

Pennsylvania Law Provides Stringent Penalties for Misclassification of Construction Workers

October 14, 2010

On October 13, the Pennsylvania Construction Workplace Misclassification Act (the Act) was signed into law by Pennsylvania Governor Edward Rendell. The Act is designed to curtail worker misclassification in the construction industry and will make Pennsylvania one of several states to enact similar legislation. The Act amends the Pennsylvania Workers' Compensation Act and the Pennsylvania Unemployment Compensation Law (but not the Pennsylvania Minimum Wage Act) by establishing a set of criteria for classifying workers as independent contractors in the construction industry. The Act also imposes notice requirements and subjects construction industry employers to both civil and criminal penalties for misclassification of workers.

Scope of the Act

The Act applies to employers subject to the Pennsylvania Workers' Compensation Act and the Pennsylvania Unemployment Compensation Law that operate within the construction industry. The Act defines construction as "erection, reconstruction, demolition, alteration, modification, custom fabrication, building, assembling, site preparation and repair work done on any real property or premises under contract, whether or not the work is for a public body and paid for from public funds."

Significantly, the Act also applies, in equal measure, to any party that intentionally contracts with a covered employer knowing that the employer intends to misclassify employees in violation of the Act. In other words, an entity or individual who does not perform work in the construction industry could be subject to the same penalties as a construction industry employer, if it is found that the entity or individual contracted with the employer with knowledge of that employer's violation of the Act.

Criteria for Independent Contractor Classification

The Act sets forth three criteria for assessing whether an individual is properly classified as an independent contractor. An individual who performs paid services in the construction industry is an independent contractor only if (1) the individual has a written contract to perform such services; (2) the individual is free from control or direction over the performance of such services, both under the terms of the contract and in fact; and (3) as to such services, the individual is customarily engaged in an independently established trade, occupation, profession, or business.

With respect to the third criteria, the Act sets forth six subfactors to be considered. An individual is customarily engaged in an independently established trade, occupation, profession, or business only if:

- (1) The individual possesses the essential tools, equipment, and other assets necessary to perform the services independent of the person for whom the services are performed.
- (2) The individual's arrangement with the person for whom the services are performed is such that the individual shall realize a profit or suffer a loss as a result of performing the services.
- (3) The individual performs the services through a business in which the individual has a proprietary interest.
- (4) The individual maintains a business location that is separate from the location of the person for whom the services are being performed.
- (5) The individual:
 - (I) Previously performed the same or similar services for another person in accordance with subparts (1) – (4) and while free from direction or control over performance of the services, both under the contract of service and in fact; or
 - (II) Holds himself out to other persons as available and able, and in fact is available and able, to perform the same or similar services in accordance with paragraphs (1), (2), (3), and (4) while free from direction or control over performance of the services.
- (6) The individual maintains liability insurance during the term of this contract of at least \$50,000.

It is not clear from the statutory language whether all six factors must be answered in the affirmative to satisfy the third criteria, or whether they are a set of factors to be considered as a whole.

Notice

The Act provides that the Pennsylvania Department of Labor and Industry (the Department) shall create a poster for job sites that outlines the requirements and penalties under the Act, to be made available on its website. In addition, the Pennsylvania Secretary of Labor and Industry (the Secretary) is provided discretion to establish a toll-free hotline to receive information on alleged violations.

Worker Misclassification Penalties

The Secretary may assess civil penalties against an employer of up to \$1,000 per misclassified employee for a first violation and up to \$2,500 per misclassified employee for each subsequent violation under the Act. Further, the Secretary may petition a court for a stop-work order to issue against an employer that would require a cessation of work by individuals who are intentionally misclassified or, if the majority of individuals working at a site are misclassified, a cessation of business operations at each site where a violation has occurred. A subsequent order releasing the stop-work order may require the employer to provide periodic reports of compliance for up to two years. A violation of a stop-work order will result in a penalty of \$1,000 per day.

Additionally, employers are subject to criminal penalties pursuant to charges that may be brought by either the Commonwealth's Attorney General or the District Attorney for the appropriate county. Employers that negligently misclassify an individual as an independent contractor commit a summary

offense, subject to a fine of not more than \$1,000. Employers that intentionally misclassify an individual as an independent contractor commit a misdemeanor of the third degree for the first violation and misdemeanor of the second degree for any subsequent violation. A prior conviction of misclassification is admissible as evidence of intent in any subsequent charge.

Retaliation

The Act prohibits employers from retaliating against any person for exercising rights granted under the Act, including, but not limited to, filing a complaint or informing any person of the employer's noncompliance with the Act. Allegations of noncompliance made in good faith are protected under the Act, regardless of whether such allegations are ultimately found to be meritorious. Taking adverse action against a person within 90 days of the person's exercise of rights protected under this Act creates a rebuttable presumption of retaliation.

Implications

This Act applies a stringent standard to worker classification in Pennsylvania's construction industry. Because the Act redefines how construction workers are classified and imposes stiff penalties for independent contractor misclassification, construction firms should immediately review their existing worker classifications, develop strategies to comply with these new standards, and address potential risks associated with misclassified independent contractors. Potential risks include inconsistencies with federal and state tax laws that could lead to increased risk of tax penalties for failure to comply with appropriate federal and state tax withholding requirements and related obligations. Businesses that routinely contract with construction firms should consider requiring their contractors to certify, in writing, that workers classified as independent contractors meet the requirements for such classification under the Act to safeguard against any penalties under the Act.

Morgan Lewis regularly advises employers with respect to all aspects of federal and state laws implicated by worker classification, including laws relating to payment of taxes, overtime and other compensation, benefits, and immigration. If you have any questions or would like further information on any of the issues discussed in this Morgan Lewis LawFlash, please contact any of the following Morgan Lewis attorneys:

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