S. HRG. 111–1146

LEVELING THE PLAYING FIELD: PROTECTING WORKERS AND BUSINESSES AFFECTED BY MISCLASSIFICATION

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING PROTECTING WORKERS AND BUSINESSES AFFECTED BY MISCLASSIFICATION, INCLUDING S. 3254, TO AMEND THE FAIR LABOR STANDARDS ACT OF 1938 TO REQUIRE PERSONS TO KEEP RECORDS OF NON-EMPLOYEES WHO PERFORM LABOR OR SERVICES FOR REMUNERATION AND TO PROVIDE A SPECIAL PENALTY FOR PERSONS WHO MISCLASSIFY EMPLOYEES AS NON-EMPLOYEES

JUNE 17, 2010

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STATEMENTS

THURSDAY, JUNE 17, 2010

ADDITIONAL MATERIAL

LEVELING THE PLAYING FIELD: PROTECTING WORKERS AND BUSINESSES AFFECTED BY MISCLASSIFICATION

THURSDAY, JUNE 17, 2010

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m. in room SD–430, Dirksen Senate Office Building, Hon. Tom Harkin, chairman of the committee, presiding.

Present: Senators Harkin, Brown, Merkley, Franken, Enzi, Isakson, and Murkowski.

OPENING STATEMENT OF SENATOR HARKIN

The CHAIRMAN. The Senate Committee on Health, Education, Labor, and Pensions will please come to order.

I want to welcome everyone to today's hearing. We are here today to talk about worker misclassification, an issue of critical importance to millions of working men and women across our country.

We all know that these are very difficult times for our economy, especially for working families. Millions of Americans are now living paycheck to paycheck. Employees across the Nation are working hard but still struggling to make ends meet. And need I say that filings for unemployment benefits were up sharply again last week? So we still have many millions of Americans unemployed or underemployed.

Over the past few years, it has become clear that a few unscrupulous employers are making these challenges even more difficult for their workers by intentionally misclassifying them as "independent contractors" to gain an advantage over their law-abiding competitors. When these companies play games with workers' rights, everyone loses: the workers, the taxpayers, and responsible businesses that play by the rules.

Misclassified workers simply do not receive the same protections under our laws. Basic standards such as the minimum wage, the right to overtime pay, unemployment compensation, workers' compensation, safety and health laws, and antidiscrimination protections do not apply to independent contractors. That means the construction worker who falls and breaks his leg is denied workers' compensation if he is an independent contractor. The truck driver who works 60 hours a week does not receive the overtime pay his family deserves if he is an independent contractor.

Misclassification is also costing the Federal and State governments billions of dollars in unpaid revenues, including the payments that support our unemployment insurance and workers' compensation systems.

Businesses are hurt by misclassification, too. An employer that misclassifies its workers may be able to outbid employers complying with the law, I am told, sometimes by as much as 30 percent. The problem is especially bad in cash industries where workers are often paid off the books making it virtually impossible to prove that employers are intentionally misclassifying workers and violating their rights.

The sad truth is that law-abiding employers lose business every day to scofflaw employers that intentionally misclassify their workers.

It should never pay to break the law, so we here in Congress have a duty to fix the problem and make sure everyone is competing on a level playing field.

The scope of the misclassification problem is staggering. There are more than 10.3 million workers in the United States who are treated as independent contractors. That is about 7.3 percent of the workforce. A Department of Labor study found that as many as 30 percent of businesses misclassifies employees as independent contractors.

So it is going to take a concerted effort by Federal and State agencies to solve this misclassification problem. Fortunately, we are off to a good start. In January, the Department of Labor hired more investigators to pursue misclassification. The Internal Revenue Service is working on a comprehensive nationwide employment tax audit program. Many States have also stepped up to the plate, and they are cracking down on misclassification.

But Federal and State agencies cannot do it alone. We also need some Federal legislation to hold employers accountable for breaking wage and hour laws by misclassifying their workers. The bill that Sherrod Brown has introduced—which I cosponsored—called the Employee Misclassification Prevention Act will do just that.

This important legislation would go a long way toward protecting workers and their families from unfair misclassification.

So I hope that today's hearing will be the first step in a bipartisan process to pass legislation to end misclassification once and for all. I look forward to working with other Members of the Congress on this issue.

With that, I will turn to Senator Enzi.

STATEMENT OF SENATOR ENZI

Senator ENZI. Mr. Chairman, I am disappointed that we are holding a hearing on S. 3254, the Employee Misclassification Prevention Act, because I think this is a symbol of what is wrong with Washington today. I think this could be called "the accountant and auditor employment program."

I agree that there are a few unscrupulous employers out there that are taking advantage of the system and they should be caught. This is going to penalize the 97 percent that are doing the right thing, give them huge additional costs, a lot of extra paperwork, and the result is going to be fines for miswriting the paperwork.

I got to participate a lot with the INS forms, and those were to catch illegal immigrants that were wrongfully employed. Every business had to collect a lot of documents from every worker and fill out a form on each worker, and then the businesses were audited. And what they were audited for were paperwork mistakes. They were not audited for whether they were catching illegal immigrants or not, whether they were hiring illegal immigrants, and they got huge fines because they did not cross a "T" or dot an "I". And I think that is exactly where this legislation is headed.

I think there are some ways that this can be done so it is a good auditing practice rather than a paperwork practice. As a former small business owner, I do not understand why instead of helping small business and entrepreneurs, we are saddling them with more paperwork, more recordkeeping, more fines, more penalties. You would think with the economy in its precarious State, that we would be doing everything in our power to help small business to do business. Everyone knows that small business entrepreneurs have been the drivers of our economic recoveries in the past recessions, and their role in our economy is just as important today.

With respect to S. 3254, one of the first mandates of the bill would be to require every single business to send every single employee and independent contractor a disclosure notice letting them know of their employment or independent contractor status. But what does that mean in the real world? According to the Small Business Administration, there are 120 million employees in our Nation. Half, or 60 million, of these employees are hired by small businesses. Because the bill requires that each disclosure notice be customized for the exact dollars earned and hours worked—let us say that each disclosure notice takes about 30 minutes to compile, complete, and share with the employee and then retained for records. That comes to about 30 million hours devoted by small businesses for these disclosures, and that relies on the employee auditing them. There is going to be a huge auditing factor that has to be built into this, and that is going to cause a lot more employees just to keep track of the paperwork.

One of the sticking points in our food safety bill is going from 900 Federal inspectors to 22,500 Federal inspectors that would greatly increase the cost. We are trying to overcome that additional cost for the bill. I can only imagine what the cost is going to be on this worker classification bill.

This bill comes to 30 million hours devoted by small businesses for these disclosures. It does not add anything on the bottom line. It does not produce any product. It does not create any sale.

According to the National Federation of Independent Businesses, the lowest dollar amount per hour for small business regulatory compliance is $37 for the smallest of businesses and up to $68 for the next size up small business. If we took the time to calculate out what it will actually cost small business, the figure would end up being in the billions. This is a complete waste of money and time for small business.

As I said, there is a way to do it, but this is not it.

Ironically, President Obama has met with small business owners twice in the Rose Garden in the past few weeks praising small business owners and talking about how we need to help them.

However, only in Washington would legislation be drafted to require companies to tell their employees that they are employees and to spend billions of dollars to do so. Small businesses have much better use for that money, money spent to help the economy.

We have to look no further than the title to find out the true intent of the hearing, "Leveling the Playing Field." This hearing is less about making sure that independent contractors are properly classified than it is about union firms that want to level the playing field against nonunion firms, and they are willing to place billions of dollars of paperwork burdens and fines and penalties on our teetering economy just so they can level the playing field.

If there are legitimate problems with the independent contractors being improperly classified—and I think there are—then I would welcome action by the Department of Labor to establish a Web site to help clear up the confusion and to help independent contractors comply with the law. In addition, we could do the same outreach to companies contracting with independent contractors. But as this bill stands before us today, it is a Washington special interest bill and it symbolizes what is wrong with Washington today. It will penalize the businesses that are doing the right thing and the ones that are doing the wrong thing will continue to do it but eventually they will be caught.

Thank you, Mr. Chairman.

[The prepared statement of Senator Enzi follows:]

PREPARED STATEMENT OF SENATOR ENZI

Mr. Chairman, I am very disappointed that we are holding a hearing on S. 3254, the Employee Misclassification Prevention Act as this bill is a symbol of what is wrong with Washington today.

As a former small business owner, I am saddened that instead of helping our small businesses and entrepreneurs we are saddling them with more paperwork, more recordkeeping and more fines and penalties. You would think that with the economy in its precarious state we would be doing everything in our power to help small businesses to do business. Everyone knows that small business entrepreneurs have been the drivers of our economic recoveries in past recessions and their role in our economy is just as important today.

With respect to S. 3254, one of the first mandates of the bill would be to require every single business to send every single employee and independent contractor a disclosure notice letting them know of their employment or independent contractor status. But what does this mean in the real world?

According to the Small Business Administration, there are 120 million employees in our Nation. Half, or 60 million, of these employees are hired by small businesses. Because the bill requires that each disclosure notice be customized for the exact dollars earned and hours worked, let's say that each disclosure notice takes 30 minutes to compile, complete, share with the employee, and then retain for records. That comes out to 30 million hours devoted by small businesses for these disclosures. According to the National Federation of Independent Businesses, the lowest dollar amount per hour for small business regulatory compliance is $37.18 for the smallest of businesses. The figure going progres-

sively higher depending upon how many employees the business hires.

Multiplying the 30 million hours by $37.18 per hour, the total cost to small business for just this one component of the bill is $1.1 trillion. That is $1.1 trillion just to tell employees that they are employees. If we include disclosure notices to all employees then the cost would be above $2 trillion dollars for the first 6 months of this bill if it becomes law. This is a complete waste of money and time for small businesses.

Ironically, President Obama has met with small business owners twice in the Rose Garden in the past few weeks praising small business owners and talked about how we need to help them. However, only in Washington would legislation be drafted to require companies to tell their employees that they are employees and to spend over a trillion dollars to do so. Small businesses have much better use for that money.

Clearly, this bill was drafted by Washington special interests. We have to look no further than the title to find out the intent of this hearing—"Leveling the Playing Field". This hearing is less about the making sure that independent contractors are properly classified than it is about union firms wanted to "level the playing field" against non-union firms. These Washington special interests are willing to place a $2 trillion drag on our teetering economy just so they can "level the playing field."

If there are legitimate problems with independent contractors being improperly classified then I would welcome the Department of Labor to establish a Web site to help clear up the confusion and to help independent contractors comply with the law. But as this bill stands it is nothing but a Washington special interest bill and symbolizes what is wrong with Washington today.

The CHAIRMAN. Thank you, Senator Enzi.

I would like to recognize Senator Brown, the sponsor of the misclassification legislation, for an opening statement.

STATEMENT OF SENATOR BROWN

Senator BROWN. Thank you, Mr. Chairman.

I appreciate the comments of Senator Enzi, which I would like to address.

I appreciate Mr. Harris joining us and thank you for your public service and all those on the second panel too.

I obviously concur with the remarks of the chairman on this problem and what it means to workers, what it means to those overwhelmingly honest businesses that compete with those firms that do not play by the rules and what this means for local and State revenues and Federal revenues too, for that matter.

The attorney general of Ohio, the 7th largest State in the Nation, published a study a year ago, finding that at least 459,000 Ohio employees might be misclassified—459,000 employees. One of these—and these are statistics and numbers, and we can talk about that from up here as long as we want. But one of these workers—let me put a human face on it—is a gentleman named Kevin Ennis who was a carpenter from Parma, a suburb south of Cleveland, south and west of Cleveland. Mr. Ennis worked for companies

that expected him to be on site every day, more than 40 hours a week—a highly skilled carpenter. These companies expected him to work like any other employee on these job sites, inside and outside.

Then he cut his thumb. He needed stitches. His employer made clear he was not really an employee and did not have health coverage, did not have workers' compensation. They had not paid into those. These companies classified him as an independent contractor even though the company was as dependent on Kevin Ennis as Kevin was on the company and as they were on employees that they did not misclassify this way.

This is an issue that affects workers like Kevin.

It is an issue that affects local tax revenues. Attorney General Cordray estimates the State of Ohio loses up to $800 million in State revenue and local tax revenue because of misclassification.

I appreciate Senator Enzi's concern for small business, and I share that and I would love to work with him on finding ways to make sure this is not an onerous burden on small business.

But I emphasize that those small businesses that play by the rules are at a competitive disadvantage. When we announced this bill with Congresswoman Woolsey, House Member from California who is the House sponsor, we had employers there, including some people in trade associations that are doing contracting. And they said that they lose contracts, they lose bids. They cannot meet the same price as those employers because they play by the rules. It is those employers who do not play by the rules.

Again, I know, whether they are NFIB members or not, those employers are small in number, relatively, that do not play by the rules, but those employers have a distinct advantage because they do not play by the rules. That is why the rules need to be tougher and need to be enforced.

I hear people talk about that when we are in a fragile economic time, it is not the time to focus on labor law reforms. That is really exactly 180 degrees wrong. Now is the time with a still fragile recovery with significant job loss, when workers are more taken advantage of because people are so desperate to get a job and do whatever it takes to feed their family, even if they are not being treated fairly, even if their employer is breaking the rules.

So that is why the time for this legislation is today.

And the last thing, Mr. Chair, I wanted to bring out—I would think that the whole philosophy of voluntary compliance would have been discredited in the last 2 years. We can trust the employers to do the right thing and we can have voluntary compliance. I mean, voluntary compliance. Wall Street? You know, the whole view of the—I do not want to go back, but I think you want to go back so you do not go forward and do stupid things.

The whole view of the Bush years on voluntary compliance is Wall Street will police itself. That did not seem to work out so well. The mining companies will police themselves for mine safety. That did not seem to work so well in West Virginia. The oil companies, in terms of worker safety—do not forget. We talk about this awful oil gusher ad nauseam, as we should, but do not forget 11 people were killed on that rig, on that platform. So whether it is voluntary compliance on worker safety, on environment, on financial reform, on financial services, financial regulation, it is not working, Mr.

Chairman, and it is time that we had rules that were enforced that are fair to everybody.

It is not a union/nonunion issue. It is enforcing a level playing field so that one company can compete on equal terms, fair terms with another, employees are treated better, and our economy will be better off as a result.

So I ask for support on the legislation that Chairman Harkin mentioned, the Employee Misclassification Prevention Act of 2010. It is designed to dramatically reduce the number of worker misclassification violations. Small business wins by that. Workers win by that and taxpayers win by that.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Brown.

Senator Isakson.

STATEMENT OF SENATOR ISAKSON

Senator ISAKSON. Thank you, Mr. Chairman.

Unlike most hearings we attend where we really are learning and have not had any experience, I ran a company for 22 years and had 800 independent contractors like Lenox Scott in Seattle and Howard Hannah in Pittsburgh in Pennsylvania, and Real Estate One in Cleveland, and Ralph Burnett in Minneapolis, and Paul Knapp in Iowa.

We need to be very careful not to demonize people who were doing it right, and because the company operates under the independent contractor laws that exist in the United States today, including the IRS 10-point test, which is the critical test to determine whether somebody is misclassified or not—there are a lot of good American business people who hire independent contractors because you cannot do what they do in an employee/employer relationship in service industries, in sales industries.

While I have the deepest of respect for Senator Brown, but to categorically chastise the 7 percent who work as independent contractors when those people who have them working under them have to meet the IRS 10-way test and all the other provisions of the law that exist today to prohibit misclassification, I would take issue with the fact that it is a rampant problem. It is a problem. Mr. Ennis in Ohio very well may have been the victim of somebody that was breaking the law anyway. So out of respect for my friends that ran businesses like I ran at one time and run them today in the cities of each of the members here, we need to be very careful not to demonize what is a very important segment that moves America from the standpoint of sales and services in a way that you could not otherwise capitalize the businesses if they had to be employer/employee. So I wanted to get that on the record.

And I hope you all will talk with those business people in your States because they can tell you the same story I can tell.

The CHAIRMAN. Well, I would say, Senator Isakson, I appreciate that. I think that there are legitimate independent contractors, obviously. But from my observation over the last few years, there has been almost a quantum rush by other businesses to misclassify workers as independent contractors. I think we are going to hear that from Mr. Harris and we have some studies from the DOL that show that.

I think what we need to do is to be able to have a system set up whereby legitimate independent contractors are permitted, but the system prevents misclassification of workers that, by all of the tests and measures, should be employees and not independent contractors. As I said, misclassification seems to be increasing, at least as I have seen, just in the last few years.

Mr. Seth Harris was sworn in as Deputy Secretary of Labor on May 26, 2009. Prior to joining DOL, he served as a professor of law at New York Law School and director of its labor and employment law programs. He also served for 7 years at DOL during the Clinton administration as counselor to the Secretary of Labor and as Acting Assistant Secretary of Labor for Policy.

Mr. Harris, welcome to the committee. Your statement will be made a part of the record in its entirety, and if you could sum up in 5 or so minutes, we would appreciate it.

STATEMENT OF SETH D. HARRIS, DEPUTY SECRETARY OF LABOR, WASHINGTON, DC

Mr. HARRIS. Thank you very much, Mr. Chairman. Thank you, Senator Enzi, members of the committee. Thank you so much for the opportunity to speak today about worker misclassification.

Worker misclassification seems to suggest a paperwork error, but it is no mere technical violation. It is a serious threat to workers and the fair application of the laws Congress has enacted to assure workers have good, safe jobs.

In simple terms, worker misclassification is the practice of treating a worker who is an employee under the law as something other than an employee, and this misclassification deprives the worker of rights and benefits that Congress intended her to have.

Whether a worker is an employee depends on which law is applicable. For example, there is the economic realities test employers must apply to determine the nature of their workers under the Fair Labor Standards Act. But regardless of what law applies, employers should assure that workers get the wages, the benefits, and the protections that are guaranteed by the law.

In this difficult economic climate, millions of Americans are struggling to stay in the middle class. Worker misclassification exacerbates that challenge. Mis-classified workers may not be paid the wages to which they are entitled. Law-abiding, responsible employers may be denied a level playing field in a hyper-competitive business environment, and the revenues flowing into Federal and State treasuries may be diminished by employers that avoid paying payroll taxes, unemployment taxes, and workers' compensation premiums.

Unfortunately, it is all too easy for employers to misclassify employees and get away with it. Misclassification alone does not violate the statutes administered by the Labor Department. For this reason and others, it can be difficult for DOL to protect workers and for workers to protect themselves under our existing laws.

Honest employers are also harmed by intentional misclassification. At least one study estimates that employers can reduce their labor costs by 20 to 40 percent by misclassifying their employees as independent contractors. Government must level the playing

field for high-road employers by ensuring that low-road employers cannot cheat and secure an unfair competitive advantage.

Mr. Chairman, the Obama administration agrees with you that our current system cannot continue. The President's fiscal year 2011 budget proposes $25 million for a DOL initiative that will include close cooperation with our partners at the IRS to address worker misclassification.

In addition, we look forward to working with this committee, through your leadership and Senator Brown's leadership, to enact legislation that will address worker misclassification under the FLSA. We strongly support many provisions of the Employee Misclassification Prevention Act and view it as a critically important legislative vehicle for addressing worker misclassification.

One measure of the scope of the misclassification problem is its affect on tax revenues. A 1984 IRS survey estimated that nearly 15 percent of employers Mis-classified employees as independent contractors under the tax laws, with an estimated revenue loss of $1.6 billion in 1984 dollars.

A 1994 Coopers and Lybrand study estimated that misclassification would cost the Federal Government almost $35 billion between 1996 and 2004.

These assessments suggest that misclassification is widespread and occurs across the country.

Addressing worker misclassification is a necessary part of the Labor Department's "good jobs for everyone" mission. We are exploring regulatory innovations, opportunities to provide better guidance to both workers and employers and improved targeted enforcement.

In April, we announced our intention to move toward a broad regulatory strategy built on the view that employers bear the responsibility to obey the law before they are visited by a DOL investigator. We call this strategy "Plan/Prevent/Protect." One way in which Plan/Prevent/Protect will be implemented is by requiring employers to inform workers about their employment status. DOL's Wage and Hour Division is working on a proposed rule that would, if it becomes a final regulation, require employers to perform an analysis of a worker's employment status, disclose that analysis to the worker and keep a copy of the analysis in the employer's files. The regulation would not change the test employers use for this analysis, but we believe it will play an important role in preventing misclassification.

Second, the Wage and Hour Division is emphasizing misclassification in its ongoing enforcement strategy. As I noted earlier, the President's fiscal year 2011 budget request included $12 million for increased wage and hour enforcement in cases where employees are likely to have been misclassified. The President also requested almost $11 million to provide grants to States to build capacity for identifying and addressing worker misclassification in the Unemployment Insurance Program through targeted employer audits and enhanced information-sharing.

And third, the Labor Department is cooperating closely on worker misclassification with our colleagues in State government. Last month, we hosted a State forum on misclassification. We invited representatives from a long list of States, including Iowa, Ohio,

Washington, Connecticut, and New York, among others. During the forum, we learned about a wide range of tools and practices the States are using to stop and prevent misclassification.

Finally, we believe legislation like EMPA is a critically important contribution to this effort. EMPA would make misclassification a violation of the law, thereby creating an important incentive for employers to make the correct decision when determining whether a worker is an employee. Only Congress can strengthen the law in this way.

In addition and consistent with DOL's upcoming proposed rulemaking, EMPA would codify an employer's obligation to provide its workers with notice of how the worker is classified. If an employer fails to give that notice, EMPA establishes a legal presumption that the worker is an employee.

And finally, the EMPA provision that authorizes the Wage and Hour Division to seek civil monetary penalties for recordkeeping violations provides an important enforcement tool not only against misclassification but against all FLSA violations.

So in sum, Mr. Chairman, the Administration proudly supports your efforts and Senator Brown's efforts to address worker misclassification. We stand ready to work with this committee and its members to advance those efforts.

I look forward to your questions.

[The prepared statement of Mr. Harris follows:]

PREPARED STATEMENT OF SETH D. HARRIS

Chairman Harkin, Senator Enzi, and members of the committee. Thank you for the opportunity to speak today about "worker misclassification."

"Misclassification" seems to suggest a technical violation or a paperwork error. But "worker misclassification" actually describes workers being illegally deprived of labor and employment law protections, as well as public benefits programs like unemployment insurance and workers' compensation because such programs generally apply only to "employees" rather than workers in general. Worker misclassification occurs when a worker who is legally an employee is treated as a self-employed worker, often referred to as an "independent contractor." Some misclassification is the result of uncertainty or misapplication of often complicated laws or situations. However, much worker misclassification is intentional. Misclassification as independent contractors also increases the opportunities for tax evasion, and some take advantage of those opportunities, with a resulting loss of Federal and State revenue. Too many workers are being deprived of overtime premiums and minimum wages forced to pay taxes their employers are legally obligated to pay and are left with no recourse if they are injured or discriminated against in the workplace. Misclassification is no mere technical violation. It is a serious threat to workers and the fair application of the laws Congress has enacted to assure workers have good, safe jobs.

In this difficult economic climate, millions of Americans are struggling to stay in the middle class. We can see the impact of these struggles in many different areas of the economy: workers trying to keep good jobs with good wages and benefits; small businesses struggling to compete in a difficult market; and State governments and the U.S. Government working to fund budgets that can provide the essential services Americans need. Worker misclassification exacerbates all of these challenges. It shortchanges workers, employers, States, and the Federal Government. Workers are not paid the wages to which they are entitled. Law-abiding, responsible employers are denied a level playing field in a hyper-competitive business environment. And the revenues flowing into Federal and State treasuries are diminished when employers that should be treating workers as employees avoid paying, unemployment taxes, workers' compensation premiums, and (unless the workers pay them) payroll taxes. When the misclassified workers themselves do not pay some or all of the employment taxes for self-employed workers, the Social Security trust funds suffer a permanent loss.

Most workers in this country simply assume they are protected by our Nation's basic employment laws—minimum wage, overtime, health and safety, workers' compensation, anti-discrimination, and unemployment insurance, among others. What they may not realize is that these protections are directly linked to their status as "employees." For example, independent contractors, a label given to individuals who are genuinely self-employed, are not "employees" and, therefore, are not protected by these laws.

Unfortunately, it is all too easy for employers to misclassify employees and get away with it. Misclassification alone does not violate the Fair Labor Standards Act (FLSA), the Occupational Safety and Health Act (OSH Act), the Mine Safety and Health Act (Mine Act), or most other statutes administered by the Labor Department. No penalty attaches under these laws when employers misclassify workers, even when the employer knows and ignores a worker's true legal status. Furthermore, employers are not obligated to perform a written classification analysis before unilaterally deciding to treat workers as though unprotected by employment laws. For these reasons and others, it can be difficult for the Labor Department's worker protection agencies to protect workers and for workers to protect themselves under our existing laws. There are, however, severe Federal tax penalties for employers who are discovered to have misclassified workers, and such employers may also be required to pay their unpaid unemployment insurance premiums.

The Labor Department's experience has shown that misclassification can be a tool for employers to evade their legal obligations to workers and thereby gain a competitive advantage over employers that obey the law. While some employers misclassify their workers in error, the Government Accountability Office (GAO) concluded that some employers choose to misclassify their employees in order to avoid laws that restrict their labor practices or require them to provide rights and benefits to employees.[1] These are the cases we are targeting.

Workers are not the only ones harmed by misclassification—honest employers are as well. At a recent hearing of the House Education and Labor Committee's Subcommittee on Workplace Safety, a representative of the Mason Contractors Association of America estimated that companies that misclassify their workers expect to reduce labor costs by as much as 30 percent, in part by not paying workers' compensation premiums. Law-abiding business owners who play by the rules are being forced out of competition by companies that skirt the law and play games with the definition of "employee."

In a 2000 study of nine States commissioned by the Department of Labor's (DOL) Employment and Training Administration (ETA), the most significant reason for misclassifying employees as independent contractors was to avoid paying workers' compensation premiums and not being subject to workplace injury and disability-related disputes.[2] At least one study estimates that employers can reduce their labor costs by 20–40 percent by misclassifying their employees as independent contractors.[3] This underscores the need to level the playing field for high road employers—we should ensure that they are not facing these unfair downward pressures in order to stay competitive.

Mr. Chairman, the Obama administration agrees with you that our current system cannot continue. The rules governing employers' decisions about whether to respect employees' rights under our Nation's employment laws must change, and they must change now. We must restore a level playing field for responsible employers and employees and ensure that workers benefit from the protections Congress intended them to have.

The Obama administration—from the Office of the Vice President and the Middle Class Task Force to the Treasury Department and DOL—is organizing itself to address this issue. Most prominently, the President's Fiscal Year 2011 budget proposes $25 million for a DOL initiative that will include close cooperation with our partners in the Treasury Department's Internal Revenue Service (IRS) to address worker misclassification. In addition, we look forward to working with this committee, through the leadership of Chairman Harkin and Senator Sherrod Brown, along with Representatives Lynn Woolsey, George Miller and Rob Andrews, to enact legislation that will address worker misclassification under the Fair Labor Standards Act. We strongly support many provisions of the Employee Misclassification Prevention Act

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[1] *Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention*, GAO–09–09717 (2009).

[2] *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs*, Lalith de Silva et al., Planmatics, Inc. (2000).

[3] *The Social and Economic Costs of Employee Misclassification in the Michigan Construction Industry*, Dale L. Belman and Richard Block, School of Labor and Industrial Relations, Michigan State University (2008).

(EMPA) and view it as a critically important legislative vehicle for addressing worker misclassification. The President's 2011 Budget also includes a proposal to help employers and the IRS clarify the status of workers for employment tax purposes, so that the incidence of (and, in some instances, the excuses for) misclassification will be reduced.

In the remainder of my testimony, I will seek to define the scope of the misclassification problem, outline the Labor Department's current plans to address it, and offer the Administration's views on the proposals that are before this committee that would make important contributions to finding a comprehensive and effective long-term solution.

THE SCOPE OF THE MISCLASSIFICATION PROBLEM

In order to understand the scope of the problem, it is necessary to define what we mean by "worker misclassification." In simple terms, worker misclassification is the practice of treating a worker who is an employee under the law as something other than an employee, thus depriving the employee of rights and benefits to which they are entitled. Whether a worker is an employee depends on which law is applicable. For example, there is the "economic realities' test employers must apply to determine the nature of their relationship with their workers under the FLSA. Under that test, which is broader than, for example, the common law test used by the IRS, employers must consider the following factors when determining whether a worker meets the statute's definition of "employee":

- The extent to which the services rendered are an integral part of the employer's business;
- The permanency of the relationship;
- The amount of the worker's investment in facilities and equipment;
- The nature and degree of control by the employer;
- The worker's opportunities for profit and loss;
- The amount of initiative, judgment, or foresight in open-market competition with others required for the worker's success; and
- The degree of the worker's independent business organization and operation.

We recognize that it is conceivable for a worker to be correctly classified differently under the different standards that apply for different statutory purposes. However, that is not typical, and in most cases, applying the various laws does result in the same worker classification.

Of course, there are legitimate independent contractors who enter into arms-length contractual arrangements with other business owners for their mutual benefit. I want to be clear that the DOL does not define misclassification as an "independent contractor" problem. Legitimate independent contractors can play an important role in our economy and many companies make good and legally appropriate use of their services. But some employers intentionally misclassify workers as independent contractors who, under the law, are employees. Sometimes the misclassification may be forced on workers. Other times, the workers are complicit in the misclassification in an effort to increase their incomes by evading income and payroll taxes. Such workers may or may not realize the risks they are taking in losing all of the protections of the social safety net that are provided to employees but not to independent contractors.

It is important to remember, however, that the workforce is not just divided into employees and independent contractors. Industries have developed a number of business models that are based on using the lowest cost labor possible, including independent contractors, leased employees, and outsourcing. Although the use of these models can be legitimate, they are frequently used without an analysis of the actual legal relationship between the company and the worker, which leads to the possibility that an employee will be misclassified and denied the rights and protections to which he or she is entitled.

Many workers do not know they have been misclassified by an employer until they need the law's protection. As a result, they are often not prepared for the consequences. For example, I recently learned about a case settled a while back by the Wisconsin Department of Workforce Development. Alvaro was a dishwasher at a family-style restaurant in Madison, WI. He was being paid less than minimum wage and did not receive overtime. When Alvaro met with the employer to discuss the issue, the employer initially said he would pay all of the overtime wages Alvaro earned. A few days later, Alvaro was visited by the employer's attorney who said that the employer would only pay a fraction of what Alvaro was owed and if he made trouble they would make trouble for him. When Alvaro filed a wage complaint with his State's Department of Workforce Development, the employer's attorney claimed that the company did not owe him the minimum wage or overtime pay be-

cause Alvaro was an independent contractor. Remember, Alvaro's job was washing dishes for the restaurant in the restaurant's kitchen.

If we take this example in the hypothetical, outside of the wage and hour context, Alvaro could have also found that his employer had treated him as an independent contractor under the workers' compensation laws. If so, Alvaro would have received no compensation if he were severely burned by scalding dish water in the workplace. He may have also found that his employer had failed to pay its share of payroll taxes for unemployment insurance (UI), Social Security, and Medicare. If so, Alvaro would have had to pay all of those taxes himself, and he would not have been entitled to UI benefits if he lost his job. There is every reason to believe that Alvaro's employer did not perform an appropriate analysis of his status under any law. It is difficult to imagine a dishwasher for a restaurant could ever be a legitimate independent contractor. Typically, these workers do not bring their own equipment, do not decide their own hours or method of work, and do not have a profit or loss motive. In this example, the employer's motive to evade the law seems clear and has devastating consequences: Alvaro did not receive wages he rightfully earned until he filed a complaint with the appropriate State agency and they settled the case.

One measure of the scope of the misclassification problem is its effect on tax revenues. A 1984 IRS survey estimated that nearly 15 percent of employers misclassified some employees as independent contractors under the tax laws, with an estimated revenue loss of $1.6 billion in 1984 dollars.[4] A 1994 Coopers & Lybrand study estimated that misclassification would cost the Federal Government $34.7 billion between 1996 and 2004.[5] The Planmatics 2000 study concluded that between 10 percent and 30 percent of the employers audited had misclassified some employees as independent contractors.[6] The economy has changed significantly since those studies were performed, and even the number of workers that self-identify as independent contractors has grown.[7] Still, these numbers suggest that misclassification occurs in significant numbers and, across the country, workers are finding themselves without the basic protections that Congress has enacted to ensure they receive fair pay, safe workplaces, and necessary supports when they are hurt or lose their jobs.

Several recent studies suggest that misclassification results in significant losses to State UI and workers' compensation funds in addition to tax revenue. When employees are misclassified, their employers typically do not pay unemployment taxes or carry workers' compensation insurance for those employees. As a result, UI and workers' compensation funds are underfunded. Moreover, employers that obey the law end up carrying the weight for scofflaws in the form of higher workers' compensation premiums.

A recent Tennessee study, for example, conservatively estimated that, due to misclassification in the construction industry alone, Tennessee lost between $4.9 million and $11.4 million in employers' unemployment insurance payments and between $30 million and $70 million in workers' compensation premiums in 2006.[8] A Michigan study estimated that the State forgoes almost $17 million annually in unemployment insurance payments because of misclassification.[9] An Ohio attorney general's report concluded that, according to conservative estimates, misclassification cost his State $20 million in payments for unemployment compensation, $103 million in workers' compensation premiums, and over $36 million in forgone State income tax revenues in 2005.[10]

Misclassification also affects an unknown number of employees in the "underground" or "shadow" economy. These workers are typically paid in cash with no re-

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[4] *Strategic Initiative on Withholding Noncompliance (SVC–1), Employer Survey, Report of Findings*, Ken Beier, Unpublished: Department of the Treasury, Internal Revenue Service, June 1989.

[5] *Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers*, Coopers & Lybrand (June 1994).

[6] *Independent Contractors, supra* note 2.

[7] In its 2005 Survey on Contingent and Alternative Employment Arrangements, the Bureau of Labor Statistics found that the number of workers who identified as independent contractors increased by 15 percent, from 6.4 percent to 7.4 percent, since 2001. *http://www.bls.gov/news.release/pdf/conemp.pdf.*

[8] *Misclassified Construction Employees in Tennessee*, Dr. William Canak and Dr. Randall Adams, Study presented to the Tennessee House Committee on Consumer and Employee Affairs on February 17, 2010. Copy available for download at *http://carpenters.org/misclassification/ALL%20DOCUMENTS/TN%20fraud%20study %201-15-10.pdf.*

[9] *Informing the Debate: the Social and Economic Costs of Employee Misclassification in Michigan*, Dale L. Belman and Richard Block, Michigan State University Institute for Public Policy and Social Research (2009).

[10] *Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local governments in Ohio*, 2009.

gard for wage standards, no tax forms are provided, and the wages are neither recorded nor reported. Many of these workers are otherwise vulnerable for a variety of reasons, including limited English language skills. While some may prefer an "under the table" arrangement, others may not know their rights or they may be afraid to assert them. The lack of recordkeeping and documentation makes it difficult to quantify just how prevalent misclassification is in this area.

DOL'S ONGOING EFFORTS AGAINST MISCLASSIFICATION

Addressing worker misclassification is a necessary part of the Labor Department's "Good Jobs for Everyone" mission. We are exploring all possible options for addressing the worker misclassification problem, including regulatory innovations by several DOL agencies, opportunities to provide better guidance to both workers and employers, and improved enforcement through information-sharing among DOL agencies and between the Labor Department, the Treasury Department, and State labor and tax agencies.

REGULATORY AGENDA

The Labor Department's Spring 2010 Regulatory Agenda announced our intention to use new tools to detect and prevent worker misclassification. Generally, DOL announced its intent to move towards a broad strategy that requires employers to understand that the burden is on them to obey the law before they are visited by a DOL investigator. We call this compliance strategy "Plan/Prevent/Protect." This new strategy will require employers and other regulated entities to: (1) create a "plan" for identifying and remediating risks of employment law violations and make the plans available to workers so they can participate in their creation, fully understand them, and help to monitor their implementation; (2) thoroughly and completely implement the plan in a manner that "prevents" legal violations; and (3) ensure that the plan's objectives are met on a regular basis so that it actually "protects" workers from violations of their workplace rights.

One way in which "Plan/Prevent/Protect" will be implemented is by increasing transparency in employers' recordkeeping requirements under the FLSA. DOL's Wage and Hour Division (WHD) is considering a rule that would propose that employers, before declaring that a worker is not an "employee" under the FLSA, not only perform a written analysis of the worker's status applying the "economic realities" test described above, but also be required to disclose the analysis to the affected worker, and keep a record of the analysis in their files for review should a Wage & Hour investigator seek this information. The proposed rule WHD is considering, if it becomes a final regulation, would not change the criteria that employers use to make this determination.

This proposed rule would increase the likelihood that an employer makes the correct classification decision in the first place. The goal is to create transparency in employment relationships for both parties. Workers should have up-front knowledge of their employment status and what the implications may be for their wages and hours. Employers should be clear about their responsibilities under the law, and take affirmative steps to ensure that they are meeting those responsibilities. Employers who want to play by the rules should find compliance with those rules to be simpler and their obligations and responsibilities more transparent. By better ensuring that the employer-employee relationship is defined at the outset, all parties involved will have the opportunity to resolve any conflicts or misunderstandings before DOL has to get involved.

Since "Plan/Prevent/Protect" is a department-wide initiative, both the Occupational Safety and Health Administration (OSHA) and the Office of Federal Contract Compliance Programs (OFCCP) will consider similar rules in the coming years. To properly protect workers under all of our DOL statutes, employers across the United States should plan ahead, perform the requisite analyses to prevent misclassification, communicate with their workers before proceeding, and actually protect workers from employment law violations.

ENFORCEMENT

WHD is emphasizing misclassification in its ongoing enforcement strategy. All new investigators are being trained how to determine workers' employment status and to ensure they have been classified properly. In 2008, WHD began tracking whether misclassification was the primary reason for a violation of the laws it enforces—and these data suggest the practice is growing. In fiscal year 2009, the Department's Wage and Hour Division (WHD) found $2,650,510.28 in back wages owed to 2,190 employees in cases where misclassification was the primary reason why the employer failed to pay the minimum wage or proper overtime. This is an increase

of almost 50 percent from fiscal year 2008, when WHD found $1,320,343.46 owed to 1,278 employees for the same reason. WHD is currently exploring ways to improve its tracking system so that investigators can always record when they discover that an employee has been misclassified, even if this was not the primary reason for a violation or did not result in any violations. This will give WHD a more accurate picture of the scope of the problem and allow it to better target its resources.

Additionally, as noted earlier, DOL is working with the Vice President's Middle Class Task Force and the Department of Treasury on a multi-agency initiative to develop strategies to address worker misclassification. The President's budget request for fiscal year 2011 included $12 million for WHD's increased enforcement of wage and overtime laws in cases where employees have been misclassified together with additional funding for our Office of the Solicitor and OSHA for their work in this area. It also included $10.95 million to provide grants to States to build capacity to identify and address worker misclassification in the Unemployment Insurance program through targeted employer audits and enhanced information sharing to enable detection. States that are the most successful will receive high performance bonuses that can also be used to further reduce worker misclassification. WHD is currently considering how best to use its proposed funding for a targeted enforcement strategy informed by the agency's experience that misclassification is particularly prevalent in industries with large numbers of low-wage, vulnerable workers.

EDUCATION AND OUTREACH

This past April, WHD launched a campaign called "We Can Help." This effort is tailored to inform low wage, vulnerable workers of their rights and benefits, how to get help if they believe those rights are violated, and to assure them that their complaint is confidential. The campaign will place a special focus on reaching employees in industries where misclassification is most prevalent, such as construction, janitorial work, hotel/motel services, food services and home health care. Through this campaign, we hope to ensure workers know more about their employment rights.

INFORMATION SHARING

One important step we are taking as part of the Administration's employee misclassification initiative is to explore ways to increase information sharing among DOL agencies, DOL and other Federal agencies, and DOL and State agencies. In its 2009 Report, the GAO concluded that increased information sharing between DOL and Treasury, and among DOL agencies, would help to increase detection and prevention of misclassification—and we agree.[11] Information sharing would allow government agencies at all levels to better leverage their resources against practices that violate the laws they enforce.

DOL's ETA is already a part of a joint initiative with the IRS and the States that is designed to improve information sharing and lead to better detection of tax and revenue losses due to worker misclassification. Through this initiative, often referred to as the "Questionable Employment Tax Practices" program (QETP), 39 States have signed memorandums of understanding with the IRS that enable the State and the IRS to participate in a two-way exchange of information. Participating States are now able to receive tax information and audit leads from the IRS, which allows them to target their State UI employer audits effectively. It is our hope that we can build on these existing relationships and develop agreements that also include Federal and State worker protection agencies to share information in a way that is meaningful despite our different jurisdictions and enforcement emphases.

PARTNERING WITH THE STATES

The importance of working with the States on employee misclassification cannot be overemphasized. Last month, DOL hosted a State Forum on Misclassification. We invited representatives from a number of State agencies and misclassification task forces to meet with DOL staff and tell us about what their States have been doing on this issue. Attendees included representatives from the States of Connecticut, Iowa, Louisiana, Maryland, Massachusetts, Ohio, New York, and Washington.

During the Forum, we learned about a wide range of tools and practices the States are using to stop and prevent misclassification, including sophisticated data analysis, various enforcement strategies, and laws passed by State legislatures to create a presumption of "employee status" or authorizing State agencies to issue

[11] GAO–09–717, *supra* note 1.

stop work orders. We also heard from the States that they are looking to the Administration to provide some leadership on this issue. We look forward to working closely with our State partners in a variety of effective ways to counter misclassification.

THE NEED FOR CONGRESSIONAL ACTION

The passage of legislation like S. 3254, the "Employee Misclassification Prevention Act" (EMPA) is critically important. Even considering the President's fiscal year 2011 budget initiative and the Labor Department's concerted efforts to expand regulatory protections, enforcement efforts, and partnerships with other government entities, legislation is needed to provide DOL with additional tools that the Department cannot use without action by the Congress.

First, EMPA would make misclassification a violation of the FLSA. For the first time, misclassification would be against the labor law. We believe this would provide employers with an important additional incentive to make the correct call when determining whether a worker is an "employee." Only Congress can strengthen the law in this way.

Second, consistent with DOL's upcoming proposed rulemaking, EMPA would codify in the FLSA an employer's obligation to provide their workers with notice of how the worker is classified. If an employer fails to give this notice, EMPA establishes a legal presumption that the worker is an "employee." This presumption will put the burden of proof on the employer to demonstrate that the worker should be excluded from coverage under the FLSA. We have discussed whether DOL has the regulatory authority to create such a presumption and concluded that action by Congress will significantly reduce the litigation risks.

Finally, the EMPA provision that authorizes WHD to seek Civil Monetary Penalties for recordkeeping violations provides an important enforcement tool not only against misclassification, but against all FLSA recordkeeping violations. Time and time again, WHD investigators and employees find minimum wage and overtime violations, but the employer's failure to keep adequate records makes it difficult or even impossible to guarantee that the employee is made whole. Employers who violate the law should not be able to avoid paying fair compensation to their workers by failing to keep records as the FLSA requires.

We strongly endorse these provisions of EMPA and look forward to working with Congress to pass effective legislation to address the misclassification problem.

I also want to briefly highlight the Unemployment Compensation Integrity Act. This is draft legislation the Department recently shared with Congress and we believe it is another necessary element of a comprehensive strategy to end misclassification. The Unemployment Compensation Integrity Act contains provisions that would enable States to retain a percentage of delinquent employer UI taxes, including those resulting from misclassification, to use for increased efforts to identify worker misclassification. This incentive for expanded State tax efforts targeted at misclassification would be another way for us to help the States in their UI tax enforcement efforts.

CONCLUSION

Thank you again for the opportunity to testify before you today, and for your thoughtful leadership in drafting the EMPA. We believe that addressing this issue is essential to ensuring a level playing field in the marketplace, and protecting workers as Congress intended when it enacted a long list of employment laws. During this fragile economic recovery, workers are too often exploited and caused to lose out on the benefits they rightfully earned, while employers who do right by their employees are placed at a competitive disadvantage that they cannot afford.

DOL, along with the White House, the Treasury Department, and States across the country are taking meaningful steps to prevent worker misclassification and address it whenever and wherever it occurs, but we need your help to make misclassification illegal and to assemble a truly comprehensive solution to this problem. We applaud your work on EMPA. We look forward to working with you in this endeavor. Thank you for your time. I am available to answer your questions.

The CHAIRMAN. Thank you very much, Mr. Harris.

We will start rounds of 5-minute questions.

Again, as you pointed out, DOL, the IRS, and other agencies are trying to tackle this problem. So tell me again how the Brown bill would help in that effort.

Mr. HARRIS. There are three provisions that we think are most important. I want to focus on those, if you do not mind.

First is for the first time in Federal employment law, it would be a violation of the Fair Labor Standards Act to misclassify a worker as something other than an employee and thereby exclude them from coverage under the Fair Labor Standards Act. A number of States have this provision in their law. We think it should be in the Fair Labor Standards Act as well.

Second, your bill would add civil money penalties to recordkeeping violations. Again, enforcing recordkeeping is a very difficult task when there is no consequence for failing to keep records. You can imagine how difficult it is for our investigators to assess how much overtime a worker has not gotten or how much a worker has actually been paid and should be given because they have not gotten the minimum wage when there is no record kept by the employer of those kinds of provisions.

And third, it creates a legal presumption, that if an employer has not kept a record, that the worker is an employee. What we do not want is employers evading the law by keeping everything secret and not doing the analysis that they are supposed to do. So absent any kind of analysis, the worker would be an employee.

We think those three provisions are very, very important to moving this effort forward.

The CHAIRMAN. Well, I think that again clarifies why the legislation is needed to buttress efforts that are now being undertaken by DOL and by IRS.

I understand that construction workers, truckers, home health care workers, and other types of home aides are among the occupations that are most likely to be misclassified. Yet, according to the Bureau of Labor Statistics, these are the jobs that are predicted to be among the fastest-growing occupations in the next decade. So tell us again what does it do to the economy and to the middle class when we have this rapid growth in these sectors and they do not have these kinds of protections.

Mr. HARRIS. Well, we view the Fair Labor Standards Act and the other array of employment laws that are implicated by this issue as essential to a strong and expanding middle class. Workers' wage protections, workers' overtime protections, the availability of unemployment insurance benefits, the availability of workers' compensation benefits if a worker gets injured on the job are essential to getting workers into the middle class, keeping them in the middle class. Although we see worker misclassification across a wide range of industries, we are most troubled by it and see it most prevalently in the low-wage industries that you identified, in construction, in health care, in janitorial services, for example. These are workers that are trying to build their way into the middle class, trying to earn a middle class wage, but if they cannot be assured of getting the minimum wage, if they cannot be assured of getting overtime when they work more than 40 hours in a week, it is very difficult for them to find and secure a place in the middle class.

The CHAIRMAN. I read your testimony last night. You used an example of a dishwasher in Wisconsin who had been misclassified. He is a dishwasher. He did not set his own hours. He had no profit or losses. He did not bring his own equipment. And yet, he was told that he was not eligible for workers' compensation or for unemployment benefits because he had not paid into the system because he

was an independent contractor. He had no idea that he was an independent contractor. He assumed he just worked for this restaurant.

Mr. HARRIS. I think that the conclusion that he was an independent contractor would have been a surprise to any employment lawyer in the country. This is somebody who was a dishwasher in a restaurant using the employer's equipment, showing up on the employer's schedule, doing the work the employer directs the worker to do. He was not paid the minimum wage. He was not paid overtime, and the employer said to him, "well, I am sorry you are not an employee, so I do not have to do those things for you." It is a nice illustration of the problem that we are facing here, low-wage workers being deprived of fair pay and fair benefits.

The CHAIRMAN. Thank you very much, Mr. Harris.

Mr. HARRIS. Thank you.

The CHAIRMAN. Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

I do not think there is anybody that does not want to catch the bad actors and that believes that there are not any bad actors.

What I am concerned about is the burden that we are putting on those that have been good actors and would be good actors and intend to be good actors, although sometimes they make a mistake.

In your testimony, you even mentioned the underground or the shadow economy and described those workers that are paid under the table and no records are being kept and the greater transparency that needs to be done. Those are not legitimate businesses. For legitimate businesses, the contract with independent contractors—there is a paperwork trail. I do not understand how the person that has this underground or shadow thing—why he would even file these papers, why he would even go to the extra work. But I understand why the person that is legitimate would go to the extra work.

So should these legitimate businesses be subjected to more paperwork burdens and fines if it is the underground and shadow businesses that are causing the problem? Do you really think this is going to catch the shadow and underground ones?

Mr. HARRIS. My hope is that the answer to that is yes, that we are going to be able to catch both——

Senator ENZI. I am hoping for more than hope on this.

Mr. HARRIS. The enterprises that we are interested in targeting at the Labor Department are the businesses that are evading the coverage of employment laws by misclassifying their workers for the purpose of gaining an advantage against their competitors. Those are the folks that we want to target.

I associate myself completely with Senator Isakson's remarks that there are legitimate independent contractors doing business in a legitimate way with legitimate businesses, as you characterized them, Senator. You are exactly right about that. We have no complaint with that industry. Those folks are doing open and legitimate business, appropriate business. They should continue doing it. Nothing in the regulation that we plan to propose or in EMPA, in my view, would in any way interfere with that relationship between the businesses and those legitimate independent contractors.

But there are businesses that are not operating in the shadow economy also that are misclassifying workers in a lot of industries. So I would say I would not limit the concern only to those in the shadow economy where it is just cash being paid under the table. There are folks who are keeping records and still misclassifying workers. We are interested in those folks as well, if they are intentionally misclassifying for the purpose of gaining an unfair competitive advantage.

Senator ENZI. Well, in your full testimony, you talk about the Plan/Prevent/Protect new strategy. Think about this from a small employer's standpoint.

Incidentally, have you been an employer?

Mr. HARRIS. No, sir.

Senator ENZI. Think about this from a small employer standpoint. No. 1, create a plan for identifying and remediating risks of employment law violations and make plans available to workers so they can participate in their creation, fully understand, and help monitor their implementation.

This is a huge mental task for somebody to undertake. Why would the Department not provide this stuff? How can you expect a small businessman to create a plan? Are we not the ones that are supposed to be setting up the rules for this thing? But we are saying, "no, you are going to create a plan for identifying, remediating risks, and make it available to the workers so they can participate." That is just one of the three.

Then they thoroughly complete and implement the plan in a manner that prevents legal violations. Good. I do not see how that winds up there.

And then ensure that the plan's objectives are met on a regular basis so it actually protects the workers from violations of their workplace rights.

Again, we are talking about a lot of paperwork, most of which will never be looked at because there are not going to be enough auditors to look at them all, but we are going to be hiring accountants to put all of this stuff together. And the business is going to have to pay the accountant because they are not going to do it for free. Again, it is going to turn into somebody coming in and evaluating to see if they really filled out the forms right, and that is what the penalties are going to be about, not the misclassifications.

How do we shift this over so it is actually the misclassifications rather than the paperwork violation?

Mr. HARRIS. Well, let me describe how we see Plan/Prevent/Protect operating in this arena with respect to misclassification. We are still in the process of developing our regulations, so it is not final.

But our intention is to provide employers with a form that they can fill out that will allow them to understand how to apply the test and they will fill out the form. And we think it will just take a few minutes. It will not take as long as half an hour as you suggested. They will fill out the form for each category of employees, those that all have the same facts around their jobs. They will fill it out. That will be the way they will analyze whether or not someone is an employee or an independent contractor or something else.

Once they have done that, they are done except that they have to provide it to the employee and put it in their files. The employee will look at it and say that description is a pretty good description of how my job works, or they will go to their employer and say, you know what? This is not right. This is not how I do my job. And the employer will fix it, I hope, or the employee will have the opportunity to complain either to the Wage and Hour Division, or under the Fair Labor Standards Act, they could sue on their own. But the employee will look at it. The employer will have it in their files. It will not be a lot of additional paperwork.

And all we are asking of the employer is avoid violations, avoid the large class action suits that we are seeing with respect to overtime, the multimillion dollar class action suits that some of these businesses are experiencing because they are misclassifying workers and excluding them from overtime protection.

So we do not think it is going to be significantly burdensome. In fact, we do not think it is going to be burdensome at all. Employers are supposed to be doing this analysis now. The test is a well-established test. They are supposed to, before they say someone is an independent contractor, know whether someone is an independent contractor under the law before they say, "no, you do not get the minimum wage. You do not get overtime protections." What our regulation and EMPA would do is simply say write it down on this form we have given you.

Senator ENZI. Do you know how many forms the employer fills out on each employee and how many forms the employee signs? If I am the unscrupulous worker, I just keep shoveling those over and saying sign this and do you understand it? Sign this. Do you understand that? The employee wanting the job just keeps signing.

So I like the problem that we are trying to get to. I am just not convinced that we are getting there, particularly not without costing a lot of time.

Incidentally, the IRS says the form takes 16 minutes to fill out. So besides getting the form, explaining the form, filling out the form, and then filing the form, there are going to be a few more minutes that are going to be taken on the thing. And you are still not going to have the trail unless you go to the business to look at it.

Mr. HARRIS. Our form will be shorter, Senator.

Senator ENZI. OK. My time is up anyway. I am sorry.

The CHAIRMAN. I was just looking, Senator Enzi, at the contents of the notice that is in the bill. No. 1, inform the individual of the classification. No. 2, include a statement directing the individual to a Department of Labor Web site. No. 3, include the address and telephone for the applicable local office of the U.S. DOL. No. 4, if they are classified as a nonemployee, include the following statement. "Your rights to wage, hour, and other labor protections depend upon your proper classification as an employee or nonemployee. If you have any questions or concerns about how you have been classified or suspect that you may have been misclassified, contact the U.S. Department of Labor." And the fifth one is include such additional information as the Secretary shall prescribe by regulation.

Senator ENZI. Mr. Chairman, I do not have any difficulty with that part, but what about the remuneration and hours relating to the performance of labor or services by each individual described in subparagraph (b)? That is where the accountant comes in.

The CHAIRMAN. I am looking at the contents of the notice that they have to give.

Senator ENZI. Yes. That is just another notice that they sign, but this is where the real recordkeeping comes in.

The CHAIRMAN. I will take a look at it.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

The Federal Labor Standards Act was passed in 1938, and with some exceptions, there has been a consensus in this country around labor law. There are sort of far-left, far-right disagreements, but there has generally been consensus that it has worked well in this country. That was sort of the beginning of an increasingly prosperous America, the beginning of a huge growth in the middle class. It is what makes our country different in many ways from almost any other rich or not-so-rich country in the world—that we have brought that prosperity and labor law is part of the reason for that.

I understand the concerns of Senator Enzi that he has expressed and Senator Isakson and I assume Senator Murkowski. I will not speak for any of them, of course. But I understand the concerns about two major things: paperwork and litigation. I am certainly willing to work on some of the things that Senator Enzi pointed out.

I want to see the independent contractors, legitimate ones—and there are many that are legitimate. In no way, Senator Isakson, did I imply that most people in these businesses are not acting properly. I do assert, though, that those that act properly are at a competitive disadvantage to those who do not, and that is why we want to concentrate obviously on those who do not and minimize the paperwork burden on those who do act properly.

So my question, Mr. Harris, is—I know this bill faces an uphill battle. I understand the labor/management divisions in this committee that are played out, unfortunately, with the same arguments on both sides for decades probably.

But I do assert, though, that there is general consensus in this country overwhelmingly in most of labor law. The example you gave of the Wisconsin dishwasher, the example I gave of the Parma carpenter. I would be shocked if no more than 10 percent of the country would believe that is the right thing to do. So I think we can get there if we can break down some of these issues that we talk about.

But talk, if you would, about the whole issue of how we make sure that the paperwork burden is not too great on those that are already playing fair and playing by the rules, and talk about how, if we write this right—and I know we have worked together on some of this—in a more precise way that litigation will actually be minimized rather than when you try to enforce it and there are too many lawsuits, that we can work that so that we can get some bipartisan support for this.

Mr. HARRIS. You are making a very important point. The surest way for an employer to avoid litigation and to avoid the other problems that come with violations of employment laws is to take preventive steps to assure that they are in compliance with the law. So the good, responsible employers that you are referring to—and I think that is the overwhelming majority in our country and even in the industries that we have identified here as potential problem areas with respect to misclassification—those employers are undertaking the analysis that your bill would require. They are recording that analysis and assuring that they have got it right, that the employees who are supposed to get the minimum wage, that are supposed to get their overtime protections, that are supposed to get workers' comp and unemployment insurance are, in fact, being treated in the way they are supposed to be treated. So for those employers, the burden will be *de minimis*. They will just have to record it. They probably are recording it already.

It is for the employers that are either hoping by happenstance that they are getting it right or are intentionally avoiding the law in order to gain a competitive advantage. Those are the employers that are going to face the burden under this law because if they have to classify their employees as being covered by the law, they may have to start to pay the minimum wage. They may have to start to pay overtime. They may have to assure unemployment taxes are paid, Social Security taxes are paid, and Medicare taxes are paid. But it seems to me that is exactly the result that we want. We do not want the employers that are getting an unfair competitive advantage to be able to sustain their unfair competitive advantage by hiding the facts from their employees, from the Wage and Hour Division, from the country. That seems to me not where we want to go.

It is not the logic of the Fair Labor Standards Act. The Fair Labor Standards Act is about fair competition, a floor on minimum wages, a soft ceiling on overtime that everyone—almost everyone is subject to unless there is good reason to exclude them.

Senator BROWN. I have almost run out of time. Well, I will yield back my time, Mr. Chairman. Thanks.

The CHAIRMAN. Thank you, Senator Brown.

Senator Isakson.

Senator ISAKSON. Thank you, Mr. Chairman.

In the Wisconsin dishwasher case, that was already a violation of the law. Right?

Mr. HARRIS. Under Federal law, misclassifying an employee right now is not a violation of the law.

Senator ISAKSON. But the employer was violating the law by treating him as an independent contractor, yet requiring specific hours of work, etc, etc, etc.

Mr. HARRIS. It was a violation of the law if by misclassifying him, the employer failed to pay the minimum wage and failed to pay any legally required overtime.

Senator ISAKSON. But he was still breaking the law because he was failing to do that when it was determined that he was being treated as an independent contractor person employee.

Mr. HARRIS. Yes, there are minimum wage violations and there were overtime violations, as I understand it.

Senator ISAKSON. My recollection goes back to when I was running the company, and I have not done that in 14 years. But if I am not mistaken, the penalty for treating somebody as an independent contractor when in fact they are an employee is 7 years back payroll tax on the business side, as well as any other Federal required programs, per person misclassified. Is that correct still?

Mr. HARRIS. Not under laws that are administered by the Labor Department. Under IRS laws, there are consequences for misclassifying an employee.

Senator ISAKSON. I think you made a great statement that kind of strikes at one of the things that I am interested in being sure we do not do. You said the people that are doing it right already do this anyway. I think that was what you—well, you are right because I had 800 independent contractors and 200 employees, which brings me to the next point.

There are a number of American businesses who employ people as employees because of the ability to have productive independent contractors that would not otherwise employ those people if they had to treat the independent contractors as employees. My organization, for example, was real estate sales. Of the 800 independent contractors, 780 of them were women who needed a job where they had flexibility in hours, they did not have to put in 40 hours if they did not want to. They could do the things an independent contractor could do. It was a lifesaving opportunity for a woman in those years in the 1980s and the 1990s.

So one thing I want to be sure we do not do is remove the opportunity for people like working moms and folks like that to be able to have meaningful jobs and meaningful income because of the benefit that an independent contractor provides to a business to capitalize the risk that it takes to start that business and then ultimately hires the employees to support the independent contractor. So we should not forget that there is a circle here. If you allow the circle to operate, your independent contractors, rather than being enemies, are actually producing jobs that would not have been there otherwise.

So I want to associate myself with what you said, that most people do this anyway. I will talk with Sherrod. I have a great regard for Sherrod, and maybe we can find some common ground on this. But as I see this, this is going to apply to everybody who has independent contractors. So it is a new level of regulation. It is a new level of authority over people that are already doing this anyway in hopes of catching the ones who are trying to cheat anyway. And I think that is what Senator Enzi was really talking about in terms of how much more layer or labyrinth the Government puts on the people that are actually risking the capital that provides the opportunities for independent contractors.

That was not a question. That was a rambling statement and I apologize.

[Laughter.]

So I will be happy to sit down with the Senator from Ohio.

But we have to be very careful that economically difficult—and I went through the 1974 recession, the 1983, 1982 recession, the 1990–91 recession. You can look at America today and people that operate businesses that use independent contractors. Staying in

business is very difficult, and any new employee that you have to hire to meet compliance in order to do something you are already doing anyway is also a burden on them. As a U.S. Senator, I want us to get all the withholding, all the payroll taxes, all the unemployment compensation taxes, everything else that we can get in. But to do that, I do not want to stop enterprise that depends on the type of flexibility in work that independent contractor status does.

And that was another statement. Thankfully my time has run out so I will not make another one.

[Laughter.]

The CHAIRMAN. I would insert here that on page 2, that remuneration and hours relating to the performance of labor or services by each individual described in subparagraph (b)—Senator Enzi brought that to my attention. I was just thinking about that. That is what you were getting at. If someone has a legitimate number of several hundred independent contractors, how can you keep the hours and remuneration when they are out there doing their own thing? That is something we have got to take a look at. I do not understand how that is done. I would be glad to work with you on that.

Senator Franken, you are next.

STATEMENT OF SENATOR FRANKEN

Senator FRANKEN. Thank you, Mr. Chairman, for holding today's hearing on this critical issue, and I want to thank my colleague from Ohio for introducing the Employer Misclassification Prevention Act, which I am proud to cosponsor.

I think today's hearing is very good. We are hearing good stuff from Senator Isakson and from Senator Enzi that I am sure can be addressed.

And I want to say to Senator Enzi that I too have been an employer, because I know that was asked of Mr. Harris. I have been an employer. I have been an independent contractor. I have employed independent contractors. I have employed employees. Sometimes it is a little tricky. Sometimes errors are made, but it is not that hard to know who is an independent contractor and who is an employee. I actually believe that Senator Isakson had a bigger company than I had. Actually, I think my mom was an independent contractor for Senator Isakson because she worked for Burnett in Minnesota. So I kind of understand this, Senator Enzi. I have been in their shoes.

I want to reward the businessmen who are doing this right, and I am like Senator Isakson. I want there to be withholding taxes withheld, and I want unemployment insurance paid. I want to punish businesses that do not play by the rules. No one is categorically demonizing businesses that hire independent contractors. I did not hear anybody doing that.

But I have to tell you when I go back to Minnesota, one of the biggest complaints I hear from my friends in the construction industry—not the real estate industry, not the entertainment industry, but in the construction industry—is that there are good laws on the books, but that there are dishonest players who keep finding loopholes, and they are the ones that are disadvantaging people

who do play by the rules. And that is what we are trying to do here.

Now, I have a rather technical question, Mr. Harris, specific to a situation that has arisen in Minnesota. A couple years ago, Minnesota implemented a law to tackle the misclassification problem. It basically required that independent contractors receive a certification from the State Department of Labor and industry if individuals submitted documentation showing that they were legitimate contractors. And this seemed like a logical solution to the problem.

However, unscrupulous employers have found a way around this. They have told workers to go register as a limited liability company. It is actually a very simple form to do this. If certified as an LLC, the workers can keep working for the employer. It would be considered a business-to-business transaction and the employer could continue to avoid paying taxes and the worker would not be protected by any labor laws. And this happens frequently to vulnerable workers, seasonal workers, those with less education, those with no other employment option.

If Federal Wage and Hour inspectors were to show up to a construction site and interview workers who revealed that they were told where and when to show up and what to do but were technically LLCs, what would Wage and Hour be able to do in this situation? And would they be able to do anything more if Senator Brown's provisions were implemented into law?

Mr. HARRIS. The technical status of the worker as an LLC is not relevant to the test under the Fair Labor Standards Act, the economic realities test. It is only if the individual is actually operating an arm's-length business that they would be an independent contractor, at least out from under the definition of employee.

But if our investigator were to show up and find that someone had been misclassified, there would be no consequence for the employer in the first instance because under the law right now, it is not a violation to misclassify a worker. And that is one of the things that the Employee Misclassification Prevention Act would change.

Second, if the employer had not kept the requisite records because the LLC actually was an employee, there is no penalty for failing to have kept the records under existing law. Our investigator could not issue any kind of a citation for civil money penalties. Under the EMPA, there would be civil money penalties available for recordkeeping violations.

What is intriguing about what is happening, what you are describing in Minnesota, is that the Minnesota State law has in it a couple of the provisions that are included in EMPA, the establishment of a violation for misclassification, the existence of a presumption, if there is no recordkeeping, that someone is an employee. And I think what you are describing is showing that there is so much economic pressure on employers to get this competitive advantage particularly in construction where it is a very competitive business, that they are trying to find new ways of getting out from under the law.

So it shows that even if we succeed with our regulation or with the EMPA or both, we have to continue to be vigilant. We have to have an enforcement strategy. We have to have cooperation with

the States. We have to not let form overtake substance. The LLC form is not the answer. The relationship is the answer.

So I think that the problem that you are describing is solvable. It is not solvable with a single tool. I think we have to all work together to find several tools to go after it.

Senator FRANKEN. Thank you. My time has expired.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator.

Senator Murkowski.

SENATOR MURKOWSKI

Senator MURKOWSKI. Thank you, Mr. Chairman.

I want to follow up with a question that Senator Isakson was pursuing and that is the existing statutes, the existing laws that are in place to go after these bad guys because I think we would all agree this is what we are trying to do. You indicated that under the IRS code there are certainly avenues there.

But it is my understanding that we have got some pretty serious penalties under the Fair Labor Standards Act, $10,000 in fines and possible imprisonment. Under Davis-Bacon, offenders can receive up to 5 years in prison for making false statements on a certified payroll. The law includes mail and wire fraud statutes, money laundering, immigration, RICO, and of course, the IRS statutes.

So is putting a penalty on this recordkeeping aspect of the issue, the problem, on top of all these other pretty serious penalties? What makes you think that this is going to enable us to capture the bad guys? You have just stated the bad guys are going to keep looking for ways around some pretty serious stuff, $10,000 in fines, up to 5 years in prison. What makes you think that this is going to make the difference?

Mr. HARRIS. I am skeptical that failure to keep records for Fair Labor Standards Act purposes would actually result in a violation of any of the laws that you just described. I think it is unlikely that it would be, for example, a wire fraud or a tax fraud situation.

There is a requirement in the Fair Labor Standards Act that employers keep records, but there is no consequence for that if they do not.

So we view recordkeeping as the leading edge of the effort to assure that workers are getting the minimum wage and overtime. If our investigators or if the worker themselves cannot know how many hours they have worked in a week or 6 weeks ago or 8 weeks ago because the employer has kept no records, if they cannot know how much they have been paid for a particular period of time because the employer has kept no records, the employee cannot protect themselves. We cannot protect the employee because it is very difficult to assess what the violation is, whether there is a violation and the quantity of the back pay that the employee should be entitled to. So the recordkeeping penalty is designed simply to create an incentive for those employers that are refusing to keep records and to ensure that they are keeping records.

Senator MURKOWSKI. Would it work to amend the Fair Labor Standards Act then to require that there would be consequences then for failure to keep those records?

Mr. HARRIS. I think it would. It would help. None of these steps are panaceas. They are all parts of larger strategies to go after misclassification and violations of wage and hour laws. But I think it will make a difference for a large number of employers because there is no consequence now. There is no remedy if you do not keep records right now, except the investigator showing up and your having to sit through an extended interview.

Senator MURKOWSKI. Well, no consequence for failure to keep records, but there are consequences if you are that bad guy that has really abused this system. And those consequences, again, are pretty substantial in some of these other areas.

Let me ask you about the efforts within the Department of Labor. There has been a pretty stepped-up effort to identify and to prosecute the willful misclassification. The 2010 regulatory agenda is going to propose these regulatory changes to make the classification decisions more thoughtful, more transparent.

You have testified that, in addition to all this, the Department of Labor is going to move out on education and outreach and partnerships with States to tackle, as you mentioned, some of the forums that you have held in a handful of States there.

So given all the attention to this issue, do we need statutory changes to investigate and to prosecute the willful violators? I mean, if we do enough that is proactive and we make clear that people understand and understand the consequences under all of these other statutes, do we need to necessarily make statutory changes here?

Mr. HARRIS. I think we do. There are certain things that Congress can do that the Labor Department cannot do. For example, we cannot create or we think it will be difficult for us to create a legal presumption that someone is an employee in the absence of paperwork that establishes they are not. That is part of Senator Brown's and Senator Harkin's bill. We cannot impose civil money penalties for recordkeeping without Congress giving us the authority to do that.

So, yes, I think it is necessary to have a statute like EMPA enacted. It will strengthen what we are able to accomplish. It will be another part of a larger arsenal that we are trying to go after this problem. So, yes, I think it is necessary.

Senator MURKOWSKI. Mr. Chairman, my time has expired. Thank you.

The CHAIRMAN. Thank you, Senator Murkowski.

Senator Merkley.

SENATOR MERKLEY

Senator MERKLEY. Thank you, Mr. Chair, and thank you, Mr. Harris.

Do employers sometimes use the independent contractor status as a way to avoid issues related to immigration? Does this contribute to the issue of illegal immigrants acquiring jobs?

Mr. HARRIS. That is an excellent question. I am not sure I have a good answer for you.

The position of the Labor Department has long been, both under Democratic and Republican Presidents, that the employment laws apply regardless of immigration status. So the minimum wage pro-

tections and the overtime protections that would apply to an employee, if they are classified as an employee, would apply regardless of whether or not they are an undocumented worker or if they are a U.S. citizen, for example.

To the extent that the recordkeeping requirements in EMPA would make it more difficult for employers in the shadow economy to avoid obeying those laws, it is possible that that would have a consequence for undocumented workers who do not want to have any paperwork associated with their employment. But as a general matter, I think that is not going to be the principal thrust of what is going to happen with this bill.

Senator MERKLEY. You do not need to elaborate on this, but I was thinking in terms of an employee having to submit a Social Security number, an employer having to submit an I-9, that this might be a convenient way for both to bypass the issue and might be a contributor to the question of integrity of employment. And I would be interested in any follow-up information you might be able to provide to us on that.

Mr. HARRIS. Sure.

Senator MERKLEY. Whereas the Labor Department does not have penalties for misclassification, IRS does. So are you currently able to coordinate or do you alert the IRS when there is an issue so that those penalties become a reasonable substitute for the penalties that you are proposing today?

Mr. HARRIS. This is part of a larger effort in the Administration. Our effort with respect to regulations and others is part of a larger effort led by the Vice President's office and the Middle Class Task Force to have the Labor Department—both the Wage and Hour Division of the Labor Department and the UI Division in the Employment and Training Administration work more closely with the IRS to assure that we have a coordinated effort to go after and target misclassification because it does occur in each of the areas. So, for example, the Employment and Training Administration works with the IRS in about 29 States in something called the Questionable Employment Tax Practices Program where they share information. It allows them to understand better where misclassification with respect to UI taxes is occurring and then to collect those taxes. It has been a wonderfully successful program and we have added an additional almost $11 million in the budget request for 2011 to strengthen that program to get more States involved in auditing to improve data sharing, data mining efforts to target misclassification. So we are engaging in that kind of cooperation now with the IRS.

Senator MERKLEY. So in those States that have that relationship, as compared to States that do not, do you see that the IRS penalties become an effective substitute for the direct penalties you are proposing in the bill?

Mr. HARRIS. I cannot speak to IRS penalties. I just do not have that information. I apologize.

Every State is involved in auditing for UI tax purposes. Some States do an excellent job. They have very sophisticated data mining technology and collect a great deal more money. Some States need additional help, additional resources in order to build their capacity, and that is what we are trying to accomplish.

Senator MERKLEY. When I was an employer, I had the situation of a previous employee, an employee before I became the director, who had been misclassified. And I can tell you dealing with the IRS on that was a major deterrent.

It also inspired me to go to a seminar on this issue. It is a little fuzzy to me now, but I believe that there were two sets of standards, one for the State law definitions and one for the Federal IRS. Am I correct about that?

Mr. HARRIS. Yes. As a general matter—and this is maybe a little more responsive to the question before. The definition of employee under the tax code is different than the definition under the Fair Labor Standards Act. It is narrower, significantly narrower. So it is possible to be an employee for Fair Labor Standards Act purposes and not an employee for tax purposes. It is not very likely, but it is certainly possible.

So you could have misclassification under the Fair Labor Standards Act. It never gets picked up in the tax system. So that is the kind of thing that we would want to focus on as well.

Senator MERKLEY. I will say that that was a confusing factor for employers to try to sort out the differing tests. If it was a coherent, single test, it might be an additional tool, making this easier for employers.

So in general, the seminar I went to said just always presume that the people you are working with are employees. People will come to you and say, "hey, classify me as an independent contractor because of this and this and this. I will have independence in this way." They said almost always that is going to be wrong. So start with the presumption and then run through the test, and then if they meet the test, put them in that category.

Is that essentially what you are trying to do in this law—trying to establish a presumption that you are an employee unless you go through the test, the four points or so, and make sure that they actually fit the legal definition?

Mr. HARRIS. That is precisely what EMPA would do, yes.

Senator MERKLEY. Thank you very much for your testimony.

Mr. HARRIS. Thank you.

The CHAIRMAN. Well, Mr. Harris thank you very much for being here and for your testimony. We appreciate it very much.

Now we will go to our second panel. Our second panel will be Colleen Gardner, commissioner of Labor for New York State. Prior to her appointment as commissioner, she served as associate commissioner for Labor Affairs where she worked to strengthen labor protections, labor standards, apprenticeship programs, and workforce development programs. Prior to joining the Labor Department, Ms. Gardner worked for 23 years for the New York State AFL–CIO as the director of Organizing and Community Services.

Catherine Ruckelshaus is legal co-director of the National Employment Law Project. Ms. Ruckelshaus joined NELP in 1995 after working for the Employment Law Center in San Francisco. For over 20 years, she has litigated and advocated for policy reforms promoting the workplace rights of immigrant and other vulnerable workers.

Mr. Frank Battaglino is the owner of Metro Test and Balance, a heating, ventilating, air conditioning contracting company. He

started this 18 years ago, and since that time the business has grown into a $10 million operation with 55 employees.

Next we have Mr. Gary Uber. Mr. Gary Uber is the co-founder of Family Private Care, a licensed nurse registry operating in Florida, Georgia, and Alabama. He has 23 years of experience in the military and civilian health care and currently serves as president of the Private Care Association of America.

Thank you all for being here, and again, as pertained to Mr. Harris, it pertains to you. All your statements will be made a part of the record in their entirety. We will just go from left to right. And if you could sum up in 5 or so minutes, I would certainly appreciate it.

Ms. Gardner, welcome and please proceed.

STATEMENT OF COLLEEN C. GARDNER, COMMISSIONER, NEW YORK STATE DEPARTMENT OF LABOR, ALBANY, NY

Ms. GARDNER. Good morning, Chairman Harkin, Ranking Member Enzi, and members of the committee. My name is Colleen Gardner and I am the commissioner of the New York Department of Labor.

Mr. Chairman, I would like to submit my longer written testimony for the record.

On behalf of Governor David Paterson, I commend the committee for your work in protecting workers and businesses from employment misclassification, and I would like to convey New York State's support for S. 3254, the Employee Misclassification Prevention Act, which will help us expand efforts to combat misclassification.

Through enhanced enforcement efforts in New York, in collaboration with other States, we have made progress toward curbing misclassification. However, this is a national problem that requires national action.

Misclassification occurs when employers improperly treat an individual as an independent contractor instead of as an employee or when an employer pays an employee off the books. It not only hurts workers, but as the members of the committee have already said, it puts law-abiding businesses at a competitive disadvantage because they must compete against businesses that illegally cut their costs by misclassifying workers. It deprives government of resources at a time when we need every tax dollar and every contribution to our UI trust fund.

New York established a joint enforcement task force on employee misclassification in September 2007 through our Governor's executive order after a study by Cornell University found that more than 10.3 percent of private sector workers in our State were being misclassified. Twelve States now have similar structures and we collaborate with nine States in the northeast on a monthly basis to talk about joint enforcement.

Our task force's efforts have resulted in 67 enforcement investigations throughout the State which identified nearly 35,000 instances of employee misclassification, over $457 million in unreported wages, more than $13.2 million in unemployment insurance taxes due, and over $14 million in unpaid wages. However, we have only scratched the surface of the problem in New York.

New York's task force is comprised of several divisions within the Labor Department, the Workers Compensation Board, the Department of Tax and Finance, the Attorney General's Office, and the New York City Controller's Office.

The task force tears down the silos of government agencies and promotes collaboration while at the same time ensuring that confidential data is protected and used only for enforcement purposes. This inter- and intra-agency coordination has yielded significant results and greater efficiencies that would not have been possible if each agency or division acted alone.

Through strategic joint enforcement, referrals of audit results, and data sharing, we ensure that an employer who is found to be engaging in misclassification is financially and legally liable for all of the resulting violations. The most egregious cases are referred to the State attorney general or local district attorneys for criminal prosecution.

We also publicize the results of our sweeps to raise public awareness of the issue and promote compliance.

Currently the task force is using the existing strained resources of its partner agencies. Increased national focus and support to the States would greatly expand the results we have already achieved. The Obama administration's request for an additional $25 million in enforcement resources will provide needed help to the States. Our experience is that the cost of these investigations are often minimal in comparison to the return on investment.

Through our investigations we have found some employers who intentionally under-report the number of workers in their businesses. We have seen one group of workers as properly paid in the books and another group of workers who work side by side with the first group are paid off the books by a subcontractor. We conducted four main street sweeps where we investigated businesses along a retail strip. Of the 303 businesses visited, nearly 40 percent had unemployment insurance violations, 25 percent had labor standards violations, and 6 percent lacked workers' compensation coverage.

Just this month, we announced the results of four worker misclassification sweeps on construction projects where subcontractors either misclassified 281 workers as independent contractors or paid them off the books and owed more than $275,000 in wages and overtime.

These cases also brought to light the human costs of misclassification. In one case, we received a call from workers who were brought in from out of State, worked nearly a month without pay, and then were fired and abandoned at a mall parking lot.

We also saw the cost of business. We found one painting subcontractor which treated all 55 of its employees as independent contractors. This illegal practice allowed unscrupulous contractors to underbid legitimate employers.

S. 3254 would provide consistent and stronger enforcement through greater coordination. Some employers use State boundaries as a way to try to avoid the law, and when they leave, States have a much harder time enforcing orders against them. The Federal Government has the ability to enforce the laws across jurisdic-

tions and therefore would be more effective than States working in isolation.

This bill establishes coordinated strategies that have worked so well in New York and other States.

Finally, employee misclassification is pervasive and harmful to employees, workers, government, and our economy. We must combine forces and take new steps to fight it. S. 3254 would provide additional important tools.

New York looks forward to continuing to work with you on this important issue.

Again, I thank you for this opportunity and welcome your questions.

[The prepared statement of Ms. Gardner follows:]

PREPARED STATEMENT OF COLLEEN C. GARDNER

SUMMARY

• The worker misclassification problem hurts workers, businesses and government. New York has taken steps to raise awareness of this problem, as well as enhanced enforcement efforts in New York and increased collaboration with other States to curb this epidemic.

• Misclassification hurts workers who are deprived of many employment rights under State and Federal law. It also hurts legitimate businesses that have to compete against businesses that illegally cut their costs through the misclassification of workers, and lastly it hurts government which does not receive required employment and income taxes.

• In 2000, the U.S. Department of Labor commissioned a study that found that 10 to 30 percent of firms audited in nine States misclassified at least some employees. In New York, the Cornell University School of Industrial and Labor Relations estimated that approximately 10.3 percent of New York State's private sector workforce is misclassified each year.

• *The New York State Joint Enforcement Task Force on Employee Misclassification* has achieved an unprecedented level of collaboration among State agencies and local governments throughout New York. Created in September 2007 and including activities through the end of March 2010, the Task Force has worked on 67 enforcement sweeps in a dozen cities throughout the State, identified nearly 35,000 instances of employee misclassification, discovered over $457 million in unreported wages, and identified more than $13.2 million in unemployment insurance taxes due and over $14 million in unpaid wages.

• Through joint enforcement sweeps, coordinated investigations, referrals of audit results and data-sharing, the Task Force conducts a coordinated approach to enforcement. The process ensures that an employer who is found to be engaging in misclassification is financially and legally liable for all resulting violations. Violations that are determined to be criminally fraudulent are referred to the State attorney general or local district attorneys for criminal prosecution. Through media events, we have widely publicized the results of the sweeps to not only promote compliance by specific industries, but also to raise awareness among employers and workers that misclassification is illegal and hurts the competitiveness of businesses playing by the rules. The coordination of State agencies also allows for efficiencies that lead to greater enforcement and compliance.

• Our discussions with employers, unions and business organizations revealed the real impact on law-abiding employers who are trying to survive in this difficult economy. This illegal practice means that legitimate employers are underbid nearly every time by unscrupulous contractors who are often from out of State with no connection to local communities.

• Several other States have followed New York's lead and have created joint enforcement task forces. Since the New York Task Force began in 2007, 12 other States have established structures similar to ours. Last October, New York cosponsored a Northeast Regional Summit on Misclassification with the State of Massachusetts. More than 70 people, representing nine States, attended the Summit and discussed enforcement strategies. We now have monthly phone calls with these Northeast States to discuss best practices and strategies. New York is also a partner in the IRS Questionable Employment Tax Practices (QETP) program which assists

in uncovering misclassification and schemes aimed at avoiding employment tax obligations.

• Our experience in New York demonstrates the value and importance of many of the provisions of S. 3254, the Employee Misclassification Prevention Act, which will help us expand our work. The requirement that offices and divisions within the U.S. Department of Labor share information on misclassification violations will have the same positive effects nationally that our own data-sharing and enforcement coordination has had in New York. Additionally, the requirement that the U.S. Wage and Hour division carry out targeted enforcement will have the same impact that the targeted sweeps have had in New York. Many of the bill's provisions will lead to the detection and deterrence of business models using incorrectly classified independent contractors.

Good morning, Chairman Harkin, Ranking Member Enzi, and members of the committee. On behalf of Governor Paterson, thank you for the opportunity for New York State to address this important issue. My name is Colleen C. Gardner, and I am the commissioner of the New York State Department of Labor. Let me commend the committee for your work in protecting workers and businesses from misclassification and note New York's support for S. 3254, the Employee Misclassification Prevention Act, which will help us expand our work.

I will be speaking today about the problem of worker misclassification and how it hurts workers, businesses, and government. I will also discuss our steps to raise awareness of this problem as well as our enhanced enforcement efforts in New York and our collaboration with other States to curb this epidemic. Let me begin with a snapshot of the results of the New York State Joint Enforcement Task Force on Employee Misclassification and the unprecedented level of collaboration it has achieved among State agencies and local governments throughout New York. Beginning with its creation in September 2007 through the end of March 2010, the Task Force's efforts have resulted in 67 enforcement sweeps in a dozen cities throughout the State, which identified nearly 35,000 instances of employee misclassification, discovered over $457 million in unreported wages, identified more than $13.2 million in unemployment insurance taxes due and discovered over $14 million in unpaid wages. However, we have only scratched the surface of the problem in New York. There is much more work to be done.

A worker is considered "misclassified' any time he or she is improperly denied the benefits and protections provided to an "employee" as that term is defined by law. This can occur when a worker who meets the legal standards for classification as an employee is instead treated as an independent contractor by an employer. It can also occur when an employee is paid "off-the-books" and is not reported at all for tax and other purposes. Misclassification hurts workers who are deprived of their employment rights under State and Federal law. It also hurts legitimate businesses that have to compete against businesses that illegally cut their costs through the misclassification of workers. Finally, it hurts government which does not receive appropriate employment and income taxes.

THE PROBLEM

As we know, worker misclassification is not a new problem. In 2000, the U.S. Department of Labor commissioned a study that found that 10 to 30 percent of firms audited in nine States misclassified at least some employees.

In New York, the Cornell University School of Industrial and Labor Relations documented the growth of worker misclassification in a February 2007 study. Cornell estimated that each year, approximately 10.3 percent of New York State's private sector workforce is misclassified in one of two ways as noted earlier: as independent contractors or paid off-the-books.[1] This means that, because of misclassification, 10 percent of our workforce may not get the wage and hour protections to which they are entitled, including overtime pay and meal breaks. That also means that these employers fail to contribute to the unemployment insurance tax system for 10 percent of our workforce and fail to pay workers' compensation premiums in the same manner.

Further, these employers pay no withholding taxes on workers who are off-the-books, and the workers they misclassify as independent contractors have been found to underreport and to underpay their withholding taxes. At a recent hearing of the

[1] Linda H. Donahue, James Ryan Lamare, Fred B. Kotler, J.D., "The Cost of Worker Misclassification in New York State" (Cornell University, H.R. School, February 2007).

U.S. House Education and Labor Committee's Subcommittee on Workplace Safety, a representative of the Mason Contractors Association of America stated,

> "By misclassifying employees as independent contractors, unscrupulous employers are able to avoid paying taxes and insurance. Businesses that misclassify employees as independent contractors can expect to reduce their labor costs by between 15 and 30 percent. This places contractors . . . at a competitive disadvantage in an industry with 20 percent gross margins."

In this difficult economy, it is more important than ever that we maintain a fair playing field for businesses who play by the rules.

The Cornell report also estimated that approximately 14.9 percent of the construction industry workforce is misclassified in a given year. These are real numbers that impact real workers, businesses and economies. Studies conducted in other States have shown similar or even higher rates of misclassified workers. Our own field experience has shown that the level of worker misclassification in New York may be even higher than what the Cornell study shows because of the high incidence of off-the-books work.

NEW YORK'S EFFORTS

The New York State Joint Enforcement Task Force on Employee Misclassification was created by an Executive order in September 2007. It is comprised of the New York State Department of Labor, the New York State Workers' Compensation Board, the Workers' Compensation Board Office of Fraud Inspector General, the New York State Department of Taxation and Finance, New York State Attorney General's Office, and the New York City Comptroller's Office. The Executive order charged the Task Force with:

- sharing information and referrals among agency partners about suspected employee misclassification violations, and pooling and targeting investigative and enforcement resources to address them;
- identifying significant cases of employee misclassification, which should be investigated jointly;
- developing strategies for systematically investigating employee misclassification in industries in which misclassification is most common;
- facilitating the filing of complaints;
- working cooperatively with business, labor and community groups to identify and prevent misclassification;
- soliciting the cooperation and participation of local district attorneys and other law enforcement agencies, and referring appropriate cases for criminal prosecution; and
- proposing appropriate administrative, legislative and regulatory changes to prevent employee misclassification from occurring.

After almost 3 years of operation and an unprecedented level of inter- and intra-agency coordination, the Task Force has made great progress on these goals. Unlike most areas of employment, misclassification cuts across many areas of Federal, State and local law enforcement. Prior to the creation of the Task Force, if one State agency—or division within a State agency—discovered a misclassification violation or received a tip about a potential violation, it did not usually refer it to another State agency or division. The Task Force tears down the silos of government agencies and promotes collaboration, while at the same time ensuring confidential data is protected, and used only for enforcement purposes.

Through joint enforcement sweeps, coordinated investigations, referrals of audit results and data-sharing, the Task Force uses a coordinated approach to enforcement. Our process ensures that an employer who is found to be engaging in misclassification is financially and legally liable for all of the resulting violations. Violations that are determined to be criminally fraudulent are referred to the State attorney general or local district attorneys for criminal prosecution.

We hold media events around the State to publicize the results of our sweeps. This publicity raises public awareness of the issue, promotes compliance by businesses, and emphasizes that misclassification is illegal and hurts the competitiveness of businesses who play by the rules—which in turn hurts workers.

We have also raised the level of scrutiny given to misclassification cases. Joint sweep and enforcement cases are chosen strategically and are evaluated in a coordinated fashion. Strategies are pursued in each case for the greatest deterrent effect. This past fall, New York also conducted comprehensive cross-training of investigators from our partner agencies to help them recognize violations in other subject areas, to share investigative and interviewing techniques, and to increase awareness of misclassification issues.

The coordination among State agencies also allows for efficiencies that lead to greater enforcement. Through May 31, 2010, we have received over 5,600 tips or leads (through emails and phone calls). We have shared those tips with our partners, and have further shared information on an additional 3,500 cases of interest to our partners. Each agency can use the tips, evidence, interviews and audits obtained by other State agencies in conducting its own enforcement efforts. These types of efficiencies are essential as we all strive to do more with fewer resources. Currently, the Task Force and its partner agencies do not have dedicated or additional enforcement resources for misclassification. Instead, we use the existing resources of the partner agencies, which has impacted the ability of our State-funded enforcement unit to conduct their regular tasks. While we have been able to do a great deal, we are hampered by our lack of misclassification resources and our eroding enforcement resources. Despite the limited resources, our efforts are making a difference in New York. With increased national focus and support to the States, we could greatly expand on the results we have already achieved.

The Obama administration's request for an additional $25 million will help provide needed enforcement resources to penalize employers that improperly misclassify employees as independent contractors. When considering this and related Federal resource investments, please note the cost of these investigations can be minimal in comparison to the return on investment related to bringing businesses into compliance. For example, a sweep performed recently at one construction site cost the State approximately $25,000 in staff and administrative costs, yet the sweep yielded $81,313 in additional taxes and $27,566 in penalties. And this includes neither the restitution of wages to impacted employees nor the future benefit to the competing employers who follow the rules.

THE RESULTS FOR NEW YORK

Worker misclassification takes many forms. We have found misclassification in large and small cities, and in poor, middle-class and affluent communities. Some employers intentionally underreport the number of workers in their business. NYSDOL has visited 24-hour diners where the employer lists five family members on its unemployment filings but the visit shows that at least 20 workers are needed to run the business. We have also found employers with a business model of core employees, who work under the direction and control of the employer, who are told to create separate business entities to appear as independent contractors. We also often see subcontracting within a business entity where one group of workers is properly paid on the books and another group of workers, who work side-by-side with the first group, are paid off-the-books by a subcontractor.

Moreover, we have found that employers owed more than $14 million in unpaid wages and overtime to workers identified by the NYSDOL Division of Labor Standards. We have referred 16 employers for felony prosecutions, and to date, 4 employers (or their corporations) have been convicted of crimes related to misclassifying their workers. Please note, only the most egregious cases are referred for prosecution: the primary goal is to bring employers into compliance and to ensure that workers are paid what they are owed including applicable civil penalties.

Just this month, we announced the results of four worker misclassification sweeps on construction sites around New York State that brought the issue of this epidemic to the public's attention. In all four of these cases, large construction projects were being built by mainstream, established developers or contractors. Yet, many of the workers on the project, hired by subcontractors, were either being misclassified as independent contractors or being paid off-the-books and were subject to serious labor law violations. In these cases, subcontractors on projects to construct private, upscale off-campus housing for students near three different State and private colleges and a major new hospital were found to be cheating 281 workers out of more than $275,000 in wages and overtime. We have also issued nearly $430,000 in penalties for these wage violations and have assessed over $167,000 in unemployment insurance taxes and penalties on these projects.

These cases also brought to light instances of the serious mistreatment of workers and the human cost of misclassification. In one case, we received a call from workers who were brought in from out-of-state, had worked for nearly a month without pay, and then were fired and abandoned at a mall parking lot. They were stranded and had no money to get home. Similarly, we were contacted by a store owner near one of the construction projects because six workers were left stranded without money after working on the project for 3 months without being paid. They were being housed by the subcontractor in an apartment and only given some money for food.

In an effort targeted at assessing compliance in urban and suburban retail tracts, we conducted four "Main Street" sweeps in different parts of New York State where we walked door-to-door and investigated most businesses along a retail strip. Of the 303 businesses visited, nearly 40 percent had UI misclassification violations, nearly 25 percent had labor standards violations, and 6 percent were issued stop-work orders by the Workers' Compensation Board for lack of workers' compensation coverage. UI findings on the firms visited indicated over 1,600 misclassified workers and unpaid UI taxes of nearly $398,000.

These results from teams of dedicated Task Force investigators from multiple State agencies brought to light the grim reality of employee misclassification and its impact on real workers. But this is only part of the story. Our discussions with legitimate employers, unions and business organizations revealed the negative impact on law-abiding employers who are playing by the rules everyday and trying to survive in this difficult economy. This illegal practice means that legitimate employers are underbid nearly every time by unscrupulous contractors who often have no connection to local communities. In one of our investigations, we found one painting subcontractor, which treated all 55 of its employees as independent contractors. The painting contractor who pays taxes on behalf of all of its employees cannot compete with the painting contractor who considers each of its employees to be an independent contractor. The diner or supermarket which pays all of its employees on the books cannot charge the same prices as the one that tries to cheat workers and our competition-based system.

NEW YORK'S TASK FORCE HAS BEEN A MODEL FOR OTHER STATES

Since the New York Joint Enforcement Task Force began in 2007, 12 other States have established structures similar to the one in New York. Last October, the NY Task Force co-sponsored a Northeast Regional Summit on Misclassification with Massachusetts. More than 70 people, representing nine States, attended the Summit and discussed enforcement, data sharing strategies and greater coordination of enforcement among States. We now have monthly phone calls with these northeast States to discuss best practices and strategies. Many of the States have their own excellent statistics to report on the benefits of targeted enforcement, data-sharing and collaboration between State agencies.

ADDITIONAL NATIONAL EFFORTS

New York, as well as 36 other States, has also partnered with the IRS, USDOL, the National Association of State Workforce Agencies (NASWA), and the Federation of Tax Administrators in the Questionable Employment Tax Practices (QETP) program. In fact, New York has engaged in data sharing with the IRS for 24 years, using at least 10 different IRS data extracts to enhance compliance efforts. With the advent of QETP, our ability to detect misclassification and other schemes aimed at employment tax avoidance has been enhanced. Since 2007, QETP data sharing has assisted NYS in finding over 21,500 misclassified workers, over $5 million in additional UI taxes due, and unreported wages exceeding $389 million.

FEDERAL LEGISLATION

What I have described today is our Task Force accomplishments with targeted enforcement, limited shared resources, and outreach and education. However, given the extent of this problem, and given the losses to workers, the Government and legitimate businesses, we need to do much more. While New York State has been a leader in enforcement against fraud and misclassification, we need Federal legislation to help provide consistent and stronger enforcement. A major reason for greater Federal involvement is that there are employers with national operations who use the same illegal practices in many of the States in which they operate. Other employers, such as construction companies, use State boundaries as a way to try to avoid the law, and when they leave, we have a much harder time enforcing our orders against them. Unlike the States, the Federal Government has the ability to enforce the laws across jurisdictions, and therefore would be more effective than States working in isolation.

Our experience in New York demonstrates the value and importance of many of the provisions within S. 3254. The requirement that offices and divisions within the U.S. Department of Labor share information on misclassification violations will have the same positive effects that our own data-sharing and enforcement coordination has had in New York. The requirement that the USDOL Wage and Hour Division carry out targeted enforcement will also have the same positive effects nationally that our own targeted sweeps have had in the State.

Additionally, the provisions in the bill requiring the U.S. Department of Labor to measure and credit States' performance in conducting Unemployment Insurance (UI) tax audits will lead to greater detection of misclassification will greatly aid the efforts of our UI Division in NY State and State UI Divisions across the country. New York has advocated for, and strongly encourages USDOL to count overall State efforts aimed at addressing misclassification through a broadening of definitions to include both audits under USDOL Tax Performance standards as well as other types of investigations States may engage in. Doing so will provide the broadest possible picture of the misclassification that is occurring and will ensure that States use their resources to go beyond the standard audits and conduct other types of investigations.

Finally, many of the S. 3254 legislative provisions will lead to the detection and deterrence business models using incorrectly classified independent contractors. The bill's provisions that require employers to keep records that accurately reflect the classification of each worker, that create penalties for failure to keep these records, and that provide a presumption of employment for employees where the records are not kept will strengthen the ability of both the Federal Government and the States to detect misclassification violations. The bill will further deter misclassification violation by clarifying that worker misclassification alone is a violation of the Fair Labor Standards Act, as well as by increasing penalties for this violation. Additionally, the requirement that government Web sites provide workers with notification of their employment status and rights will help lead to more complaint-driven compliance. New York also encourages the addition of a specialized notice for workers who are treated as independent contractors for tax purposes under section 530 of the IRS code.

Employee misclassification is pervasive and harmful to our employers, workers, government and our economy. We must combine forces and take new steps to combat it. The provisions of S. 3254 will add important tools to the Federal Government's ability to enforce the Fair Labor Standards Act in regards to misclassification. On behalf of Governor Paterson, New York looks forward to continuing to work with Congress, Federal agencies, employers, and other States on this important issue. Again, I thank you for this opportunity and welcome your questions.

The CHAIRMAN. Thank you very much, Ms. Gardner.

And now Mr. Battaglino. Welcome and please proceed.

STATEMENT OF FRANK BATTAGLINO, OWNER, METRO TEST AND BALANCE, CAPITOL HEIGHTS, MD

Mr. BATTAGLINO. Chairman Harkin and members of the committee, thank you for inviting me here today.

My name is Frank Battaglino and I am the owner of Metro Test and Balance located in Capitol Heights, MD. I am here today representing the Sheet Metal and Air Conditioning National Association, as well as the Campaign for Quality Construction.

The Campaign for Quality Construction represents six construction contractor associations with approximately 27,000 contractor members nationwide. The majority of the CQC members are family-owned businesses, most with 10 or fewer employees.

I am here today because it is time for Congress to act. SMACNA testified in 1996 on the issue of misclassification and stated that worker misclassification in the construction industry was rising rapidly. Nothing was changed. The epidemic continues to grow, and the rise has nothing to do with career enhancement or worker opportunity. It has everything to do with unfair, low-wage competition.

As I said before, I am the owner of Metro Test and Balance. I presently employ 55 people in the Washington metropolitan area. I have been in business since 1991 when I started my company. I began with a set of equipment that I mustered together with an

old Ford van. I now have a 15,000-square foot facility with over 20 trucks on the road.

A person takes risks when they decide to become a business owner, but they also accept certain responsibilities. Workers' rights and workers' conditions are important to me now, but they were important to me 20 years ago when I started. I was still able to grow and make money. I am living proof that when a company chooses the path of legality and responsibility for its workers' rights, it can still be very successful. Do not let employers who do not want to do the right thing tell you otherwise.

My company performs a number of services ranging from commercial HVAC duct work fabrication, installation, test and balance, and indoor air quality. Our customers include Federal, State, and local governments, as well as private work.

We face a very big disadvantage due to the worker misclassification. Lately we are being beat out of competitive bids by unusually low bids. This is a direct result of companies deliberately misclassifying their workers as independent contractors. There is no other way we could be outbid by such a large amount.

Maryland recently passed a law to help with this problem in the construction industry, but the law is new and it focuses only on the construction industry.

A company that regularly uses so-called independent contractors can be at least 20 to 30 percent below our bids. So an honest company gets beat out by a company scamming the system and plain hard-working people are just being taken advantage of.

This does not hurt just small companies. It hurts big companies too. Let me give you one example of a large SMACNA contractor in Atlanta with several hundred workers. The contractor had a new potential worker come to him to ask if he could sign up for a worker training program. The guy had been working for another contractor for several years, but in order to work, the guy had to agree to be an independent contractor. The Atlanta contractor now understands how he was being beat out on a lot of bids.

This causes a number of problems not only for companies but also for taxpayers, Federal, State, and local governments. They lose revenue and we end up paying for social services that usually are covered by employee-mandated benefits. As an employer, I pay 50 percent of my employees Social Security and Medicare. I pay unemployment insurance and workers' comp insurance.

By the way, this past year—this April—I paid my first quarter Maryland workers' comp/unemployment insurance premiums in April of this year, and the check was for over $32,000. That was the highest it has ever been. So it is ridiculous and that is just the first quarter, generally the highest, but it was the first quarter.

I am also required to pay overtime. There are a lot of expenses associated with being an employer, and I do not mind. But it is time for Congress to make sure all businesses are paying their fair share. Responsible employers and government alike have to partner for this cause. With the loss of tax revenues, we both are being asked—more accurately being forced—to cover these expenses while companies scamming the system are benefitting with higher profits and less responsibility. Right now, unethical businesses are stealing work from honest contractors with little fear of getting

caught. There is no direct law prohibiting misclassification, and there are too many loopholes and violations in the laws that we do have.

I urge the committee to please take quick and strong action to stop worker misclassification and to pass S. 3254, the Employee Misclassification Prevention Act, as soon as possible. Thank you.

[The prepared statement of Mr. Battaglino follows:]

PREPARED STATEMENT OF FRANK BATTAGLINO

SUMMARY

Metro Test and Balance in Capitol Heights, MD.

• Representing the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA) and the Campaign for Quality Construction (CQC).
• CQC represents six construction contractor associations with approximately 27,000 contractor members nationwide.
• The vast majority of SMACNA members and CQC members are very small, family-owned businesses—the majority with 10 or fewer employees.

Time for Congress to act.

SMACNA testified in 1996 on the issue of misclassification and stated that worker misclassification in the construction industry was rising rapidly. Nothing has changed.

• The epidemic continues to grow and has nothing to do with career enhancement or worker opportunity.
• It has everything to do with unfair, low-wage competition. It is important to legitimate businesses like mine all across the country.

Background—employ 55 people in the Washington metropolitan area.

Work is commercial HVAC duct work fabrication and installation, Test and Balance services and indoor air quality testing. Customers include Federal, State and local governments and private work—a host of pharmaceutical, defense-based contractors and numerous medical facilities.

• I have been in business since 1991 when I started my company.
• Purchased some equipment and an old Ford van.
• I now have a 15,000-square foot facility with over 20 trucks on the road.

A person takes risks when they decide to become a business owner but—they also accept certain responsibilities.

• I was still able to grow and make money.
• I am proof that when a company chooses the path of legality, it can still be successful.
• Don't let employers who *don't want* to do the right thing tell you otherwise.

Misclassification is hurting my business.

We are put at a competitive disadvantage due to the worker misclassification problem. Other companies deliberately misclassify their workers to save money.

• A company can save at least 20 to 30 percent on labor costs by misclassifying.
• I pay 50 percent of my employees' social security and medicare, plus unemployment insurance and worker's compensation premiums. (My 1st quarter unemployment insurance was $32,000). I am required to pay overtime & provide OSHA safety training and more.
• Honest companies gets beat out by companies scamming the system—who then make higher profits and have fewer responsibilities.
• Big companies & small companies get hurt—SMACNA example from large Atlanta firm.
• Taxpayers and Federal, State and local governments lose tax revenue and pick up the tab for a variety of social services.
• Maryland recently enacted a law addressing misclassification in construction.

Unethical business owners are "stealing" work from honest contractors with little fear of getting caught—there is no direct law prohibiting the practice and too many loopholes.

I urge the committee to take quick and strong action to stop worker misclassification and to pass S. 3254, The Employee Misclassification Prevention Act as soon as possible.

Good morning Chairman Harkin and members of the committee. Thank you for the opportunity to testify here today.

My name is Frank Battaglino and I am the owner of Metro Test and Balance, Inc. located in Capitol Heights, MD. I am here today representing the Sheet Metal and Air Conditioning Contractors' National Association as well as the Campaign for Quality Construction.[1]

The Sheet Metal and Air Conditioning Contractors' National Association (SMACNA) is supported by more than 4,500 construction firms engaged in industrial, commercial, residential, architectural and specialty sheet metal and air conditioning construction in public and private markets throughout the United States. Working on a wide variety of projects across the Nation in urban and suburban areas, SMACNA contractors specialize in heating, ventilating and air conditioning; architectural sheet metal; industrial sheet metal; kitchen equipment; specialty stainless steel work; manufacturing; siding and decking; testing and balancing; service; and energy management and maintenance.

I am also representing The Campaign for Quality Construction which represents six construction contractor associations with approximately 27,000 contractor members nationwide. CQC members compete in public and private sector markets and perform both as prime and subcontractors. I would like to emphasize that the vast majority of SMACNA members and CQC members are very small, family-owned businesses—the majority of which have 10 or fewer employees.

I am here today because it is time for Congress to act. SMACNA testified in 1996 on the issue of misclassification and stated that worker misclassification in the construction industry was rising rapidly. Nothing has changed. The epidemic continues to grow and the rise has nothing to do with career enhancement or worker opportunity. It has everything to do with unfair, low-wage competition. Addressing this problem is important with regard to workers' rights in our country and it is important to legitimate businesses like mine all across the country.

MY BACKGROUND

As the owner of Metro Test and Balance, I currently employ 55 people in the Washington metropolitan area. I have been in business since 1991 when I started my own company. I started out with a set of equipment that I mustered together and an old Ford van. I now have a 15,000-square foot facility with over 20 trucks on the road.

A person takes risks when they decide to become a business owner but they also accept certain responsibilities. Workers' rights and working conditions are important to me now, but they were also important to me in my old Ford van in 1991 when I started.

I was still able to grow and make money. I am living proof that when a company chooses the path of legality and responsibility for its workers' rights it can still be very successful. Don't let employers who *don't want* to do the right thing convince you that it can't be done or that following the law will kill entrepreneurship. It should be noted that movement from skilled production jobs into supervisory, management and even business ownership are unrivaled in the union sector of the construction industry.

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[1] The Campaign for Quality Construction represents six construction associations allied in an ongoing legislative Campaign for Quality Construction. These groups are: the Mechanical Contractors Association of America (MCAA), the Sheet Metal and Air Conditioning Contractors' National Association (SMACNA), the National Electrical Contractors Association (NECA), the International Council of Employers of Bricklayers and Allied Craftworkers (ICE), the Finishing Contractors Association (FCA), and The Association of Union Constructors (TAUC). According to 2002 U.S. Census Bureau Construction Statistics, specialty subcontracting comprises 61 percent of industry employment.

Our organizations represent the high-skill, leading edge sector of the specialty contracting industry, providing the top-tier training, wages, health and welfare and pension benefits necessary for a strong workforce skill base. According to 2002 U.S. Census Bureau Construction Statistics, specialty subcontracting comprises 61 percent of industry employment. The figure for the specialty segment of the industry, however, is slightly higher in more recent figures published by the U.S. Department of Labor's Bureau of Labor Statistics.

WHAT WE DO AND HOW MISCLASSIFICATION IS HURTING MY BUSINESS

My company performs a number of services ranging from commercial HVAC duct work fabrication and installation, Test and Balance services to indoor air quality testing. Our customers include Federal, State and local governments as well as private work—a host of pharmaceutical, defense-based contractors and numerous medical facilities.

We have found ourselves bidding for work at a disadvantage because of the worker misclassification problem. Increasingly we were being beat out of competitive bids by unusually low bids. We know this is a direct result of companies deliberately misclassifying their workers as independent contractors. There is no other way we could be outbid by such large amounts. In fact, the problem was so pervasive that the State of Maryland recently enacted a law to address the problem in construction.

Misclassification occurs when an employer improperly classifies a worker as an independent contractor. Misclassification is known to be particularly prevalent in the construction industry and is blatantly used as a cost-cutting tool. Employers who misclassify their workers reap substantial savings and gain unfair competitive marketplace advantages by avoiding payment of Social Security and Medicare taxes, payment of Federal and State unemployment insurance taxes, and payment of workers' compensation premiums. Employers who misclassify workers as independent contractors gain other competitive advantages such as lower administrative costs and more limited liability.

A company that regularly uses this practice can be at least 20 to 30 percent below our bids. So an honest company gets beat out by a company scamming the system and plain hard working people are just being taken advantage of. Vague, complex and subjective rules regarding independent contractor determinations, legal loopholes and lax enforcement all contribute to the growth of this problem.

I am not the only one with this problem. Let me give you one example of a large SMACNA contractor in Atlanta. The contractor had a new potential worker come to him to ask if he could sign up for a worker training program. The guy had been working for another contractor for several years but in order to work the guy had to agree to be an independent contractor. The Atlanta contractor now understands why he was losing bids and he is a larger contractor with several hundred workers. So misclassification hurts legitimate contractors large and small.

This causes a number of problems not only for companies such as mine but also for taxpayers, Federal, State and local governments that lose tax revenue. There are broader social consequences when taxpayers and governments end up paying for social services that are usually covered by employee-mandated benefits.

As an employer I pay 50 percent of my employees' Social Security and Medicare. I pay unemployment insurance and worker's compensation premiums. By the way, I paid my Maryland worker's unemployment insurance premiums in April of this year and the check was for over $32,000. The highest it has ever been. I am required to pay overtime. There are a lot of expenses associated with being an employer and I don't mind, but it is time for Congress to make sure all businesses are paying their fair share.

CONCLUSION

Responsible employers and government alike have to partner for this cause. CQC employers contribute to a healthy economy and provide opportunities for economic advancement for employees. As I have said in my testimony, too often these ethical contractors compete against employers, in both the private and public market, who deliberately classify workers as independent contractors and who otherwise are not fully compliant with the law. Unfortunately, it is an epidemic that contributes to a degradation of the quality of the workforce and to the quality of life for American workers.

With the loss of tax revenue both ethical companies and taxpayers are being asked, or more accurately, being forced to cover these expenses while these companies scamming the system are benefiting with higher profits and less responsibility.

It is not too strong to say unethical business owners are "stealing" work from honest contractors with little fear of getting caught. There is no direct law prohibiting misclassification and too many loopholes for violations of the laws we do have.

The CQC supports, without reservation, efforts to stem the workforce degradation that is the direct result of misclassification. I urge the committee and Congress to take quick and strong action to stop worker misclassification and to pass S. 3254, The Employee Misclassification Prevention Act as soon as possible.

Thank you.

The CHAIRMAN. Mr. Battaglino, thank you very much for that very profound statement and for being here.

We will turn to Ms. Ruckelshaus, and please proceed.

STATEMENT OF CATHERINE K. RUCKELSHAUS, LEGAL CO-DIRECTOR, NATIONAL EMPLOYMENT LAW PROJECT, NEW YORK, NY

Ms. RUCKELSHAUS. Thank you, Chairman Harkin and members of the committee. Thank you for the opportunity to testify today.

My name is Cathy Ruckelshaus and I am the legal co-director of the National Employment Law Project. We are a nonprofit based in New York, and we promote access to and retention of good jobs for low-income workers.

At NELP, we have had the opportunity to learn about job conditions in industries such as agriculture, construction and day labor, garment, meat packing, janitorial, trucking, home care, and retail. In too many of these industries we see sub-minimum wages, lack of the health and safety protections, and we see employees being treated as independent contractors when they should not be.

Today and in my written testimony, I describe independent contractor misclassification and its impacts on workers, on State and Federal Government coffers, and on law-abiding employers.

We have heard this morning about who independent contractors are, but I think it is important to note, as has been noted, this morning that we all know that every day employers legitimately contract with other independent businesses typically to perform specialty jobs that the contractor performs for a variety of other customers. These routine practices are not the subject of independent contractor misclassification reforms.

Second, genuine independent contractors constitute a small proportion of the American workforce because by definition, an independent contractor is in business for him or herself. True independent contractors bring a specialized skill. They invest capital in their business, and they perform a service that is not part of the receiving firm's overall business. True independent contractors aim to make a profit. They are entrepreneurs that can pass on increased costs to their customers like higher gas prices or an increase in the cost of safety equipment. Examples of true independent businesses are a plumber, called in by an office manager to fix a leaky sink, or a computer technician on a retainer with a manufacturing company to troubleshoot computer glitches.

How does it happen? We have heard that employers misclassify employees as independent contractors by giving them a 1099 instead of a W–2. They often pay them off the books providing no tax reporting or withholding. Many of these employers require workers to sign a contract stating that they are an independent contractor as a condition of getting a job. They do this because the employers can be off the hook for workplace rules. They can be off the hook for safety net benefits. They can save upwards of 30 percent of payroll costs, and they can underbid their competitors in labor-intensive sectors, especially like construction and building services.

We have heard again this morning that calling employees independent contractors is a broad problem and it affects a wide range

of jobs. I am going to just mention three examples that I have experienced in my practice.

One is Faty Ansoumana who worked as a delivery worker in a Gristede's store in Manhattan. He worked 7 days a week, 12 hours a day for $90 a week. He and his fellow delivery workers were hired through two middlemen labor brokers who stationed the workers in stores around New York City. They reported directly to the stores and provided deliveries for the customers. When we challenged the low pay, the store said the workers were not their employees and the labor broker said they were all independent contractors.

Janitors from South America and Korea were sold franchise agreements in Massachusetts for the ability to clean stores in Massachusetts. They were told where to clean, what stores to clean, and what materials to use. They were found to be employees and got unemployment benefits even though their employer told them they were independent contractors.

And NELP represented some home care workers in Pennsylvania who were not paid for travel time and overtime. Once we filed the lawsuit, their employer called everybody in and said sign this independent contractor agreement. You are no longer our employees. If you want to keep your job, you have to sign this independent contractor agreement. This was a tactic obviously to try to avoid the liabilities, but it did not work.

The impacts are when workers are labeled an independent contractor, even though it does not have any necessarily legal meaning, it does carry a punch and it deters workers from claiming their rights. We have a complaint-driven system and that is a big problem.

We have heard already that it impacts the States and Federal coffers. My testimony outlines that 20 States have done studies tallying up the lost dollars and it is in the billions.

What we should do about it is follow the Department of Labor's lead and target misclassification and we should also pass the Employee Misclassification Protection Act which is essentially a right-to-know or transparency bill. The EMPA would require employers just to notify workers of their status and then to keep records on hours and pay. These are typically records that employers are already keeping even for their contractors, for vendors and for other contractors, including payments and hours off and that are worked for a job. These proposed reforms in the EMPA are reasonable, possible, and necessary. They could be implemented with little effort and to much impact on our country's workers.

Thank you for permitting me to testify and I look forward to the questions.

[The prepared statement of Ms. Ruckelshaus follows:]

PREPARED STATEMENT OF CATHERINE K. RUCKELSHAUS

SUMMARY

My name is Cathy Ruckelshaus, and I am the legal co-director of the National Employment Law Project (NELP), a non-profit organization that seeks to promote access to and retention of good jobs for workers. In the over 20 years I have spent working with and on behalf of workers around the country, I have been struck by the success some businesses have had in devising ways to evade responsibility for fair pay, health and safety, and other workplace standards. Calling employees inde-

pendent contractors ("1099-ing" them, so-called because of the IRS Form 1099 issued to independent contractors), and the related tactic of paying workers off the books or in cash with no tax reporting or withholding, is a top choice of these employers.

My testimony describes independent contractor misclassification and its impacts on workers, on State and Federal Government coffers, and on law-abiding employers. It highlights the heightened activity on this important issue in the States, following studies showing staggering losses in the billions of dollars in the form of unpaid and uncollectible income taxes, payroll taxes, and unemployment insurance and workers' compensation premiums due to this practice. I support the introduced Federal Employee Misclassification Protection Act (EMPA), and suggest some further ideas for policy reforms to contend with this unchecked and growing practice.

Businesses legitimately contract every day with other independent businesses, often to perform specialty jobs that the contractor performs for a variety of customers. Yet, genuine independent contractors constitute a small proportion of the American workforce, because by definition, an "independent contractor" is in business for him- or herself. True independent contractors bring specialized skill, invest capital in their business, and perform a service that is not part of the receiving firm's overall business.

Calling employees "independent contractors" is a broad problem and affects a wide range of jobs. It could be happening to someone you know. A 2000 study commissioned by the U.S. Department of Labor found that up to 30 percent of firms misclassify their employees as independent contractors. Many States have studied the problem and find high rates of misclassification, especially in construction, where as many as 4 in 10 construction workers were found to be misclassified.

If enacted, the EMPA would be an important first step to encourage transparency in employment relationships. If workers know about their employment classification and the impacts of that status, they will be better prepared to report any violations. In addition, U.S. DOL will be better equipped to determine whether there is compliance if employers maintain basic records of their contractors's pay and hours.

Senator Harkin and members of the committee, thank you for this opportunity to testify today on the important subject of independent contractor misclassification and its impacts on workers and their families, law abiding employers, and our economy.

My name is Cathy Ruckelshaus, and I am the legal co-director of the National Employment Law Project (NELP), a non-profit organization that seeks to promote access to and retention of good jobs for workers. In the over 20 years I have spent working with and on behalf of workers around the country, I have been struck by the success some businesses have had in devising ways to evade responsibility for fair pay, health and safety, and other workplace standards. Calling employees independent contractors ("1099-ing" them, so-called because of the IRS Form 1099 issued to independent contractors), and the related tactic of paying workers off the books or in cash, is a top choice of these employers.

I and my colleagues at NELP have worked to ensure that *all* workers receive the basic workplace protections guaranteed in our Nation's labor and employment laws; this work has given us the opportunity to learn up close about job conditions in a wide variety of industries: garment, agricultural, construction and day labor, janitorial, retail, hospitality, home health care, trucking, poultry and meat-packing, high-tech, and other services. We have seen low, often sub-minimum wages, lack of health and safety protections and work benefits, and rampant discrimination and mistreatment of workers in these jobs.

An important part of our work focuses on simply enforcing the basic fair pay laws already on the books. Because unscrupulous employers use independent contractor schemes to flout these rules, we have worked with allies in State legislatures and agencies to tighten enforcement of core labor standards in those sectors where independent contractor abuses persist. This background in enforcement and State practices informs my testimony today.

Today, I will describe independent contractor misclassification and its impacts on workers, on State and Federal Government coffers, and on law-abiding employers. I will highlight the heightened activity on this important issue in the States, following the State studies showing staggering public losses due to the practice. I will conclude with comments on the introduced Federal Employee Misclassification Protection Act (EMPA), and suggest some further ideas for policy reforms to contend with this unchecked and growing practice.

I. WHAT IS INDEPENDENT CONTRACTOR MISCLASSIFICATION AND HOW COMMON IS IT?

Employers legitimately contract every day with other independent businesses, typically to perform specialty jobs that the contractor performs for a variety of customers. These routine practices are not the subject of independent contractor misclassification reforms.

Yet, genuine independent contractors constitute a small proportion of the American workforce, because by definition, an "independent contractor" is in business for him- or herself.[1] True independent contractors bring specialized skill, invest capital in their business, and perform a service that is not part of the receiving firm's overall business. Examples are a plumber called in by an office manager to fix a leaky sink in the corporate bathroom, or a computer technician on a retainer with a manufacturing company to trouble-shoot software glitches.

But, with increasing frequency, employers misclassify employees as "independent contractors," either by giving their employees an IRS Form 1099 instead of a Form W–2, or by paying the employee off-the-books and providing no tax forms or tax reporting and withholding. Many of these employers require workers to sign a contract stating that they are an independent contractor as a condition of getting a job. Here are some reasons why this independent contractor misclassification is on the rise:

- Firms argue they are off-the-hook for any rule protecting an "employee," including the most basic rights to minimum wage and overtime premium pay, health and safety protections, job-protected family and medical leave, anti-discrimination laws, and the right to bargain collectively and join a union. Workers also lose out on safety-net benefits like unemployment insurance, workers compensation, and Social Security and Medicare.
- Misclassifying employers stand to save upwards of 30 percent of their payroll costs, including employer-side FICA and FUTA tax obligations, workers compensation and State taxes paid for "employees."
- Businesses that 1099 and pay off-the-books can underbid competitors in labor-intensive sectors like construction and building services, and this creates an unfair marketplace.

The U.S. Government Accountability Office (GAO) concluded in its July 2006 report, "employers have economic incentives to misclassify employees as independent contractors because employers are not obligated to make certain financial expenditures for independent contractors that they make for employees, such as paying certain taxes (Social Security, Medicare, and unemployment taxes), providing workers' compensation insurance, paying minimum wage and overtime wages, or including independent contractors in employee benefit plans."[2]

Most workers in labor-intensive and low-paying jobs are not operating a business of their own. As the U.S. Department of Labor's Commission on the Future of Worker-Management Relations (the "Dunlop Commission") concluded, "[t]he law should confer independent contractor status only on those for whom it is appropriate—entrepreneurs who bear the risk of loss, serve multiple clients, hold themselves out to the public as an independent business, and so forth. The law should not provide incentives for misclassification of employees as independent contractors, which costs Federal and State treasuries large sums in uncollected social security, unemployment, personal income, and other taxes."[3]

A. Misclassification is Found in Nearly Every Low-Wage Job Sector

Calling employees "independent contractors" is a broad problem and affects a wide range of jobs. It could be happening to someone you know. A 2000 study commissioned by the U.S. Department of Labor found that up to 30 percent of firms misclassify their employees as independent contractors.[4] Many States have studied

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[1] *See, Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 43.

[2] *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 25.

[3] U.S. DEP'T OF LABOR, Commission on the Future of Worker-Management Relations, (1995), *available at http://www.dol.gov/__sec/media/reports/dunlop/dunlop.htm#Table.*

[4] Lalith de Silva *et al.*, "Independent Contractors: Prevalence and Implications for Unemployment Insurance Program" i–iv, *prepared for* U.S. Department of Labor, Employment and Training Division by Planmatics, Inc. (Feb. 2000), *available at http://wdr.doleta.gov/owsdrr/00-5/00-5.pdf.*

the problem and find high rates of misclassification, especially in construction, where as many as 4 in 10 construction workers were found to be misclassified.[5]

Most government-commissioned studies do not capture the so-called "underground economy," where workers are paid off-the-books, sometimes in cash. These workers are *de facto* misclassified independent contractors, because the employers do not withhold and report taxes or comply with other basic workplace rules. Many of these jobs are filled by immigrant and lower-wage workers.[6]

In my practice, I have met workers who were misclassified. Here are a couple of examples:

• Faty Ansoumana, an immigrant from Senegal, worked as a delivery worker at a Gristede's grocery store in midtown Manhattan. He worked as many as 7 days a week, 10–12 hours a day and his weekly salary averaged only $90. He and his fellow delivery workers, who had similar pay and hours, were all hired through two middlemen labor agents, who in turn stationed the workers at grocery and pharmacy chain stores throughout the city. The workers all reported directly to the stores and provided deliveries pursuant to the stores' set delivery hours and under the stores' supervision. Many delivery workers were required to bag groceries and to do other non-delivery work, including stocking shelves. When NELP challenged the abysmally low pay, the stores said the workers were not their employees, and the labor brokers said the deliverymen were independent contractors.[7] We were able to recover $6 million for the over 1,000 workers in the lawsuit, but only after overcoming the stores' claims that they were not responsible.

• Janitors from Central and South America and Korea were recruited by a large building services cleaning company, Coverall, Inc., to clean office buildings in MA and other States. The janitors were "sold" franchise agreements for tens of thousands of dollars, permitting them to clean certain offices assigned by Coverall. The janitors were told where to clean, what materials to use, and were not permitted to set their own prices for the cleaning services. When one janitor quit when she couldn't make ends meet, she applied for unemployment benefits in MA and was told she was an "independent contractor" and not eligible. She challenged that decision and Massachusetts' Supreme Judicial Court ruled in her favor. NELP wrote an *amicus* brief in Coverall and provided assistance.[8]

• Home health care workers in Pennsylvania were hired as employees by a home health care agency to place them in individual homes, where they cared for elderly and disabled people. The employees were not paid overtime or for their time spent traveling from household to household during their workdays, and they brought a lawsuit with NELP's help to claim their unpaid wages. Several months after the lawsuit was filed, the home care agency told each of these employees that they had to sign an agreement calling them "independent contractors" if they wanted to keep their jobs. Nearly all of the workers did so to keep their jobs, even though none of the other aspects of their job conditions, pay, or assignment and direction changed, and none was running an independent business.[9] Independent contractor misclassification occurs with an alarming frequency in: construction,[10] day labor,[11] janitorial

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[5] *See* Fiscal Policy Institute, "New York State Workers Compensation: How Big is the Shortfall?" (January 2007); Michael Kelsay, James Sturgeon, Kelly Pinkham, "The Economic Costs of Employee Misclassification in the State of Illinois" (Dept of Economics: University of Missouri–Kansas City: December 2006); Peter Fisher *et al.*, "Nonstandard Jobs, Substandard Benefits," Iowa Policy Project (July 2005); Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health: December 2004);" State of New Jersey, Commission of Investigation, "Contract Labor: The Making of an Underground Economy" (September 1997).

[6] Francois Carre, J.W. McCormack, "The Social and Economic Cost of Employee Misclassification in Construction (Labor and Worklife Program, Harvard Law School and Harvard School of Public Health:" December 2004), at p. 8.

[7] *Ansoumana et al.* v. *Gristedes et al.*, 255 F.Supp.2d 184 (S.D.N.Y. 2003).

[8] *Coverall North America, Inc.* vs. *Commissioner of the Division of Unemployment Assistance*, SJC–09682, 447 Mass. 852 (2006).

[9] *Lee's Industries, Inc. and Lee's Home Health Services, Inc. and Bernice Brown*, Case No. 4–CA–36904 (Decision by National Labor Relations Board Division of Judges), 2/25/10.

[10] Christian Livermore, *State Fines Hospital Subcontractor in Pay Scheme*, Times Herald-Record, June 10, 2010, *http://www.recordonline.com/apps/pbcs.dll/article?AID=/20100610/BIZ/6100321/-1/NEWS*; Francois Carre, J.W. McCormack, *et al.*, "The Social and Economic Cost of Employee Misclassification in Construction" 2, Labor & Worklife Program, Harvard Law School and Harvard School of Public Health, Dec. 2004, *available at http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Work__Misclass__Stud__1.pdf.*

[11] Abel Valenzuela and Nik Theodore, *On the Corner: Day Labor in the United States* (January 2006).

and building services,[12] home health care,[13] child care,[14] agriculture,[15] poultry and meat processing.[16]

We find the same misclassifications in high-tech,[17] delivery,[18] trucking,[19] home-based work,[20] and the public[21] sectors. These are the sectors that should be targeted by any enforcement efforts.

II. WHAT IS THE IMPACT ON WORKERS AND THEIR FAMILIES?

Just because an employer calls a worker an "independent contractor" does not make it legally true. But, these labels carry some punch and deter workers from claiming rights under workplace laws that rely on individual complaints for enforcement.[22] Because misclassified independent contractors face substantial barriers to protection under labor and employment rules, workers and their families suffer. The same occupations with high rates of independent contractor misclassification are among the jobs with the highest numbers of workplace violations.[23] The result is, our "growth-sector" jobs are not bringing people out of poverty and workers across the socio-economic spectrum are impacted.

Workers could lose out on: (1) minimum wage and overtime rules; (2) the right to a safe and healthy workplace and workers' compensation coverage if injured on the job; (3) protections against sex harassment and discrimination; (4) unemployment insurance if they are separated from work and other "safety net" benefits; (5) any paid sick, vacation, health benefits or pensions provided to "employees;" (6) the right to organize a union and to bargain collectively for better working conditions, and (7) Social Security and Medicaid payments credited to employee's accounts.

III. WHAT IS THE IMPACT ON FEDERAL AND STATE GOVERNMENT RECEIPTS?

Federal and State governments suffer hefty loss of revenues due to independent contractor misclassification, in the form of unpaid and uncollectible income taxes, payroll taxes, and unemployment insurance and workers' compensation premiums.

Federal Losses

A 1994 study by Coopers and Lybrand estimated the Federal Government would lose $3.3 billion in revenues in 1996 due to independent contractor misclassification, and $34.7 billion in the period from 1996 to 2004.[24]

A 2000 study commissioned by the U.S. DOL found that between 10 percent and 30 percent of audited employers misclassified workers.[25] Misclassification of this magnitude exacts an enormous toll: researchers found that misclassifying just 1 percent of workers as independent contractors would cost unemployment insurance (UI) trust funds $198 million annually.

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[12] *See Coverall North America, Inc.* vs. *Commissioner of the Division of Unemployment Assistance*, SJC–09682, 447 Mass. 852 (2006); *Vega* v. *Contract Cleaning Maintenance*, 10 Wage & Hour Cases 2d (BNA) 274 (N.D. IL 2004).

[13] *See Bonnette* v. *Cal. Health & Welfare Agcy.*, 704 F.2d 1465 (9th Cir. 1983).

[14] *See, e.g.*, IL Executive Order conferring bargaining status on child day care workers otherwise called independent contractors: *http://www.gov.il.gov./gov/execorder.cfm?eorder=34*.

[15] *Sec'y of Labor* v. *Lauritzen*, 835 F.2d 1529 (7th Cir. 1988).

[16] *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 30.

[17] *Vizcaino* v. *Microsoft Corp.*, 97 F.3d 1187 (9th Cir. 1996).

[18] *Ansoumana et al.* v. *Gristedes et al.*, 255 F.Supp.2d 184 (S.D.N.Y. 2003).

[19] Steven Greenhouse, The *New York Times*, *Clearing the Air at American Ports*, *http://www.nytimes.com/2010/02/26/business/26ports.html*.

[20] *Employment Arrangements: Improved Outreach Could Help Ensure Proper Worker Classification*, GAO–06–656 (July 2006), at p. 31.

[21] Phillip Mattera, "Your Tax Dollars at Work . . . Offshore," Good Jobs First (July 2004) *http://www.goodjobsfirst.org/publications/Offshoring_release.cfm*.

[22] The vast majority of DOL's Wage & Hour Division's (WHD) enforcement actions are triggered by worker complaints. *See, e.g.* U.S. Gov't. Accountability Office, GAO–08–962T, *Better Use of Available Resources and Consistent Reporting Could Improve Compliance 7* (July 15, 2008) (72 percent of WHD's enforcement actions from 1997–2007 were initiated in response to complaints from workers); David Weil & Amanda Pyles, *Why Complain? Complaints, Compliance, and the Problem of Enforcement in the U.S. Workplace*, 27 Comp. Lab. L. & Pol'y J. 59, 59–60 (2005) (finding that in 2004, complaint-derived inspections constituted about 78 percent of all inspections undertaken by WHD.)

[23] *See,* National Employment Law Project, *Holding the Wage Floor*, *http://nelp.3cdn.net/95b39fc0a12a8d8a34_iwm6bhbv2.pdf*.

[24] Coopers & Lybrand, Projection of the Loss in Federal Tax Revenues Due to Misclassification of Workers. Prepared for the Coalition for Fair Worker Classification (1994).

[25] Planmatics, Inc., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs* (February 2000).

A 2009 report by the Government Accountability Office (GAO) estimated independent contractor misclassification cost Federal revenues $2.72 billion in 2006.[26] The GAO's estimate was derived from data reported by the IRS in 1984, finding that 15 percent of employers misclassified 3.4 million workers at a cost of $1.6 billion (in 1984 dollars).

According to a 2009 report by the Treasury Inspector General for Tax Administration,[27] the IRS's most recent estimates of the cost of misclassification are a $54 billion underreporting of employment tax, and losses of $15 billion in unpaid FICA taxes and UI taxes.[28] The $15 billion estimate is based on 1984 data that has not been updated. The report explained,

> "Preliminary analysis of Fiscal Year 2006 operational and program data found that underreporting attributable to misclassified workers is likely to be markedly higher than the $1.6 billion estimate from 1984."

State Losses

A growing number of States have been calling attention to independent contractor abuses by creating inter-agency task forces and committees to study the magnitude of the problem. Along with academic studies and other policy research, the reports document the prevalence of the problem and the attendant losses of millions of dollars to State workers' compensation, unemployment insurance, and income tax revenues.

A review of the findings from the 20-State studies of independent contractor misclassification demonstrates the staggering scope of misclassification, the difficulties in reaching precise counts of workers affected and funds lost, and the potential for enforcement initiatives to return much-needed funds to State coffers.[29]

• **States are losing hundreds of millions of dollars.** Audits conducted by California's Employment Development Department between 2005 and 2007 recovered a total of $111,956,556 in payroll tax assessments, $18,537,894 in labor code citations, and $40,348,667 in assessments on employment tax fraud cases.[30] Each year, Connecticut's State income tax receipts were reduced by $65 million; the workers' compensation system lost $57 million in unpaid premiums; and the unemployment insurance fund lost $17 million.[31] In Illinois, a 2006 study estimated that independent contractor misclassification resulted in a loss of $39.2 million in unemployment insurance taxes, and between $124.7 million and $207.8 million in State income taxes each year from 2001 to 2005.[32] From 1999 to 2002, 11 percent of all Maine employers and 14 percent of construction employers misclassified their workers, resulting in an annual average loss of $314,000 in unemployment compensation taxes, $6.5 million in workers compensation premiums, between $2.6 million and $4.3 million in State income taxes, and $10.3 million in FICA taxes from construction alone.[33] A recent study of the Massachusetts construction industry found that misclassification of employees resulted in annual losses of up to $278 million in uncollected income taxes, unemployment insurance taxes, and worker's compensation premiums.[34] A recent analysis of workers' compensation and unemployment com-

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[26] U.S. General Accounting Office, Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention (August 2009).

[27] **N/A.**

[28] Treasury Inspector General for Tax Administration, While Actions Have Been Taken to Address Worker Misclassification, and Agency-Wide Employment Tax Program and Better Data Are Needed (February 4, 2009).

[29] *See* NELP, *Independent Contractor Misclassification Imposes Huge Costs on Workers and Federal and State Treasuries*, *http://www.nelp.org/page/-/Justice/2010/IndependentContractorCosts.pdf?nocdn=1*. For an additional compendium of some State-based independent contractor studies, *see http://www.carpenters.org/EmployerPayrollFraud/studies_reports.aspx*.

[30] California Employment Development Department, Annual Report: Fraud Deterrence and Detection Activities, report to the California Legislature (June 2008).

[31] William T. Alpert, *Estimated 1992 Costs in Connecticut of the Misclassification of Employees*. Department of Economics, University of Connecticut (1992). The first annual report from the Joint Enforcement Commission on Worker Classification reported that the Labor Department reclassified 7,900 workers as employees, uncovered more than $53 million in wages and additional unemployment tax of $750,000, assessed over $2 million in additional tax, and collected $90,000 in civil penalties against violating employers. *State of Connecticut Joint Enforcement Commission on Worker Misclassification, Annual Report*, (February 2010).

[32] Michael P. Kelsay, *et al.*, *The Economic Costs of Employee Misclassification in the State of Illinois*. Department of Economics, University of Missouri-Kansas City. (2006).

[33] Francoise Carre 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).

[34] Francois Carre, J.W. McCormack, *et al*. "The Social and Economic Cost of Employee Misclassification in Construction" 2, Labor & Worklife Program, Harvard Law School and Har-

pensation data in New York State found that noncompliance with payroll tax laws means as many as 20 percent of workers' compensation premiums—$500 million to $1 billion—go unpaid each year.[35] A 2009 report by the Ohio attorney general found that the State lost between $12 million and $100 million in unemployment compensation payments, between $60 million and $510 million in workers compensation premiums and between $21 million and $248 million in foregone State incomes tax revenues.[36] Pennsylvania's unemployment trust fund lost over $200 million, and its workers compensation fund lost $81 million in 2008.[37]

• **Studies most likely underestimate the true scope of misclassification.** Many of the studies are based on unemployment insurance tax audits of employers registered with the State's UI program. The audits seek to identify employers who misclassify workers, workers who are misclassified, and the resulting shortfall to the UI program. Researchers extrapolate from UI audit data to estimate the incidence of misclassification in the workforce and its impact on other social insurance programs and taxes. UI audits rarely identify employers who fail to report any worker payments to State authorities and workers paid completely off-the-books, where misclassification is generally understood to be even more prevalent.

• **Independent contractor misclassification rates are rising.** In California, for example, the number of unreported employees increased by an impressive 54 percent from 2005 to 2007. In Illinois, the rate of misclassification by violating employers increased by 21 percent from 2001 to 2005.[38] A recent report by the Ohio attorney general reported a 53.5 percent increase in the number of workers reclassified from 2008 to 2009.[39] A study of misclassification in Massachusetts's construction industry from 2001 to 2003 noted that both the prevalence of misclassification and the severity of the impact have worsened over the years.

IV. EMPA AND STATE MODELS FOR FEDERAL POLICY REFORMS

A. States Are Taking the Lead on Reforms

The problem is so pervasive that States have led the way in reforms[40]:

• Many States create a presumption of employee status so that workers providing labor or services for a fee are presumed to be "employees" covered by labor and employment laws. This is already law in over 10 States' workers' compensation acts.[41] Several States with recently enacted construction industry-specific laws[42] and in Massachusetts' wage act.[43]

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vard School of Public Health, Dec. 2004, *available at http://www.faircontracting.org/NAFCnewsite/prevailingwage/pdf/Work_Misclass_Stud_1.pdf.*

[35] *New York State Workers' Compensation: How Big Is the Coverage Shortfall?*, (New York: Fiscal Policy Institute, Jan. 2007). A 2007 study issued by the Cornell University School of Industrial and Labor Relations estimated annual misclassification rates of about 10.3 percent in the State's private sector and approximately 14.9 percent in the construction industry. Average UI taxable wages underreported due to misclassification each year was $4,238,663, and UI tax underreported was $175,674,161. 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 (Feb. 2007).

[36] Richard Cordray, Ohio attorney general, Misclassification of Employees as Independent Contractors (May 11, 2010).

[37] Testimony of Patrick T. Beaty, Deputy Secretary for Unemployment Compensation Programs, Pennsylvania Department of Labor and Industry, before the House of Representatives Commonwealth of Pennsylvania, Labor Relations Committee on HB 2400, The Employee Misclassification Prevention Act (April 23, 2008).

[38] Michael P. Kelsay, *et al.*, *The Economic Costs of Employee Misclassification in the State of Illinois.* Department of Economics, University of Missouri-Kansas City. (2006).

[39] Richard Cordray, Ohio attorney general, Misclassification of Employees as Independent Contractors (May 11, 2010).

[40] Each year, NELP summarizes the leading State legislative and executive independent contractor reforms. For the 2009 sessions, *See*, NELP, *Summary of Independent Contractor Reforms: New State Activity* (June 2009), and previous round-ups cited therein, available at: *http://www.nelp.org/page/-/Justice/SummaryIndependentContractorReformsJuly2009.pdf.*

[41] See definition of "worker" in the WA State workers' compensation act as an example: *http://apps.leg.wa.gov/RCW/default.aspx?cite=51.08.180.* At least 10 States (AZ, CA, CO, CT, DE, HI, NH, ND, WI, WA) have a general presumption of employee status in their workers' compensation acts (regardless of what job the injured worker has).

[42] IL, MD, DE. *See, e.g.,* Illinois HB 1795, creates a presumption of employee status in construction across several IL State labor and employment laws. An employer may overcome the presumption of employee status by showing an "ABC–Plus" test: (a) the individual is free from control or direction over performance of the work, both under the contract and in fact; (b) the service is outside the usual course of business for which the service is performed, and (c) the individual is customarily engaged in an independently established trade, occupation or business, or (d) the individual is deemed a legitimate sole proprietor or partnership. The law requires co-

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• Several States have created inter-agency task forces to share data and enforcement resources when targeting independent contractor abuses.[44]

• Others create "statutory employees" in certain industries (construction, trucking) where independent contractor schemes prevail.[45] Similarly, States have created job-specific protective laws that target persistent abuses to encourage compliance, regardless of the label (independent contractor or employee) attached to the worker. At least five States have farm labor contracting laws (CA, FL, IA, OR and WA).[46] Six States have laws that regulate day labor (AZ, FL, GA, IL, NM and TX).[47]

• Last year, State attorneys general in at least three States (MT, NJ, and NY) announced that they intended to file lawsuits against FedEx Ground Package System, Inc., alleging that the delivery company misclassified more than 1,000 truck drivers in the three States.[48]

B. The Employee Misclassification Prevention Act (EMPA)

The Employee Misclassification Prevention Act (EMPA) (S. 3254), introduced in the Senate by Senator Sherrod Brown this past April, would amend the FLSA to require employers to keep records of independent contractors engaged to work, provide notice to those workers of their status as an "employee" or "independent contractor," would require the U.S. DOL to create an "employee rights Web site," and would impose a penalty for employer misclassification.[49]

If enacted, the EMPA would be an important first step to encourage transparency in employment relationships. If workers know about their employment classification and the impacts of that status, they will be better prepared to report any violations. U.S. DOL will be better equipped to determine whether there is compliance if the employers maintain the basic records of their contractors. These are records employers would likely keep in any event when dealing with outside vendors and contractors, including payments and the labor that was the basis for those payments, including, in some cases, hours worked on the job.

These minimal requirements would help in misclassification cases, when workers are denied basic wage and hour protections; they would also help law-abiding employers playing by the rules who are undercut by misclassifying firms, and provide the information needed to recover much-needed tax and payroll revenues lost when workers are mistreated as independent contractors.

A complementary bill, the Taxpayer Responsibility, Accountability and Consistency Act of 2009 (S. 2882) was introduced by Senator Kerry late last year.[50] This bill would amend the Internal Revenue Code to modify the rules giving employers a "safe harbor" when they misclassify employees as independent contractors, and would permit the IRS to issue guidance on the subject. This bill is vital to serious reform seeking to combat independent contractor abuses.[51]

Much progress can be made to combat independent contractor misclassification by beefing up enforcement of existing labor and employment laws in those sectors where independent contractor abuses are most prevalent, and enhancing the Department of Labor (DOL)'s enforcement tools. EMPA would assist this effort by creating transparency for workers and employers.

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operation and data-sharing by the State departments of labor, employment security, revenue, and workers' compensation. *http://www.ilga.gov/legislation/fulltext.asp?GAID=9&SessionID=51&GA=95&DocTypeID=HB&DocNum=1795&LegID=30630&SpecSess=&Session*.

[43] *http://www.mass.gov/legis/laws/mgl/149-148b.htm*.

[44] *See*, NELP, *Summary of Independent Contractor Reforms: New State Activity* (June 2009), and documents cited therein, available at: *http://www.nelp.org/page/-/Justice/SummaryIndependentContractorReformsJuly2009.pdf*.

[45] *Id.*

[46] *See*, NELP, *Subcontracted Workers: The Outsourcing of Rights and Responsibilities* (March 2004). *http://nelp.3cdn.net/6c45e49f59c0266787_yxm6bnvfc.pdf*.

[47] ARIZ. REV. STAT. §23–551 et seq.; FLA STAT. ANN. § 448.20 et seq.; GA. CODE ANN. §34–10–1 et seq.; 820 ILL. COMP. STAT. 820/175 et seq.; N.M. STAT. ANN. 50-–15–1 et seq.; TEX. LAB. CODE ANN. §92.001 et seq.

[48] Reuters, *Three States may sue FedEx for labor violations, http://www.reuters.com/article/idUSTRE59J52520091020*.

[49] Rep. Lynn Woolsey introduced a companion bill in the House, H.R. 5107.

[50] *http://www.govtrack.us/congress/billtext.xpd?bill=s111-2882*.

[51] A major bar to effective enforcement against independent contractor abuses is the safe harbor provision in the Internal Revenue Code, at Section 530 of the Revenue Act of 1978, 26 U.S.C. §7436. Currently, employers decide whether their workers are employees or independent contractors with little scrutiny from the IRS and no consequences. Under current law, an employer who is found by the IRS to have misclassified its workers can have all employment tax obligations waived. Section 530 also prevents the IRS from requiring the employer to reclassify the workers as employees in the future. Among other factors, a business can rely on its belief that a significant segment of the industry treated workers as independent contractors, thereby perpetuating industry-wide noncompliance with the law.

In addition, the Obama administration's budget for 2011 seeks $25 million for the DOL's Misclassification Initiative to target misclassification with additional enforcement personnel and competitive grants to State unemployment insurance programs to address independent contractor abuse. The fiscal year 2011 Budget includes a joint Labor-Treasury initiative to strengthen and coordinate Federal and State efforts to enforce statutory prohibitions, identify, and deter misclassification of employees as independent contractors.[52] It should be supported.

The CHAIRMAN. Thank you, Ms. Ruckelshaus, for being here.

Now we will finish up with Mr. Uber.

STATEMENT OF GARY UBER, CO-FOUNDER, FAMILY PRIVATE CARE, HOBE SOUND, FL

Mr. UBER. Chairman Harkin, Ranking Member Enzi, and members of the committee, thank you for the opportunity to testify today on the topic of worker misclassification.

My name is Gary Uber and I am co-founder of Family Private Care, Inc., a licensed nurse registry operating in the State of Florida.

I am testifying today on behalf of the Private Care Association, Inc., which is a member of the Coalition to Preserve Independent Contractor Status.

As a threshold matter, I support the committee's interest in the proper classification of workers as employees or independent contractors. Our nurse registry has devoted substantial time and expense to developing systems designed to ensure that the independent contractors with whom it does business are properly classified.

I have serious concerns, however, about the possible effects of certain proposals aimed at ensuring proper classification such as S. 3254, the Employee Misclassification Prevention Act. My concern is that the intensified government efforts to identify misclassified workers and punish the firms that do business with them can result in firms such as mine deciding that the regulatory risks of doing business with independent contractors have become intolerable. If that were to occur, the millions of legitimate independent contractors who, like any other business, needs clients to survive will begin to close their businesses and start looking for employment. That is not a prospect that the caregivers with whom we do business would appreciate.

By way of background, I am a former Navy corpsman who obtained a masters degree in social work and became a hospital administrator. I left that job in 1998 to pursue my entrepreneurial passion and establish my own business, a nurse registry. I feel very fortunate that I had the opportunity at that time to leave my employment and become an entrepreneur. Every day I feel blessed that my nurse registry empowers caregivers to operate their own businesses.

Our registry does business with approximately 800 registered caregivers, all of whom operate as independent contractors. We also have an office staff of 45 employees. The caregivers who obtain client opportunities through our registry are principally certified nursing assistants and companions.

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[52] *http://www.dol.gov/dol/budget/2011/bib.htm*.

A registry operating in the State of Florida is licensed as a nurse registry. In Florida, there are approximately 345 licensed nurse registries, 2,356 licensed home health agencies which are providers of home care that operate with employee caregivers.

The demand for home care in Florida is robust, so both agencies and registries are always actively seeking caregivers. This means that caregivers have ample opportunity to choose whether they will work as employees or as independent contractors.

The principal function of a caregiver registry is to introduce consumers to caregivers who have passed a rigorous background screening, credential verification protocol, help a consumer find caregivers who meet the consumer's specifications, and provide administrative support for those relationships which generally includes reporting the amount of client fees a caregiver receives on an Internal Revenue Service form 1099.

Caregiver registries are a high-volume/low-margin business. We operate with hundreds and some even thousands of caregivers. The economic realities test used to determine whether an individual is an employee or independent contractor for purposes of the FLSA creates substantial uncertainty for registries because an important consideration under that test is the degree to which a caregiver is economically dependent on the registry. We need to rely heavily on representations made by a caregiver to ascertain whether the caregiver satisfies that requirement.

Under the bill, if DOL were to determine the caregivers under contract with the registry are employees of the registry, the registry would be exposed to a penalty of up to $1,100 per caregiver. In my case, that is $880,000 regardless of any violation of the minimum wage or overtime requirements. If the misclassification were determined to be repeated or willful, the maximum penalty would increase to $5,000 per caregiver, which for our registry would be $4 million.

Since our registry has been treating caregivers as independent contractors for 12 years, our registry could be determined to have repeatedly misclassified the caregivers which would expose it to high penalty. Operating a business under a potential liability of this magnitude is intolerable especially in light of the possibility of personal liability under the FLSA.

The bill also proposes a recordkeeping requirement for hours worked. A registry cannot require caregivers to comply with any specific guidelines for reporting their hours worked in order to avoid compromising the caregiver independent contractor status for other purposes and because they work for consumers, not for us. Consequently there would be no uniformity in the manner which caregivers could determine the number of hours worked.

Furthermore, for live-in cases, a caregiver's fee is generally determined as a fixed amount per day. So for these cases, the reporting of hours would serve no purpose other than to satisfy a new government mandate.

The anti-retaliation provision the bill proposes could have adverse consequences for our industry. As I mentioned, nurse registries commonly rely heavily on representations by caregivers as their being a legitimate independent contractor. If a caregiver were to provide false information in that regard, a registry might decide

to cease doing business with that caregiver because the caregiver honesty and integrity are extremely important in this industry. Caregivers provide their care in their clients' homes, including many hours while their clients are asleep. The bill would prohibit a registry from taking this action.

As I mentioned, I fully support the committee's interest in proper worker classification, but I believe current law is adequate for deterring any intentional misclassification. Under the FLSA, the prospect of liquidated damages plus attorney's fees is more than sufficient to discourage firms from knowingly engaging in such practices.

In my view, a better approach for encouraging proper worker classification would be to develop additional safe harbors that provide greater certainty for firms that operate in industries with significant numbers of independent contractors and to help educate individuals who seek to work as independent contractors on the actions they should take to properly establish themselves as independent contractors.

Thank you for the privilege to testify this morning. I would be pleased to answer any of your questions.

[The prepared statement of Mr. Uber follows:]

PREPARED STATEMENT OF GARY UBER

SUMMARY

It is submitted that the Fair Labor Standards Act (″FLSA″) in its current form provides a sufficient deterrent against worker misclassification. The prospect of liquidated damages plus attorneys' fees effectively discourages firms from knowingly engaging in such practices.

Certain proposals aimed at ensuring proper classification, such as S. 3254, the *Employee Misclassification Prevention Act*, would increase the financial risks associated with doing business with independent contractors to an intolerable level, which could result in companies ceasing to do business even with legitimate independent contractors. If that were to occur, the millions of *legitimate* independent contractors, who—like any other business—need clients to survive, would begin to close their businesses and start looking for employment.

Our principal concerns with S. 3254 are as follows:

6. The proposed penalties for misclassification would increase to an intolerable level the financial risks associated with doing business with independent contractors;

7. The proposed recordkeeping requirements are unworkable for a caregiver registry;

8. The proposed notice requirement would adversely affect the working relationship between an independent contractor and the contractor's clients;

9. The proposed anti-retaliation provision could reward unethical conduct; and

10. The bill overall appears premised on the false assumption that the decision whether an individual will work as an employee or independent contractor is made by a firm doing business with the individual, rather than by the individual.

The committee's interest in proper worker classification is a laudable one, but it should be certain that no action is taken that could eliminate economic opportunities for legitimate independent contractors.

It is submitted that an alternative approach for encouraging proper worker classification would be to develop additional safe harbors that provide greater certainty for firms that operate in industries with significant numbers of independent contractors, and to help educate individuals who seek to work as independent contractors on the actions they should take to properly establish themselves as independent contractors.

Chairman Harkin, Ranking Member Enzi and members of the committee, thank you for the opportunity to testify today on the topic of worker classification. My name is Gary Uber and I am a co-founder of Family Private Care, Inc. a licensed

nurse registry[1] operating in the State of Florida. I am testifying today on behalf of Private Care Association, Inc.,[2] which is a member of the Coalition to Preserve Independent Contractor Status.[3]

As a threshold matter, I support the committee's interest in the proper classification of workers as employees or independent contractors. Our nurse registry has devoted substantial time and expense to developing systems designed to ensure that the independent contractors with whom it does business are properly classified.

I have serious concerns, however, about the possible effects of certain proposals aimed at ensuring proper classification, such as S. 3254, the *Employee Misclassification Prevention Act*. My concerns are that the increasingly intensified government efforts to identify misclassified workers and punish the firms that do business with them can result in firms, such as mine, deciding that the regulatory risks of doing business with independent contractors have become intolerable. If that were to occur, the millions of legitimate independent contractors,[4] who—like any other business—need clients to survive, would begin to close their businesses and start looking for employment. In the home-care industry, that is not a prospect that the caregivers with whom we do business would welcome.

By way of background, I am a former military corpsman who obtained a masters degree in social work and became a hospital administrator. I left that job in 1998 to pursue my entrepreneurial passion and establish my own business, a nurse registry. I feel very fortunate that I had the opportunity at that time to leave my employment and become an entrepreneur. Every day, I feel blessed that my nurse registry empowers caregivers to operate their own business.

Our registry has been in business for 12 years; it does business with approximately 800 registered caregivers—all of whom operate as independent contractors. We also have an office staff of 45 employees. The caregivers who obtain client opportunities through our registry are principally certified nursing assistants and companions. Most of their clients are consumers. The consumers generally offer two types of opportunities, namely, (i) hourly opportunities, and (ii) live-in opportunities.

Florida began regulating registries in 1947.[5] Currently, a registry operating in the State of Florida is licensed as a "nurse registry."[6] In Florida, as of June 11, 2010, there were approximately 345 licensed nurse registries,[7] and 2,356 licensed home health agencies,[8] which are providers of home care that operate with employee caregivers. The demand for home care in Florida exceeds the number of caregivers available to meet that demand, so both agencies and registries are always actively seeking caregivers. This means that caregivers have ample opportunity to choose whether they will work as employees or as independent contractors.

A principal attraction for caregivers to work as independent contractors is that they can make more money as independent contractors, because they receive a much larger portion of a client payment than a caregiver who works as an employee of an agency. Also, caregivers have more control over when they work and for whom they work, since registries merely offer them client opportunities, and they alone decide which opportunities to pursue. It is industry practice for caregivers to register with multiple registries, so the opportunities available through our registry will sel-

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[1] Chapter 400 of the Florida Statutes Annotated ("FSA"), section 400.462(15), defines a *nurse registry* as:

Any person that procures, offers, promises, or attempts to secure health-care-related contracts for registered nurses, licensed practical nurses, certified nursing assistants, home health aides, companions, or homemakers, *who are compensated by fees as independent contractors*, including, but not limited to, contracts for the provision of services to patients and contracts to provide private duty or staffing services to health care facilities licensed under chapter 395 or this chapter or other business entities. (Emphasis added).

[2] *www.privatecare.org.* The Private Care Association, Inc. is a national association representing caregiver registries. Caregiver registries (i) provide background-screening and credential-verification services for independent-contractor caregivers, and (ii) assist such caregivers in finding client opportunities. Many registries also provide administrative support for the care relationships they facilitate.

[3] *www.iccoalition.org.*

[4] *See, e.g.,* Bureau of Labor Statistics News Release *The Employment Situation—May 2010*, Table A–8 *Employed persons by class of worker and part-time status*, USDL–10–0748 (June 4, 2010), reporting 8.952 million self-employed workers during May 2010, and 8.910 million in April 2010. It is submitted that a material number of these individuals are legitimate independent contractors.

[5] *See, Repeal of Nurse Registry Regulation?*, Staff of Florida House of Representatives, Committee on Health Care Licensing and Regulation, at p. 5 (October, 1999).

[6] *See, above,* note 1.

[7] *See, http://ahca.myflorida.com/MCHQ/Long__*Term__Care/FDAU/docs/SummaryAllActive.pdf.

[8] Id.

dom if ever represent the totality of the opportunities from which a caregiver can choose. Once a caregiver and a client agree to work together, they are the only parties that can terminate the care relationship; a nurse registry has no right to interfere with or to terminate a care relationship. Under the registry model, caregivers work for their clients and they are paid by their clients, albeit commonly through an escrow account that a registry maintains to facilitate the delivery of a client's payment.

The principal functions of a caregiver registry are to introduce consumers to caregivers who have passed a rigorous background-screening and credential-verification protocol, help a consumer find caregivers who meet the consumer's specifications, and provide administrative support for those care relationships, which generally includes reporting the amount of client fees a caregiver receives on an Internal Revenue Service Form 1099.[9]

Caregivers who obtain client referrals through our registry generally are exempt from the overtime and minimum-wage requirements imposed by the Fair Labor Standards Act (the "FLSA"), because they are covered by the FLSA's companionship exemption[10] when they perform services at a care recipient's private home.

As mentioned, I have concerns with S. 3254, the *Employee Misclassification Prevention Act*. My principal concerns are as follows:

1. The proposed penalties for misclassification would increase to an intolerable level the financial risks associated with doing business with independent contractors;
2. The proposed recordkeeping requirements are unworkable for a caregiver registry;
3. The proposed notice requirement would adversely affect the working relationship between an independent contractor and the contractor's clients;
4. The proposed anti-retaliation provision could reward unethical conduct; and
5. The bill overall appears premised on the false assumption that the decision whether an individual will work as an employee or independent contractor is made by a firm doing business with the individual, rather than by the individual.

I. THE PROPOSED PENALTIES FOR MISCLASSIFICATION WOULD INCREASE TO AN INTOLERABLE LEVEL THE FINANCIAL RISKS ASSOCIATED WITH DOING BUSINESS WITH INDEPENDENT CONTRACTORS

Caregiver registries are a high-volume, low margin business; we operate with hundreds, and some even thousands, of caregivers. The *economic realities* test used to determine whether an individual is an employee or independent contractor for purposes of the FLSA[11] creates substantial uncertainty for registries, because an important consideration under that test is the degree to which a caregiver is economically dependent on a registry. Registries commonly do not know that answer, and need to rely on the representations caregivers make to us about their other clients, but those representations are not always reliable.

Under current law, the FLSA risk is manageable for registries, because the companionship exemption exempts caregivers from its overtime and minimum-wage mandates, so long as the exemption requirements are satisfied. Under the bill, if caregivers under contract with a registry were determined to be employees of the registry, the registry would be exposed to a penalty of up to $1,100 per caregiver, in my case, $880,000 (800 caregivers x $1,100)—regardless of any violation of the minimum-wage or overtime requirements.

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[9] Internal Revenue Service data indicate that the compliance rate for recipients of Forms 1099 is 97 percent. *E.g., TAX COMPLIANCE Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches*, GAO–06–1000T, at 11 (July 26, 2006) GAO, *Tax Gap: Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions*, GAO–06–453T, at 17, (Feb. 15, 2006); GAO, *Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability but Will Require a Variety of Strategies*, GAO–05–527T, at 18 (Apr. 14, 2005).

[10] 29 U.S.C. §213(a)(15).

[11] The U.S. Court of Appeals for the Fifth Circuit recently explained the economic realities test in *Cromwell* v. *Driftwood Elec. Contrs., Inc.*, 348 Fed. Appx. 57, 59 (5th Cir. 2009):

To determine if a worker qualifies as an employee under the FLSA, we focus on whether, as a matter of economic reality, the worker is economically dependent upon the alleged employer or is instead in business for himself. *Hopkins* v. *Cornerstone Am.*, 545 F.3d 338, 343 (5th Cir. 2008). To aid in that inquiry, we consider five non-exhaustive factors: (1) the degree of control exercised by the alleged employer; (2) the extent of the relative investments of the worker and the alleged employer; (3) the degree to which the worker's opportunity for profit or loss is determined by the alleged employer; (4) the skill and initiative required in performing the job; and (5) the permanency of the relationship. *Id.* No single factor is determinative.

If the misclassification were determined to be *repeated* or *willful*, the maximum penalty would increase to $5,000 per caregiver, which for our registry would be $4,000,000. Since our registry has been treating caregivers as independent contractors for 12 years, our registry might be determined to have *repeatedly* misclassified caregivers, which would expose it to the higher penalty. Operating a business under a potential liability of this magnitude is intolerable, especially in light of the possibility of personal liability under the FLSA.[12]

If nurse registries no longer existed, caregivers and consumers would both suffer. Caregivers would be left principally with two options, namely, working as an employee at a facility or as an employee of an employee-based agency. Their only other option would be to work for consumers directly, which would leave the consumers vulnerable because the critical background-screening and credential-verification that registries provide would be missing. Consumers would need to fend for themselves in that regard.

While one might suggest another possible option: that a registry simply ensure that caregivers are paid overtime; that is not feasible for caregiver registries, because a caregiver's fee is determined and paid by the consumer, not the registry. A registry has no right to compel a consumer to pay overtime.

Also, I have found that for most cases there is a finite amount of funds available to pay for home care. For consumers whose home care is paid for with a long-term care insurance policy, these policies typically pay a *capitated* fixed amount per day or per week. For consumers who pay for home care with private funds, they, too, typically operate on a fixed budget. Government programs, such as Medicaid, already are stretched, and under the recently enacted *Patient Protection and Affordable Care Act of 2010*, Medicaid programs will soon begin covering an estimated 16 million additional new participants,[13] some of whom will likely need home care.

Since the option of simply ensuring that caregivers are paid overtime is not feasible for nurse registries, and the elimination of registries from the marketplace would harm not only the registry owners and their office staff but also the caregivers and consumers who currently rely on registries, the bill would have devastating consequences for the nurse-registry industry. Moreover, even outside our industry, for any firm that does business with a significant number of independent contractors, the excessive penalties the bill proposes would cause such a firm to thoughtfully consider whether prudent judgment would permit it to continue those relationships. If firms were to decide to discontinue doing business with independent contractors, the unfortunate victims would be the millions of legitimate independent contractors who find it increasingly difficult to maintain their business, as their potential client base diminishes. I respectfully submit that the confiscatory penalties the bill proposes for worker misclassification are inadvisable.

II. THE PROPOSED RECORDKEEPING REQUIREMENTS ARE UNWORKABLE FOR A CAREGIVER REGISTRY

The bill also proposes a recordkeeping requirement for hours worked. Because our caregiver registry does business only with independent-contractor caregivers, we are not familiar with the detailed and complex U.S. Department of Labor ("DOL") regulations that govern the determination of compensable hours worked.

Equally important, a caregiver registry cannot require caregivers to comply with any specific guidelines for reporting their hours worked, in order to avoid compromising the caregivers' independent-contractor status for other purposes, and because they work for consumers, not for us. Consequently, the number of hours worked that caregivers would report would be determined exclusively by the caregivers and/or their clients; there would be no uniformity in the manner by which such hours are determined.

Furthermore, for live-in cases, which generally pay a fixed amount per day, caregivers likely would report as hours worked all hours they spend at a consumer's home. A likely outcome of this exercise would be for a caregiver to overestimate the number of compensable hours worked while on a live-in case, and become dissatisfied with the daily rate that a consumer pays for such work. While the dissatisfaction likely could be resolved after ascertaining the truly compensable hours worked, a government policy that creates this type of conflict seems counterproductive. Furthermore, because for these live-in cases a caregiver's fee is generally determined

[12] *E.g., Lambert* v. *Ackerley*, 180 F.3d 997, 1011–12 (9th Cir. 1999); *Chao* v. *Hotel Oasis, Inc.* 493 F.3d 26 (1st Cir. 2007).

[13] Congressional Budget Office, Cost estimate to Speaker Nancy Pelosi, U.S. House of Representatives, Washington DC (March 20, 2010).

as a fixed amount per day, the reporting of hours would serve no purpose other than to satisfy a new government mandate.

For the reasons mentioned, the proposed requirement that firms maintain records of hours worked by independent contractors is inappropriate for independent contractors who perform services pursuant to fee arrangements that are *not* based on an hourly rate, and it is unworkable for the nurse registry industry.

III. THE PROPOSED NOTICE REQUIREMENT WOULD ADVERSELY AFFECT THE WORKING RELATIONSHIP BETWEEN AN INDEPENDENT CONTRACTOR AND THE CONTRACTOR'S CLIENTS

The content of the proposed notice requirement suggests that a caregiver's decision to work as an independent contractor is actually being made by the nurse registry, and is highly suggestive that such decision is probably not in the caregiver's best interests. The proposed notice would "inform the individual of the individual's classification," would direct the individual to a DOL Web site containing information "about the rights of employees under the law," and advise the individual that his or her "rights to wage, hour and other labor protections depend on [the individual's] proper classification as an employee or non-employee." Such information injects an element of adversity into the relationship between a caregiver and a nurse registry, and encourages a caregiver to seek assistance from the Government to protect his or her interests.

For home care, this type of notice is counterproductive. As mentioned, in Florida, the demand for caregivers exceeds the supply, and there are far more employee-based agencies than there are registries. Caregivers register with a nurse registry only after they have made the affirmative decision to work as independent contractors. A caregiver's independent-contractor status is not something that a registry imposes on the caregiver.

Furthermore, caregivers commonly register with multiple nurse registries. The bill would require that each time a caregiver registers with another nurse registry, the registry would need to provide the caregiver with another notice.

At best, the net result of this proposal would be to impose yet another paperwork burden on businesses that increases their cost of operations, with little discernable benefit. At worst, a likely effect of a notice such as that proposed would be to increase the probability of some type of lawsuit being filed against a nurse registry in the event a registry ever decides to cease doing business with a particular caregiver or is unable to offer a caregiver the volume of client referrals that the caregiver is seeking.

IV. THE PROPOSED ANTI-RETALIATION PROVISION COULD REWARD UNETHICAL CONDUCT

The anti-retaliation provisions the bill proposes could have adverse consequences for nurse registries. As noted, nurse registries commonly rely heavily on representations by caregivers as to their being a legitimate independent contractor. If a caregiver were to provide false information in that regard, a registry might decide to cease doing business with the caregiver, because caregiver honesty and integrity are extremely important in this industry. Caregivers provide their care in their clients' homes, including many hours while their client is asleep.

The bill's anti-retaliation provisions would prohibit a registry from severing its relationship with a caregiver who provided false information about the caregiver's professed independent-contractor status and, as a result, was determined to be an employee of the registry for purposes of the FLSA or Federal employment taxes.

At a minimum, I would urge that the anti-retaliation provision be qualified so it would apply only to the extent that an individual did not provide any false information that the company relied upon when engaging the individual as an independent contractor.

Another potential problem the anti-retaliation provision would create is that it would increase the litigation risks associated with severing a relationship with any caregiver who opposes any practice, files a complaint or institutes a proceeding concerning an individual's status for purposes of the FLSA or Federal employment tax purposes. Such a caregiver could always allege that the relationship was severed in retaliation for such actions. While anti-retaliation provisions are not uncommon for employment relationships, this represents an unprecedented expansion of this concept to independent contractors. Because of the litigation risks it would create for even *bona fide* independent-contractor relationships, I respectfully urge that such a provision not be enacted.

V. THE BILL OVERALL APPEARS PREMISED ON THE FALSE ASSUMPTION THAT THE DECISION WHETHER AN INDIVIDUAL WILL WORK AS AN EMPLOYEE OR INDEPENDENT CONTRACTOR IS MADE BY A FIRM DOING BUSINESS WITH THE INDIVIDUAL, RATHER THAN BY THE INDIVIDUAL

Finally, the bill appears premised on the false assumption that the decision whether a caregiver will work as an employee or independent contractor is being made by a registry, rather than the caregiver. The bill would punish a firm for doing business with an individual as an independent contractor if the individual were determined not to be an independent contractor. In an industry such as ours, we offer our services only to self-employed caregivers. We do our best to ensure that any caregiver who applies for registration actually is an independent contractor.

We necessarily need to rely heavily on what a caregiver tells us. If a caregiver provides a registry with materially false information, which results in the caregiver not qualifying as an independent contractor, the bill would still penalize only the registry; the caregiver would be unaffected. Worse still, the registry would be prohibited from severing its relationship with that caregiver.

In my view, consideration should be given to developing some type of statutory protection for firms that reasonably rely on representations made to them by individuals who represent themselves as being self-employed, and such firms should not be prohibited from severing their relationship with an individual who provides the firm with materially false information and is determined to have been misclassified.

VI. CONCLUSION

As noted, I fully support the committee's interest in proper worker classification. I fear, however, that an approach to this issue that subjects firms that do business with independent contractors to the prospect of excessive financial penalties in the event of misclassification can have the unfortunate effect of reducing opportunities for legitimate independent contractors. Especially in today's economic climate, but even when our economy is strong, a government policy that has the effect of limiting economic opportunities for individuals is inadvisable.

The effects of the bill would not be limited to firms that do business with independent contractors. They and the independent contractors would certainly be directly affected, but other firms and the larger economy would be indirectly affected. In home care, the employee-based firms would benefit, as they would be able to pay caregivers less and charge consumers more, because the competitive effect of nurse registries that keep client fees low and caregiver fees high would be eliminated. Of course, consumers and caregivers would suffer. Outside of home care, firms that currently do business with independent contractors would likely pass through to their customers, in the form of higher prices, the higher operating costs they would incur due to their inability to continue outsourcing projects to independent-contractor specialists to achieve high efficiency.

In my view, a better approach for encouraging proper worker classification would be to develop additional safe harbors that provide greater certainty for firms that operate in industries with significant numbers of independent contractors, and to help educate individuals who seek to work as independent contractors on the actions they should take to properly establish themselves as independent contractors.

I believe current law is adequate for deterring companies from intentionally misclassifying workers as independent contractors. Under the FLSA, the prospect of liquidated damages plus attorneys' fees is more than sufficient to discourage firms from knowingly engaging in such practices.

Thank you for the privilege to testify this morning. I would be pleased to answer any questions you might have.

The CHAIRMAN. Thank you very much, Mr. Uber, for being here and for your testimony.

We will start a round of 5-minute questions.

Ms. Gardner, I know that New York, like many other State governments, is facing significant fiscal challenges. The core safety net programs, like unemployment insurance, have been especially strained by the combined effect of tighter budgets and greater demand for services.

Does the current prevalence of misclassification contribute to this dilemma, and how have your efforts in New York helped to address this problem?

Ms. GARDNER. Absolutely. I mean, we have seen less money coming into our unemployment insurance trust funds. We have situations where employers are not paying taxes. Our State budget—we are still trying to work on it right now. We are at a $9 billion deficit, and the fact that employers are paying people off the books or incorrectly classifying workers as independent contractors means less State money revenues are coming in. And given the fact that it is a growing problem, I think the tools that we have right now are not working, and that is why we need additional tools.

The CHAIRMAN. Thank you.

Mr. Battaglino, again my compliments to you on your work and taking a small business and growing it. You are the kind of person I think of when I think of a successful small business, someone who started with nothing, built it up, has employees, has an honest, good record.

We have heard some concerns today that the bill that I sponsored with Senator Brown would impose too big a burden on businesses by requiring them to give notice to workers about their employment status and, in some circumstances, to keep track of hours and compensation. Now, I have had some discussions about that up here behind the dais but to me that seems like something employers should be doing already.

Do you as a business owner think that these recordkeeping requirements are unduly burdensome?

Mr. BATTAGLINO. No, sir. Up until a few years ago, probably 2 years ago, we used to do a lot more private work. And the private work does not take that much paperwork in one aspect, but then we got into doing more government work because of the economy. And so we had to start with doing all these certified payrolls for the Davis-Bacon laws and the first source laws in Washington, DC. I mean, it took a little extra, but it was not that burdensome on us. We did what we had to do to get the work.

Does it cost more? It is a very small cost. If you asked me what would I rather do, would I rather hire a person to do the extra work or would I rather pay 5 more percent taxes at the end of the year on my profit, I would hire the person and give them a job before I have to pay 5 more percent taxes in a year and give it to the Federal and State government and have them do what they want with it. OK?

So I kind of look at it that way. What is the less of two evils? And the paperwork is not that cumbersome. It just is not.

The CHAIRMAN. Mr. Battaglino, you may be too practical for us.

[Laughter.]

Mr. BATTAGLINO. Well, I probably am but that is how I look at things in my world. I started out real simple and I never thought that I would ever get—in 2008, I had 75 employees and because of the recession, I am down to 55 and probably out of the 55, I should be really down to 45, but these guys have been with me so long. Right now, this year has been the hardest. We are kind of eating through profits of last year. We are keeping enough work going to keep us above water. It is not the greatest, but we are not in the red.

The CHAIRMAN. But you have had experiences——

Mr. BATTAGLINO. I have been through three recessions. I have been through 1991. I have been through the 2000 and now this one. This one has been the worst, 1991 was easy. It was just me. It was me and my wife and that was it. And she never saw me because I was building my business, and then slowly I started adding people on. But as I started adding people on, I did all the right things. I got my compensation insurance and my liability insurance. It is just something that resonates with me because at the end of the day when I put my head on my pillow, I want to know that the people that work for me are taken care of and that if something happens to them, they are not going to come after me because I got plenty insurance to take care of them. That is how my parents brought me up and I firmly believe in that.

Senator Enzi, you may not agree with me on some things. We probably agree on a whole host of other things, but that is what I share and that is what I believe and that is why I am here today.

The CHAIRMAN. Well, I compliment you. To me that is what a small business person epitomizes.

Mr. BATTAGLINO. You know, there is another aspect that no one has talked about. Right now, I kind of want to be proactive because that is what we do in our company. We kind of look ahead so that if something happens, it is not going to cost us a boatload of money.

We are bringing up a generation of workers that are not necessarily covered under any kind of Social Security, any kind of retirement whatsoever. So in the next generation, if I have 10 million people now—in the construction industry, as we get older, we have to bring these new people in, and if we do not get in front of it now, we are going to bring these new people in and the dishonest people are going to try to make them misclassified workers. What is that going to do to us in 20–30 years when these 20-, 30-year-olds cannot work anymore? Their backs are broken. Their knees are shot. They got no Social Security because they never paid in. They got no 401(k). They got nothing. You know what is going to happen? It is called Medicaid and it is called welfare because when they get 60, there is nothing for them. I mean, most of these people are uneducated. They are disadvantaged workers and they are being taken advantage of.

So that has been an important part for me.

The CHAIRMAN. Mr. Battaglino, thank you very much. A very profound statement.

Senator Enzi.

Senator ENZI. Thank you, Mr. Chairman.

Mr. Battaglino, I really admire you for being in business. I have been there. I have been in both the shoe business and the accounting business. I know how tough it is. I know that a person really has not been in business unless they sit straight up in the middle of the night and say, "tomorrow is payroll, how am I going to meet payroll?"

Mr. BATTAGLINO. Been there.

Senator ENZI. Yes. That is small business and it happens more frequently than anybody who has dreams of starting a business may believe. I always hope that reality exceeds their dreams, but it does not always happen that way.

And I want to catch anybody that is doing these things that I consider to be completely illegal—completely illegal. I am just hoping that we can do it without putting a whole lot more burden on you and your business.

We already have a little situation—I do not know how you feel about it—in the health care law. Any company that conducts business that spends more than $600 with another business is now going to have to file a 1099 on it. So that is another little requirement. We just keep adding little requirements at a time, and pretty quickly they become back-breaking.

So I am hoping that we can get at the bad guys without hurting the good guys. As I see it, this law is going to affect both pretty drastically.

Ms. Ruckelshaus, on March 27, 2007, you appeared before a House committee on this very issue, and in response to a question from Representative Price about the 20-factor IRS independent contractor test and whether anything else could be done, you responded,

> "In my opinion, legislative action on the actual test is not necessary right now because the ways the laws are drafted, if they were enforced correctly and fully, we would not need any legislative changes."

In light of the extra $25 million in the President's budget and the new joint operations of the Department of Labor and Treasury enforcing this misclassification issue, have you changed your mind in support of S. 3254 today?

Ms. RUCKELSHAUS. I have changed my mind to the extent to which the EMPA permits the Department of Labor to collect penalties for recordkeeping violations. It also makes it a violation per se to misclassify somebody even if they are getting full overtime and full minimum wage. That was the problem with the previous Department of Labor's position, and in my opinion the current Department of Labor's position is they do not see it as a violation of their statutes, of any of their statutes if someone misclassifies a worker without any other labor and employment violations.

So I think I have because they are not enforcing the Fair Labor Standards Act the way I was reading it, which is, if you misclassify somebody as an independent contractor, typically there is another violation. So you should go ahead and enforce that statute.

Senator ENZI. Thank you.

Mr. Uber, you made some comments about the penalties, the new civil penalties of the $1,100 and then the $5,000 proposed under this bill. Could you kind of restate that for me again?

Mr. UBER. Certainly. The current laws that are on the books in our estimation are more than adequate to deter people from misclassifying workers. I actually would ask the Senators today why are we not doing a better job of enforcing the laws that are already on the books.

The other part of this that concerns me is there is a personal liability that I would be exposed to as a business owner, which means that the personal assets that I have could be exposed, which is creating an environment which would certainly cause me to ponder seriously about doing what I did 12 years ago, which is very

similar to my colleague. And we have 45 employees as well. So we have both employees and independent contractors.

We do everything in our power to do it right, and we are doing it right. And the fear is—and it has been expressed in this room many times already—coming after the good guys with this particular legislation. And that is a big concern to me.

Senator ENZI. It sounds like your business has a lot of competition in the States where you operate. It also sounds like independent contractors that you contract with also have a competitive choice. They can work for the State-licensed businesses like yours or they can work for the employment agencies.

Could you describe what would happen if the independent contractors that you contract with felt that you were causing them to violate the law?

Mr. UBER. Well, I think any additional elements that we place on the workforce, independent contractors, employees, it does not matter. But when you continue to put this pressure on them to function in an environment that is not well-defined—if you are trying to find out Department of Labor law and other issues as it pertains to independent contractors, you have to go to two different Federal areas. States have their own issues regarding these matters. So it is very complicated right now to even get the information you need to function properly.

So there are some things that I would prefer to see us do in the sense of bringing all these things together so that we can look at them. Independent contractors that come to us represent themselves as independent contractors. That is their job. And so we need a place that they can go to and easily get information on what it means to be an independent contractor, what the requirements are on that individual if they choose to be an independent contractor, and the same for firms such as mine that choose to use both employees and independent contractors.

Senator ENZI. Thank you. I thank all of you for your testimony, and I will have some more written questions that I hope you will respond to.

I also have some letters that I would like to be a part of the record.

The CHAIRMAN. Without objection, so ordered.

[The information referred to may be found in Additional Material.]

The CHAIRMAN. Senator Brown.

Senator BROWN. Thank you, Mr. Chair.

I want to make a unanimous consent request that the written testimony of the Messenger and Courier Association of America be submitted for the record of this hearing, if I could, Mr. Chair.

The CHAIRMAN. Without objection.

[The information referred to may be found in Additional Material.]

Senator BROWN. Thank you.

I will start with Ms. Gardner. Would you talk about the financial estimates, the estimates of tax revenue, what this will mean? The Obama administration has apparently said upwards of around $7 billion in revenue over 10 years. When we have looked at Massachusetts, Illinois, California, New York, Ohio, when we look at the

estimates that various government officials or others have made, it seems that estimate may be conservative. Could you comment on that?

Ms. GARDNER. Yes. Our own estimates have found that more than 10 percent of workers are misclassified in New York State probably because we have a high rate of off-the-books work. So then there are not any taxes paid in those instances. There is not any money paid into our unemployment insurance trust fund. There is no additional funds to our State revenues. So we think it clearly gives employers about a 30 percent advantage by not following through with their obligations to workers.

And in addition, we are finding a lot of instances where workers are not properly paid for overtime or not even paid the minimum wage. So it also takes money out of the hands of the economy. So it is costly to States.

Senator BROWN. Thank you, Ms. Gardner.

Mr. Battaglino, as Chairman Harkin said, people like you really are what this country is all about that started with little and have, obviously, run a very successful business and created a whole lot of middle class households in Maryland. So thank you for that.

She talked about a 30 percent advantage that an employer less honorable than you would have. Talk to me about what you have seen among other employers that you compete with on bids you make, on business you try to attract where you have seen this playing field that is far from level.

Mr. BATTAGLINO. OK. Let me start out with in the construction industry, because that is what we do, there is a lot of, I guess you could say, proponents between union and nonunion. Typically when things are good and there is plenty of work, especially in this town—this town has its boom times, and right now it is not very good. The difference between union and nonunion in the good times is 2 to 5 percent, very close. OK? It is not that significant. Generally you can negotiate the percentages out of your price if you want to get the job. But especially now in the bad times, we are seeing 30 percent differences, and we are looking at it saying, There is no way. I am bidding work and I am getting beat 20 percent below my cost.

Yesterday we were bidding a job and it came back to us, and the guy says, "look, this is where the number is at." And I am looking and I am discounting all my labor for using apprentices, using helpers, and he is still 20 percent below my costs. I say, there is no way. There is no way.

So I have to attribute some of it to this possibly. I mean, I do not know. I lose a job. I do not go out and hide behind columns and see how these people pay their people. I am not privy to that information. I could only suspect that the only way they could be getting that low is they are cheating. They are not paying their benefits. They are not paying their unemployment. They are not paying their compensation. I mean, there is no other way that you could pay a person a decent wage and still be that low and still be in business.

The Davis-Bacon—that kind of protects us a little because they cannot get away with it as much on government work, but on the private work, we cannot even touch it.

Senator BROWN. And you are just certain because in good times, the differential between union and nonunion is 2 to 5 percent.

Mr. BATTAGLINO. Two to five percent———

Senator BROWN. So you are certain this is not a union/nonunion issue.

Mr. BATTAGLINO. Oh, no. No, not at all. That is why I brought that up because I do not want people to say, "well, you are just a union contractor and you are just trying to fight for your life." No. That ain't it. No.

In good times, the difference is 2 to 5 percent. In good times we are sometimes lower than the nonunion guys. OK? So there is a disparity there that people have about union and nonunion.

What you got to look at is how these dishonest contractors are running their businesses. I cannot name names. There is a few of them that I have on my mind. I am not going to do it on a camera or anything.

[Laughter.]

But we have our suspicions, and actually they have kind of been caught on the Davis-Bacon stuff. So they chased them away from there because they were cheating on that.

Senator BROWN. But they are still doing private work.

Mr. BATTAGLINO. They are still doing private work and we cannot touch them.

Senator BROWN. Thank you, Mr. Battaglino.

Mr. BATTAGLINO. Battaglino.

Senator BROWN. Battaglino. Why can I not say that? Geez. All the Italians in my State.

You should know this that I sent a note to Senator Enzi who has told me this is the first example of two Italian Senators from the same State in American history, he and Senator Barrasso. And I sent a note that Mr. Battaglino should be the third Italian Senator from Wyoming if you would care to move out there.

[Laughter.]

Mr. BATTAGLINO. No. I like my business.

Senator BROWN. Some of us in bigger States think that Wyoming, considering its population—we have the same number of Senators they do, but anyway, that is a whole other question.

[Laughter.]

Let me ask you one other question, Mr. Battaglino. If our legislation, Senator Harkin's and my legislation, passes, how would your business change. Just briefly. We are kind of running short on time. But how would your business actually change?

Mr. BATTAGLINO. Well, for me it would not change at all.

I did not want to bring this up, but I believe the Department of Labor has solicited my company and probably a bunch of other ones, and they want us to voluntarily participate in something they are doing. So they sent us this form. And my bookkeeper says, the Department of Labor wants us to participate. And my first reaction was, wow, what do they want us to participate in? What are they doing? What is this about? All I got to think is could they talk to the IRS if I do not participate?

Senator BROWN. We are from the Government. We are here to help you.

Mr. BATTAGLINO. Yes. I got this diabolical thing going on. I am going, "well, what is it?" She goes, "well, they just want us to report our hours to them." Again, if I could use the phone, I could find out exactly what it is, but they said, "we just want you to report your hours" and I think—not the wages, but the hours and how many full-time employees we had consistently each month, which I said, "well, go ahead and do it. I know what they are trying to get at." And I say, "I think maybe it has got to do with what I am going to do." I say, "go ahead and do it."

And she does it, and once it is set up, it is set up. Computers are wonderful things. Quick Books Pro for Construction is great. It is not that cumbersome.

Senator BROWN. Thank you, Mr. Battaglino.

The CHAIRMAN. We are in a vote. There is less than 10 minutes left, and I want to get to Senator Merkley before we have to go vote.

Senator MERKLEY. Thank you very much, Mr. Chair.

Ms. Ruckelshaus, I wanted to ask you. My impression—this is what I am drawing from many years ago as an employer—was that the test was things such as do you set your own hours, do you provide your own equipment, do you have multiple customers, and do you advertise to obtain your own customers. And one piece of evidence in Oregon was do you have a business card, for example. Is that pretty much the difference? Am I missing some key factors here between an employer and an independent contractor?

Ms. RUCKELSHAUS. Yes, that is pretty close. Another key one that the courts look at and the States look at is whether or not the service you are providing is integrated into the overall service of the business with whom you are contracting because if you are doing things that regular employees would likely be doing, then that is a factor again, considering them an independent contractor.

Senator MERKLEY. Like a part-time worker essentially.

Ms. RUCKELSHAUS. Right.

Senator MERKLEY. OK.

Well, so we have situations that arise that are a little fuzzy. Mr. Uber was noting that his role as a registry is different—well, he did not quite say this, but this is what I am interpreting—is different from that of a temp service because he is facilitating independent contractors finding their customers. And there are Web sites that do that in other areas and so on and so forth.

So in that sort of situation, under this law, would there be a way for such an employer or company owner to make sure that they are protected? Because he is raising a legitimate question about not being at risk, not being uncertain. Is there a way that they could establish going to a Federal Department, and say, "this is the way I operate" and have it documented so that they are not putting their personal assets at risk and living in a world of uncertainty?

Ms. RUCKELSHAUS. I mean, his business—and he points this out in his testimony. A lot of his workers are exempt anyway under the Fair Labor Standards Act because they are companions. But putting that aside, I think if EMPA were to pass, he would provide each of his workers with a notice, which would basically affirm what they have already agreed, which is that they are independent contractors, and they both agree. If the worker does not agree or

there is some question and she is confused, then that is good because it would raise the issue and they could talk about it and clear up any confusion that might be connected to that relationship.

Then the keeping that he would be required to undertake under EMPA is again records that employers likely already keep because you have to give a 1099 anyway to these independent contractors. So it is really just a mechanism, a transparency and right-to-know mechanism. It is actually going to help them if the Department of Labor ever comes knocking.

Senator MERKLEY. Fair enough, but let us not take Mr. Uber as an example. Some other owner who is looking at it. Well, there is some uncertainty here. Is there a way that they could reach outside of their organization to get an affirmation that would give them legal protection that they have made the right decision in classifying someone as a worker or as an independent contractor?

Ms. RUCKELSHAUS. Under current law, you can with the Internal Revenue Service. You can get a determination from the Internal Revenue Service. And then you have a safe harbor going forward.

The Department of Labor can give consultations. They do not bless your relationship, but they can give you consultation and information.

Senator MERKLEY. Well, I think that safe harbor might be something we should explore if we do not feel like it is satisfactory.

Did you want to comment on that, Mr. Uber?

Mr. UBER. Yes, Senator. I would just like to comment from the vantage point of it, which is not as clear as it is described. You know, to have to constantly function in an environment where we want to comply—we are as much on board with this as far as identifying misclassified workers as anyone in the room. On the other hand, I do not see that what this bill will give us is a better way of gaining certainty as to whether we are using independent contractors properly.

I do not believe that it is increased paperwork. It is more things that we have to do. I stand by my testimony in that we have current laws on the books that need to be enforced, and if we will enforce those laws, then I think we can get a long way to where we are going or where we want to go.

Senator MERKLEY. Ms. Gardner, in your work in New York, do you have a situation where you are able to assist employers or owners of companies who are wrestling with the lack of clarity as to whether someone is an independent contractor or an employee and can give them some sort of affirmation so that they feel like they are on solid and safe ground?

Ms. GARDNER. Yes, we do that all the time. We did a targeted sweep in the car wash industry and found a high rate of misclassification. And one of the things we did following those sweeps is we found a lot of the employers just did not know the law. So we did some compliance education to help those employers bring them into compliance moving forward.

Senator MERKLEY. Thank you very much.

Thank you, Mr. Chair.

The CHAIRMAN. Thank you, Senator Merkley.

I thank you all. I have more questions. I was going to do another round, but as you can see, we have got about 2 minutes left in this vote. Therefore, we will leave the record open for 10 days for questions to be submitted in writing to you from anyone who is on the committee or who may not have been here today.

I want to thank all of you very much for being here today. It has been a great session. I think we learned a lot, and hopefully, we will be able to move this legislation forward, taking into account the fact that there are good actors out there, as well as bad ones. But we have to stop this misclassification because it is hurting the good people out there that are doing the right thing, and that is what we want to do. Thank you all very much.

The committee will stand adjourned.

[Additional material follows.]

ADDITIONAL MATERIAL

PREPARED STATEMENT OF DALE E. BROWN, CAE, PRESIDENT & CEO OF THE FINANCIAL SERVICES INSTITUTE, INC.

The Financial Services Institute (FSI)[1] commends the Senate Committee on Health, Education, Labor, and Pensions for its examination of the issues surrounding the proper classification of workers as independent contractors or employees. By misclassifying workers as independent contractors, companies avoid withholding income taxes and paying Social Security and Medicare taxes. Intentional misclassification of workers creates an unlevel playing field by giving an unfair competitive advantage to businesses who fail to classify their workers correctly.

Despite our support of the committee's examination of these issues, FSI has significant concerns with legislation introduced to address the misclassification of workers. On April 22, the *Employee Misclassification Prevention Act* (S. 3254) was introduced, by Senator Sherrod Brown (D–OH). The bill would amend the Fair Labor Standards Act of 1938 (FLSA) by increasing the financial consequences for a company that misclassifies an individual as an independent contractor and imposes new recordkeeping and notice requirements for companies that do business with independent contractors.

The bill would have serious unintended consequences for independent broker-dealers and independent financial advisors that deliver essential financial products, service and advice to middle-class Americans who are planning for their retirement, the education of their children or other important financial goals. Independent broker-dealers and independent financial advisors operate in a heavily regulated and documented industry in which cash payment for services is strictly prohibited. They responsibly pay their taxes and are properly classified as independent contractors. In fact, financial advisors choose to affiliate with independent broker-dealers so they can own and operate their own small business and exert greater control over the means of its operation. Nevertheless, the bill would introduce a significant degree of uncertainty that would result in an unlevel playing field for independent broker-dealers who offer an important alternative to financial advice and services from Wall Street firms.

FINANCIAL ADVISORS OF INDEPENDENT BROKER-DEALERS ARE CORRECTLY CLASSIFIED AS INDEPENDENT CONTRACTORS

For more than 30 years, the independent broker-dealer industry has provided the investing public with comprehensive and affordable financial solutions to their financial needs. The lynchpin of the independent broker-dealer industry is a network of financial advisors who operate with maximum flexibility and are responsible for the entirety of their business operations. These independent financial advisors are small business owners and entrepreneurs who benefit from a decentralized business structure. As small business owners, these financial advisors usually own or rent their own office, employ their own staff, and are subject to independent broker-dealer inspection primarily for the purposes of complying with securities laws. In the United States, approximately 188,000 financial advisors—or approximately 61.7 percent of all practicing registered representatives—operate as self-employed independent contractors.[2]

The independent broker-dealer business model focuses on offering financial solutions to clients who constitute the backbone of America's investor class. Financial advisors associated with independent broker-dealers primarily serve "Main Street Americans"—families able to invest only tens or hundreds of thousands—rather than millions—of dollars. The independent broker-dealer model provides those investors with access to products and services that maximize their ability to achieve their financial goals. The independent broker-dealer industry is able to efficiently serve consumers and offer services at affordable prices because the primary business relationship is between the financial advisor and the consumer, not the broker-dealer and the consumer.

In order to protect investors, independent broker-dealers and their financial advisors are heavily regulated under Federal and State securities laws. The Securities

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[1] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as Federal investment advisers, and their independent contractor registered representatives. FSI has 121 Broker-Dealer member firms that have more than 188,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,700 Financial Advisor members.

[2] Cerulli Associates at *http://www.cerulli.com/*.

Exchange Act of 1934 mandates that anyone who effectuates securities transactions register with the SEC or associate with a broker-dealer that is registered with the SEC.[3] There is a corresponding SEC requirement that a registered broker-dealer become a member of a self-regulatory organization, such as the Financial Industry Regulatory Authority (FINRA) (formerly, the National Association of Securities Dealers).[4] Under requirements of FINRA, broker-dealers are responsible for overseeing the securities operations of their associated financial advisors.[5] Under FINRA's "Conduct Rules," a broker-dealer must provide significant supervision and monitor its financial advisor workforce, including establishing written procedures to ensure compliance with Conduct Rules by each financial advisor.[6] Due to the nature of their business model, independent broker-dealers have long set the standard for supervision and compliance in the securities industry.

Under Federal tax law, how a worker is classified is primarily a function of the degree to which the employer exercises "control" over the worker—the more control, the more likely the worker will be classified as an employee. A careful analysis of the relationship between a registered representative and an independent broker-dealer firm makes it clear that registered representatives associated with independent broker-dealer firms are properly classified as independent contractors for purposes of employment taxes.[7] In fact, there is precedent holding that financial advisors associated with broker-dealers can be properly classified as independent contractors.[8] Despite these facts, regulatory mandates give the appearance of significant control by the broker-dealer. As a result, independent broker-dealers are periodically required to engage in an expensive defense of the appropriateness of worker classification status of their financial advisors.

IMPACT OF PROPOSED LEGISLATION ON INDEPENDENT BROKER-DEALERS, FINANCIAL ADVISORS AND THEIR CLIENTS

While independent broker-dealers properly classify their workers, compliance with the securities regulatory requirements can easily be mistaken for an employer's efforts to control the activities of their employees. As a result, independent broker-dealers are periodically subject to erroneous claims of improper worker classification. The proposed legislation would likely increase the volume of such claims and the cost of defending against them. The legislation would subject such firms to great uncertainty, as disgruntled former affiliated independent financial advisors, along with the Internal Revenue Service, would be empowered to question their worker classification status. The bill would do so by:

• **Enhancing the Consequences of Worker Misclassification.**—The bill would modify the FLSA to provide that any failure to accurately classify an individual as an employee would constitute an FLSA violation. It also would double the amount of liquidated damages the FLSA imposes for a violation of its minimum-wage or overtime requirements with respect to an individual who was misclassified as a non-employee (i.e., increase from two times actual damages to three times actual damages). A company would be subjected to a new civil penalty of up to $1,100 for each individual whom the company misclassifies as a non-employee, or with respect to whom the company violates the FLSA's minimum wage, overtime or record-keeping requirements. The maximum penalty would increase to $5,000 for a company that repeatedly or willfully commits such violations.

• **Shifting the Burden of Proof.**—If a company fails to comply with the new recordkeeping or notice requirements with respect to an individual, the individual would be presumed to be an employee of the company, which presumption could be rebutted only by clear and convincing evidence of the individual's independent-contractor status.

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[3] 15 U.S.C. §78o(a)(1); *see also* 1999 FSA 385 (May 10, 1999).

[4] 15 U.S.C. §78o(c).

[5] NASD Rule 3010(a).

[6] *Id.*

[7] For a full analysis of the proper classification of financial advisors associated with independent broker-dealer firms for the purposes of employment taxes, please see the July 9, 2008 legal memorandum prepared by the McIntyre Law Firm, PLLC for the Financial Services Institute.

[8] The Taxpayers Relief Act of 1997 Act states:

"In determining for purposes of the Internal Revenue Code of 1986 whether a registered representative of a securities broker-dealer is an employee . . . no weight shall be given to instructions from the service recipient which are imposed only in compliance with investor protection standards imposed by the Federal Government, any State government, or a governing body pursuant to a delegation by a Federal or State agency." Pub. L. No. at §921, (1997).

• **Intensifying State Enforcement Efforts.**—The bill would amend the provisions of the Social Security Act that impose conditions a State must satisfy to qualify for Federal funding of its unemployment programs to require a State to focus additional resources on worker classification in order to qualify for Federal funding for its unemployment programs.

In effect, these provisions go beyond mere enforcement of proper worker classification. Instead, we fear they will coerce firms who correctly classify workers into abandoning their business model in order to reduce their exposure to nuisance suits and regulatory inquiries. If independent broker-dealers were forced to reclassify their financial advisors as employees, the additional costs and compliance burdens would cripple their ability to remain profitable while also providing the services needed by their advisors and their clients. As a result, the status of this successful and valuable business model would be significantly threatened by the legislation.

We urge the committee to consider these important implications for independent broker-dealers and their affiliated financial advisors as it examines the issue of worker classification.

PREPARED STATEMENT OF CHARLES F. CHIUSANO, VICE PRESIDENT AND CFO, AVANT BUSINESS SERVICES; ON BEHALF OF THE MESSENGER COURIER ASSOCIATION OF AMERICA (MCAA)

Chairman Harkin and Ranking Member Enzi, I appreciate having this opportunity to provide testimony to the committee on the important issue of the need for businesses to properly classify individuals as independent contractors or employees. I share your concern over businesses which intentionally misclassify employees as independent contractors and I would like to share with the committee the background on the messenger courier industry, our business model which relies upon independent contractors, and our concerns with legislation introduced in both the House and Senate addressing the misclassification of employees as independent contractors.

I am the vice president and CFO of Avant Business Services which is a messenger courier company based in New York with operations throughout the New York City metropolitan area and Connecticut. Our company has been providing business services to our customers for over 70 years. Throughout that time, Avant Business Services has relied upon using independent contractors to meet our customers' needs.

Avant Business Services employs approximately 250 individuals and utilizes the services of about 150 independent contractors to make deliveries. We have offices in Manhattan, Stamford and Hartford. However, not all deliveries are made by independent contractors. In fact, we use employees to make deliveries in New York City where there is no investment on the individual's part, no delivery equipment is needed, the individual bears no risk of profit or loss and we need to provide direction and control. Avant Business Services is a longstanding member of the Messenger Courier Association of America (MCAA) which is the non-profit association of the messenger courier industry. My testimony today is submitted on behalf of the MCAA to speak for our industry on this critical issue.

The same-day courier industry is an integral part of the American economy, providing transportation of packages, medical supplies, bulk materials and documents among businesses and corporations in the United States and beyond. What distinguishes the expedited courier sector from other components of the delivery supply chain is the emphasis on less than 24 hours, just-in-time delivery of packages based on customer demand.

Courier businesses are small businesses and have a long history of positive influence in their communities. Firms typically employ about 25 individuals, who receive good salaries and benefits, and utilize up to three times that many independent owner-operator drivers annually. There are more than 5,000 small businesses that make up the multi-billion dollar same-day courier industry.

Couriers pick up and deliver important business documents or packages that need to be sent or received quickly either locally, regionally, or nationally. Couriers also deliver items that the customer is unwilling to entrust to other means of delivery because they are either time-sensitive or require specialized individual handling, such as medical supplies, blood, machine parts, and organs for transplant.

While there are many industries that use courier services, certain industries critically depend on couriers for expedited same-day or less than 24 hours delivery on a daily basis. Biomedical labs and analysis centers use couriers to retrieve and deliver samples for testing and evaluation. The manufacturing industry relies on couriers to distribute parts to keep their plants operating smoothly. Financial institutions must transfer multiple documents every day between branches processing centers and the Federal Reserve. Law firms must deliver confidential documents on

very strict deadlines and use couriers to ensure rapid delivery. Pharmaceutical distributors utilize couriers to transport medications to pharmacies, hospitals and nursing homes daily. And pharmacies utilize couriers to deliver medications to the homebound. These are just a few examples of our primary customer markets—each courier company, dependent on their expertise and regional needs, has a unique customer market profile.

Due to the critical need, fragility, confidentiality or special handling of items, these packages cannot be slotted into the existing delivery times for next day or 2-day delivery offered by the Postal Service and the large overnight delivery companies; they must be delivered according to the customer's schedule and specifications. Organs must be delivered in a certain timetable in order to be viable for transplantation, medical specimens delivered for testing can be the most useful to the patient if results are available quickly, and legal documents are often prepared and delivered to the client or judge on unforgiving deadlines.

For these types of goods, courier service is the only form of delivery that does not jeopardize the item delivered or the business involved. Owner-operator drivers are a key part of the same-day delivery practice as they provide the ability for flexible scheduling and ensure a courier will always be available for a customer delivery.

The business model for the courier industry is particularly reliant on independent contractors, which are engaged to perform a variety of deliveries. The nature of the industry, with its on-demand, often unscheduled delivery model, requires a varying number of courier drivers on any given day and time of day to complete a set service. The business model is also supported by numerous dedicated employee resources in a variety of executive, clerical and administrative functions.

To meet their customers' demands, courier services contract with competent, ambitious, and responsible individuals on an "as needed" basis to service their community every day. These independent owner-operators pick up and deliver letters, important business documents or packages that need to be sent or received quickly within a local area. Because these items are transported according to the customer's own timetable and oftentimes these shipments are time sensitive, the owner-operator business model allows courier companies to staff each day of work appropriately.

In our industry, independent contractors contribute to a healthy competition in many respects. Independent contractors bid for work from courier companies and by so doing set the price paid for their work. It is common in our industry for individuals starting out as an independent contractor providing services to courier companies and overtime starting their own courier company and competing with the company to which they formerly provided services. In fact, Birol Aran was an individual who started as an independent contractor in 1993 and now owns and operates Manhattan Express Courier Service and is a competitor of Avant Business Services.

In many instances, independent contractor owner-operator drivers can make significantly more money offering their services competitively to multiple businesses rather than receiving work from just one company. We have independent contractors who have made a good living and have provided services to our company dating back to 1990. It is this entrepreneurial spirit and opportunity that helps drive our industry and our country.

Many independent contractors in our industry enjoy the flexibility of being an independent contractor. Accepting or rejecting work based on their desire and ability to work is very attractive to many independent contractors. There are many examples of independent contractors telling companies that they will not work on certain days or not accept dispatch after certain hours or refuse a job because they don't want to drive a long distance.

The use of independent contractors by our industry is not a recent trend or a new phenomenon. Independent contractors have been an integral part of our industry since our early beginnings dating back well over 100 years. Our industry has evolved as the economy has changed, but the need for independent contractors has remained a constant.

We share your concern over businesses which intentionally misclassify employees as independent contractors. As an industry reliant upon independent contractors for our mutual success, we are keenly aware of the need to properly classify individuals as independent contractors or employees. MCAA urges all of its members to use industry best practices in making determinations of whether an individual is an employee or an independent contractor. Our member companies make the determination about whether an individual is an independent contractor or an employee based upon guidance from Federal, State and private sources. These are not decisions taken lightly.

When engaging with an independent contractor, Avant Business Services executes a written contract with the independent contractors they use. A 1099 form for the

services of the independent contractor is issued and the independent contractor is informed of their responsibility to pay their taxes on the income their company has earned. We also confirm that the independent contractor has the proper insurance for themselves and their vehicle. This is how we operate at Avant Business Services. And after 37 years in this industry, it is safe to say that this is the norm for other companies in this industry.

Our industry has great concerns over the legislation introduced in the Senate and House of Representatives addressing the issue of classification of individuals as independent contractors. Legislation to eliminate the safe harbor found in Section 530 of the Internal Revenue Code in particular is very troubling to our industry. The intention of these bills may be to go after those companies or even industries that have intentionally misclassified individuals. However, the reality is that these bills will affect all companies using independent contractors.

We have two broad concerns with S. 3254 introduced by Senator Brown and supported by many members of this committee. First, this legislation creates additional new mandates and requirements on all businesses using independent contractors. These new requirements, in a vacuum, may not seem to some as too onerous. Unfortunately, we don't operate our businesses in a vacuum. These changes must be considered in the context of existing and new mandates being imposed on our businesses. For example, the recently enacted health care reform bill will require significant new reporting requirements for transactions between our businesses and other businesses.

Second, our concern about the employees rights Web site called for in this legislation does not appear to recognize the benefits of being an independent contractor. Independent contractors often have much greater economic opportunity than employees as well as the freedom to work when they want and where they want.

We would urge this committee to proceed cautiously with this legislation. Our industry has seen the successful use of industry guidance as a way to ensure proper compliance. In the State of Minnesota, our industry was able to pass a State law providing such guidance with the support of organized labor and the trucking industry. We also urge the committee to review the New York State Department of Labor (NYS DOL) Guidelines for the Messenger Courier Industry (a copy is attached). We believe this guidance established after an extensive period of discovery between the NY State Messenger Courier Association and the NYS DOL can act as a template for successful guidance throughout the country. We would recommend Congress consider this approach as an alternative to the changes in law proposed by Senator Brown.

The Courier Industry is connected to every important segment of American commerce, literally saving lives daily and improving the health and well-being of our citizens. The most important deliveries, including financial transactions, critical machine parts, lab reports and life saving medications, are performed by independent contractors working for over 5,000 small courier companies. For over 100 years, our industry has been served by a business model that is a great example of the American Dream. Our independent contractor is a person who works hard, follows the rules and provides efficient flexible services that cannot be duplicated. We recommend that any future legislation consider how it will impact our industry and its essential core component: the independent contractor.

ATTACHMENT.—NEW YORK STATE DEPARTMENT OF LABOR GUIDELINES FOR DETERMINING WORKER STATUS: MESSENGER COURIER INDUSTRY

The following guidelines are used by the Unemployment Insurance Division, the Division of Labor Standards and the Division of Safety and Health to establish whether an employment relationship or an independent contractor status exists when companies engage the services of messengers and/or couriers who own or lease vehicles.

Independent contractors are excluded from coverage under the Unemployment Insurance Law and not afforded certain protections provided by Labor Standards and Safety and Health law. These are persons who are actually in business for themselves and hold themselves available to the general public to perform services. A person is an independent contractor only when free from control and direction in the performance of such services. All factors concerning the relationship between the two parties must be taken into consideration to determine if the party contracting for the services exercises, or has the right to exercise, supervision, direction and control over the courier or messenger. No one single factor is controlling, nor do all factors need to be present to establish the nature of the relationship.

Employers may request a formal determination of the status of couriers/messengers performing services for unemployment insurance purposes by writing to the Liability and Determination Section and furnishing complete details of the relationship. An employer who assumes a courier/messenger to be an independent contractor and does not report and pay taxes based upon the assumption, may find they are subject to retroactive assessment, interest or penalty, if it is later determined through an audit, benefit claim or some other review, that there was an employment relationship. Therefore, it is to the employer's advantage to request a determination when the status of a courier/messenger is in question.

The Department of Labor is implementing these guidelines with an effective date of January 1, 2006. Therefore, employers may discontinue reporting couriers/messengers for unemployment purposes when the application of these guidelines results in a status of independent contractor as of January 1, 2006. Please note the prospective nature of the implementation. As a result, the Unemployment Insurance Division will not issue redeterminations and refunds for previously reported individuals.

Employers with questions regarding the interpretation or application of the factors outlined in the guidelines in relation to an unemployment insurance matter may contact the Liability and Determination Section at (518) 457–2635. Employers with questions in relation to a Division of Labor Standards issue should call (518) 457–4256. Division of Safety and Health issues may be referred to (518) 457–2238.

INDUSTRY BACKGROUND

These guidelines will be used to determine the worker status of couriers who own or lease a vehicle. Couriers who utilize company vehicles are presumed to be employees as they have no risk of investment or exposure to profit or loss. It is industry practice that bike messengers own their own bike, and along with foot messengers are admitted employees of messenger companies providing delivery services to their customers.

A courier is a person who provides pickup and delivery of goods for customers, transporting the product in a motorized vehicle. A messenger provides similar services to customers via foot or bike delivery. Some companies use both messenger and courier delivery persons.

In large metropolitan areas, the pickup and delivery could be within blocks, or within or across boroughs. In suburban or rural areas, the pickup and delivery could involve a large geographic area covering hundreds of miles.

Bike and foot messengers are commonly used to transport smaller goods and packages in metropolitan areas, while couriers are able to accommodate larger and multiple customer requests.

Products and goods to be picked up and delivered are based on the specific need of the customer including, but not limited to, manufactured goods, legal, financial, and banking documents, office supply products, film, pharmaceuticals, portfolios, blueprints, clothing, costumes, art work, and personal items.

Courier and messenger companies may provide 24/7 on-demand pickup and delivery services for customers, and a courier company may also provide established routes involving multiple pickup and delivery services for customers. A courier may perform both on-demand and route delivery services.

Courier and messenger companies offer on-demand assignments via a dispatch system using communication devices such as two-way radios, pagers, beepers, cell phones or palm pilots to relay the details of the assignment. Assignments are offered to one courier or messenger at a time.

The courier and messenger company establishes the fee charged to its customer which may be based on factors such as size and weight of package, volume, distance, urgency of the delivery, frequency of the route, and number of stops. Couriers are generally paid a percentage of the fee charged to the customer for on-demand assignments while messengers are normally paid the higher of an hourly rate or fee basis for similar type assignments. A courier who performs a fixed route delivery is aware of the established stops and the fee to be received at the beginning of each day's route. The fee is usually not hourly or a percentage of the amount charged to the customer but rather a set amount which might for example be on a daily or weekly basis.

A courier company may utilize a third party as its agent for the purposes of paying the courier, issuing end of year tax documents, offering discount insurance and benefit packages, and performing background checks on its potential courier pool. The courier may be required to enter into a contract with the third party who acts as the agent of the courier company. The third party provisions contained in a contract with a courier are mutually agreed on between the courier company and the third party and the provisions are as if required and enforced by the courier com-

pany. Third parties may be paid an administrative fee by both the courier company and courier for its services.

DETERMINING WORKER STATUS

Couriers

With respect to couriers, there are two types of services that may be performed:

• On Demand—customer requests same day or next day pickup and delivery of an item from Point A to Point B that may vary each day and for which a courier receives an established or negotiated fee.

• Route Delivery—customer or courier company has an established route(s) or territory within which are multiple locations for pickup and delivery of items that may vary each day and for which a courier receives an established or negotiated fee.

Through the application of these guidelines, the worker status of a courier who performs both on-demand and route delivery services will be based on the factors that apply to each type of service and may result in two different worker status outcomes.

On Demand

Indicators of Independence

The strong factors a courier performing on-demand services as an independent contractor are:

(1) The courier owns or leases a motorized vehicle. Couriers driving such vehicles need not hold a commercial driver's license.

A lease must have evidence of substantial investment by the courier such as:

• The lease is fair market value.

• It is for a minimum of at least 1 year.

• The courier is obligated to satisfy the terms of the lease even if courier services are discontinued.

• There is a reasonable interest rate.

(2) The courier is responsible for all expenses such as fuel, vehicle repairs, maintenance and insurance, tolls, occupational accident insurance or workers' compensation coverage, and communication devices or scanning equipment.

(3) The courier is free to negotiate the fee offered for services and is not prohibited from renegotiating an established fee on an assignment by assignment basis.

(4) The courier is paid on a negotiated per completed assignment basis, and not by the hour.

(5) The courier is free to accept or reject a dispatched assignment based on conditions such as work hours and schedule.

(6) The courier receives an advertising fee for displaying courier company or courier company's customer's signage on the vehicle.

(7) The courier's services are not exclusive to a courier company and the courier is free to obtain and accept assignments from others.

(8) The courier establishes own route and sequence or priority of pickups and deliveries.

(9) The courier receives and resolves customer complaints.

(10) The courier is not required to display the courier company name on the vehicle other than what may be required on an assignment for security purposes.

(11) Manifests are provided by the courier.

Other factors that lead to independence are:

(12) The courier possessed a "dba" or a Federal Employer Identification Number at the time of hire.

(13) The courier is able to provide a substitute or engage other couriers without approval or notification of the courier company, so long as the substitute meets the courier company's specifications with respect to driver motor vehicle licensing, drug testing, criminal background checks and insurance requirements.

The courier is primarily responsible for obtaining substitute or replacement driver but may seek assistance from the courier company or third party agent.

(14) The courier is not provided with training, other than a general orientation session to familiarize the courier with basic customer pickup or delivery characteristics.

Indicators of Employment

The strong factors a courier performing on-demand services as an employee are:

(1) The courier company sets the rate of pay.

(2) The courier company pays or reimburses the courier for expenses such as fuel, tolls, vehicle repairs, maintenance, insurances.
(3) The courier is required to accept assignments.
(4) The courier is not free to obtain assignments from others.
(5) The courier is covered under the courier company's Workers' Compensation Policy.
(6) The courier has a set work schedule or required to be available for assignments during a pre-established period.
(7) The courier company establishes the route, sequence or priority of the pickup or delivery.
(8) The courier company maintains authority to insure all customer requirements are carried out by the courier even if the courier agreed to the requirements at the time his/her services were engaged.

However, the courier company's right to insure customer requirements are carried out by the courier regarding security and appearance of vehicle, delivery and pickup times, shipment integrity, compliance of governmental regulations, and general standards of conduct is a reasonable business practice and not an indication of control over the courier's services.

(9) The courier company prohibits the courier from participating in the process of resolving customer complaints.
(10) The courier is required to display courier company name or customer name on the vehicle at all times even when not on an assignment.
(11) Manifests are provided free of charge by the courier company.

Other factors that lead to employment are:

(12) The courier company establishes earlier delivery/pickup timeframes than those required by the customer, or if no timeframe was established by the customer, the courier company specifies a timeframe to the courier.
(13) The courier is required to keep in communication with the courier company while on route for purposes beyond relaying information from the courier company customer to the courier or beyond the courier company's customer request regarding the status of delivery.
(14) The courier company provides substitutes or replacement drivers.
(15) The courier company requires attendance at training or orientation sessions for issues other than those required by governmental agencies or on subjects such as use of the communication equipment, the proper completion of paperwork, or the courier company's customer policies and/or procedures.
(16) The courier company restricts the courier from performing courier service for any customer of the courier company upon termination of the relationship between the parties.
(17) The courier company requires the courier to wear a uniform or attire that includes identifications or logos beyond those associated with the courier company.
(18) The courier is required to perform services personally.

Neutral Factors

Factors that neither point to an independent contractor or employment relationship are:

(1) The courier is required to wear a uniform or attire with the courier company logo or identification.
(2) The courier is required to carry a courier company badge or other identification for security purposes.
(3) The courier company or its third party agent interviews or screens prospective couriers by performing background checks such as drug testing or motor vehicle checks prior to issuing assignments.
(4) The courier is paid by the courier company for the delivery even if the delivery did not meet the standards or parameters of the courier company's customer.
(5) The courier may contact the courier company upon pickup or delivery of item/article but does so out of courtesy, as a means to obtain additional assignments.
(6) The courier is required to keep in contact with the courier company while on route for purposes of relaying information from the courier company's customer to the courier, or for purposes of confirming with the courier company's customer its pickup and delivery timeframe adherence.
(7) The delivery/pickup timeframe is set by the courier company's customer.
(8) The courier is required by the courier company to attend training or orientation sessions for issues mandated by governmental agencies such as OSHA or the Transportation Security Administration, or on subjects such as proper completion of paperwork or courier company customer policies and/or procedures.

(9) The courier may be required to obtain a "dba" or obtain a Federal Employer Identification Number as a condition of obtaining assignments.
(10) The courier and the courier company jointly resolve customer complaints.
(11) The courier company is responsible for customer billing and collecting.
(12) The courier is required to sign a Non Disclosure agreement (NDA). The purpose of such an agreement is to protect the courier company's confidential information including but not limited to clients, addresses, billing rates, and contact names and telephone numbers.
(13) Customer or third party provides manifests.

Route Delivery

Indicators of Independence

The strong factors a courier performing route delivery services as an independent contractor are:

(1) The courier owns or leases a motorized vehicle used for delivery services. A lease must have evidence of substantial investment by the courier such as:

- The lease is fair market value.
- It is for a minimum of at least 1 year.
- The courier is obligated to satisfy the terms of the lease even if courier services are discontinued.
- There is a reasonable interest rate.

(2) The courier is responsible for all expenses such as fuel, vehicle repairs, maintenance and insurance, tolls, occupational accident insurance or workers' compensation coverage, and communication devices or scanning equipment.
(3) The courier is free to negotiate or renegotiate terms of the route such as the stops or rate of pay.
(4) The courier negotiates the rate of pay that is other than an hourly rate.
(5) The courier is free to accept or reject assignments.
(6) The courier receives an advertising fee for displaying courier company or courier company's customer's signage on the vehicle.
(7) The courier receives an advertising fee from either the courier company or the courier company's customer for wearing a customer's badge, ID, uniform or attire.
(8) The courier is unrestricted from performing delivery services for others including while on route for courier company's customer except as may be restricted by governmental authorities such as DEA or DOT Office of Hazardous Materials.
(9) The courier's services are not routinely monitored by the courier company to insure customer requirements are carried out, but the services may be monitored for administrative purposes such as customer billing or determining courier compensation.
(10) The courier receives and resolves customer complaints.
(11) The courier is not required to display the courier company's name on the vehicle other than what may be required on an assignment for security purposes.
(12) Manifests are provided by the courier.

Other factors that lead to independence are:

(13) The courier possessed a "dba" or a Federal Employer Identification Number at the time of hire.
(14) The courier is able to provide a substitute or engage other couriers without approval or notification to the courier company, so long as the substitute or other courier meets the courier company's specifications with respect to driver motor vehicle licensing, drug testing, criminal background checks and insurance requirements.
The courier is primarily responsible for obtaining substitute or replacement drivers but may seek assistance from the courier company or third party agent.
(15) The courier is responsible for lost or damaged product.
(16) The courier is responsible for providing or obtaining appropriate containers required for the delivery/pickup of the product.

Indicators of Employment

The strong factors a courier performing route delivery services as an employee are:

(1) The courier is paid at a base hourly rate or on a fee basis established by the courier company.
(2) The courier company pays or reimburses the courier for expenses such as fuel, tolls, vehicle repairs, maintenance, insurances.
(3) The courier is required to accept additional assignments.
(4) The courier company prohibits the courier from performing delivery services for others.

(5) The courier is covered under the courier company's Workers' Compensation Policy.

(6) The courier company maintains authority to insure all customer requirements are carried out by the courier even if the courier agreed to the requirements at the time his/her services were engaged.

However, the courier company's right to insure customer requirements are carried out by the courier regarding security and appearance of vehicle, delivery and pickup times, shipment integrity, compliance of governmental regulations, and general standards of conduct is a reasonable business practice and not an indication of control over the courier's services.

(7) The courier company prohibits the courier from participating in the process of resolving customer complaints.

(8) The courier is required to display courier company name or customer name on the vehicle at all times even when not on an assignment.

(9) Manifests are provided free of charge by the courier company.

Other factors that lead to employment are:

(10) The courier is required to keep in communication with the courier company while on route for purposes beyond relaying information from the courier company customer to the courier or beyond the courier company's customer request regarding the status of delivery.

(11) The courier company provides substitute or replacement drivers.

(12) The courier company requires attendance at training or orientation sessions for issues other than those required by governmental agencies or on subjects such as use of the communication equipment, the proper completion of paperwork, or the courier company's customer policies and/or procedures.

(13) The courier company restricts the courier from performing courier service for any customer of the courier company upon termination of the relationship between the parties.

(14) The courier is required to wear, without compensation, a courier company badge, ID, uniform or attire that includes identifications beyond those of the courier company such as the courier company's customer.

(15) The courier is required to perform services personally.

Neutral Factors

Factors that neither point to an employment or independent contractor relationship are:

(1) The courier is required to wear a uniform or attire with the company logo or identification.

(2) The courier is required to carry a courier company badge or other identification for security purposes.

(3) The courier company or its third party agent interviews or screens prospective couriers by performing background checks such as drug testing or motor vehicle checks prior to issuing assignments.

(4) The courier is paid by the courier company for the delivery even if the delivery did not meet the standards or parameters of the courier company's customer.

(5) The courier is required to keep in contact with the courier company while on route for purposes of relaying information from the courier company's customer to the courier, or for purposes of confirming with the courier company's customer its pickup and delivery timeframe adherence.

(6) The frequency, sequence, timeframe or delivery instructions/regulations of the route are established by the courier company's customer.

(7) The courier is required to report daily to a distribution center to initiate the day's assignments.

(8) The courier is required by the courier company to attend training or orientation sessions for issues mandated by governmental agencies such as OSHA or the Transportation Security Administration, or on subjects such as proper completion of paperwork or courier company customer policies and/or procedures.

(9) The courier may be restricted by the courier company's customer from performing delivery services for others while on route for the customer for reasons established by the customer such as a concern for security or identity theft of customer's product or product integrity of the customer's goods.

(10) The courier may be required to obtain a "dba" or obtain a Federal Employer Identification Number as a condition of obtaining assignments.

(11) The courier and the courier company jointly resolve customer complaints.

(12) The courier company is responsible for customer billing and collecting.

(13) The courier is required to sign a Non Disclosure agreement (NDA). The purpose of such an agreement is to protect the courier company's confidential informa-

tion including but not limited to clients, addresses, billing rates, and contact names and telephone numbers.

(14) The courier company's customer or third party provides manifests.

(15) The courier company's customer may provide special containers required for delivery/pickup of the customer's product.

(16) The courier may be required to be responsible to load or unload the vehicle at a distribution center and may perform other routine functions normally associated with the delivery of the product such as the boxing of the product.

BIKE AND FOOT MESSENGERS

Within the messenger industry, it is standard practice that bike and foot messengers (messengers) are considered to be employees of the messenger company providing delivery services to its customers. It is also the custom that bike messengers provide their own bike, bag, lock, helmet, map, clipboard, cycling clothing and mobile communication devices and are responsible for the maintenance costs of the aforementioned items. The working relationship between messengers and the messenger company utilizing their delivery services for its customers contains significant common law indicators of an employment relationship:

- The messenger company makes standard withholding deductions from the messenger's earnings.
- The messenger company may provide fringe benefits to the messenger.
- The messenger company sets the rate of pay which is normally based on the higher of an hourly rate or fee basis.
- The messenger company sets the work schedule.
- The messenger company requires the services to be performed personally and the messenger is not able to provide his/her own substitute.
- The messenger company covers the messenger under the company's Workers' Compensation policy.
- The messenger company sets the order and priority of delivery.
- The messenger company requires the messenger to accept an assignment.
- The messenger company requires the messenger to follow all company rules and regulations.

PREPARED STATEMENT OF THE COALITION TO PRESERVE INDEPENDENT CONTRACTOR STATUS

The Coalition to Preserve Independent Contractor Status (the "Coalition") appreciates the opportunity to submit testimony concerning the important issue of worker classification. The Coalition consists of industry associations, businesses and independent contractors that share a common interest in preserving the legal status accorded independent contractors, and in the creation of economic opportunities for all individuals, whether they offer their services as independent contractors or employees.

The Coalition absolutely supports the proper classification of workers, and the proper and timely compliance by independent contractors with their Federal, State and local tax reporting and payment obligations. Moreover, it supports government policies aimed at enhancing these objectives, provided that such policies do not undermine the rights of independent contractors and their clients to do business with each other.

In the current climate of record-high numbers of Americans out of work, the Coalition submits that one of the Government's top priorities should be to support all facets of economic growth, regardless of whether they involve sectors in which individuals work as independent contractors or employees. The Congress should not thwart these opportunities by undermining the sound business relationships between independent contractors and their clients.

The Coalition opposes the enactment of S. 3254, the *Employee Misclassification Prevention Act* because its provisions would increase the regulatory risks of doing business with independent contractors to an excessively high level.

We are concerned that if S. 3254 were enacted, companies that rely on the services of independent contractors would face additional burdens when engaging in those legitimate and legal business practices. Such burdens limit companies' flexibility to retain independent contractors, which would reduce their efficiency and ultimately threaten opportunities for not only independent contractors but also employees. The bill does not take into account the unique business models that individual companies rely on to remain competitive, and would be particularly detrimental in these challenging economic times.

S. 3254 is premised on the misguided assumption that there is widespread misclassification of contracted individuals, and it fails to acknowledge that individ-

uals who operate as independent contractors generally do not wish to be classified as an employee. Status as a contractor affords both individuals and client companies the flexibility to agree to terms that are in the best interest of each party. The bill would unnecessarily add confusion and uncertainty to the long-standing administration of the Fair Labor Standards Act ("FLSA") and thus undermine economic growth.

The following outlines the specific reasons for our concerns with S. 3254.

1. The proposed financial sanctions for worker misclassification are disproportionate.

Our principal concern with the bill involves the new financial sanctions it proposes for worker misclassification. The proposed sanctions, when added to the sanctions already imposed under current law, would expose a company to penalties that are highly disproportionate to the offense. The FLSA is already punitive in this regard, as it exposes a company that fails to pay minimum wage or overtime to actual damages plus liquidated damages plus attorneys' fees.[1] The bill would make those sanctions even more onerous when worker misclassification is involved, by increasing the double damages to treble damages and adding to that a penalty of up to $1,100 or $5,000 per mis-classified worker. This would elevate the offense of worker misclassification to a higher magnitude than the *criminal* predicate acts[2] that form the basis for a civil penalty under the Racketeer Influenced and Corrupt Organizations Act ("RICO"), which imposes only treble damages plus attorneys' fees.[3]

Worse yet, the $1,100 per-misclassified-worker penalty and treble damages would be imposed in the form of *strict liability*. Levying these extreme monetary penalties on companies that have not demonstrated a willful intent to wrongly misclassify individuals as contractors under the FLSA is inappropriate. Currently, businesses are required to apply multiple factors contained in an *economic realities* test to properly classify individuals, which takes into account the unique circumstances of the engagement, the type of services provided as well as the scope of work performed under the terms of their contract. Such an overly broad capacity for expanded penalties would likely result in punitive damages for legitimate contracting practices.

While the threshold for imposing the higher $5,000 per-misclassified-worker penalty is more demanding, it still only requires that a misclassification be *repeated* or *willful*. This means that a firm that has been doing business for many years with many independent contractors might satisfy the *repeated* requirement, which would subject the firm, once again, to *strict liability* for the higher confiscatory financial sanctions. The effect of this penalty scheme would be to impose the harshest penalties on those firms that offer the most opportunities to independent contractors.

It is respectfully submitted that the bill's proposed financial sanctions would create a strict-liability trip wire for misclassification that would be so costly to businesses that few would continue doing business with any but the most exaggeratedly independent of the independent contractors, *i.e.*, those with multiple existing clients, a substantial capital investment in the business and a robust Web presence or other evidence of significant business advertising. The individual freelancer who seeks to use a personal computer to earn extra money on a part-time basis, or who seeks to start a new freelance business and is searching for that first client, would likely find no company willing to take the risk. Even those independent contractors who have been in business for years, but who work principally for only a very few large clients, would likely find those clients less willing to continue those relationships, due to the risk that the individual could be found to be economically dependent on one of them. This bill poses a mortal threat to individuals who rely on contracting opportunities for their livelihood.

2. Defining a non-employee to include entities whose owner is a service provider would penalize firms for adopting prudent policies designed to ensure compliance.

The bill's *per se* treatment as a non-employee for purposes of the proposed record-keeping and notice requirements of any individual who offers services through an entity in which the individual owns an interest is an affront to the many companies

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[1] See, 29 U.S.C. § 216(b).

[2] RICO defines "racketeering activity" to include violations of various predicate criminal statutes including mail and wire fraud. § 1961(1). *Hemi Group, LLC* v. *City of New York*, 130 S. Ct. 983, 995 (U.S. 2010).

[3] See, 18 U.S.C.S. § 1964. "Congress intended RICO's civil remedies to help eradicate 'organized crime from the social fabric' by divesting 'the association of the fruits of ill-gotten gains.'" *Genty* v. *Resolution Trust Corp.*, 937 F.2d 899, 910 (3d Cir. 1991) (quoting *United States* v. *Turkette*, 452 U.S. 576, 585, 101 S. Ct. 2524, 2529, 69 L. Ed. 2d 246 (1981)).

that have taken prudent measures to ensure that they are doing business only with legitimate non-employees.

Firms that do business with large numbers of independent contractors commonly develop a systematic process for conducting due diligence on such contractors to ensure that they are truly self-employed. Inasmuch as an important consideration in these determinations, particularly at the State level, is whether an individual is independently established as a separate trade or business, some firms have made the decision to do business only with vendors that operate in the form of an entity, as the existence of an entity offers compelling evidence of a *bona fide* trade or business.

Similarly, growing numbers of independent contractors, recognizing the increasingly hostile regulatory environment for independent contractors, have established legal entities to allay the fears among potential clients that doing business with them would expose the clients to a misclassification risk.

We are aware of what are sometimes referred to as pre-packaged incorporations, where a business, as part of its registration process for independent contractors, creates a legal entity for the contractor, but the bill does not seek to distinguish between those contrived arrangements and the legitimate arrangements discussed above. Rather, it disregards them all.

It is respectfully submitted that the important State laws that govern and recognize the separate legal status accorded a valid legal entity should not be disregarded, absent a compelling reason. The bill's proposed sweeping disregard of any such entity in which a service provider holds an ownership interest is overly broad, and should be rejected.

3. Requiring companies to maintain records of hours worked by non-employees would be burdensome, counterproductive and disruptive to business relationships.

The bill would require companies to maintain records of hours worked by non-employees, without regard to whether their fees are determined on an hourly basis.

This new requirement would place non-employees at a competitive disadvantage relative to their larger competitors. While clients already likely maintain records of hours worked by vendors who render services on hourly engagements, clients likely do not maintain any such records for other engagements, where fees are determined on a basis *other than* hours worked.

Even with respect to hourly engagements, it is not likely that the records maintained for hours worked are necessarily determined in accordance with U.S. Department of Labor ("DOL") regulations governing the determination of compensable hours worked. If the proposal were construed to require compliance with such DOL regulations, the resultant burden imposed on non-employees and their clients—even with respect to hourly engagements—would be excessive and to no discernable purpose.

With respect to engagements for which fees are determined on a basis *other than* hours worked, to require firms to maintain records of hours worked by such vendors would serve no business purpose, create confusion over how the hours should be determined, and likely disrupt the parties' business relationship.

For example, in some industries, independent contractors have invested substantial resources in developing computer programs and other high-technology applications that permit the delivery of high-quality services with few hours' work, at least as determined on a client-by-client basis. A substantial fee might be charged for these services, which reflects not only the hours worked for a specific client but also the hours worked and other investment in developing the underlying system. To be sure, there are myriad examples of different types of arrangements in which a firm engages an independent contractor with specialized expertise to provide a service or produce a deliverable, or to sell products on a commissioned or buy-sell basis, where the agreed compensation has no relationship at all to the number of hours worked. To require an independent contractor to provide its clients with a record of hours worked on such engagements could create unnecessary tension with the client. For example, an independent contractor might find it uncomfortable charging a client a substantial fee for a deliverable that required only a few hours' work, even though the value of deliverable far exceeds the fee. Furthermore, while the client might have no interest in knowing the number of hours worked on such an engagement, once the client does know, it could be upsetting. Finally, if the DOL were to require these independent contractors to determine their hours in accordance with DOL regulations, the requirement would approach the absurd.

For the reasons outlined above, it is respectfully submitted that the bill's proposal to require a company to maintain records of hours worked by non-employees on engagements *other than* hourly engagements is inadvisable and should be rejected.

4. Requiring companies to maintain records of the "accurate classification of the status" of non-employees is unnecessary.

The bill would require a company to maintain records showing an accurate classification of the status of each individual with whom the company does business as either an employee or a non-employee.

Companies commonly undertake due diligence to confirm the self-employed status of the independent contractors with whom they do business. Depending upon the industry, the type of services and other aspects of an independent-contractor engagement, the specific due-diligence criteria will differ. Companies that engage large numbers of independent contractors to provide similar types of services commonly do not maintain a specific due-diligence file for each individual. Requiring companies to do so would be unnecessary and would serve only to create additional barriers to a contracting opportunity for self-employed individuals. Moreover, the burden it would impose on companies to create these records would significantly limit their flexibility to meet changing business needs and economic fluctuations.

Also, requiring a company to maintain such a due-diligence file only with respect to independent contractors would put independent contractors at a competitive disadvantage compared to larger firms, to which the requirement would not apply, and would hamper contractors' best value proposition for companies seeking to retain them. For example, if a company were seeking to outsource a discrete project, the burden of preparing a due-diligence file on an independent contractor for that one project might be sufficient to dissuade the company against offering the project to independent contractors, and instead to offer it only to larger vendors to which the due diligence requirement would not apply.

5. Requiring companies to provide a specified notice to non-employees is burdensome and likely to lead to increased enmity and litigation between contracting parties.

The bill would require a company to provide non-employees with a notice to "inform the individual of the individual's classification," to direct the individual to a DOL Web site containing information "about the rights of employees under the law," and to advise the individual that his or her "rights to wage, hour and other labor protections depend on [the individual's] proper classification as an employee or non-employee."

The proposed notice requirement suggests that self-employed service providers are having their independent contractor status imposed on them. For legitimate independent contractors, such a notice would be insulting and degrading; it also would accord them second-class standing relative to their larger competitors, as similar notices are not required for any other vendors.

Also, the content of the notice would create uncertainty and unnecessary confusion for independent contractors. The proposed notice suggests that contractors may be entitled to certain protections afforded only to employees. Currently, companies must determine the legal classification of individuals by utilizing a multifactor test of economic realities. The promulgation of the proposed notice does not take into account the many factors used to determine an individual's status for many individual service contracts and might be susceptible to being construed to mean that certain independent contractors are entitled to protections for which they do not qualify.

Finally, for a company that does business with large numbers of independent contractors, the notice requirement would increase the cost of engaging new contractors and likely give rise to additional confusion and questions from the contractors once they receive the notice. The additional costs such a company would incur in complying with this new duty and in responding to the questions the notices would produce would reduce the company's efficiency. The effects of the resulting reduced efficiency would be passed on to customers in the form of higher prices.

The Coalition respectfully urges that this proposal not be enacted.

6. Creating a presumption of employee status for failure to maintain records or provide requisite notice would be unfair.

The bill provides that a company's noncompliance with the proposed recordkeeping or notice requirements with respect to an individual would result in the individual being *presumed* an employee, which presumption could be rebutted only by establishing the individual's independent-contractor status by *clear and convincing* evidence, which is a demanding standard.

This proposal is insidious, as it would create a trap for the unwary. Companies would not intuitively suspect that the Government imposes any such duty with respect to their dealings with vendors. Thus, the proposal likely would disproportionately affect small businesses that do not have an in-house legal department. The provision would provide the DOL with overwhelming leverage to convince companies that violate the notice and/or recordkeeping requirements to reclassify independent

contractors to employee status, as the burden of meeting the *clear and convincing* standard under the economic realities test would be daunting.

The Coalition respectfully urges that this proposal be rejected.

7. The proposed anti-retaliation provision would reward unethical conduct and create a new litigation hazard.

The bill would prohibit a company from discharging or in any other manner discriminating against an individual who opposes any practice, files a complaint or institutes a proceeding concerning an individual's status for purposes of the FLSA or Federal employment tax purposes.

The proposed anti-retaliation provision would advance a policy of protecting individuals who misrepresent their status as being self-employed. An important component of the *economic realities* test is a consideration of the degree to which a putative independent contractor is economically dependent on the putative employer. A company cannot meaningfully evaluate this factor without obtaining information solely in the possession of an independent contractor, namely, the extent to which the contractor performs services for others. If a contractor provides materially false information, and as a consequence the contractor is misclassified, the client would have a legitimate reason to cease doing business with that contractor, but the bill would prohibit that.

Also, the proposal would provide an independent contractor who fails to meet contract terms with a new form of protection against the client terminating their engagement, *e.g.*, by filing an Internal Revenue Service ("IRS") Form SS–8[4] and seeking a determination by IRS of their status as an employee or independent contractor. Under the bill, the filing of the Form SS–8 arguably would provide the individual with a basis for asserting that any subsequent termination by the client was in retaliation for that action.

Finally, the proposal would put individuals who operate as independent contractors at a disadvantage relative to larger competitors, because it would create a new litigation hazard associated with doing business with independent-contractor vendors that would not exist with other vendors.

For the foregoing reasons, the Coalition opposes this provision.

8. New mandate for States to enact laws imposing penalties for misclassifying workers.

The bill would amend the provisions of the Social Security Act that impose conditions a State must satisfy to qualify for Federal funding of its unemployment programs to require a State's laws to require States to enact laws that create new penalties for worker misclassification. This would result in additional layers of complexity for companies and independent contractors in an already complicated system of determining an individual's status under existing Federal and State statutes.

Additionally, such a mandate would exacerbate the already excessive penalties proposed under S. 3254. Such provisions would do nothing to clarify existing company obligations for determining an individual's status as an employee or independent contractor for any purpose.

The Coalition would oppose this proposal for the foregoing reasons and also the reasons mentioned above under section 1.

9. Permit DOL to share information on worker misclassification with IRS.

The bill would permit the DOL's Wage and Hour Division to share information concerning worker misclassification with the IRS. States and the Federal Government already participate in extensive sharing of information about the classification of workers. Moreover, detailed information already is required from companies from several Federal agencies. It has yet to be demonstrated that additional systems of information sharing between Federal agencies will result in more effective enforcement of current laws. Until it is demonstrated by both the DOL and the IRS that the capability exists to streamline a system of enhanced information sharing, additional efforts will only serve to further burden an already beleaguered system used to enforce employment classification requirements. Furthermore, a determination

[4] The Form SS–8 is the Internal Revenue Service ("IRS") form used to obtain a determination from IRS as to the status of an individual as an employee or independent contractor for Federal taxes. To create another reason for individuals to submit Forms SS–8 would only add to an already overburdened IRS. A recently released audit report prepared by the Treasury Inspector General for Tax Administration ("TIGTA"), *Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing*, 2010–30–025 (March 23, 2010), found that the Form 8919 that the IRS created in response to a prior TIGTA audit report is contributing to a substantial increase in the volume of Form SS–8 submissions that is overwhelming IRS staff who respond to them.

needs to be made as to what type of information would be collected by the DOL and whether that information would be helpful to the IRS.

For the foregoing reasons, the Coalition opposes this proposal.

10. Require new DOL Web page containing information about the disparity of rights accorded employees versus independent contractors.

The proposed creation of a new DOL Web site emphasizing the regulatory distinction between employees and independent contractors would have the effect of deemphasizing the fundamental *business* differences between these two very different means of pursuing a livelihood. At a minimum, such a Web site should also mention the business differences.

Furthermore, the proposed Web site that would emphasize how independent contractors are denied protections accorded to employees not only would suggest that the two options are merely differences by degree, as opposed to being two fundamentally different approaches to income production, but it also would tacitly discourage individuals from pursuing self employment. From a public policy perspective, such a message from a government agency is morose. To be sure, rather than encouraging enterprising citizens to pursue their entrepreneurial dreams and grow the economy, the message would encourage individuals to secure refuge in the safety of employment, with all of the attendant government protections accorded that status.

The Coalition opposes this proposal.

11. The general effect of the bill would be to fundamentally re-characterize independent contractors from small businesses to hybrid employees.

An overarching concern with S. 3254 is that it would diminish the fundamental distinctions under the FSLA between employees and independent contractors, and inject an element of adversity between the contracting parties. The employee-type protections that the bill would impose on companies that do business with independent contractors, *e.g.*, the anti-retaliation provisions and the recordkeeping and notice requirements, would have the effect of converting independent contractors into a new status of *hybrid-employee*. This would be a decidedly negative change for those individuals who seek to establish their own business and compete head-to-head with larger firms.

Also, the new litigation hazards that the bill would create for companies doing business with independent contractors, and the exorbitant financial sanctions the bill would impose on a company for misclassifying workers, would tend to dissuade companies from doing business with independent contractors. Moreover, the proposed new notice requirements and DOL Web site content would tend to cause individuals to possibly question whether their decision to pursue self employment was a prudent decision; and for individuals newly investigating the possibility of pursuing this path, the Government's message to them would not be encouraging.

The cumulative effect of the bill's proposals would likely cause a material reduction in the amount of business conducted by independent contractors and a corresponding reduction in the number of individuals who operate as independent contractors. The Coalition respectively submits that such a policy is a threat to economic growth and threatens the livelihood of individuals who wish to remain independent contractors.

The Coalition submits that the Government should assist in the efforts of companies to create economic opportunities for employees and independent contractors alike through policies that encourage entrepreneurship; and it should recognize the benefits of opportunities afforded to individuals that are legitimately classified as independent contractors. Especially at a time when our economy attempts to recover from the magnitude of job losses not seen since the Great Depression, government policies should not place additional burdens on any form of legitimate economic activity.

The Coalition would appreciate the opportunity to work with the committee to develop proposals that help ensure the proper classification of individuals as employees or independent contractors while preserving the rights and prospects of legitimate independent contractors.

Respectfully submitted,

RUSSELL A. HOLLRAH,
Executive Director,
Coalition to Preserve Independent Contractor Status.

PREPARED STATEMENT OF JAMES P. HOFFA, GENERAL PRESIDENT, INTERNATIONAL BROTHERHOOD OF TEAMSTERS

The International Brotherhood of Teamsters strongly supports the Employee Misclassification Prevention Act (S. 3254). We commend Senator Sherrod Brown for introducing the bill, and Chairman Tom Harkin, Subcommittee Chair Patty Murray, and other members of the committee for cosponsoring this much-needed legislation. We would also like to express our appreciation to Chairman Harkin and Ranking Member Mike Enzi for convening this hearing to examine the rapidly escalating problem of worker misclassification—its impact on workers, compliant employers, and Federal and State governments—and to discuss efforts to crack down on this insidious practice.

The International Brotherhood of Teamsters represents more than 1.4 million men and women in a broad array of industries and occupations. Since its founding in 1903, the Teamsters Union has been a part of American workers' long and hard fight for dignity and fairness in the workplace and a fair share of our Nation's prosperity. This decades-long struggle has produced vital workplace laws guaranteeing important benefits and protections for workers.

These gains are now in jeopardy. We are seeing accelerating and intensified efforts to weaken and erode important workplace benefits and legal protections through the misclassification of workers. Millions of workers are illegally classified as independent contractors but essentially work as employees. They are "independent contractors" in name only and are cheated of important benefits and protections.

The problem of worker misclassification has skyrocketed. It is spreading to a broad range of industries, including industries where misclassification had not been a problem. Large segments of entire industries, such as construction, base their business model on misclassification of workers and tax fraud.

Worker misclassification cheats everyone: workers and their families; compliant and law-abiding businesses, Federal and State governments and taxpayers.

The law grants workers many important workplace benefits and protections so long as the worker is an *employee*. Those who are self-employed or are genuinely independent contractors have few rights in the workplace, but do control where they work.

Workers who are misclassified by their employers as independent contractors end up with the worst of both worlds. They are without meaningful control over their work, and they are also without the legal protections and benefits of employees. They have no rights to minimum wage or overtime, or to employer-provided health insurance, retirement benefits or paid leave. They are not covered under workplace safety and health laws, nor do they have legal rights to equal opportunity in the workplace or to job-protected family and medical leave. They have no rights under the veterans' reemployment law.

Workers misclassified as independent contractors have no rights to workers' compensation if injured or killed on the job, and no rights to unemployment insurance if laid off or fired. They are liable for both the employer's share of Social Security and Medicare taxes and for their own.

Sadly, many workers are not aware they've been misclassified and assume that they are employees. Often it is only when they are injured in the workplace or let go from the job and denied benefits that they find out they are "independent contractors."

Misclassification creates an uneven playing field. Lawful and ethical employers are placed at a competitive disadvantage. Companies that misclassify their workers as independent contractors have up to a 30 percent competitive advantage over law-abiding businesses. They unfairly cut their labor and administrative costs and avoid labor and employment law obligations. Undercut by unfair competition, responsible employers are cheated out of business opportunities. This uneven playing field also depresses wages and labor standards. Law-abiding employers subsidize the "free-loaders" by shouldering increased burdens for workers' compensation and for the unemployment insurance fund.

Misclassification also costs Federal and State governments billions of dollars in lost, but needed tax revenue. Between 1996 and 2004, $34.7 billion of Federal tax revenue went uncollected because employees were misclassified as independent contractors, according to a recent study. States also lose billions of dollars a year in income taxes, unemployment insurance taxes and workers' compensation premiums due to misclassification. Local governments with an income tax or "piggy-back" on Federal income tax also lose revenue.

For example, on average, 30 percent of Michigan employers misclassify employees or underreport employee payroll. The State loses $22 million–$33 million in income

tax revenue per year. The cost to the Federal Government has been estimated at $57.9 million–$96.5 million annually.

The Ohio attorney general estimates the State is losing $890 million annually for unemployment insurance tax, workers' compensation and State and local income taxes.

In Tennessee, researchers found that approximately 21 percent of the construction workforce was misclassified as independent contractors or paid under the table in 2006. That resulted in losses of $14 million to the State unemployment trust fund, $91.6 million in workers' compensation premiums and $115.4 million in Federal income and employment taxes.

This revenue loss is not pocket change. There is no excuse for allowing so many businesses to avoid paying their fair share. It is imperative that Congress try to solve this problem. The Teamsters Union supports efforts by the U.S. Senate to crack down on businesses that illegally classify their employees as independent contractors.

But first it's important to understand why misclassification is skyrocketing.

WHAT IS FUELING THE SKYROCKETING PREVALENCE OF MISCLASSIFICATION?

According to the National Employment Law Project:

> "under current law, there are only limited penalties, reporting requirements, and complaint procedures that regulate employers who hire independent contractors."

There are also significant tax loopholes in the law that facilitate, indeed encourage, misclassification.

The Employee Misclassification Prevention Act is an important step in solving this escalating problem. The legislation makes it an explicit violation of the Fair Labor Standards Act to make an inaccurate classification—that is, to misclassify. It would require employers to properly classify their workers, keep records of their classification, permit workers to challenge their classification and protect them from retaliation. It would also increase penalties under appropriate circumstances.

Passage of this legislation is needed to end this escalating abuse of the law. Also needed is passage of the Taxpayer Responsibility, Accountability, and Consistency Act (S. 2882/H.R. 3408) to close current tax loopholes that facilitate misclassification and payroll fraud. Allowing this situation to continue unabated rewards to cheaters at the expense of workers and law-abiding businesses and taxpayers.

The International Brotherhood of Teamsters looks forward to working with you to enact this much-needed legislation.

PREPARED STATEMENT OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS (NFIB)

Thank you for the opportunity to submit comments for the record on behalf of the National Federation of Independent Business (NFIB) regarding the classification of workers. The NFIB is the Nation's leading small business advocacy organization representing over 350,000 small business owners across the country. The typical NFIB member employs about 8 to 10 employees with annual gross receipts of about $500,000.

Small business plays an important role in the overall economy, accounting for half of the Nation's GDP and employs half of the American workforce, creating 75 percent of the net new jobs over the last decade.

Small businesses continue to struggle through the recession. While lost sales continue to be the No. 1 problem facing small business owners, uncertainty is second.[1] The new mandates, legal requirements, and regulations coming from Washington, create even more uncertainty for small business owners, which impedes growth and job creation.

That is why it is important for Congress to carefully consider any changes made to the current laws regarding independent contractors. S. 3254, the Employee Misclassification Prevention Act, takes a number of additional steps that could raise new challenges for businesses looking to hire a contractor and for businesses hoping to fill contract jobs. Specifically, new paperwork and notice requirements—coupled with efforts already underway to increase investigations and enforcement of worker classification cases—will place new burdens on many small businesses.

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[1] *Small Business Credit in a Deep Recession—NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 10; Issue 1; 2010.

THE IMPORTANCE OF INDEPENDENT CONTRACTORS TO SMALL BUSINESS

To better understand the role that independent contractors play in the small business economy, the NFIB Research Foundation conducted a survey regarding the use of independent contractors.[2] As the survey notes, independent contractors play a large and important role in the small business economy.

While a business may hire a contractor in any number of fields, the survey was limited to three common fields—construction, transportation/delivery, and computer services. Just examining these three areas, 61 percent of the entire small business population relied on at least one contractor in one of these three fields over the last 3 years.[3]

The survey also attempted to understand why a small business might rely on an independent contractor. Lack of in-house expertise and no need to make an investment in an employee surfaced as the top reasons to rely on an independent contractor.[4] Small business owners decided to hire a regular employee based on the need for reliability and accountability.[5]

The findings of the survey make practical sense. If a business owner is setting up a new software system for his business, hiring a permanent IT employee may not make sense if the business only needs the services of the IT specialist for the installation of the software. This is a legitimate set of facts for hiring an independent contractor and Congress needs to make sure that changes to the law do not chill this type of business opportunity for both the business owner and the contractor.

The use of an independent contractor covers both sides of an economic equation. On the one side is the firm that needs the specialized skills of a particular firm to fill a need for a short period of time. Filling this need helps the hiring firm to operate more efficiently. On the other side of the equation is the firm filling the specialized need and seeking other similar opportunities. It is this side of the equation that provides a steady income and the opportunity to create and expand smaller firms.

Independent contractors play an especially important role for small businesses and, in turn, play an important role in the overall economy. Small businesses, even those consisting of one person, that handle relatively small jobs are simply part of the overall process. Scale is what differentiates them from their larger counterparts.

CHANGES TO INDEPENDENT CONTRACTOR RULES AND THE IMPACT ON SMALL BUSINESSES

Business owners currently face a number of different tests and rules relative to the hiring of an independent contractor. In addition to the requirements under labor law, business owners also face a vague 20-factor IRS test and differing State standards. A lack of clarity in the law can place small business owners at a disadvantage when attempting to comply with the law.

This confusion is particularly true relative to the IRS test. The current test allows the IRS to examine the classification of employees based on a 20-factor test, but not all 20 factors must be used. The basis for the test is determining whether or not the business owner has control over the contractor. If the business owner has control, then the contractor should be classified as an employee.

S. 3254 only makes the current system worse and disproportionately impacts small businesses. First, S. 3254 will place a heavy new paperwork burden and notice requirement on small business owners. The cost of complying with Federal Government paperwork is an empty expense for a small business owner, taking away capital that can be better spent on reinvesting in the business and creating jobs. Specifically, the bill would require the business to maintain documents relative to the classification of employees and independent contractors. Based on an NFIB Research Foundation survey, the cost of complying with personnel-related paperwork is about $36 per hour.[6] When considering that hourly cost to the many different contracting jobs a firm may be involved with, this would be a major new cost to small business owners.

This new paperwork burden would be added to the enormous new paperwork burden recently passed by in the Patient Protection and Affordable Care Act (PPACA).

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[2] *Independent Contractors—NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 8; Issue 6; 2008.

[3] *Ibid*.

[4] *Ibid.*

[5] *Ibid.*

[6] The $36 per hour expense for personnel-related paperwork is adjusted for inflation from the original survey amount. *Paperwork and Record-keeping—NFIB Small Business Poll*, NFIB Research Foundation, Washington, DC, Volume 3; Issue 5; 2003.

The PPACA requires a business to report all service-related transactions as well as the purchase of goods for over $600. A copy of the information return must be sent to both the business from which the services or goods are purchased and the IRS. This is a huge new paperwork requirement on small business. Even worse, the intent behind all of this new reporting is to audit more businesses adding even more compliance costs to operating a business.

Second, the requirements in S. 3254 also have a disparate impact on small business. The cost of complying with paperwork and government regulations falls disproportionately on small businesses. These businesses usually do not have the in-house staff that a larger firm would to handle paperwork and regulations. This means that a small firm must either bring in a new employee just to handle paperwork or outsource the task to another firm. All of this makes the small business less efficient and less competitive, placing small firms at a disadvantage compared to their larger competitors.

In addition, to the legislation considered by the committee today, pending before both the Senate and House of Representatives is legislation that would change the tax law relative to the classification of employees. Both bills—S. 2882 and H.R. 3408—would allow the IRS to draft regulations to establish a test for classifying workers and, at the same time, would remove the current legal standards that allow business to challenge IRS audits. Under these bills the only way that a business could protect itself from misclassification penalties is if the business passed a previous IRS audit or requests a private letter ruling from the IRS.

This is an unworkable system for small businesses. The only way to be certain that their classification of a worker will not be subject to IRS penalties would be to seek approval from the IRS. It makes no sense to force small businesses to receive permission before they make a decision about their business.

S. 3254 only makes the current system worse, by adding new paperwork and notice requirements on small business owner. When coupled with the potential changes in S. 2882 and H.R. 3408, the new requirements in S. 3254 will make decisions with regard to hiring workers or contractors even more complex and risky. Making the situation even worse, is the increased audits and enforcements already underway. In fact, at the beginning of this year, the IRS announced 6,000 random audits of businesses focusing on employment taxes, with particular attention on employee classification issues.

Small business owners continue to struggle to recover from the recession and uncertainty is one of their two biggest concerns. Increasing the regulatory burden and government paperwork requirements does nothing to help small business owners recover from the recession. Increased regulations, paperwork, and audits take away money that could be used to grow the business and create jobs.

Small business owners do not oppose efforts to clarify the rules relative to classifying workers. For more than three decades, a murky standard has developed around this area of the law creating a confusing and unclear standard for classifying workers. The challenge with the bill currently being considered by the committee is that it does nothing to clarify the standard, but simply requires the business to collect more information.

Instead of adding to the regulatory and compliance burden already faced by small business owners, Congress needs to consider ways to reduce this burden. By reducing these burdens, we can reduce the cost of doing business and create an environment that allows small business to compete and innovate. This will ultimately strengthen the economy and help small business owners to create new jobs.

NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED (NASE),
WASHINGTON, DC 20004,
June 15, 2010.

Hon. TOM HARKIN, *Chairman,*
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
428 Dirksen Senate Office Building,
Washington, DC 20510.

Hon. MICHAEL B. ENZI, *Ranking Member,*
Committee on Health, Education, Labor, and Pensions,
U.S. Senate,
835 Hart Senate Office Building,
Washington, DC 20510.

DEAR CHAIRMAN HARKIN AND RANKING MEMBER ENZI: Micro-businesses, those with fewer than 10 employees, have long been pillars of innovation and job creation in our Nation, fueling much of what is great about America. During this uncertain economic time, the role of these vital businesses has become even more important. Furthermore, with big business downsizing and many industries in flux, a large number of citizens find themselves in a position in which the only viable avenue of employment is self-employment.

Our tax code is often the biggest hurdle faced by entrepreneurs due to its complexity and paperwork burden. Micro-businesses and the self-employed are particularly disadvantaged since many of these entrepreneurs handle their accounting and tax preparation on their own. Worker classification regulations are a prime example of an area of the code causing consternation amongst business owners.

Of the 23 million self-employed Americans, a large number are independent contractors and a significant number of micro-businesses utilize contractors for services within their business. Upon review of the Employer Misclassification Prevention Act (S. 3254), the National Association for the Self-Employed (NASE) is concerned that this legislation's approach to worker classification will negatively impact our Nation's smallest businesses.

The core issues plaguing worker classification stem from the fact that classification of an individual into an employee or an independent contractor is **subjective** under the tax code. The IRS has a complicated 20-point checklist that can be used as a guideline in determining whether or not an individual is an employee or an independent contractor. Yet, using this checklist does not guarantee that a person is correctly classified. Other IRS materials published to assist in classification are equally convoluted. NASE members have indicated that when utilizing the IRS's tax assistance help line on this issue, they have received different answers from different agents on this same issue. A large part of the problem is that there is no one, single, homogenous definition of the term "employee." Thus, there is no clear and concise manner for a self-employed individual or micro-business owner to easily determine when an individual should be classified as an independent contractor or an employee.

The Employer Misclassification Prevention Act does not address this central problem of classification rules. Rather the legislation focuses on increased enforcement and audits, instead of simplifying regulations which would lead to better compliance. Furthermore, the bill will increase accounting costs and the paper load on small businesses.

We urge you to oppose the Employer Misclassification Prevention Act (S. 3254) due to the harmful impact it will have on the small business community. This legislation will ultimately create a disincentive for businesses and consumers to utilize the services of independent contractors, hobbling many entrepreneurs in this challenging economic climate.

The NASE strongly believes that our policymakers should be focused on drafting legislation that removes and/or simplifies regulatory barriers on our Nation's smallest businesses and prospective entrepreneurs, freeing up both their time and money to start, manage and grow their business; a business that enables them to provide for their family and contribute to their local community.

If you have any questions or comments, please contact Kristie Arslan, NASE's executive director, via phone at 202–466–2100 or e-mail at karslan@naseadmin.org.

Thank you for your consideration.

Sincerely,

ROBERT HUGHES,
NASE President.

[Whereupon, at 12:07 p.m., the hearing was adjourned.]

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