Fair Play Act Targets Commercial Trucking Industry

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The misclassification of employees as independent contractors has been a focal point for the New York State Department of Labor (NYSDOL). As part of New York's continuing effort to target worker misclassification, the state legislature has passed new legislation that targets the commercial trucking industry. The Commercial Goods Transportation Industry Fair Play Act (the act), which took effect April 10, 2014, creates a legal standard that will make it very difficult for the trucking industry to continue to lawfully utilize independent contractors.

Background

To fully appreciate the impact of the act, it is important to understand how the commercial trucking industry works and the prior status of the law. Typically, when a shipper wants materials transported by truck, it will negotiate a price for services with a transportation broker. The broker is usually an independent business that does not have its own drivers and is not an authorized motor carrier. The broker will contract with an authorized motor carrier to actually haul the load, since drivers are not permitted to transport goods unless operating under the authority of an authorized motor carrier.

The motor carrier often utilizes the services of an owner/operator, with an independent contractor agreement, to haul the load. The owner/operator is typically paid a negotiated percentage of the price received by the motor carrier. A dispatcher, usually employed by the motor carrier, communicates the shipper's instructions to the owner/operator, such as where and when to pick up and deliver the shipment.

There are many federal regulations that control this relationship. For example, the motor carrier is required to have a written lease agreement with the owner/operator if the load is being transported in equipment the motor carrier does not own, which is usually the case.

Federal regulations require that the lease agreement contain certain language that reserves the right of the motor carrier to exert control over the owner/operator. For example, the lease must state that the motor carrier maintains "exclusive possession, control, and use of the equipment for the duration of the lease." [i] Regulations also require the motor carrier to maintain liability and cargo insurance and the right to inspect the motor vehicle when contracting with owner/operators. Further, the owner/operator must display the motor carrier's logo while transporting a load. [ii]

The regulations also specifically state that owner/operators may still properly be classified as independent contractors despite a motor carrier lessee's compliance with federal law and the related administrative requirements. [iii] This is consistent with case law, which has held that limited control for the purpose of adhering to legal regulations does not create an employer-employee relationship. [iv] Nonetheless, New York's Workers' Compensation Appeal Board (WC Appeal Board) and Unemployment Insurance Appeal Board regularly issued decisions finding that motor carriers misclassified owner/operators as independent contractors by maintaining the limited control required by the federal regulations.

In 2011, motor carriers finally obtained some relief. In *Matter of Choto v. Consolidated Lbr. Transp.*, 82 A.D.3d 1369 (3d Dep't 2011), an owner/operator claimed he was an employee of the motor carrier and was therefore entitled to collect workers' compensation benefits. After an administrative hearing, the matter was appealed to the WC Appeal Board. The WC Appeal Board determined that the owner/operator was in fact an employee, relying heavily on the motor carrier's reservation of control over the owner/operator as required by federal regulations.

The appellate division reversed the WC Appeal Board, noting that under New York law, the factors relevant to determining whether an employer-employee relationship exists "include the right to control the claimant's work, the method of payment, the right to discharge, the furnishing of equipment and the nature of the work, and no single factor is dispositive." ˅ The court acknowledged that the transportation industry is heavily regulated and that a motor carrier's compliance with federal regulations cannot serve as the basis of a finding of employee status. The court further noted that a motor carrier dispatcher advising an owner/operator of where and when to pick up and deliver a load is not dispositive of whether there is employee status.

Matter of Choto clarified that motor carriers may properly classify owner/operators as independent contractors provided they do not exert control over them beyond what is required by law, rule or regulation. Many motor carriers were relieved by this decision, which provided clear and binding authority as to how to properly structure the owner/operator relationship to avoid misclassification liability. Their relief was short lived, however, as on Jan. 10, 2014, Gov. Andrew M. Cuomo signed the act into law.

The Act

The act created Article 25-C of the New York Labor Law. Most troubling for motor carriers, the act creates a legal presumption that any person who transports commercial goods for a commercial goods transportation contractor is an employee unless one of two tests is fully satisfied. The term "commercial goods transportation contractor" is broadly defined in the act to essentially include any business or person that compensates a driver with a state driver's license who transports goods in New York and operates a commercial motor vehicle.

For owner/operators to legally qualify as independent contractors under the act, their compensation must be reported on a Federal Income Tax Form 1099 and they must either qualify as a "separate business entity" or pass what is commonly called the "ABC test." The fact that a motor carrier and owner/operator agree in writing that there is an independent contractor relationship will not avoid liability for misclassification.

To qualify as a separate business entity, an owner/operator must be a sole proprietor, partnership, corporation or other entity that satisfies an 11-part test. The 11 criteria, all of which must be met in order for the driver to qualify as an independent contractor, are summarized as follows:

(1) the owner/operator is free to determine on its own the means and manner of providing services, limited only by requirements to meet the desired result or federal rule or regulation;

(2) the business entity can continue to exist even if its relationship with the contractor ends;

(3) the owner/operator has substantial capital investment in the business entity beyond ordinary tools and equipment;

(4) the business entity owns or leases the capital goods and bears the risk of loss and profit;

(5) the business entity is free to perform services to others and the general public on a continuing basis;

(6) the business entity receives a 1099 for services provided to the contractor;

(7) there is a written contract between the business entity and contractor, specifying their relationship as independent contractors or separate business entities;

(8) if the services require a license or permit, the business entity pays for the license or permit under its own name, or, where permitted by law, pays for reasonable use of the contractor's license or permit;

(9) the business entity may hire its own employees without contractor approval, subject to applicable statutory or regulatory requirements, and the business entity pays its employees directly without reimbursement from the contractor;

(10) the business entity is not required to presents itself as an employee of the contractor; and

(11) the business entity is free to perform similar services for others on whatever basis and whenever it chooses. [vi]

While the act is new, the elements of the separate business entity test are generally consistent with the holding in *Matter of Choto*, particularly since the act contains a carve out allowing a motor carrier to retain control over owner/operators provided such control is required by law, rule or regulation. However, the legal presumption of employee status is significant, leaving it unclear whether *Matter of Choto* remains entirely good law.

More specifically, *Matter of Choto* recognized that some degree of control beyond federal regulations could exist in an independent contractor relationship, such as a dispatcher communicating to owner/operators where and when to pick up and deliver loads. Because of the new statutory presumption, however, such limited control is now arguably dispositive of employee status. This is problematic for motor carriers who, as a practical matter, must use dispatchers to meet their customers' needs.

'ABC' Test

A motor carrier that is unable to meet the 11-part separate business entity test may still rely on the three-part "ABC" test to qualify owner/operators as independent contractors. Under the ABC test, first, the driver must be free from the control and direction of the contractor in performing services, both in the contract and in its application. Second, the service provided by the driver must be different from the services provided by the contractor or otherwise not part of the usual business of the contractor. Third, the driver must be customarily engaged in carrying out the same services as an independent established trade or profession rather than simply working for the contractor. Finally, although not separately listed in the ABC test, the owner/operator must receive a Form 1099 for compensation received for services.

The first part of the ABC test has been frequently litigated and should not be difficult for attorneys to analyze. The second and third elements, however, are somewhat ambiguous and are not defined by statute or regulation. While those elements are also found in similar statutes such as the New York State Construction Industry Fair Play Act, there are no published opinions analyzing their meaning. Thus, it remains challenging for attorneys to counsel clients on compliance with the test.

Violations

As a final point, employers should be aware that all commercial goods transportation companies are required to display a poster prepared by the NYSDOL regarding the act. The poster, which is available on the NYSDOL's website, must be prominently displayed in an accessible location where commercial goods transportation activity occurs. Even if a company classifies all drivers as employees, it must still display the poster. Employers should also be cautioned that the act prohibits retaliation of any kind against individuals who report alleged violations.

The potential consequences of a violation are serious. Violations of the act will trigger liability for unpaid unemployment and workers' compensation insurance contributions as well as business, corporate and personal tax liabilities. Such liability can be significant, as many owner/operators receive revenue through a contractor relationship that is much higher than what employee drivers are paid. The NYSDOL will generally treat all such revenue as unreported income for purposes of determining owed unemployment and workers compensation contributions, resulting in an over inflation of wages upon which the assessment is based.

Additionally, violations of the act may result in civil and criminal liability. A first violation may result in a $1,500 penalty, with a $5,000 penalty for each subsequent violation. If it is determined that the employer willfully violated the law, a penalty of up to $2,500 is authorized for the first violation, with a $5,000 penalty for each subsequent violation, per employee, within a five year period. Affiliated entities are generally liable for civil penalties as well.

Willful violations can result in criminal liability and increased fines as well as debarment from public works contracts for one year. An officer or a shareholder who owns or controls at least 10 percent of the outstanding stock of a corporation and who knowingly permits a willful violation is personally subject to the civil and criminal penalties.

It is critical for motor carriers and brokers to review their written contracts and evaluate actual day-to-day relationships with owner/operators for compliance with the act. Too often, companies wait until after a claim has been filed or an audit begins to address this issue. There is incredible value in companies being proactive by conducting self-audits and examining contracts well before a complaint is filed or an investigation begins.

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Endnotes:

[i] 49 C.F.R. §376.12.
[ii] See 49 U.S.C. §14102; 49 C.F.R. §§376.11-12.
[iii] 49 C.F.R. §376.12(c)(4).

[iv] See *Matter of Charles W. Wannen*, 57 A.D.3d 1029 (3d Dept. 2008).
[v] *Matter of Choto*, 82 A.D.3d at 1369.
[vi] See N.Y. Labor Law §862-b.

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