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INSURANCE AGENT FOR NORTHWESTERN MUTUAL FOUND TO BE INDEPENDENT CONTRACTOR, NOT EMPLOYEE

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This article discusses a favorable ruling for insurance companies on the issue of independent contractor misclassification. The court held that Northwestern Mutual Life Insurance Company had not misclassified as an independent contractor a life insurance agent who alleged that he was an "employee" under the New Jersey Wage Payment Law.

In a very favorable ruling for insurance companies, a federal district court recently held that Northwestern Mutual Life Insurance Company had not misclassified as an independent contractor ("IC") a life insurance agent who alleged that he was an "employee" under the New Jersey Wage Payment Law. This decision comes soon after another favorable ruling for insurance companies in a case closely watched by the entire industry—an opinion by the U.S. Court of Appeals for the Sixth Circuit holding that agents for American Family Insurance were ICs and not employees under ERISA. This decision may be more meaningful than the *American Family* case because the test for IC status under ERISA is far less challenging for companies to meet than the test for IC status under the New Jersey Wage Payment Law. On the other hand, the evidence in this *Northwestern Mutual* case was far stronger for IC status than was the evidence in the *American Family* case. Thus, while insurance companies should gain comfort from this new decision, the risk of a game-changing decision adversely affecting another carrier cannot be ignored. There is, however, a great deal that companies in this industry and other business sectors can do to shore up their IC compliance in the meantime, as discussed at the last section of this article.To date, the majority of court decisions addressing cyber losses primarily involve three separate lines of coverage: comprehensive general liability ("CGL"), crime/fidelity, and cyber insurance. These decisions provide a starting point for determining whether a particular cyber-related claim is covered by insurance.

The Facts

For about 15 years, the plaintiff, Fred Walfish, was a Northwestern Mutual financial representative, but in 2010 he entered into a new relationship with a general agency owned and operated by a general agent, Robert Seery, doing business as the Seery Agency. From 2010 on, the plaintiff sold insurance under a contract with the Seery Agency and filed taxes as a sole proprietorship called Fred Walfish Insurance. During that time, he sold both Northwestern Mutual policies as well as the policies of about 20 other companies to his clients. Walfish received no more than one-third of his overall commissions from Northwestern products.

Walfish rented an office from the Seery Agency and later its successor. He had "not a clue" as to how much time he spent in this rented office and how much time he spent out in the field. Walfish failed to sell a minimum number of Northwestern policies in 2015, and by June 2016 he was no longer associated with Northwestern Mutual. Walfish, however, continued to sell insurance to his clients and operate Fred Walfish Insurance thereafter.

Walfish brought a proposed class action lawsuit against Northwestern Mutual alleging that it violated the New Jersey Wage Payment Law by making expense deductions from his commissions and the commission payments of other Northwestern Mutual agents. He alleged that the company exercised substantial control over the performance of his work and that under the employee-friendly ABC test for IC status in New Jersey articulated in 2015 by the New Jersey Supreme Court in the *Sleepy's* case, the company cannot establish each of the three prongs of the so-called ABC test used for IC status in that state.

The Court's Decision

Both parties each made motions for summary judgment. Judge William J. Martini of the U.S. Court for the District of New Jersey granted Northwestern Mutual's motion and denied Walfish's.

As to the first prong of the ABC test, which requires that the defendant establish that the individual in question "has been and will continue to be free from control or direction over the performance of … service, both under his contract of service and in fact," the court noted that a worker must allege control other than control required by regulatory authorities. It therefore discounted "control" that was simply imposed upon Walfish "to ensure regulatory compliance," such as requirements that he maintain his insurance agent license, provide accurate marketing materials to his clients, and keep accurate records.

As to the requirement that the agent maintain minimum sales, the court found that this was a sales incentive structure, not a form of control over the agent's performance. Similarly, as to the allegation that the company required Walfish to deal exclusively in Northwestern Mutual products, the evidence showed that he derived substantial income from non-Northwestern business. Finally, as to the argument that the company exercised control by requiring attendance at annual meetings, such control was *"de minimis"* in the court's view.

Prong B is a two-part prong in New Jersey: the company must establish that the service is "either outside the usual course of the business for which the 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." The B prong is "disjunctive," meaning that a company need only prove one or the other part of the second prong to satisfy this segment of the test.

The court's decision is unclear on the "usual course" part of prong B. In one part of the opinion, the court noted that the evidence is in dispute as to whether Northwestern Mutual "sells" insurance or not, but then seemingly concluded that the company does not "sell" insurance. But the decision is crystal clear on the "location-of- work" part of prong B, holding that Walfish did not "regularly report to any Northwestern office."

Finally, as to prong C, which requires the defendant to establish that the individual "is customarily engaged in an independently established trade, occupation, profession or business," the court found that Northwestern met its burden as to this prong as well. In particular, the court found that Walfish operated his own business as a sole proprietorship, received income from about 20 different insurance companies, took tax deductions related to the operation of a business, and continued to operate his insurance business after his relationship with Northwestern Mutual ended.

Analysis and Takeaways

There are few IC misclassification cases that have stronger facts favoring IC status than the facts in this case—regardless of the test being used under federal or state law. New Jersey's ABC test is far more challenging for a company to meet than any federal test for IC status, and more challenging than any other state IC standards other than the test in Massachusetts (which has been interpreted to exclude real estate salespersons) and California (which is currently limited to so-called wage claims). In those two states, the B prong of their ABC tests is not a two-part "disjunctive" prong as noted above for New Jersey. Rather, the IC test in those two states contains a prong B that has only one part: it requires the company to prove that the service being provided by the worker in question is "outside the usual course of the [company's] business."

Even though the ABC tests in Massachusetts and California are the most employee-friendly in the U.S., there are legitimate ways to maintain an IC business model in those states, other than by reclassifying ICs as employees.

In the *Northwestern Mutual* case, the federal court may well have decided the "usual course" factor was satisfied when it seemingly held that Northwestern did not "sell" insurance. But, there is some question whether California or Massachusetts, or for that matter other states with a similar ABC test, would follow the same form of logic that Judge Martini did to determine if the insurance agent performed services outside of the usual course of the company's business; that is, determining if Northwestern (like Walfish) actually "sells" insurance. The judge's analysis and reasoning makes perfect sense. Unfortunately, courts in other states have applied their ABC tests in ways that defy common sense.

So, what should a company in the insurance business (or a company in any other industry) do to best minimize these types of lawsuits and maximize their chances of success if they are sued for IC misclassification? Instead of simply hoping that the plaintiff's factual allegations are as weak as they were in the *Northwestern Mutual* case, many companies have resorted to a process such as IC Diagnostics, which enhances compliance with IC laws by restructuring, re-documenting, and re-implementing their IC relationships in a customized and sustainable manner without any change in a company's business strategy or business model. Where the company is in the insurance industry, the process should be keyed to federal and state regulatory requirements.

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