pennsylvania
DEPARTMENT OF LABOR & INDUSTRY

Written Testimony of Christopher Hallock
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Department of Labor & Industry

Chairman Dawkins, Chairman Mackenzie, and members of the Committee, thank you for inviting me to testify today. My name is Christopher S. Hallock, and I am the Deputy Secretary of Safety and Labor Management Relations for the Pennsylvania Department of Labor and Industry (L&I). The Bureau of Labor Law Compliance (BLLC) is one of the four Bureaus that I oversee. BLLC is tasked with enforcing 13 laws that protect workers' rights to receive timely compensation, minimum wage and overtime, and ensure workplace protections for children, among other things. BLLC also enforces Act 72 of 2010 – the Construction Workplace Misclassification Act. Worker misclassification has long been a well-known problem in the construction industry and led to Pennsylvania enacting Act 72.[1] Act 72 prohibits employers from misclassifying construction workers who meet the definitions of "employee" under Pennsylvania's UC and WC laws as independent contractors. Under the Act, a construction worker is presumed to be an employee unless all of the statutory criteria of an independent contractor are met.

Misclassification is a significant issue affecting Pennsylvania's workforce and economy. A misclassified worker is denied essentially all workplace protections, most of which apply only to workers who are employees. Thus, when an employer misclassifies a worker as an independent contractor, they wrongly prevent that worker from accessing minimum wage or overtime, protection from discrimination, family and medical leave, the right to organize, workers' compensation, unemployment compensation, and more. In addition, misclassification improperly saddles the worker with the responsibility for paying the full payroll tax contribution to Social Security and Medicare, a portion of which ought to be paid by an employer.

More than being just a worker issue, the proper classification of employees is about fairness in business competition. When employers misclassify workers, law-abiding businesses suffer because they are forced to compete in the marketplace on unequal terms against unscrupulous employers that are avoiding payroll tax contributions, unemployment compensation taxes, workers' compensation insurance premiums, or paying overtime. Communities also suffer by not enjoying the full amount of tax revenue they are owed. This means that parks, schools, and police and fire departments are all negatively impacted by misclassification, in addition to additional strain being placed on the healthcare system.

In 2023, BLLC conducted 249 Act 72 investigations, finding 712 misclassified workers. In the first five months of 2024, the Bureau has investigated 121 entities and found that these companies misclassified 356 construction industry employees. However, employee misclassification adversely affects more than the construction industry. A survey of state and federal studies by the National Employment Law Project found high rates of misclassification among workers in the janitorial, home care, real estate,

[1] 43 P.S. §§ 933.1– 933.17

tech, local delivery, and trucking industries.[2] Misclassification is also expanding exponentially with the ubiquity of the platform or "gig" economy. It has become a tenet of business for platform companies to leverage their power as the employer to require that their workers agree to one sided and constantly changing terms of service. While a true independent contractor can negotiate terms and conditions at arm's length, gig workers' only recourse to not agreeing with the terms posed is not working.

BLLC is not the only Bureau at L&I that works to combat worker misclassification. The Bureau of Workers' Compensation (BWC) and Office of Unemployment Compensation Tax Services (OUCTS) are also active in efforts to ensure the proper classification of workers.

According to the Bureau of Workers' Compensation, since 2023 approximately 300 misclassified employees were injured, resulting in $450,000 in lost compensation. Moreover, the impact of worker misclassification directly impacts the Uninsured Employers' Guaranty Fund (UEGF). An employee injured while performing their duties for an uninsured employer may file a petition against the UEGF. If the petition is granted by a Workers' Compensation Judge, the UEGF is then secondarily liable for payment of compensation and medical bills if the employer fails to pay. This puts the Fund in the position of having to make up the difference for employers who wrongly fail to obtain or provide workers' compensation to misclassified workers, and increases costs for compliant businesses. The Fund has outstanding liabilities of nearly $26 million.

In 2022 and 2023, the OUCTS identified 24,232 misclassified workers, resulting in $378.3 Million in underreported wages and $8.2 Million in underreported UC tax contributions. Already in 2024, as of May 27th, there have been 6,455 misclassified workers, resulting in $100.3 Million in underreported wages and $1.7 Million in underreported UC tax contributions. The failure by misclassifying employers to pay UC taxes makes it harder for misclassified employees to access UC benefits and strained the overall solvency of the UC Trust Fund.

L&I's Center for Workforce Information and Analysis (CWIA) estimates that fifteen percent of Pennsylvania employers misclassify their employees, which equates to approximately 185,000 workers being misclassified. Based on these projections, misclassification costs the UC Trust Fund approximately $52 Million per year.

From lost revenue to unprotected employees to unfair competition, this much is clear: Pennsylvania must take action to stop the accelerating expansion of misclassification. It is true that not all employers that misclassify employees do so intentionally. We understand that it can be challenging for a well-intentioned business owner to know what makes a worker an employee when Pennsylvania lacks a uniform definition of "employee" or "independent contractor." The Workers' Compensation Act, Act 72, and the Unemployment Compensation Act all have slightly different but statutorily distinct tests for determining employee status. Additionally, a body of common law has developed additional criteria for determining employee status for wage and hour purposes. As such, inconsistent standards and tests exist that employers, and particularly small businesses, have difficulty understanding and applying.

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[2] National Employment Law Project, Independent Contractor Misclassification Imposes Huge Cost on Workers and Federal and State Treasuries, 2 (Oct. 2020), https://s27147.pcdn.co/wpcontent/uploads/Independent-Contractor-Misclassification-Imposes-Huge-Costs-WorkersFederal-State-Treasuries-Update-October-2020.pdf

In its final report issued in December of 2022[3], the Joint Task Force on the Misclassification of Employees, which included representatives from the L&I and the Office of the Attorney General as well as appointees from all four legislative caucuses, unanimously agreed to a series of pragmatic recommendations to the General Assembly to address misclassification. I would like to highlight several of those proposals. The Task Force recommended that a uniform definition of "employee" be applied across all of Pennsylvania's labor and employment laws. Given the unique nature of the construction industry, Act 72's articulation of the test should be preserved for construction workers. In general, however, the Task Force recommended that the General Assembly consider adopting a streamlined, multifactor test for employee status. Under this test, the three factors examined to determine independent contractor status are whether:

1) The individual is free from control or direction over their work, both under the contract of service and in fact;
2) The individual's work is outside the usual course of business of the employer; and
3) The individual is customarily engaged in an independently established trade, occupation, profession, or business.

The test's simplicity would streamline compliance for employers, while also providing workers with robust protection from misclassification, ensuring that only those truly in business for themselves are classified as independent contractors.

Next, the Task Force recommended that the General Assembly should give L&I enforcement tools that will help promote greater compliance. Although Act 72 currently permits L&I to issue stop-work orders, the convoluted process for doing so has meant that no such order has ever actually been issued. In keeping with a broader definition of employee that applies across industries, L&I should be given the power to issue cease-operations orders, and the process for obtaining the orders should be streamlined. Currently, it takes, at least one month to obtain a stop-work order. A construction project has typically concluded by then, or at least the portion of work completed by the violating employer. The ability to issue a cease-operations order more quickly would not only serve as a powerful deterrent against misclassification but could be issued for violations in any industry. L&I is cognizant that the ability to issue such an order expeditiously must be balanced with due process, notice, and an opportunity for the employer to contest it.

Additionally, the Task Force also recommended that L&I be granted the authority to debar employers that misclassify employees from bidding on or participating in state-funded or supervised construction or procurement contracts. Debarring employers that misclassify employees would also underscore the Commonwealth's commitment to working only with contractors that operate within the parameters of the law.

To assist with the increased cost of broader civil enforcement, the Task Force recommended that L&I should be permitted to assess investigative costs and counsel fees against employers found in violation of the law and that L&I should also be provided with funding to hire additional investigators. Governor Shapiro's 2024-25 budget requests funding for BLLC to hire 12 additional investigators. L&I needs those resources to better address the misclassification of vulnerable and exploited Pennsylvanians.

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[3] Statewide Joint Task Force on the Misclassification of Employees, Final Report (2022) available at https://www.dli.pa.gov/Individuals/Labor-ManagementRelations/llc/Documents/Act-85-Final-Report.pdf

With regard to enforcement in criminal cases, the Task Force urged the General Assembly to enhance criminal penalties for employers that misclassify employees. The maximum penalty an employer currently faces, even if they have previously been convicted of misclassifying employees, is conviction for a second-degree misdemeanor, resulting in a maximum $5,000 fine and up to two years in prison. Misclassification persisting as a widespread problem in the construction industry is a clear indicator that current penalties do not have a sufficient deterrent effect. The Task Force recommended strengthening penalties in order to enhance the deterrent effect. A first offense when an employer knowingly misclassifies employees should be a first-degree misdemeanor and escalate to a third-degree felony for second and subsequent offenses. Additionally, it should be easier to hold employers higher up the chain responsible for what happens on their jobsites. It is laughably easy for a general contractor to claim ignorance for how subcontractors classify their workers despite it being commonly known that some subs intentionally misclassify workers as a cost savings measure that the general contractor also enjoys the benefit of. The current standard for imputing culpability makes it virtually impossible to hold end-user employers accountable.

Testimony before the Task Force made it clear that labor brokers are a large driver of misclassification within the construction industry. Labor brokers are a primary supplier of workers that are hired on a job-by-job, or even day-by-day basis, and are therefore easy to misclassify. Labor brokers often operate out of a vehicle and move from location to location. They strategically structure their business to operate below the radar, often paying workers in cash, and are able to quickly disappear upon an indication of law enforcement. To address this issue, the Task Force recommended creating a comprehensive system for registering and bonding labor brokers.

A genuine effort to address misclassification must include resources for L&I to conduct public education campaigns. Broad public education about worker misclassification will help employers that want to abide by the law to understand what their obligations are and will also assist misclassified workers to recognize that their employer has improperly classified them and what resources are available to them. More public outreach on what constitutes misclassification will also make it more difficult for an employer to assert that they were not aware of the issue or that the law requires workers to be classified properly.

Finally, there should be consideration given to authorizing misclassified employees to pursue a private right of action that includes remedies. Private rights of action are a common feature of labor and employment laws, and already exist in Pennsylvania's Wage Payment and Collection Law and Minimum Wage Act. Permitting private actions would relieve L&I of some of its overwhelming civil enforcement burden and create an additional deterrent against misclassification.

Employee misclassification has been a longstanding problem in Pennsylvania. Without legislative action to increase the tools available to L&I, to increase penalties and clarity around misclassification, and to educate workers and employers of the broad costs of misclassification, misclassification will continue to have a devastating effect on Pennsylvania. It robs employees of the wages, benefits, and protections they are entitled to, forces law-abiding employers to compete on an uneven playing field, and drains badly needed state and local revenues. The Department of Labor and Industry urges the General Assembly to take action to rectify this urgent matter. Thank you for the opportunity to testify today.

The Prevalence and Cost of Worker Misclassification and How to Rein It In

Testimony of Stephen Herzenberg, Executive Director, Keystone Research Center
House Labor & Industry Committee, 523 Irvis Office Building, June 11, 2024

Good morning. My name is Stephen Herzenberg, I am the executive director of Keystone Research Center (https://keystoneresearch.org/) and hold a PhD in economics from the Massachusetts Institute of Technology. Thank you for the opportunity to provide testimony to this informational meeting on worker misclassification.

My remarks today make two main points. First, worker misclassification is a widespread problem in today's U.S. economy, not just in the construction industry. Second, a number of states and localities across the country have sought in the past decade to rein in worker misclassification and deploy innovative enforcement approaches. Both these points lead to straightforward conclusions. Pennsylvania should enact legislation that reduces worker misclassification throughout the economy. Pennsylvania should also seek to adopt best enforcement practices through a mix of legislative and administrative reforms.

The Broad Reach and High Costs of Worker Misclassification

A 2023 Economic Policy Institute (EPI) study identifies and cities research showing widespread misclassification of workers among construction workers *and* 10 other occupations: truck drivers, janitors and cleaners, home health aides, retail workers, housekeepers, landscapers, customer service reps/call center workers, security guards, delivery drivers, and manicurists and pedicurists.[1] EPI then uses a conservative methodology to estimate the cost to workers of being misclassified.[2] For each occupation, EPI provides a range of potential costs, with the high cost applying if misclassified workers receive no additional pay in lieu of their ineligibility for employee benefits, and also have to pay the employee share of Social Security and Medicare and paperwork costs associated with independent contractor status. The low cost assumes misclassified workers receive additional pay in lieu of benefits but still have to pay the employee share of Social Security and Medicare and paperwork costs.

Across the 11 occupations, the midpoint of the range of the cost to workers goes from a low of just over $5,500 for manicurists and pedicurists to a high of over $14,500 for truck drivers. As a percent of compensation for employees (i.e., workers in the same occupation who are not misclassified), the cost to workers (again at the midpoint of the EPI range) goes from 20% of compensations to 27.5%, the highest cost again incurred by truck drivers.

A study released last month on two types of gig workers, passenger drivers (e.g., Uber and Lyft drivers) and delivery workers, provides hard data on the poor pay of (misclassified) independent

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[1] John Schmitt, Heidi Shierholz, Margaret Poydock, and Samantha Sanders, "The economic costs of worker misclassification," January 25, 2023; https://www.epi.org/publication/cost-of-misclassification/. Footnote 3 includes references to research documenting misclassification in the 11 occupations/occupational groups.

[2] For the details of the EPI methodology, see Heidi Shierholz, John Schmitt, and Margaret Poydock, "EPI comments on DOL's proposed rulemaking on employee or independent contractor classification under the Fair Labor Standards Act: Public Comments," December 13, 2022; https://www.epi.org/publication/epi-comments-on-dols-proposed-rulemaking-on-employee-or-independent-contractor-classification-under-the-fair-labor-standards-act/.

contractors.[3] The study sought to evaluate the consistency of driver pay with a promise made California Proposition 22 (a gig company-sponsored 2020 California ballot measure) that drivers would earn at least 120 percent of local minimum wages.[4] The new study analyzed data on 52,370 trips by 1,088 drivers who worked on six passenger and delivery platforms in five major metro areas (Boston, Chicago, Los Angeles, San Francisco, and Seattle). It found that in jurisdiction did drivers make the local minimum wage. In California, net pay for ride-share drivers, taking into account costs incurred by drivers, equaled $7.63 with tips, less than half the $16 per hour minimum wage. For delivery workers outside California, net pay equaled $8.36 per hour.

EPI also estimates the cost to social insurance programs of worker misclassification as independent contractors. Its low estimate suggests a decline in total per-worker revenue received by social insurance programs between $585 per year (security guards) and $1,781 per year (construction workers). Its high estimate puts the range of annual revenue losses between $1,101 (security guards) and $3,031 (truck drivers).

Pennsylvania's own Joint Task Force on Misclassification of Employees estimated that Pennsylvania had 259,000 misclassified employees from 2020Q3 to 2021Q2 and that this cost the UC Trust Fund $91 million in contributions; and the General Fund $6.4 million to $124.5 million.[5] Estimated losses to misclassified employees who suffered injury or illness at work in 2021 without workers' compensation insurance equaled $153 million.

Innovative Enforcement Practices

Across the country over the past decade, gig companies with deep pockets have deployed three main tactics to ensure they are not required to classify their drivers or other gig workers as employees: state pre-emption legislation to prohibit local governments from setting labor standards platform based companies; carve-outs, exemptions, and redefinition of platform-based workers as nonemployees; and weakening legal tests and definitions of employee status for all workers.[6] In a countertrend, several states have sought to strengthen laws designed to make it harder for

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[3] Ken Jacobs, Michael Reich, Tynan Challenor, and Aida Farman, "Gig Passenger and Delivery Driver Pay in Five Metro Areas," May 2024; https://laborcenter.berkeley.edu/wp-content/uploads/2024/05/Gig-Passenger-and-Delivery-Driver-Pay-in-Five-Metro-Areas.pdf.

[4] The California Supreme Court is considering the constitutionality of Proposition 22. Just yesterday in a related case, an 11-judge federal appeals court ruled in favor of California Assembly Bill 5 (AB5), the state law that precipitated the Proposition 22 ballot initiative. AB5 codified an ABC test for determining if workers in California are independent contractors and required ride-haul and delivery companies, in particular, to treat drivers as employees. See Levi Sumagaysay, "California gig worker law withstands challenge from Uber at federal appeals court," June 10, 2024; https://calmatters.org/economy/2024/06/ab-5-california-uber/.

[5] See Joint Task Force on Worker Misclassification of Employees, "Act 85 of 2020: Joint Task Force on Worker Misclassification of Employees Final Report," December 1, 2022; https://www.dli.pa.gov/Individuals/Labor-Management-Relations/llc/Documents/Act-85-Final-Report.pdf. Earlier studies in other states of the cost of worker misclassification in construction alone, when adjusted based on Pennsylvania construction employment compared to the states of the studies, put the cost of misclassification to the PA UC system at as much as $11 million; the cost to state income taxes as much as $47 million; and the cost in workers' compensation premiums at as much as $83.4 million. See Stephen Herzenberg and Russell Ormiston, "Illegal Labor Practices in the Philadelphia Regional Construction Industry," January 2019, Table 1; https://keystoneresearch.org/wp-content/uploads/KRC-Illegal-Labor-Con.-Final-01-08-1995-2.pdf.

[6] This paragraph is based on Jennifer Sherer and Margaret Poydock, "Flexible work without exploitation," Economic Policy Institute, February 23, 2023; https://www.epi.org/publication/state-misclassification-of-workers/,

companies with workers that work largely or exclusively for a single main company (or "client") to claim those "dedicated" workers are independent contractors. One main approach has been to adopt a three-factor (or "ABC") test for independent contractor status.

1. The work is done without the direction and control of the employer.
2. The work is performed outside the usual course of the employer's business.
3. The work is done by someone who has their own, independent business or trade doing that kind of work.

The EPI brief cited above highlights California and Massachusetts and also has a table that lists 17 states that have adopted an ABC test for purposes of unemployment compensation law (and two others that have done so for construction); and six that have adopted an ABC test for purposes of wage/hour or other regulations (with three additional having done so for construction). (Pennsylvania is not in either category.) The EPI brief then cites four states that have used an ABC test and/or other enforcement measures to reduce misclassification. New Jersey, for example, has empowered its state commissioner of labor to issue stop-work orders to work sites of employers found illegally misclassifying workers; created a state Office of Strategic Enforcement and Compliance responsible for interagency coordination of enforcement of wage payment, benefit, and tax laws; made misclassification of employees for the purpose of evading payment of insurance premiums a violation of state fraud prevention laws that is subject to fines starting at $5,000 for a first violation, $10,000 for a second violation, and $15,000 for each subsequent violation; and requiring creation of a statewide, publicly accessible database of certified payroll information for public works projects.

Other states with (Vermont, Nevada) and without (Colorado, Virginia) ABC tests have also increased penalties and many states have established multiagency task forces on worker misclassification.

States and localities have adopted four other intertwined trends in innovative enforcement, to reduce worker misclassification and other labor standards violations.

First, many localities and state Attorney General Offices have established their own enforcement offices. Pennsylvania's Office of the Attorney General did that when Governor Shapiro was Attorney General, led by now Secretary of Labor & Industry, Nancy Walker. Philadelphia also established its own enforcement office. Allegheny County is in the process of setting up an enforcement office.

Second, learning in part from federal USDOL enforcement innovations, states have adopted more strategic, industry specific approaches, including pro-active targeting of some investigations (as opposed to simply responding to complaints) and using publicity to bring attention within an industry to sanctions imposed on violators.

Third, localities (e.g., San Francisco and Seattle) have funded worker centers and other community organizations embedded in neighborhoods from which exploited workers come. These can become the "eyes and ears" of state and local enforcement entities, substituting for labor unions in industries or industry segments with low union density.

Fourth, there has been a gradual effort, in conjunction with interagency misclassification task forces, to expand "data sharing" and formal data sharing "MOUs" (memoranda of understanding), both

within states and localities and between federal agencies such as the Internal Revenue Service (IRS)) and states/localities.

A recent *New York Times* op ed both documents the spread of worker misclassification to more industries and shows how effective enforcement can help prevent it.[7]

To increase their effectiveness, these new approaches, including pro-active industry specific enforcement, interagency task forces, partnering with community organizations, and efforts to promote increased data sharing require funding and staff support.

Thanks to the Joint Task Force on Worker Misclassification, the good follow up work of this committee, and the reform efforts begun at the Department of Labor & Industry, Pennsylvania is well positioned to join the ranks of leading states when it comes to routing out worker misclassification and enforcing labor standards in general. Congratulations and keep it up!

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[7] Terri Gerstein, "More People Are Being Classified as Gig Workers. That's Bad for Everyone," *The New York Times*, Jan. 28, 2024; https://www.nytimes.com/2024/01/28/opinion/rights-workers-economy-gig.html.