

Comments of
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before the

National Council of Insurance Legislators Workers' Compensation Insurance Committee

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Re: Proposed Employee Misclassification Workers' Compensation Coverage Model Act

Employment payroll fraud is a serious concern for the United Brotherhood of Carpenters and responsible employers in the construction industry. A significant motivation to commit fraud is to evade workers' compensation premiums. We support the draft model primarily because of the strong enforcement language. There are some concerns, though, and suggestions for improving the language. Those will be described below. First, it is appropriate to describe why payroll fraud is a serious threat to our industry. Our goal is to promote lawful employment standards and law abiding employers. A business should not be put in a competitive disadvantage simply because it follows the law.

The Problem and Use of "Labor Subcontractors"

In the context of workers compensation, payroll fraud comes in two forms. First, construction employers misclassify workers as independent contractors when they are truly employees, or employee duties are categorized in a less costly classification code-a roofer, for instance, is claimed as a landscaper. Second, employees are paid "off the books" by either check or cash, and the payments are not reported to workers compensation carriers or as otherwise required by federal and state law.

Payroll fraud is done to evade income-tax withholding, paying employment taxes, overtime and workers compensation premiums. In the construction industry fraud gives irresponsible employers a 30 percent or more advantage in labor costs. And in a competitive industry like ours that means responsible employers who play by the rules (and their employees) lose work. Fraud is more common in construction, because of competitiveness, mobility of employers and the workforce, the temporary nature of the work and the multiple layers of contractors and subcontractors. The practice is much larger than many think, and it is not isolated to mom-and-pop businesses on small projects-they occur on all types of construction-small, large, residential, commercial, public and private. The industry is not the only one that loses. States and the federal government are losing much needed revenue and insurers are cheated out of workers' compensation premiums, increasing costs for those who do pay-making them even less competitive.

Frequently, we are told that misclassification is mostly unintentional, because the rules defining employment are numerous and subjective. For us, we do not find that to be the case. A growing trend in the industry is the use of so-called labor subcontractors. For instance, a drywall

contractor will hire a labor subcontractor to provide labor on a construction project. The drywall contractor will have a small workforce that is mostly supervision on the project, and it pays taxes and workers' compensation premiums. But things are different for the labor subcontractor. The labor subcontractor will normally have a workers' compensation policy, but it only reports to its carrier a fraction of its true workforce. That is not confusion--it is fraud as a business plan. Such schemes have led to markets being lost to scofflaws.

We have seen fraud cases throughout the country--in Connecticut, New York, New Jersey, Kentucky, Tennessee, Florida, Louisiana, Oregon and elsewhere. Violations of the law not only include workers' compensation premium fraud, they also include racketeering activity, money laundering, mail fraud, conspiracy and grand theft. (See attached examples.) As a general rule, state law enforcement agencies have been overwhelmed by the degree of fraud in the construction industry either through lack of resources or deficiencies in the law. But most states have been fighting back and improving law enforcement. In that way, the model legislation can be a great benefit to a growing movement on behalf of legitimate employers who play by the rules.

Comments on the Draft Model

We support the draft model because of its strong enforcement language and the requirement that independent contractors in the construction industry have coverage. The model language is based on Florida law: it provides felony penalties for workers' compensation premium fraud and stop work orders for premium fraud and the failure to have coverage. Florida, in fiscal year 2007-2008, issued over 2,500 stop work orders, caused an additional 6,427 workers to have coverage and added \$8 million to the premium base. Since its 2003 reforms, which included increased enforcement, workers' compensation rates have been decreased by 58.3 percent.*

We believe that the following would also improve compliance with the law:

Section 2(F) Definition of Independent Contractor

We prefer the ABC definition used in many unemployment codes, but we can support the Wisconsin-based definition in the draft, because the model comes along with very good enforcement language.

Section 3(A)(1)(b) Coverage Requirements

The model provides an exemption process for construction companies. The language used in the model is based on Florida law, and it is some of the better exemption language we have seen. What we need to avoid is someone opening an LLC (or being directed to open an LLC), getting an exemption and then working in what is otherwise an employment relationship. It would be best not to allow exemptions. If exemptions are to remain in the model, at a minimum, make it a criminal penalty to require employees to get exemptions (as is done in Florida law §440.105(2)(a)(1)) and make it plain that an exemption will not apply if the independent contractor definition in §2(F)(2) doesn't fit the parties' working relationship.

Section 5(E) Application Requirements

Subsection (E) has all of the materials that are to be required in applications for coverage. I recommend adding a requirement for information on independent contractors in order to uncover potential abuse.

* *Joint Report to the President of the Florida Senate and the Speaker of the Florida House of Representatives*, by the Florida Department of Financial Services Division of Insurance Fraud/Bureau of Workers' Compensation and Division of Workers' Compensation, pp. 14-15 (January 1, 2009).

Section 7 Penalties

(E) This subsection makes it a second degree felony to submit false information on an insurance application. It would be benefited by adding conspiracy language. Often, contractor-service recipients, insurance brokers and check cashing businesses conspire with subcontractors to violate the law. Such conspiracy language exists in Florida law §440.105(4)(b)(4).

(K) This language provides for a judicial appeals process for appeals of enforcement actions. The language should clarify that an administrative process can be used. Administrative appeals law is used, for instance, in Florida, which is the basis for the language in the model.

Other items:

1) More frequent premium renewals: For construction contractors require renewals for premium purposes every three months. Renewal applications should disclose the names of employees, independent contractors, their duties and compensation. The same penalties for false or misleading information in 7(E) should apply to the renewals. Employment in the industry fluctuates and can be used as a covering argument in premium fraud cases. That becomes more difficult when premium renewals are required more frequently. In Washington, employers report to the state every three months. Also, employers and insurers could benefit by making additional premium payments/refunds sooner.

2) Disclosure: We believe that there should be disclosure of classification codes and remuneration of the workforce on insurance certificates. An insurance certificate for a payroll of \$500,000 looks the same as one for \$50,000. Disclosure, along with more frequent premium renewals, will make it harder to cover up premium fraud. Given the degree of fraud we are seeing in the industry, disclosure should trump concerns over confidentiality of proprietary information. A more middle ground could be disclosure of remuneration in ranges. Also, Washington posts the estimated number of employees on its coverage verification web site.

3) Funding: Enforcement will not be effective if resources are inadequate. Penalty revenue should be dedicated for enforcement work. This is done, for instance, in Connecticut and, through forfeiture, in Florida.