

HOUSE BILL REPORT

HB 2334

As Passed House:
February 14, 2014

Title: An act relating to simplifying and enforcing employee status under employment laws to ensure fairness to employers and employees and address the underground economy.

Brief Description: Simplifying and enforcing employee status under employment laws to ensure fairness to employers and employees and address the underground economy.

Sponsors: Representatives Riccelli, Sells, Moscoso, Seaquist, S. Hunt, Green, Appleton, Ryu, Reykdal, Bergquist, Takko, Goodman, Pollet and Ormsby.

Brief History:

Committee Activity:

Labor & Workforce Development: 1/21/14, 1/24/14 [DP];

Appropriations: 2/3/14, 2/7/14 [DP].

Floor Activity:

Passed House: 2/14/14, 51-45.

Brief Summary of Bill

- Creates the Employee Fair Classification Act, which prohibits misclassification of employees as independent contractors and creates remedies, including civil penalties and damages.
- Defines "independent contractor" for purposes of the Employee Fair Classification Act and establishes the same definition for purposes of the Minimum Wage Act, unemployment insurance, industrial insurance, and other employment laws.

HOUSE COMMITTEE ON LABOR & WORKFORCE DEVELOPMENT

Majority Report: Do pass. Signed by 5 members: Representatives Sells, Chair; Reykdal, Vice Chair; Green, Moeller and Ormsby.

Minority Report: Do not pass. Signed by 4 members: Representatives Manweller, Ranking Minority Member; Condotta, Assistant Ranking Minority Member; Christian and G. Hunt.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Staff: Joan Elgee (786-7106).

HOUSE COMMITTEE ON APPROPRIATIONS

Majority Report: Do pass. Signed by 18 members: Representatives Hunter, Chair; Ormsby, Vice Chair; Chandler, Ranking Minority Member; Carlyle, Cody, Dunshee, Green, Haigh, Hudgins, S. Hunt, Jinkins, Kagi, Lytton, Morrell, Pettigrew, Seaquist, Sullivan and Tharinger.

Minority Report: Do not pass. Signed by 13 members: Representatives Ross, Assistant Ranking Minority Member; Wilcox, Assistant Ranking Minority Member; Buys, Christian, Dahlquist, Fagan, Haler, Harris, G. Hunt, Parker, Schmick, Springer and Taylor.

Staff: Mary Mulholland (786-7391).

Background:

Employment standards and benefits generally apply only if an employer-employee relationship exists rather than an independent contractor relationship. Various multi-part tests are used to determine whether an individual is an independent contractor. For purposes of prevailing wage, industrial insurance, and unemployment insurance, a six-part statutory independent contractor test is applied. This test requires that:

- the individual has been and will be free from direction and control, both under the contract and in fact;
- the individual's services are outside the usual course of business for which the service is performed, or outside all the places of business, or the individual must pay the costs of the principal place of business where the services are performed;
- the individual has an independently established business, or a principal place of business that qualifies for an Internal Revenue Service (IRS) deduction;
- the individual is responsible for filing a schedule of expenses with the IRS;
- the individual has a separate set of books and records that reflect all items of income and expenses; and
- the individual has an active and valid registration with the Department of Revenue, has a unified business identifier number, and has any other required state accounts for the payment of taxes.

In the construction industry, a seventh required element is that the individual be registered as a contractor or licensed as an electrical contractor. (For industrial insurance, a threshold question is whether a person under contract brings more than their personal labor to the job and for unemployment insurance, persons outside construction may also be independent contractors under an alternative three-part test.)

For purposes of the Minimum Wage Act, which also addresses overtime, a common law economic dependence test applies. The inquiry under this test is whether the worker is economically dependent on the alleged employer or is instead in business for himself or herself. Other wage laws also do not have statutory tests. These include the Wage Payment Act, which provides for an administrative or court action to collect wages under the

Minimum Wage Act and other wage laws, as well as establishes other requirements. Other laws address deductions from wages and otherwise address failure to pay wages.

If an employer treats a worker as an independent contractor rather than as an employee, the employer may be liable under the various employment laws. Some employment laws address the liability of general contractors for violations of a subcontractor. For example, for purposes of unemployment insurance and industrial insurance, a general construction contractor is not liable for a subcontractor's taxes under certain circumstances.

Summary of Bill:

Employee Fair Classification Act. The Employee Fair Classification Act (EFCA) is enacted.

Prohibitions and Requirements. Certain actions by employers and other persons are prohibited. These are:

- willfully misclassifying an employee as an independent contractor. "Misclassification" is designating an employee as a nonemployee. "Willful" is a knowing and intentional action that is not accidental or the result of a bona fide dispute;
- charging a misclassified employee a fee or making unlawful deductions from compensation;
- requiring or requesting an employee to agree to or sign a document that results in misclassification;
- forming, assisting in, or inducing the formation of a business entity or paying or collecting a fee for the use of a business entity, or the purpose of facilitating or evading detection of a violation of the EFCA; and
- conspiring with, aiding and abetting, assisting, or advising an employer (for remuneration) with the intent of violating the EFCA.

Employers who engage independent contractors must post a notice stating that a worker has a right to be classified as an employee if the worker does not meet independent contractor requirements and that a complaint may be filed with the Department of Labor and Industries (Department) or in court if a person believes misclassification has occurred. The notice must be in English, Spanish, and any other language primarily spoken by the majority of the workforce.

Bona fide independent contractors, commissioned outside salespeople, individuals employed on a casual and sporadic basis, and volunteers are not employees under the EFCA.

Employer-Employee Relationship. An employer-employee relationship exists when an individual performs labor or services for an employer. Proof that an individual is not an employee must be established by a preponderance of the evidence.

A person may be an employee of two or more employers at the same time.

Definition of Independent Contractor. An "independent contractor" is an individual who performs labor or services under either of two tests. The ABC test requires that:

- the individual is and will continue to be free from control or direction, both under the contract and in fact. Control or direction includes the right to control or direct as well as general control or direction over the individual's physical activities;
- the labor or service is either outside the usual course of business for which the labor or service is performed or outside of all the places of business of the enterprise for which the labor or service is performed; and
- the individual is customarily engaged in an independently established trade, occupation, business, or profession that is of the same nature as that involved in the contract.

An alternative test requires that:

- the individual is and will continue to be free from control or direction, both under the contract and in fact. Control or direction includes the right to control or direct as well as general control or direction over the individual's physical activities;
- the individual's business is not financially dependent on the relationship with the party engaging the individual and the business continues after the relationship ends;
- the individual has a substantial investment of capital in the business;
- the individual gains profits and bears losses as a result of managerial skills and capital investment;
- the individual makes his or her labor or services available to the public or business community on a continuing basis;
- the individual files a schedule of expenses with the IRS;
- the party engaging the individual does not represent the individual as an employee;
- the individual has the right to perform similar labor or services for others;
- the individual has an active and valid registration with the Department of Revenue and any other state agencies for purposes of taxes; and
- the individual has a separate set of books and records.

Acts taken to comply with laws are not proof of independent contractor status.

Enforcement. Administrative enforcement as well as a private cause of action are authorized under the EFCA.

Administrative. The Department may investigate violations and for any of the prohibited acts may order payment of:

- a civil penalty of \$1,000 to \$10,000 per employee, or \$10,000 to \$25,000 if the person engaged in a pattern or practice;
- damages of three times the wages and benefits denied or withheld and reimbursement for taxes and the value of benefits paid by the employee. Liability is joint and several for employers and other persons; and
- taxes owed.

The Department may also order reinstatement and reclassification of the employee, or front pay in lieu of reinstatement.

For a notice violation, the Department may order payment of a civil penalty of \$1,000 to \$10,000.

Cause of Action. Individual and class actions are authorized. If the court determines that a person, including an employer, engaged in any of the prohibited acts, the court must order payment of damages of: (1) the greater of (a) three times the wages and benefits unlawfully denied or withheld or (b) statutory damages of \$1,000 to \$10,000 per employee or \$10,000 to \$25,000 per employee if a pattern or practice is shown; and (2) attorneys' fees and costs. The court may also order employers and other persons to reimburse the employee for taxes and the value of benefits paid by the employee. Liability is joint and several for employers and other persons.

Employers may also be ordered to pay taxes, and may be subject to injunctive or other relief, including reinstatement and reclassification or front pay in lieu of reinstatement.

Other Enforcement Provisions. A three-year statute of limitations for both administrative and court actions is tolled during any period that an employer deterred an action. A "pattern or practice" means that within the previous 10 years, the employer was convicted for nonpayment of wages or delinquent in payment of a court ordered or administrative assessment for nonpayment of wages. The Department may initiate collection procedures for unpaid premiums and may send its determination to the Employment Security Department.

A general construction contractor is liable for violations of an independent contractor or subcontractor only when the general exerts substantial control over the day-to-day work of the subcontractor or independent contractor.

Account. The EFCA Account (Account) is created. Civil penalties must be deposited into the Account, which is appropriated, and moneys in the Account may be used only for enforcement of the EFCA.

Implementation. The Department has rule-making authority and may develop a plan for strategic enforcement of the EFCA, prioritizing industries and workplaces with a high concentration of violations.

Existing employment laws. The EFCA independent contractor tests apply to prevailing wage, wage deductions, the Wage Payment Act, the Minimum Wage Act, unemployment insurance, and industrial insurance. Most existing statutory tests are repealed. The EFCA provisions on the employer employee relationship also apply to these other laws.

The EFCA provisions on general construction contractor liability also apply to to wage deductions, the Wage Payment Act, and the Minimum Wage Act.

A contractor who violates prevailing wage laws or the EFCA, or both laws, for a second time within a five-year period is barred from bidding on a public works contract for one year and is also subject to other sanctions.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.

Staff Summary of Public Testimony (Labor & Workforce Development):

(In support) This bill is about fair play and fair pay. Some people play by the rules and some game the system. Treating employees as independent contractors cheats workers from pay and workers' compensation benefits. We have a social contract that people will get paid a day's work and that competition should be fair.

Misclassification is a trend that robs schools and public safety and other services and hurts middle class workers and families. Current laws do not have enough teeth to address misclassification.

Employers misclassify to avoid paying overtime and taxes. Employers can skim 30 percent off their payroll costs. Misclassification puts employers who follow the law at a disadvantage. It is theft against workers and against companies that play by the rules.

This bill provides additional tools to address the underground economy. Hundreds of millions of dollars in lost tax revenue have been recovered by states that have addressed the underground economy. In Washington, \$274 million in one year was lost due to unpaid state taxes.

Janitors, home care workers, restaurant employees, and other low wage workers are being forced to sign contracts stating they are independent contractors. These are not people who own businesses.

This bill clearly delineates who is a traditional employee and who is a true independent contractor. Tests would be applied to all laws. Currently, similar fact patterns can produce different results. The ABC test was chosen because more than half of states use it and there is a track record. Lawyers, doctors, and outside sales people such as those who sell Mary Kay products are all protected. The alternative test captures real estate agents, web developers, and others who may still be subject to control but are not employees. Exempting outside sales people and casual labor provides uniformity with other laws.

Some industries, such as the agricultural and hotel industries, have multiple layers, which makes it hard to enforce rights. Under the bill, employees can have more than one employer.

Regardless of a person's immigration status, all workers in the country have a right to be fairly paid.

(Opposed) Having two definitions is confusing. Both exclude persons from being an independent contractor if there is general control over physical activities. This issue becomes a jury question so these cases will have to go to trial.

Wage issues are complicated matters about which people can disagree. Even judges can reach different conclusions. The bill purports to be aimed at scofflaws but affects all

employers. It will increase costs to all employers by tilting the playing field. Meritless cases will be more difficult to fight.

The bill makes most people employees despite the intent or desire of the parties involved. It creates a broad presumption about independent contractors. The bill allows an employee to have more than one employer. There is concern about whether a general contractor would simultaneously be considered an employer of a subcontractor's employee.

In the trucking industry, independent contractor owner-operators are widely used and have been used for over a century. This model is specifically authorized by federal law and owner operators are also exempt from workers' compensation. Several laws, including a law creating a presumed employee status, have been found preempted by a federal law preempting rates, routes, and services. The trucking industry can't meet the test even though federal law authorizes independent contractors. This bill will lead to litigation. Trucking companies are currently litigating cases with state agencies. Carriers are leaving Washington because of these types of issues.

This bill contains burdensome notification requirements and is unnecessary. Companies like Avon would have to come to Washington to overcome the presumption that their direct sellers are employees. Any exemption for direct sellers should conform to federal standards.

This bill does not work for small businesses, which employ about 85 percent of the people in the state. The requirements are onerous and burdensome and the complexity is overwhelming.

Staff Summary of Public Testimony (Appropriations):

(In support) Some bad actors are gaming the system, which denies workers benefits, hurts employers who play by the rules, and robs the General Fund.

This bill addresses employers underpaying or not paying workers and intentionally misclassifying them. Workers will get the wages they are owed and will spend and not rely on the state's resources. In one case \$1.5 million was stolen from seven drywall workers and in another case \$110,000. Death was threatened if a person did not leave the country. One worker was paid \$3 per hour and another did not receive \$20,000 owed on a prevailing wage job. Many workers in the janitorial industry are misclassified; they are told when to work, are supervised, and the contractor provides the materials. Some are making less than minimum wage. The entire janitorial industry is hurt by these practices. There are repeat offenders. Contractors must be held accountable.

This bill will have a positive impact on the state's coffers. With a similar bill, New York City brought in \$400 million in revenue. The Employment Security Department found in 2011 that \$100 million annually is lost to the state and that 12,000 workers were misclassified in 2012. Employers can skim off 30 percent of payroll costs by misclassifying. The cost to the federal government has been estimated at \$3 billion. Other states are working on this issue. The return on investment for workers' compensation fraud is 9 to 1. Private actors will refer quality cases to the state. House Bill 1440 from the 2013 regular session was very different and also the fiscal impact.

The three-part test will make clear who is an employee and who is an independent contractor. The test does not eliminate the ability to be an independent contractor. It creates a bright line. Last year's issues with direction and control and general contractor liability have been addressed. Lawyers, doctors, and real estate brokers are all protected under the bill.

(Opposed) Direct sellers will have to prove they are independent contractors. The bill is too broad. The Department of Labor and Industries and the Employment Security Department's budgets will be impacted by increased audits, explanations, and appeals. The bill will increase costs to employers. The bill does not conform to federal law on direct sellers.

Persons Testifying (Labor & Workforce Development): (In support) Representative Riccelli, prime sponsor; Teresa Mosqueda, Washington State Labor Council; Diego Rondón Ichikawa, National Employment Law Project; Andrea Schmitt, Columbia Legal Services; Joel Coronado and Cariño Barragan, Casa Latina; Robert Bruner, Teamsters Local 117; Larry Boyd, Teamsters Local 174; Neil Hartman, Washington State Building and Construction Trades Council; Billy Wallace, Washington and Northern Idaho District Council of Laborers; Matt Haney, Service Employees International Union 6; Nicole Grant, Certified Electricians of Western Washington; Miguel Perez Gibson, Progreso Latino; Emily Murphy, One America; and Simon Gorbaty.

(Opposed) Tim O'Connell, Association of Washington Business; Philip Talmadge, Washington Trucking Association; Van Collins, Associated General Contractors; Mark Johnson, Washington Retail Association; Jeff Hansrom, Direct Sellers Association; Susan Eerdmans, Avon; and Gary Smith, Independent Business Association.

Persons Testifying (Appropriations): (In support) Representative Riccelli, prime sponsor; Teresa Mosqueda, Washington State Labor Council; Rebecca Smith, National Employer Law Project; Andrea Schmitt, Columbia Legal Services; Omar Rubi, Painters Allied Trades; Dave Meyers, Washington State Building Trades; Javier Merino; Carino Barragan, Casa Latina; Matt Haney, Service Employees International Union Local 6; and Billy Wallace, Northwest Laborers.

(Opposed) Mark Johnson, Washington Retail Association.

Persons Signed In To Testify But Not Testifying (Labor & Workforce Development): None.

Persons Signed In To Testify But Not Testifying (Appropriations): None.