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November 12, 2013

For the Senate of the United States,  
Subcommittee on Employment and Workplace Safety,  
Committee on Health, Education, Labor and Pensions

## **Payroll Fraud: Targeting Bad Actors Hurting Workers and Businesses**

### **Introduction**

Thank you for the opportunity to testify before this committee. My name is Daniel Odom, and I am the Chief Operations Officer and Vice President of Odom Construction Systems Inc. We are based in Knoxville, TN, and we have offices in Lexington, KY, Nashville, TN, Kingsport, TN, and most recently in Austin, TX. We have hundreds of employees throughout our work area which consists of the entire southeast and, in certain circumstances, other areas of the country. In the last year, we have completed projects in Tennessee, Virginia, Kentucky, Georgia, Alabama, Texas, and Michigan. We are currently involved in those states plus Louisiana and Florida, and are actively pursuing work in other areas.

I would like to deal with the payroll fraud, or misclassification, issue. Payroll fraud happens when a worker is an employee and is called an independent contractor and sent a 1099 form. It also happens when employees are paid off the books, something that is extremely common in the construction industry. Payroll fraud has stolen jobs from our company and employees and is crippling the construction industry. Our company's regional experience, as well as lengthy history, allows us to have a comprehensive perspective on how payroll fraud threatens companies like ours that provide decent middle-class jobs by doing business in a fair, honest, and legitimate way.

### **Company and Personal History**

The parent company of Odom Construction, Gilbert Plastering and Painting, started in Knoxville in 1883. In 1982, it was purchased and incorporated as Odom Construction Systems by my father Bill Odom. It has been operating in Tennessee, and expanding into the areas noted above, ever since. A now third generation family business, my brother William Odom (CEO), and Melinda Sands (CFO) also have spent their entire working lives in this business.

Odom Construction is a specialty contractor focusing on interior systems trades (carpentry, drywall, plastering, acoustical ceilings, etc) as well as masonry. We also have a very

technology-driven prefabrication operation for walls and trusses. Almost everything we do is self-performed.

Odom Construction, like many family businesses, has as its roots, strong values and high business ethics. We believe in treating our employees well, compensating them fairly for the tremendous work they do on our behalf, and caring for their well-being and that of their families. As such, we have employees that have been with our company for their entire careers, several spanning 25 years plus. Seeing the well being of those families jeopardized by fraudulent business practices is the primary reason I am here today.

We have existed as 100% open shop, and 100% union shop in our past, and we currently exist as a hybrid operation. Many of our carpenters are represented by the Carpenters' Union. Other trades are open shop. Payroll fraud does not affect only union or only non-union aspects of our business. It is crippling to all our field personnel, and by association, their families as well, regardless of their affiliation with any labor or trade organizations.

Personally, I have grown up in this business. As did my brother, I started working summers during school as the lowest man on the totem pole, cleaning up as a general labor. I worked up through the plasterer's trade as I completed my degree at the University of Tennessee, Knoxville.

My experiences in the office began shortly after I graduated in 1997, and I have worked as an assistant estimator, estimator, project manager, vice president, chief operations officer, and I am also now the president of OCS Steel, our prefabrication division. As such, I believe my experience is varied and fairly extensive in this industry that I love, and it is with great passion that I testify to try and protect it.

### **The Problem of Payroll Fraud**

The payroll fraud problem has been documented and testified to before, but it has gotten pervasively worse as a function of the severe recession our country faced. As I am sure you are aware, the construction industry was profoundly affected by the recession. To make matters worse, the construction industry was also being decimated from within by the problem of payroll fraud.

At its most basic definition, payroll fraud is a method used to misclassify workers, construction trades people in this case, as independent subcontractors or off-the-books employees for the sole purpose of underbidding law-abiding employers by avoiding paying employment taxes, withholding tax, workers' compensation premiums and overtime. When deployed, this method allows our competition to show up on bid day with a cost basis for their labor that is 20%-30% lower than those of us that play by the rules. In our line of work, the value of labor on a total project can be 50% of the project value, and so these methods allow those companies to compete at a level that no law-abiding contractor can reasonably touch.

Moreover; in our business it is not too hard to figure out who is an employee. When you supply building materials, tools, equipment, training and daily instruction and set hours of work, you have an employee. The notion that the problem is mostly negligence or confusion does not wash. Much of the abuse we see is intentional.

### **How Payroll Fraud Hurts Law-Abiding Companies**

Payroll fraud destroys companies like ours because the savings a company can achieve by using illegal tactics is so significant that we cannot overcome it by legal means. While we have a huge, best in class, focus on training and productivity in our organization, there comes a point where you reach the limit to the efficiencies you can reasonably expect to achieve. We also cannot erase this gap through better buyout of our materials. Materials in construction are predominantly commodity-based goods, and within certain variances, we all pay essentially the same prices for the products we use. We cannot overcome payroll fraud even by more Draconian methods of slashing the hourly wages of field employees. It is difficult enough to staff projects with wages having been beaten down as much as they have been in the last five years without having to do so at rates we haven't seen since the 1990's. Even at those rates, to which our markets have been pushed as a direct result of payroll fraud, we still wouldn't be on a level playing field.

### **An example of Payroll Fraud in the Real World**

We frequently find ourselves in competition with a contractor that some say uses payroll fraud tactics through brokers that supply its labor. The Tennessee Department of Labor collected over \$61,000 in unpaid unemployment contributions and interest from that contractor for three or more projects spanning many years. Some of those projects were publicly financed. One of those projects, new student housing for a secondary education institution, we priced close to \$1,000,000. Allowable profit margins and overhead for office salaries and expenses are pretty well defined in our industry, and 15% is a reasonable total markup. If you consider the total markup of that job at \$150,000, the \$61,000 delinquency payment for three or more projects was less than half for just one.

The payment was a fine that, for all practical purposes, took a small bite out of an overall profit margin. It was essentially just a cost of doing business and arguably well worth the risk. There were no limits placed on this contractor against bidding future publicly-funded work, as we have competed against them many times ever since. In most cases they beat us, and they beat others that price the work with all taxes and premiums included in their proposals.

### **How the Federal Government can Help**

Many of the parameters for successfully eliminating payroll fraud from the construction industry are in place, but I feel it will take comprehensive, yet sensible, action by the Federal Government to put this issue to bed for a couple of reasons.

Several states, including now my home state of Tennessee, have made attempts at addressing this issue on their own. While it is very encouraging that a state like Tennessee has listened to the issue and enacted some positive legislation to try and proactively address the issue, what we find regionally is that not all states understand it, and the ones that do are enacting legislation with varying focus and levels of enforcement. The end result is the offenders scurry from state to state, manipulating the system in increasingly sophisticated ways, and then concentrating in other less-savvy states until they decimate the local construction economies, and then moving on only to repeat the cycle.

The Federal Government can look at the various state plans, and find out what is working and what is not working to create a plan that enforceable across all states.

Second, this is an issue that crosses state borders. One of the worst offenders against which we compete is based out of Georgia, but regularly prices work in Tennessee and other states in the region. Since those types of companies are using labor brokers that are sometimes based out of Florida or other regional states, there could be three states involved on a single project. As such, no single state is able to fully take charge of a prosecution across state lines. Interstate regulation is a primary function of the Federal Government, and certainly applies to this problem. Additional focus by US Attorneys would certainly help here by prosecuting egregious cross-border violators.

Lastly, the Federal Government already has functional systems in place that could be part of a sensible comprehensive treatment of this issue. One example is E-Verify. Our company has been E-Verify compliant for years, and while it is actually very easy to use, reliable, and accurate, it is also probably the easiest Federal system to circumvent in our industry. The project I noted above was an E-Verify project. We see notorious operators in our industry function without interruption on publicly funded projects (including projects with ARRA funding) simply because there is no enforcement of this provision. However, the system is in place, and with intelligent modifications to the implementation of it, could be used as an effective tool.

## **Conclusion**

I noted in the introduction that this devastating issue has gotten worse during the recession. Back in the 1990's when the entire labor broker payroll-fraud phenomena really hit the Southeast, the bad apples gained a poor reputation within the industry. In many cases, when general contractors would receive bids from the questionable contractors, and those prices looked artificially low, they would toss those bids into the trash, because the risk just wasn't worth it. However, as opportunities dried up, and there wasn't always ten other jobs that could be bid if you lost the last one, suddenly the generals starting using those numbers out of fear that, if they didn't, the guy across the street would, and there just wasn't that much else out there to bid.

What that means now is that the prevalence of those players in the market, coupled with reduced opportunity overall due to recession, is phasing out law-abiding businesses like ours until there won't be anything left but the bad operators. If we wait until that happens, then when action comes, it will be too late. Trades people are leaving our industry in mass to seek employment in other safer industries with wages that haven't been beaten into the ground by the criminal operators. This is not going to be a light switch we can turn back on and fix once the workforce disappears. Without action, construction stands to go the way of many elements of manufacturing in our country's history. Yet, this time, it is not being sent overseas. It is happening right under our noses on our soil, and it is hurting workers and their families, as well as shutting down a whole industry of contractors that believe in building middle-class jobs and who are just trying to do things the right way and make a reasonable profit to support their own families.