

**MISCLASSIFICATION OF EMPLOYEES:
EXAMINING THE COSTS TO WORKERS,
BUSINESSES, AND THE ECONOMY**

HEARING

BEFORE THE

SUBCOMMITTEE ON WORKFORCE PROTECTIONS

COMMITTEE ON EDUCATION
AND LABOR

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

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**MISCLASSIFICATION OF EMPLOYEES:
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**Thursday, September 26, 2019
House of Representatives,
Subcommittee on Workforce Protections,
Committee on Education and Labor,
Washington, DC**

The subcommittee met, pursuant to call, at 10:19 a.m., in Room 2175, Rayburn House Office Building, Hon. Alma S. Adams [chairwoman of the subcommittee] presiding.

Present: Representatives Adams, DeSaulnier, Takano, Wild, Stevens, Byrne, Walker, Cline, Wright, and Keller.

Also Present: Representatives Scott, Norcross, and Foxx.

Staff Present: Tylease Alli, Chief Clerk; Ilana Brunner, General Counsel; Sharit Cardenas, Labor Policy Fellow; Emma Eatman, Press Assistant; Eli Hovland, Staff Assistant; Eunice Ikene, Labor Policy Advisor; Stephanie Lalle, Deputy Communications Director; Jaria Martin, Clerk/Assistant to the Staff Director; Kevin McDermott, Senior Labor Policy Advisor; Richard Miller, Director of Labor Policy; Max Moore, Office Aid; Merrick Nelson, Digital Manager; Udochi Onwubiko, Labor Policy Counsel; Veronique Pluviose, Staff Director; Banyon Vassar, Deputy Director of Information Technology; Jonathan Walter, Labor Policy Fellow; Joshua Weisz, Communications Director; Rachel West, Senior Economic Policy Advisor; Cyrus Artz, Minority Parliamentarian; Courtney Butcher, Minority Director of Member Services and Coalitions; Akash Chougule, Minority Professional Staff Member; Cate Dillon, Minority Staff Assistant; Rob Green, Minority Director of Workforce Policy; Dean Johnson, Minority Staff Assistant; Jeanne Kuehl, Minority Legislative Assistant; John Martin, Minority Workforce Policy Counsel; Hannah Matesic, Minority Director of Operations; Audra McGeorge, Minority Communications Director; Carlton Norwood, Minority Press Secretary; Brandon Renz, Minority Staff Director; and Ben Ridder, Minority Professional Staff Member, and Lauren Williams, Minority Professional Staff Member.

Chairwoman ADAMS. Good morning, the Subcommittee on Workforce Protections will come to order. Welcome to everyone. I note that a quorum is present. So I also note for the subcommittee that Mr. Norcross of New Jersey is permitted to participate in the hear-

ing today with the understanding that his questions will come only after all Members of the Workforce Protection Subcommittee on both sides of the aisle who are present have an opportunity to question the witnesses.

The subcommittee is meeting today in a legislative hearing to hear testimony on misclassification of employees and its cost to workers, businesses, and the economy.

Pursuant to Committee Rule 7(c), opening statements are limited to the Chair and the Ranking Member. This allows us to hear from our witnesses sooner and provides all Members with adequate time to ask questions.

I recognize myself now for the purpose of making an opening statement.

Today we are gathered to discuss worker misclassification, a pervasive problem that imposes significant cost to workers, businesses, and our economy. When a worker who should be an employee under the law is categorized anything else, such as an independent contractor, there is misclassification. And this misclassification is too often used as a cost cutting strategy by low road employers to gain an unfair competitive advantage. And while we do need more up to date comprehensive national research on misclassification, we know from available data that a significant portion of the U.S. workforce may be affected. As our witnesses will testify, this has severe consequences for workers.

The Fair Labor Standards Act has a broad employment standard that helps ensure a wide range of workers have basic wage and hourly protections. This year our committee has passed legislation to strengthen these protections so that hardworking Americans are paid fairly for their labor. This includes passing an increase to the minimum wage out of the House for the first time in more than a decade.

This subcommittee has also sought to hold the Administration accountable for promoting weak overtime protections. When workers are misclassified, they lose out on these and other protections that ensure workers are paid for the hours that they work. This can translate into a significant income loss for low wage workers. For example, in 2012 the Wage and Hour Division recovered roughly \$250,000 in unpaid overtime and minimum wages for 75 workers who were misclassified by a cleaning company, the equivalent of nearly 3 months of earnings.

And misclassification is not only bad for workers, it also harms businesses that classify the employees lawfully by providing bad actors an unfair advantage. Estimates show that employers can save as much as 30 percent on payroll and related taxes by misclassifying workers. And as we will hear from our witnesses, law abiding businesses who want no part of misclassification schemes are forced to compete against low road employers who use misclassification as a strategy to undercut their competitors by evading basic labor protections.

Finally, worker misclassification harms our economy. Available data show that misclassification deprives our government of badly needed tax revenue that could be spent on our communities. According to the 2009 GAO report, roughly 15 percent of employers misclassified 3.4 million workers in 1984. In that year alone,

misclassification cost the Federal Government \$1.6 billion in lost tax revenue. Adjusted for inflation, that is \$3.72 billion today.

Conversation around misclassification is nothing new. A Department of Labor Commission report from nearly 20 years ago indicated that anywhere between 10 and 30 percent of employers in audited states misclassified at least 1 of their workers. For decades unscrupulous employers have tried to cut labor costs by treating workers who should be considered employees under the law as anything but employees.

The evidence is clear that misclassification violates workers' rights, damages law abiding businesses, and increases the burden on taxpayers. State governments across the country and across the political spectrum, from the District of Columbia to Missouri, have taken bipartisan steps toward combating misclassification. And over the last several years at least 20 states have enacted laws to more effectively combat misclassification and more than 15 states have initiated innovative government taskforces to do the same. As states take the lead, the Federal Government must also do its part to uphold worker protections and defend the many employers who play by the rules.

And that is why Congress must pass the Payroll Fraud Prevention Act. This legislation would help reduce misclassification by requiring employers to accurately classify their workers and to provide all workers they hire with a written notice of their classification. The bill would hold employers accountable for misclassification by establishing civil penalties for violations and extend the private right of action to misclassified employees to recover lost wages.

The bill would also improve the detection of misclassification by directing the Wage and Hour Division to conduct audits of industries with frequent incidents of misclassification.

Each of us in this room has a responsibility to ensure that workers are properly treated as employees when in fact they are employees and provided the protections that they are guaranteed under the law.

Today's hearing is an opportunity for this committee to come together, build upon state level efforts and take concrete bipartisan steps toward improving the lives of workers across the country.

I want to thank the witnesses for their testimony and express my appreciation for taking the time to be with us today.

I now recognize the distinguished Ranking Member for the purpose of making an opening statement.

[The statement by Chairwoman Adams follows:]

**Prepared Statement of Hon. Alma S. Adams, Chairwoman,
Subcommittee on Workforce Protections**

Today, we are gathered to discuss worker misclassification, a pervasive problem that imposes significant costs to workers, businesses, and our economy.

When a worker who should be an employee under the law is categorized as anything else, such as an independent contractor, there is misclassification.

And this misclassification is too often used as a cost cutting strategy by low-road employers to gain an unfair competitive advantage.

While we do need more up-to-date, comprehensive national research on misclassification, we know from available data that a significant portion of the U.S. workforce may be affected.

As our witnesses will attest, this has severe consequences for workers.

The Fair Labor Standards Act has a broad employment standard that helps ensure a wide range of workers have basic wage and hour protections.

This year, our committee has passed legislation to strengthen these protections so that hardworking Americans are paid fairly for their labor.

This includes passing an increase to the minimum wage out of the House for the first time in more than a decade.

This subcommittee has also sought to hold the Administration accountable for promoting weak overtime protections.

When workers are misclassified, they lose out on these and other protections that ensure workers are paid for the hours they work.

This can translate into a significant income loss for low-wage workers.

For example, in 2012, the Wage and Hour Division recovered roughly \$250,000 in unpaid overtime and minimum wages for 75 workers who were misclassified by a cleaning company—the equivalent of nearly three months of earnings.

And misclassification is not just bad for workers, it also harms businesses that classify their employees lawfully by providing bad actors an unfair advantage.

Estimates show that employers can save as much as 30 percent on payroll and related taxes by misclassifying workers.

As we will hear from our witnesses, law-abiding businesses who want no part of misclassification schemes are forced to compete against low-road employers who use misclassification as a strategy to undercut their competitors by evading basic labor protections.

Finally, worker misclassification harms our economy.

Available data shows that misclassification deprives our government of badly needed tax revenue that could be spent on our communities.

According to a 2009 GAO report, roughly 15 percent of employers misclassified 3.4 million workers in 1984.

In that year alone, misclassification cost the federal government \$1.6 billion in lost tax revenue. Adjusted for inflation, that is \$3.72 billion today.

The conversation around misclassification is nothing new.

A Department of Labor-commissioned report from nearly 20 years ago indicated that anywhere between 10 and 30 percent of employers in audited states misclassified at least one of their workers.

For decades, unscrupulous employers have tried to cut labor costs by treating workers who should be considered employees under the law as anything but employees.

The evidence is clear that misclassification violates workers' rights, damages law-abiding businesses, and increases the burden on taxpayers.

State governments across the country and across the political spectrum, from the District of Columbia to Missouri, have taken bipartisan steps towards combatting misclassification.

Over the last several years, at least 20 states have enacted laws to more effectively combat misclassification and more than 15 states have initiated innovative government taskforces to do the same.

As states take the lead, the federal government must also do its part to uphold worker protections and defend the many employers who play by the rules.

That is why Congress must pass the Payroll Fraud Prevention Act.

This legislation would help reduce misclassification by requiring employers to accurately classify their workers and to provide all workers they hire with a written notice of their classification.

The bill would hold employers accountable for misclassification by establishing civil penalties for violations and extend a private right of action to misclassified employees to recover lost wages.

The bill would also help improve the detection of misclassification by directing the Wage and Hour Division to conduct audits of industries with frequent incidents of misclassification.

Each of us in this room has a responsibility to ensure that workers are properly treated as employees, when in fact they are employees, and provided the pay protections they are guaranteed under law.

Today's hearing is an opportunity for this Committee to come together, build upon state-level efforts, and take concrete, bipartisan steps towards improving the lives of workers across the country.

I want to thank the witnesses for their testimony and express my appreciation for taking the time to be with us today.

I now yield to the Ranking Member, Mr. Byrne, for an opening statement.

Mr. BYRNE. Thank you, Madam Chairwoman, for yielding.

This subcommittee has jurisdiction over the Fair Labor Standards Act, which offers protections to more than 143 million workers in this country every day. Today the Majority has scheduled this hearing to examine how workers are classified under the Fair Labor Standards Act, in particular, the challenges and implications of determining whether worker is an employee who works for a business, an independent contractor who works for themselves but provides services to a business, or a worker who is employed by a separate business.

To compete in our modern and ever-changing economy, companies and individuals are seeking flexible workforce arrangements. We hear about that a lot in this committee. Workers recognize and seek out the benefits and flexibility these arrangements provide as they can significantly improve the quality of life for many workers, as well as their families. This is a growing trend among American workers that should be encouraged, not impeded.

I have two members of my family who have chosen to be independent contractors so that they can have that flexibility. We do not want to impede that, we want to encourage that. Many businesses who also value flexibility are turning to these independent contractors. The use of independent contractors makes sense for many job creators to obtain high quality services and for many workers who want to offer their skills on their own terms, and for consumers who benefit from a reduction in the cost of goods and services.

The overwhelming majority of businesses follow the law and want to do what is expected of them. Sometimes it seems we as policy makers make it harder than it needs to be for that to happen.

Which brings me to the Democrats' purported solution, the Payroll Fraud Prevention Act of 2019. This proposed legislation would amend the Fair Labor Standards Act to radically expand reporting mandates for employers and create new and punitive penalties for misclassifying employees. In other words, the legislation will increase the legal risk to business owners and make it too costly for them to use independent contractors to provide services. In fact, all workers providing services to a business will get swept up in the extreme mandates in this bill, not only independent contractors, but also sub-contractor employees, vendor employees, caterers, delivery drivers, taxi drivers, and others. Tying the hands of independent contractors and other service providers with excessive bureaucratic red tape will also increase the cost for consumers and will limit work opportunities for individuals who desire flexibility or who want to work on their own terms, which is increasingly the case in our workforce, especially among younger people, especially among women.

The Fair Labor Standards Act already has strong remedies in place for employers who misclassify workers and violate minimum wage and overtime requirements. All workers should be paid in full for their work. That is why we committee Republicans support enforcement of the Fair Labor Standards Act as written. We shouldn't penalize Americans who work for themselves or companies for

doing business with them. Instead, we should applaud these Americans for their entrepreneurial spirit.

The draft bill we examine today is lacking in many ways and adds additional complexity to what is already a complicated area of law, which is demonstrated by the fact that the bill would apply to all types of business relationships that I am sure were unintended. Instead of considering an unworkable bill that will damage workers and business, we should be discussing how to modernize the Fair Labor Standards Act and bring it into the 21st century, something I have been calling for a long time. Our laws do not match the workplace of the 21st century.

Finally, I find it interesting that the issue we are discussing in today's hearing was also a primary focus of a bill that this committee approved yesterday, which would turn the independent contractor classification on its head. There was an additional Democrat amendment yesterday offered which would further muddy the waters for independent contractors. It appears to me that committee Democrats decided on their preferred approach, which makes me question the purpose of today's meeting. It seems to me the decision has already been made and this hearing is a fig leaf for the decision that was made and acted on by the full committee yesterday.

I do thank the witnesses for being here and I look forward to their testimony.

And I thank you for yielding, Madam Chairman.

[The statement by Mr. Byrne follows:]

**Prepared Statement of Hon. Bradley Byrne, Ranking Member,
Subcommittee on Subcommittee on Workforce Protections**

This Subcommittee has jurisdiction over the Fair Labor Standards Act (FLSA), which offers protections to more than 143 million workers in this country every day. Today, the Majority has scheduled this hearing to examine how workers are classified under the FLSA—in particular, the challenges and implications of determining whether a worker is an employee who works for a business, an independent contractor who works for themselves but provides services to a business, or a worker who is employed by a separate business.

To compete in our modern and ever-changing economy, companies and individuals are seeking flexible workforce arrangements. Workers recognize and seek out the benefits and flexibility these arrangements provide as they can significantly improve the quality of life for many workers as well as their families. This is a growing trend among American workers that should be encouraged, not impeded. Many businesses who also value flexibility are turning to independent contractors.

The use of independent contractors makes sense for many job creators to obtain high-quality services, and for many workers who want to offer their skills on their own terms, and for consumers who benefit from a reduction in the cost of goods and services.

The overwhelming majority of businesses follow the law and want to do what is expected of them. Sometimes, it seems, we as policymakers make it harder than it needs to be for that to happen, which brings me to the Democrats' purported solution, the Payroll Fraud Prevention Act of 2019.

This proposed legislation will amend the FLSA to radically expand reporting mandates for employers and create new and punitive penalties for misclassifying employees.

In other words, the legislation will increase the legal risks to business owners and make it too costly for them to use independent contractors to provide services. In fact, all workers providing services to a business will get swept up in the extreme mandates in this bill, not only independent contractors but also subcontractor employees, vendor employees, caterers, delivery drivers, taxi drivers, and others. Tying the hands of independent contractors and other service providers with excessive bureaucratic red tape will also increase costs for consumers and will limit work oppor-

tunities for individuals who desire flexibility or who want to work on their own terms.

The FLSA already has strong remedies in place for employers who misclassify workers and violate minimum wage and overtime requirements. All workers should be paid in full for their work. That is why Committee Republicans support enforcement of the FLSA.

We shouldn't penalize Americans who work for themselves or companies for doing business with them. Instead we should applaud these Americans for their entrepreneurial spirit.

The draft bill we are examining today is lacking in many ways and adds additional complexity to what is already a complicated area of law, which is demonstrated by the fact that the bill would apply to all types of business relationships that I am sure were unintended. Instead of considering an unworkable bill that will damage workers and businesses, we should be discussing how to modernize the FLSA and bring it into the 21st century.

Finally, I find it interesting that the issue we are discussing in today's hearing was also a primary focus of a bill that the committee approved yesterday, which would turn the independent contractor classification on its head. There was an additional Democrat amendment offered which would further muddy the waters for independent contractors. It appears to me that Committee Democrats decided on their preferred approach, which makes me question the purpose of today's hearing.

However, I thank the witnesses for being here and I look forward to their testimony.

Chairwoman ADAMS. And thank you very much.

Without objection, all Members who wish to insert written statements into the record may do so by submitting them to the Committee Clerk electronically in Microsoft Word format by 5:00 p.m. on Wednesday, October 9, 2019.

At this time I want to introduce our witnesses. First of all, we have Miss Sally Dworak-Fisher who is an attorney at the Public Justice Center, a nonprofit legal organization in Maryland whose mission is pursuing systemic change to build a more just society. Ms. Dworak-Fisher leads the PJC's workplace justice project where she is litigating cases under the Fair Labor Standards Act, Maryland wage laws, and has led policy efforts to expand and improve protections for low wage workers and victims of wage theft.

Mr. Alexander Passantino is a member of the DC office, leader for Seyfarth Shaw, LLP's Wage and Hour Litigation Practice Group, a former acting administrator of the U.S. Department of Labor's Wage and Hour Division. Mr. Passantino focuses his practice on all aspects of wage and hour law and represents employers before the United States Department of Labor.

Mr. Matt Townsend is the chief executive officer of OCP Contractors, an interior systems contractor with offices in Cleveland, Columbus, and Toledo, Ohio. Mr. Townsend is testifying in his capacity as president of the Signatory Wall and Ceiling Contractor's Alliance, a national association representing construction company owners who employ tens of thousands of carpenters, drywall finishers, plasterers, and laborers throughout the United States.

Mr. Alexander M. Chemers is a shareholder in the Los Angeles office of Ogletree, Deakins. Mr. Chemers defends employers against wage and hour claims, ranging from single plaintiff administrative proceedings to class actions involving thousands of putative class members.

Miss Maria Crawford is from Altadena, California, proud wife of 25 years, mother of 2 adult daughters, grandmother of 2 beautiful granddaughters. Maria is an outspoken leader among gig workers,

saying technology is a source of opportunity that is not contingent on unfair labor standards.

Attorney General Karl A. Racine is the first elected attorney general for the District of Columbia. He has prioritized data driven juvenile justice reform, consumer protection efforts, aimed at assisting the District's most vulnerable residents, measures to advance democracy and safeguard public integrity, and legal actions to protect affordable housing in communities across the District.

Welcome to all of you. We appreciate all of the witnesses for being here today and look forward to your testimony. And let me remind the witnesses that we have read your written statements and they will appear in full in the hearing record.

Pursuant to Committee Rule 7(d) and committee practice, each of you is asked to limit your oral presentation to a five minute summary of your written statement.

Let me remind the witnesses that pursuant to Title 18 of the U.S. Code Section 1001, it is illegal to knowingly and willfully falsify any statement, representation, writing, document or material fact presented to Congress, or to otherwise conceal or cover up a material fact.

Before you begin your testimony please remember to press the button on the microphone in front of you so that it will turn on and Members can hear you. As you begin to speak the light in front of you will turn green. After 4 minutes the light will turn yellow to signal that you have 1 minute remaining. When the light turns red your five minutes have expired and we ask that you please wrap up your comments.

So we will let the entire panel make their presentations before we move to Member questions. When answering a question, please remember once again to turn on your microphone.

I am going to first recognize Miss Dworak-Fisher for her testimony.

TESTIMONY OF SALLY DWORAK-FISHER, ATTORNEY, PUBLIC JUSTICE CENTER

Ms. DWORAK-FISHER. Good morning, Chairwoman Adams, Members of the committee. Thank you for allowing me the opportunity to testify today.

My name is Sally Dworak-Fisher and I am an attorney at the Public Justice Center in Maryland. I lead our workplace justice project, which litigates cases involving the failure to pay wages under the Fair Labor Standards Act, or FLSA, and Maryland wage laws.

We primarily represent low wage workers, many of whom work in high growth industries. Our cases involve violations of the basic, minimum, and overtime requirements of the FLSA. Often the first response we hear from an employer is that the FLSA does not even apply, that our clients are beyond the reach of the statute. Why? Because the FLSA protects employees, but these businesses have classified their workers as independent contractors, unprotected by the statute.

Where businesses misclassify an employee as an independent contractor, they not only deny the worker earned wages, they erode the effectiveness of the FLSA and create a race to the bottom as

law abiding employers struggle to compete with those who cut costs through misclassification.

My testimony today will briefly cover three things. First, I will describe the scope of the Fair Labor Standards Act, second, I will discuss some disturbing trends we have seen, and finally, I will conclude with a request for a Federal commitment to ensuring that the bedrock protections of the Fair Labor Standards Act are not undermined by schemes that eliminate coverage for vulnerable low wage workers whom the Act was designed to protect.

The FLSA was enacted to eliminate substandard working conditions, and it defined covered employees broadly to achieve that purpose. The FLSA's definition of employee includes to suffer or permit to work, and it was deliberately adopted from child labor laws in effect in most states. That definition distinguishes the FLSA from common law and many statutory laws and gives it broader coverage than the common law and most other statutes.

While the sufferer permit language is deliberately broad, however, not every worker is an employee. Independent contractors, people who are in business for themselves, are not covered. However, employers cannot avoid the FLSA's minimum wage and overtime requirements simply by labeling employees independent contractors. The FLSA framework looks to whether the worker is economically dependent on the business or is in fact in business for themselves. Unfortunately, we have seen many businesses claim that they do not employ the people who work for them. Often as a condition of getting a job these workers are forced to sign contracts calling them independent contractors, even as those businesses assign them hourly work and gives them a schedule and sets their pay rate. Other businesses have gotten more creative, requiring a worker to form a limited liability corporation, for example. Yet these workers are not running their own business by any definition, they are not entrepreneurs, they lack power to negotiate their pay. To the extent that they have any control over their income, it depends more on working longer, not on the exercise of any managerial or entrepreneurial skill. And they are usually engaged to provide a product or service integral to the business, usually something the business markets to its own clients or consumers. These workers put in long hours, but when they ask to be paid minimum wage or overtime that they are due, the business denies responsibility as their employer. Thus, the first hurdle in many of our cases is even proving that the employees are entitled to coverage as employees, a hurdle that often burdens our enforcement efforts.

Unfortunately, the experience of our clients is common, particularly among low wage workers. And without a robust campaign to combat misclassification, law abiding businesses find it difficult to compete, cheating becomes the norm, and the FLSA, along with other workplace protections, is undermined.

We need Federal reform to ensure that the FLSA protects the employees Congress intended it to protect. The Payroll Fraud Prevention Act would amend the record keeping requirements of the FLSA to require employers to notify workers of their classification. This bill, if enacted, would provide important transparency for workers and their employers. It would require a deliberate analysis

at the outset and help prevent misclassification. It would also deter misclassification through increased penalties and a rebuttable presumption of employee status where notice is not provided.

These reforms are a necessary first step to creating a culture of compliance that ensures that the FLSA's promise is realized for the millions of workers who depend on it.

Thank you again for the opportunity to be with you today.
[The statement of Ms. Dworak-Fisher follows:]



Testimony of
Sally Dworak-Fisher
Public Justice Center

Hearing Before the
United States Congress
House Committee on Education and Labor
Workforce Protections Subcommittee

*Misclassification of Employees: Examining the Costs to Workers,
Businesses, and the Economy*

September 26, 2019

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**Testimony of Sally Dworak-Fisher,
Public Justice Center
Before the U.S. House Committee on Education and Labor
Workforce Protections Subcommittee**

September 26, 2019

Chairwoman Adams, Ranking Member Byrne, and members of the Subcommittee: thank you for this opportunity to testify today on the continued importance of the bedrock wage protections for employees under the Fair Labor Standards Act (“FLSA”) in today’s economy, and the critical question of how to draw the line between employees protected by the Act and independent contractors who are not. The scope of the FLSA, and the related question of who is protected and who is not, significantly impact workers and their families, law abiding employers, and the broader economy. With good jobs increasingly replaced by temporary, part-time, low-wage, and unstable work, the concern for “labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being” that motivated the passage of the FLSA is as compelling today as it was in 1938.¹

My name is Sally Dworak-Fisher, and I am an attorney at the Public Justice Center (PJC), a non-profit organization that uses legal advocacy tools to pursue social justice, economic and racial equity, and fundamental human rights for people who are struggling to provide for their basic needs. Our Workplace Justice Project partners with low-wage workers, community and labor organizations, and fellow advocates to promote justice and equity in the workplace. We litigate in state and federal courts, and we are active in promoting policies to expand the rights and protections of low-wage and vulnerable workers.

As a PJC attorney, I frequently represent low-wage workers in wage-and-hour cases involving violations of the Fair Labor Standards Act. Our clients have included construction workers, restaurant workers, hotel and residential cleaning workers, guest workers, and home health care workers. Too frequently, these hard-working individuals – mothers and fathers, sons and daughters – are not paid the bedrock minimum and overtime wages they have earned, and that they so sorely need. And too frequently, the defendants in our cases deny responsibility for their failures to pay, claiming that they did not “employ” the workers in question because they classified the workers as independent contractors. Yet our clients are *not* in business for themselves; far from being “independent contractors,” they often work long hours to advance the business interests of the entity that hired them, have no real power to negotiate their pay, and lack other indicia of operating an independent business.

For example, we regularly see low-wage home health care workers being forced to sign contracts saying they are “independent contractors” even as they are assigned a pay rate and a work schedule by the home care business. We also see workers being paid off the books completely, with no reporting or withholding of the basic payroll taxes or

¹ See The Center for Law and Social Policy (CLASP), *The Struggles of Low-Wage Work* (“CLASP Fact Sheet”), 2018, https://www.clasp.org/sites/default/files/publications/2018/05/2018_lowwagework.pdf.

insurance; and we see businesses denying responsibility where they have subcontracted their workforce to a third party. Alarmingly, the low-wage workers we represent also tend to work in high-growth industries with high rates of workplace violations.²

The failure to pay basic minimum and overtime wages renders an already-vulnerable population even more vulnerable. Particularly given wage stagnation and the failure to raise the federal minimum wage, workers who are cheated out of an already-low wage are more likely to be unable to meet other basic human needs, like the need for food or housing.³ And when businesses cheat by misclassifying their employees as independent contractors to avoid paying bedrock wages, they create a race to the bottom by undercutting law-abiding employers who treat their workers as employees. Without robust enforcement of the FLSA, cheating becomes the norm, and undermines Congress's intent to provide basic wage protections to "those who toil, [] those who sacrifice a full measure of their freedom and talents to the use and profit of others."⁴ Eroding FLSA coverage and protections through independent contractor misclassification also creates ripple effects on the broader economy, diminishing job quality, leaving already financially-strapped families scrambling to make ends meet, and increasing poverty and the need for public benefits.

My testimony will discuss: a) employee status under the Fair Labor Standards Act, including why that statute contains expansive coverage and who is excluded as an independent contractor; b) how businesses use independent contractor misclassification schemes to escape liability and undermine the Act's effectiveness to the detriment of both low-wage workers and law-abiding businesses; c) recent developments related to the question of who is considered an "employee" under state wage laws; and d) the need to recommit to the purposes of the FLSA and renew efforts to combat misclassification.

² See CLASP Fact Sheet ("Low-wage work is the fastest growing job sector"); see also Nat'l Emp. Law Project, *Holding the Wage Floor* (Oct. 2016), <https://s27147.pcdn.co/wp-content/uploads/2015/03/Holding-the-Wage-Floor2.pdf> (documenting "sweatshop conditions" in high-growth industries such as janitorial, restaurant, retail, home healthcare). See also David Weil, *Examining the Underpinnings of Labor Standards Compliance in Low Wage Industries* (Report to Russell Sage Foundation, 2012), <https://www.russellsage.org/sites/default/files/Weil.Final%20Report%202012.pdf>.

³ See, Beth Jarosz and Mark Mather, *Low-Income Families: Rising Inequality Despite Economic Recovery*, in *The Working Poor Families Policy Brief* 1-13 (Spring 2018), http://www.workingpoorfamilies.org/wp-content/uploads/2018/04/Spring-2018_WPFP-Policy-Brief.pdf. See also, Jeff Stein and Andrew Van Dam, *For the Biggest Group of American Workers, Wages Aren't Just Flat, They're Falling*, Wash. Post, June 15, 2018, <https://www.washingtonpost.com/news/wonk/wp/2018/06/15/for-the-biggest-group-of-american-workers-wages-arent-just-flat-theyre-falling/> (noting that four-fifths of privately employed workers experienced wage loss); see also Emmie Martin, *The Government Shut Down Highlights a Bigger Issue: 78 percent of U.S. Workers Live Paycheck to Paycheck*, CNBC, Jan. 9, 2019, <https://www.cnbc.com/2019/01/09/shutdown-highlights-that-4-in-5-us-workers-live-paycheck-to-paycheck.html>.

⁴ *Tennessee Coal, Iron & R.R. Co. v. Muscoda Local No. 123*, 321 U.S. 590, 597 (1944).

I. The Fair Labor Standards Act Contains Intentionally Broad Definitions to Effectuate its Purposes.

A. “Employ” means “to suffer or permit” to work

In 1938, amidst the Great Depression, Congress passed the Fair Labor Standards Act out of concern for “labor conditions detrimental to the maintenance of the minimum standard of living necessary for health, efficiency, and general well-being of workers.”⁵ The purpose of the Act was “to eliminate, as rapidly as practicable, substandard labor conditions throughout the nation. It sought to raise living standards without substantially curtailing employment or earning power.”⁶ At the same time, Congress also sought to level the playing field for those businesses disadvantaged by substandard labor conditions, finding that such conditions were “an unfair method of competition.”⁷ Broadly speaking, the Act prohibited three substandard labor conditions: 1) paying less than the minimum wage; 2) employing young children; and 3) working employees for more than 40 hours in a week without an overtime premium.⁸

Congress recognized that in order to achieve its humanitarian and fair-competition objectives, the Act must have broad coverage. As the Supreme Court explained:

The purpose is to raise living standards. This purpose will fail of realization unless the Act has sufficiently broad coverage to eliminate in large measure from interstate commerce the competitive advantage accruing from savings in costs based upon substandard labor conditions. Otherwise the Act will be ineffective and will penalize those who practice fair labor standards as against those who do not.⁹

Accordingly, Congress purposefully chose language that was unambiguously broader than other labor statutes and that provided protection where the common law did not.

The FLSA defines an “employee” to mean “any individual employed by an employer,”¹⁰ and it defines “employer” to include “any person acting directly or indirectly in the interest of an employer in relation to an employee”¹¹ At the heart of each of those definitions is the word “employ,” and it is the definition of “employ” that sets the FLSA apart. “Employ” is defined broadly; it “includes to suffer or permit to work.”¹²

⁵ 29 U.S.C. § 202.

⁶ *Powell v. United States Cartridge Co.*, 339 U.S. 497, 510-11.

⁷ 29 U.S.C. § 202; see also *Citicorp Indus. Credit v. Brock*, 483 U.S. 27, 36 (1987) (discussing “Congress’ desire to eliminate the competitive advantage enjoyed by goods produced under substandard conditions” and ensuring that interstate commerce was not an “instrument of competition in the distribution of goods produced under substandard labor conditions”).

⁸ 29 U.S.C. §§ 206, 212, 207.

⁹ *Roland Elec. Co. v. Walling*, 326 U.S. 657, 669-70 (1946).

¹⁰ 29 U.S.C. § 203(e)(1).

¹¹ 29 U.S.C. § 203(d).

¹² 29 U.S.C. § 203(g).

As the Supreme Court has repeatedly noted, the definition of “employ” distinguishes the FLSA from – and renders broader coverage than – both common law and other statutory law. Congress chose a definition “whose striking breadth ... stretches the meaning of ‘employee’ to cover some parties who might not qualify as such under a strict application of traditional agency law principles” and that definition stands in contrast to other labor or employment statutes.¹³ The FLSA is deliberately broader than common law; it “contains its own definitions, comprehensive enough to require its application to many persons and working relationships which, prior to this Act, were not deemed to fall within an employer-employee.”¹⁴ Indeed, it is well established that the FLSA’s definitions establish such an expansive understanding of employment that a “broader or more comprehensive coverage of employees ... would be difficult to frame.”¹⁵

Of note, Congress deliberately incorporated the “suffer or permit” standard that was well-established by child labor statutes in effect in 32 states and the District of Columbia.¹⁶ Those statutes imposed liability on businesses for the work of minors even when those minors were hired and directly employed by third parties considered independent contractors. For example, Massachusetts affirmed a conviction of a restaurateur where the restaurant had hired an independent contractor to provide entertainment, and that contractor in turn hired minors to work in the restaurant after hours.¹⁷ Similarly, in Montana, a corporation that hired an independent contractor to remove equipment from its premises was liable where that contractor hired a minor to perform the removal work.¹⁸

Indeed, the “suffer or permit” standard broadly held businesses accountable where they had to the opportunity to detect work and the power prevent it from occurring.¹⁹ In Tennessee, a manufacturer “employed” a minor because one of its employees hired the child as a helper, and the manufacturer was aware of the work and did not stop it.²⁰

¹³ See *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992).

¹⁴ *Walling v. Portland Terminal Co.*, 330 U.S. 148, 150-51 (1947).

¹⁵ *United States v. Rosenwasser*, 323 U.S. 360, 362 (1945). In fact, Congress created “the broadest definition that has ever been included in any one act.” *Id.* at 363 n.3 (quoting statement of drafter of definitions, Senator Black, 81 Cong. Rec. 7648, 7656-57 (1937)). *Accord Tony & Susan Alamo Foundation v. Sec’y of Labor*, 471 U.S. 290, 300 n.21 (1985) (Senator Black’s floor statement shows “the comprehensive nature of the Act’s definitions”).

¹⁶ *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728 & n. 7 (1947); *accord Darden*, 503 U.S. at 326.

¹⁷ *Commonwealth v. Hong*, 158 N.E. 759, 759-60 (Mass. 1927).

¹⁸ *Daly v. Swift & Co.*, 300 P. 265, 266-68 (Mont. 1931); see also *Antenor v. D & S Farms*, 88 F.3d 925, 929 n. 5 (11th Cir. 1996) (explaining that language was designed to reach businesses that contracted with third party middlemen to hire and supervise children).

¹⁹ See Wage and Hour Div., U.S. Dep’t of Labor, Adm’r Interp. No. 2016-1, Joint Employment under the Fair Labor Standards Act 4 (2016). See also *Curtis & Gartside Co. v. Pigg*, 134 P. 1125, 1127-30 (Okla. 1913) (affirming judgment against a manufacturer, which contracted with a father for child’s work in non-dangerous conditions only, where a direct employee of the manufacturer nonetheless allowed child to perform the prohibited dangerous work).

²⁰ *Chattanooga Implement & Mfg. Co. v. Harland*, 239 S.W. 421, 421-23 (Tenn. 1921).

Likewise, in New York, a farm “employed” a minor where one of its drivers hired the child as his assistant.²¹

In sum, the “suffer or permit” standard of the FLSA is intended to prevent substandard labor conditions and unfair competition by guaranteeing minimum and overtime wages to “employees,” including in appropriate circumstances those directly employed by middlemen or other third parties, and even those who would not be protected under the common law.

B. Independent contractor status under the FLSA

While Congress deliberately incorporated broad language to further the important humanitarian purposes of the Act, the “suffer or permit” standard was not intended to be limitless. For example, the FLSA is “not so broad as to include those who, without any express or implied compensation agreement, might work for their own advantage on the premises of another.”²² Nonetheless, Congress did not define the class of workers excluded as “independent contractors.”

Simply put, independent contractors are individuals who are in business for themselves; they are, *ipso facto*, *not* employees. Unlike employees, independent contractors generally do not provide their labor or work as part of an operation under the common control of a larger business. Rather, they provide “a defined product;” or perform “a distinct activity.”²³ A true independent contractor “appears, does a discrete job, and leaves again.”²⁴

Perhaps an obvious example of an independent contractor is the plumber who is called to an office to fix the workroom sink. Although the plumber is, under the very broadest interpretations “suffered” or “permitted” to perform work in the office, no one would argue that the plumber is an “employee” under the FLSA for those few hours of work. Rather, that plumber is an independent businessperson; they appear, engage in a distinct activity unrelated to the service or goods produced by their client, provide the office with a finished product in the form of a working sink, leave, and bill the office according to rates they generally set themselves. Notably, an independent contractor has the power to determine the basic features of their business relations, such as the rates they charge, how, where, and when the work is performed, and whether and when to seek opportunities for expansion or contraction; moreover, like any business owner, “an

²¹ *People v. Sheffield Farms-Slawson-Decker Co.*, 121 N.E. 474, 475–77 (N.Y. 1918); see also *Nichols v. Smith’s Bakery, Inc.*, 119 So. 638, 639–40 (Ala. 1928) (reversed judgment for bakery, whose drivers hired children to assist them and who directly paid the children).

²² *Rutherford Food*, 331 U.S. 722, 728–29 (citing *Walling*, 330 U.S. 148, 152).

²³ *Reyes v. Remington Hybrid Seed Co.*, 495 F.3d 403, 408 (7th Cir. 2007).

²⁴ *Id.*

independent contractor's decisions and actions have significant impacts on opportunities for profits or losses.²⁵

In the absence of a statutory definition in the FLSA, federal courts have developed multi-factored analysis designed to assist in answering the ultimate question: "whether the worker is economically dependent on the employer or *in business for him or herself*."²⁶ Because the common law focuses narrowly on the purported employer's ability to control the worker rather than the worker's economic dependence on the employer or whether the worker is in business for themselves, the common law does not apply in the FLSA context.²⁷ Rather, courts look to the "economic realities" of the relationship between the worker and the business to answer the question. The factors that federal courts analyze generally include: (1) the extent to which the work performed is an integral or essential aspect of the employer's business; (2) whether the worker has an opportunity for profit or loss depending on their managerial skill; (3) the extent of the relative investments of the employer and the worker; (4) whether the work performed requires special skills and initiative; (5) the permanency of the relationship; and (6) the degree of control over the means or manner of the work.²⁸ No single factor is determinative; each one is analyzed with a totality-of-the-circumstances approach in keeping with Congress's intent to ensure that the FLSA effectively combats substandard employment conditions. "The lived reality of the worker is paramount and supersedes any categorization that a business may have made of its workers, even when the parties have signed a putative independent contractor agreement and the business routinely issues 1099s, rather than W-2s."²⁹ The existence of a contract is not controlling because "[t]he FLSA is designed to defeat rather than implement contractual arrangements."³⁰

The "economic realities" analysis has been used to delineate between employees and workers who are in business for themselves in a variety of contexts, including jobs in the modern economy that offer a worker flexibility over certain aspects of their work. For example, workers at a staffing agency were not independent contractors upon consideration of all the factors, although they were able to work for several different agencies and were a transient workforce.³¹ Similarly, nurses assigned work through a

²⁵ David Weil, *Lots of Employees Get Misclassified as Contractors: Here's Why It Matters* ("Weil, Lots of Employees Get Misclassified"), Harvard Business Review (July 5, 2017), <https://hbr.org/2017/07/lots-of-employees-get-misclassified-as-contractors-heres-why-it-matters>.

²⁶ Wage and Hour Div., U.S. Dep't of Labor, Adm'r Interp. No. 2015-1, *The Application of the Fair Labor Standards Act's "Suffer or Permit" Standard in the Identification of Employees Who Are Misclassified as Independent Contractors 2* ("Independent Contractor AI") (2015) (emphasis supplied).

²⁷ *Id.*

²⁸ *Id.*; see also *Schultz v. Capital Int'l Sec., Inc.*, 466 F.3d 298, 304-5 (4th Cir. 2006) for discussion of six factor "economic realities" analysis to determine whether a worker is an employee or an independent contractor under the FLSA.

²⁹ *Guerra v. Teixeira*, Civil Action No. TDC-16-0618, 2019 U.S. Dist. LEXIS 12074, at *17 (D. Md. Jan. 25, 2019).

³⁰ *Sec'y of Labor, United States Dep't of Labor v. Lauritzen*, 835 F.2d 1529, 1544-45 (7th Cir. 1987).

³¹ *Brock v. Superior Care, Inc.*, 840 F.2d 1054, 1060-61 (2d Cir. 1988). In *Brock*, the Court noted that the transient nature of the healthcare work of the nurse plaintiffs was caused by the nature of the profession and not the workers' success in marketing or managerial skill.

registry were not in business for themselves though they had flexible scheduling and could work for other agencies.³² The economic realities analysis revealed that “when the nurses *are* available for work they are dependent upon [the registry] to provide it, and when they are working on assignment for [the registry] they are, during those workweeks, employees. . . .”³³ Indeed, Courts applying the economic realities analysis have found a worker dependent on the business to which they provide their labor in various contexts, such as: home researchers paid on a piece rate with flexible hours;³⁴ cake decorators who could choose which cakes to decorate;³⁵ courier drivers;³⁶ and restaurant workers who could determine, to some extent, their own schedules.³⁷

II. Independent Contractor Misclassification Undermines the FLSA, Hurting Workers, Reputable Businesses, and the Public.

A. Independent contractor misclassification is a serious problem

The classification of an individual as an employee or independent contractor is a critical one not only for the individual worker, but for businesses, government, and the general public. Independent contractors lack important workplace protections. Not only are they excluded from the FLSA’s minimum wage and overtime protections, they are ineligible for unemployment insurance, or workers’ compensation; they are also not shielded by anti-discrimination laws or family and medical leave protections, and they lack the right to collectively bargain to improve conditions. Moreover, businesses are not responsible for paying federal Social Security or payroll taxes or state employment taxes or unemployment insurance taxes for their independent contractors, as they are for their employees.³⁸ As a result, the financial incentive to misclassify employees as independent contractors is significant: businesses can save as much as 30% of payroll and related taxes they would otherwise pay for an employee.³⁹ Left unaddressed, independent contractor misclassification causes three major harms:

First, misclassified workers are deprived of workplace protections and remedies to workplace harms like discrimination and wage theft.
Second, businesses that play by the rules compete with businesses taking unfair advantages to their bottom line by skirting taxes. And finally, state and local governments and their constituents are divested of millions of

³² *Solis v. A+ Nursetemps, Inc.*, No. 5:07-cv-182-Oc-10PRL, 2013 U.S. Dist. LEXIS 49595 (M.D. Fla. Apr. 5, 2013).

³³ *Id.* at 7.

³⁴ *Donovan v. DialAmerica Marketing, Inc.*, 757 F.2d 1376, 1379 (3d Cir. 1985).

³⁵ *Dole v. Snell*, 875 F.2d 802 (10th Cir. 1989).

³⁶ *Air Couriers International v. EDD*, 150 Cal. App. 4th 923 (Cal. Ct. App. 2007).

³⁷ *Doty v. Elias*, 733 F. 2d 720 (10th Cir. 1984).

³⁸ See Independent Contractor AI; see also Nat’l Emp. Law Project, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries* (“NELP, *Misclassification Costs*”) (Sept. 2017), <https://www.nelp.org/publication/independent-contractor-misclassification-imposes-huge-costs-on-workers-and-federal-and-state-treasuries-update-2017/>.

³⁹ NELP, *Misclassification Costs*.

dollars in lost payments to unemployment insurance funds, payroll taxes, and workers' compensation funds.⁴⁰

Unfortunately, recent experience suggests that in many industries, the race to the bottom continues, as companies compete to cut payroll costs via misclassification schemes new and old. In the home health care industry, for example, we find that agencies frequently classify their employees "independent contractors," when the worker is clearly not running their own business. A "contract" rendering the worker liable for self-employment taxes and acknowledging their status as a contractor is required as a condition of work even as the agency sets the worker's hourly pay rate, assigns them to clients, and prohibits them from employment with a competitor agency.

Still other businesses effectively misclassify workers by paying them off the books, meaning they do not include these employees in any payroll treatment at all. Indeed, we have seen workers in the construction industry given boilerplate "contracts" suggesting they are liable for their employment taxes even where they are paid by the hour and treated as an employee.

Worse yet, businesses have gotten creative in other industries: without using the term "independent contractor," they effectively deny FLSA protections through schemes that have the same effect. Some businesses have required employees to form a limited liability corporation or a franchise company-of-one as a condition of getting a job. Too frequently, businesses "contract with workers as owners, franchisees, or partners to explicitly avoid worker protections and tax obligations that come with employee status."⁴¹ Although the business may not use the label "independent contractor," the intent and effect are the same. As the Deputy Commission of the Labor Commission in Utah explained in the wake of a large-scale enforcement action against employers who had misclassified their employees as "owners" in an LLC: "we will see individuals who are clearly employees called independent contractors. Now, we're seeing them called members of LLCs. The beat goes on."⁴²

Of concern, some "gig" companies have also "joined powerful corporate allies and lobbyists on a far-reaching, multi-million dollar influence campaign to rewrite worker classification standards for their own benefit . . ."⁴³ Uber, Lyft, and Handy, for example, are in the business of providing transportation and housekeeper services to the general public and exert significant power over the workers who provide their

⁴⁰ Anna Deknatel and Lauren Hoff-Downing, *ABC on the Books and in the Courts: An Analysis of Recent Independent Contractor and Misclassification Statutes ("ABC on the Books")*, 18 U. Pa. J. L. & Soc. Change 53, 55 (2015).

⁴¹ *Id.* at 81.

⁴² *Id.* See also Independent Contractor AI, n.2 (noting that "the Department has seen an increasing number of instances where employees are labeled something else, such as 'owners,' 'partners' or 'members of a limited liability company'").

⁴³ Nat'l Emp. Law Project, *Rights at Risk: Gig Companies' Campaign to Upend Employment as We Know It* ("NELP, Rights at Risk") 1 (2019), <https://s27147.pcdn.co/wp-content/uploads/Rights-at-Risk-4-2-19.pdf>.

companies' essential services. "They impose take-it-or-leave-it non-employee contracts on their workers while setting fee rates, extracting penalties, and dictating when and how workers interact with their customers."⁴⁴ However, they have engaged in state-level policy advocacy to create carve-outs that would enable them to claim that their workers are independent contractors.

While working to re-write the rules, some gig companies also deny their workers are employees under current laws. They claim that because the jobs they offer provide "flexibility," their workers must be independent contractors, as if it is impossible to provide flexible work to employees. Yet this is a false dichotomy: flexible work is not incompatible with employee status, as some 'gig' companies and others, including several courts, have recognized.⁴⁵ Moreover, any belief that flexibility is truly incompatible with employee status is belied by the extensive efforts to rewrite the rules to legalize misclassification, as well as by the words of Handy's political strategist who asked rhetorically, and tellingly: "What is ultimately a better business decision? To try to change the law in a way you think works for your platform, or to make sure your platform fits into the existing law?"⁴⁶

B. Misclassified workers often labor in industries with low rates of pay

Unfortunately, the workers we see losing their FLSA protections through various misclassification schemes are lower-wage workers who can least afford to be denied minimum or overtime wages. We routinely represent vulnerable home health care workers in our practice. Nationally, 91% of these workers are women, 58% have a high school education or less, 56% are non-white, 24% percent are foreign-born, and 21% percent are single parents.⁴⁷ Their median hourly wage in Maryland is just \$11, below the living wage for a single adult in Baltimore City. Many are forced to work long hours in multiple jobs to feed their families and pay the rent – and even then, 45% of Maryland home health care workers rely on means-tested public assistance for themselves and their families. We have seen home healthcare workers forced to sign "contracts" as a condition of employment, where they acknowledge that they are responsible for employer-side payroll taxes. Similarly, in the construction industry, we represent misclassified employees who are frequently paid "off the books" without any payroll withholdings at all. Often these construction workers are paid a lump sum based on the number of hours worked; they are not protected from unemployment, not covered by workers'

⁴⁴ *Id.* at 2.

⁴⁵ See Nat'l Emp. Law Project, *Flexibility and the On-Demand Economy*, June 2016, <https://www.nelp.org/publication/flexibility-in-the-on-demand-economy/>; Nat'l Emp. Law Project, *Flexible Work Hours and Employee Status: The Truth about AB 5*, June 2019. See also *supra* notes 31-37. https://www.nelp.org/publication/flexible-work-hours-employee-status-truth-ab-5/#_ednref5 (highlighting gig companies like Managed Q and other companies such as Hello Alfred and Bird that offer flexibility while classifying workers as employees).

⁴⁶ NELP, *Rights at Risk*, *supra* n. 43 at 3.

⁴⁷ Paraprofessional Healthcare Institute, *Facts 5: Home Care Aides at a Glance* (February 2014), <http://phinational.org/sites/phinational.org/files/phi-facts-5.pdf>.

compensation, and, too frequently, they are informed that their employer simply “does not pay overtime.”

Our experience representing misclassified employees is consistent with data and case law reflecting what industries and which workers are most likely to be impacted by misclassification. Misclassification appears common in jobs where the workers performing the labor are not, in fact, independent business owners. Industries where misclassification has been found include: construction,⁴⁸ day labor,⁴⁹ janitorial and building services,⁵⁰ home health care,⁵¹ agriculture⁵², poultry and meat processing,⁵³ delivery,⁵⁴ trucking,⁵⁵ and home-based work.⁵⁶ Indeed, shifts in the way that businesses operate in our economy, sometimes referred to as “fissuring,” include the increased

⁴⁸ See *Guerra v. Teixeira*, Civil Action No. TDC-16-0618, 2019 U.S. Dist. LEXIS 12074, at *37 (D. Md. Jan. 25, 2019); Francoise Carré, *(In)dependent Contractor Misclassification* (Econ. Policy Inst., June 8, 2015), <https://www.epi.org/publication/independent-contractor-misclassification/> (noting that construction, low-wage in-person services, and light manufacturing stand out as settings in which labor standards violations and misclassification are most common); *Calderon v. J. Younes Constr. Llc & John Younes, LLC*, No. 12 C 3793, 2013 U.S. Dist. LEXIS 87817, at *18 (N.D. Ill. June 23, 2013). See also Workers Defense Project, *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry* (2009), http://www.workersdefense.org/wp-content/uploads/2013/04/Building-Austin_Report-2.pdf; Francoise Carré, J.W. McCormack, et al., *The Social and Economic Cost of Employee Misclassification in Construction 2* (Dec. 2004), https://scholarworks.umb.edu/csp_pubs/43/.

⁴⁹ See Abel Valenzuela and Nik Theodore, *On the Corner: Day Labor in the United States* (Jan. 2006), <http://www.coshnetwork.org/sites/default/files/Day%20Labor%20study%202006.pdf>.

⁵⁰ See *Harris v. Skokie Maid & Cleaning Serv.*, No. 11 C 8688, 2013 U.S. Dist. LEXIS 97117, at *24 (N.D. Ill. July 11, 2013); David Weil, *Enforcing Labour Standards in Fissured Workplaces: The U.S. Experience*, 22 *Econ. & Lab. Rel. Rev.* 2, 33-54 (July 2011); *Bulaj v. Wilmette Real Estate and Management Co., LLC*, No. 09 CV 6263, 2010 U.S. Dist. LEXIS 112302 (N.D. Ill. Oct. 21, 2010); *Coverall North America, Inc. vs. Commissioner of the Division of Unemployment Assistance*, 857 N.E.2d 1083 (Mass. 2006); *Vega v. Contract Cleaning Maintenance*, 10 *Wage & Hour Cases 2d* (BNA) 274 (N.D. Ill. 2004).

⁵¹ See, e.g., *Lemaster v. Alt. Healthcare Sols., Inc.*, 726 F. Supp. 2d 854, 863 (M.D. Tenn. 2010); *Crouch v. Guardian Angel Nursing, Inc.*, 2009 U.S. Dist. LEXIS 103831 (M.D. Tenn. Nov. 4, 2009); *Bonnette v. Cal. Health & Welfare Agcy.*, 704 F.2d 1465 (9th Cir. 1983).

⁵² See *Lauritzen*, 835 F.2d 1529.

⁵³ See Wage and Hour Div., U.S. Dep't of Labor, *U.S. Dept' of Labor Uncovers Wage and Child Labor Violations at Mississippi Slaughterhouse* (Sept. 11, 2018), <https://www.dol.gov/newsroom/releases/whd/whd20180910-1>; U.S. Gov't Accountability Office, GAO-06-656, *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification* (“GAO, Improved Outreach”) 30 (July 11, 2006), <https://www.gao.gov/new.items/d06656.pdf>; *Heath v. Perdue Farms, Inc.*, 87 F. Supp. 2d 452, 457 (D. Md. 2000).

⁵⁴ See *Flores v. Velocity Express, LLC*, 250 F. Supp. 3d 468, 471 (N.D. Cal. 2017); *Ansaumana et al. v. Gristedes et al.*, 255 F. Supp. 2d 184 (S.D.N.Y. 2003). See also U.S. Dep't of Labor Investigation Results in *Louisiana-Based Transportation Company Paying \$25,032 in Back Wages to 24 Employees at Mississippi Branch* (Feb. 14, 2019), <https://www.dol.gov/newsroom/releases/whd/whd20190213>.

⁵⁵ See Smith, Bensman, Marvy, “The Big Rig: Poverty, Pollution and the Misclassification of Truck Drivers at America's Ports,” (2010), http://nelp.3cdn.net/000beaf922628dfea1_cum6b0fab.pdf; Steven Greenhouse, *The New York Times*, *Clearing the Air at American Ports*, <http://www.nytimes.com/2010/02/26/business/26ports.html>.

⁵⁶ See GAO, *Improved Outreach* at 31.

reliance on outsourcing and subcontracting, which has been shown to erode working conditions and wages.⁵⁷

C. Recent and comprehensive data is lacking

Regrettably, recent federal data measuring the scope of misclassification and its impact on workers, business and government coffers is nonexistent. However, a 2009 report by the Government Accountability Office (GAO) estimated that 15 percent of employers misclassified workers in 1984, to the tune of \$2.72 billion in federal tax losses in 2006 dollars.⁵⁸ A study commissioned by the U.S. Department of Labor (DOL) back in 2000 found that between 10% and 30% of audited employers misclassified employees, and that a 1% misclassification rate would result in a loss of \$198 million to unemployment insurance (UI) trust funds.⁵⁹ The IRS, which uses a narrower test based on the common law,⁶⁰ estimated in 2009 that misclassification was costing \$54 billion in underreporting of employment tax, and \$15 billion in unpaid FICA and UI taxes.⁶¹ At the same time, a number of state-level studies suggest that independent contractor misclassification is widespread and depriving not only workers of bedrock wages and workplace protections, but depriving states of critical UI funds, workers' compensation funds and general revenue from income taxes.⁶² However, these studies likely undercount the costs of misclassification. Even if they were more current, most studies do not account for the impact of workers being paid off-the-books or in cash.⁶³

⁵⁷ See Nat'l Emp. Law Project, *Who's the Boss?: Restoring Accountability for Labor Standards in Outsourced Work* (May 2014), <https://www.nelp.org/wp-content/uploads/2015/02/Whos-the-Boss-Restoring-Accountability-Labor-Standards-Outsourced-Work-Report.pdf>; David Weil, *The Fissured Workplace: Why Work Became So Bad For So Many And What Can Be Done To Improve It* (Harvard University Press, 1st ed. 2014).

⁵⁸ GAO, *Improved Outreach* at 2.

⁵⁹ Lalith De Silva, et al., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, Planmatics, Inc., iv (2000), <https://wdr.doleta.gov/owdrr/00-5/00-5.pdf> (prepared for the U.S. Department of Labor Employment and Training Administration).

⁶⁰ Moreover, Section 530 of the Internal Revenue Act of 1978, 26 U.S.C. § 7436, allows businesses to claim a "safe harbor" under which they can effectively misclassify workers with impunity by claiming that they have been misclassifying them continuously and that misclassification is the norm in the industry. See Franco Ordoñez and Mandy Locke, *IRS' 'Safe Harbor' Loophole Frustrates Those Fighting Labor Tax Cheats* (Dec. 14, 2014), <https://www.mcclatchydc.com/news/nation-world/national/economy/article24777397.html>. The U.S. Treasury has estimated that narrowing that loophole would generate an additional \$9 billion dollars in tax revenue over 10 years. *Id.* Similarly, a 2010 Congressional Research Service estimated that modifications to the rule would yield \$8.71 billion for FYs 2012-21. GAO, *Improved Outreach* at 30.

⁶¹ Treasury Inspector General for Tax Administration, *While Actions Have Been Taken to Address Worker Misclassification, Agency-Wide Employment Tax Program and Better Data are Needed* ("Treasury IG, *Better Data Needed*") (Feb 4, 2009), <https://www.treasury.gov/tigta/auditreports/2009reports/200930035fr.pdf>.

⁶² NELP, *Misclassification Costs*.

⁶³ In 2005, Bear Stearns estimated that the U.S. was losing \$35 billion annually due to off-the-books employment. Justich and Ng, "The Underground Labor Force is Rising to the Surface," 3, Bear Stearns Asset Management (2005), https://cdn.factcheck.org/UploadedFiles/Bear_Sterns_20_million_illegal.pdf.

Meanwhile, the financial costs to the worker and the worker's family may be the difference between paying rent and homelessness. Aside from the other loss of rights listed above, misclassified employees lose their right to minimum wage and overtime. This loss of income is often significant, particularly for low-wage workers putting in long hours and struggling to make ends meet. In one typical case, the U.S. Department of Labor's Wage and Hour Division (WHD) recovered roughly \$250,000 in unpaid overtime and minimum wages and for 75 workers who were misclassified by a cleaning company, representing nearly three months of earnings.⁶⁴ Workers who are misclassified and denied the bedrock wage protections afforded by the FLSA may also be forced to seek public benefits; when they do, the public assumes the cost, effectively subsidizing businesses that cheat. In short, misclassification schemes are denying workers and their families hard-earned wages, undercutting reputable businesses trying to play by the rules, and burdening the public at large through an increasing demand for public services and a decreasing pool of businesses contributing.

III. Some States Apply the "ABC" Analysis to Questions of Employee Versus Independent Contractor Status Under State Wage Laws.

Recently, some states with wage statutes that –like the FLSA– define "employ" as including "to suffer or permit to work" have turned to a tried-and-true analysis for determining whether a worker is an employee or an independent contractor. The analysis is one that is well known and often used to determine whether a worker is a covered employee for the purposes of unemployment insurance – the "ABC" test.⁶⁵ The ABC test presumes a worker is an employee unless the employer can prove each of the three prongs of the test. In general, the employer must demonstrate, the employing business must show:

- (A) That the individual worker is free from direction and control both under the contract and in the actual performance of it;
- (B) That the service performed by the individual is performed outside the usual course of business of the employer; *and*
- (C) That the individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service at issue.⁶⁶

⁶⁴ Wage and Hour Div., U.S. Dep't of Labor, *US Labor Department obtains judgment against Illinois-based Skokie Maid; more than \$500,000 in unpaid wages, damages to be paid to 75 misclassified workers* (May 3, 2012), <https://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=Midwest/20120503.xml>

⁶⁵ 24 states have this definition in their unemployment insurance law Alaska, Arkansas, California, Connecticut, Delaware, Florida, Hawaii, Illinois, Indiana, Louisiana, Massachusetts, Maryland, Nebraska, New Hampshire, New Jersey, New Mexico, Nevada, Oklahoma, Rhode Island, Tennessee, Virginia, Vermont, Washington, and West Virginia. Another eight states use a test that includes part "C" in combination with other factors (Colorado, Georgia, Idaho, Minnesota, Oregon, Pennsylvania, South Dakota, and Utah). This is also the law in over ten states' workers' compensation acts: AZ, CA, CO, CT, DE, HI, NH, ND, WI, WA. Massachusetts' minimum wage act and its wage payment law use the ABC test as well. Mass. Gen. Laws ch. 149, § 148b, <http://www.mass.gov/legis/laws/mgl/149-148b.htm>.

⁶⁶ *ABC on the Books* at 65.

The three prongs of the ABC test, each of which must be satisfied, focus specifically on the question of whether in fact an individual worker is in business for herself.

For example, the New Jersey Supreme Court held that the ABC test used in the New Jersey Unemployment Compensation Act governs whether a plaintiff is an employee or independent contractor for purposes of the state's two wage statutes.⁶⁷ The question was certified to the state supreme court in a case involving mattress delivery drivers.

New Jersey's Wage-and-Hour Law (WHL) defines "employ" similarly to the FLSA, – ie, "to suffer or permit to work."⁶⁸ By regulation, New Jersey had adopted the ABC test of its unemployment insurance code to distinguish between employees and independent contractors. The state's Wage Payment Law (WPL) defines "employee" as "any person suffered or permitted to work by an employer, except that independent contractors and subcontractors shall not be considered employees."⁶⁹ However, the WPL was silent on the question of how to distinguish employees from such contractors. In holding that the ABC analysis governed the question of employee status under both statutes, the court interpreted "two complementary statutes to determine and effectuate the intent of the legislature."⁷⁰ The court was mindful of the need to further the remedial purposes of those laws.⁷¹ It noted that like the FLSA, "the WPL and WHL address the most fundamental terms of the employment relationship," including the right to timely and predictable payments and protection from unfair wages and excessive hours.⁷² Notably, the court declined to apply the "economic realities" framework used by federal courts applying the FLSA. The court found that such a "totality of the circumstances" analysis is likely to produce varying results.⁷³ "By contrast, requiring each identified factor to be satisfied to permit classification as an independent contractor, the 'ABC' test fosters the provision of greater income security for workers, which is the express purpose of both the WPL and the WHL."⁷⁴

Likewise, the Supreme Court of California held that the "suffer or permit" standard under California wage law required businesses asserting independent contractor status to establish each of the three ABC factors.⁷⁵ *Dynamex* involved package delivery drivers who had been classified as employees until the company adopted a new policy and contractual arrangement classifying them as independent contractors. After a lengthy review of prior decisions, the court noted that prior case law "emphasizes statutory purpose as the touchstone for deciding whether a particular category of workers should be considered employees rather than independent contractors for purposes of social

⁶⁷ *Hargrove v. Sleepy's LLC*, 106 A.3d 449 (2015).

⁶⁸ *Id.* at 458 (citing N.J.S.A. § 34:11-56a(1)).

⁶⁹ *Id.* at 456 (citing N.J.S.A. § 34:11-4.1(b)).

⁷⁰ *Id.* at 456.

⁷¹ *Id.* at 458.

⁷² *Id.* at 463.

⁷³ *Id.* at 455-6.

⁷⁴ *Id.* at 464.

⁷⁵ *Dynamex Operations W. v. Superior Court*, 4 Cal. 5th 903 (2018).

welfare legislation.”⁷⁶ As in *Hargrove*, the court declined to use the “economic realities” test, noting “the disadvantages, particularly in the wage and hour context, inherent in relying upon a multifactor, all the circumstances standard. . . .”⁷⁷ Such disadvantages include the fact that the “lack of an easily and consistently applied standard often leaves both businesses and workers in the dark” and that a multifactor analysis “affords a hiring business greater opportunity to evade its fundamental responsibilities . . . by dividing its work force into disparate categories and varying the working conditions.”⁷⁸

These states, whose wage laws were enacted to address the same concerns motivating the FLSA, have adopted an analysis that illuminates what it means to “employ” a worker and how to determine who is an independent contractor. Whether using the “economic realities” analysis of the federal courts or the “ABC” test used in some states, the ultimate question is always the same, however: is the worker in business for himself? Either analysis, properly applied, results in broad coverage for workers “employed” by a business, consistent with the statutory purposes and legislative intent.

IV. Renewed Commitment to Combatting Misclassification, Protecting Workers, and Leveling the Playing Field for Reputable Businesses is Needed.

Businesses have become more creative in finding ways to misclassify employees, denying them bedrock workplace protections while exempting themselves from contributing their share to public coffers. Indeed, the threat of widespread and, in some industries, legalized misclassification appears to have grown in recent years, undermining the effectiveness of the FLSA to the detriment of workers and law-abiding businesses. There is an urgent need to prioritize combatting these developments, beginning with gaining a better understanding of its current scope. As Dr. David Weil, former Wage and Hour Administrator under President Obama and now Dean and Professor at the Heller School of Social Policy and Management at Brandeis University recently explained: “We have already faced decades of flat real earnings and deteriorating labor conditions for much of the workforce and a widening of income inequality for the economy as a whole. Allowing further erosion of employer responsibility in the physical and digital workplaces will only intensify those troubling trends.”⁷⁹

A. It is not clear that combatting misclassification remains a priority

Unfortunately, combatting the misclassification of employees as independent contractors is no longer clearly a federal priority. As an initial matter, the DOL took the unusual and step of rescinding the 2015 Administrator’s Interpretation that provided guidance on the identification of independent contractors under the FLSA. The rescission potentially

⁷⁶ *Id.* at 935.

⁷⁷ *Id.* at 956.

⁷⁸ *Id.* at 955.

⁷⁹ Weil, *Lots of Employees Get Misclassified*.

signals “an intention to move away from addressing worker classification as a fundamental problem worth addressing.”⁸⁰

Further, while DOL prioritized combatting misclassification prior to 2016, it is not clear that this remains a priority. For example, in 2011 the DOL had launched an initiative to strengthen and coordinate federal and state efforts to identify and deter employee misclassification. As part of the Department’s Strategic Plan to, DOL committed to: target investigations in industries with the most substantial independent contractor abuses; target efforts to recoup unpaid payroll taxes due to misclassification; coordinate with states on enforcement; and develop regulatory changes to identify and target misclassification.⁸¹ Some 45 states had entered into Memoranda of Understanding (MOU), partnership agreements, cooperative agreements, or common interest agreements with the Department to facilitate state-federal agency information sharing needed to identify and detect firms misclassifying workers. However, those agreements have expired for 13 states and currently only 32 states have active agreements.⁸² Moreover, the DOL’s most recent strategic plan contains no mention of misclassification.⁸³

In place of a clear and coordinated effort to combat misclassification now stands a single DOL Opinion Letter responding to a particular company inquiring about its particular relationship with its service providers.⁸⁴ Opinion letters do not represent official policy, and they are necessarily limited to the facts as presented by the requesting business. Thus, even assuming the facts as presented by the business are completely and always accurate, an opinion letter only applies to that individual situation. Unfortunately, Opinion Letters may be relied on by other businesses to claim that any misclassification they engaged in was in good faith because they share some similarities. “They are often referred to as ‘get-out-of-jail free cards’ because they mean that the Labor Department won’t initiate enforcement proceedings against a company with a favorable letter.”⁸⁵ They may also be used to convince state or local legislators that all similar businesses are entitled to an exemption that strips their workers of employee rights under state laws. Opinion Letters were discontinued during the Obama administration. In the words of Dr. Weil, opinion letters are a “capricious tool for settling complicated regulatory questions.”⁸⁶

⁸⁰ *Id.* at 5.

⁸¹ See U.S. Dep’t of Labor, *Strategic Plan, Fiscal Years 2011-2016*, https://upload.wikimedia.org/wikipedia/commons/8/87/United_States_Department_of_Labor_-_Strategic_Plan_Fiscal_Years_2011-2016.pdf.

⁸² Although no longer a clear priority for the Department of Labor, its Wage and Hour Division has continued to investigate and resolve cases of misclassification. See Wage and Hour Div., U.S. Dep’t of Labor, *WHD Press Releases About Misclassification as Independent Contractors*, <https://www.dol.gov/whd/media/press/whdprssToc.asp?topic=MIS#CurrentTopic>.

⁸³ See U.S. Dep’t of Labor, *Strategic Plan, FY 2018-2022*, <https://www.dol.gov/sites/dolgov/files/legacy-files/budget/2019/FY2018-2022StrategicPlan.pdf>.

⁸⁴ U.S. Dept. of Labor Wage and Hour Div., USDOL Opinion Letter, FLSA 2019-6 (Apr. 29, 2019).

⁸⁵ Noam Schreiber, *Labor Department Says Workers at a Gig Company are Independent Contractors*, N.Y. Times, Apr. 29, 2019, <https://www.nytimes.com/2019/04/29/business/economy/gig-economy-workers-contractors.html>.

⁸⁶ *Id.*

B. A renewed commitment to combatting misclassification is urgently needed

The need to refocus and recommit to the humanitarian goals of the FLSA, to ensure that businesses that suffer or permit work pay their employees the bedrock minimum and overtime wages to which they are entitled, and to penalize cheating businesses that undercut their competition through misclassification schemes is paramount. Robust enforcement of the FLSA – including enforcement on behalf of the vulnerable workers whose employers seek to misclassify them through schemes old and new – should be a priority.

The Payroll Fraud Prevention Act (“PFPA”) represents a critical step in the right direction. The Act would require businesses to properly classify their workers and to keep records of those classifications. Moreover, the PFPA would foster transparency by requiring covered businesses to provide notice to an individual of that individual’s classification, along with information regarding how to reach the Department of Labor with questions or concerns and a statement directing individuals to a website with further information. To encourage compliance with the notice requirement, businesses that fail to provide proper notice will be presumed employers under the FLSA, subject to a heavy burden of rebuttal. The PFPA would also both deter misclassification and encourage enforcement by increasing damages to employees who are misclassified and by ensuring that workers who voice complaints or oppose any practice related to their misclassification are protected from retaliation. Moreover, high-violation industries would be subject to targeted audits, which will create compliance incentives in those industries that need it most. Further deterring violations and combatting misclassification, the bill would subject employers to civil penalties of up to \$1,100 per violation, and up to \$5,000 for willful violations. Finally, the PFPA would require information-sharing such that further action could be taken against cheating businesses to level the playing field for everyone. Specifically, the PFPA would require all divisions within the DOL to report misclassification to the Wage and Hour Division, which could in turn report it to the Internal Revenue Service. In short, the PFPA would go a long way toward creating the culture of compliance that is sorely needed.

Finally, data collection and research on misclassification should be conducted regularly and inform future policy efforts. The data and research conducted by various state governments in response to the recession was piecemeal and incomplete even when it took place. Additionally, federal agency estimates were admittedly dated even when published in 2009, and current, comprehensive data collection is lacking. Regular and current comprehensive research and data on the scope of misclassification – including clear guidance on how to measure it – is necessary to develop informed policy in the future.⁸⁷

⁸⁷ See Treasury IG, *Better Data Needed*.

V. Conclusion

The Fair Labor Standards Act and the concerns that motivated it are as compelling and relevant today as they were at the time of passage. Indeed, the need to ensure that the businesses that “suffer or permit” individuals to work for them pay those workers all wages due under the FLSA is critical, particularly as the growth of low-wage, contingent work forces more people to scrape by with unpredictable part-time employment. The good news is that determining whether an individual is protected as an employee is not difficult. The essential question is always whether that individual is running their own business. Relevant factors courts examine under the FLSA typically include: (1) the extent to which the work performed is an integral or essential aspect of the employer’s business; (2) the workers have opportunities for profit or loss depending on their managerial skill; (3) the extent of the relative investments of the employer and the worker; (4) whether the work performed requires special skills and initiative; (5) the permanency of the relationship; and (6) the degree of control over the means or manner of the work. Some states rely on the “ABC” test when the status of a worker as an employee or independent contractor arises under state wage law. Both analyses provide a method of interpreting the “suffer or permit” language in cases raising the question of whether a worker is an employee or independent contractor, and either analysis, properly applied, will provide broad coverage consistent with the purposes of the statute.

Although the clear intent of the FLSA was to broadly cover workers who would not be covered under the common law, too many businesses still attempt to deny that they “employ” the individuals who work for them. The incentive to do so is compelling, because employees are more expensive than independent contractors, for whom businesses are not required to pay employment taxes, much less minimum wage and overtime wages. It appears that this problem may be worsening, though current data and research on its scope is sorely lacking. Anecdotally at least, businesses seem to be getting more creative with the ways they misclassify, including requiring workers to form their own LLCs or franchises. In some industries, such as home healthcare, it appears that businesses routinely require workers to sign independent contractor contracts as a condition of work. Still others, particularly in the gig economy, are trying to re-write state rules to exempt their workers through legalized misclassification, even as they incorrectly claim those same workers are already exempt because of the “flexible” schedules these businesses offer.

While combatting misclassification of employees as independent contractors was unquestionably a federal priority in years past, it is not clear whether coordinated and strategic enforcement continues. A recent opinion letter issued to a single business based on that business’s version of the facts may signal a troubling intent to turn back the clock and strip employee protections, to the detriment of workers, their families, reputable businesses, and the public coffers. Legislation such as the Payroll Fraud Prevention Act of 2019 would raise awareness of the importance of proper classification under the FLSA through better notice and recordkeeping requirements and enhanced penalties, and it would send a strong message that the bedrock protections of the FLSA cannot be ignored

with impunity. Similarly, renewed efforts to collect and analyze data would help provide a more current understanding of developing trends and allow for the creation of proactive measures to address them.

Thank you.

Chairwoman ADAMS. Thank you very much.

I want to recognize now Mr. Chemers. I am sorry. I think I missed someone. Oh, excuse me, Mr. Passantino. Okay, you are recognized for five minutes.

**TESTIMONY OF ALEXANDER PASSANTINO, J.D., PARTNER,
SEYFARTH SHAW, LLP**

Mr. PASSANTINO. Thank you. Good morning, Chairwoman Adams, Ranking Member Byrne, and Members of the subcommittee. Thank you today for the opportunity to speak with you regarding the important issue of independent contractor status in today's workplace.

My name is Alex Passantino. I am a partner in the Washington, DC office of Seyfarth Shaw where my practice focuses on helping employers comply with the wide variety of wage and hour laws. Despite my representation of employers, my testimony today is solely my own.

The majority of my practice involves counseling employers on issues such as independent contractor status, overtime exemptions, regular rate of pay, and other pay practices. Prior to working at Seyfarth I served as the deputy and acting administrator of the Wage and Hour Division. For the past 22 years, both in private practice and at Wage and Hour, I spent the majority of each working day addressing compliance issues related to the wage and hour laws. During that time I have experienced a broad spectrum of uses of independent contractors, from contractors taking advantage of the aftermath of Hurricane Katrina in New Orleans and Gulfport, to businesses carefully assessing whether a particular worker can qualify as an independent contractor, to workers all but begging to work as independent contractors, to new economy companies attempting to navigate their obligations under the law. I have seen the good, the bad, and the ugly of this issue.

Make no mistake, there are businesses out there that intentionally misclassify workers in an effort to gain an economic advantage. But in my experience, and particularly in my practice, the overwhelming majority of businesses are trying to make the right decision on the classification issue. And the businesses that are doing it the right way have an interest in ensuring that their competitors are doing it the right way.

But even the businesses doing it the right way don't always get the assessment right. The standard for determining whether a worker is an independent contractor or an employee under the FLSA is a seemingly constant moving target. We have had multiple pronouncements by the DOL over the past several years and we have had far more court decisions. Even when the factors that are considered are the same, the focus placed on those factors differs. Different courts considering the same exact business models have come to different conclusions based on their own understanding of the facts and their own understanding of the relative importance of those facts. Clarifying the standard in a meaningful way would go a long way to leveling the playing field and ensuring compliance.

Unfortunately, the Payroll Fraud Prevention Act does nothing to provide that clarity. Instead, it simply changes the risk assessment. Businesses will need to provide detailed notice to an as-

tounding number of individuals. Failure to do so, or a failure to provide a 100 percent accurate notice, can result in a heightened burden of proof and severely increased penalties, including unprecedented civil money penalties and treble damages.

The PFPA would force business into a series of impossible choices. Do they provide the notice described in the Act to everyone contemplated in the Act, which could include employees, independent contractors, employees of subcontractors, taxi drivers who transport company executives, and many others, or do they ignore certain covered individuals and take the risk that they will be more heavily penalized down the road? The incredible breadth of the definitions covered makes it effectively impossible to achieve complete compliance. Instead, it will almost certainly force businesses to decide to forego at least in part compliance with the PFPA based on an assessment of the risks associated with that noncompliance.

It seems odd to create a new legislative requirement that will be ignored in a wide range of circumstances, but that's precisely what this definition does. As a result, businesses may even reconsider whether to continue to use independent contractors. Ultimately, the PFPA is likely to chill legitimate use of independent contractors. The risk of litigation will simply be too great, the penalties too severe.

Unfortunately, the worst offenders, those who willfully misclassify the most vulnerable workers without any basis for doing so, are likely to continue to do so. They are already undeterred by the specter of a massive wage and hour lawsuit and potentially bankrupting damages. Changing the burden of proof and doubling already crippling damages are not going to cause these businesses to hand a worker a piece of paper advising them of who to call when they have an issue.

For most workers the PFPA will have no practical impact. Employers of employees will spend millions of dollars creating, sending, and tracking millions of notices telling employees that they are employees and providing a web address, street address, and phone number of a wage and hour office.

At a time when many businesses and workers are seeking flexibility in their working relationships, the PFPA would dramatically limit that flexibility. This result is bad for employees and employers alike. Rather, the focus should be on developing a legislative solution that protects innovation and flexibility while protecting those most in need of protection.

Thank you for the opportunity to share my thoughts. I look forward to your questions.

[The statement of Mr. Passantino follows:]

Testimony of Alexander J. Passantino, Esq.

**Before the
United States House of Representatives
Committee on Education and Labor
Subcommittee on Workforce Protections**

**Hearing on
“Misclassification of Employees: Examining the Costs to Workers, Businesses,
and the Economy”**

September 26, 2019

Chair Adams, Ranking Member Byrne, and Members of the Subcommittee:

Thank you for the opportunity to speak with you today regarding the important issue of independent contractor status in today’s workplace.

I am a partner in the Washington, DC office of Seyfarth Shaw LLP, where my practice focuses on helping employers comply with the Fair Labor Standards Act (FLSA), the Service Contract Act, the Davis-Bacon and Related Acts, and state laws related to the payment of minimum or prevailing wages and overtime. The majority of my practice is providing advice and counsel to employers on independent contractor status, overtime exemptions, and other pay practices. I also represent employers during wage-hour investigations by the Department and state enforcement agencies.

I have been working on wage and hour issues since entering private practice in the Fall of 1997. In 2005, I left private practice and joined the leadership team of the U.S. Department of Labor’s Wage & Hour Division (WHD). In 2006, I was appointed Deputy Administrator of WHD and, in 2007, I became the Acting Administrator. President George W. Bush nominated me to serve as the Administrator in March 2008. I left WHD in 2009 and returned to private practice.

Despite my representation of many employers attempting to comply with the FLSA’s obligations, my testimony today is solely my own.

In my testimony today, I will be discussing the proposed Payroll Fraud Prevention Act of 2019 (PFPA), and how that Act is likely to impact businesses—whether they be large, multi-state employers or small businesses, educational employers, or non-profits. The PFPA creates enormous administrative burdens on employers and businesses across the country. Lawful businesses will be forced to engage in a series of box-checking exercises that will benefit few, if any, workers. Unlawful businesses are not likely to change their behavior in any meaningful way, and, thus, few, if any workers will benefit. In reality, the largest beneficiaries are likely to be attorneys—both plaintiffs’ attorneys bringing suit and defense attorneys representing

businesses in counseling and litigation--as well as the companies that will build the systems required to generate the millions of forms that will be required under the PFPA.

Below, I discuss the provisions of the PFPA.

Definition of "Covered Individual" [Section 2(a)]

The PFPA creates a new defined term: "covered individual," which is defined as ". . . an individual providing labor or services for remuneration [for such employer]." Most notably, under the PFPA, every covered individual must be provided with the notice described below. The breadth of this requirement is shocking. Without further limitations on this definition, based on something such as the nature of the relationship, the amounts expended on the remuneration, or the existence of another entity required to provide the notice, PFPA notices would need to be provided to:

- Employees;
- Independent contractors;
- Staffing company employees;
- Employees of a subcontractor;
- Employees of vendors, such as cleaning services or HVAC repair services;
- Taxi drivers who transport company executives from the airport to the office;
- An individual who delivers a catered lunch to an office meeting; and
- Every other individual who does virtually anything for any amount of pay for an employer.

The incredible breadth of the definition's coverage makes it effectively impossible to achieve compliance. Instead, it will almost certainly force businesses to decide to forego compliance with the PFPA--at least in part--based on the relative severity of the risks associated with that non-compliance. It seems odd to create a new legislative requirement that will be ignored in a wide range of circumstances, but that is precisely what this definition does.

On the other hand, the PFPA definition of "covered individual" would not include volunteers, interns, student-learners, and others who are not provided with remuneration for their work.

Classification & Notice Requirement [Section 2(b)]

Section 2(b) of the PFPA would revise Section 11(c) of the FLSA to require classification of employees as employees. It also would require notice to be provided to every covered individual. That notice would need to identify (1) the classification of that covered individual [employee is the only identified classification in the PFPA]; (2) the web address established by

the Department of Labor; (3) the address and telephone number for the “applicable local office of the Department of Labor”; and (4) for non-employee covered individuals, a statement regarding proper classification and a direction to contact the Department of Labor. The notice must be provided within six months of the effective date of the PFPA, and, after that time, on the first date of employment or provision of services or labor.

With respect to the timing of the notice, it is important to note that the Department of Labor has 180 days after enactment to create the website noted in (2) above. A compliant notice--which must include a statement directing must be issued within six months of enactment. With hundreds of millions of individually-tailored notices required to be issued within a maximum of 184 days, it is possible that businesses will have four days to properly prepare notices. This is a recipe for failure and the time frame for business compliance should be established based on the Department of Labor’s successful completion of its obligation to set up the website.

With respect to the requirement to provide the address and telephone number of the “applicable local office of the Department of Labor,” this, too is a recipe for non-compliance. There are hundreds of Department of Labor offices. WHD has eight district and area offices in California alone. This does not include field stations (usually located in more remote locations, and without on-site management). Eight district and area offices of WHD cover the state of Texas; one of those offices is in Albuquerque, New Mexico. If the goal of this requirement is to create a “gotcha” trap for those providing the notice, then the current draft would appear to be among the more effective ways to achieve that goal. If, however, the goal of the requirement is to direct covered individuals to a resource through which they might contact WHD, the directing them to WHD’s toll-free number -- 1-866-4-USWAGE -- would be a better option.

Finally, regarding the requirement that the covered individual be advised of his or her “classification,” the only classification identified in the PFPA is “employee.” Given the consequences of improper notification (discussed below), it is imperative that the PFPA make clear whether the classification is binary (*i.e.*, employee or non-employee) or whether there are other classifications available.

Consequences, Part 1: Presumption [Section 2(b)]

The first consequence of (a) failing to provide the notice; (b) failing to provide the notice in a timely manner; or (c) failing to provide the proper notice is a presumption -- rebuttable only by clear and convincing evidence -- that the covered individual is an employee. As suggested above, this will result in businesses deciding whether to ignore the notice requirements based on whether the presumption of employee status is rebuttable.

Take, for example, a pizza delivery driver who delivers pizza to a company luncheon and who, in addition to his hourly compensation from the pizza delivery company, is provided with a cash tip by the company providing the luncheon. The pizza delivery driver would appear to fall under the definition of “covered individual.” If that is the case, the business would need to decide whether to provide the pizza delivery driver with the required notice or whether to accept the risk that the driver claims employee status at some time in the future. In many cases, the business would decide not to provide the notice. It is important to note, however, that the decision would

not be made on a conclusion that the delivery driver was not a covered individual, nor would it be based on a conclusion that the notice was not required. Instead, it would be an assessment that (1) the law required the notice to be provided to this individual, but (2) the consequences for failing to do so were not troubling.

Or, take the more difficult case of a business using a subcontractor. What obligations does the business have with respect to the employees of the subcontractor? It would appear that the business must also provide notice to the subcontractor's employees who are performing work for the business. Under the currently-drafted PFPFA, the notice would need to be provided on the very day on which the work begins; failure to provide that notice on that day would mean a presumption of employment, even if joint employment was not an issue. In many circumstances, the business would not even know who the individual worker was. Under the PFPFA, however, failing to provide the required notice would mean a heightened standard -- clear and convincing evidence -- to establish that the business was not an employer.

Consequences, Part 2: Liquidated Damages and Civil Money Penalties [Section 2(d)]

Perhaps the most significant consequences associated with the PFPFA are the enhanced liquidated damages and civil money penalties. Liquidated damages are doubled when minimum wage or overtime violations are accompanied by a failure to properly classify a covered individual as an employee. It is unclear whether defenses to liquidated damages generally are available under this provision, and whether those defenses are available as to each component independently (*i.e.*, the liquidated damages and/or the doubling of the liquidated damages). It also is unclear what constitutes a "violation" of section 11(c)(2). If an employer classifies an employee as an employee, but fails to provide notice, is that a "violation"? What is sufficient to qualify as "classification" such that the enhanced penalty would not apply?

Civil money penalties would be fundamentally changed. Far from simply triggering enhanced penalties for violations associated with classification issues, the PFPFA eliminates the repeated or willful standard for the assessment of civil money penalties. Under the PFPFA, any violation of the FLSA's minimum wage or overtime requirements would be subject to civil money penalties of up to \$1,100, and the existing repeated or willful violations would see their civil money penalties raised from \$1,100 to \$5,000. This is a significant and unprecedented change to the FLSA's penalty structure.

In reviewing the PFPFA, there are a few additional issues that should be addressed. First, for the overwhelming number of workers, the PFPFA will have no practical impact whatsoever. Employers of employees will spend millions of dollars creating and sending millions of notices, with the only extra information being provided to the employee being a new web address and an address and phone number of a WHD office. This hardly seems like an effective use of those dollars. At the other extreme, those employers who wholly disregard their obligations under the FLSA are not likely to change their ways and take on a rigorous administrative process to ensure the proper notifications.

Instead, the PFPFA is likely to most dramatically impact a small number of workers who are performing services in highly-flexible and cutting-edge models. At a time when many businesses and workers are seeking flexibility in their working relationships, in an effort to participate more fully in the global economy, the PFPFA would instead dramatically limit that flexibility, forcing businesses to make decisions that would place large numbers of employees under a regulatory scheme that was last updated in the 1960s and is fraught with uncertainty (*i.e.*, the FLSA's "hours worked" standards). This result is bad for employees and employers alike; rather the focus should be on developing a legislative solution that protects innovation and flexibility while protecting those most in need of protection.

Second, it seems misguided to create a legislative scheme that forces businesses to choose between (1) strict compliance and millions of dollars of wholly unnecessary paperwork and analysis (*i.e.*, providing timely notices to pizza delivery drivers); and (2) non-compliance based on an assessment that such non-compliance carries with it a minimal level of consequence. The legislation should be crafted to ensure an effective path to its end goal. If providing notice to pizza delivery drivers is not what was intended, that should be addressed in the definitions or express requirements/exclusions, not left to the risk tolerance/assessment of the businesses that must comply.

Third, to avoid the "gotcha" possibilities of the PFPFA, the notice and classification requirements should be as clear as possible. As noted above, as currently drafted, the PFPFA is ambiguous in a number of places, which can result in costly litigation in the future.

Finally, the PFPFA cannot be considered in a vacuum. The FLSA's regulatory scheme was developed for the workplace of a different century. The regulations use as examples messengers working the crossword puzzle, firemen playing checkers, and telephone operators with switchboards in their homes. Most of the cases cited in these regulations are from the 1940s and 1950s. To say that the workplace has changed significantly since that time is an understatement. Many of the workers most likely to perform work subject to the PFPFA are precisely the types of workers that demonstrate just how significant that change has been.

Thank you for the opportunity to share my thoughts on the PFPFA.

Chairwoman ADAMS. Thank you very much.
Mr. Townsend, you are recognized for five minutes, sir.

TESTIMONY OF MATT TOWNSEND, CEO OF OCP CONTRACTORS, INC., PRESIDENT, SIGNATORY WALL AND CEILING CONTRACTORS ALLIANCE (SWACCA)

Mr. TOWNSEND. Good morning, Chairwoman Adams, Ranking Member Byrne, and Members of the subcommittee.

My name is Matt Townsend. I am the CEO of OCP Contractors, a construction company that employs 500 men and women working across the State of Ohio and in neighboring states. I am privileged to appear before you today in my capacity as president of the Signatory Wall and Ceiling Contractor's Alliance. SWACCA is an association representing construction company owners who employ tens of thousands of carpenters, drywall finishers, plasterers, and laborers throughout the United States. We thank you for holding this hearing and allowing me to explain the threat of worker misclassification poses to the ability of law-abiding employers in my industry to compete, to innovate, and to create jobs.

Our members are entrepreneurs who do not want to be complicit in the misclassification racket in order to compete. But rampant misclassification in the construction industry is making it hard for law-abiding employers to compete and to provide fair pay and economic security for our employees. In my industry, misclassification is a choice to disregard the legal responsibilities of being an employer. It provides a competitive advantage by transferring to workers and taxpayers financial obligations and the risks associated that honest business owners accept.

SWACCA members pursue their work through a cost competitive bidding process in which 60 to 80 percent is the cost of labor. This includes the number of workers, how much time they will need to finish the project, and to what degree they will have to work overtime to finish on schedule. If our estimates about labor costs are wrong, our profits quickly evaporate. But workers get paid for every hour worked and they get overtime when their work exceeds 40 hours in a week. People using the misclassification model can always submit a lower bid because they don't have to worry about how many hours it takes the workers to complete the project or whether they work overtime to get the job done on schedule. For them, labor is a fixed cost. They pay a predetermined amount for each piece of drywall finished or square foot of framing or ceiling installed, and not one penny more, not matter how many hours it takes.

Make no mistake, in the misclassification schemes I see, contractors control and direct their workers at the jobsite just like my company does. These are regular crews economically dependent on a boss who takes them from jobsite to jobsite. By disassociating themselves from the legal responsibilities and costs of being employers, these so-called contractors get a tremendous competitive advantage.

The Ohio Attorney General estimated that misclassifying workers provides at least a 20 to 30 percent competitive cost advantage against law abiding employers. When competing against a company like mine that pays middle class wages, sponsors training programs, and offers retirement and health benefits, the advantage is more than 50 percent.

The people running these rackets know that a shrinking number of investigators face considerable barriers bringing them to justice. Investigations require evidence from vulnerable workers, afraid of being blacklisted from future jobs and anxious about being on the government's radar screen. When workers do come forward, holding bad actors financially accountable is complicated by layers of shell companies upon which misclassification schemes are typically built.

The rampant misclassification of workers in my industry isn't just bad for us employers, it also hurts workers and their families. For example, a contractor employed a crew of over 1,000 misclassified workers on more than 2 dozen hotel and apartment projects. The workers toiled over 50 hours a week without breaks or overtime. They are not paid in regular intervals, and when the contractor finally issued checks, they bounced. Misclassification in the construction industry also victimizes taxpayers to the tune of \$2.6 billion a year. This is because these schemes don't withhold payroll taxes, social security, or FICA contributions, they don't pay unemployment insurance or worker's compensation premiums. Instead, they throw the cost of unemployed and injured workers on taxpayer funded programs while fueling tax fraud, labor trafficking, and other serious crimes.

I know every Member here today supports law abiding entrepreneurs responsibly pursuing productive and profitable activities benefitting our companies, our customers, our workers, and our communities. But in the construction industry, pervasive

misclassification is rapidly undermining the viability of the traditional model of American free enterprise.

So on behalf of the law abiding construction employers, I thank you for holding this hearing. I hope that it will result in concrete proposals to address the rampant misclassification plaguing my industry.

I welcome any questions you may have.
[The statement of Mr. Townsend follows:]

TESTIMONY OF MATT TOWNSEND
PRESIDENT OF THE SIGNATORY WALL AND CEILING CONTRACTORS ALLIANCE
CEO, OCP CONTRACTORS, INC.

BEFORE THE WORKFORCE PROTECTIONS SUBCOMMITTEE
HOUSE EDUCATION AND LABOR COMMITTEE

HEARING ON MISCLASSIFICATION OF EMPLOYEES: EXAMINING THE COSTS TO
WORKERS, BUSINESSES, AND THE ECONOMY

September 26, 2019

Good morning Chairwoman Adams, Ranking Member Byrne, and Members of the Subcommittee.

My name is Matt Townsend. I am the majority owner and CEO of OCP Contractors, Inc., a construction contracting firm that employs approximately 500 men and women building and renovating healthcare facilities, hotels, educational buildings, and other structures across the state of Ohio and neighboring states. I have 43 years of experience in the construction industry dating back to when I was a teenager framing houses.

I am privileged to appear before you today in my capacity as President of the Signatory Wall and Ceiling Contractors Alliance—SWACCA. SWACCA is a national association representing construction company owners who employ tens of thousands of carpenters, drywall finishers, plasterers, and laborers to perform billions of dollars of framing, drywall, ceiling, and other interior systems work annually throughout the United States. SWACCA prides itself on serving as a voice for responsible employers. Our members are entrepreneurs competing on the basis of quality services, efficient execution, and the thoughtful implementation of training and innovation. Like other honest business owners in our industry, SWACCA members do not want to be complicit in the misclassification racket in order to compete. We thank you for holding this hearing and allowing me to explain the threat that worker misclassification poses to the ability of law-abiding employers in my industry to compete, to innovate, and to create jobs.

In my industry, misclassification is not about making tough calls applying complicated laws to ambiguous facts. Rather, it is a choice simply to disregard wage and hour laws, workers' compensation laws, unemployment insurance regulations, and other basic responsibilities of being an employer. This is done for the purpose of gaining an advantage against law-abiding competitors, realizing tremendous profits, and avoiding the financial risks that honest entrepreneurs must accept. Business owners using the misclassification model do not bear the risks of unanticipated overtime, bad planning, or poor execution. Instead, this racket transfers these risks onto workers and taxpayers. Let me explain how this works in the real world.

SWACCA's members operate businesses that provide all of the interior systems work—such as framing, drywall finishing, and ceiling installation—required on construction projects. We are hired through a cost-competitive bidding process administered by a general contractor or a construction manager that has been retained by a property owner. The most significant cost in

any interior systems bid is the cost of labor. This includes the number of workers, how much time they will need, and to what degree they will have to be paid overtime to get the job done on schedule. If a bid is accepted and our estimates about labor costs are wrong, our profits evaporate quickly. We may even lose money. But our workers get paid for every hour worked. They get overtime when their work exceeds forty hours in a week. Social Security and employment taxes are withheld, and appropriate workers' compensation insurance is in force throughout the duration of each project. Like other honest business owners, SWACCA members bear the risk of an inaccurate bid—not their workers. This is the way it should be in a competitive, free enterprise system that rewards company owners for taking risks informed by intelligent planning, and mitigated by the application of experience and innovation.

Contrast this with the increasingly pervasive business model in our industry that is rooted in a decision to treat every worker doing framing, drywall, and ceiling work on a jobsite as an independent contractor without regard to the requirements of the Fair Labor Standards Act (FLSA) and other basic workplace laws. Contractors using this business model can always submit a lower bid than a law-abiding contractor while knowing they will still pocket enormous profits. This is because in developing their bids these contractors do not worry about how many hours the workers will labor to complete the project or whether they will work over forty hours a week to get the job done on time. They do not worry about the costs of workers' compensation or unemployment insurance. This is because they know that under the misclassification model they have chosen the actual onsite work is turned over to lower-tier subcontractors, who are really just labor brokers. The misclassification racket relies on these labor brokers paying their crews of workers a set amount for each piece of drywall finished or square foot of framing or ceiling installed. But these are not lawful "piece rate" arrangements. These contractors do not pay one penny more for the work when the men and women doing it labor over 40 hours a week to finish on schedule. This business model requires a steadfast insistence that all of these workers are independent business operators—even though it flies in the face of reality—because it justifies evading unpredictable costs, like payment of overtime. The probability and costs of being brought to justice for such blatant disregard of the law are low. To people without scruples, these potential costs are greatly outweighed by the advantages that systematic misclassification provides in bidding work, realizing big profits, and avoiding entrepreneurial risk.

Make no mistake, the characterization of these workers as independent business owners is not based on a good faith assessment of the law. Under the typical misclassification schemes used in my industry, our competitors and their labor brokers tell the workers where to go and what to do. They control and direct their workers at the jobsite just like my company does. These workers have no capacity to negotiate what they will be paid. They are regular crews, economically dependent on a labor broker as they move from jobsite to jobsite as directed by someone who is clearly the boss. These workers are not exercising discretion and independent business judgment in scheduling their work like legitimate business owners do. To the extent wages vary among these workers because one installs more sheets of drywall than another on a given day, these differences are no more an indication that they are independent business owners than the disparate pay nineteenth-century miners received at the end of a workday based on the varying amounts of coal they hauled from the earth.

Often, these misclassified workers are paid in cash. Some may get a 1099 tax form consistent with the assertion that they are independent contractors. And it is not uncommon for misclassified construction workers to even have papers showing an LLC was created in their name. But these paperwork formalities are an absurd example of placing form over substance. Given the control the subcontracted labor brokers have over these workers, such paperwork no more makes them independent contractors than if the staff in a Congressional office had their own LLCs and were issued 1099s. Nobody would buy that such an arrangement comports with the requirements of the FLSA and other workplace laws. That is really akin to what is happening on the ground in my industry.

Simply put, by disregarding the law and exploiting desperate workers through a business model premised on dissociating themselves and their lower-tier of labor brokers from the legal responsibilities and costs of being employers, these contractors get a windfall. Disregarding the requirements of the FLSA and requirements related to workers' compensation, unemployment insurance, Social Security taxes, FICA, and many other costs that law-abiding contractors must include in their bids provides them with a tremendous competitive advantage.

How much of an advantage is it? The Ohio Attorney General has estimated that the misclassification of workers as independent contractors provides a 20-30% labor cost advantage against law-abiding employers.¹ When competing against a company like mine that pays middle-class wages, sponsors registered apprenticeship programs, and offers a retirement plan and health benefits, the misclassification model offers closer to a 50% cost advantage.

What makes this situation even more troubling is that this business model also facilitates the evasion of sanctions for non-compliance with the FLSA and other laws. As the state of Tennessee explained in a report earlier this year:

“When [one of] these business owners learns their non-compliance has been identified and they are subject to a penalty, they shut down their businesses. The owner will reopen as a newly formed business entity that is a continuation of the closed business. By reopening under a new name, business owners avoid assessed monetary penalties for non-compliance”²

Serially closing and opening what amount to shell companies is easy because these entities have no employees, no assets, no benefit plans, and no training programs. There is no real value in these entities the way that there is with law-abiding companies. This leaves workers no recourse against these entities even when cases are pursued by Wage and Hour Division investigators. SWACCA members and the workers in the communities where we operate see contractors who have been cited for misclassification operating under a new entity with the same workforce and no apparent change in their business model. To the extent they are ever held liable, these operators view the penalties as an acceptable cost of business.

¹ [Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio \(Feb. 18, 2009\)](#).

² [Annual Report on Employer Coverage Compliance, Tennessee Bureau of Workers' Compensation at 12 \(February 1, 2019\)](#).

Some may cite enforcement statistics or a handful of recent large recoveries the Labor Department won from employers misclassifying workers as independent contractors as evidence that the system is addressing misclassification. That is a nice theory. It may make some of us feel good. It justifies others denying the scale or nature of the misclassification problem. But it is not reality. In the real world—and on the ground in my industry—the reality is that these large recoveries made by Wage and Hour investigators are really an indication of the pervasiveness of misclassification and the boundless ambitions of the people using it. In my experience, the shrinking cadre of Wage and Hour investigators make admirable and determined efforts, but they are overwhelmed by the nature and scope of the problem.

At the front end of investigations, enforcement officials are hindered by the fact that the investigations rely on getting statements and evidence from a transient and fearful workforce. The workforce that the misclassification racket relies upon is not limited to immigrant labor. It also includes financially insecure construction workers who have no concerns about their work authorization, but who view the value of getting what they are owed as not worth the risk of being blacklisted from future jobs. Many also decide that getting paid properly is not worth being on the “radar screen” of government investigators, who they fear may ask questions that can cause them legal problems. These include questions about whether these individuals have been making their own tax payments or engaging in misrepresentations necessary to obtain work under the misclassification model. Such misrepresentations may relate to claims about holding certain certifications or having valid insurance coverage. On the back end, investigators are hobbled by the time and effort it takes to assign ultimate financial responsibility for unpaid overtime and hours worked. This entails sifting through the dense layers of shell companies upon which misclassification schemes rely for the fiction that everyone on a jobsite is their own employer operating an independent business.

Many SWACCA members have faced instances where investigators have acknowledged that they just do not have the time and resources to pursue what are obviously unlawful misclassification schemes. This may be because the schemes do not appear to be large enough to warrant devoting limited enforcement resources to address them. Other times, cases warranting the resources are not pursued because of the reticence of the affected workers to come out of the shadows. Make no mistake about it, the contractors who rely on the misclassification model are well aware that in many markets they are shielded by the sheer volume of these schemes and the suasion they have over workers who become complicit in the misrepresentations upon which they are built.

Honest employers in my industry view their workers as partners critical to their success. They make investments to maximize the skill and efficiency of their workers to reduce the probability that they will have to pay for unanticipated work hours to fix things that were not done right the first time. Honest employers invest in safety training that leads to fewer injuries on job sites because we care about our workers and want to reduce the premiums we pay for the workers' compensation insurance we carry. Under the misclassification model, business owners have no incentive to invest in training their workforce to be safer and more efficient because they don't bear the risks of unanticipated overtime to redo work or for accidents on the job.

In 2014, the McClatchy News Service published an extensive series of reports called "Misclassified: Contract to Cheat." This reporting across seven states (California, Florida, Illinois, Missouri, North Carolina, South Carolina, and Texas) documented the common travails of what was then estimated to be ten million construction workers exploited through misclassification.³ As the McClatchy reporters noted, this model relies on not paying workers for all hours worked, not giving an overtime premium for workweeks in excess of 40 hours, and leaving workers to fend for themselves without any workers' compensation or other recourse if they are injured on the job. SWACCA members can confirm that these are truly representative examples of what we see every day across the country.

In my industry, rampant misclassification isn't just bad for honest employers. It also hurts workers and their families. In depriving workers of their rights, purveyors of misclassification also rob workers of their dignity. When workers are misclassified, there is no employer accepting responsibility under health and safety laws for providing bathroom facilities at the job site or paying for bathroom breaks consistent with wage and hour laws. So on job sites where misclassified workers are used it is not uncommon to see water bottles full of urine left behind. Sometimes the workers even sleep at the job site because their pay may be withheld until the project is done. In fact, I know of one project at which a woman was misclassified and worked well in excess of forty hours a week installing drywall and cleaning up the worksite. She was not paid regularly and had to sleep in the luxury apartment tower she was helping to build. She was fired and kicked off the jobsite the day she got injured. In another case I know of, a contractor employed a crew of 1,000 misclassified workers on more than two dozen hotel, apartment, and mixed-use construction projects over a 21-month period. The workers toiled nine hours a day without rest breaks or overtime. The employer illegally withheld large amounts of their pay, and when he did finally issue checks, they bounced due to insufficient funds.

Let me also be clear that the men and women trapped in the misclassification racket are not the only workers harmed by this business model. It also impacts the employees of honest businesses that truly care about their workers. Legitimate, law-abiding employers want to pay their workers family-sustaining wages and provide retirement and health benefits if they can afford to do so. These employers know that fairly paid, economically secure workers do better work and are less likely to leave. This increases productivity and reduces costly turnover. And creating jobs that are a path to the middle class is something in which honest business owners take pride. It is something for which they rightly receive the praise and admiration associated with succeeding in America's free enterprise system. People using the misclassification model, however, place those of us who are well-meaning, law-abiding employers at a competitive disadvantage. Their greed and disregard of the law make it harder for us to provide stability for our workers. In some construction markets, the widespread reliance on misclassification is creating a race to the bottom that suppresses the wages and working conditions of the entire construction workforce and places the economic viability of honest employers at risk.

By evading all of the legal requirements and costs associated with being an employer, the people using the misclassification model victimize more than just their law-abiding competitors and America's construction workforce. It is estimated that construction employee

³ Last accessed September 21, 2019 at <http://media.mcclatchydc.com/static/features/Contract-to-cheat/>

misclassification costs taxpayers \$2.6 billion a year.⁴ This is because misclassification schemes do not withhold payroll taxes. They do not make FICA contributions. They do not pay unemployment insurance premiums. They do not pay workers' compensation premiums. They throw the costs of unemployed and injured workers onto taxpayer-funded social safety nets, while fueling tax fraud, wage theft, labor trafficking, and other serious crimes. In my experience it is not uncommon for misclassified workers to labor ten hours a day, six days a week doing framing and drywall work several stories above the ground. They often lack any safety equipment. When they are injured on the job and must get treatment, these people cannot afford to pay for it. There is no insurance or workers' compensation to cover the costs. So the costs are borne by public hospital emergency rooms and other taxpayer-funded programs, including Medicaid.

Candidly, I find it hard to see how this situation will change in my industry unless the federal government takes action to better deter, detect, and punish those who attempt to gain a competitive edge over honest employers by willingly victimizing vulnerable workers and the American taxpayer through misclassification. It may be too much to ask for additional funding for more Wage and Hour investigators. But maybe clear direction can be given to those who are already on the job to focus their limited investigative and audit resources on industries like construction, in which rampant misclassification is threatening to make honest entrepreneurship economically infeasible. Additionally, the federal government could follow the lead of some states by increasing penalties for repeated or willful misclassification. The handful of bad actors who are caught flagrantly disregarding the law should pay a price that does not allow them to view the penalties as an acceptable cost of doing business. It is also clear that workers must be better educated about their rights and what they stand to lose when they are misclassified. Any such education, however, will be of little value if workers do not feel protected against retaliation when they do step forward to assert their rights.

As I said at the outset, SWACCA members and other honest employers in the construction industry do not want to be complicit in the misclassification racket in order to compete. But this business model poses daunting challenges for law-abiding entrepreneurs in my industry across the country. It also causes real and serious harm to workers and taxpayers. So on behalf of SWACCA's members and other law-abiding, responsible employers seeking to grow their businesses by taking risks, applying knowledge, and deploying innovation, I thank you for drawing attention to this issue. I hope that the spotlight you are shining today is just the start of a larger conversation leading to meaningful action that addresses the increasingly pervasive misclassification of workers in my industry. I welcome any questions you may have.

⁴ Last accessed September 21, 2019 at <http://stoptaxfraud.net/wp-content/uploads/2019/03/Estimating-the-Construction-Tax-Gap-SCP-2-19.pdf>

Chairwoman ADAMS. Thank you very much.
Mr. Chemers, you have five minutes, sir.

**TESTIMONY OF ALEXANDER CHEMERS, J.D., SHAREHOLDER,
OGLETREE, DEAKINS, NASH, SMOAK & STEWART, P.S.**

Mr. CHEMERS. Chair Adams, Ranking Member Byrne, and Members of the subcommittee, I appreciate the opportunity to testify before you on the Payroll Fraud Prevention Act.

My name is Alexander Chemers. I am an attorney and a shareholder with Ogletree, Deakins, Nash, Smoak & Stewart, though I am appearing today in my individual capacity.

I have spent my entire legal career in California. I appear before Federal and state courts and I see on a daily basis the real work effects that laws like the PFPA have after they are passed. More employment class actions are filed in California state courts than in the 49 other states combined. That is not because more companies violate the law in California, it is because well intentioned legislation has resulted in a maze of legal obligations with unclear and ever-changing requirements, where businesses face excessive penalties for even hyper technical violations of the law.

The PFPA is similarly well intentioned in seeking to reduce the misclassification of independent contractors. The bill's provisions, however, will do little or nothing to address that issue. The centerpiece of the PFPA is the requirement that all workers receive a notice informing them whether they are an independent contractor or an employee, along with detailed information, including the address and telephone number of the Department of Labor's local office. Let me be plain, virtually every person in the United States who works for a living would receive at least one, and in some cases, many notices. It is unclear whether this information will help educate workers or result in them contacting the DOL, or whether the DOL will do anything in response to the notices. It is also unclear, and perhaps doubtful, that persons who are already flouting existing laws by misclassifying workers, will even issue the notices.

What is clear is that law abiding businesses will incur millions of dollars preparing and maintaining the notices. It is also clear that the vast majority of the notices, which would be issued to persons who are already classified as employees, will serve no purpose.

Finally, it is clear that businesses will be exposed to enforcement actions and private lawsuits for even hyper technical violations of the notice requirement. That is because the next major elements of the PFPA include a presumption of employee status along with enhanced damages and penalties for violations of the statute. Like the notice provision, these remedies are unlikely to advance the PFPA's stated goal.

The FLSA already provides significant remedies for the misclassification of workers, including unpaid wages, liquidated damages, and attorney's fees and costs. It is unclear what impact, if any, there will be from piling on yet more damages.

Once again, the only thing we know for sure is that the PFPA will burden and penalize businesses of every size. The severe consequences for violating the PFPA apply with equal force to a business that intentionally misclassifies a worker as to a business that cannot prove compliance with the notice requirement.

For example, a business could be exposed to millions of dollars in penalties for not issuing notices, even if that company does not use any independent contractors. Likewise, hyper technical violations, such a notice that references the DOL's wrong local office, would expose a business to a presumption of employee status and penalties.

The combination of the PFPA's detailed notice requirement, together with the severe penalties for noncompliance creates a perfect gotcha statute. We already have too many of those. One example is the Fair Credit Reporting Act, which requires businesses to

issue stand alone disclosures to job applicants before obtaining a consumer report. Plaintiff's firms have seized on hyper technical violations of this notice requirement, like a disclosure form stapled to other new hire documents, to seek millions of dollars in penalties.

Another example is California's Private Attorney General's Act, frequently referred to as PAGA. Like the Payroll Fraud Prevention Act, PAGA is premised on aggrieved parties giving notice to a state agency of the claimed violations. In practice, the state agency rarely, if ever, investigates claims, a pattern that will likely be repeated by the DOL here.

Like the PFPA, PAGA authorized civil penalties for alleged violations, including the misclassification of workers. These penalties, which easily reach into the millions of dollars, are routinely used by plaintiff's firms to threaten law abiding businesses with catastrophic damages and even bankruptcy.

If there are concerns surrounding the use of independent contractors, further enforcement in this area should be balanced and narrowly tailored to reduce misclassification while minimizing the harm to businesses and others who lawfully partner with independent contractors.

As presently drafted, the PFPA undermines that balance and risk imposing severe costs and penalties without any demonstrated benefit.

Thank you for the opportunity to share my thoughts.

[The statement of Mr. Chemers follows:]

**Testimony of
Alexander M. Chemers**

**Before the U.S. House of Representatives
Committee on Education and Labor
Subcommittee on Workforce Protections**

Hearing on the Payroll Fraud Prevention Act of 2019

September 26, 2019

Introduction

Chair Adams, Ranking Member Byrne, members of the Subcommittee, I appreciate the opportunity to testify before you today on the Payroll Fraud Prevention Act of 2019 (PFPA).

My background informs my comments on this proposed legislation. I graduated from law school in California, clerked for a federal judge, and have spent my entire legal career practicing employment law in California. I am a Shareholder in the law firm of Ogletree, Deakins, Nash, Smoak & Stewart, P.C. In that capacity, I help businesses comply with federal and state wage laws, including determining whether to classify workers as employees or independent contractors in California and throughout the United States. I litigate a significant number of cases involving the question of employee status, as well as claims for unpaid wages and other benefits. I use the term “wage-and-hour” to broadly describe this area of the law. My practice requires me to regularly appear in federal court, including matters that are pending before the four districts that comprise California—the Southern District, Central Districts, Eastern District, and Northern District of California. I also appear frequently before California state courts in cases involving wage-and-hour claims asserted under California state law.

As discussed at further length below, the PFPA seeks to import into the Fair Labor Standards Act (FLSA) aspects that already exist under California state law. As a result of my litigation practice, I see—on a daily basis—the impact that legislation like the PFPA has already had in California. I wish to share my thoughts regarding the likely consequences—intended and unintended—of the PFPA. While I do bring extensive experience as an employment law practitioner, I am not testifying today on behalf of my law firm or clients.

Scope Of Anticipated Testimony

In deciding whether the PFPA is necessary, this Committee and the Congress will need to consider whether workers are routinely misclassified as independent contractors and, if so, the effects of such misclassification on our society. My comments do not focus on those preliminary questions, which may be more appropriate for labor economists or

other persons who have studied the relevant issues. Instead, I seek to answer the following two questions:

Question 1 – Assuming that the misclassification of workers poses a major issue, will the PFPA help to “ensure that employees are not misclassified,” as stated in the Act?

Question 2 – What impact, if any, will the PFPA have beyond its stated goal of “ensur[ing] that employees are not misclassified”?

Consequently, I offer my thoughts as to whether the PFPA will be effective in addressing the misclassification of workers as independent contractors, as well as other likely consequences of the Act.

I note at the outset that I believe in a measured approach to the issue of employment classification. I agree that independent contractors should satisfy criteria in order to fall within the category of “non-employee,” and both the FLSA and many states already impose substantive requirements limiting who can be an independent contractor.¹ While there need to be restrictions, I also believe there is a place in our economy for genuine independent contractors. Independent contractors are found in nearly every industry, across all sectors, and encompass both “blue-collar” and “white-collar” occupations including financial advisors, information technology specialists, physicians, truck drivers, athletes, authors, artists, accountants, consultants, and lawyers.

While we should endeavor to minimize the misclassification of workers, we also need to offer a path for the many businesses who utilize genuine independent contractors. This is not only important to the businesses that rely on independent contractors, but to the independent contractors themselves (many of them small business owners), who need flexibility to grow their own businesses and to provide their services outside the confines of a traditional employer/employee relationship. Legislation premised on the belief that all or nearly all independent contractors are misclassified is, in my view, a mistake, as are bills that seek to effectively outlaw the use of independent contractors, including California’s recently passed Assembly Bill 5² or the Protecting the Right to Organize Act of 2019 currently under consideration by this Committee.

The businesses that I represent rely on independent contractors to varying degrees. They also utilize independent contractors for different reasons, including the desire for specialized skills and/or equipment, short-term help, controlling costs, and enlisting small businesses with an entrepreneurial bent. I have found that companies are generally doing their best to classify workers properly as either an employee or independent contractor. There are always bad actors (just as there are employers who fail to pay minimum wage or overtime to persons who are classified as employees), but that is the exception and not the rule in my experience.

¹ See, e.g., *Fact Sheet 13: Employment Relationship Under The Fair Labor Standards Act (FLSA)*, <https://www.dol.gov/whd/regs/compliance/whdfs13.htm>.

² See https://leginfo.ca.gov/fares/billNavClient.xhtml?bill_id=201920200AB5.

Individual Elements Of The Payroll Fraud Prevention Act

In my opinion, the following elements of the PFFA deserve particular attention:

1. The requirement that businesses provide detailed notice to all workers of their employment status;
2. The presumption of employee status if the notice is not provided; and
3. Liquidated damages and civil penalties for violations of the statute.

Notice And Recordkeeping Requirements

The PFFA proposes to add a "Recordkeeping; Classification; Notice" section to the FLSA at 29 U.S.C. § 211(c). This would require every employer to provide written notice to each "individual providing labor or services for remuneration for such employer or enterprise and engaged in commerce or in the production of goods for commerce." Such notices would be provided to all existing workers (whether employee or non-employee), at the time of any change in status, and to new workers at the start of the engagement.

The required notices must: (i) inform the individual of his/her classification as employee or non-employee; (ii) direct the individual to a newly created Department of Labor (DOL) website; (iii) include the address and telephone number "for the applicable local office of the Department of Labor"; and (iv) include language advising the individual of his/her rights and directing them to contact the U.S. DOL with any questions or concerns related to their employment status. The person issuing the notices must also maintain copies of the notices or risk severe consequences, as discussed below.

The potential impact of the notice and recordkeeping requirements on employers will be significant. As currently drafted, the PFFA would obligate businesses to issue notices numbering in the tens of millions. This is not hyperbole; the PFFA expressly requires that notices be provided to all workers, including both employees and independent contractors. If not amended, the PFFA could also require businesses to issue millions of notices with minimal, if any, notice.³

³ Section 3 of the PFFA proposes that, "[n]ot later than 180 days after the date of the enactment of this Act, the Secretary of Labor shall establish a single webpage on the Department of Labor website" containing certain information. Section 2 of the PFFA similarly requires that existing workers receive the required notices "not later than 6 months after the date of enactment" of the Act. Those notices must, among other information, direct individuals "to the Department of Labor website established under section 3" of the Act. Read in conjunction, these provisions preclude businesses from issuing notices until after the DOL establishes the necessary webpage. If the DOL does not do this promptly and instead waits until the end of the six-month period (as permitted under the current version of the Act), businesses would be required to issue the notices on

Not only is the sheer volume of the notices immense, the notices must be customized for each jurisdiction. For example, a business with operations across the United States would need to issue several dozen different versions of the notice identifying each local DOL office. Indeed, a company with operations in California would be obligated to provide eight (8) different versions of the notice just to California workers.⁴ Because workers are entitled to tailored versions of the notices, businesses would also need to verify—prior to providing any notice—the location where each employee or non-employee performs services. Businesses would have to regularly scrutinize the address and telephone notice of each DOL office, since any change in the address or telephone number would require that businesses immediately update the notices. Businesses would also be obligated to maintain copies of tens of millions of notices, with particular diligence paid to the millions of notices provided to independent contractors, and without any limitation on how long the notices must be maintained. This is on top of the significant regulatory burdens that are already placed on businesses, and which smaller companies particularly struggle to comply with.

A few thoughts regarding the notice and recordkeeping requirements:

The notices apply to all persons providing services, regardless of the duration or scope of those services. The PFPFA, by its terms, applies to every worker engaged by every employer. The scope of the notice requirement is enormous. For example, a business that contracts with a plumber to fix its toilets would be obligated to provide notice. In that same vein, businesses would need to provide notices to gardeners, electricians, florists, caterers, and any other vendors that they use, even if the services provided are episodic and unrelated to the contracting entity's normal business operations. A small business that hires an accountant to do its taxes would be presumed to be the employer of that accountant, unless notice is provided. Likewise, a dentist who runs a small practice and who asks another dentist to handle emergency appointments during her vacation would also be presumed to be the employer of that dentist, despite him or her holding an advanced degree. Other examples abound.

The notices may impose significant costs on businesses. As noted above, the PFPFA will force businesses to issue customized notices to large swaths of the American workforce. The cost of the notices may be one of the topics that Congress wishes to investigate further and before taking action on the Payroll Fraud Prevention Act. If you assume that each notice costs only \$.25 to create and maintain, however, the cost would be \$37,500,000.00.⁵ I suspect that the actual cost in resources and payroll hours would be far higher than that.

an incredibly short time frame. To avoid these issues, the PFPFA should be amended, at a minimum, to give businesses more than six months to issue notices to existing workers.

⁴ There are presently eight offices of the DOL in California: Fresno Area Office, Los Angeles District Office, Sacramento District Office, San Diego District Office, Orange Area Office, San Francisco Area Office, San Jose District Office, and West Covina District Office. See <https://www.dol.gov/whd/local/index.htm>.

⁵ Assuming at least 150 million persons in the United States workforce and one notice per person: $150,000,000 \times \$0.25 = \$37,500,000$.

Federal and state law already impose onerous notice requirements. The notice requirement under the PFFPA would add to a lengthy list of other notices required under federal and state law. For example, a business in California is already obligated to provide more than ten separate notices regarding various legal requirements.⁶

The notices are unnecessary as to employees. The vast majority of persons who receive the notices will already be classified as employees. It is unclear what incremental benefit, if any, will accrue from providing notices to persons who are not classified as independent contractors.

The notices may be unnecessary as to independent contractors. It is also unclear to me whether the notices will benefit people who are classified as independent contractors. I understand that the notices contain information informing each independent contractor of his or her classification, and advising them where to report any concerns related to that classification. To achieve any real benefits, the following would need to happen: (1) significant numbers of workers must read the notices; (2) these workers would need to realize that they are classified as independent contractors and not employees; (3) they would contact the local DOL office to complain about their classification; (4) those queries would result in a DOL investigation into the matter; and (5) those investigations must result in a change of status for these workers (after all, if the employer was correct in concluding that the worker was an independent contractor, the entire exercise will have been a waste of time and resources). Whether any, let alone all, of those prerequisites will occur is uncertain.

The effectiveness of the first step—*i.e.*, whether independent contractors will actually read the notices—is hard to predict. Perhaps some will, but likely many will not. As for the second step, I have found that the vast majority of independent contractors already understand that they are classified as independent contractors. Many businesses enter into written agreements with independent contractors that memorialize their status. Indeed, in determining whether an independent contractor relationship exists, the Internal Revenue Service examines, among other things, if there are “[w]ritten contracts which describe the relationship the parties intend to create.”⁷ Thus, businesses that seek to use independent contractors are strongly incentivized under current law to inform persons of their classification, and routinely do so. Finally, it is unclear whether independent contractors will actually contact the DOL’s offices, or whether imposing further and additional notice requirements will instead cause confusion. I discuss below the next steps in the required causal chain.

The notices direct persons to contact the United States DOL. As noted above, notices under the PFFPA must contain contact information for the local DOL office, along with instructions to contact that office “[i]f you have any questions or concerns about how you have been classified or suspect that you may have been misclassified. . . .” The PFFPA does not address how such questions or concerns will be addressed, or whether Congress will provide additional funding that will enable the DOL to respond to such

⁶ A partial list of these requirements is found here: <https://www.dir.ca.gov/wp/nodb.html>.

⁷ See <https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation>.

inquiries. As such, the bill will create enormous loads of paperwork for government agencies at great cost, all the while providing little or no evidence that such efforts will address the perceived problem.

The Presumption Of Employee Status If Notice Is Not Provided

To the extent that a business cannot prove that notice was provided to an independent contractor, the PFPA establishes a presumption that the worker is an employee, which can be rebutted “only through a presentation of clear and convincing evidence that a covered individual . . . is not an employee of the person or enterprise.”

Based on the statutory language, even hyper-technical violations of the statute would result in the presumption of employee status. For example, a plaintiff could argue that he or she is presumed to be an employee in any of the following scenarios:

1. The notice was not provided;
2. The notice was provided but it listed the wrong office for the DOL;
3. The notice was provided and listed the applicable local office of the DOL but the address and/or telephone number was incorrect; or
4. The notice was provided and contained all of the necessary information but now cannot be located by the business.

When the PFPA’s detailed notice and record keeping requirements are combined with the presumption of employee status and extensive remedies available under the Act, plaintiffs’ attorneys will have a powerful cudgel to yield against employers, whether or not those businesses have in fact misclassified any workers as independent contractors, and even if those businesses made a good-faith effort to comply with the FLSA.

Additional Liquidated Damages And Civil Penalties

Perhaps most troubling is that the PFPA seeks to impose enhanced damages and penalties for violations of the statute, including hyper-technical violations of the notice requirement.

Under the current version of the FLSA, a worker who is improperly classified as an independent contractor can recover “the amount of their unpaid minimum wages, or their unpaid overtime compensation” and “an additional equal amount as liquidated damages.”⁶ In other words, a plaintiff can recover any wages that were unpaid, along with an equal amount in liquidated damages. Section 216(b) also authorizes a court to, “in addition to any judgment awarded to the plaintiff or plaintiffs, allow a reasonable attorney’s fee to be paid by the defendant, and costs of the action.”

The PFPA seeks to further increase the remedies available under the FLSA. This includes language providing that “liquidated damages are doubled,” *i.e.*, that a plaintiff could effectively recover treble (triple) damages.

⁶ 29 U.S.C. § 216(b).

The Act also authorizes a “civil penalty” that is “not to exceed \$1,100” or, “in the case of a person who has repeatedly or willfully committed such violation, not to exceed \$5,000.” This penalty would be imposed for “[a]ny person who violates section 6, 7, 11(c), or 15(a)(6).” Thus, the penalty could be applied against persons who fail to pay minimum wage⁹ or overtime¹⁰ or who “wrongly classify an employee of the persons as a non-employee”¹¹ The penalty, however, could also be applied against persons who do not comply with the notice requirement, which the PFPA seeks to add at 29 U.S.C. § 211(c).

Here are several reasons why the PFPA’s dramatic increase in damages and penalties is concerning:

The PFPA authorizes penalties for hyper-technical violations of the notice requirement. As noted above, the PFPA authorizes a civil penalty of up to \$5,000 for each violation of the FLSA, as amended. This includes violations of the notice requirement, *e.g.*, a business that fails to inform an independent contractor of his or her employment would be liable for the civil penalty. But, it would also permit the same penalty if a business provides the required notice but cannot subsequently locate that notice, or where a business “violates” the statute by listing the incorrect address or telephone number for the local DOL office. Most astoundingly, the PFPA requires that businesses issue tens of millions of notices to employees. Consequently, a business could be deemed to have violated the notice requirement and exposed to considerable amounts of civil penalties even if the company engages zero independent contractors. As this illustrates, the ability of plaintiffs or the DOL to pursue hyper-technical violations will do nothing to solve any underlying issues related to the misclassification of some workers.

The threat of immense penalties will compel businesses to settle lawsuits regardless of their merit. By allowing not only treble damages for unpaid wages but up to \$5,000 in civil penalties per person, the PFPA would allow the DOL to seek crippling penalties against alleged wrongdoers. For example, a business with only 1,000 workers could face millions of dollars in unpaid wages and up to \$5,000,000 in civil penalties. I am familiar with such situations, because these types of civil penalties are regularly sought by private plaintiffs in California pursuant to the Private Attorneys General Act of 2004 (PAGA).¹² I have litigated dozens of cases involving claims under the PAGA. I know from firsthand experience that the immense exposure from PAGA claims—often reaching into the tens of millions of dollars—can drive businesses to settle claims that they might otherwise litigate to trial, since an adverse outcome would cripple or even bankrupt the business.

⁹ Pursuant to Section 6 of the FLSA, 29 U.S.C. § 206.

¹⁰ Pursuant to Section 6 of the FLSA, 29 U.S.C. § 207.

¹¹ Pursuant to Section 15(a)(6) of the FLSA, if amended in the manner sought under the PFPA.

¹² Labor Code § 2698 *et seq.*

The FLSA already provides remedies for violations of the statute.

Significantly, a business that misclassifies workers as independent contractors risks significant financial exposure under the current version of the FLSA. Even without the PFPA, a prevailing plaintiff can recover double damages, along with their attorneys' fees and costs.¹³ Therefore, the FLSA not only discourages businesses from misclassifying their workers, it contains strong financial incentives for plaintiffs—and attorneys—to file civil lawsuits. Authorizing yet more damages and penalties will only encourage more class action lawsuits, many of which will do little to benefit the workers on whose behalf the cases are pursued. Rather, these additional amounts are piling on and imposing crushing liability in the event that workers are found to be employees, even in close cases.

Cautionary Tale No. 1 – Notice Requirements Under The Fair Credit Reporting Act

As noted above, the PFPA imposes detailed notice and recordkeeping requirements, with even hyper-technical violations exposing a business to severe consequences. In evaluating the potential negative impacts of the PFPA, Congress may wish to consider analogous notice requirements under the Fair Credit Reporting Act (FCRA).¹⁴

Under the FCRA, employers who obtain a consumer report on job applicants must disclose that process “in a document that consists solely of the disclosure.”¹⁵ The FCRA does not provide any other guidance as to what does, or does not, satisfy the requirement of a stand-alone disclosure. It does, however, establish a penalty of \$1,000 for each willful violation of the statute.¹⁶

Plaintiffs' firms have filed numerous lawsuits under the FCRA. Without showing any actual harm to consumers, these plaintiffs have sought millions of dollars in statutory penalties. They routinely allege that employers have violated the FCRA's notice requirement by including “extraneous” information in the disclosure. This includes hyper-technical violations including situations where an employer has presented the disclosure at the same time as other new hire documents, or where the disclosure is stapled together with other documents.¹⁷

¹³ The current version of the FLSA also authorizes civil penalties “not to exceed \$1,100 for each such violation” of the minimum wage and overtime provisions. 29 U.S.C. § 216(e)(2).

¹⁴ 15 U.S.C. § 1681 *et seq.*

¹⁵ 15 U.S.C. § 1681(b)(2)(A).

¹⁶ 15 U.S.C. § 1681n.

¹⁷ See *Woods v. Caremark PHC, L.L.C.*, No. 4:15-cv-00535-SRB, 2015 WL 6742124 at *2 (W.D. Miss. Nov. 2, 2015) (denying motion to dismiss where plaintiff alleged that defendant violated the stand-alone disclosure requirement by including “1) an overbroad authorization for third parties to provide information to Defendant and its consumer reporting agency, 2) state-specific notices that did not apply to Plaintiff, and 3) that the form was ‘part of a five-page stapled packet of three documents.’”).

Unless the PFPA is amended, it will similarly allow plaintiffs to seek severe penalties—including a presumption of employee status and treble damages—based on hyper-technical violations of the Act.

Cautionary Tale No. 2 – California’s Private Attorneys General Act

Another cautionary tale is presented by California’s PAGA statute.¹⁸ The Golden State’s experiences with PAGA over the last 15 years illustrate some of the potential unintended consequences of the PFPA, including the following.

Government Agencies Cannot Keep Pace With Complaints. Although the PFPA presumes that the DOL’s local offices will have the resources to handle any and all complaints, PAGA illustrates the pitfalls of this approach.

Prior to initiating a PAGA lawsuit, a plaintiff is required by statute to send a letter outlining the alleged violations to a California state agency, the Labor & Workforce Development Agency (LWDA).¹⁹ The LWDA is then given 60 calendar days to decide whether to investigate the complaint.²⁰

Because of the statutory requirement, thousands of PAGA notices are submitted to the LWDA each year.²¹ In practice, “less than half of [the] PAGA notices were reviewed [in recent years], and [the] LWDA estimates that less than 1 percent of PAGA notices have been reviewed or investigated since PAGA was implemented” in 2004.²²

I am concerned that persons who contact the DOL pursuant to the PFPA will find it is similarly non-responsive.

PAGA Authorizes Crippling Civil Penalties. Another similarity to the PFPA are the civil penalties authorized by PAGA, though the California statute permits private plaintiffs and attorneys (rather than the DOL) to seek those penalties. As mentioned above, the prospect of a PAGA plaintiff recovering a crippling amounts of penalties regularly force defendants to settle cases, regardless of how strong their defenses are or whether they actually broke the law.

¹⁸ PAGA allows private persons to sue to collect civil penalties for violations of the California Labor Code. Similarly to a collective action under the FLSA, a PAGA plaintiff can seek these penalties on behalf of themselves as well as other allegedly “aggrieved employees.” PAGA penalties are assessed per “aggrieved employee,” per pay period, for each allegedly violated statute. The default penalty amount under PAGA is \$100 per employee per pay period for the initial violation, and \$200 for each subsequent violation. Labor Code § 2699.3(a)(1)(A).

¹⁹ Labor Code § 2699.3(a)(2)(A).

²¹ *The 2016-2017 Budget: Labor Code Private Attorneys General Act Resources*, <https://lao.ca.gov/publications/report/3403> (identifying 6,047 PAGA notices in 2012, 7,626 PAGA notices in 2013, and 6,307 PAGA notices in 2014).

²² *Id.*

PAGA Has Led To A Flood Of Litigation. Federal and state courts in California are groaning under the weight of wage-and-hour lawsuits, including claims based on the misclassification of workers as independent contractors. In 2018, plaintiffs filed nearly 2,500 class actions in California state courts alleging violations of PAGA and similar statutes.²³ In comparison, less than 1,000 class actions involving employment claims were filed in the state courts of the 49 other United States combined.²⁴ I am concerned that other jurisdictions will witness similarly staggering numbers of lawsuits if the PFFPA is passed.

Conclusion

While I appreciate and share the concerns surrounding the use of independent contractors, further enforcement in this area should be balanced and narrowly tailored to reduce incidences of misclassification, while minimizing the harm to businesses and others who lawfully partner with independent contractors. As presently drafted, the PFFPA undermines this balance and risks imposing severe penalties without any demonstrated benefit. I appreciate the opportunity to submit my comments and I look forward to discussing these items with you further at the hearing.

²³ Based on data collected from the Courthouse News Service, <https://www.courthousenews.com/>.

²⁴ *Id.*

Chairwoman ADAMS. Thank you very much.
Miss Crawford, you are recognized for five minutes, ma'am.

TESTIMONY OF MARIA CRAWFORD, GIG WORKER

Ms. CRAWFORD. Thank you, Chairwoman Adams, Ranking Member Byrne, and Members of the subcommittee.

My name is Maria Crawford and I am a gig worker from Altadena, California. I am a proud wife of 25 years, a mother, and a grandmother. I previously worked in the IT field for over 15 years, but lost my job to outsourcing. At the age of 54 I found it difficult to start a new career, bringing me to online work, or gig work.

I spend most of my time gigging for Instacart and also work for Postmates, DoorDash, Cavier, and Uber Eats. I start every day unsure of how much work will be available. Some apps allow me schedule shifts in advance, while others I can do on demand. Because base compensation is so low, it is important that I check what shift incentives are available on the different platforms. Once I am done scheduling myself, I wait for my first customer order. When I get one, I have a short amount of time to decide if I want to take it despite not being told where I am delivering it to. Since I get dinged on passing on too many orders, I am pressured into taking jobs that don't pay well. I then rush through the grocery store, since my time is monitored, pay for the groceries, and then make my delivery.

After I complete an order I am given a breakdown of my total compensation, which is a nontransparent mix of base pay, incentives, and customer tips. Initially I found the pay to be good, but over time I found it difficult to earn a living wage, despite it being my primary job and income that my family relies on.

I believe I am misclassified as an independent contractor instead of an employee, which means I am losing out on protections that could ensure fair pay and hours. Sometimes my pay is so low it dips below the \$12 an hour minimum wage in my state. In fact, a job could cost me money after factoring in car maintenance and gas. My pay structure seems to change often. I now must rely on tips and incentives to make ends meet.

I do not get paid for any down time, even if I am on a scheduled shift. I sometimes have to wait a long time without pay for customers to receive their orders. On top of that, these apps have also been accused of stealing our tips.

I am told that the advantage to my type of work is the flexibility to set my own schedule. The truth, flexibility is totally dependent on a narrow window of time when most orders come in. This means I have to compete with co-workers for lucrative shifts. I also don't have the flexibility to pick and schedule these lucrative shifts or even stay on the app unless I meet unreasonable standards.

Instacart has a demerit system, which they call reliability incidents. I can get a reliability incident if I pass on too many orders, even if I would lose money, if I want to finish early, or if I sign up for a shift but then can't make it due to an emergency. So, when I want to be flexible with my work, Instacart punishes me. Maintaining a high customer rating is also vital to the job. On Instacart, if your rating drops to a 4.2 out of 5 stars, you are kicked off the app completely. Just to be clear, 4.2 stars is an 84 percent rating. Imagine if Members of Congress had to maintain this approval rating to keep their jobs.

The app on my phone dictates my ability to take orders. It constantly tracks me. It sets and changes my pay. It times my work. It can discipline me. I have less control over my work now than before when I was properly classified.

With no transparency in how I am paid and how my work is evaluated, it is impossible to budget for my family, especially when I am expected to pay for worker's compensation, disability, health insurance, unemployment, liability insurance, auto insurance, social security, as well as Federal, state, and local income taxes.

While I am fortunate to have financial support from my husband, I still rely on my retirement savings to make ends meet. I don't see how this type of work is sustainable for families.

Despite this, why do I do this work? Again, as a woman in her 50s I have found it difficult to find a new job, despite over a decade of experience. I saw this new technology as a source of opportunity in a new and growing sector, and I know that its success is not contingent upon workers being treated this way. I raise these issues not to single out my employers because this practice is widespread and growing. I fear that if we let these companies continue to misclassify their workers, it will only incentivize this bad corporate behavior.

What we are asking for is not radical. We want the same fair labor standards that have fueled innovation in this Nation for years. I ask you to support the Payroll Fraud Prevention Act and help prevent workers like me from being misclassified so we can have family sustaining wages and benefits.

Thank you.

[The statement of Ms. Crawford follows:]

Written Testimony of
Maria Crawford

for hearing on
“Misclassification of Employees: Examining the Costs to Workers, Businesses, and the Economy”
Committee on Education and Labor Subcommittee on Workforce Protection
U.S. House of Representatives
September 26, 2019

Hello my name is Maria Crawford, and I am a gig worker from Altadena, California. I am one of the roughly 57 million U.S. workers who are considered part of the gig economy¹.

I am a proud wife of 25 years, a mother of two adult daughters, and a grandmother to two beautiful grandchildren. I worked in the I.T. field for a utility company for over 15 years, but lost my job to outsourcing. At the age of 54, I have found it difficult to start a new career. This difficulty, as well as the promise of good wages and flexible scheduling brought me to the field of online platform work, often referred to as “gig work.”

While I spend most of my “gig work” time on the app Instacart, I also do work for Postmates, Door Dash, Caviar, and Uber Eats. All of these platforms classify me as an “independent contractor” but I believe I am a misclassified employee. That misclassification makes it hard for me to get the protections that would help make sure I have fair, steady pay.

I start every day unsure of how much work will be available for me that day. Some apps allow me to schedule shifts in advance, while others I can do on demand. Scheduling a shift reserves time in advance, where I am available to take orders in a specific part of town. My window to work is from about 11 am to 7:30 pm, since I am not comfortable making deliveries after dark, and since there is very little work on any platform available in the morning. Because base compensation for many of these platforms is so low, it is also important that I check to see what shift incentives are available on which platforms. Shift incentives include a bonus per delivery for working in a specific geographic area or working a specific day and time.

Once I’m done scheduling myself for the day, I usually log into Instacart and wait for a customer order, which we call a “batch.” My phone will alert me when a customer places an order giving me the opportunity to review it on my screen before I accept it. Sometimes I’m not told where to deliver the groceries to until after I accept the batch. I’m only told where to purchase groceries from and how far the delivery is from that store.

If I have a prescheduled shift, then I have three and a half minutes to review the order, and no one else can claim it. If I am working “on demand,” orders appear to anyone else working on demand and are often claimed in seconds. I’m told what I will get paid for the order, as well as the amount of tip the customer has added. Since I get dinged for passing on too many orders, I am often pressured into taking jobs that pay me very little money and in some extreme cases may even COST me money after factoring in things like fuel and wear and tear on my car.

¹ <https://www.forbes.com/sites/timccue/2018/08/31/57-million-u-s-workers-are-part-of-the-gig-economy/#341d65fa7118>

I then rush through my grocery store as fast as I can, since my time is monitored. If the customer orders an item that is out of stock, I have to message them about an adequate replacement item and hope that they respond in an adequate amount of time. If they take too long to respond, my delivery could be late, which could negatively impact my customer rating.

After I complete an order, I'm given a breakdown of my total compensation. Its broken down into several categories: "batch payment," incentive pay, which includes things like "peak boosts" and "quality bonuses," and the customer tip. My "batch payment" is the base delivery fee. This is determined through a non-transparent number of factors including how many items are in the order, how many people are working on the platform in the area, and how far from the store the delivery takes me. A "peak boost" is an incentive to take an order no other workers want to take, an order that needs to be expedited, or to prioritize orders during busy times. The availability of peak boosts are unpredictable and inconsistent. A "quality bonus" is an extra \$3 only available when I get a perfect customer rating for doing both the shopping and the delivery on an order. Finally, tips are inconsistent and can change up to three days after I make a delivery.

Initially, I found the pay on these platforms to be good, but over time, I found it more and more difficult to earn a living wage, despite it being my primary job and income that my family relies on. I think that they are misclassifying me as an independent contractor which means I am losing out on protections that could help make sure I have fair pay and hours.

Let me explain some of the ways in which I think I am losing out because I am being misclassified.

First and foremost, sometimes my pay is so low it often dips below the minimum wage in my state, which is \$12 an hour. My pay is not only low, but my structure seems to be changing often, where now I must rely on tips and incentives to make ends meet.

Most apps do not reimburse me for expenses, so when you factor in car maintenance costs I might be making less than minimum wage. I do not get paid for waiting time, even if I am on a scheduled shift. There are times where I have to sit in a store or parking lot and wait for an order before I can deliver it. I do not get paid for that time. I sometimes have to wait a long time for customers to come get their orders that I am delivering. I do not get paid for that time. Imagine if members of Congress were only paid for times they voted!

To complicate things further and exacerbate the problem of low pay, Instacart and DoorDash have been accused in the past of using customer tips to cover part of my base pay for each order, instead of adding tips on top of that pay.² I'm sure most customers are unaware of this practice, and would feel deceived if they learned of it. While they say that they are no longer doing this, there is no way for me to confirm whether this is still happening or. I do not want to ask my customers, because it would be awkward and may harm my customer rating.

I am told that the advantage to my type of work is the flexibility and freedom to set my own schedule. I, in theory, can work any time and any day. The truth is my "flexibility" is totally dependent on a very narrow window of time when most orders come in, usually around lunchtime and after 5. This means I have to compete with my coworkers for lucrative shifts. Often this means I get waitlisted.

I also do not have the flexibility to pick and schedule these lucrative shifts, or even stay on the app, unless I meet unreasonable standards. Instacart has a demerit-based system which they call "reliability

² <https://www.theverge.com/2019/2/6/18214335/instacart-reverse-controversial-pay-policy-tip-stealing>

incidents.” If I pass on too many orders, even if I think I will make too little money, I will receive a reliability incident. If I sign up for a shift but decide I want to finish early, they penalize me with a “reliability incident.” If I sign up for a shift but decide I can’t make it anymore and don’t give them 6 hours notice, they penalize me with a “reliability incident.” If I receive a certain number of reliability incidents, I can only work certain hours of the day, which may not be lucrative. If I receive a certain number of reliability incidents, I lose my ability to set my schedule a week ahead of time. So when I want to be flexible with my work, Instacart punishes me by stopping me from being able to set a flexible schedule.

Maintaining a high customer rating is VITAL to work on these platforms. On Instacart, if your rating drops to a 4.2 out of 5 stars, you get “fired” and are completely unable to access the app. Just to be clear, 4.2 stars is an 84% rating. Imagine if members of Congress had to maintain an 84% approval rating to keep their job!

The app on my phone dictates my ability to take orders. It constantly tracks me. It sets my pay. It times my work. It has the ability to discipline me. While there is a way to appeal discipline, I fear retaliation as the process is vague and inconsistent. I feel as though I have less control over my work now, than in my previous job when my employer rightly classified me as an employee!

With no pay standards or transparency in how I’m paid and how my work is evaluated, it is impossible to plan ahead and budget for my family. Especially, when, unlike my previous job, I am expected to pay for workers compensation insurance, disability insurance, health insurance, unemployment insurance, liability insurance, automobile insurance, social security, as well as, federal, state, and local income taxes.

These platforms encourage their employees to save 20% of their income to pay for these expenses, but when the base compensation is so low, I know most gig workers simply do not have the ability to do this. While I am fortunate to have financial support from my husband, I still rely on my retirement savings to help make ends meet. I don’t see how this type of work is sustainable for younger individuals, let alone families.

We are told that many people who do this type of “gig work” are merely supplementing their income from their primary low paying jobs — but in my experience — my “primary low-paying job” is another gig job!

I know that there are fellow gig workers forced to live in their cars and rely on social services just to get by. I also know that there are workers who do similar grocery delivery work for companies like Peapod, who are paid as hourly employees and do not face these struggles.

With all of these difficulties, one might wonder, “Why do I do this type of work?” Again, as I stated before, as a woman in her 50s, I have found it difficult to find a new job — despite over a decade of experience in the I.T. field. I am not anti-technology and I was excited to get experience working in a new and growing sector. I see new technology as a source of opportunity — not a means to bypass worker’s rights. As someone who has spent her entire career in the tech industry, I know that the success of new technology is NOT contingent upon workers being treated this way.

I raise all of these issues up, not to single out my employers — because I know I am not alone with these problems, nor are they unique in how they treat their workers. Gig work is a work trend that is growing. I fear that if we let companies like Instacart, Postmates, Door Dash, Grub Hub, Caviar, Uber Eats and other platforms continue to exploit their workers, it will only incentivize this bad corporate behavior.

I am proud of the fact that I was part of a broad coalition, full of hard-working people like me in my home state of California who fought for the passage of AB 5 so fewer workers are misclassified. I am honored to be here today to share my story, as you look to what the federal government can do to fight misclassification.

What we are asking for is nothing radical. We do not want to stop technological progress — we in the tech industry embrace it. All we are asking for, are fair labor standards and the free and fair right to organize that have fueled innovation and technological progress in this great nation for years.

On behalf of workers like me across the country who struggle to get by, I ask you all to support the Payroll Fraud Prevention Act, and help prevent workers like me from being misclassified so we can have family sustaining wages and benefits.

Chairwoman ADAMS. Thank you.
Attorney General Racine, you are recognized for five minutes, sir.

TESTIMONY OF THE HONORABLE KARL A. RACINE, J.D., ATTORNEY GENERAL FOR THE DISTRICT OF COLUMBIA, OFFICE OF THE ATTORNEY GENERAL FOR THE DISTRICT OF COLUMBIA

Mr. RACINE. Good morning, Chairwoman Adams and Ranking Member Byrne.

I am Karl Racine, the attorney general for the District of Columbia. I can assure you that my customer rating is likely below 4.2, although I am happy to have been reelected just last year.

One of my top priorities is protecting workers' rights in the District. That is why I am here to testify in support of the Payroll Fraud Prevention Act.

My office has implemented a broad effort to protect District workers by enforcing the District's wage laws to fight wage theft, an illegal practice that denies workers the wages or benefits they have earned.

Businesses do this in multiple ways, such as failing to pay the required minimum wage, refusing to pay overtime, or misclassifying employees as independent contractors. Wage theft affects millions of workers across all job types and income levels nationwide. The District of Columbia's efforts have given us a better understanding of one particular form of wage theft called worker misclassification.

We are grateful for the opportunity to discuss this important issue with the Subcommittee on Workforce Protections. Worker misclassification is a type of payroll fraud that hurts workers, undercuts law abiding businesses, and cheats taxpayers. In its most common form, an employer improperly classifies an employee as an independent contractor to unlawfully cut payroll costs. We found that this practice, as CEO Townsend's testimony makes clear, is prevalent and indeed rampant in aspects of the District's construction industry.

Often employers target vulnerable low wage and immigrant workers who may not fully understand their rights under District law, or how to seek and enforce their rights. This creates a ripple effect of harms.

First, employers who misclassify employees illegally duck costs that they ordinarily would bear and shift those costs on the back of workers. Misclassified workers are forced to foot their employer's social security and Medicare tax bills, leaving them with less take home pay than properly classified employees. They lose out on labor protections and on programs like worker's compensation.

In the states and territories with strong wage laws, like the District of Columbia, employers who misclassify employees avoid the requirement to provide a higher minimum wage, overtime pay, and paid sick leave.

Second, this isn't just stealing from employees, it is also stealing from law abiding companies that play by the rules. In the construction industry, for example, work is often awarded through a rigorous bidding process. By illegally evading payroll costs, an employer that misclassifies its employees is often able to underbid competitors. Should other companies looking to make a quick buck follow suit, we will end up in a true race to the bottom.

Third, if this unlawful practice becomes an industry norm, it also impacts the government and taxpayers too.

Both the Federal Government and the District fund social benefit programs, like social security, Medicare, and unemployment insurance through payroll taxes. All employers are required by law to pay into these programs and support our fellow citizens. But employers who misclassify employees don't pay their fair share. They are shorting the public and pocketing the difference.

As you know, my office recently commissioned an economic report that examined just how much worker misclassification can unlawfully cut costs for companies in the District's construction industry. The researchers found that by misclassifying workers a company could illegally reduce its labor cost by at least 16.7 percent and as high as 48 percent.

To close, our experience enforcing worker misclassification in the District has taught us that it causes concentric harm, beginning with the worker and radiating across the industry and to taxpayers. Stopping worker misclassification therefore not only protects workers, it also protects fair competition and government benefit programs that serve taxpayers. I am encouraged that the proposed Payroll Fraud Protection Act seeks to punish and deter worker misclassification by making the practice a violation of the Fair Labor Standards Act, increasing damages available to workers and imposing monetary penalties on companies who engage in this unlawful behavior. In our experience, we have found that these steps are invaluable in enforcing and deterring worker misclassification.

I look forward to your questions.

Thank you.

[The statement of Mr. Racine follows:]



Statement of Karl A. Racine
Attorney General of the District of Columbia
Office of the Attorney General

Before the

The Subcommittee on Workforce Protections
United States House of Representatives

Public Hearing

Misclassification of Employees: Examining the Costs to Workers, Businesses, and the Economy

September 26, 2019
Time 10:15am
Rayburn House Office Building 2175

I. Introduction

Good morning Chairwoman Adams and Ranking member Byrne. I am Karl Racine, Attorney General for the District of Columbia. I am here today to testify in support of the “Payroll Fraud Prevention Act” which would make it a violation of the Fair Labor Standards Act (FLSA) for employers to engage in worker misclassification. I have made it one of my top priorities to protect workers’ rights in the District—including workers’ rights to fair wages, overtime pay, and paid sick leave—and to create economic opportunity for all our residents.

My office has implemented a broad effort to protect District workers through enforcing the District’s wage laws to fight wage theft. Wage theft is the illegal practice of denying workers’ wages or benefits they have earned, and can occur in multiple forms, such as failing to pay the required minimum wage, refusing to pay overtime, or misclassifying employees as independent contractors. Wage theft affects millions of workers nationally and happens across all job types and income levels, though low-wage and immigrant workers are especially vulnerable. Through enforcing the District’s wage laws, we have learned specifically about how worker misclassification harms workers on the ground, and we are grateful for the opportunity to share our experience with the Subcommittee on Workforce Protections.

Worker misclassification is a type of payroll fraud. In its most common form, worker misclassification occurs when an employer classifies a worker—who should be considered an employee—as an “independent contractor.” Companies do this in order to unlawfully cut their payroll costs. This illegal behavior creates a ripple effect of harms, stretching from workers to the entire industry, and on to taxpayers and the government itself.

First, misclassification harms workers. Misclassification should be understood as a form of wage theft because it deprives these employees of money they have earned. For example,

misclassified workers are routinely shorted on overtime pay. In addition, while employers and employees normally pay an equal share of Social Security and Medicare taxes, a misclassifying employer shifts their own tax burden to the worker. This leaves misclassified workers footing their employer's tax bill, cutting further into their take-home pay. Misclassified workers are especially harmed in states and territories, like the District of Columbia, that have strong wage laws. For example, a misclassified District worker would not be able to access the District's \$14.00 minimum wage (increasing to \$15.00 next year), guaranteed overtime pay, or the provision of paid sick leave. In taking a hard look at this issue, my office has found that worker misclassification is rampant, particularly in the District's construction industry. The victims are often vulnerable low-wage workers who may not fully understand their rights under District law or how to seek relief for misclassification violations and other wage violations that flow from it.

Second, the harms from worker misclassification extend to the overall industry where such misclassification is occurring. This is particularly true in the construction industry, where work is often awarded through a bidding process. A misclassifying employer is often able to underbid its competitors by illegally evading costs associated with payroll--which include Social Security and Medicare taxes, local payroll taxes such as the District's unemployment insurance tax, and other payroll-related costs such as workers' compensation insurance premiums. An unscrupulous employer that wins business by misclassifying workers is stealing business from law-abiding companies that play by the rules. Even worse, they could kick off a race-to-the-bottom, where other companies looking to make a quick buck follow suit. We simply cannot let an unlawful practice become an industry norm.

Third, misclassification harms the government and taxpayers. Both the federal government and the District depend on payroll taxes to administer social benefit programs that

serve the public. The federal government administers the Social Security and Medicare programs that serve senior citizens, and the District administers a local unemployment benefits program to assist workers who find themselves out of work through no fault of their own. All employers are required by law to pay into these programs in order to support our fellow citizens. But when employers misclassify workers, they don't pay their fair share into these programs. They are shorting the public and pocketing the difference.

In fact, my office recently commissioned an economic report that examined just how much worker misclassification can unlawfully cut costs for companies in the District's construction industry. The researchers found that by misclassifying workers, a company could illegally reduce its labor costs by *at least* 16.7 percent; 11.5 percent comes from reduced worker take-home earnings and 5.2 percent comes from lost tax and social insurance payments. Put another way, assume an employer has \$100 in labor costs associated with an employee. If that employer misclassifies that worker, the employer can unlawfully save \$16.70 in labor costs. Of this amount, \$11.50 reflects lost worker take-home earnings and \$5.20 reflects lost tax and social insurance payments.

This 16.7 percent unlawful cost savings was a conservative, baseline estimate. For example, misclassified workers often experience other forms of wage theft, such as working unpaid hours "off the clock." And if a misclassified worker experienced wage theft such that their hourly rate was only 90% of their properly classified peers, the illegal cost savings would increase to 27 percent. Similarly, misclassified workers also frequently do not receive benefits provided to their properly classified peers, such as health insurance. If a misclassifying employer doesn't pass through the value of any of these typical benefits to misclassified workers, the illegal cost savings jumps to 48 percent.

To close, our experience enforcing worker misclassification in the District has taught us that it causes a harm that is concentric—it begins at the worker, and radiates out to the industry and the public fisc. Stopping worker misclassification therefore not only protects workers; it also protects fair competition and government benefits programs that serve taxpayers. I am therefore encouraged that the proposed Payroll Fraud Prevention Act seeks to punish and deter worker misclassification by not only making the practice a violation of the FLSA, but also increasing damages available to workers and imposing monetary penalties on companies who engage in this unlawful behavior. In our experience enforcing local District laws, we have found that increased damages and penalties are invaluable in enforcing and deterring worker misclassification. I appreciate the opportunity to testify on this important issue and look forward to continuing to work with the Subcommittee and its partners on laws and policies that advance workers' rights. I am available to answer any questions that members of the Subcommittee may have.

Chairwoman ADAMS. Thank you very much.

Under Committee Rule 8(a), we will now question witnesses under the five minute rule. We will alternate between the parties.

I will now recognize myself for five minutes.

Ms. Dworak-Fisher, how do the purposes of the Fair Labor Standard align with its broad standard for employment? You need to turn on your mic.

Ms. DWORAK-FISHER. Sorry about that. The purpose of the Fair Labor Standards Act was to eliminate substandard working conditions. So, the definition of employ, to suffer or permit, is intentionally broad to effectuate that purpose.

Chairwoman ADAMS. Okay. So would narrowing the Fair Labor Standards Act employment standard from the broad suffer or permit standard to a narrower common law standard leave some workers without protections?

Ms. DWORAK-FISHER. It would leave a great many workers without protection. The whole point of the Fair Labor Standards Act is—well, not the whole point, but one of the points of the Fair Labor Standards Act is to reach beyond common law to cover more employees. And so that would essentially roll back the clock on protections for their workers.

Chairwoman ADAMS. Okay. You state in your testimony that we lack recent comprehensive national data on the extent to which employers are misclassifying their workers. What do we know from the data that we do have about the prevalence of misclassification, and how would more current comprehensive national data help us combat employee misclassification?

Ms. DWORAK-FISHER. Yes. I believe the last time—at least the Department of Labor had done an analysis was back in 2000 and it found that millions of workers had been misclassified, up to 30 percent of firms misclassified their employees as independent con-

tractors, costing billions of dollars in state and Federal coffers and lost wages to the employees.

I think it is important to get a more recent comprehensive look at the scope of the problem because if we understood the scope of the problem, it would be even more imperative that we take action to combat misclassification.

Chairwoman ADAMS. Attorney General Racine, your office recently issued a report estimating the economic incentives to misclassifying employees in the District of Columbia's construction industry. Why was this information helpful for your efforts to combat misclassification? And do you think that your efforts and efforts by the states would be helped by up to date and comprehensive national data on misclassification?

Mr. RACINE. No doubt about it. I think there is, you know, a porous amount of relevant and current data, and so often times we are guided by anecdote and, of course, our investigations. I think that, clearly, if we are able to compile better data, we will not only have a better sense of the scope of the problem, but also perhaps uncover better ways to enforce and otherwise ameliorate the issue.

The reason why we went outside of our office to contract with researchers is that we really wanted to understand exactly the cost factor. How much money, at minimum, are companies who cheat saving. And I think CEO Townsend really, you know, said it right when he talked about his industry in particular. These are competitive businesses. When companies can save 16.7 percent by illegally misclassifying an employee or a bunch of employees, they have a competitive advantage against their company peers who are following the law.

I hear in our enforcement cases from companies like Mr. Townsend's, who are very happy that we are enforcing the law because they are tired of losing out to those companies who break the law.

Chairwoman ADAMS. Okay. Miss Dworak-Fisher, are there states that make misclassification a violation of their wage and hour laws? And how would making misclassification a violation help prevent misclassification and help workers hold employers accountable.

Ms. DWORAK-FISHER. Yes. This isn't anything particularly new. Several states actually make misclassification a violation of their wage and hour laws. I believe Wisconsin, Massachusetts, New Jersey. And complementing that with a clear statement in the Federal law, in the FLSA, that misclassification is a standalone violation, would go a long way to preventing misclassification by the mere virtue of the fact that you are requiring employers to complete an analysis of someone's status before they—at the time of hiring. So it would create a level of transparency that we don't currently have.

Chairwoman ADAMS. Okay. I am going to yield now to and recognize the Ranking Member for the purpose of questioning the witnesses.

Mr. BYRNE. Thank you, Madam Chairman.

Mr. Passantino, like you, I have read the bill that we are here today to talk about and it seems to me it was very poorly drafted. Someone was not paying close attention to detail when they did it, which causes me to question the seriousness of it. But in your testi-

mony, you describe a number of unrealistic and unworkable mandates in the bill, including the expansive definition of a covered individual, which would include pizza delivery drivers.

Can you further explain why the mandates are unrealistic and unworkable?

Mr. PASSANTINO. Thank you. The definition of covered individual in the bill is an individual providing labor or services for remuneration for such employer. So it is anyone who is providing labor or services to an employer who gets paid for that. There is no clarity on whether it has to be a direct or indirect payment, so if I am counseling a client, I am going to tell them that they can't assume that it has to be a direct payment. And the reason why I use an example of a pizza delivery driver who brings pizzas to a lunch is because if that person gets a tip then there is a further complicating question as to whether there has been remuneration.

Under the Act that employer, that putative employer would need to decide do I have to hand, in addition to this \$20 bill that is a tip, a notice that says you are not my employee to that pizza delivery driver. In all likelihood, they are going to ignore the requirement to do that because it is going to be an administrative nightmare, but if they do that, then there is a presumption that person is an employee if that person ever sues. That would have to be rebutted by clear and convincing evidence under the Act.

Mr. BYRNE. And clear and convincing evidence is a higher standard than a preponderance of the evidence?

Mr. PASSANTINO. Yes, it is a much higher standard.

Mr. BYRNE. So, Right. So the reason I was concerned about that was not just because you might have some that don't comply, but you might have some that are not going to do certain things because they don't know how to comply. And isn't that an equal concern here?

Mr. PASSANTINO. I think there is a combination of businesses that don't know how to comply and then it is not going to do anything to address—a contractor that decided that 1,000 laborers were independent contractors is not going to issue those people notice that said that they were independent contractors. They are not going to—they are just going to ignore that obligation under the law.

Mr. BYRNE. If they are going to violate the law today, they certainly are going to violate something like this.

Mr. PASSANTINO. Correct.

Mr. BYRNE. Mr. Chemers, in your testimony you discussed the fact that most independent contractors understand how they are classified based on a written agreement. Can you elaborate on the types of written agreements that businesses and independent contractors enter?

Mr. CHEMERS. If you ask most business owners, they are already entering into written agreements with independent contractors. They are usually referred to on their face as independent contractor agreements and we have even had testimony today as to the existence of such agreements. And the reason for that is existing law already encourages and incentivizes businesses to enter into written agreements. For instance, the Internal Revenue Service. When it looks at whether someone is properly classified as an

independent contractor or an employee, one of the requirements is that there be written contracts which describe the relationships the parties intend to create. So you are already seeing persons described in the written agreement with those businesses as independent contractors.

And so if the point of the PFPA is to provide notice and in large—in significant cases, that is already occurring naturally.

Mr. BYRNE. Now, if I am paying an employee, every year I give him a W-2. If I am paying an independent contractor, I give them a 1099, right?

Mr. CHEMERS. That is correct.

Mr. BYRNE. And then it is the independent contractor's responsibility to pay the taxes that are due on the income that is stated in the 1099, right?

Mr. CHEMERS. That is correct. In addition to—at the outset of the relationship you are typically going to have a written contract at various points during the relationship, including with respect to taxes. There will be a reaffirmation of that relationship.

Mr. BYRNE. When I was listening to testimony earlier about lost government income, and that must mean that the independent contractors who are getting their 1099s aren't paying the taxes that are due under the law. So this presumed in all of that we got people that are just violating the law.

So when I look at all of this, I guess I go back to what I see as what the relationship is between the vast majority of businesses and the vast majority of independent contractors, and that is perfectly legitimate independent businesses working with one another and one is providing services to the other and the other is paying them for it. Don't we do that in America all the time?

Mr. CHEMERS. As I look at this bill again, and as shared in my written comments, the key issue is whether or not you think the issue of independent contractor misclassification is a major one for society. That this bill as constructed does little to nothing, in my view, to actually address that issue.

Mr. BYRNE. I agree.

Thank you. I yield back.

Chairwoman ADAMS. Thank you very much. I want to recognize now the gentlelady from Pennsylvania, Miss Wild.

Ms. WILD. Thank you, Madam Chair.

I would like to address my first question to Ms. Dworak-Fisher. Mr. Chemers and Mr. Passantino have expressed concern about providing workers with notice of their employment status. And they also state that employers are subject to monetary penalties for violations of notice requirements.

Do you have a response to those concerns and their analysis regarding penalties for notice violations?

Ms. DWORAK-FISHER. I do actually. And I was just looking at the bill. I think that it is incorrect to say that a notice violation in and of itself will trigger a penalty. By my reading of the bill, the additional penalties only kick in if the worker is in fact misclassified. The bill specifies that a person who violates section 11(c)(2), which is the classification section, not the notice section. So I don't believe there will be in fact any penalties for the notice violations.

Second, I think the notice actually is a good idea. At least in the cases that we see, a notice actually would prevent litigation in many cases because a worker could question at the outset what their classification is and the bill would protect them from retaliation and enable them to actually find that out at the outset, ask questions, and to the extent it is needed, come to us or somebody else and then we can call the employer and work it out without recourse to litigation.

Ms. WILD. Thank you. So it is your position then that the penalties are only if the actual status is misclassified as opposed to notice violations?

Ms. WILD. Right.

Ms. DWORAK-FISHER. Only where the worker is in fact misclassified would those additional penalties kick in, not for hyper technical violation of the notice provision.

Ms. WILD. Okay. And staying with you, if I could for a moment, it sounds like the most recognizable form of misclassification happens when an employee is simply misclassified as an independent contractor. But in your written testimony, there was a statement that misclassification can look different than just an independent contractor status.

Can you elaborate on that?

Ms. DWORAK-FISHER. Right. Well, certainly that is—the most obvious is where someone is called an independent contractor when they are not. We have also seen situations where a worker is forced or requested to form their own LLC. I have certainly read about cases where you have franchisers of one as a way to just sort of make it look like someone is an independent contractor when they are not.

So it can take many forms.

Ms. WILD. Okay. Thank you.

Mr. Townsend, do you think the Federal Government should follow the lead of some states by penalizing employers for repeated or willful misclassification?

Mr. TOWNSEND. In my industry one of the biggest concerns—

Ms. WILD. Mm-hmm, that is why I am asking you.

Mr. TOWNSEND.—is the rampant misclassification of workers. And in my company, we hire our employees, we direct our employees on where and what to do and how to work each day. When there is an independent contractor who brokers out labor to individual laborers who work and toil in the field every day under their direction without receiving overtime pay, without getting worker's comp, without getting any Federal unemployment taxes or social security, that is the issue that I am dealing with. It is basically people that choose to follow the laws versus those that blatantly disregard them.

Ms. WILD. And does that put you at a competitive disadvantage? You or others who are following the law?

Mr. TOWNSEND. It puts us in extreme competitive disadvantage.

Ms. WILD. Can you elaborate?

Mr. TOWNSEND. And the reason for that—yes. So if I am a dishonest labor broker or misclassified worker, I get paid a set price per hour. That price per hour is what that worker receives. What my workers receive is that price per hour plus all the taxes, bur-

dens, that the Federal and state governments give, plus worker's comp, plus overtime pay, and so forth. And the example without health and welfare attached to it, it is a 26 percent disadvantage in my sector. If you add health insurance to that, it becomes over 50 percent disadvantaged. And if I add a retirement plan to that, it becomes over a 60 percent disadvantage. It is a significant disadvantage.

Ms. WILD. So those who follow the law are at a disadvantage?

Mr. TOWNSEND. I am purely talking about bad actors versus quality good free enterprise contractors that follow the laws.

Ms. WILD. Thank you so much.

Chairwoman ADAMS. The lady yields back. Thank you. I will now recognize the gentleman from Virginia, Mr. Cline.

Mr. CLINE. Thank you, Madam Chair, and thank the witnesses for being here.

This committee should be focused on returning power back to employers and employees instead of creating nearly impossible compliance frameworks with new regulations that do nothing to prevent the misclassification of employees.

Independent contractors and the businesses who employ them share in a mutually beneficial relationship that allows for flexible terms for both parties. These benefits are then passed on to the consumer through a reduction in the cost of goods and services.

Wherein misclassification of an employee occurs, there are current ramifications to disincentivize the intentional practice of this and to compensate for the damages to the employee. These remedies include liability for back wages or overtime pay and can be coupled with a monetary penalty to the employer.

This proposed bill increases the legal risk to business owners to the extent that it is not feasible for them to engage with independent contractors. This will increase the cost for business owners, this would eliminate opportunities for independent contractors and inflate prices for consumers.

We should work to lower the misclassification of workers certainly, but we need to allow employers and independently contracted employees to continue to utilize a relationship that works for them. Far too often Washington, DC identifies a problem and then responds by over regulating it without regard to the real and harmful impacts it has on constituents.

Let us move forward not move backward. This is a 20th century regulation for a 21st century economy.

So I would ask Mr. Passantino, you discussed both your work at the Department of Labor and your work advising businesses who want to be in compliance while using independent contractors. Can you elaborate on what the likely outcome would be on imposing these regulations on employers in such a short timeframe?

Mr. PASSANTINO. I think one of the issues is that the bill requires the Department of Labor to establish a website providing information on the independent contractor issue, which is probably actually a good thing, to have some more information for employers and employees out there. The issue is that the Department of Labor is required to do that within 180 days. The bill also says that employers have to provide notice containing that website information within 6 months, which maybe there is a day or 2 difference between 6

months and 180 days, but it is not enough time for employers who are going to have to issue hundreds of thousands of these notices, to make sure that they have the right website information included. If they don't get it out in a timely manner, then they are going to be subject to the presumption that all of those individuals who don't receive the notices are employees.

Mr. CLINE. Thank you.

Mr. Chemers, I represent a rural district with a lot of small businesses. Can you discuss the actual costs and complications associated with the newest requirements to the employees and their impact on small rural businesses in particular?

Mr. CHEMERS. Yes. I mean there is going to be two types of costs that businesses, including your constituents, will experience. One will be the actual hard cost of manufacturing, printing the notices, providing them to workers, then maintaining those notices for an indefinite period. It could be 1 year, it could be 10 years. So you have this actual hard cost. This could also be in the cases of larger businesses engaging a vendor to have some sort of an electronic process. And then in addition to that you have the payroll costs, because someone, whether it is the business owner, someone in the HR department, is going to be responsible for creating these notices.

And one point that I don't think has been stressed enough today is you are going to have to do detailed notices for each one of your workers because of the requirement that you list the local DOL office. So, for example, in California, a business with operations in California would have to provide eight different versions of that notice to their workers just in that state. And so every time before you even issue a notice you are going to have to look, you know, what local jurisdiction is this person in, where is the DOL office, has the DOL's address or telephone number changed since I last issued those notices, all to try to get it right with this notice requirement, which to my view doesn't have any demonstrated benefit in the first place.

Mr. CLINE. This proposed legislation would apply to anyone who provides a service for a business. Can you give any examples of services that an employer may use that would improperly be included by the qualifications of the bill?

Mr. CHEMERS. We do not have enough time during today's proceeding to discuss all the ways in which people use independent contractors, but it can be for a small business an outside accountant, a lawyer, it could be a plumber on a short range basis, you could have an event at your office and you could hire a caterer to come in for that. And as currently drafted, the PFPA would require notice to all of those workers. And if you don't provide those notices, there is this presumption of employee status. So, again, you are a small business, someone in your office is having a birthday and you have someone come in and provide flowers for that, if you don't issue them the notice, they are presumed to be your employee. And that, you know, to my view makes no sense.

Mr. CLINE. Thank you.

Madam Chair, I yield back.

Chairwoman ADAMS. Thank you very much.

Now I yield to the gentleman from California, Mr. Takano.

Mr. TAKANO. Thank you, Chairwoman Adams, for this critical and timely hearing on the misclassification of employees and the evasion of the requirements under the Fair Labor Standards Act.

Misclassifying workers is wage theft, whether intentional or not. This is clearly a problem, which is why over 20 states have passed laws to correct the wrongdoings, states like California, which recently passed and signed into law AB5.

And I want to correct something that my colleagues on the other side of the aisle have been saying. This is not about taking away an employee's flexibility. Instead, this is about ensuring they are properly protected under the Fair Labor Standards Act. In fact, the FLSA does not prohibit split shifts or flexible scheduling models.

Mr. Townsend, you mentioned in your testimony that companies can underbid you if they set up a model where they have no intention of paying overtime to the workers, ever. They misclassify their workers as independent contractors and say they are not entitled to overtime pay.

Mr. Townsend, can you talk more about this practice and what you do in contrast?

Mr. TOWNSEND. Thank you, Congressman.

Yes, I would like to speak on a personal level of what I see in that regard. The abuses we see are, in terms of overtime, happen in misclassifications and you can physically see it in the states I work in and the states I visit. And it is a particular type of building that goes up and the telltale signs of that are workers working on Saturdays, workers working on Sundays without the proper fall protection, without the proper safety equipment, and so forth.

So that to me is a physical display of taking advantage, of not paying overtime. When you are there on a Saturday and Sunday and you have worked Monday through Friday already, obviously there is something going on there. I certainly can't afford to have my employees work Saturdays and Sundays.

So the competitive advantage there, or the abuse therein lies with the pure no accountability for taxes, payroll, so forth, that again helps cause the spread of the disadvantage.

Mr. TAKANO. So you, as someone who follows the rules, are put at a disadvantage for those who get around the rules.

Do you think increasing penalties for overtime violations when there is a misclassification would be helpful in cracking down on denying workers overtime pay through misclassification?

Mr. TOWNSEND. In regards to that issue, I am not really a lawyer or a litigator, but I do think we need to do something to further deter bad actors through stiffer penalties. We certainly can't maintain the status quo.

Mr. TAKANO. Well, thank you.

Ms. Dworak-Fisher, how likely is it for a worker to receive back pay of wages if it is found that they were misclassified by an employer today?

Ms. DWORAK-FISHER. In the cases that we litigate today, or sometimes they don't get to litigation because the issue of the employee status or misclassification is a hurdle that the employer will put up and then we will negotiate it and often the double damages will not necessarily be something that the worker receives.

But if it was clear that misclassification was an independent violation, that would enable further enforcement and the threat of double damages, or even treble damages, has been—we have seen it be effective as a deterrence where employer's businesses that may not have been complying with the law get the message that you can't violate the law with impunity. And therefore, the additional damage is essential.

If I could just respond briefly to some of the notice concerns that I hear raised.

Mr. TAKANO. Please do.

Ms. DWORAK-FISHER. I have heard a lot about the details of the notice and how cumbersome it is and how this is going to create additional costs. And it sounds to me like there is actually some room to negotiate that or some concerns around the margins of what the notice should contain. And it sounds like, you know, I would be hopeful that folks could work across the aisle and maybe look to other areas where notice is already given. Like, you know, they have to give notice to the IRS or 1099s, or something like that.

Mr. TAKANO. Because this particular complaint indicates that there is an acknowledgement that there is a problem with misclassification.

Ms. DWORAK-FISHER. Right. Absolutely.

Mr. TAKANO. My time is up and I am going to have to yield back. I yield back, Madam Chair.

Chairwoman ADAMS. Thank you very much.

I want to recognize the gentleman from Texas. Mr. Wright, you are recognized for five minutes.

Mr. WRIGHT. Thank you, Madam Chairman.

Mr. Passantino, you may recall Ronald Reagan used to say that government's view of the economy is moves, tax it, and if it keeps moving, regulate it. Based on this bill, I would conclude that view hadn't changed much in 40 years.

I want to ask you, because you mentioned in your testimony that this bill will force a business to choose between strict compliance, including millions of dollars of unnecessary paperwork; on the other hand, noncompliance and consequences of that noncompliance. Would you elaborate a little bit on the structure and your concern for the structure of the bill.

Mr. PASSANTINO. Sure. Thank you.

I think the issue really stems from the overbroad definition of covered individual, which as we were talking about a little earlier, would include all kinds of people who no one would ever contemplate as being an employee or an independent contractor, who provide services or labor to an employer for money. So if we start with this incredibly broad understanding of who the law requires to get notice, employers either have to decide that every time a CEO or a business executive gets into a taxi and pays someone for that service, they have to provide them a notice that says they are an independent contractor or they are an employee. If they choose not to do that, then they are creating a presumption that person is an employee under the FLSA.

I think a lot of businesses are going to conclude we are not going to give that notice, but the point is the law shouldn't be structured

in a way that requires employers to say, you know what, we are not going to comply with this requirement under the Act because we don't think the penalties are harsh enough on this piece.

Mr. WRIGHT. Right.

Mr. Chemers, our powerhouse economy that has been the American economy almost since its inception, but certainly in the last 100 years, was built not on government regulation, but on entrepreneurship. In your experience, can you tell me what you would suggest the effect of this bill would have on entrepreneurship, and in particular, people that want to become entrepreneurs and start businesses?

Mr. CHEMERS. Thank you.

There are many reasons why people start small businesses and become independent contractors. And I think some of our larger businesses originally started out in the American economy as just being a one or two-person business and it grew from there. Well, a restriction like this, where businesses become unfair to bring on and use the small businesses for even episodic and random tasks, for which their core business isn't even involved in, I think is harmful to those businesses in restricting how flexible they can be. And it can also be I think damaging to the independent contractors. Again, for instance, an outside accountant. You know a small business may use an outside accountant. That is also going to fall within the PFPA. Notice is going to be required and there is going to be this presumption, among other potential harms from the Act.

Mr. WRIGHT. You mentioned earlier in California employers are already required to provide 10 separate notices regarding various legal requirements. And the extent to notice requirements under the proposed legislation adds another burdensome and unnecessary mandate on employers. Did I hear you right, that this would have really no effect on the problem it is supposedly going to address, and that is the misclassification of employees?

Mr. CHEMERS. I think the issue is that as we sit here today, we have no confidence it will have any impact. And that is because in order for those notices to cause any meaningful change, you need at least five things to happen.

One, in the first place, someone needs to already not be aware that they are an independent contractor, and I think there is some doubt as to that fact. Two, when they get the notice, they will have to actually read the notice. And given all the things we see on a daily basis, that is unclear to me. Three, in response to reading the notice, they are going to have to contact the DOL. Four, in response to any complaint, the DOL is going to have to actually take some action, which again we don't have any confidence that is going to happen. And last, in response to some sort of investigation, there will have to actually be a finding of misclassification.

And so you are going to need all those things to happen and I think that is very uncertain. What we do know for sure is, I think there is—just to be clear, based on the current definition, we are not talking about hundreds of thousands or millions or tens of millions. Every person that performs services in the United States is arguably, according to the PFPA, entitled to a notice.

Mr. WRIGHT. Great. Thank you very much.

And I yield back.

Chairwoman ADAMS. Thank you.

I now yield to the gentleman from California, Mr. DeSaulnier, you have five minutes.

Mr. DESAULNIER. Thank you, Madam Chair.

And I want to begin by agreeing with the Ranking Member, one of my favorite attorneys, a very charming man, that obviously we have to look at this issue and it would be nice to work on it in a bipartisan way.

I will say that as a Member from California, as a former chair of the labor committee in the California State Senate, who continues to be engaged—and I do want to point out for the record that the two Republican witnesses are lawyers, not entrepreneurs, so it is sort of ironic. I am just trying to be a little bit light with that comment. And as somebody who owned businesses in California and didn't find the regulations burdensome—sometimes they were a nuisance, I agree with that, and they could be better.

Having said that, the real problem we have in my view is this is just a symptom of the larger problem of capital being the driver of the U.S. economy versus wages. And we know, whether you want to leave Picardy or just follow the evidence, there has got to be a balance here, and it is out of whack.

But the enforcer of good ethical behavior, when I started in the restaurant business was, Mr. Townsend, where we didn't need a lot of attorneys or regulation in my view because there was an ethical bond between the business community and if somebody was cheating, especially in a local community, everyone would know about it. The Chamber would be involved with that.

So, Mr. Townsend, having worked with a former Member, Mimi Walters, when we were both in the legislature, when we had licensed contractors coming to us, and maybe it was because Orange County was particularly licensed contractors who did swimming pools, they came in and just said they couldn't compete because there was too much competition from people who were totally unlicensed. And then we created a taskforce, and it was bipartisan, so that all the departments would be more focused to go after the bad behavior. Which I think we could all agree, Mr. Passantino, you sort of alluded to that as let us get after the bad behavior and bring everyone back up. And then we can have a further discussion about innovation and Uber and Lyft and what their responsibilities are.

Mr. Townsend, you have already talked about this a little bit. It is really hard for you to compete, as you said, against companies that have a 7 or a 10 percent, 20 percent advantage. My attorney once wholly said to me, they said well, they make a risk assessment that they are assuming they are not going to get caught. But then you have to compete with them, and you have to make a payroll every day. That is a huge disadvantage.

So how do we re-instill and strengthen your position for people to make sure that the regulations are appropriate, and you can compete fairly against people who have no interest and basically make a risk assessment that they are going to make money as long as they can, until they get caught?

Mr. TOWNSEND. I first would again lean on the legitimate contractor versus the illegitimate contractor. And, you know, again,

when we talk about overtime, worker's comp, unemployment insurance, social security, that being paid by legitimate contractors, therein where a misclassified worker that is directed every day by an individual to do the same work my crews do, that competitive disadvantage is quite frankly 26 percent right out of the gate. And that grows, again as I stated, with if you add health insurance and retirement income to that.

Mr. DESAULNIER. How about if you were competing against a business that did these things or marginalized it and had unlimited investment to wait you out until you went out of business to take your customers?

Mr. TOWNSEND. That would be a significant problem.

Mr. DESAULNIER. Well, that is one of the problems we have in the gig economy. And as somebody who is proud of innovation, being from the Bay Area, and being very engaged—I know the governor has said this in California, we want to continue—and the Labor Federation asked too to have these discussions to make these conflicts work in an efficient way.

So I think it is a misrepresentation, if I can use that work, that for those of us who think there is a problem in California and supported AB5, want to put legitimate businesses out of business, we want to work out some of the changes in the innovation that give benefit to consumers, workers, and shareholders, proportionately, but we don't want to indirectly or directly help people who don't want to play by the rules and then hide behind the statement that you are inhibiting innovation, which to me is just an euphemism to cheat.

So therein lies the challenge. I think this conversation is a good one. It would be nice if it was more balanced between the business community and people who want to have workers' voice. But having said that, right now, we are at almost a historical mismatch between income inequality and the voice of workers and how their lives are determined.

And with that I will yield back the balance of my time.

Chairwoman ADAMS. Thank you, I recognize the gentleman from Pennsylvania, Mr. Keller, for five minutes, sir.

Mr. KELLER. Thank you, Chairwoman, and thank you to the members of the panel for your testimony today.

Just a couple of things I want to make sure I got right in the testimony.

Mr. Passantino, you actually were in private practice and then you worked for the Department of Labor on wage issues and compliance?

Mr. PASSANTINO. That is correct. And now I am back in private practice.

Mr. KELLER. Okay. Looking at the regulations—and I heard this many times—that this would place on employers that are doing things properly, in your opinion, the resources that would take, would that limit what the Department could then do to make sure we are enforcing the law, the current law, against people that are the bad actors doing it intentionally?

Mr. PASSANTINO. I think it has the potential to do that. The Department has to balance its resources just like any agency in the government does. The Wage and Hour Division has to figure out

where its best use of resources is. I would hope that they wouldn't spend their time on the high wage workers who are independent contractors and they would spend them on low wage workers who are misclassified as independent contractors. But I mean there is no guarantee that they do anything on that front, and they are going to get complaints across the spectrum. And I know from experience that people in this room don't like when their constituents don't get their complaints answered, so that drives some of it as well.

Mr. KELLER. Right. In other words, but there would be a lot of paperwork that would be additional work to do, currently over what they are doing?

Mr. PASSANTINO. Sure. It is every person who provides a service has to get this notice.

Mr. KELLER. And much of that paperwork probably wouldn't even get looked at, quite frankly. The potential is there.

Mr. PASSANTINO. That is probably right.

Mr. KELLER. Yeah, that the—and also you are experienced both in private practice and with the government. When you are dealing with employers, would you say that the vast majority of the employers want to get it right and do the right thing?

Mr. PASSANTINO. That has been my experience, yes.

Mr. KELLER. That has been your experience? That has been my experience too, having worked in private industry and having run a business and having been an entrepreneur, a general contractor. We want to do things properly. And most people want to. Most of our constituents do. So when we are sitting here talking as elected officials about people who are breaking the law, we are saying our constituents are—a lot of them—I believe mine do it right and I want to commend those that do, and those that don't, you know, need to be held accountable.

Again, Mr. Chemers, I want to ask you a question, because you had mentioned about a business that would hire an accounting firm, notice would have to go out to the accounting firm that they might be subject to this rule, they might be an employee of the company hiring them.

Mr. CHEMERS. Based on the way the PFFPA is drafted, if you are a small business and you hire an outside accounting firm, as many of them do because you don't have the resources or need for a full-time accountant, you would have to issue them a notice that identified them as an independent contractor. And if you fail to issue them a notice identifying them as such, there would then be this presumption that they were your employee.

Mr. KELLER. Okay. And again, that might be if I ran a business out of my house, I would have to send that to my garbage man because he picks up my garbage and that is part of my business? I mean technically they could file a complaint under the—the way this is written.

Mr. CHEMERS. Again, if you are a small business, and you have a caterer come in to provide food, that would be someone to whom a notice is required to be given. If you have a florist come in, if you have a plumber come in, you know, to fix your toilets, all of those people fall within the language of the Act as drafted.

Mr. KELLER. Okay. I appreciate that.

Just a couple of remarks, I guess, I will have on the whole thing. The vast majority of the people that are constituents get it right, they do it properly. My constituents I don't believe are out to cheat people. And we as elected officials all the time talk about how we are pro jobs, pro jobs, pro jobs, and we want people to have jobs. But this to me looks like Congress trying to interfere with the employee/employer relationship between many of the people who are doing it properly. You can't be pro jobs and anti-business. I think we should focus on making sure that whatever we do, we are not unduly penalizing the people that get it right, and that is the vast majority of the people we represent.

You know, and making a person that provides a service to a business an independent contractor, that would be like making a person that does some printing for any one of our campaigns, one of our campaign volunteers. I mean I think we are really stretching here on things.

Again, my message is you can't be pro jobs and anti-business. I think we need to look at solutions that really get to the heart of the issue of the people who are not abiding by the current law we have.

Thank you.

I yield back.

Chairwoman ADAMS. Thank you, sir.

I recognize the gentlelady from Michigan, Miss Stevens.

Ms. STEVENS. Thank you, Madam Chair, and thank you to our witnesses for today's hearing on what is also a piece of legislation that is standing before us amending the Fair Labor Standards Act of 1938.

Most certainly, our economy has changed in dramatic and tremendous ways since the 1930s and with that so has the nature of work. And I think it is fair to say that we can't be pro economy and pro job if we aren't pro worker and if we aren't pro for the people who are really going to be contributing to the productivity and the outputs of our economy.

Ms. CRAWFORD, I want to particularly commend you for your courageous and bold testimony, your first-hand narrative, your remarkable career in technology, your inspiring family, and what it means to be a worker in the gig economy. And you mentioned in your testimony that you sometimes have, you know, waiting periods that, you know, you are maybe not paid for. Can you describe these times for us?

Ms. CRAWFORD. Yes, I can. Thank you.

Sometimes I will multitask apps when I am not on an active order, especially with Instacart, and I try to decline the less profitable offers when I am on shift. It is risky to have multiple apps running because depending on the app, I have either 30 seconds to 4 minutes to evaluate whether I want to take an order or not.

Ms. STEVENS. So you have blacked out your time to do a job, but if it is not necessarily there, you are just kind of hanging in the balance.

I think as we kind of—we get compelled to talk about the future of work, but the future of work is here. And it is fair to say that while apps drive your work, you are not an app and you are an actual worker that is signed up and ready to deliver a service. And

as we all know in this hyper digital environment, it is still people that will move our economy. So we are glad that you do that work, but we are also delighted that you brought these comments here today.

And, Ms. Dworak, just kind of piggy backing off of that, are there times when an employee should be paid for waiting time, as we have maybe seen in other industries, that you could elaborate for us here today?

Ms. DWORAK-FISHER. Sure.

Yes, there are—under the Fair Labor Standards Act there are times where an employee must be paid for waiting time. The FLSA has a well-established framework for that. You determine whether the employee is engaged to wait, in which case it is compensable time, or just waiting to be engaged, in which case it is not compensable time. And the analysis there really looks to, you know, how long does the worker have to respond to the offer, whether they are free to decline without adverse consequences, whether they are free to go about their daily lives outside the waiting time. You know, can they go grocery shopping, can they do all manner of other things. If the time is their own, then they are waiting to be engaged and it is not compensable.

Ms. STEVENS. It sounds like the most recognizable form of misclassification happens when an employer misclassifies an employee as an independent contractor. But your testimony also states that misclassification can take other forms. So how else can an employer misclassify its workers outside of this?

Ms. DWORAK-FISHER. Sure.

Well, in some situations the employer might ask the employee to set up their own LLC, to form a franchising business of one, or, you know, other times they are just not classified at all, paid off the table or, you know, paid under the table in cash, those types of situations.

Ms. STEVENS. Well, it is certainly a moment for our gig economy as it relates and speaks to and compels this notion of a 21st century labor movement and how we can value the work of people and make sure that people are earning a fair living wage and that one job should be enough.

And so with that, I am going to yield back the remainder of my time.

Thank you, Madam Chairwoman.

Chairwoman ADAMS. And thank you very much.

At this time, I want to yield to the gentlelady from North Carolina, Ranking Member of Education and Labor, Dr. Foxx, you are recognized.

Mrs. FOXX. Thank you, Madam Chairman. And I want to thank our witnesses for being here today.

Mr. Chemers, the proposed bill states that if an employer fails to give an individual covered by the legislation a notice identifying the individual's employment status, then the individual is presumed to be an employee and you have talked about that a good bit.

Could you elaborate a little more on what this means and what the purpose of the provision is, what your concerns are about it?

Mr. CHEMERS. Thank you.

I will start with just the description of what the presumption is, which is if you fail to issue one of the notices, and that could be failing to issue the notice at all, or as currently drafted, if you issue it and it doesn't have the correct local office for the DOL, or it has the correct office for the DOL but doesn't have the correct address or telephone number, if you do any of those things, there can be an argument that this presumption applies. And in that case, you will have to prove as a business, or someone engaging an independent contractor, by clear and convincing evidence, which is a very high standard, that they were properly classified as an independent contractor. So that is what that provision would do. And what I find a little perplexing is that strong presumption doesn't actually apply to people necessarily who are misclassifying workers. And that is what I understood to be the focus of today's hearing. There has been a lot of testimony on that. But it doesn't punish that. What it punishes is again, is just the failure to provide notice.

So if you have a business that is intentionally misclassifying workers, but providing those notices, that presumption will not apply to it. But if you have a well-meaning, law abiding business, particularly a smaller business that may have a harder time understanding what its obligations are under the law, and it fails to provide the notice, then that presumption will apply to that business, even if it has a very good faith basis for classifying that worker as an independent contractor.

Mrs. FOXX. So everything on the notice has to be perfect or else they are in violation? It is a gotcha kind of thing?

Mr. CHEMERS. That would be my concern based on how it is currently drafted and how we have seen other similar legislation, once it goes into effect, the arguments that are made.

Mrs. FOXX. Mr. Passantino, we know the current test for determining if an individual is an employee or independent contractor can be difficult to apply, particularly for small businesses. However, the assumption from my colleagues across the aisle is that most employers are willfully and intentionally misclassifying workers.

Based on your experience, do you think that is the case, or do most employers who misclassify do so unintentionally while acting in good faith? How does the proposed legislation treat the overwhelming majority of employers acting in good faith?

Mr. PASSANTINO. I think that is one of the issues with the legislation, is it treats someone who willfully misclassifies and someone who innocently misclassifies in the same way.

So someone who decides that all of their 1,000 laborers are independent contractors is treated the same way as someone who makes a bad judgment call on whether a freelance journalist should be treated as an independent contractor or an employee. There are legitimate uses of independent contractors, there are a number of different tests that are out there, there are a number of different ways that those tests are applied. I have seen cases where it is literally the exact same position and if you read the two court decisions, you would think that one of the people was just nailing something into the wall and the other one was launching a rocket. There are a fundamentally different description of the

facts based on the cases, and because of that employers can never have 100 percent certainty whether they are properly classifying.

So you have—under this provision it is treated exactly the same whether someone is doing it willfully and intentionally, or whether someone is doing it innocently.

Mrs. FOXX. As someone who over the years has been in the construction business and knows about hiring independent people to work for them, I can certainly understand that situation and the examples that you and Mr. Chemers have given are so appropriate, I think.

Mr. Chemers, in your testimony you state that if this bill goes into effect, we would likely see a flood of litigation as a result. It sounds to me like a full employment bill for bureaucrats and lawyers, frankly.

So could you further elaborate on what you believe that be the case?

Mr. CHEMERS. Very quickly, my starting point is whether or not there are already enough remedies under the FLSA, and we have talked about them. There is already you can recover unpaid wages, liquidated damages, attorneys' fees, you can bring a collective action on behalf of dozens or hundreds of people, and there is a lot of activity already under the FLSA with misclassification.

What you do by stacking additional penalties, my concern—and this is what we see in California and why I have to rush back there after we are done today—is there is this gold rush mentality of we just have to bring a lawsuit and a small business or a large business will look at the potential exposure to it, potentially in the millions of dollars, and they will decide that rather than hire their own attorneys and have that risk, they will pay some amount of money. And, again, that is what we see in California, and this why it is such a hotbed of wage and hour litigation.

Mrs. FOXX. It seems to me that there is always the assumption on the other side of the aisle that the private sector is made up of a bunch of crooks and that all they want to do is abuse people. That is not my experience. Unlike Mr. Keller, my experience is they are almost all very honest people.

I yield back.

Chairwoman ADAMS. Thank you.

At this time, I want to yield to the gentleman from Virginia, the chair of Education and Labor. Mr. Scott, you are recognized.

Mr. SCOTT. Thank you, Madam Chair.

Ms. Dworak-Fisher, you read the section on fines. As I understand it, the fines are up to a certain amount. Does that suggest that any fine imposed would consider whether it is a technical or intentional violation or whether it is one off or a frequent violation?

Ms. DWORAK-FISHER. Absolutely. There is discretion. It is up to. In other words, depending on the severity of the violation. I would point out—

Mr. SCOTT. And the fine would be proportional to the severity?

Ms. DWORAK-FISHER. Yes.

Mr. SCOTT. Thank you.

Mr. Townsend, you indicated that there is a significant savings that can be achieved with misclassification. How often do those savings affect the winning of a bid?

Mr. TOWNSEND. The construction industry has the largest amount of misclassified workers. In the State of North Carolina, the state has a 35 percent disadvantage and the State of Texas is greater than that.

Mr. SCOTT. You mean 35 percent reduction in costs to help you on a bid?

Mr. TOWNSEND. Thirty-five percent, I am sorry, was the amount of misclassified workers. In the reduction of bid, the percent I discussed was, out of the gate for me, my company and the constituents I represent, it is about 26 percent out of the gate.

Mr. SCOTT. And how often does that affect you winning or losing a bid?

Mr. TOWNSEND. It affects me greatly. I can speak in terms of my personal experience in regards to—I am going to talk about wood frame structures in my industry where these are low rise structures, under 10 stories, that are constructed out of wood. That particular market segment, we don't even spend time bidding and it is gone. That segment has been taken over by misclassified workers ruled by independent contractors and labor brokers.

Mr. SCOTT. How does misclassification affect compliance with Davis-Bacon?

Mr. TOWNSEND. Davis-Bacon, greatly. Again, these actors that I am discussing, again, I am talking about legitimate contractors versus illegitimate contractors. In contrast, the bad actors pay a base rate, hopefully, they then don't pay overtime, they work their people at a straight base rate, contrasted to the companies I represent. We pay overtime for the first hour for any time worked over 40 hours and we pay all the benefits that go along with that.

Mr. SCOTT. Thank you.

Mr. Racine, could you say a word about why this legislation is necessary?

Mr. RACINE. Sure, Congressman.

I think enforcement of laws that are on the book is extremely important. And I think that when we have identified a problem like a problem like misclassification, it is incredibly important for the business community and the community of employees to know that there will be laws and there will be enforcement as to those important issues.

If I could just take 1 minute max to tell you a little bit about what we do at the office of attorney general in the District of Columbia in regards to the investigations that we have. And there are indeed instances where the issue relates to a computer snafu, a software glitch, et cetera. It is not really a bad actor, it is a mistake. And when we come across those mistakes, they do in fact happen, we don't penalize. What we do is we try to make sure that the mistake is fixed, we might enter into a consent decree whereby we go back every 6 months for a period of 18 months to see whether the mistake has occurred again.

And so it really is I think not a world of pinheaded bureaucrats and zealot enforcers, certainly not in the District of Columbia, but more so people who are really trying to get it right and level the playing field and being very, very judicious in regards to how we seek penalties.

Mr. SCOTT. Thank you.

Ms. Dworak-Fisher, one of the problems with defining somebody as an employee rather than as an independent contractor occurs when you are, as we have heard, using multiple apps at the same time. If you are doing Uber, then you know what you are doing, but if you are doing Uber and Lyft at the same time and there is an accident, who owes the worker's compensation, if you work more than 40 hours, who owes the overtime? How would this work with somebody that is working multiple apps at the same time?

Ms. DWORAK-FISHER. So it would depend on whether they were determined to be employees or independent contractors. To the extent that they are employees, each hiring or each employing entity would be responsible for minimum wage and worker's comp and overtime for each hour that they actually worked.

Now, the secondary question is whether having an app open is compensable work. And as I mentioned earlier, that depends on the analysis of whether you are engaged to wait and waiting to be engaged.

So, you know, the FLSA would provide a framework for figuring that out in terms of whether you are an employee and whether it is compensable work.

Mr. SCOTT. Thank you, Madam Chair.

Chairwoman ADAMS. And thank you very much. I want to recognize the gentleman from North Carolina, Mr. Walker, for five minutes, please.

Mr. WALKER. Thank you, Madam Chair.

The more I study this, the more this looks like a classic case where the government continues to overreach, and then overreach seems sometimes to do more damage than good. In reviewing this it seems like it is more lack of enforcing the laws that are already on books than more regulatory processes.

Many of these independent contractors, if you look at this information, are single moms or individuals that are looking to supplement their income.

Miss Crawford, I don't know if that is the case with you, but I have read a little bit about your background and certainly how hard you work, and some Uber driver. I think some of that, if that is correct.

The use of these contractors makes sense for many job creators to obtain high quality services. Many of these workers want to offer these skills on their own terms and for consumers, who benefit from a reduction in the costs of goods and services. Unfortunately, the PFPA act will increase the legal risk—the legal risk—lawyers—to business owners and make it prohibitive for them to engage independent contractors who provide needed services.

You know, I think specifically about entrepreneurs. You know, 2/3 of all jobs are small businesses and some of these wonderful new ideas and startups trying to launch out and follow additionally the regulations.

I have got a couple of questions for Mr. Chemers, but I want to start with Mr. Townsend since you peaked my interest. You brought up my home state of North Carolina. You said that 35 percent are misclassified workers or bad actors. Is that what you are saying?

Mr. TOWNSEND. That was a government statistic we had received.

Mr. WALKER. What government statistic was that?

Mr. TOWNSEND. Department of Labor.

Mr. WALKER. Okay. So that is easy to be able to ascertain.

You are I think the president, is that correct? What is the organization that you are the president of?

Mr. TOWNSEND. SWACCA is the acronym, it is the Signatory Wall and Ceiling Contractor's Alliance.

Mr. WALKER. All right. And how many governing—I think I looked at your website, there are 11 directors or presidents or regional directors, is that correct?

Mr. TOWNSEND. There are 11.

Mr. WALKER. Okay. And is that a volunteer position?

Mr. TOWNSEND. Yes, it is.

Mr. WALKER. Okay. And the 11 guys, you volunteer the time to be able to represent this specific union that represents—is it wall and ceiling contractors? Is that was it—

Mr. TOWNSEND. Correct.

Mr. WALKER. Okay. Thank you. Just wanted to make sure I was clear on the background there.

Mr. Chemers, what if an employer were to provide a notice to an employee but list the wrong office for the Department of Labor? What implications would that have for the employer who was attempting to comply with the law?

Mr. CHEMERS. Based on the way that the PFFA is currently drafted, that would have the same impact as if they didn't provide a notice at all.

Mr. WALKER. So I assume there are penalties? How does that play out? Unpack that for me for just a minute.

Mr. CHEMERS. Yeah. I mean the most significant thing that will flow from that will be the presumption of employee status. So, again, even though regardless of whether or not that company intentionally misclassified that worker, there will then be that negative legal inference and there are going to be a much-heightened legal standard for them to prove that worker was in fact an independent contractor. Again, whether they don't issue the notice or if there is some technical violation with the notice that was issued.

Or also let us say someone doesn't maintain copies and can't find that notice 3 or 5 years after the fact.

Mr. WALKER. So it could be completely unintentional but still set off a chain of problematic—that could last for some time?

Mr. CHEMERS. Based on the way the statute is currently drafted, yes.

Mr. WALKER. That is unfortunate. This proposed legislation seemed like it would result—just transparently being a lot of money for plaintiffs' lawyers and not actually solve the problem, which I think—listen, I think that is the intent of everybody on the panel, is to solve this issue of bad actors. We get that and we respect that. But I think it could create a problem of misclassifications of employees. I mean do you agree with that? Does it not solve the problem?

Mr. CHEMERS. If the key issue is trying to reduce the misclassification of workers, the focus of this bill on a notice re-

quirement and then negative presumptions and other penalties and remedies flowing from that presumption I think is the wrong way to go about curing that issue.

Mr. WALKER. Well, I am going to talk slow here for a second for you to get a sip of that water. I have got one more question for you there and I would like for you to elaborate. Maybe some of the reasons that businesses that you represent might choose to use independent contractors to begin with.

Mr. CHEMERS. There are a host of reasons. One is obtaining specialized skills. Again, a small business might need an accountant or a lawyer. Many small businesses use human resources administrators because that is not a function they do internally. And just as we are sitting here today, the thought that you are going to hire an outside human resources administrator, that person would need to generate a notice that identifies themselves as an independent contractor and then provide that notice to themselves under the PFPA. And so that is specialized skills, specialized equipment, ways to deal with fluctuating demands. A lot of time, you know, if you are in a seasonable business, if you are in a farming economy and that is what you have to deal with, you may have a lot of need for workers during a certain time of year and other times of year you may not have any need because of, you know, when the crops come in.

Mr. WALKER. Thank you, Miss Chairman.

I yield back, Madam Chair.

Chairwoman ADAMS. Thank you.

The gentleman from New Jersey, Mr. Norcross. You are recognized.

Mr. NORCROSS. Thank you, Madam Chairwoman, and appreciate very much holding this hearing. It is something that I saw in private life long before I came here to Congress.

What I want to start with is, the fact is that from what I am hearing, everybody on the panel believes there is an issue here, the way that we fix it.

So let me start with you, Miss Crawford. We all agree with the great spirit of starting your own company, becoming your own boss, and working forward. In the job that you described that you have, jumping between the applications or how you get it, do you personally feel like you are your own boss?

Ms. CRAWFORD. Thank you for that question.

No, I do not feel like I am personally my own boss because there is so much control through the apps. It dictates the time and the pay. I have no negotiation avenue. It is either I take the offer, or I don't. I know that my co-workers, or fellow workers, in some instances they are just trying to make ends meet and they will take a low paying offer because they might have to make a car payment or pay insurance or just buy food for the family.

Mr. NORCROSS. So as an independent contractor, or your own boss as many described it, have you hired anybody to work for your new company?

Ms. CRAWFORD. No, I have not.

Mr. NORCROSS. Do you know any of the other drivers that you work with who have then expanded their base and hired people?

Ms. CRAWFORD. No.

Mr. NORCROSS. So that spirit is absolutely alive today in starting your own company. There is a difference between owning your own company and growing it and working to survive. And that is what we all hear. And there are bad actors.

And that is where I just want to shift here for a moment to you, Mr. Townsend, the construction industry, something I spent 37 years in and we saw day in and day out. When you are bidding, whether it is a government funded job, which has a little bit more protections in that certified payroll set to come across. Can you walk me through the bidding process, which is historically how you get all your work. Why those small independent contractors who have their own pickup truck who show up only work for one GC, or general contractor, all the time? They are really an employee that they are turfing off some much of this liability that they carry, how does that hurt you as a contractor who has maybe a collective bargaining agreement or 50 of your own employees? Walk me through that.

Mr. TOWNSEND. Thank you, Congressman.

So to walk you through the bid first.

Mr. NORCROSS. Well, why is there a competitive advantage for those small one-man shops? I am not talking about competition that is playing on the same field as you. Walk us through that. How does that help them?

Mr. TOWNSEND. The biggest competitive advantage, as I continue to reiterate, is the good actor versus the bad actor scenario.

So looking at my business, our costs incorporate if there is going to be overtime or not, they incorporate special taxes and issues that might be unique to a city or jurisdiction. We incorporate unemployment insurance, we—

Mr. NORCROSS. Well, the worker's comp is very big.

Mr. TOWNSEND. Yes. So when we look to the other side, again, they are paying a base rate to an employee that maybe gets a 1099, maybe doesn't, maybe gets paid in cash, as Ms. Dworak-Fisher discussed. That is where the disadvantage comes in, right there at that exchange. There are none of those benefits paid. And that takes me back to that minimum 26 percent disadvantage.

Mr. NORCROSS. How about when it comes to worker safety? Those bad actors that you described, do they generally have good OSHA standards and teach their employees or themselves on how to be safe on the job?

Mr. TOWNSEND. Thank you for that question.

The quick answer is no. The true world is—in my world we have apprenticeship training programs, we have journeyman upgrading programs, we have continuing training o employment, all of our people are 30-hour OSHA trained as a rule and a policy. Compare that to an individual who is a classified worker getting paid a base rate. They at that point in time have no worker's compensation employee, they have no skill set. They are supposed to provide their own safety equipment and personal protective equipment out of their own paycheck.

Mr. NORCROSS. Thank you. And I only have a few seconds left, but I just want to make it a real distinction between those who want to become entrepreneurs, start their own company, which we want to encourage, versus somebody who just wants to get an em-

ployee off their payroll, so that they now become their own accountant, their own tax advisor, their own retirement counselor, their own lawyers, so that liability, their own insurance agent, to give them that flexibility. That doesn't sound like to me somebody who wants to become an entrepreneur. It sounds like a company just trying to turf that off.

I yield back the balance of my time.

Chairwoman ADAMS. Thank you very much.

I remind my colleagues that pursuant to committee practice, materials for submission for the hearing record must be submitted to the Committee Clerk within 14 days following the last day of the hearing, preferably in Microsoft Word format. The materials submitted must address the subject matter of the hearing and only a Member of the committee or an invited witness may submit materials for inclusion in the hearing record. The documents are limited to 50 pages each. Documents longer than 50 pages will be incorporated into the record via an internet link that you must provide to the Committee Clerk.

Again, I want to thank the witnesses for their participation today. What we have learned is very valuable and Members of the committee may have some additional questions for you, and we ask the witnesses to please respond to those questions in writing. The hearing record will be held open for 14 days in order to receive those responses.

I do remind my colleagues that pursuant to committee practice, witness questions for the hearing record must be submitted to the Majority Committee Staff or Committee Clerk within 7 days. The questions submitted must address the subject matter of the hearing.

I now recognize the distinguished Ranking Member for his closing statement.

Mr. BYRNE. Thank you, Madam Chairwoman.

I want to thank the witnesses for being here today, for your testimony. This was very enlightening. As usual, we hear new pieces of information and that helps us understand these issues better.

I do want to make sure I add my voice to something that was said by some of the others. And I practiced law in the labor and employment area for a long time. There is not 30 percent of the people out there that are not complying with this law. That is just not true. Now, we have heard this today for the first time, and we are going to run it down. But if that were true there would be massive Federal activity going on out there to do something about it, particularly in the Obama Administration there would have been, and there was none.

So whatever that figure came from, it is false and we need to call out false information when we get it.

I represented construction contractors that were unionized and some that were not unionized. And I found that unionized contractors, non-unionized contractors worked very hard at complying with the law, because it hurts them when they don't comply with the law, and sometimes it hurts them very badly. So I don't want there to be any sort of insinuation out there that somehow non-unionized contractors are not obeying the law. That is not true.

What is true is that we have a rapidly changing American workforce and workplace. And things are moving a lot faster than the government moves. The government just isn't nimble enough apparently to keep up with it. We have a lot of people, a lot of younger people, a lot of women who are looking for different ways to work. And we haven't come up with very good ways to try to deal with those different ways to work. And some of them have taken action on their own, started their own businesses to become independent contractors so they could give themselves the flexibility that they wanted. I have those in my own family.

And, you know, we should be mindful of that fact and not creating through our laws and policies impediments to them. Let them do their thing. You know, in America, because we have let private individuals do their thing, we have become the most powerful economy in the world with more freedom and opportunity than people all over the world have. In fact, the reason so many people are literally dying to get into this country is because of those freedoms and those opportunities. And the worst thing the government can do would be to put together a law like this and put it out there and create that impediment.

When I read this bill and I saw that it literally turns on its head our fundamental notion of how we handle legal disputes in this country—you know, typically somebody files a complaint, the burden of proof is on the person who files the complaint. This bill would turn that around, make it a presumption against the person against whom the complaint has been filed, and then say that person can only defend themselves against that presumption by making proof on a clear and convincing standard basis. Everybody in the law knows what that means. It is almost like you have to meet the same standard in criminal court.

Ladies and gentlemen, that is not America. The person that wrote that could not have been serious, because we are not going to do that. We are not going to subject employers or anybody else in this country to that standard.

So I heard some mention during the testimony that there was room for negotiation. There hasn't been any negotiation. This piece of legislation was just given to us, boom, there it is. If we want to be serious about this issue, and I am very serious about this issue, let us deal with it on a realistic basis, what is really going on out there in the American economy, what is really going on out there in terms of compliance or noncompliance with the laws that exist today, what can we do—I heard at least one Member say this—working together to deal with that situation.

This bill that has been drafted that we have seen for discussion purposes is not it. The bill was passed out of committee yesterday is absolutely not it. None of them are going anywhere. But if we really want to solve it, there is something we could do to get something somewhere and I am ready to get to work on that.

With that, Madam Chairwoman, I yield back.

Chairwoman ADAMS. Thank you, sir.

I want to again thank our witnesses for sharing their expertise and experiences with us.

I recognize myself now for the purpose of making my closing statement.

Again, I thank you all very much for being here. Your compelling testimony shed a much-needed light on unscrupulous employers that misclassify their workers in order to evade labor laws and save on labor costs. We heard how this business model hurts workers who are paid below the minimum wage, forced to work more hours without overtime pay, or make less pay than they earned. We heard how worker misclassification hurts honest businesses that are put at a competitive disadvantage by businesses that save money by stripping workers of labor protections. And we heard how misclassification hurts taxpayers that are forced to shoulder higher taxes or cuts to services due to the lost state and Federal tax revenue.

The consequences of misclassification are so severe that states across the political spectrum have taken the lead in combating misclassification. If these states can work across the aisle to end misclassification, there is no reason we cannot do the same to fulfill our responsibility to protect workers and honest employers.

I am pleased that we discussed the Payroll Fraud Prevention Act, which would outlaw misclassification nationwide and hold accountable those employers that ignore workers' right.

As part of the legislative process, today's witnesses have provided helpful input on how we can strengthen and improve the current discussion draft of this bill.

With this legislation, the committee has an opportunity to stand united in taking a significant step to uphold workers' rights and improve the lives of workers across the country. Simply put, each of us here today believes workers should receive fair pay and fair treatment for their work.

I look forward to working with all of my colleagues toward that shared goal.

And if there is no further business before the committee, without objection, the committee stands adjourned.

[Additional submission by Chairwoman Adams follows:]



September 26, 2019

The Honorable Alma Adams
Chair
House Education & Labor
Subcommittee on Workforce
Protections
2176 Rayburn House Office Building
Washington, DC 20515

The Honorable Bradley Byrne
Ranking Member
House Education & Labor
Subcommittee on Workforce
Protections
2176 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Adams and Ranking Member Byrne:

Thank you for holding the hearing today on "Misclassification of Employees: Examining the Costs to Workers, Businesses and the Economy." The Construction Employers of America (CEA) representing 15,000 signatory contractors who employ approximately 1.4 million workers, has long been concerned about the issue of employee misclassification and how it is harming American businesses and workers. The CEA strongly supports strengthening the Fair Labor Standards Act.

CEA companies adhere to ethical employment relationships and practices but they are increasingly forced to compete in the private and public market against unlawful, unethical companies that deliberately misclassify workers as independent contractors to gain an unfair competitive advantage. The practice is widely acknowledged by public policy experts to be epidemic in the construction industry.

Misclassification Hurts Lawful Employers, Workers, Taxpayers and Governments

1) Lawful and Ethical Employers: For legally compliant employers, misclassification creates an uneven playing field. Compliant employers are forced to compete in the marketplace against unlawful employers who unfairly cut their labor and administrative costs up to 30% and who otherwise unfairly shed their labor and employment law obligations relative to responsible employers. Lawful employers have higher costs and get underbid by employers who misclassify. It too frequently creates a competitive edge that quality, safety and training cannot overcome. Important legal obligations including overtime pay, workers compensation, EEO, family and medical leave, and other labor and employment law protections respected and adhered to by CEA contractors are simply avoided by unfair employers who have taken the slight risk of enforcement exposure by simply misclassifying their way out of responsible employment requirements.

2) Workers and their families: Working families are severely hurt when they lose essential benefits and worker protections. They are not adequately protected with unemployment insurance or eligible for workers' compensation and are not eligible for overtime pay. They are burdened with paying the full portion of Social Security and Medicare taxes and they are not covered by employment or labor laws thereby missing out on workforce protections provided by federal and state laws. In today's economy, good paying jobs with benefits are already scarce. Workers who are misclassified as independent contractors are significantly less likely to receive any type of health and pension benefits.



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Page Two

3) Taxpayers and government at all levels: Misclassification costs the government and the taxpayers, at all levels, substantial, uncollected revenues. Governments lose Social Security taxes, unemployment insurance taxes, and income taxes. There are broader social consequences because less revenue means less money is available for vital federal, state and local services and programs. Various individual state studies have shown losses in some states to be in excess of \$2.6 billion in a single year.

The Problem is Growing and Congressional Action is Needed Now

Studies show that misclassification of employees is steadily increasing. Unfortunately, the epidemic rise of worker misclassification in construction has nothing to do with career enhancement or individual entrepreneurship, but rather everything to do with unfair low-wage competition and workforce degradation.

The construction industry can ill afford declining skills and abilities at a time when projects are expanding in complexity and sophistication. Unfair competition by firms that misclassify employees to avoid the payment of employment taxes and other requirements of employment law threatens the maintenance of workforce standards.

Respectfully,

Construction Employers of America (CEA)

International Council of Employers of Bricklayers and Allied Craftworkers (ICE-BAC) <i>Matt Aquilino</i> maquilino@icebac.org	Sheet Metal & Air Conditioning Contractors' National Association (SMACNA) <i>Stan Kolbe</i> skolbe@smacna.org
Finishing Contractors Association International (FCA) <i>Mike Oscar</i> moscar@finishingcontractors.org	Signatory Wall and Ceiling Contractors Alliance (SWACCA) <i>John Nesse</i> jnesse@mguidance.com
Mechanical Contractors Association of America (MCAA) <i>John McNerney</i> jmcnerney@mcaa.org	The Association of Union Constructors (TAUC) <i>Todd Mustard</i> tmustard@tauc.org
National Electrical Contractors Association (NECA) <i>Marco Giamberardino</i> mgiamberardino@necanet.org	

CEA engages on national, state, and local public policy initiatives to strengthen the domestic construction industry and provide opportunities for top-quality construction workers to earn the skills they need to command high wages.

Our members, affiliated companies, and highly skilled workforce complete exemplary work that meets or exceeds our clients' expectations. Our projects are completed on time, on budget, with a well-trained, efficient workforce that takes pride in the quality of its construction. Our clients expect the best, and we deliver.

[Additional submissions by Mr. Byrne follow:]

Supplemental Statement from Ranking Member Bradley Byrne

**Workforce Protections Subcommittee Hearing on “Misclassification of Employees:
Examining the Costs to Workers, Businesses, and the Economy”
Thursday, September 26, 2019**

On September 26, 2019, at a hearing before the Subcommittee on Workforce Protections, a Democrat-invited witness, Mr. Matt Townsend, testified that according to the Department of Labor (DOL), 35 percent of workers in the state of North Carolina are misclassified. However, DOL has indicated that it has not issued a study or report so stating.



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Government Affairs

James W. Tobin III
Executive Vice President & Chief Lobbyist

October 7, 2019

The Honorable Alma S Adams
U.S House of Representatives
222 Cannon House Office Building
Washington, DC 20515

The Honorable Bradley Byrne
U.S. House of Representatives
119 Cannon House Office Building
Washington, DC 20515

Dear Chairwoman Adams and Ranking Member Byrne:

On behalf of the approximately 140,000 members of the National Association of Home Builders (NAHB), I am pleased to submit this statement in response to the Subcommittee's September 26, 2019 hearing on the issue of worker misclassification.

The Subcommittee is considering the *Payroll Fraud Prevention Act (PFPA)*, draft legislation that would impose new notice and reporting responsibilities on employers in an attempt to minimize the misclassification of workers. NAHB believes that pursuing greater compliance through legislation will have little effect on bad actors who knowingly skirt the law and intentionally misclassify their employees. Instead, well-intentioned employers – particularly small businesses that operate without the benefit of a compliance officer or human resources department – will be caught in the crosshairs of a reporting obligation that could come at a significant burden in terms of cost and time.

The correct classification of workers as either employees or independent contractors is important for all small businesses, but it is especially so for home builders. The home building industry is characterized by many relatively small firms that operate over limited geographic areas and rely heavily on subcontractors. Approximately 81 percent of NAHB single family builders build fewer than 25 homes per year, while approximately 61 percent build fewer than 10 homes a year. During the past 40 years the role of subcontractors and professional specialists in the home building industry has increased significantly. Work typically performed by specialty trade contractors includes: excavation, framing, plumbing, electrical, tile, finish carpentry, masonry, painting, drywall, and paving.

The relationship between general contractors and their subcontractors is highlighted in *Matter of Ovadia v. Office of the Indus. Bd Of Appeals*, 19 N.Y.3d 138, 946 N.Y.S.2d 86, 89, 969 N.E.2d 202 (2012). While the case involved the question of whether the employees of a subcontractor were jointly employed by the general contractor (the court found they were not), of particular interest is the Court's implicit recognition that in the construction industry the subcontractor is a distinct entity with its own employees:

The Court noted that many of the usual factors used to establish a joint employer relationship are not applicable in the construction setting; that if those factors were "applied consistently in the construction realm, [they] would likely render most general contractors the joint employers of their subcontractors' employees - a proposition that does not reflect the actual relationships in the construction industry." The reason lies in the fact that the general contractor normally interfaces solely with the principal of the subcontractor, not with the subcontractor's employees.

Id. at 143, 946 N.Y.S.2d 86, 89, 969 N.E.2d 202.

NAHB supports maintaining the efficiency and flexibility of the marketplace by continuing to allow employers to classify their workers as independent contractors, as merited. At the same time, we support enforcement of present law to ensure a level playing field for all small businesses. NAHB joins those who recognize the anticompetitive impact of misclassification of employees on local economies. However, the proposed enforcement provisions and heightened burden of proof that employers must satisfy in the *PFPA* threaten established good business practices and the industry's long-standing business model.

Under the *PFPA*, employers would be required to notify all "covered individuals" who are defined as those "providing labor or services for remuneration for such employer or enterprise" of their classification as either an employee or as an independent contractor. Further, employers would be required to provide every individual not classified as an employee with contact information for their local office of the U.S. Department of Labor (DOL) if the worker has any concerns about their classification. Lastly, the bill presumes all workers are employees if they are not notified by an employer, with rebuttal only possible with presentation of "clear and convincing evidence" by the employer to the contrary. This is true whether the worker is properly classified an employee or not – triggering a significant civil penalty to be leveled on an employer simply for failure to provide a notice to an individual for whom they already are responsible and liable under tax and employment law.

The breadth of the notice requirement in the *PFPA* is particularly onerous for such a decentralized industry. For example, builders doing business in various metro areas or with projects taking place in more than one state would be required to find and maintain information on multiple regional and local Department of Labor offices for any subcontractors or independent contractors with whom they contract on home construction. Would the builder need to provide contact information for the office with jurisdiction over the area where the home build project is located or the business address of the builder? Or the address at which the independent contractor's business is licensed? Or both? And would a builder be responsible for providing notices to all independent contractors and subcontractors' employees on down the construction work chain? A builder contracts with an average of 22 building firms on a home building project, all of whom are "providing services" as defined by the *PFPA*. Accordingly, a builder could potentially be responsible for gathering contact information for and issuing notices to dozens if not hundreds of "covered individuals" – particularly if engaged on a larger community development project or multiple active projects at the same time. This is a herculean task for a large employer with a dedicated human resource department, much less a small builder with only a handful of employees on payroll. As the Court noted in *Ovadia*:

As a practical matter, general contractors in the construction industry do not hire or supervise the workers employed by their subcontractors; they do not usually maintain the employment records for each worker or track the individual workers' schedules or rates of pay. The primary objective of a general contractor is to keep the project on schedule and to coordinate the work among subcontractors in order to avoid costly delays in the completion of the project. Thus, general contractors frequently interact with the principals and supervisors of the subcontractors and generally have no direct control or functional supervision over the employees performing work for the subcontractors.

If the Subcommittee's goal is truly to reduce employee misclassification in practice, NAHB recommends that compliance could be improved through additional education efforts by the Internal Revenue Service and DOL's Wage and Hour Division concerning the benefits and responsibilities of being an independent contractor. This would be useful for employers as well as individuals who are new to the experience of being a subcontractor. The creation of a dedicated page on DOL's website to communicate, in plain language, the rights of workers who are classified as independent contractors as proposed in the *PFPA* is also a good step.

Further, NAHB views the current patchwork of conflicting state and federal statutes defining the term "employee" as a contributing factor to worker misclassification. By establishing yet another new term of "covered individual" under the Fair Labor Standards Act (FLSA), the proposed legislation would only add a layer of confusion for employers and independent entrepreneurs to navigate in their efforts to comply with the law. Rather, NAHB recommends the Subcommittee give serious consideration to conforming the FLSA's existing definition of "employee" with the predominant definition established across federal

statutes using the "common-law" test. The *Modern Worker Empowerment Act* (H.R. 4069) achieves this goal of harmonizing the definition of "employee" for purposes of all federal statutes, and passage of this legislation would be a welcome step by Congress for small employers.

Thank you for considering our views.

Sincerely,

A handwritten signature in black ink, appearing to read "James W. Tobin III". The signature is stylized and cursive.

James W. Tobin III

CC: Members of the Subcommittee on Workforce Protections

[Additional submission by Mr. Racine follows:]



September 2019
Issue Brief and Economic Report

Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry



Karl A. Racine
Attorney General
for the District of Columbia
oag.dc.gov

ISSUE BRIEF

**Illegal Worker Misclassification:
Payroll Fraud in the District's Construction Industry**

*Misclassifying Workers as Independent Contractors Harms Workers, the Industry,
and the District*

INTRODUCTION

Illegal worker misclassification is a practice that seriously harms some of the District's workers, law-abiding businesses, and the public. Illegal worker misclassification is a form of payroll fraud where employers classify workers who should be considered direct employees as independent contractors. This practice allows the employer to avoid paying important taxes and following crucial employment laws. It is rampant in the District's construction industry, and it has serious consequences for the District and its residents:

- Misclassified workers lose basic employee protections like minimum wage, overtime, and paid sick leave. They are denied participation in important programs like unemployment insurance and workers' compensation. And they are left footing the bill for payroll taxes their employers fraudulently avoid. These burdens often fall heaviest on immigrant and low-wage workers who are least likely to be willing to risk complaining or enforcing their rights.
- Law-abiding construction contractors lose out on business opportunities when their competitors illegally undercut them. Employers who misclassify their employees evade labor costs, helping them squeeze legitimate contractors out.
- The public loses out on important payments that support social insurance programs like Social Security, Medicaid, unemployment insurance, and workers' compensation. These are programs designed to protect all of us, and contractors committing payroll fraud undermine them.

The Office of the Attorney General (OAG) commissioned a study to determine how much labor costs construction companies avoid—and how much everyone else loses out—when they commit payroll fraud by misclassifying their employees. We found that:

- **The cost evasion of illegally misclassifying workers in the District's construction industry begins at 16.7 percent**, which companies can use to underbid and undercut high-road employers.
- Moreover, payroll fraud is rarely committed alone; it is accompanied by wage theft and other practices to cheat workers out of what they are due. **Coupled with even a modest amount of**

wage theft, the cost evasion of doing business illegally can reach 27 percent, a massive amount in a competitive, bid-oriented industry.

- Further, employers committing payroll fraud rarely pass on the cost savings from misclassification, like the cost of providing employee healthcare, to their workers. **If employers keep all the money they did not pay in fringe benefits for themselves, the cost evasion of doing business illegally jumps from 16.7 to 48.1 percent.**

Those illegally gotten gains are accrued on the backs of some of the District's most vulnerable workers, of contractors trying to operate the right way, and of District taxpayers. That is why OAG is using its enforcement authority to sue companies committing this kind of payroll fraud and deter illegal behavior.

This Issue Brief describes what illegal worker misclassification is; what our study found about its significant, detrimental effect on the District and its residents; and what OAG is doing to combat it.

WHAT IS ILLEGAL WORKER MISCLASSIFICATION AND WHERE DOES IT HAPPEN?

Illegal worker misclassification is a form of payroll fraud where employers classify workers who should be considered direct employees as independent contractors instead. Through unlawfully misclassifying employees, an employer avoids paying important taxes and following crucial employment laws.

By improperly classifying workers as independent contractors, businesses illegally reduce their labor costs in multiple ways:

- First, for each misclassified worker, the company evades mandatory payroll taxes that fund social welfare programs, such as Social Security, Medicare, and unemployment insurance.
- Second, because misclassification fraudulently keeps workers off a company's official payroll, employers can illegally reduce other payroll-related costs, such as workers' compensation insurance premiums.
- Third, because independent contractors are not subject to overtime laws, employers can unlawfully avoid providing overtime pay to workers.

By evading these costs, employers can illegally increase profits and also gain an unlawful advantage in the market.

Misclassification is disturbingly common. While there has not been a District-specific study of the prevalence of misclassification, the last nationwide study by the Internal Revenue Service found that 15 percent of employers engaged in misclassification, affecting 3.4 million workers and robbing the federal fisc of \$1.6 billion annually (in 1984 dollars).¹

¹ Treasury Inspector General for Tax Inspection 2013, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rulings*, at 1, available at <https://www.treasury.gov/tigta/auditreports/2013reports/201330058fr.pdf>.

Unsurprisingly, illegal worker misclassification is most common in industries where committing payroll fraud gives the most significant undue advantage. For example, industries where work is awarded by bid, thereby creating significant pressure to keep labor costs down, are ripe for misclassification. Likewise, misclassification is common in industries with high injury rates, which drive up workers' compensation insurance premiums. The construction industry fits both descriptions well and is known for rampant misclassification. One study found that as many as one third of construction workers in southern states are misclassified.² Even in California, with its robust worker protections and enforcement, one in six construction workers is misclassified.³

HOW DOES MISCLASSIFICATION HARM WORKERS?

Crucially, misclassification strips workers of key protections to which they are entitled.

- **Misclassified workers lose the guarantees of federal and state employment and labor laws.** These include basic protections such as minimum wage, overtime, and paid sick leave; they also include labor law protections, such as those allowing for organizing and collective bargaining.
- **Misclassified workers miss out on important safety net programs and benefits.** Those who find themselves unemployed or injured on the job lose the protection of unemployment insurance and workers' compensation—important safety net programs that are especially crucial in high risk and unstable industries such as construction. When one carpenter was asked if he received anything for an on-the-job injury, such as medical attention or compensation, he explained that the only thing he ever got was “more work.” Misclassified workers are also ineligible for important benefits like paid leave, health insurance, and retirement plans that companies otherwise provide to employees.
- **Misclassified workers are left footing their employers' tax bill.** In a typical employer-employee relationship, both employer and employee pay an equal portion of the employee's wages in Social Security and Medicare taxes. When a worker is misclassified as an independent contractor, they are responsible for paying both the employee *and* employer share of Social Security and Medicare taxes. This imposes additional unexpected tax liability on misclassified workers, who are often low-wage earners least able to shoulder an

“If the job doesn't cover it, you have to pay full taxes. Because they're not even doing the taxes. You gotta eat and save money at the end of the day to pay taxes.”
— Padison Alberto Vargas, carpenter who experienced misclassification and wage theft

² Ordonez, Franco, and Many Locke. 2014a. “Immigrants are Most Susceptible to Worker Misclassification.” McClatchy Washington Bureau, September 5, available at <https://www.charlotteobserver.com/news/business/article9160514.html>.

³ Yvonne Yen Liu, Daniel Flaming, Patrick Burns, Economic Roundtable 2014, Sinking Underground: The Growing Informal Economy in California Construction, at 1, available at https://economicrt.org/wp-content/uploads/2014/09/Sinking_Underground_2014.pdf

extra cost. In addition, workers may not understand their tax responsibilities, especially where employers refuse to provide them with the appropriate tax forms. In such circumstances, workers may later become ineligible for Social Security and Medicare, both of which require regular tax contributions over time.

HOW DOES MISCLASSIFICATION HARM THE INDUSTRY?

Misclassification also takes a toll on businesses who attempt to operate legally. This is especially so in industries like construction, where work is procured through a bidding process. By unlawfully misclassifying workers and avoiding labor costs, a business can underbid lawfully operating companies, squeezing them out of potential business opportunities. Misclassification can also prompt other companies to improperly cut corners and avoid costs themselves. For example, because costs for materials and permits are more fixed, contractors may consider cutting safety measures or depressing worker pay and benefits. On-the-fence contractors may start misclassifying their own workers. In this way, misclassification can spread from a few bad apples, creating the risk of forming an industry standard practice.

HOW DOES MISCLASSIFICATION HARM THE PUBLIC?

Finally, misclassification cheats the public out of resources for important social insurance programs.

- **Social Security and Medicaid lose significant resources.** By committing payroll fraud, a would-be employer shirks their responsibility to pay into Social Security and Medicare, putting the burden of paying their portion on workers who may be ill-equipped to do so. If workers don't take up this unfair burden, then taxpayers are cheated out of the benefits of these programs.
- **State-run unemployment insurance programs go underfunded.** Employers also avoid paying contributions to unemployment insurance programs, which protect workers who become unemployed through no fault of their own.
- **Workers' compensation premiums go unpaid.** Since employers avoid covering misclassified workers under their workers' compensation insurance, the public may end up footing the bill for medical care and disability for low-income, uninsured workers.

“It’s ironic, you know, that you got these contractors making profit from taxpayers’ money, but they don’t contribute to the system.”
— Raul Castro, Organizer, Keystone Mountain Lakes Regional Council of Carpenters

WHAT WE FOUND: THE EFFECT OF ILLEGAL MISCLASSIFICATION ON DISTRICT WORKERS, BUSINESSES, AND THE PUBLIC

OAG commissioned a research report to determine the costs a construction contractor in the District can evade by illegally misclassifying its workers. Importantly, this report primarily considers only the costs of misclassification, not the full range of illegal practices that typically accompany misclassification (and that are discussed in more detail below).

Our main finding is that **a construction contractor in the District can reduce their labor costs by 16.7 percent through the act of unlawfully misclassifying workers as independent contractors alone.** This comes from foregone payments to workers and avoiding tax and social insurance payments. For every \$100 a misclassifying employer pays in labor costs, it saves \$11.50 in payments to the worker by not paying overtime and shifting the burden of payroll taxes to the worker. The misclassifying employer avoids an additional \$5.20 by not paying unemployment insurance taxes and reducing its workers' compensation premium.

In an industry where every dollar counts, a 16.7 percent premium on doing business legally is significant. Holding all else equal, this gives law-breaking contractors a marked advantage over high-road employers who play by the rules. And it generally puts substantial pressure on industry players to cut corners in safety or labor costs or, worse, to likewise misclassify their workers.

Stunningly, the 16.7 percent advantage contractors gain from illegally misclassifying their workers is just the beginning of the costs they can evade—and the harm they can do—by skirting workplace laws. The report makes conservative assumptions to measure the impact of misclassification in isolation. But rarely is misclassification committed by itself: It is often accompanied by other practices like wage theft (failing to pay owed wages, overtime, or minimum wage) and failing to offer fringe benefits that would otherwise be provided to employees. These practices quickly change the economics of the construction business even further. For example, our report makes the following findings:

- **If illegally misclassified workers experience even a modest amount of wage theft**, receiving only 90 percent of the average hourly wage of legally classified workers, **then the cost reduction for doing business illegally jumps from 16.7 to 27 percent.** To put this in context, misclassified workers in the carpentry business have found themselves working for less than one third of the advertised hourly wage.
- Legally classified workers often receive several employer-provided benefits, such as paid leave, health insurance, and retirement benefits. The report assumes that the misclassified worker receives the full value of these benefits in the form of additional wages. Making a more realistic (but still very conservative) assumption, **if misclassified workers receive only half the value of the fringe benefits to which they ought to be entitled, the cost reduction of doing business illegally jumps from 16.7 to 48.1 percent.**

These quickly mounting numbers demonstrate the strong incentive for contractors to combine the practice of illegally misclassifying their workers with other practices that further diminish worker pay and protections. The more low-road businesses engage in these practices, the more they undermine the market, making it difficult for high-road businesses to operate legally in the District. And the more construction companies make misclassification a regular business practice, the more District and federal

social safety net programs get drained, and the more workers lose out on pay, benefits, and protections owed to them.

HOW IS OAG FIGHTING ILLEGAL WORKER MISCLASSIFICATION?

Given the substantial incentives to misclassify workers, enforcement agencies must create a significant deterrent effect to ensure compliance with the law. Unfortunately, although the federal repercussions of misclassification are felt in the tax system, the Internal Revenue Service has very little power to address it. Under the “Safe Harbor Rule,” Section 530 of the Revenue Act of 1978, to avoid any tax consequences from misclassification, a company must only show a reasonable basis for classifying workers as independent contractors, including that it has always structured its work this way or that it is a practice that is widespread in the industry. If it does so effectively, it can freely avoid any penalties.

“

“We’re all immigrants, they know that we need the work and that we won’t say anything.”

— Anonymous electrician who experienced misclassification, wage theft, and unsafe working conditions

Meanwhile, private lawsuits to enforce misclassification laws are important but can have limited effectiveness. It can be hard for workers, particularly immigrant workers concerned about their immigration status, to come forward and fight a company. Those who do often need the pay that they have been denied for so long, creating pressure to settle with the company and compromise the value

of their claim. These infrequent and low-dollar settlements can be written off by companies as the cost of doing business illegally.

In the face of these challenges, the District government has filled the void. In 2013, the Council of the District of Columbia passed the Workplace Fraud Amendment Act to combat this very problem in the construction industry. This law provides that in most circumstances, construction workers are considered employees. And should an employer seek to classify a worker as an independent contractor, the employer must show that the worker is free from the employer’s control, is economically independent, and performs work outside the scope of the employer’s core business. OAG has the authority to take construction companies to court for illegally misclassifying their workers, and recover penalties and restitution to enforce the law.

OAG currently has two attorneys in its Housing and Community Justice Section focused on workplace justice and who are actively pursuing enforcement actions against companies who appear to be illegally classifying their workers. In August 2018, OAG sued Power Design, Inc.—a national electrical subcontractor that does extensive business in the District—and related companies for misclassifying over 500 electrical workers, as well as for related violations of the minimum wage, overtime, sick leave, and unemployment insurance laws. Power Design used a labor structure found throughout the District’s construction industry. Instead of hiring employees to do electrical work, it contracted with third-party subcontractors, who in turn hired hundreds of workers—all classified as “independent contractors”—to complete projects at Power Design worksites. These workers functioned in every way like employees of Power Design and should have been treated accordingly, with all the protections employee status provides. OAG’s suit seeks statutory penalties under the Workplace Fraud Act as well as damages,

liquidated damages, and penalties for violations of an array of other employment law violations. In addition to this lawsuit, OAG is actively investigating similar misclassification schemes in the construction industry that illegally keep workers off the books and unprotected.

OAG seeks to continue affirmatively protecting the rights of workers in the District of Columbia. Workers who believe that they have been illegally misclassified or experienced other forms of wage theft can contact OAG's Housing and Community Justice Section by phone at (202) 442-9854. Workers can also learn about their rights under District of Columbia law and how they can get help if their rights are being violated at <https://oag.dc.gov/workers-rights>.

ECONOMIC ANALYSIS**Economic Analysis of Incentives to Fraudulently Misclassify Employees in District of Columbia Construction**

Dale Belman and Aaron Sojourner*
May 22, 2019

EXECUTIVE SUMMARY

This Report analyzes the cost savings to construction companies generated by worker misclassification prohibited by the District of Columbia's Workplace Fraud Act (WFA), D.C. Code § 32-1331.01, *et seq.* We develop estimates of how much higher a typical D.C. construction company's labor costs would be if they pay their employees legally compared to their costs if they fraudulently misclassify employees as independent contractors. We assume that the cost of basic hourly labor compensation paid in either case is equal. Cost differences are generated by evading or shifting overtime pay, taxes, and legally-required social-insurance contributions under fraudulent misclassification. Under these conservative assumptions, a company employing workers legally would incur 16.7% higher costs than if the company fraudulently misclassified its employees. The total impact is split as 11.5% in reduced worker take-home compensation and the other 5.2% from evaded publically-mandated payments toward Social Security, Medicare, unemployment insurance, and workers' compensation systems. These estimates likely understate the economic differences between operating legally and fraudulently. Less-conservative but realistic assumptions result in larger savings to companies and greater losses to misclassified employees and the public. For instance, if the company does not pass through any of the value of typical employee benefits to misclassified employees, then operating legally costs 48% more per worker-hour than operating fraudulently. If fraudulently-misclassified workers experience some wage theft and receive only 90 percent of the average hourly wage of legally-classified workers, then this single change from the baseline scenario increases the estimated legal-cost premium to 27%. General contractors and developers can share in the gains from the company's fraudulent misclassification. This kind of fraud undermines the ability of law-abiding companies to survive.

** Belman is a professor at the School of Human Resources and Labor Relations at Michigan State University. Sojourner is an associate professor at the Carlson School of Management at the University of Minnesota.*

INTRODUCTION

This Report provides a generalized analysis and valuation of (i) the cost savings to construction companies generated by worker misclassification prohibited by the District of Columbia's Workplace Fraud Act (WFA), D.C. Code § 32-1331.01, *et seq.*; (ii) economic loss to the District of Columbia resulting from WFA violations; and (iii) economic loss to misclassified workers resulting from WFA violations. To accomplish this, we evaluated general payroll costs associated with operating in the construction industry in the District of Columbia and analyzed general cost savings generated by failing to comply with the WFA. Our findings and conclusions are summarized in this Report.

Our analysis is designed to inform assessment of savings derived from fraudulent misclassification in cases of WFA violations with limited financial information available. The Report answers the question: for each dollar paid to a construction company that is fraudulently misclassifying employees, how would the division of economic value between the company, its workers, the general contractor and developer, and the public treasury differ if the company were legally classifying its workers as employees? We use public information sources to estimate the company savings realized through misclassification of employees.

MODEL

The core of our economic analysis takes the perspective of a typical construction company operating in D.C. and deciding whether to legally classify an hourly worker as an employee or to fraudulently misclassify the employee as an independent contractor. First, we model the key economic parameters and how they affect the flow of resources to different parties. We build an example. This yields conclusions about the economic impacts of fraudulent misclassification per hour of work. Second, we reframe the example so the impacts are posed per dollar of a fraudulent labor contract. Third, we consider how to incorporate additional factors into the analysis.

Typical impacts per hour of work

Consider the typical flow of resources if the company classifies its employee legally (see Table 1: "Legally" column). Based on the best-available data, we make the following assumptions, which are reflected in Table 1.

- **Hourly Pay (Post-SS&M).** Construction employees earn \$24.92 per hour in wage and salary income on average in the Washington, D.C. area.¹ The employee will have \$1.96

¹ U.S. Bureau of Labor Statistics. Occupational Employment Statistics for workers in construction and extraction occupations in the Washington-Alexandria-Arlington metropolitan area in May 2018. https://www.bls.gov/oes/current/oes_47894.htm#47-0000

(7.65 percent of regular and overtime pay) deducted towards Social Security and Medicare taxes (SS&M), making the employee's post-deduction hourly wage \$23.01. The company will pay another \$1.96 (7.65 percent) to Social Security and Medicare as the employer contribution without it showing up on the employee's pay stub.

- **Hourly Overtime Pay (Post-SS&M).** A typical construction worker earns an average of \$0.76 per hour in overtime pay. Of this amount, \$0.70 goes to the worker and \$0.06 goes to the employee share toward Social Security & Medicare taxes.²
- **Hourly Tax-Exempt Benefit Costs.** A typical construction worker earns an additional \$7.48 in benefits that include overtime pay, paid leave, supplemental pay, health insurance, and employment-based retirement benefits.³ After separating out overtime pay as set out above, the balance, excluding overtime pay, equals \$6.72. We will refer to this balance as "benefits." Benefits are exempt from taxes and social insurance contributions.
- **Social Insurance Costs.** As discussed above, the employer and employee each pay taxes of 7.65 percent of the employee's hourly pay (including overtime) toward SS&M. In addition, the employer will pay for two legally-required forms of social insurance: workers' compensation and unemployment insurance. We estimate each contribution at 5 percent of gross hourly wage costs, including overtime (\$1.28 per hour each).^{4,5}

If a company bids on a contract assuming that workers will be paid as legally classified employees, this implies a typical hourly labor cost totaling \$36.91. The worker takes home

² Construction workers employed full time typically work 42.6 hours per week, implying a 50-percent overtime pay increase required on 6.1 percent of hours (2.6/42.6), according to the U.S. Bureau of Labor Statistics Current Population Survey (<https://www.bls.gov/cps/cpsaat21.htm>).

³ The total of these four types of benefits equal 30 percent of wage and salary compensation for construction workers nationally according to the U.S. Bureau of Labor Statistics Employer Costs of Employee Compensation data (https://www.bls.gov/news.release/archives/ecec_12142018.htm). This share is similar between the U.S. and the Washington metro area among all workers (<https://www.bls.gov/opub/mlr/cwc/bls-introduces-new-employer-costs-for-employee-compensation-data-for-private-industry-workers-in-15-metropolitan-areas.pdf>).

⁴ Although workers compensation insurance is frequently purchased from private insurers, it is usually considered social insurance because, similar to unemployment insurance or Social Security, it is required by state or federal statute, addresses a failing of the private market, and is intended to improve social welfare broadly defined. In some states, state agencies are the workers' compensation provider of last resort. Workers' compensation premiums in construction are higher than for the average employer due to the higher risk of occupational injury and experience rating of employers. A premium quote site, workerscompensationshop.com, provides hourly premium ranges for D.C. employers of construction labor. The midpoint of the range for employees doing electrical wiring is 3.74%, tile installation is 4.40%, flooring is 4.49%, HVAC installation is 4.51%, painting is 5.55%, carpentry is 5.58%, plumbing is 5.64%, and concrete construction is 7.07%. We assume a 5 percent workers' compensation premium, which is in the middle of these estimates.

⁵ Unemployment insurance taxes for construction are higher than average. The average is 2.7 percent (District of Columbia Department of Employment Services Unemployment Insurance Handbook for Employers, April 11, 2016, page 15). We assume a 5 percent rate, just below twice the average rate.

\$30.43 per hour in pay and benefits after accounting for the employee’s Social Security and Medicare contribution. The balance, \$6.48, goes toward costs of legally-mandated social insurance.

Table 1: Typical flow of resources per hour of work by legal status of employment

Company classifying employee:	Legally	Fraudulently
Total: Value to Worker	\$30.43	\$26.80
Hourly Pay (post-SS&M)	\$23.01	\$26.80
Hourly Overtime pay (post-SS&M)	\$0.70	\$0
Hourly Tax-Exempt Benefit Costs	\$6.72	\$0
Total: Value to Social Insurance Contributions	\$6.48	\$4.84
SS&M Tax – Employee Share	\$1.96	\$4.84
SS&M Tax – Employer Share	\$1.96	\$0
Unemployment insurance tax	\$1.28	\$0
Workers’ compensation cost	\$1.28	\$0
Total: Employer hourly labor cost	\$36.91	\$31.64

Note: SS&M is Social Security and Medicare tax.

How would these flows differ if the company were to hire the hour of labor through fraudulent misclassification of the employee as an independent contractor? Our analysis rests on two primary, conservative assumptions.

1. Worker hourly pay under fraudulent misclassification equals the value of a legally-employed worker’s hourly wage and salary income plus full benefit costs. This conservative assumption isolates the difference caused by fraudulent misclassification *per se*. Later in the Report, we consider the case where the worker does not receive the full costs of benefits as wages, which magnifies the company’s advantage from fraudulent misclassification.
2. The company’s savings from misclassification would come from:
 - a. avoiding paying overtime,
 - b. shifting employer’s Social Security and Medicare contribution to the worker, and
 - c. evading workers’ compensation and unemployment insurance costs.

In this case, the worker is paid a pre-tax wage of \$31.64, equal to the employee’s pre-tax hourly wage (\$24.92) plus the full value of benefits (\$6.72). However, under fraudulent misclassification, the employer evades its SS&M tax payment. The employee must cover both the employee and employer payment to Social Security and Medicare on this whole amount,

totaling \$4.84.⁶ This leaves a post-SS&M wage of \$26.80 per hour for the employee fraudulently misclassified as an independent contractor (see Table 1: “Fraudulently” column).

Typical impacts per dollar of fraudulent labor cost

Comparing the total hourly labor costs between legal and fraudulent classification of the employee implies the employer’s hourly costs are 16.7 percent higher (\$5.27 per hour) when operating legally.⁷ The \$5.27 per hour in fraudulent cost saving comes from a combination of \$3.63 lower worker earnings and \$1.64 in lower tax and social insurance payments (see Table 2: Impacts per dollar of fraudulent labor costs).

Table 2: Impacts per dollar of fraudulent labor cost

Company classifying employee	Legally	Fraudulently	Legally - Fraudulently Difference	
			Dollars	Percent of Total Fraudulent Cost
Total: Worker	\$30.43	\$26.80	\$3.63	11.5%
Total: Public	\$6.48	\$4.84	\$1.64	5.2%
Total labor cost	\$36.91	\$31.64	\$5.27	16.7%

Put another way, for every \$100 in labor cost for a fraudulently-misclassifying company, the company saves \$16.70 in costs relative to what it would have to pay if it operated legally or relative to what a similarly-productive, law-abiding competitor would pay. This implies an estimated 16.7 percent *legal-cost premium*, the percentage increase in costs for operating legally over fraudulently. Of this 16.7 percent, 11.5 percent comes from lost worker take-home earnings and 5.2 percent comes from lost tax and social-insurance payments.

This difference creates a strong incentive for companies to operate fraudulently. Companies operating fraudulently can easily underbid those operating legally. It also creates a strong incentive for general contractors and developers to turn a blind eye to fraud.

Distribution of the gains from fraudulent misclassification

Where do these fraudulently-saved dollars go? We assume a workflow involving three parties: the fraudulently-misclassifying company, the general contractor who hired the company, and

⁶ Note that the SS&M contributions for a misclassified worker are higher than the SS&M contributions for a worker legally classified as an employee. This is because we assume that a properly classified employee’s tax-exempt benefits are fully passed through in the form of taxable wages should that worker be misclassified as an independent contractor—thus increasing the compensation subject to SS&M taxes. We make this assumption to isolate the *per se* effect of misclassification. As discussed below, incomplete pass-through of such benefits would increase the savings associated with misclassifying workers.

⁷ Legal/Fraudulent hourly cost = $\$36.91/\$31.64 = 1.167 = 16.7$ percent higher.

the developer who hired the general contractor. Through the bidding and negotiation process, these parties implicitly divide the gains from these evaded costs between themselves. For every \$100 in fraudulent labor cost, the legal cost is estimated at \$116.70. This \$16.70 difference (L-F) can be shared in any combination between the company, general contractor, and developer.

$$\text{Legal cost} - \text{Fraudulent cost} = \text{Company Gain} + \text{General Contractor Gain} + \text{Developer Gain}$$

$$L - F = C + G + D$$

$$1 = C/(L-F) + G/(L-F) + D/(L-F) = \text{Company share} + \text{General Contractor share} + \text{Developer share}$$

For instance, suppose the company bid \$105.00, then its gain is \$5.00 and its share of the gain is 29.9 percent.⁸ The general contractor gets \$11.70 in savings relative to the cost of hiring a legally-operating company and can share this value with the developer by underbidding any competing general contractors who would hire competing, law-abiding companies at cost \$116.70. The general contractor can win and cover its costs with any bid between \$116.70 and \$105.00, so it has \$11.70 to divide between itself and the developer. If they divided it equally, the general contractor would bid \$110.85, claiming \$5.85 in general-contractor gain and yielding \$5.85 in gain from cost saving to the developer. The general contractor and developer shares of gain from the fraudulent operations of the misclassifying company would each be 35 percent.

If a fraudulently-operating company is observed to have a labor subcontract worth \$B, this is the sum of F + C. Auditing the company's books may reveal evidence about the difference between the amount paid to the company from the general contractor (B=F+C) and the amount spent on misclassified labor (F). This difference would be the company's gain (C).

With an estimate of a company's fraudulent labor cost (F) in hand, applying the estimated 16.7 percent legality premium gives a basis for estimating economic impacts of fraudulent misclassification.

If fraud goes undetected and unpunished, standards in the industry can unravel and force law-abiding companies out of business. Just as the company has an incentive to use fraudulent misclassification to lower its labor costs so as to win bids, the general contractor has an incentive to accept the lower bid and pass some of that value to the developer through its bid. This will disadvantage general contractors who only use law-abiding subcontractors. The developer, in turn, has an incentive to accept the lower bid from the general contractor who hires the fraudulently-misclassifying company.

⁸ \$5.00/\$16.70 = 0.299.

Incorporating additional factors

Our approach has been developed with specific, simplified assumptions about how the construction labor market functions and estimates depend on these assumptions. This section discusses how to incorporate additional factors into the analysis.

- ***Incomplete pass through of benefit value:*** We assumed that misclassified workers would receive the full value of benefits that would have been earned had that worker been properly classified. If less than full pass-through occurs, the fraudulent labor cost will be reduced by lowering both payments to workers and to the public. The difference in labor cost between legal and fraudulent operations will be larger. For instance, in the typical case considered above, if only half the value of benefits (half of \$6.72) passes through, then the legal-cost premium almost doubles, from 16.7 percent to 30.5 percent. If none of the benefit value passes through, then the legal-cost premium rises to 48.1 percent.
- ***Wage theft:*** If workers are not paid what they are owed or promised so that the effective hourly wage when operating fraudulently is below the hourly wage when operating legally, the fraudulent labor cost decreases by that amount, raising the labor-cost difference between legal and fraudulent operations. For instance, if a worker classified fraudulently would receive only 90 percent of the hourly wage that the worker would if classified legally (90 percent of \$24.92), then this one change from the baseline scenario increases the legal-cost premium to 26.7 percent.
- ***Materials:*** If the contract includes nonlabor inputs, then their cost should be deducted from the value of the bid (B) before estimating labor costs because these material costs should be similar whether operating legally or fraudulently. In general, the legal-cost premium will be maximized when the labor share of costs is maximized. Contracts including material costs will shrink the total-cost difference. Our information suggests that this rarely occurs, because higher-level contractors usually provide materials to the companies they hire to avoid paying markups.
- ***Value of missing insurance:*** The lack of coverage by workers' compensation and unemployment insurance is a significant but difficult to quantify loss to the employee and to society. The cost of workers' compensation and unemployment insurance capture the expected value of the benefit stream triggered by the loss. The absence of these benefits can impose heavy collateral costs on specific individuals, on their families, and public institutions. The possible absence of health insurance given incomplete pass-through of benefits exacerbates this. For example, consider a misclassified worker lacking workers' compensation insurance and medical insurance coverage and unable to pay the cost of medical care after a workplace injury. They will not have income during

their convalescence. The individual and family will bear these costs along with health care institutions, social welfare organizations, and public benefit systems (like food stamps or public housing) that absorb the costs of unreimbursed care and family support in the face of loss of income. Misclassified employees may also have more difficulty exercising and enforcing other employee rights, such as those involving minimum wage, occupational safety and health, concerted activity and organizing, and protection from discrimination.

- *Unfair competition for law-abiding companies:* The increase in the proportion of construction workers who are misclassified as independent contractors impacts how business is done in the construction industry. Companies that fraudulently misclassify gain the advantage of reduced labor costs. They are in a position to submit lower bids than competitors who follow the law. As the number of companies that misclassify increases, law-abiding companies win fewer bids, and have less work. Over time, misclassification progresses from a method used by unscrupulous companies to earn additional profits to the price of survival in the industry. Reducing the use of misclassified workers provides a level playing field for law-abiding companies.
- *Tax payments and off-the-books payments:* our model assumes that Social Security and Medicare taxes are paid in both scenarios. We also implicitly assume that the worker will pay income taxes out of their earnings in either case. A factor that may contribute to the violation of these assumptions is if workers are paid completely off the books, rather than as fraudulently-misclassified independent contractors issued a 1099. With a 1099, the tax authorities have a paper trail and so the audit risk is higher. Without any documentation, audit risks are lower and incentives to evade taxes are stronger. If misclassified workers do not pay these taxes, then that value stays with the worker rather than going to the public. This does not affect the legal-cost premium but does affect the distribution of value between worker and public. Off-the-books payment may also indicate legal vulnerability of workers and be associated with increased risk of wage theft and incomplete benefit cost pass-through.

ABOUT THE AUTHORS**Dale Belman**

Belman is a labor economist and professor at Michigan State University in the School of Human Resources and Labor Relations. He has published in *Industrial and Labor Relations Review*, *Industrial Relations (Berkeley)*, *Review of Economics and Statistics*, *Labour*, *Journal of Business and Economic Statistics*, and *Oxford Economic Papers*. Along with Paul Wolfson, he was recognized by Princeton University with the Bowen Prize for the book, *What Does the Minimum Wage Do?* (Upjohn, 2014).

Belman completed his Ph.D. in Economics at the University of Wisconsin, Madison in 1986. His undergraduate work was completed at Bowdoin College. Prior to working at MSU, he was a professor at the University of Wisconsin, Milwaukee. He has served as president of the Institute for Construction Economics Research, a non-profit foundation which provides non-partisan research on topics of concern to construction industry stakeholders.

Aaron Sojourner

Sojourner is a labor economist and associate professor at the University of Minnesota's Carlson School of Management in the Department of Work and Organizations. The *Economic Journal*, *Journal of Human Resources*, *Journal of Public Economics*, *Industrial and Labor Relations Review (ILRR)*, *Management Science*, *Early Childhood Research Quarterly*, and *Industrial Relations* have published his work and he serves on the ILRR international editorial board. He received the John T. Dunlop Scholar Award from the U.S. Labor and Employment Relations Association in 2016, which recognizes emerging scholars for outstanding research contributions to issues of national significance.

Sojourner has a wide range of policy experience and community service. He spent the 2016-'17 academic year in Washington, D.C. serving as senior economist for labor for the U.S. President's Council of Economic Advisers, established in 1946 to offer the president objective economic advice on the formulation of economic policy. Previously, he has served on Minneapolis Mayor Betsy Hodges's Cradle-to-K Cabinet, advising the city on how to reduce racial disparities through policies affecting children's first 3 years, as a director of Spring Bank, a community bank in the Bronx and Harlem, N.Y, and as a fellow in the U.S. Senate's Labor Policy Office.

Sojourner completed his Ph.D. in economics at Northwestern University in 2009. He has a masters in public policy analysis from the University of Chicago and a bachelors in history from Yale University.

[Additional submission by Mr. Townsend follows:]



October 1, 2019

The Honorable Alma Adams
Chair, Subcommittee on Workforce Protections
Committee on Education and Labor
U.S. House of Representatives
Washington, DC 20515

VIA E-MAIL: Tylease.ali@mail.house.gov

Re: **Clarification of the Record, September 26, 2019 Hearing on
"Misclassification of Employees: Examining the Costs to Workers,
Businesses, and the Economy."**

Dear Chair Adams,

I testified at the above-referenced hearing on Thursday, September 26, 2019. During the hearing, in an exchange with Chairman Scott, I cited published data concerning the rate of misclassification among construction workers in North Carolina. Later in the hearing, Mr. Walker asked me for the source of that data and I mistakenly recalled that it came from the Labor Department.

By this letter, I wish to clarify that while the figure I recalled accurately reflected published data on the rate of misclassification among North Carolina construction workers, the data did not come from the Labor Department. Rather, it came from one article that was part of a larger 2014 McClatchy News Service series entitled *Misclassification: Contract to Cheat*. This investigative reporting was cited in my written testimony in footnote 3. The entire series of reports may be found online at <http://media.mcclatchydc.com/static/features/Contract-to-cheat/>. The specific data I cited came from the September 2014 report in that series by Mandy Locke, David Raynor, Rick Rothacker, and Franco Ordoñez entitled *NC's \$467 million problem: Abuse of workers, failure to collect taxes*. A copy of this story can be found here: <http://media.mcclatchydc.com/static/features/Contract-to-cheat/467-million-dollar-problem.html>

I appreciate the opportunity to clarify the source of the figure I cited during the hearing.

Respectfully,

Matt Townsend
President

**Signatory Wall and
Ceiling Contractors Alliance**
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[Whereupon, at 12:22 p.m., the subcommittee was adjourned.]

