been applied in courts – as reflected in S863 elimination of "trade," "occupation" or "profession" from the C prong test. The Court in *Sleepy's* held that the test is satisfied when an individual has a trade, occupation or profession "that will plainly persist despite the termination of the challenged relationship." It cited *Trauma Nurses*, which held that the "independent nature of their profession would survive" without the existence of the brokerage. And even though some of the nurses worked through only the one brokerage, those nurses *could* use "other services or brokers to obtain assignments." Contrary to those holdings, the DOL has found mental health professionals were not engaged in an "independently established business, occupation or trade" because they received a majority of their income from the one brokerage.

The DOL has also rejected "side gig" work – individuals who engage in part-time freelance work distinct from their full-time occupation. Pyrotechnicians in *Garden State Fireworks*, for example, worked with fireworks only a few weekends a year. All were either retirees or employed full-time in other occupations. But the DOL held the individuals had not established "a business or enterprise" that was "of the same nature" as that of the pyrotechnic work being performed. The appellate division rejected that approach, emphasizing that individuals who were otherwise fully employed could lose side contract work without risk of becoming unemployed.

Problem of S863:
The legislation would overturn both lines of C prong interpreting case law and replace it with the DOL's more restrictive, losing interpretation. S863 would strike the language recognizing occupations, trades and professions, which was the basis of the courts' analysis in *Carpet Remnant* and *Trauma Nurses*. It would instead require a "business or enterprise" – language which was used in the DOL adjudication of *Garden State Fireworks* but which was rejected by the appellate division.

S863 would also add the requirement that the business or enterprise be "of the same nature as that involved in the work being performed." This change would affect the availability of "side gig" contract work – another point on which the Department of Labor has brought a more restrictive interpretation than the courts. In *Garden State Fireworks*, for example, the DOL insisted that such an arrangement "does not equate to an independently established enterprise or business."

Again, the appellate division rejected that interpretation as an *unreasonable, arbitrary and capricious* reading of the law. The court emphasized that an individual otherwise fully employed could lose side contract work without any risk of their becoming unemployed, that it was independently established and therefore consistent with established law.

The interpretation is contrary to the holding of New Jersey courts. One also wonders how an entrepreneur could ever build a business under the DOL interpretation, if the requirement from the outset is a client base that can support the individual full time, and maintain that support even with the loss of any given client.

New Jersey as National Outlier:
California is the only state to have adopted the truncated B prong test and applied that standard to all employment statutes. And even California has not attempted to cut out independent trades, occupations and professions from the ABC test. The sky hasn't fallen yet in New Jersey, likely because DOL adjudications don't get widespread attention, and the agency overreach continues to be overturned in court. But if these losing standards become prevailing law, we need only look across the country to California to see the chaos and economic dislocation that will follow.