Testimony of Colleen C. Gardner,

Commissioner of the New York State Department of Labor
before the U.S. Senate Committee on Health, Education, Labor and Pensions

"Leveling the Playing Field: Protecting Workers and Businesses affected by Misclassification"

June 17, 2010

David A. Paterson, Governor
Colleen C. Gardner, Commissioner

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Good morning, Chairman Harkin, Ranking Member Enzi, and Members of the Committee. Thank you for the opportunity to address this important issue. My name is Colleen C. Gardner, and I am the Commissioner of the New York State Department of Labor. Let me commend the Committee for your work in protecting workers and businesses from misclassification and note New York's support for S. 3254, the Employee Misclassification Prevention Act, which will help us expand our work.

I will be speaking today about the problem of worker misclassification and how it hurts workers, businesses, and government. I will also discuss our steps to raise awareness of this problem as well as our enhanced enforcement efforts in New York and our collaboration with other states to curb this epidemic. Let me begin with a snapshot of the results of the New York State Joint Enforcement Task Force on Employee Misclassification and the unprecedented level of collaboration it has achieved among state agencies and local governments throughout New York. Beginning with its creation in September 2007 through the end of March 2010, the Task Force's efforts have resulted in 67 enforcement sweeps in a dozen cities throughout the State, which identified nearly 35,000 instances of employee misclassification, discovered over $457 million in unreported wages, identified more than $13.2 million in unemployment insurance taxes due and discovered over $14 million in unpaid wages. However, we have only scratched the surface of the problem in New York. There is much more work to be done.

A worker is considered "misclassified" any time he or she is improperly denied the benefits and protections provided to an "employee" as that term is defined by law. This can occur when a worker who meets the legal standards for classification as an employee is instead treated as an independent contractor by an employer. It can also occur when an employee is paid "off-the-books" and is not reported at all for tax and other purposes. Misclassification hurts workers who are deprived of their employment rights under state and federal law. It also hurts legitimate businesses that have to compete against businesses that illegally cut their costs through the misclassification of workers. Finally, it hurts government which does not receive appropriate employment and income taxes.

The Problem

As we know, worker misclassification is not a new problem. In 2000, the United States Department of Labor commissioned a study that found that 10 to 30 percent of firms audited in nine states misclassified at least some employees.

In New York, the Cornell University School of Industrial and Labor Relations documented the growth of worker misclassification in a February 2007 study. Cornell estimated that each year, approximately 10.3 percent of New York State's private sector workforce is misclassified in one of two ways as noted earlier: as independent contractors or paid off-the-books.[1] This means that, because of misclassification, 10 percent of our workforce may not get the wage and hour protections to which they are entitled, including overtime pay and meal breaks. That also means that these employers fail to contribute to the unemployment insurance tax system for 10% of our workforce and fail to pay workers' compensation premiums in the same manner.

[1] Linda H. Donahue, James Ryan Lamare, Fred B. Kotler, J.D., "The Cost of Worker Misclassification in New York State" (Cornell University, H.R. School, February 2007).

Further, these employers pay no withholding taxes on workers who are off-the-books, and the workers they misclassify as independent contractors have been found to underreport and to underpay their withholding taxes. At a recent hearing of the U.S. House Education and Labor Committee's Subcommittee on Workplace Safety, a representative of the Mason Contractors Association of America stated, "By misclassifying employees as independent contractors, unscrupulous employers are able to avoid paying taxes and insurance. Businesses that misclassify employees as independent contractors can expect to reduce their labor costs by between 15 and 30 percent. This places contractors … at a competitive disadvantage in an industry with 20% gross margins." In this difficult economy, it is more important than ever that we maintain a fair playing field for businesses who play by the rules.

The Cornell report also estimated that approximately 14.9% of the construction industry workforce is misclassified in a given year. These are real numbers that impact real workers, businesses and economies. Studies conducted in other states have shown similar or even higher rates of misclassified workers. Our own field experience has shown that the level of worker misclassification in New York may be even higher than what the Cornell study shows because of the high incidence of off-the-books work.

New York's Efforts

The New York State Joint Enforcement Task Force on Employee Misclassification was created by Executive Order in September 2007. It is comprised of the New York State Department of Labor, the New York State Workers' Compensation Board, the Workers' Compensation Board Office of Fraud Inspector General, the New York State Department of Taxation and Finance, New York State Attorney General's Office, and the New York City Comptroller's Office. The Executive Order charged the Task Force with:

- sharing information and referrals among agency partners about suspected employee misclassification violations, and pooling and targeting investigative and enforcement resources to address them;
- identifying significant cases of employee misclassification, which should be investigated jointly;
- developing strategies for systematically investigating employee misclassification in industries in which misclassification is most common;
- facilitating the filing of complaints;
- working cooperatively with business, labor and community groups to identify and prevent misclassification;
- soliciting the cooperation and participation of local District Attorneys and other law enforcement agencies, and referring appropriate cases for criminal prosecution; and
- proposing appropriate administrative, legislative and regulatory changes to prevent employee misclassification from occurring.

After almost three years of operation and an unprecedented level of inter- and intra-agency coordination, the Task Force has made great progress on these goals. Unlike most areas of employment, misclassification cuts across many areas of federal, state and local law enforcement. Prior to the creation of the Task Force, if one state agency -- or division within a state agency -- discovered a misclassification violation or received a tip about a potential violation, it did not usually refer it to another state agency or division. The Task Force tears down the silos of government agencies and promotes collaboration, while at the same time ensuring confidential data is protected, and used only for enforcement purposes.

Through joint enforcement sweeps, coordinated investigations, referrals of audit results and data-sharing, the Task Force uses a coordinated approach to enforcement. Our process ensures that an employer who is found to be engaging in misclassification is financially and legally liable for all of the resulting violations. Violations that are determined to be criminally fraudulent are referred to the State Attorney General or local district attorneys for criminal prosecution.

We hold media events around the State to publicize the results of our sweeps. This publicity raises public awareness of the issue, promotes compliance by businesses, and emphasizes that misclassification is illegal and hurts the competitiveness of businesses who play by the rules -- which in turn hurts workers.

We have also raised the level of scrutiny given to misclassification cases. Joint sweep and enforcement cases are chosen strategically and are evaluated in a coordinated fashion. Strategies are pursued in each case for the greatest deterrent effect. This past fall, New York also conducted comprehensive cross-training of investigators from our partner agencies to help them recognize violations in other subject areas, to share investigative and interviewing techniques, and to increase awareness of misclassification issues.

The coordination among state agencies also allows for efficiencies that lead to greater enforcement. Through May 31, 2010, we have received over 5,600 tips or leads (through emails and phone calls). We have shared those tips with our partners, and have further shared information on an additional 3,500 cases of interest to our partners. Each agency can use the tips, evidence, interviews and audits obtained by other state agencies in conducting its own enforcement efforts. These types of efficiencies are essential as we all strive to do more with fewer resources. Currently, the Task Force and its partner agencies do not have dedicated or

additional enforcement resources for misclassification. Instead, we use the existing resources of the partner agencies, which has impacted the ability of our state-funded enforcement unit to conduct their regular tasks. While we have been able to do a great deal, we are hampered by our lack of misclassification resources and our eroding enforcement resources. Despite the limited resources, our efforts are making a difference in New York. With increased national focus and support to the states, we could greatly expand on the results we have already achieved.

The Obama Administration's request for an additional $25 million will help provide needed enforcement resources to penalize employers that improperly misclassify employees as independent contractors. When considering this and related federal resource investments, please note the cost of these investigations can be minimal in comparison to the return on investment related to bringing businesses into compliance. For example, a sweep performed recently at one construction site cost the state approximately $25,000 in staff and administrative costs, yet the sweep yielded $81,313 in additional taxes and $27,566 in penalties. And this includes neither the restitution of wages to impacted employees nor the future benefit to the competing employers who follow the rules.

The Results for New York

Worker misclassification takes many forms. We have found misclassification in large and small cities, and in poor, middle-class and affluent communities. Some employers intentionally underreport the number of workers in their business. NYSDOL has visited 24-hour diners where the employer lists five family members on its unemployment filings but the visit shows that at least 20 workers are needed to run the business. We have also found employers with a business model of core employees, who work under the direction and control of the employer, who are told to create separate business entities to appear as independent contractors.

We also often see subcontracting within a business entity where one group of workers is properly paid on the books and another group of workers, who work side-by-side with the first group, are paid off-the-books by a subcontractor.

Moveover, we have found that employers owed more than $14 million in unpaid wages and overtime to workers identified by the NYSDOL Division of Labor Standards. We have referred 16 employers for felony prosecutions, and to date, four employers (or their corporations) have been convicted of crimes related to misclassifying their workers. Please note, only the most egregious cases are referred for prosecution: the primary goal is to bring employers into compliance and to ensure that workers are paid what they are owed including applicable civil penalties.

Just this month, we announced the results of four worker misclassification sweeps on construction sites around New York State that brought the issue of this epidemic to the public's attention. In all four of these cases, large construction projects were being built by mainstream, established developers or contractors. Yet, many of the workers on the project, hired by subcontractors, were either being misclassified as independent contractors or being paid off-the-books and were subject to serious labor law violations. In these cases, subcontractors on projects to construct private, upscale off-campus housing for students near three different state and private colleges and a major new hospital were found to be cheating 281 workers out of more than $275,000 in wages and overtime. We have also issued nearly $430,000 in penalties for these wage violations and have assessed over $167,000 in unemployment insurance taxes and penalties on these projects.

These cases also brought to light instances of the serious mistreatment of workers and the human cost of misclassification. In one case, we received a call from workers who were brought

in from out-of-state, had worked for nearly a month without pay, and then were fired and abandoned at a mall parking lot. They were stranded and had no money to get home. Similarly, we were contacted by a store owner near one of the construction projects because six workers were left stranded without money after working on the project for three months without being paid. They were being housed by the subcontractor in an apartment and only given some money for food.

In an effort targeted at assessing compliance in urban and suburban retail tracts, we conducted four "Main Street" sweeps in different parts of New York State where we walked door-to-door and investigated most businesses along a retail strip. Of the 303 businesses visited, nearly 40 percent had UI misclassification violations, nearly 25 percent had labor standards violations, and 6 percent were issued stop-work orders by the Workers' Compensation Board for lack of workers' compensation coverage. UI findings on the firms visited indicated over 1,600 misclassified workers and unpaid UI taxes of nearly $398,000.

These results from teams of dedicated Task Force investigators from multiple state agencies brought to light the grim reality of employee misclassification and its impact on real workers. But this is only part of the story. Our discussions with legitimate employers, unions and business organizations revealed the negative impact on law-abiding employers who are playing by the rules everyday and trying to survive in this difficult economy. This illegal practice means that legitimate employers are underbid nearly every time by unscrupulous contractors who often have no connection to local communities. In one of our investigations, we found one painting subcontractor, which treated all 55 of its employees as independent contractors. The painting contractor who pays taxes on behalf of all of its employees cannot compete with the painting contractor who considers each of its employees to be an independent

contractor. The diner or supermarket which pays all of its employees on the books cannot charge the same prices as the one that tries to cheat workers and our competition-based system.

New York's Task Force has been a Model for Other States

Since the New York Joint Enforcement Task Force began in 2007, twelve other states have established structures similar to the one in New York. Last October, the NY Task Force co-sponsored a Northeast Regional Summit on Misclassification with Massachusetts. More than 70 people, representing nine states, attended the Summit and discussed enforcement, data sharing strategies and greater coordination of enforcement among states. We now have monthly phone calls with these northeast states to discuss best practices and strategies. Many of the states have their own excellent statistics to report on the benefits of targeted enforcement, data-sharing and collaboration between state agencies.

Additional National Efforts:

New York, as well as 36 other states, has also partnered with the IRS, USDOL, the National Association of State Workforce Agencies (NASWA), and the Federation of Tax Administrators in the Questionable Employment Tax Practices (QETP) program. In fact, New York has engaged in data sharing with the IRS for 24 years, using at least 10 different IRS data extracts to enhance compliance efforts. With the advent of QETP, our ability to detect misclassification and other schemes aimed at employment tax avoidance has been enhanced. Since 2007, QETP data sharing has assisted NYS in finding over 21,500 misclassified workers, over $5 million in additional UI taxes due, and unreported wages exceeding $389 million.

Federal Legislation

What I have described today is our Task Force accomplishments with targeted enforcement, limited shared resources, and outreach and education. However, given the extent of this problem, and given the losses to workers, the government and legitimate businesses, we need to do much more. While New York State has been a leader in enforcement against fraud and misclassification, we need federal legislation to help provide consistent and stronger enforcement. A major reason for greater federal involvement is that there are employers with national operations who use the same illegal practices in many of the states in which they operate. Other employers, such as construction companies, use state boundaries as a way to try to avoid the law, and when then leave, we have a much harder time enforcing our orders against them. Unlike the states, the federal government has the ability to enforce the laws across jurisdictions, and therefore would be more effective than states working in isolation.

Our experience in New York demonstrates the value and importance of many of the provisions within S.3254. The requirement that offices and divisions within the U.S. Department of Labor share information on misclassification violations will have the same positive effects that our own data-sharing and enforcement coordination has had in New York. The requirement that the USDOL Wage and Hour Division carry out targeted enforcement will also have the same positive effects nationally that our own targeted sweeps have had in the State.

Additionally, the provisions in the bill requiring the U.S. Department of Labor to measure and credit states' performance in conducting Unemployment Insurance (UI) tax audits will lead to greater detection of misclassification will greatly aid the efforts of our UI Division in NY State and State UI Divisions across the country. New York has advocated for, and strongly encourages USDOL to count overall state efforts aimed at addressing misclassification through a broadening of definitions to include both audits under USDOL Tax Performance standards as

well as other types of investigations states may engage in. Doing so will provide the broadest possible picture of the misclassification that is occurring and will ensure that states use their resources to go beyond the standard audits and conduct other types of investigations.

Finally, many of the S.3254 legislative provisions will lead to the detection and deterrence business models using incorrectly classified independent contractors. The bill's provisions that require employers to keep records that accurately reflect the classification of each worker, that create penalties for failure to keep these records, and that provide a presumption of employment for employees where the records are not kept will strengthen the ability of both the federal government and the states to detect misclassification violations. The bill will further deter misclassification violation by clarifying that worker misclassification alone is a violation of the Fair Labor Standards Act, as well as by increasing penalties for this violation. Additionally, the requirement that government websites provide workers with notification of their employment status and rights will help lead to more complaint-driven compliance. New York also encourages the addition of a specialized notice for workers who are treated as independent contractors for tax purposes under Section 530 of the IRS code.

Employee misclassification is pervasive and harmful to our employers, workers, government and our economy. We must combine forces and take new steps to combat it. The provisions of S. 3254 will add important tools to the federal government’s ability to enforce the Fair Labor Standards Act in regards to misclassification. New York looks forward to continuing to work with Congress, federal agencies, employers, and other states on this important issue. Again, I thank you for this opportunity and welcome your questions.