SHEET METAL AND AIR CONDITIONING CONTRACTORS' NATIONAL ASSOCIATION, INC.

December 13, 2022

VIA ELECTRONIC SUBMISSION

Jessica Looman
Acting Administrator
Wage and Hour Division
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

RE: Public Comments on RIN 1235-AA43 – Employee or Independent Contractor Classification Under the Fair Labor Standards Act

Dear Ms. Looman:

The Sheet Metal and Air Conditioning Contractors' National Association (SMACNA) is an international trade association representing 3,500 signatory contracting firms with more than 100 chapters throughout the United States, Canada, Australia, and Brazil. SMACNA provides its sheet metal and air-conditioning contractor members with assistance in areas including business management, labor relations, marketing, governmental affairs, and technical research and development – on both a national and local level.

SMACNA provides these comments in support of the DOL's Notice of Proposed Rulemaking, *Employee or Independent Contractor Classification Under the Fair Labor Standards Act*, 87 Fed. Reg. 62218 (Oct. 13, 2022) (hereafter "Proposed IC Rule"). As outlined in detail below, SMACNA supports the Proposed IC Rule because it returns to the "totality-of-the-circumstances analysis" for the "economic reality test," which means that each factor is analyzed "in the context of the ultimate inquiry of whether the worker is economically dependent on the employer or in business for themselves." This is consistent with the FLSA's sweeping definition of "employee," which the Supreme Court has described as "the broadest definition [of 'employee'] that has ever been included in any one act."[1]

While the Proposed IC Rule is an important step, SMACNA believes that the construction industry needs stronger protections against the deliberate misclassification of workers as independent contractors – also called "***worker status fraud***." Specifically, the DOL should develop rules specific to the construction industry to prevent unscrupulous contractors from deliberately misclassifying workers to gain an unfair advantage over law-abiding contractors that pay workers middle-class wages and benefits. Not only does this lead to general

[1] *United States v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945) (quoting 81 Cong. Rec. 7657 (1937) (statement of Sen. Hugo Black)).

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disrespect for the law, but also it creates perverse incentives for businesses facing vigorous competition to cheat in order to meet the artificially low prices of their dishonest counterparts.

I. BACKGROUND

In 1938, Congress enacted the FLSA to combat the pervasive "evils and dangers resulting from wages too low to buy the bare necessities of life and from long hours of work injurious to health."[2] Congress intended the FLSA "to free commerce from the interferences arising from the production of goods under conditions that were detrimental to the health and well-being of workers,"[3] and to protect "the rights of those who toil, of those who sacrifice a full measure of their freedom and talents to the use and profit of others."[4] To that end, the FLSA establishes a federal minimum wage and requires employers to pay "a rate not less than one and one-half times the regular rate" to employees who work more than forty hours in a single workweek.[5]

The term "independent contractor" is not defined in the FLSA. Nevertheless, in accordance with the FLSA's "remedial and humanitarian" purpose, "employee" is defined to mean "any individual employed by an employer," "employer" is defined to include "any person acting directly or indirectly in the interest of an employer in relation to an employee," and the term "employ" means "to suffer or permit to work."[6] These definitions are intentionally broad.

As the Supreme Court has recognized, the FLSA's definitions are so "comprehensive" that they apply "to many persons and working relationships" that did not historically "fall within an employer-employee category."[7] Decades later, the Court again noted the "striking breadth" of the FLSA's definitions of "employ," which "stretches the meaning of 'employee' to cover some parties who might not qualify as such" under "traditional agency law principles."[8]

Notwithstanding these broad statutory definitions, use (or misuse) of independent contractors in the construction industry is rampant. According to the DOL's own figures, the construction industry represents only ***6.9%*** of the total U.S. workforce, but it has nearly ***20%*** of the (reported) independent contractors.[9] A significant portion of these workers are misclassified.

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[2] S. Rep. No. 75–884, at 4 (1937).

[3] *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 727 (1947).

[4] *Tennessee Coal, Iron & R.R. Co. v. Muscoda Local No. 123*, 321 U.S. 590, 597 (1944), *superseded in part by statute*, 29 U.S.C. § 254(a) (1947).

[5] 29 U.S.C. §§ 206(a), 207(a)(1).

[6] 29 U.S.C. § 203(e)(1); 29 U.S.C. § 203(g).

[7] *Walling v. Portland Terminal Co.*, 330 U.S. 148, 150-51 (1947) (citation omitted).

[8] *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992).

[9] Proposed IC Rule, 87 Fed. Reg. at 62265.

By contrast, the financial services industry similarly represents approximately 6.9% of the total U.S. workforce, but it has only 9.6% of the total independent contractors.[10]

The construction industry is not a statistical anomaly. Worker misclassification in the construction industry is a long-standing and pervasive problem. While returning to the "totality-of-the-circumstances analysis" for the "economic reality test" is an important step, SMACNA believes that the DOL should also consider promulgating stronger protections against "worker status fraud" in the construction industry.

II. HISTORY OF CHEATING IN THE CONSTRUCTION INDUSTRY

Since the 1980s, SMACNA has sounded the alarm on worker status fraud. In 1999, SMACNA called worker status fraud "***an epidemic in the construction industry***." Even then, it was becoming impossible for legitimate contractors to compete against unscrupulous contractors that classified more than half of their workers as independent contractors. Unfortunately, the industry's prognosis has only gotten worse.

The construction business is highly competitive. Projects are frequently awarded to the lowest bidder and, as a result, there is an inherent pressure to lower costs and win more projects. Because material costs are typically similar, unscrupulous contractors look to worker status fraud as an easy way to reduce labor costs. For example, worker status fraud avoids "employee" related costs, such as: employment taxes, withholding of employee-side taxes, unemployment insurance, workers' compensation premiums, health insurance, retirement benefits, paid sick leave, family medical leave, and overtime premium pay. Contractors who misclassify their workers as independent contractors also avoid I-9 (or worker status) verification requirements, OSHA safety standards, and any potential union organizing.

To be clear, worker status fraud in the construction industry is ***not*** about unsophisticated businesses making "difficult legal calls" or applying complicated legal factors to ambiguous facts. ***It is about cheating***. It is about unscrupulous contractors making a conscious decision to avoid tax laws, wage and hour laws, workers' compensation laws, unemployment insurance laws, and other basic responsibilities of being a legitimate construction contractor. This is done for the express purpose of gaining a competitive advantage against law-abiding competitors, realizing tremendous profits, and avoiding the financial risks that honest entrepreneurs must accept. Construction contractors that engage in worker status fraud do not bear the risks of unanticipated overtime, bad planning, or poor execution. Instead, this racket transfers these risks onto workers and taxpayers.

Unfortunately, the statistics show that "crime pays" and worker status fraud gives unscrupulous contractors a significant competitive advantage against legitimate contractors that play by the rules. Study after study has shown that, by engaging in worker status fraud, ***unscrupulous contractors can reduce their labor costs by as much as 50%***:

[10] Proposed IC Rule, 87 Fed. Reg. at 62265.

- A 2021 study by the Midwest Policy Institute found:
    - Unscrupulous contractors in Wisconsin can reduce their labor costs by ***31%*** by misclassifying workers as independent contractors.
    - Unscrupulous contractors in Minnesota can reduce their labor costs by ***36%*** by misclassifying workers as independent contractors.
    - Unscrupulous contractors Illinois can reduce their labor costs by ***29%*** by misclassifying workers as independent contractors.[11]
- In 2020, Harvard Law Professor Mark Elrich opined that "[t]he ability to eliminate as much as ***30% (or more)*** of labor costs by simply reclassifying a company's workforce as independent contractors was a clever and effective method to gain a competitive edge over other contractors who continued to bear the burden of required mandates."[12]
- A 2019 study in the District of Columbia found that contractors who misclassify workers reduce their labor costs by ***16.7% to 48.1%***.[13]
- A 2011 study estimated that ***19%*** of California construction workers were misclassified as independent contractors and these workers earned only 67 cents for every dollar earned by comparable workers with employee status.[14]
- A 2010 study by the Ohio Attorney General's office estimated that misclassifying a worker makes a ***20% to 30%*** cost difference per worker.[15]

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[11] Nathaniel Goodell and Frank Manzo IV, M.P.P., *The Costs of Wage Theft and Payroll Fraud in the Construction Industries of Wisconsin, Minnesota, and Illinois* (January 14, 2021) (available at https://dwd.wisconsin.gov/misclassification/pdf/meetings/210114/costs-of-payroll-fraud.pdf).

[12] Mark Elrich, *Misclassification in Construction: The Original Gig Economy*, ILR Rev. (2020) (available at https://lwp.law.harvard.edu/files/lwp/files/erlich_ilrr_final_article_11.28.20.pdf).

[13] Karl Racine, Attorney General for the District of Columbia, *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry*, (May 22, 2019) (available at https://oag.dc.gov/sites/default/files/2019-09/OAG-Illegal-Worker-Misclassification-Report.pdf).

[14] Yvonne Yen Liu and Daniel Flaming, *Sinking Underground: The Growing Informal Economy in California Construction*, Economic Roundtable (September 2014) (available at https://economicrt.org/publication/sinking-underground/).

[15] Press Release, Sherrod Brown Senator for Ohio, Sen. Brown Joins Colleague in Announcing Bill to Ensure that Workers Receive Protection and Benefits They Have Earned (April 22, 2010) (available at: http:// www.brown.senate.gov/newsroom/press/release/sen-brown-joins-colleague-in-announcing-bill-to-ensure-that-workers-receive-protection-and-benefits-they-have-earned).

- A 2007 study by the Minnesota Office of the Legislative Auditor found that a construction contractor could lower its labor costs by ***26%*** by misclassifying employees as independent contractors.[16]

As you can see, contractors that "play by the rules" are at a competitive disadvantage. Not surprisingly, then, over the past 20 years, numerous studies have found misclassification rates in the construction industry varied from ***12%*** to ***33%***:

- A 2020 analysis estimated that, in 2017, between ***12.4% and 20.5%*** of the construction industry workforce were either misclassified as independent contractors or working "off-the-books."[17]

- Statewide estimates in Tennessee, New Jersey and California suggested that ***11% to 21%*** of their state's construction workforce was either misclassified or working off the books.[18]

- Studies on New York City and Los Angeles County suggest that these rates may be higher in metropolitan areas, with rates between ***25% and 30%*** in the two jurisdictions.[19]

- A 2011 study estimated that ***19%*** of California construction workers who were independent contractors were misclassified.[20]

- In 2014, McClatchy Company released a report entitled "*Contract to Cheat*," which was the result of a yearlong investigation into worker misclassification in the construction industry. The investigation focused on federal housing projects from 28 states that were funded by the 2009 economic stimulus package. The investigators reviewed payroll records from these projects and interviewed hundreds of workers and employers. According to the McClatchy report, the rate of misclassification of construction workers varied by state but ***was as high as 35.2% in North Carolina and 37.7% in Texas***.[21]

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[16] Minnesota Office of the Legislative Auditor, Auditor, *Illegal Worker Misclassification: Payroll Fraud in the District's Construction Industry*, (November 2007) (available at https://www.auditor.leg.state.mn.us/ped/pedrep/missclasssum.pdf).

[17] Russell Ormiston, Dale Belman, and Mark Erlich, "*An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry*," (January 2020) (available at https://stoptaxfraud.net/wp-content/uploads/2020/03/National-Carpenters-Study-Methodology-for-Wage-and-Tax-Fraud-Report-FINAL.pdf) .

[18] *Id.*

[19] *Id.*

[20] Yvonne Yen Liu and Daniel Flaming, *Sinking Underground: The Growing Informal Economy in California Construction*, Economic Roundtable (September 2014) (available at https://economicrt.org/publication/sinking-underground/).

[21] Franco Ordoñez and Mandy Locke, "*IRS' 'Safe Harbor' Loophole Frustrates Those Fighting Labor Tax Cheats*," McClatchy Washington Bureau, December 14, 2014 (available at https://www.mcclatchydc.com/news/nation-world/national/economy/article24777397.html).

- A 2009 study in Michigan found that ***26.4%*** of construction firms misclassified employees; among those who did so, ***18.9%*** of their employees were misclassified.[22]

- A 2004 study of construction firms in Massachusetts misclassified employees and ***one-in-seven construction workers*** were misclassified as independent contractors.[23]

III. WORKER STATUS FRAUD HARMS WORKERS, TAXPAYERS, AND COMPANIES THAT PLAY BY THE RULES

The harm precipitated by worker status fraud is concentric. It begins with the workers, stripping them of protections and benefits they would otherwise be entitled to as employees, such as workers' compensation, unemployment insurance, paid sick leave, minimum wage protection, and overtime pay. The harm then emanates to the construction industry, as law-abiding employers are confronted with a race to the bottom, competing against unscrupulous companies operating on illegally suppressed costs. Finally, the harm extends to state and local governments, as the unscrupulous companies enjoy the benefits of doing business within their borders while evading the payroll taxes that they are required to pay and socializing the cost of underpaying workers on the tax paying public.

A. WORKER STATUS FRAUD HARMS WORKERS.

Studies have shown that misclassified workers make significantly less than workers paid as employees. One government expert calculated that a construction worker earning $31,200 a year before taxes would be left with an annual net compensation of ***$10,660.80*** if paid as an independent contractor, compared to $21,885.20 if paid properly as an employee.[24] That is a 50% reduction in the employee's take-home wages.

In addition, important legal obligations including prevailing wage, workers compensation, EEO, family and medical leave, overtime, unemployment compensation, minimum wage, Medicare and other labor and employment laws adhered to by lawful contractors are irrelevant to the employers misclassifying workers. Oftentimes, employees misclassified as independent contractors are left without the benefit of economic, workforce, and legal protections to which they are fully entitled.

In today's economy, good paying jobs with health care and related benefits are already scarce in construction and other industries. However, workers classified as independent

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[22] Dale Belman and Richard Block, "*The Social and Economic Costs of Employee Misclassification in Michigan*," Michigan State Institute for Public Policy and Social Research, 2009 available at https://ippsr.msu.edu/sites/default/files/MAPPR/ARMisClass.pdf).

[23] Françoise Carré, et. al, "*The Social and Economic Costs of Employee Misclassification in Construction*," Construction Policy Research Center, (December 17, 2004).

[24] Tim Crowley, UI Tax Chief, U.S. Department of Labor, *Worker Misclassification – An Update from Constitution Ave.* (Oct. 24, 2012).

contractors are even less likely to receive any type of health and pension benefits, including workers compensation should they be injured on the job. They are burdened with paying the full portion of Social Security and Medicare taxes yet numerous reports document that they are not making these payments, mistakenly assuming they are employees and that their employee contributions are being made by the employer. Often these misclassified workers are unaware of the employment laws altogether for a variety of reasons ranging from language difficulties, workplace inexperience and many others.

A 2022 report by the University of California Berkeley Labor Center analyzed the number of construction worker families in the U.S. enrolled in safety net programs, including: Medicare, Medicaid, the earned income tax credit, Temporary Assistance for Needy Families, and the Supplemental Nutrition Assistance Program.[25] Shockingly, 39% of construction worker families are enrolled in at least one safety-net program, costing state and federal taxpayers $28 billion a year. That compares to 31% of all working families. Additionally, 31% of construction workers do not have health insurance compared to 10% of all workers.

The authors of the report attributed the high degree of reliance on public assistance to several factors. Chief among them was worker status fraud. As the authors explained:

> The practices of misclassification and paying off the books are most likely to occur in industries where it is most profitable and most easily hidden, both true of the construction industry. Employers in construction can accrue tremendous savings by avoiding employment taxes and workers' compensation premiums, and the layers and layers of subcontracting characteristic of the industry make these practices easy to conceal. In most states, general and subcontractors are not liable or—and in fact benefit from—payroll fraud found further "down the chain" of subcontractors; these practices continue "with or without the knowledge, assistance or willful ignorance of the owners, developers, general contractors, or construction managers." Overall, ***between 12.4 and 20.5% of construction workers are either misclassified or paid under the table***.[26]

Construction is a dangerous industry. 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. Misclassified workers are also deprived of OSHA safety training and safety programs, which are generally operated by their employer.

Worker status fraud also deprives workers of needed skills training. It is no secret that the construction industry is facing a nationwide skill shortage. A recent report from McKinsey

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[25] Ken Jacobs et al, "*The Public Cost of Low-Wage Jobs in the US Construction Industry*," UC Berkley Labor Center, January 2022 (available at https://laborcenter.berkeley.edu/wp-content/uploads/2022/01/The-Public-Cost-of-Low-Wage-Jobs-in-the-US-Construction-Industry-FINAL.pdf).

[26] *Id.* at 3.

& Company found that, in October 2021, 402,000 construction positions remain unfilled, which is the second-highest level recorded since data collection began in December 2000.[27] Another study found that the construction industry will need to attract nearly 650,000 additional workers on top of the normal pace of hiring in 2022 to meet the demand for labor.[28]

Training and apprenticeship programs operated by local unions provide the best training in the construction industry.[29] For example, SMACNA and SMART's partnership has been providing skilled, trained, and certified workers to respond in a timely manner to meet industry demands for more than a century. SMART, with more than 203,000 members, provides classroom, hands-on, on-the-job and rapid response training to its members through federal and state registered apprenticeships in more than 150 state of the art training centers located throughout the United States and Canada. Workers who are misclassified as independent contractors have no access to these programs and, if the worker status fraud epidemic is allowed to continue, the industry will continue to fail to meet the nation's need for skilled construction workers.

Worker status fraud also harms diversity, equity, and inclusion. Misclassified workers are not entitled to protection of anti-discrimination laws. These fundamental protections – including the right to be free from race discrimination – are inapplicable to independent contractors. In contrast, directly employed workers are entitled to protections from state and federal anti-discrimination laws. What is more, many collective bargaining agreements promote diversity, equity, and inclusion by providing a structured pathway for local residents to gain access to career training in the skilled trades. Most skilled trade apprenticeships offer "earn while you learn" programs that mandate five years of training consisting of over 800 hours of classroom education and 8,000 hours of on-the-job training under the supervision of an experienced and highly skilled tradesperson. In some cases, the completion of a skilled craft apprenticeship program includes the awarding of a two-year Associate's Degree from a local community college. These opportunities are not available for workers who are misclassified as independent contractors.

B. WORKER STATUS FRAUD HARMS TAXPAYERS.

Worker status fraud also costs federal and state governments billions of dollars in tax revenue.

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[27] Available at https://www.mckinsey.com/capabilities/operations/our-insights/bridging-the-labor-mismatch-in-us-construction.

[28] Available at https://www.abc.org/News-Media/News-Releases/entryid/19255/abc-construction-industry-faces-workforce-shortage-of-650-000-in-2022.

[29] Argyres & Moir, Building Trades Apprentice Training in Massachusetts: An Analysis of Union and Non-Union Programs, 1997-2007, LABOR RESOURCE CENTER (Oct. 2008); see also Bradley & Herzenberg, Construction and Apprenticeship Training In Pennsylvania, KEYSTONE RESEARCH CENTER (2002) ("Union apprenticeship programs have outperformed non-union ones on all critical measures of program success that we have examined: enrollment levels, graduation rates, enrollment and graduation rates for minorities and females, increases in enrollment levels to meet expanding industry needs.").

According to a 2020 analysis, the gap between what taxpayers pay to the federal government and what they should pay is about ***$600 billion per year***.[30] The construction industry is a major contributor to these tax losses.

Specifically, it has been estimated that worker status fraud in the construction industry contributes an estimated loss of ***$8.4 billion per year*** in state and federal income taxes, unemployment insurance contributions, Social Security, and Medicare taxes.[31]

Contractors that break the law offload as much as $3.48 billion in federal employment taxes they are obligated to pay onto the backs of their workers and their families.[32] In addition, workers' compensation insurance carriers are cheated out of $2 billion in premiums. These are only the midlevel estimates. Using more aggressive assumptions, criminal contractors shave as much as ***$17.3 billion*** in costs by breaking the law.[33]

Other studies have identified similar nonreporting or underreporting of income by misclassified workers:

- In 2022, the Pennsylvania Joint Task Force on Misclassification of Employees found that, in 2021, worker status fraud cost the state unemployment fund $91 million. The task force also found that worker status fraud caused a loss of revenue of $6.4 million to $124.5 million in general fund collection.[34]

- A 2021 study by the Midwest Policy Institute found:

    - Wisconsin annually loses $40 million in state tax revenues due to worker status fraud in construction, including: $8 million in income taxes, $6 million in unemployment insurance contributions, and $26 million in workers' compensation premiums.

    - Minnesota annually loses $136 million in state tax revenues due to worker status fraud in construction, including: $65 million in income taxes, $13 million in unemployment insurance contributions, and $58 million in workers' compensation premiums.

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[30] Natasha Sarin, *The Case of a Robust Attack on the Tax Gap*, U.S. Dept. of the Treasury (Sept. 7, 2021), (available at https://home.treasury.gov/news/featured-stories/the-case-for-a-robust-attack-on-the-tax-gap).

[31] Russell Ormiston, et al, *An Empirical Methodology to Estimate the Incidence and Costs of Payroll Fraud in the Construction Industry*, 5 (2020) (available at https://faircontracting.org/wp-content/uploads/2020/03/National-Carpenters-Study-Methodology-for-Wage-and-Tax-Fraud-Report-FINAL.pdf).

[32] *Id.*

[33] *Id.*

[34] Pennsylvania Department of Labor, *Joint Task Force on Misclassification of Employees* (Dec. 1, 2022).

- Illinois annually loses $186 million in state tax revenues due to worker status fraud in the construction industry, including: $60 million in income taxes, $23 million in unemployment insurance contributions, and $103 million in workers' compensation premiums.[35]

- A 2021 report in Massachusetts found that worker status fraud resulted in a $24.5 million to $40.6 million shortfall in the state's unemployment insurance fund in 2019. Misclassification similarly resulted in a reduction between $37 million and $78.3 million in workers' compensation insurance premiums.[36]

- In 2019, the New Jersey Task Force on Employee Misclassification found that "the failure to properly classify construction employees resulted in state income taxes not being paid for up to $11 million in off-the-books employment and nearly $9 million from employment of misclassified workers."[37]

- In 2015, the New York Joint Enforcement Task Force on Employee Misclassification identified approximately 26,000 instances of worker misclassification and nearly $316 million in unreported wages. In addition, the task force found that, since August 2007, there have been 140,000 instances of worker misclassification and nearly $2.1 billion in unreported wages.[38]

- In 2014, a study by McClatchy Company found that annual tax losses amount to about $400 million in Florida, $467 million in North Carolina, and $1.2 billion in Texas.[39]

- A 2010 study by the Ohio Attorney General's office estimated that the state of Ohio loses approximately $160 million a year in tax revenue due to worker misclassification.[40]

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[35] Nathaniel Goodell and Frank Manzo IV, M.P.P., *The Costs of Wage Theft and Payroll Fraud in the Construction Industries of Wisconsin, Minnesota, and Illinois* (January 14, 2021) (available at https://dwd.wisconsin.gov/misclassification/pdf/meetings/210114/costs-of-payroll-fraud.pdf).

[36] Tom Juravich, et. al, *The Social and Economic Costs of Illegal Misclassification, Wage Theft and Tax Fraud in Residential Construction in Massachusetts* (June 28, 2021) (available at https://www.umass.edu/lrrc/sites/default/files/Juravich%20Wage%20Theft%206%2028%2021.pdf).

[37] New Jersey Department of Labor, *Report of Task Force on Employee Misclassification* (July 2019) (available at https://www.nj.gov/labor/assets/PDFs/Misclassification%20Report%202019.pdf).

[38] New York Department of Labor, *Annual Report of the Joint Enforcement Task Force on Employee Misclassification* (Feb. 1, 2015) (available at https://dol.ny.gov/system/files/documents/2021/02/misclassification-task-force-report-2-1-2015.pdf).

[39] Franco Ordoñez and Mandy Locke, "*IRS' 'Safe Harbor' Loophole Frustrates Those Fighting Labor Tax Cheats*," McClatchy Washington Bureau, December 14, 2014 (available at https://www.mcclatchydc.com/news/nation-world/national/economy/article24777397.html).

[40] Press Release, Sherrod Brown Senator for Ohio, Sen. Brown Joins Colleague in Announcing Bill to Ensure that Workers Receive Protection and Benefits They Have Earned (April 22, 2010) (available at:

- One study found that 30% of Michigan employers misclassified employees or underreported employee payroll. The study estimated that Michigan loses $22 million to $33 million in income tax revenue per year.

- A 2006 study in Tennessee found that approximately 21% 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.

- A 2004 study in Massachusetts study estimated that, from 2001-2003, up to $7 million of workers' compensation premiums were not paid for misclassified construction workers.[41]

C. WORKER STATUS FRAUD HARMS COMPANIES THAT PLAY BY THE RULES.

Worker status fraud creates an uneven playing field. Unfortunately, the construction industry is becoming increasingly defined by contractors who do not play by the rules. Lawful and ethical employers are placed at a competitive disadvantage. Specifically, these unprincipled contractors attempt to win bids and fatten their profit margins by intentionally doing things that subvert the law. They will submit drastically low bids knowing they have no intention of following prevailing wage laws, even when mandated by law. These contractors are increasingly engaged in "misclassifying" their employees as "independent contractors" in order to avoid paying federal and state taxes, workers' compensation, and unemployment insurance benefits. This allows them to submit an even lower bid while simultaneously ripping off the taxpayers by not paying requisite taxes.

Unfortunately, it has also become a de facto part of the "race to the bottom" business model to utilize and exploit illegal and undocumented workers and pay them sub-standard wages (or not pay them at all, in some cases). This uneven playing field also depresses wages and labor standards. Law-abiding employers subsidize the "freeloaders" by shouldering increased burdens for workers' compensation and for the unemployment insurance fund. And finally, these contractors are not averse to using inferior materials, and taking unsafe shortcuts that put workers, as well as the project itself, in danger.

Not surprisingly, these contractors, and the organizations that represent them are the most vocal opponents of restrictions regarding independent contractors and prevailing wage laws.

An analysis by the University of California found that $10.1 billion of the $21.2 billion that federal and state taxpayers spent in 2002 on public assistance programs in California went to

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http:// www.brown.senate.gov/newsroom/press/release/sen-brown-joins-colleague-in-announcing-bill-to-ensure-that-workers-receive-protection-and-benefits-they-have-earned).

[41] Françoise Carré, et. al, "*The Social and Economic Costs of Employee Misclassification in Construction*," Construction Policy Research Center, (December 17, 2004).

families of low-wage workers. Similar analyses have demonstrated corresponding public costs attributable to low-wage employers in New York, Wisconsin, and Illinois.

Conversely, a growing body of research demonstrates that in many industries, contractors that provide good wages and benefits and respect workplace laws deliver higher quality services for government agencies and the taxpayers.

In construction, research has indicated that high road contractors that comply with workplace laws and provide quality training, along with family-sustaining wages and benefits, typically have better skilled and more productive workforces that increase both the productivity and quality associated with public construction work.[42] And that results in savings for the taxpayers.

It is simply a matter of common sense and economics. A highly paid, highly trained workforce is more productive, which can have the effect of producing lower labor costs than a low-wage, low-skill workforce.

As early as the 1980's, an audit by the U.S. Department of Housing and Urban Development (HUD) of seventeen HUD sites found a "direct correlation between labor law violations and poor-quality construction" on HUD projects, and found that the quality defects on these sites contributed to excessive maintenance costs. The HUD Inspector General concluded that "[T]his systematic cheating costs the public treasury hundreds of millions of dollars, reducing workers' earnings, and driving the honest contractor out of business or underground."

More recently, a survey of New York City construction contractors by New York's Fiscal Policy Institute found that contractors with workplace law violations were more than five times as likely to have a low performance rating than contractors with no workplace law violations. Other studies have found that construction workers who receive higher wages and quality training are at least 20 percent more productive than less skilled and lower paid workers.

IV. THE DOL SHOULD FOLLOW STATE EFFORTS TO REDUCE MISCLASSIFICATION IN THE CONSTRUCTION INDUSTRY

In order to reduce misclassification in the construction industry, several states have enacted legislation specifically targeting misclassification in the construction industry.

For example, in 2007, Illinois enacted the Illinois Employee Classification Act "to address the practice of misclassifying employees as independent contractors" in the construction industry.[43] The law established a presumption of an employer-employee relationship, requiring an employer to affirmatively prove a worker is an independent contractor for the worker to be

[42] Available at https://faircontracting.org/wp-content/uploads/2022/03/The-33-Cost-of-repeal-of-Prevailing-Wage-to-Wisconsin.pdf.

[43] 820 Ill. Comp. Stat. 185/3.

classified as such.[44] To prove the classification of an independent contractor, a putative employer must meet a ***three-part test***. Employers are required to report up-to-date records for each individual who performs services for the employer in an attempt to ensure correct classification based on the nature of the work.[45] If an employer violates law by failing to keep adequate records, failing to affirmatively prove a worker's independent contractor status, or by other means, the employee has the ability to bring suit under a private right of action. Employers who are found to have violated the Act can face civil penalties and criminal penalties, including enhanced penalties for willful violations.

In the same year, Minnesota passed a similar statute targeting misclassification in the construction industry and provides for a presumption of an employer-employee relationship.[46] Specifically, an individual who performs public- or private-sector commercial or residential building construction or improvement services in Minnesota is an independent contractor only if he or she is registered as an independent contractor and meets all the requirements of a statutory nine-factor test.[47]

New Jersey has also enacted a classification law specifically targeted to the construction industry.[48] The law presumes that all workers are deemed to be employees, unless the employer can show that the worker satisfies each element of the three-factor test.

Other states have passed laws targeting misclassification more broadly.

California law presumes that any worker rendering services for another is an "employee" (and not an independent contractor) unless the employer demonstrates that the worker is an independent contractor.[49] However, the test does not apply to a contractor–subcontractor relationship in the construction industry if certain conditions are met, including that the "[t]he subcontract is in writing" and "the subcontractor is licensed by the Contractors State License Board and the work is within the scope of that license."[50]

Massachusetts passed one of the most comprehensive independent contractor statutes in the country. The statute covers all industries, establishes an "employee" presumption, requires the putative employer to disprove "employee" status via a three-prong test, carries civil and

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[44] *See id*. 185/10(b).

[45] *See* 820 Ill. Comp. Stat. 185/43.

[46] Minn. Stat. § 181.723.

[47] *Id.* § 181.723 subdiv. 4.

[48] N.J. Stat. § 34:20-4.

[49] Cal. Labor Code § 2750.3, subsequently renumbered as Cal. Labor Code §§ 2775-2787, effective September 4, 2020.

[50] Cal. Labor Code § 2781.

criminal penalties, and violations can be alleged as willful or non-willful.[51] The statute, however, only applies if the employer has both misclassified the worker and, as a result of the misclassification, thereby violated another employment statute.[52]

These state laws demonstrate that the federal framework for policing independent contractor abuse in the construction industry is wholly deficient. As outlined below, even in the absence of Congressional action, the DOL must still take proactive steps to curb the current epidemic in the construction industry.

V. THE PROPOSED RULE SHOULD BE CLARIFIED AND EXPANDED FOR THE CONSTRUCTION INDUSTRY

The Proposed IC Rule is an important step in curbing worker status fraud. Nevertheless, given the long-standing and pervasive fraud in the construction industry, SMACNA believes that the DOL should consider promulgating stronger protections against the practice in the construction industry.

A. THE PROPOSED IC RULE'S RETURN TO THE "TOTALITY-OF-THE-CIRCUMSTANCES ANALYSIS" IS CONSISTENT WITH THE TEXT AND PURPOSE OF THE FLSA.

Returning to the "totality-of-the-circumstances analysis" for the "economic reality test" is consistent with the "striking breadth" of the FLSA's definitions of "employ," which "stretches the meaning of 'employee' to cover some parties who might not qualify as such" under "traditional agency law principles."[53] The Proposed IC Rule appropriately frames the ultimate question as follows: "whether the workers are either [(a)] economically dependent on the employer for work or [(b)] in business for themselves."[54]

The Proposed IC Rule makes clear that "no one factor, or subset of factors is necessarily dispositive."[55] This is important because highly-skilled craftspersons – like Sheet Metal Workers – should not be presumed to be an independent contractor simply because they are highly skilled. For example, Sheet Metal Workers are highly skilled craftpersons, who sketch, design, fabricate and install all systems and components, starting with flat sheets of metal. Sheet Metal Workers install, test, balance and maintain all HVAC systems and items they fabricate. The fact that Sheet Metal Workers – and other construction workers, including carpenters,

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[51] Mass. Gen. Laws ch. 149, § 148B (2014) (performing any service renders worker employee unless employer can show worker satisfied statutory test).

[52] *Id.* § 148B(d) (providing requirements and punishments for violation); see also Buscaglia, supra note 7, at 126 (noting misclassification alone is insufficient under Massachusetts statute).

[53] *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992).

[54] *Proposed IC Rule*, 29 C.F.R. § 795.105(a).

[55] *Proposed IC Rule*, 29 C.F.R. § 795.110(a)(1).

electricians, etc. – are highly skilled should not be used to find that the "skill and initiative" factor is met.

Indeed, the Proposed IC Rule makes clear that highly skilled craft workers are not independent contractors merely because they possess these skills:

> Both employees and independent contractors may be skilled workers. To indicate possible independent contractor status, the worker's skills should demonstrate that he or she exercises independent business judgment. Further, the fact that a worker is in open market competition with others would suggest independent contractor status. For example, ***specialized skills possessed by carpenters, construction workers, and electricians are not themselves indicative of independent contractor status; rather, it is whether these workers take initiative to operate as independent businesses, as opposed to being economically dependent, that suggests independent contractor status***.[56]

In a footnote, the Proposed IC Rule specifies:

> [W]hether workers use those specialized skills to exercise business-like initiative is what makes this factor probative of the ultimate inquiry of whether the workers are in business for themselves. Thus, ***the skills of cable installers, carpenters, construction workers, and electricians, for example, even assuming that they are specialized, are not themselves indicative of independent contractor status***. Carpenters, construction workers, electricians, and other workers who operate as independent businesses, instead of being economically dependent on their employer, are independent contractors.[57]

This is correct as far as skills. Indeed, the DOL should make clear that, for workers who are highly skilled, the "skill and initiative" factor should ***not*** be used to weigh against employee status.

In the above text, the phrase "operate as independent business" needs greater explanation by the DOL. An independent business is a separate legal entity whose viability does not depend on its relationship with another firm or firms. For example, an "independent business" would typically have a separate corporate status, it would advertise its business, it would have a separate business address, and frequently employ workers to perform the services it provides. In the construction industry, this would mean that the business submits a bid to perform work and, if selected, enters into a contractual arrangement to provide services and, if necessary, would hire additional employees to perform the work within the scope and time period specified in the parties' contract.

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[56] *Proposed IC Rule*, at 62256.

[57] *Proposed IC Rule*, at 62256 at n.473.

There is a similar issue with the following example in the Proposed IC Rule:

Example: Skill and Initiative

A highly skilled welder provides welding services for a construction firm. The welder does not make any independent judgments at the job site beyond the decisions necessary to do the work assigned. The welder does not determine the sequence of work, order additional materials, think about bidding the next job, or use those skills to obtain additional jobs, and is told what work to perform and where to do it. In this scenario, the welder, although highly skilled technically, is not using those skills in a manner that evidences business-like initiative. The skill and initiative factor indicates employee status.

A highly skilled welder provides a specialty welding service, such as custom aluminum welding, for a variety of area construction companies. The welder uses these skills for marketing purposes, to generate new business, and to obtain work from multiple companies. The welder is not only technically skilled, but also uses and markets those skills in a manner that evidences business-like initiative. The skill and initiative factor indicates independent contractor status.[58]

The first (i.e., the highly skilled welder who provides welding services for a construction firm) example is appropriate. Again, though, the second example (i.e., the highly skilled welder who provides a specialty welding service) needs to be clarified. Specifically, the example should clarify how the worker "markets those skills in a manner that evidences business-like initiative." For example, the worker has incorporated a separate business entity, the worker advertises its services in the given market, has a separate business address, and is entitled to engage additional workers to perform the services contracted. In the absence of these clarifications, the two workers in the example are too similar. The fact that the second worker provides "specialty welding service" should not matter. Both workers are highly skilled and, as a result, the "skill and initiative" factor is not met. What is more, the factor should not be contorted in order to weigh in favor of independent contractor status.

Duration is another factor that should not weigh in favor of independent contractor status for construction workers – like those in the skilled construction trades – because their work is seasonal in nature. As courts have made clear, "[m]any seasonal businesses necessarily hire only seasonal employees, [and] that fact alone does not convert seasonal employees into seasonal independent contractors."[59]

[58] *Proposed IC Rule*, at 62256.

[59] *Baker v. Flint Eng'g & Constr. Co.*, 137 F.3d 1436, 1440 (10th Cir. 1998).

B. THE PROPOSED IC RULE SHOULD BE MODIFIED TO ADDRESS CONCERNS SPECIFIC TO THE CONSTRUCTION INDUSTRY.

The Proposed IC Rule creates a new Part to the DOL Regulations: 29 C.F.R. Part 795—Employee or Independent Contractor Classification under the Fair Labor Standards Act. While this is a positive development, the DOL should promulgate additional regulations in Part 795 for specific industries, including the construction industry.

If there is a concern that the construction industry is too varied, then the independent contractor regulations could be limited to "laborers and mechanics" in the construction industry. These are the categories of workers protected by the minimum wage provisions of the Davis-Bacon Act, so Congress already believes that these classes of workers are in need of protection.[60]

1. The DOL Should Create an Employee Presumption for Laborers and Mechanics in the Construction Industry.

In the construction industry, the DOL should create a rebuttable presumption that "laborers and mechanics" are "employees" of the engaging business. In addition, the DOL should clearly identify the burden of proof is on the hiring business to establish an independent contractor or vendor relationship with the worker. This presumption would provide greater certainty to workers and construction industry employers.

This does not require a reimagination of the FLSA. Instead, given the epidemic of worker status fraud in the construction industry, the DOL has determined that special rules need to be applied to "laborers and mechanics" perform construction work. Although the Davis-Bacon Act applies only to federal construction projects, the thrust of the DOL rules would be consistent with Congressional action in the industry.

Remember, too, the FLSA has "the broadest definition [of 'employee'] that has ever been included in any one act."[61] In addition, unlike other federal statutes, the FLSA does not contain an express exclusion for "independent contractors."[62] Thus, given the history of worker status fraud in the construction industry, the DOL can justify its special rulemaking based on its need to take affirmative steps to protect construction workers from being misclassified and losing protections of the FLSA (and other federal and state statutes).

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[60] The Davis-Bacon Act is a protective labor law that, among other things, requires certain federal government contracts "for construction, alteration, and/or repair . . . of public buildings or public works of the United States" to contain a provision "stating the minimum wages to be paid various classes of laborers and mechanics. 40 U.S.C. § 276a.

[61] *United States v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945) (quoting 81 Cong. Rec. 7657 (1937) (statement of Sen. Hugo Black)).

[62] The NLRA, for example, the definition of "employee" expressly excludes "independent contractor. See 29 U.S.C. § 152(3) (defining "employee" to not include "any individual having the status of an independent contractor").

2. The DOL Should Create a "Notice of Independent Contractor Status" Form for Independent Contractors in the Construction Industry.

To ensure that workers are aware of their classification, the DOL should require independent contractors in the construction industry to complete a "Notice of Independent Contractor Status" Form. The purpose would be two-fold: (1) true independent contractors would have notice of their legal requirements under federal and state law, including tax withholdings, workers' compensation, unemployment, and other legal requirements and (2) there would be documentation – other than a tax from (i.e., FORM 1099-MISC) – documenting the workers' treatment as an independent contractor and the duration of the work.

Ideally, the "Notice of Independent Contractor Status" Form would be signed and dated ***prior to*** the commencement of the work ***and*** then signed and dated ***immediately upon completion*** of the independent contractor's work. If the contractor was hiring other independent contractors to complete the work, the same form would need to be completed by all putative contractors prior to and after commencement of the work. This would allow state and federal regulators the ability to track the work being performed and ensure that the workers are properly classified. As noted above, worker status fraud is often successful because it is hidden via IRS 1099 forms or because of cash payments to individual workers. The "Notice of Independent Contractor Status" Form would help shed light on any such practice.

As far as content, the form could include, for example, the following affirmations by the putative employer and contractor:

> *"I have assessed the independent contractor factors and believe that this relationship has rebutted the employer/employee presumption and is truly an independent contractor/vendor relationship."*

In addition, the failure to complete this notice before the commencement of the work and immediately upon completion could be used as evidence of misclassification or even willful misclassification.

At the same time, the "Notice of Independent Contractor Status" Form would provide some assurance to small contractors that they are following the law. Indeed, it is not intended to be a "gotcha" for unsuspecting small business but instead to assist with notification of the rules and ensuring that federal and state officials are able to track any bad actors.

3. The DOL Should Make Clear that More Restrictive State Laws Are Not Preempted.

As noted above, many states have taken the lead in attempting to contain the epidemic of worker status fraud in the construction industry. Any industry-specific regulations by the DOL should make clear that these state efforts are not preempted.

In summary, the Proposed IC Rule is a positive step, but it is not sufficiently comprehensive to address the above concerns in the construction industry. The DOL should

therefore continue to consider rulemaking to protect workers and SMACNA contractors from unscrupulous contractors that unfairly compete and exploit workers.

VI. CONCLUSION

SMACNA supports the Proposed IC Rule because it will provide greater clarity and consistency through the codification of the longstanding six-factor economic reality test. While returning to the long-standing "totality-of-the-circumstances analysis" is an important step, ***SMACNA believes that the construction industry needs stronger protections against worker status fraud***. Specifically, SMACNA believes that the DOL should develop rules specific to the construction industry to prevent unscrupulous contractors from deliberately misclassifying workers to gain an unfair advantage over law-abiding contractors that pay workers middle-class wages and benefits. Not only does this lead to general disrespect for the law, but also it creates perverse incentives for businesses facing vigorous competition to cheat in order to meet the artificially low prices of their dishonest counterparts.

These steps will help address the epidemic of worker status fraud in the construction industry. Honest contractors, workers, taxpayers, government programs, and enforcement officials will benefit from taking the steps outlined above. Contractors – especially small contractors in the construction industry – will benefit from a level playing field with their competitors. Workers will receive greater net compensation and benefits, as they are entitled to under federal and state laws. Taxpayers will avoid the costs that widespread misuse of independent contractors transfers to them through lost revenues for social safety net programs associated with fraudulent independent contractors. DOL enforcement officials will have the benefit of a well-understood framework for vindicating workers' rights under the FLSA, which will deter rather than encourage the misclassification of workers. Accordingly, in addition to adopting the Proposed IC Rule with the modifications set forth above, the DOL should also develop rules specific to the construction industry to prevent unscrupulous contractors from deliberately misclassifying workers. This will eliminate their unfair advantage over law-abiding contractors that pay workers middle-class wages and observe all federal, state, and local required benefit obligations.

Sincerely,

Aaron Hilger
Chief Executive Officer

cc: Martin J. Walsh, Secretary
U.S. Department of Labor