Testimony Regarding Maryland Senate Bill 272
Before the Senate Finance Committee
February 9, 2012

Catherine Ruckelshaus, Legal Co-Director
National Employment Law Project[1]

Thank you for this opportunity to submit written testimony on Maryland Senate Bill 272, a proposed amendment that would shrink coverage of the newly-enacted Maryland Workplace Fraud Act and create unnecessary confusion for employers and workers. I submit this testimony on behalf of the National Employment Law Project (NELP).

NELP is a non-profit research and advocacy organization that works to ensure good jobs and economic security for our nation's workers. For over 40 years, NELP has specialized in labor standards enforcement and access to good jobs for all workers. NELP has a long history of serving families hardest hit by economic downturns by promoting policies to ensure that workers are properly paid and treated fairly on the job, and that they have access to unemployment insurance benefits when they are separated from their jobs.

Introduction

Senate Bill 272 would gut a recently-passed law aimed at combatting independent contractor abuses in two high-violation industries, replacing an objective and easy-to-apply test for employee status with one that is confusing, unpredictable, and easy-to-manipulate by employers seeking to evade baseline labor standards. Its effect would be to allow a greater number of employers to orchestrate job arrangements that deprive workers of fair pay and other job-protection laws, creating pressure on law-abiding employers to follow suit in order to compete, and costing the state millions of dollars in uncollected payroll and related revenues. This proposal is bad policy, for three reasons:

(1) As the just-enacted Workplace Fraud Act passage underscored, employer use of independent contractor misclassification is on the rise in a broad swath of industries, especially in construction, and it costs the states, law abiding employers and workers.

---

[1] 75 Maiden Lane, Suite 601, New York, NY 10038. cruckelshaus@nelp.org.

(2) It would again encourage misclassification of employees as independent contractors and create confusion for a whole new set of workers and their employers, thereby undermining application of other minimum labor standards and frustrating tax collection; and

(3) It would accelerate the erosion of job standards in two growth industries that are poised to generate economic recovery when the law has not yet had a chance to have an impact.

I. As the Maryland Legislature Recently Acknowledged, Independent Contractor Abuse is on the Rise, Hurting Workers, Law-Abiding Employers, and Costing States Billions of Dollars.

Joining a nationwide state and federal movement to combat the problem[2], Maryland's legislature passed the Workplace Fraud Act in 2009, to rein in independent contractor abuses in construction and landscaping that allow employers to cut payroll costs by as much as 30 percent, leaving workers unprotected by critical workplace protection laws and creating a competitive disadvantage for those employers who play by the rules.[3] The legislature recognized that workers who are misclassified as independent contractors are denied access to unemployment insurance, workers' compensation and the minimum wage, while the taxpayers are deprived of millions of dollars in uncollected payroll taxes.

Employers use contingent employment structures with increasing frequency in a number of leading industries like construction and landscaping, the two targeted by the Workplace Fraud Act. These convoluted arrangements can bar workers from receiving wage and hour protections that protect employees only, and in some cases create confusion among workers and enforcement agencies as to who is the responsible employer or employers. Calling workers "independent contractors" or treating them as non-employees by paying them off-the-books with no tax withholdings is one way employers try to evade basic minimum wage and overtime rules[4].

---

[2] For a series of legislative round-ups of state efforts to combat the problem of independent contractor misclassification, *see, eg., Summary of Independent Contractor Reforms 2011,* http://www.nelp.org/page/-/Justice/2011/2011IndependentContractorReformUpdate.pdf?nocdn=1

[3] For a collection of state studies showing billions of dollars of lost revenues to states, *see,* National Employment Law Project, http://www.nelp.org/page/-/Justice/2011/2011IndependentContractorReformUpdate.pdf?nocdn=1

[4] For general background on the problem and its impacts, *see* *Leveling the Playing Field: Protecting Workers and Businesses affected by Misclassification*, NELP's 2010 Congressional testimony, http://www.nelp.org/page/-/Justice/2010/MisclassTestimonyJune2010.pdf?nocdn=1.

These business arrangements can save the companies billions of dollars of payroll and other taxes paid for employees. Employers stand to save up to 30 percent percent of payroll and other taxes, and state and federal tax revenue losses quickly get up into the billions of dollars[5]. Thus there is a strong incentive for firms to misclassify workers as independent contractors, or to insert subcontracting entities like temp or leasing firms, or labor agents in between them and the workers. These structures save companies money, but hurt workers and their families, local and state governments, and law-abiding employers who play by the rules and do not mischaracterize the employment relationship of their employees.

In recognition of the problem, Governor O'Malley created the interagency Joint Enforcement Task Force on Workplace Fraud in July 2009, comprised of agency staff from the Maryland Department of Labor, Licensing and Regulation, the Attorney General's Office, the Comptroller's Office, the Insurance Administration, and the Workers' Compensation Commission[6]. The Task Force is charged with coordinating and enhancing state efforts to combat and prevent workplace fraud. The Task Force's annual reports for 2009[7], 2010[8] and 2011[9] show that even despite the Workplace Fraud law, 20 percent of Maryland employers misclassify their employees as independent contractors, costing the state 22 million dollars in unemployment insurance payments alone.[10]

II. SB 272 Would Encourage Abuse and Undermine Other Minimum Labor Standards and Tax Laws.

Maryland's Workplace Fraud Act uses an objective and difficult-to-manipulate test to determine whether a worker is an "employee" or an "independent contractor," a version of the test that has long been used in Maryland's unemployment insurance (UI) law and a majority of other state UI laws. In addition, a growing number of states (IL, DE, ME, NE, NY, WI, MA, others) have adopted the same test or a close variation thereof in order to combat independent contractor abuses. The most basic version of this so-called ABC test requires employers to overcome a presumption that a worker is an employee by showing that: (a) an individual is free from control or direction over performance of the work, both under contract and in fact; (b) the service provided is outside the usual course of the business for which it is performed; and (c) an individual is customarily engaged in an independently established trade, occupation or business.

---

[5] *Leveling the Playing Field: Protecting Workers and Businesses affected by Misclassification*, NELP's 2010 Congressional testimony, http://www.nelp.org/page/-/Justice/2010/MisclassTestimonyJune2010.pdf?nocdn=1.

[6] http://www.dllr.state.md.us/workplacefraudtaskforce/

[7] http://www.dllr.state.md.us/workplacefraudtaskforce/

[8] http://www.dllr.state.md.us/workplacefraudtaskforce/2010workplacefraudrpt.pdf

[9] http://www.dllr.state.md.us/workplacefraudtaskforce/wpftfannrep2011.pdf

[10] *Id. a*t 1.

The most effective laws combating independent contractor misclassification are those that are the simplest to administer. Creating a presumption of employee status, as the Workplace Fraud Act does, is objective and relatively easy to enforce, as the decades of states' applications of their UI laws with this test show. The idea of these objective tests is to truly determine *whether the worker in question is in business for him or herself.*

The Maryland legislature should take note that this is the central question: are the construction and landscape workers who are the subject of the Workplace Fraud Act running their own businesses? The public policy behind scrutinizing employment structures in high-violation industries is to deter the rampant wage theft, UI and workers compensation violations that persist in these jobs.

By contrast, the proposed test in SB 272 would import the multi-factor so-called "20-factor" test used by the Internal Revenue Service to determine employee status. This multi-factor test is based on the common-law concept of employment, which has been developed for completely different purposes. The common-law definition of master/servant was not to offer protection to employees, but rather to determine whether the master was liable to third parties for a servant's negligent acts. Thus, the common-law test for employment, and, accordingly, for tort responsibility, was whether the alleged "employer" had the "right to control the manner and means by which the product is accomplished." *Community for Creative Non-Violence v. Reid,* 490 U.S. 730, 751-52 (1989); *Darden*, 530 U.S. at 321. Where the alleged master had the right to control details of the servant's work and the work was performed negligently, it was fair to hold the master accountable. This is not the purpose of the labor standards laws like the Workplace Fraud Act, and should therefore not provide the underlying test.

No other state that has aimed to combat independent contractor misclassification has decided to use this confusing and unpredictable test. It considers factors that are easy to manipulate by an employer, which can unilaterally decide to do things like[11]: (1) not withhold payroll taxes from the worker; (2) require the worker to provide tools and equipment; (3) pay the worker by the job or by flat rate; (4) not provide the worker with workers compensation insurance, and instead require the worker do to so, and (5) require the worker to sign an agreement stating he was an independent contractor as a condition of getting a job.

SB 272 would potentially allow employers to compel their construction or landscape employees to waive the protections of the state's minimum wage and unemployment and workers compensation laws to which they would otherwise be entitled as a condition of getting a job. Signing an "independent contractor" agreement, requiring the worker to get his own workers compensation insurance and to buy gloves or goggles, for instance, may alone be enough to keep the worker outside the protection of these laws that most workers take for granted.

---

[11] *See, e.g.,* http://www.irs.gov/pub/irs-pdf/fss8.pdf

True independent contractors are outside the protective scope of the state's labor and employment statutes. In turn, one who hires an independent contractor is not required to provide labor and employment protections or to pay unemployment insurance tax contributions. But, an employee cannot be transformed into an independent contractor by contract, agreement or fiat. Under existing law, the unemployment insurance agency may look through the "tag" the employer has placed on the employment relationship and "determine, as a matter of fact, whether the relationship (regardless of what it may be called) comes within the statute." *Warren v. Board of Appeals*, 226 Md. 1, 14, 172 A.2d 124, 129 (1961).

Thus, SB 272 would encourage precisely the form of independent contractor misclassification that is the subject of increasing scrutiny, regulatory activity, and enforcement actions at the state and federal level, including in Maryland, as evidenced by its Workplace Fraud Act and Task Force.

III. The law would accelerate the erosion of job standards in an industry that is already rife with independent contractor misclassification.

It is well-documented that general contractors on construction jobs hire contractors and subcontractors to complete their projects. In turn, the subcontractors and sub-subcontractors typically hire individual construction workers to perform the labor.[12] The end result is often a complicated web of dozens of subcontractors engaged on one construction site. General contractors interviewed for one study reported that as much as 95 percent of workers on their worksites were employed by subcontractors[13].

---

[12] *See, e.g.,* Linda H. Donahue, James Ryan Lamare, Fred B. Kotler, *The Cost of Worker Misclassification in New York State.* Cornell University School of Industrial Labor Relations (February 2007), page 20; Françoise Carré and Randall Wilson, *The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry*, Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health (2005), available at %http://www.law.harvard.edu/programs/lwp/Maine%20Misclassification%20Maine.pdf.; *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry,* Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (June 2009), available at http://www.buildaustin.org/Building%20_Austn_Report.pdf, .

[13] *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry,* Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (June 2009), available at http://www.buildaustin.org/Building%20_Austn_Report.pdf, page 11.

Other state-based studies, including those covering Massachusetts[14], Maine[15], Florida[16], Connecticut, Indiana, Tennessee, and Delaware have found high rates of independent contractor misclassification by construction contractors.

These subcontracting arrangements often result in violations of minimum wage and overtime laws and other labor standards, as contractors facing stiff competition for contracts attempt to lower their overall bids by contracting with subcontractors willing to complete their portion of the project for the lowest price. The United States Department of Labor's (DOL) Wage & Hour Division has named construction one of its top priority industries[17], citing its high violation levels and use of subcontracting structures. The DOL recently settled a case against a construction company for unpaid wages, noting in its press release:

> The misclassification of employees as independent contractors is an alarming trend, particularly in industries such as construction that often employ low-wage, vulnerable workers and in which the Wage and Hour Division has historically found significant wage violations. The practice is a serious threat both to workers entitled to good, safe jobs, and employers who obey the law. Too often workers are deprived of overtime and minimum wages, and forced to pay taxes that their employers are legally obligated to pay. Honest employers have a difficult time competing against scofflaws. The Labor Department is committed to ensuring that

---

[14] Linda H. Donahue, James Ryan Lamare, Fred B. Kotler, *The Cost of Worker Misclassification in New York State.* Cornell University School of Industrial Labor Relations (February 2007), page 20. . In the past year, MA's Joint Task Force on the Underground Economy and Employee Misclassification recovered nearly $6.5 million through its enforcement efforts: $2 million in new unemployment insurance taxes; $1.6 million in overdue taxes through review and investigation; $1.8 million in fines, and $1 million in other funds recouped through civil and criminal actions. Available at http://www.mass.gov/Elwd/docs/dia/task_force/ar_2010.pdf.

[15] Françoise Carré and Randall Wilson, *The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry*, Construction Policy Research Center, Labor and Worklife Program, Harvard Law School and Harvard School of Public Health (2005), available at http://www.law.harvard.edu/programs/lwp/Maine%20Misclassification%20Maine.pdf.

[16] http://www.myfloridacfo.com/siteDocs/MoneyServiceBusiness/WC_MSBReport-Rec.pdf. (Finding workers compensation fraud most prevalent in the construction industry in FL.)

[17] US Department of Labor Strategic Plan, 2011-2016, at 30; available at http://www.dol.gov/_sec/stratplan/StrategicPlan.pdf.

> workers receive the pay and benefits to which they are legally entitled, and to level the playing field for employers that play by the rules.[18]

In this labor-intensive industry, subcontractors are under enormous pressure to reduce labor costs, sometimes to the extent that they cannot meet basic labor standards requirements.[19] General contractors facing stiff competition for contracts push heavily on subcontractors to reduce project costs, which leads – intentionally or not – to neglect for workers' rights as subcontractors are forced to trim expenses. Cost often becomes the primary consideration and a lower priority is placed on safety and employment practices of subcontractors. While a competitive bidding process solely based on price may drive down short-term costs for developers, the practice also creates a race-to-the-bottom among subcontractors who cut costs at the expense of their employees' safety and wages.[20]

Numerous studies of wage theft in the construction industry show high labor standards violation rates. A leading survey of low-wage workers in New York, Chicago and Los Angeles found that 12.7 percent of workers in the residential construction industry experienced a minimum wage violation; 70.5 percent suffered an overtime violation; and 72.2 percent worked off-the-clock without receiving pay[21]. Similarly, a study of the construction industry in Austin, Texas found one in five workers was denied payment for their work, and fifty percent were not paid overtime. Only 11 percent of workers in that study reported that they were able to recover their wages[22].

Violation rates are even higher in some segments of the construction industry. A national study of employment violations among day-laborers – workers seeking temporary job

---

[18] "US Department of Labor recovers more than $203,000 in overtime back wages for 224 drywall installers in Lafayette, La.," June 7, 2011, http://www.dol.gov/whd/media/press/whdpressVB3.asp?pressdoc=Southwest/20110607.xml.

[19] *See, e.g.*, *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry,* Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (June 2009), available at http://www.buildaustin.org/Building%20_Austn_Report.pdf.

[20] *Id.*at 37.

[21] Annette Bernhardt, Ruth Milkman, Nik Theodore et al, *Broken Laws, Unprotected Workers* at 32, 34, 35, http://www.nelp.org/page/-/brokenlaws/BrokenLawsReport2009.pdf?nocdn=1

[22] *Building Austin, Building Injustice: Working Conditions in Austin's Construction Industry,* Workers Defense Project in collaboration with the Division of Diversity and Community Engagement at the University of Texas at Austin (June 2009), at p. 17, available at http://www.buildaustin.org/Building%20_Austn_Report.pdf.

assignments, mainly in the construction industry – found that nearly half of all day laborers were denied payment by an employer for work and 48 percent were underpaid for their work.[23] Nearly two-thirds of day-laborers reported that they do not know their rights as a worker, and 70 percent of day laborers nationwide do not even know where to report a workplace violation. As a result, abusive employers are often able to continue to violate workers' rights with impunity.[24]

The frequency of wage theft for construction workers suggests that it is not a rarely occurring anomaly, but a standard practice in the industry. Independent contractor misclassification exacerbates the confusion as to whether a worker is covered by labor standards and the lack of accountability by employing entities.

In addition, the Workplace Fraud Act is too new to alter with SB 272. While the Maryland three-year-old Task Force using the law has conducted information and outreach efforts, begun to compile data to share among the participating agencies, and coordinated a handful of investigations, its work is just beginning.

The Task Force's inter-agency collaboration and employer outreach is likely beginning to lay important groundwork for future compliance, but the enforcement actions by participating agencies have yet to take hold in any meaningful way. For instance, in 2011, the Department of Labor and Industries issued a total of *four* citations under the law and collected *zero* wages and penalties from employers[25]. The unemployment insurance department has stepped up its state audits, discovering more unreported earnings, but it too has yet to make a dent in collections of those unpaid taxes, and has collected *zero* penalties as permitted under the law. *Id.* at 16-17. The workers compensation commission reports no enforcement actions in the 2011 Task Force Report.

Similarly low levels of enforcement are reported in the Task Force Reports for 2010 and 2009, where data collection, information sharing, and employer outreach took precedence over direct enforcement. For instance, in the 2010 Report, the Task Force conducted three joint audits for the year, the Department of Labor and Licensing issued seven citations and collected zero penalties, and the unemployment insurance division initiated 16 audits. The workers compensation commission focused on employer education and did not collect or assess any penalties or issue any citations.

The Workplace Fraud Act has just begun to be tested and take effect in Maryland, and SB 272 would eviscerate its intended effect, rewarding employers seeking to skirt basic labor standards protections.

---

[23] Melendez, Theodore, Valenzuela, p. 14.
[24] *Id.* at p. 23.
[25] *Id. a*t 14.

The proposed SB 272 is bad policy for the reasons outlined above, would narrow the test for determining covered employment under Maryland's labor and employment systems, and would encourage evasion of other employment and tax laws.

Thank you for the opportunity to present testimony on this important issue impacting Maryland's workers and the State's most vulnerable citizens.