

Memo

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To: Jordan Estey, Susan Nolan, Workers Compensation Committee NCOIL
Re: Comments on August 12, 2009, NCOIL working draft of *Proposed Workers' Compensation Coverage and Employee Misclassification Model Act*
Date: August 21, 2009

Section 2. Definitions

B. and E.3. These sections exclude from the definition of employer an occupier of a personal residence carrying out construction on their own premises. This exception creates the very real possibility of swallowing the whole rule in the residential construction industry. For instance, a construction contractor who has purchased a unit in a condominium tower under construction, or who owns a residence in a building being renovated, would not be required to cover its workforce.

We can understand that the requirement for coverage of independent contractors in the construction industry can burden rue homeowners fixing their homes. We suggest adopting the Tennessee language that avoids this outcome. See Tennessee HB 1645 (2008) (attached). A major factor in the Tennessee language provides that homeowners are not excluded from the obligation to provide coverage if the homeowner is receiving compensation for the construction work. HB 1645 §1(C).

D.1.d. This subsection in the "Employee" definition excludes persons in the construction industry who perform services for an employer in the course of that employer's trade, business or occupation. It may seem that who is or is not an employee in the industry is addressed by requiring coverage for all—including sole proprietors and independent contractors. But that is not entirely the case. Employment becomes relevant for application of exemptions from coverage and for who is required to pay for coverage. The issue is additionally compounded by the deletion of the same phrase in F.1. We recommend deleting from D.1.d:

“, other than in the construction industry,”

F.1. The attempt to clarify misses the mark. According to the change, an independent trade or business is further defined as what is required by a particular trade or industry. A further sliding scale is created that can cause confusion and weaken precedent for employers and regulators to follow. We recommend deleting:

“as required by the particular industry, trade, business, profession, and/or occupation in which the services or work being performed are categorized.”

Former 3. The former subsection 3 deletes the requirement that the burden of proof rests on the individual claiming independent contractor status. We prefer putting that language back in the model, because it will assist law enforcement efforts. Also, given the remedial policy behind workers compensation, those claiming to be exempt from it should carry the initial burden of proving independent contractor status.

Section 3. Coverage requirements

We recommend the following clarifying note in Section 3 Coverage Requirements for the reasons stated in the discussion of Section 2 D.1.d above:

“Workers in the construction industry may be sole proprietors or classified as independent contractors by employers, but their actual business relationship and classification may not pass the independent contractor test in section 2.G, making the worker an employee. In such circumstances it would be improper for any exemption the employee may have from coverage to apply to the employer’s business relationship with the employee, and it would be improper for the employer to require the employee to pay for workers’ compensation coverage.”

Section 4. Employer/Contractor Disclosure Requirements

B: The change to this subsection makes it optional, rather than mandatory, for a contractor to collect evidence of workers’ compensation insurance. A requirement is preferable for many reasons.

*The change in the model is contrary to a trend in the states to require additional disclosure for an important reason—there is significant fraud in the construction industry. In New York City, for instance, 25 percent of construction workers are misclassified as independent contractors or paid off the books.¹ A 2007 study done for California’s workers compensation system found that there was \$100 billion of under-reporting to workers compensation carriers in 2002.² The degree of under-reporting increased with

¹ *Building Up New York, Tearing Down Job Quality: Taxpayer Impact of Worsening Employment Practices in New York City’s Construction Industry*, Fiscal Policy Institute (New York City Construction) (December 2007) available at:

<http://www.carpenters.org/misclassification/ALL%20DOCUMENTS/Taxpayer%20Impact%20of%20Underground%20Constr%20Economy%20in%20NYC%20-FPI%2012-07.pdf>.

² *Fraud in Workers’ Compensation Payroll Reporting: How Much Employer Fraud Exists and How are Honest Employers Impacted*: Report for the Commission on Health and Safety and Workers’

Compensation, by Frank Neuhauser and Colleen Donovan, University of California, Berkeley (August 2007) available at:

<http://www.carpenters.org/misclassification/ALL%20DOCUMENTS/Calif%20Fraud%20Study%202007.pdf>.

higher risk categories—like construction. And that drove up costs by as much as eight times for law-abiding high-risk employers. Much of the fraud in the construction industry is coming from the growing use of so called labor subcontractors that either don't have insurance or commit premium fraud. States are responding. The number of jurisdictions that require proof of workers compensation to get building permits, for instance, is increasing. Also, see the new robust disclosure requirements regarding public construction projects in Vermont Act No. 54 (2009) (attached) and New Hampshire HB 471 (2007) (attached).

*Compliance inspectors that work in the field that we have spoken to like this requirement, because it makes their investigations more efficient. Oftentimes it is easier to get a subcontractor's certificate from a general contractor rather than a subcontractor that is elusive and non-responsive to information requests.

*The requirement adds a degree of self policing to the industry.

C. The changes in this subsection would eliminate the requirement for employers to submit copies of quarterly earning reports. Given the high degree of fraud, we would recommend making the submissions a requirement in the construction industry.

New D. See our comments for B. To further assist law enforcement, we recommend that the language in D read as follows:

“A contractor shall require a subcontractor, including independent contractors and sole proprietors working in the construction industry, to provide the information required by Section 4(B), and the contractor shall keep the information on its construction sites where the subcontractor, independent contractor or sole proprietors are working and at its principle place of business. That information shall be made available to law enforcement agencies upon request.”

Section 5 Application requirements

A. One of the changes to this subsection removes the requirement to include the names of employees in insurance applications. We do not support this change, because it will complicate investigations of premium fraud. The original language should be restored.

Section 6 Payroll Audit Procedures

C. This subsection provides for less frequent audits of small contractors. Requiring audit and application procedures can improve compliance in the construction industry. Contractors that seek to violate the law through premium fraud will gravitate towards insurers that are known to have less strict applications and auditing practices, putting stricter insurers at a competitive disadvantage. Given the proven track record of payroll fraud in the construction industry, stricter action is necessary.

When we discuss premium fraud with construction contractors many of them express surprise that others get away with it when their carriers audit them frequently. The model

doesn't take into account that many smaller construction employers may look small because of underreporting. The rule that provides for less auditing of smaller contractors creates another unwelcome incentive to underreport in order to escape thorough on-site audits. We suggest a rule that the yearly on-site audits of construction employers contain a percentage of employers who are not generating an amount or premium required to be experience rated:

“In no event shall employers in the construction class, generating more than the amount of premium required to be experience rated, be audited less than annually. A minimum of ten percent of employers in the construction class that do not generate more than the amount of premium required to experience rated will be audited annually. The annual audits required for construction classes shall consist of physical onsite audits.”

Section 7 Penalties

Former B. This subsection which creates a specific penalty for failing to properly classify an individual as an employee is deleted. We strongly recommend that it be reinstated. There is a trend in states specifically prohibiting that fraud device. Four states adopted such language in 2009 alone, and it has also been recommended in federal legislation. The model should reflect that trend in order to create added deterrence. At a minimum, it needs to be applied to the construction industry.

C. This change increases the monetary penalty for not having coverage from 1.5 times to 2 times the penalty that should have been paid. We support this change. We are unaware of any jurisdictions where there are arguments to reduce penalties. In a tough economy we can expect more business to cut corners, and dropping their compensation coverage can be one way to do it. For that reason we need to support small business that struggle to play by the rules with fines against competitors that skew the market by not doing so.

F. The \$500 charge on employers for not providing access to information is made optional. In the first draft it was mandatory. We would recommend going back to the previous language, because any deterrence that results in competed audits could relieve the burden on state law enforcement agencies to complete the job.

Needed Addition: The penalty section correctly punishes premium fraud as a crime. But failing to have any coverage is not criminal. That creates an unwelcomed incentive to not have coverage because the penalties are less. Not having criminal penalties conflicts with many states that do have them. For instance, Connecticut, Florida, Georgia, Kentucky, New York, New Jersey, North Dakota, Tennessee and many other jurisdictions provide criminal penalties for failing to have coverage.