

**HOUSE OF REPRESENTATIVES
DEMOCRATIC COMMITTEE**

BILL ANALYSIS

BILL NO: **HB2400** PN3545
COMMITTEE: Labor Relations
DATE: April 3, 2008

SPONSOR: Rep. Lentz

PROPOSAL/EXECUTIVE SUMMARY: This bill would establish the Employee Misclassification Prevention Act, which seeks to prevent misclassification of workers as independent contractors.

EXISTING LAW: *The PA Workers' Compensation Act*, the act of June 2, 1915 (P.L. 736, No. 338), established a no-fault system, administered by the Department of Labor and Industry, to ensure that employees injured while on the job receive assistance. Under this act, the employee gives up his/her right to sue the employer for damages and, in return, the employer agrees to pay the injured employee's his/her medical cost and a partial wage. Under the law, employers are required to keep records and make contributions based on employment.

Regarding classification of employees, Section 104 of this law establishes a general rule that employees are persons that perform services for another for a valuable consideration, but does not include persons whose employment is casual in nature and not in the regular course of the employer's business.

The Unemployment Compensation Law, the act of December 5, 1936 (2nd Sp. Sess., 1937 P.L. 2897, No. 1), established the unemployment compensation system in the Commonwealth, administered by the Department of Labor and Industry. Like workers' comp, under this law, employers are required to keep records and make contributions based on employment.

Section 4(i) of this law provides a definition of "employee" as every individual who is performing services for an employer in employment subject to the act. Section 4(l)(1) of this act goes on to define "employment" as "all personal service performed for remuneration by an individual under any contract of hire, express or implied, written or oral, including service in interstate commerce, and service as an officer of a corporation." However, also included in this section (within subsection 2(b)), the act provides that services performed by an individual for wages shall be deemed to be employment subject to this act, unless and until it is shown to the satisfaction of the department that — (a) such individual has been and will continue to be free from control or direction over the performance of such services both under his contract of service and in fact; and (b) as to such services such individual is customarily engaged in an independently established trade, occupation, profession or business.

Presently, neither the UC nor WC law specifically addresses independent contractors.

Court decisions have provided a general set of guidelines for determining whether or not an individual is an employee or an independent contractor. The existence of an employer/employee

relationship at a certain time is determined by the degree of control that exists for the work. The criteria for that determination includes: (1) the employer's right to control the work; (2) the manner in which is performed; (3) the nature of the work; (4) the skills required for the work; (5) which party supplies the tools to be used; (6) whether payment is based by time spent on the job or based on the job; (7) whether the work is a regular part of the employer's business; and (8) the right of the employer to terminate the relationship at any time.

BACKGROUND: The issue of classification of employees as independent contractors has become a concern because of the increasing claims of such by employers. If an employer wrongly categorizes an individual as an independent contractor when he/she is, in fact, really an employee, the employer escapes payment of workers' compensation, unemployment compensation, and other required taxes and premiums on the individual. As a result, dishonest employers have an unfair business advantage over competitors who follow the law. As well, if the individual becomes injured while on the job and is then determined to have been an employee, the insurer is paying benefits for individuals for whom they did not collect premiums.

ANALYSIS: This legislation would create the Employee Misclassification Prevention Act.

Performance of Services

The legislation would require that any person receiving wages for services rendered must be considered an employee of the party that pays the wages, unless the Department of Labor and Industry agrees that:

1. the individual is free from direction of the employer;
2. the services are outside of the employer's usual course of business; and
3. the individual customarily performs work for another, independently established business, trade, or profession.

In making a determination, the department will not consider an employer's failure to withhold wages for income taxes or workers' or unemployment compensation for that employee.

Improper Classification of Employees

Employers, or agents of employers, who misclassify employees for the purposes of workers' or unemployment compensation or who fail to pay other contributions required by law, shall be subject to penalties and other actions (see below).

The secretary of the Department of Labor and Industry is required to notify the state Attorney General of violations, whose office will have full authority to investigate.

Criminal Penalties

If convicted of misclassifying workers and failing to pay required contributions, the employer or agent will face the following criminal penalties:

1. If the failure was done knowingly – guilty of a 3rd degree felony, and:
 - a. For a 1st offense – sentenced to pay fines of up to \$15,000, and/or imprisoned for up to 3 ½ years.
 - b. For a subsequent offense – sentenced to pay fines up to \$30,000 and/or imprisoned for up to 7 years.
2. If the failure was unintentional – guilty of a 3rd degree misdemeanor, and:

- a. For a 1st offense – sentenced to pay a fine up to \$2,500, and/or imprisoned for up to 180 days.
- b. For a subsequent offense – sentenced to pay a fine up to \$5,000, and/or imprisoned up to 1 year.

Civil Actions and Remedies

Employers in violation will also face administrative actions by the secretary and may be subject to civil action(s) brought by misclassified employees:

1. Debarment – Upon conviction or determination of violation by the secretary, the employer (or firm, corporation, or partnership in which the employer has an interest) will be prohibited from receiving public contracts for up to 3 years.
2. Administrative Penalty – The secretary may assess administrative penalties of up to \$2,500 for an initial violation and \$5,000 for each subsequent violation. The amount assessed would take into consideration the employers' previous violations, seriousness of violations, good faith of the employer, and size of the business. Each misclassification would be a separate offense.
3. Actions by Employees – If the employer had knowledge of misclassification, such employees or their representatives may seek civil action for damages, attorney fees and costs.

Stop-Work Orders

If the secretary finds (after notice and hearing) that an employer has misclassified an employee, or has failed to pay required benefits and contributions, a stop-work order would be issued for the employer and penalties would be assessed. Orders and penalties would remain in effect against any successor business entity that is engaged in a similar occupation and has at least one of the same officers or principals against whom the order was issued.

1. Stop-work orders would require that all business operations cease within 72 hours after receiving notice and would remain in effect until the secretary issues a release or finds that the employer has properly classified the employee. After the release order, the employer would be required to file periodic reports with the department for a probationary period of up to 2 years. Filing times and report requirements would be determined by the department.
2. Penalties would be assessed for conducting business after a stop-work order (\$1,000 per day). Additional penalties may be assessed for each misclassified individual (\$5,000 per individual).

Procedure

All civil actions and remedies, stop-work orders, and penalties would be subject to notice, adjudication, and appeal rights under Title 2 of the Pennsylvania Consolidated Statutes (Judiciary and Judicial Procedure). The department would be granted powers that may be necessary to investigate complaints, including powers to issue subpoenas, administer oaths, and take testimony.

Commonwealth Court

The secretary may request enforcement of subpoenas and orders through Commonwealth Court.

Certain Agreement Prohibited

Agreements or requests for an individual to sign documents that would result in the misclassification of individuals as independent contractors or not accurately reflect the work relationship would be prohibited.

Retaliation Prohibited

Employers and other parties would be prohibited from discriminating or retaliating against any employee who exercises rights granted by this bill. Adverse action taken against an individual within 90 days of the person's exercise of rights would raise a rebuttable presumption of acting in retaliation.

Use of Penalty Funds

All funds collected through penalties would be applied to enforcement and administration costs of the department.

Rules and Regulations

The department may promulgate rules and regulations necessary to implement this legislation.

EFFECTIVE DATE: July 1, 2008 or in 60 days – whichever is later.

PREPARED BY: Joanne Manganello, Vicki DiLeo, 787-5780