



2022 CLM Construction Conference

Sept 21st – 23rd 2022

San Diego, CA

**Workers' Misclassification and Its Effect on the Construction Industry:
A Review of National Trends**

**I. The possible impacts of the misclassification of workers and why the distinction
between Employee and Independent Contractor Matters**

The United States Department of Labor estimates that as of the year 2000, approximately 30 percent of all construction firms engaged in the practice of misclassifying workers.¹ That practice in the construction industry was noted to be approximately three times the misclassification rate that occurred in other industries. This practice has wide-ranging and often unforeseen effects, including on businesses and insurance carriers. In some instances, criminal penalties can also be imposed on a business. Moreover, a misclassification can impose unexpected liabilities on several different entities. This session will explore these liabilities from a national perspective by exploring growing trends and the approaches of different states to the issue of worker misclassification.

II. How different jurisdictions handle worker misclassifications:

A. Pennsylvania:

Pennsylvania requires employers to carry workers' compensation insurance for their employees. This applies to individuals working in the construction industry.

In 2011, the PA legislature passed the Construction Workplace Misclassification Act.² The stated purpose of that Act, was to combat the deceptive business practice of classifying employees as independent contractors so a business could avoid the expenses and responsibilities associated with having employees, including carrying workers' compensation insurance. This practice of "misclassifying" employees as independent contractors was "more widespread in construction than in many other industries."³

The Construction Workplace Misclassification Act applies to individuals who work for a business that performs construction services. Those services include the building, reconstruction, demolition, alteration, modification, custom fabrication, building, assembling,

¹ H.R. JOURNAL, No. 193D-33, at 743 (May 5, 2009).

² Construction Workplace Misclassification Act, 43 P.S. §§933.1-933.17

³ Department of Labor and Industry v. Workers' Comp. Appeal Bd., 187 A.3d 914, 924 (Pa. 2018).

site preparation and repair work.⁴ However, it would not apply to a company that is not in the business of construction.

If the Construction Workplace Misclassification Act applies, then the steps required to demonstrate that the individual in question is an independent contractor and not an employee are quite onerous. Those requirements not only include requirements such as a written contract between the company and the putative independent contractor, freedom direction and or control, but also proof of liability insurance of at least \$50,000.00.⁵ If a business entity is subject to the Construction Workplace Misclassification Act, and the requirements for an independent contractor are not met then the individual in question will be determined to be an employee.

In Pennsylvania, the impact of an individual being “misclassified” as an independent contractor instead of an employee, can have several different ramifications. From an insurance perspective, a carrier believing that their policy is limited to a specific set of employees in a company may be subject to added liability for other individuals later determined to be employees of the company. Alternatively, a carrier who simply provides a limited policy so that a construction company can provide proof of insurance to other contractors involved in a particular project, with no listed employees, maybe be subject to added liability if it is later determined that workers are employees. That added liability may include payment of wage loss and medical benefits that far exceed the low premiums associated with the limited policy.

The Construction Workplace Misclassification Act also allows for consideration of criminal penalties, including a \$1,000.00 fine for a first violation and \$2,500.00 for each subsequent violation.⁶ Moreover, an employer may be subject to criminal liability for failure to carry workers compensation insurance for employees in PA.

Employers engaging in construction work in PA may also face liabilities from the Uninsured Employers Guaranty Fund. That Fund, established in 2007, has broad powers, including the ability to stop work for an employer that does not meet its liabilities as required by the law. The Fund can also seek reimbursement of costs, interest, and attorneys fees accumulated during the underlying PA workers’ compensation case where the Fund is a party.

Statutory employer principles should also be considered. Contractors who are not in possession or control of the premises and use subcontractors for services that are a “regular or recurrent” part of the business may be a statutory employer.⁷

B. Florida

Florida requires construction companies to provide workers’ compensation insurance for employees. Like other states, construction companies in Florida will seek to classify individuals

⁴ Department of Labor and Industry v. Workers’ Comp. Appeal Bd., 187 A.3d 914, 926 (Pa. 2018)(finding that a restaurant was not part of the construction industry, and not subject to the Construction Workplace Misclassification Act, when the restaurant hired an individual to remodel the restaurant and that individual was later injured).

⁵ 43 P.S. §933.3(b).

⁶ 43 P.S. §933.6(a).

⁷ Six L’s Packing Co. v. WCAB (Williamson), 44 A.3d 1148 (Pa. 2012).

as independent contractors to avoid the requirements to provide workers' compensation coverage. If an employer fails to secure compensation as required by Florida law, penalties can include up to \$5,000.00 for each employee of that employer who is classified by the employer as an independent contractor but that is later found not to meet the independent contractor requirements.

Relative to workers' compensation, Florida law regarding what constitutes an employee includes an independent contractor working or performing services in the construction industry.⁸ As a result, many individuals working in the construction industry may be determined to be employees for purposes of Florida workers' compensation.

In 2012, Broward County deputies and the state division of insurance fraud went after a construction company that allegedly funneled over 70 million dollars through other entities to avoid paying workers' compensation coverage.⁹ Officials involved in the investigation noted that workers' compensation fraud, including misclassifying workers, resulted increased premiums for legitimate business.

A subcontractor's failure to obtain the necessary workers' compensation insurance may also impact the general contractor. If the subcontractor does not obtain the necessary insurance than the employees of the subcontractor may be statutory employees of the general contractor.

Florida provides protection from employers who provide workers' compensation insurance for employees against possible civil suits. Conversely, companies that classify an individual as an independent contractor and do not secure workers' compensation insurance may be subject to civil suites, which can have higher awards than workers compensation cases.¹⁰

C. Texas

Texas does not require employers to obtain workers' compensation coverage.¹¹ Employers can choose whether they want to have workers' compensation coverage for employees. If they choose not to have coverage, the employers must notify the Texas Workers' Compensation Division. However, employers who elect not to cover employees with workers' compensation insurance are subject to personal injury lawsuits from employees that are injured at work. Those personal injury suites have higher awards than an employer may be subjected for a workers' compensation claim.

Additionally, employees may elect to waive their rights to workers' compensation insurance and elect to retain a common law right of action against the employer for injuries.¹²

D. California

⁸ §440.02 Florida Statutes

⁹ "Operation Dirty Money" Bust Takes Down Workers' Comp Fraud Ring. CBS News Miami, cbsnews.com/miami/news/operation-dirty-money-bust-takes-down-workers-comp-fraud/

¹⁰ § 440.11 Florida Statutes

¹¹ Texas Labor Code, Title 5. Workers' Compensation, §406.002

¹² Texas Labor Code, Title 5. Workers' Compensation, §406.034

Effective January 1, 2020, a law known as AB 5 took effect. That law codified previous case law regarding the test to determine whether an individual was an independent contractor. The law placed the burden on the employer to show that the worker is free from control direction and control of the hiring company regarding the work performed, the worker performed activities that were outside the usual course of the hiring companies' business, the person is customarily engaged in an independently established trade, occupation, or business of the same nature as that involved in the work performed.¹³ The law provides that the above referenced test would not apply to a relationship between a contractor and a subcontractor in the construction industry if a number of criteria are met, including the subcontract in writing, the subcontractor being licensed by the Contractors State License Board, a separate business location from the contractor, the ability to hire and fire other persons, possession of insurance, and the subcontractor customarily engaged in an independently established business of the same nature as the work performed.¹⁴ If the contractor is able to demonstrate that AB 5 does not apply, then the factors set forth in a 1989 California Supreme Court case (Borello) will apply. Those factors include the alleged independent contractor's ability to control the manner of the work performed, the skill required in the occupation, who supplies the tools, whether payment is by the time or by the job, and the length of time that the services are utilized.¹⁵

The effect of misclassifying workers as independent contractors in California can be significant as demonstrated by a 2006 case where a labor commissioner's actions resulted in a stop work order and a penalty assessment of \$1,000.00 per worker, in total a \$15,000.00 fine was upheld.¹⁶

A business may also be subject to tort liabilities for injuries suffered by employees when workers' compensation insurance is not secured.¹⁷

Criminal sanctions may also be imposed on a business that knew, or reasonably expected to know, that workers' compensation insurance is required and fails to secure that insurance. Those sanctions can include possible imprisonment in the county jail for up to one year, and fines.¹⁸

II. Avoiding the risks of misclassifying workers in the construction industry:

A. Contractors:

Contractors should be aware of the legal standards in their respective states and analyze whether the workers truly meet the requirements for an independent contractor versus an employee.

¹³ California Labor Code, §2750.39(a)(1).

¹⁴ California Labor Code, §2750.39(f).

¹⁵ S.G. Borello & Sons, Inc. v. Dept. of Industrial Relations (1989) 48 Cal.3d 341

¹⁶ JKH Enterprises v. Department of Industrial Relations (2006) 142 Cal.App.4th 1046

¹⁷ California Labor Code § 3706

¹⁸ California Labor Code § 3700.5

The statutory employer legal principles may extend liability on contactors who did not hire or directly contract with the workers in question but ultimately may be liable for payment of benefits. As a result, potential liability under a statutory employer analysis extends to those who contract with other business entities.

Contractors should be aware that their decisions in classifying workers may have far reaching implications. Those include possible monetary awards in favor of misclassified workers and criminal sanctions. As a result of statutory employer principles, a contractor who misclassifies workers risks damaging business relationships with other contractors, including general contractors, if those other contractors are held liable for the misclassification of workers.

Contractors who obtain insurance policies based on assertions that workers are independent contractor and not employees may also be subject to disputes in coverage if it is determined that the contractors misclassified workers.

B. Insurers:

Insurers who provide insurance, including workers' compensation insurance to businesses engaged in the construction industry, should work closely with their broker/agent and the insured entity to determine whether the individuals performing work for the insured are truly independent contractors or employees. Premiums on a policy should be adjusted to include workers who are in fact employees despite initial information from the contractor. That adjustment should include an analysis of factors utilized to make the distinction between an employee and an independent contractor. Failure to assess this risk can result in the insurance carrier paying awards far exceeding the premiums collected on a policy.

Insurers should also review whether the policy language applies to the work being performed at the job site and whether modifications are required to limit liability for unforeseen risks associated with the misclassification of workers.

The statutory employer principles also require insurance carriers to investigate whether the contractor they insure is doing business with other entities at a job site who may not have insurance for their employees. If a business, in many cases the general contractor, is determined to be a statutory employer then the business' insurance carrier may be liable for awards for workers from another contractor.