

New Connecticut Law Increases Penalties for Employer Misclassification of Independent Contractors

May 7, 2010

A recently enacted Connecticut state law, H.B. 5204, increases the civil penalty imposed upon employers that are found to have engaged in the improper classification of independent contractors. Connecticut law previously provided that employers engaging in employee misclassification and misrepresentation of independent contractors were liable for a single \$300 civil penalty. The new provisions, which become effective October 1, 2010, increase that penalty by providing that *each day* of the violation constitutes a separate offense, thereby subjecting employers that are found to have misclassified contractors to a penalty of \$300 per day per contractor.

The new legislation is part of a broader state campaign to crack down on companies that illegally misclassify workers as independent contractors, as announced by the Connecticut Attorney General in March 2010. The change was recommended by a Connecticut commission established in 2008 explicitly to address problems of worker misclassification of independent contractors. The commission took aim at misclassification because, in its view, it results in misclassified workers not being eligible for benefits such as minimum wage and overtime, unemployment insurance, and workers' compensation, and their not being protected by antidiscrimination and health and safety laws. Moreover, as the Connecticut State Assembly readily acknowledged, misclassified independent contractors often fail to pay state wage taxes, and the increased penalties enacted last week will undoubtedly serve as a significant revenue source for the state.

For all states hard hit by the economic recession, this revenue source is a powerful incentive for state government enforcement. Indeed, the Connecticut crackdown comes amid efforts to crack down on misclassification of employees as independent contractors by approximately one-third of the states, including California, Colorado, Delaware, Illinois, Indiana, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Pennsylvania, Rhode Island, Vermont, and Wisconsin. It also dovetails with recent efforts on the federal level to address misclassification.

The new Connecticut penalty provision applies only to the misclassification of workers as independent contractors, and not to other state laws concerning wages, employment regulation, personnel files, or other workers' compensation provisions. Nonetheless, this new law makes the penalties so high that for some industries and positions the penalties for such misclassification may exceed the compensation paid to the individuals.

Increased Federal Focus on Enforcing Misclassification Penalties

As noted in our February 9, 2010 LawFlash, “U.S. Department of Labor’s Proposed 2011 Budget Reflects an Increased Emphasis on Enforcement” (available online at http://www.morganlewis.com/pubs/LEPG_Proposed2011Budgets_LF_09feb10.pdf), the Department of Labor’s (DOL’s) proposed 2011 budget reflects a federal emphasis on employee reclassification. Specifically, the DOL’s budget includes \$25 million for a joint DOL-Treasury initiative to strengthen and coordinate federal and state efforts to enforce statutory prohibitions, and to identify and deter misclassification of employees as independent contractors. The budget adds new investigators to audit companies for misclassification of independent contractors, new attorneys to pursue litigation against violators, and funds to reward those states that are most successful at detecting and prosecuting employers that fail to pay the proper taxes due to misclassification.

Recently proposed federal legislation also seeks to ensure the proper classification of employees. The Employee Misclassification Prevention Act was introduced in the Senate on April 22, 2010, and previously in the House as H.R. 5107. This legislation would amend the Fair Labor Standards Act to require employers to keep records of nonemployee workers who perform labor or services for remuneration and to penalize employers that misclassify employees as nonemployees. It also would enact other means to reduce the number of misclassification violations, including without limitation (1) increasing penalties for employers that misclassify their employees, with fines of \$1,100 per employee for first-time violators, and up to \$5,000 per employee for repeat violators; (2) providing retaliation protection for workers who are discriminated against because they have sought to be accurately classified; (3) coordinating incident reporting between the DOL and the Internal Revenue Service (IRS); and (4) mandating that states conduct audits to identify employers that misclassify workers as independent contractors and directing states to enact or strengthen state penalties for worker misclassification.

This new bill joins legislation (S. 2882), described in our February 9 LawFlash, aimed at shifting the burden of proof to employers to demonstrate that their employees are classified correctly and closing a tax code “safe harbor” relief provision that allows employers to classify some workers as independent contractors.

What Employers Can Do Now to Avoid Misclassification Penalties

To ensure that all workers are properly classified, companies should perform an independent contractor risk assessment that accounts for the various tests state and federal agencies use to establish “independent contractor” status. For example, in Connecticut, meeting the common-law employee test applied under many states’ laws is insufficient; independent contractors also must meet the far more rigorous so-called “ABC” test.

If a company determines that some of its workers are not properly classified, it should consider with counsel whether to prospectively alter their classification or to modify some of the workers’ tasks to enhance independent contractor status and reduce the potential for a challenge. A company’s efforts to do so will reflect positively on any assessment of whether it willfully misclassified workers or in good faith treated them as independent contractors.

Companies must also take seriously any claim made for workers’ compensation or unemployment insurance by an independent contractor (or former independent contractor) because Connecticut and other states have made a renewed effort to coordinate joint investigations of misclassification complaints with other state agencies, including those responsible for collecting state wage taxes.

If you have any questions or would like more information on any of the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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