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New Pennsylvania Law Penalizes Construction Industry Employers Who Misclassify Workers

By Thomas Benjamin Huggett and Matthew J. Hank

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Background

Workers classified as employees are entitled to an array of protections, including workers' compensation and unemployment insurance. Such protections generally do not apply, however, to workers classified as independent contractors. As federal and state laws have multiplied protections for employees, companies have had an increased incentive to classify workers as independent contractors and thus escape increased regulation. Workers, on the other hand, have had an increased incentive to insist that they are employees and thus receive the benefits of the laws.

The result has been increased litigation over worker classification, especially in the wage and hour and benefit contexts. The outcome of most of these cases has depended on the application of several tests attempting to measure the degree of control that the hiring party exercises over the worker, with greater control tending to show employee status. Each of those tests depends on a variety of factors, such as the tax treatment of the hired party, which courts may or may not consider in a given case, and which courts may weigh differently in different cases. The lack of clarity in the law regarding who is an independent contractor has made it difficult for companies to ensure their workers are properly classified.

Construction Workplace Misclassification Act

The recently enacted Pennsylvania Construction Workplace Misclassification Act attempts to provide clearer rules governing the classification of employees in the construction industry. Under the Act, to be properly classified as an independent contractor, a construction worker must meet three criteria:

1. have a written contract to perform services;
2. be free from the hiring party's control or direction when performing such services; and
3. be customarily engaged in an independently established trade, occupation, profession or business.

The Act provides no elaboration for what constitutes a written contract to perform services. For example, the law does not specify whether the contract must be separate from a purchase order or a bid document, or whether those documents (so long as they are in writing) would suffice. As to the second criterion, degree of control, the Act likewise provides no guidance. Until the Pennsylvania Department of Labor promulgates regulations pertaining to these first two criteria, therefore, courts will likely apply judicially created tests evaluating what constitutes a written contract, and assessing degree of control.

Unlike the uncertainty as to the written contract and degree of control criteria, however, the Act is explicit about the requirements to meet the third criterion. For the hired party to be "customarily engaged in an independently established trade, occupation, profession or business," the hired party must:

1. possess the essential tools for the job, independent of the person for whom the services are performed;
2. realize a profit or loss as a result of performing the services;
3. perform the services through a business he owns, at least in part;
4. maintain an independent business location;
5. either perform similar services for another hiring party while meeting the first four requirements or credibly hold himself out as able to perform similar services; *and*
6. maintain individual liability insurance during the term of the contract of at least \$50,000.

As was noted during the legislative debate on the bill, these criteria are not flexible and do not allow room for individual circumstances. Each criterion must be specifically met in order to classify a worker as an independent contractor.

Under the Pennsylvania Construction Workplace Misclassification Act, construction industry employers who misclassify workers for purposes of the Workers' Compensation Act or the Unemployment Compensation Law may be penalized with fines or incarceration. Officers and agents of those employers, and those who intentionally contract with such an employer knowing that it intends to misclassify workers in violation of the Act, are subject to the same penalties. The Act also prohibits retaliation against whistleblowers.

The Act's harshness is lessened, however, by two considerations. First, the hiring party's good faith is a defense to liability. Second, the Act contains no private right of action; all actions to enforce it depend on the Department of Labor and Industry prosecuting a case.

Practical Implications for Hiring Parties in the Construction Industry

- The Act only directly applies to the construction industry. In other industries, companies may continue to classify workers according to the common law tests that prevailed before the Act.
- In the construction industry, when deciding whether a worker is an independent contractor for purposes of workers' compensation and unemployment insurance, companies should begin their analysis by asking whether the worker meets *all six* of the criteria needed to conclude that the hired party is customarily engaged in an independently established trade, etc. Those criteria are inflexible, and if a single one is missing, the worker must be classified as an employee.
 - Although these considerations are officially only for workers' compensation and unemployment compensation, once the individual is classified as an employee for those purposes, that designation will, as a practical matter, carry forward to all other treatment of the individual as an employee.

- If all six of the criteria are met, the degree of control exercised over the hired party must be kept to a minimum. This does not mean specifics of the job are delegated, nor is oversight on previously agreed upon deadlines and quality eliminated, but daily supervision and control must be avoided to maintain the hired party's status as an independent contractor.

It is strongly recommended companies make a contemporaneous record of why they believe that the worker is an independent contractor. Since there must be a written contract with that worker anyway, it makes sense to write into the contract the reasons that both parties agree that it is an independent contractor relationship. Even if a court ultimately disagrees with the assessment, a well reasoned, detailed explanation in the contract of why it is believed the worker is an independent contractor will go a long way toward establishing good faith. Good faith is, after all, a defense to liability under the Act.

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