TESTIMONY OF MATT TOWNSEND
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BEFORE THE WORKFORCE PROTECTIONS SUBCOMMITTEE
HOUSE EDUCATION AND LABOR COMMITTEE

HEARING ON MISCLASSIFICATION OF EMPLOYEES: EXAMINING THE COSTS TO WORKERS, BUSINESSES, AND THE ECONOMY

September 26, 2019

Good morning Chairwoman Adams, Ranking Member Byrne, and Members of the Subcommittee.

My name is Matt Townsend. I am the majority owner and CEO of OCP Contractors, Inc., a construction contracting firm that employs approximately 500 men and women building and renovating healthcare facilities, hotels, educational buildings, and other structures across the state of Ohio and neighboring states. I have 43 years of experience in the construction industry dating back to when I was a teenager framing houses.

I am privileged to appear before you today in my capacity as President of the Signatory Wall and Ceiling Contractors Alliance—SWACCA. SWACCA is a national association representing construction company owners who employ tens of thousands of carpenters, drywall finishers, plasterers, and laborers to perform billions of dollars of framing, drywall, ceiling, and other interior systems work annually throughout the United States. SWACCA prides itself on serving as a voice for responsible employers. Our members are entrepreneurs competing on the basis of quality services, efficient execution, and the thoughtful implementation of training and innovation. Like other honest business owners in our industry, SWACCA members do not want to be complicit in the misclassification racket in order to compete. We thank you for holding this hearing and allowing me to explain the threat that worker misclassification poses to the ability of law-abiding employers in my industry to compete, to innovate, and to create jobs.

In my industry, misclassification is not about making tough calls applying complicated laws to ambiguous facts. Rather, it is a choice simply to disregard wage and hour laws, workers' compensation laws, unemployment insurance regulations, and other basic responsibilities of being an employer. This is done for the purpose of gaining an advantage against law-abiding competitors, realizing tremendous profits, and avoiding the financial risks that honest entrepreneurs must accept. Business owners using the misclassification model do not bear the risks of unanticipated overtime, bad planning, or poor execution. Instead, this racket transfers these risks onto workers and taxpayers. Let me explain how this works in the real world.

SWACCA's members operate businesses that provide all of the interior systems work—such as framing, drywall finishing, and ceiling installation—required on construction projects. We are hired through a cost-competitive bidding process administered by a general contractor or a construction manager that has been retained by a property owner. The most significant cost in

any interior systems bid is the cost of labor. This includes the number of workers, how much time they will need, and to what degree they will have to be paid overtime to get the job done on schedule. If a bid is accepted and our estimates about labor costs are wrong, our profits evaporate quickly. We may even lose money. But our workers get paid for every hour worked. They get overtime when their work exceeds forty hours in a week. Social Security and employment taxes are withheld, and appropriate workers' compensation insurance is in force throughout the duration of each project. Like other honest business owners, SWACCA members bear the risk of an inaccurate bid—not their workers. This is the way it should be in a competitive, free enterprise system that rewards company owners for taking risks informed by intelligent planning, and mitigated by the application of experience and innovation.

Contrast this with the increasingly pervasive business model in our industry that is rooted in a decision to treat every worker doing framing, drywall, and ceiling work on a jobsite as an independent contractor without regard to the requirements of the Fair Labor Standards Act (FLSA) and other basic workplace laws. Contractors using this business model can always submit a lower bid than a law-abiding contractor while knowing they will still pocket enormous profits. This is because in developing their bids these contractors do not worry about how many hours the workers will labor to complete the project or whether they will work over forty hours a week to get the job done on time. They do not worry about the costs of workers' compensation or unemployment insurance. This is because they know that under the misclassification model they have chosen the actual onsite work is turned over to lower-tier subcontractors, who are really just labor brokers. The misclassification racket relies on these labor brokers paying their crews of workers a set amount for each piece of drywall finished or square foot of framing or ceiling installed. But these are not lawful "piece rate" arrangements. These contractors do not pay one penny more for the work when the men and women doing it labor over 40 hours a week to finish on schedule. This business model requires a steadfast insistence that all of these workers are independent business operators—even though it flies in the face of reality—because it justifies evading unpredictable costs, like payment of overtime. The probability and costs of being brought to justice for such blatant disregard of the law are low. To people without scruples, these potential costs are greatly outweighed by the advantages that systematic misclassification provides in bidding work, realizing big profits, and avoiding entrepreneurial risk.

Make no mistake, the characterization of these workers as independent business owners is not based on a good faith assessment of the law. Under the typical misclassification schemes used in my industry, our competitors and their labor brokers tell the workers where to go and what to do. They control and direct their workers at the jobsite just like my company does. These workers have no capacity to negotiate what they will be paid. They are regular crews, economically dependent on a labor broker as they move from jobsite to jobsite as directed by someone who is clearly the boss. These workers are not exercising discretion and independent business judgment in scheduling their work like legitimate business owners do. To the extent wages vary among these workers because one installs more sheets of drywall than another on a given day, these differences are no more an indication that they are independent business owners than the disparate pay nineteenth-century miners received at the end of a workday based on the varying amounts of coal they hauled from the earth.

Often, these misclassified workers are paid in cash. Some may get a 1099 tax form consistent with the assertion that they are independent contractors. And it is not uncommon for misclassified construction workers to even have papers showing an LLC was created in their name. But these paperwork formalities are an absurd example of placing form over substance. Given the control the subcontracted labor brokers have over these workers, such paperwork no more makes them independent contractors than if the staff in a Congressional office had their own LLCs and were issued 1099s. Nobody would buy that such an arrangement comports with the requirements of the FLSA and other workplace laws. That is really akin to what is happening on the ground in my industry.

Simply put, by disregarding the law and exploiting desperate workers though a business model premised on dissociating themselves and their lower-tier of labor brokers from the legal responsibilities and costs of being employers, these contractors get a windfall. Disregarding the requirements of the FLSA and requirements related to workers' compensation, unemployment insurance, Social Security taxes, FICA, and many other costs that law-abiding contractors must include in their bids provides them with a tremendous competitive advantage.

How much of an advantage is it? The Ohio Attorney General has estimated that the misclassification of workers as independent contractors provides a 20-30% labor cost advantage against law-abiding employers.[1] When competing against a company like mine that pays middle-class wages, sponsors registered apprenticeship programs, and offers a retirement plan and health benefits, the misclassification model offers closer to a 50% cost advantage.

What makes this situation even more troubling is that this business model also facilitates the evasion of sanctions for non-compliance with the FLSA and other laws. As the state of Tennessee explained in a report earlier this year:

> "When [one of] these business owners learns their non-compliance has been identified and they are subject to a penalty, they shut down their businesses. The owner will reopen as a newly formed business entity that is a continuation of the closed business. By reopening under a new name, business owners avoid assessed monetary penalties for non-compliance . . . ."[2]

Serially closing and opening what amount to shell companies is easy because these entities have no employees, no assets, no benefit plans, and no training programs. There is no real value in these entities the way that there is with law-abiding companies. This leaves workers no recourse against these entities even when cases are pursued by Wage and Hour Division investigators. SWACCA members and the workers in the communities where we operate see contractors who have been cited for misclassification operating under a new entity with the same workforce and no apparent change in their business model. To the extent they are ever held liable, these operators view the penalties as an acceptable cost of business.

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[1] Report of the Ohio Attorney General on the Economic Impact of Misclassified Workers for State and Local Governments in Ohio (Feb. 18, 2009).

[2] Annual Report on Employer Coverage Compliance, Tennessee Bureau of Workers' Compensation at 12 (February 1, 2019).

Some may cite enforcement statistics or a handful of recent large recoveries the Labor Department won from employers misclassifying workers as independent contractors as evidence that the system is addressing misclassification. That is a nice theory. It may make some of us feel good. It justifies others denying the scale or nature of the misclassification problem. But it is not reality. In the real world—and on the ground in my industry—the reality is that these large recoveries made by Wage and Hour investigators are really an indication of the pervasiveness of misclassification and the boundless ambitions of the people using it. In my experience, the shrinking cadre of Wage and Hour investigators make admirable and determined efforts, but they are overwhelmed by the nature and scope of the problem.

At the front end of investigations, enforcement officials are hindered by the fact that the investigations rely on getting statements and evidence from a transient and fearful workforce. The workforce that the misclassification racket relies upon is not limited to immigrant labor. It also includes financially insecure construction workers who have no concerns about their work authorization, but who view the value of getting what they are owed as not worth the risk of being blacklisted from future jobs. Many also decide that getting paid properly is not worth being on the "radar screen" of government investigators, who they fear may ask questions that can cause them legal problems. These include questions about whether these individuals have been making their own tax payments or engaging in misrepresentations necessary to obtain work under the misclassification model. Such misrepresentations may relate to claims about holding certain certifications or having valid insurance coverage. On the back end, investigators are hobbled by the time and effort it takes to assign ultimate financial responsibility for unpaid overtime and hours worked. This entails sifting through the dense layers of shell companies upon which misclassification schemes rely for the fiction that everyone on a jobsite is their own employer operating an independent business.

Many SWACCA members have faced instances where investigators have acknowledged that they just do not have the time and resources to pursue what are obviously unlawful misclassification schemes. This may be because the schemes do not appear to be large enough to warrant devoting limited enforcement resources to address them. Other times, cases warranting the resources are not pursued because of the reticence of the affected workers to come out of the shadows. Make no mistake about it, the contractors who rely on the misclassification model are well aware that in many markets they are shielded by the sheer volume of these schemes and the suasion they have over workers who become complicit in the misrepresentations upon which they are built.

Honest employers in my industry view their workers as partners critical to their success. They make investments to maximize the skill and efficiency of their workers to reduce the probability that they will have to pay for unanticipated work hours to fix things that were not done right the first time. Honest employers invest in safety training that leads to fewer injuries on job sites because we care about our workers and want to reduce the premiums we pay for the workers' compensation insurance we carry. Under the misclassification model, business owners have no incentive to invest in training their workforce to be safer and more efficient because they don't bear the risks of unanticipated overtime to redo work or for accidents on the job.

In 2014, the McClatchy News Service published an extensive series of reports called "Misclassified: Contract to Cheat." This reporting across seven states (California, Florida, Illinois, Missouri, North Carolina, South Carolina, and Texas) documented the common travails of what was then estimated to be ten million construction workers exploited through misclassification.[3] As the McClatchy reporters noted, this model relies on not paying workers for all hours worked, not giving an overtime premium for workweeks in excess of 40 hours, and leaving workers to fend for themselves without any workers' compensation or other recourse if they are injured on the job. SWACCA members can confirm that these are truly representative examples of what we see every day across the country.

In my industry, rampant misclassification isn't just bad for honest employers. It also hurts workers and their families. In depriving workers of their rights, purveyors of misclassification also rob workers of their dignity. When workers are misclassified, there is no employer accepting responsibility under health and safety laws for providing bathroom facilities at the job site or paying for bathroom breaks consistent with wage and hour laws. So on job sites where misclassified workers are used it is not uncommon to see water bottles full of urine left behind. Sometimes the workers even sleep at the job site because their pay may be withheld until the project is done. In fact, I know of one project at which a woman was misclassified and worked well in excess of forty hours a week installing drywall and cleaning up the worksite. She was not paid regularly and had to sleep in the luxury apartment tower she was helping to build. She was fired and kicked off the jobsite the day she got injured. In another case I know of, a contractor employed a crew of 1,000 misclassified workers on more than two dozen hotel, apartment, and mixed-use construction projects over a 21-month period. The workers toiled nine hours a day without rest breaks or overtime. The employer illegally withheld large amounts of their pay, and when he did finally issue checks, they bounced due to insufficient funds.

Let me also be clear that the men and women trapped in the misclassification racket are not the only workers harmed by this business model. It also impacts the employees of honest businesses that truly care about their workers. Legitimate, law-abiding employers want to pay their workers family-sustaining wages and provide retirement and health benefits if they can afford to do so. These employers know that fairly paid, economically secure workers do better work and are less likely to leave. This increases productivity and reduces costly turnover. And creating jobs that are a path to the middle class is something in which honest business owners take pride. It is something for which they rightly receive the praise and admiration associated with succeeding in America's free enterprise system. People using the misclassification model, however, place those of us who are well-meaning, law-abiding employers at a competitive disadvantage. Their greed and disregard of the law make it harder for us to provide stability for our workers. In some construction markets, the widespread reliance on misclassification is creating a race to the bottom that suppresses the wages and working conditions of the entire construction workforce and places the economic viability of honest employers at risk.

By evading all of the legal requirements and costs associated with being an employer, the people using the misclassification model victimize more than just their law-abiding competitors and America's construction workforce. It is estimated that construction employee

[3] Last accessed September 21, 2019 at http://media.mcclatchydc.com/static/features/Contract-to-cheat/

misclassification costs taxpayers $2.6 billion a year.[4] This is because misclassification schemes do not withhold payroll taxes. They do not make FICA contributions. They do not pay unemployment insurance premiums. They do not pay workers' compensation premiums. They throw the costs of unemployed and injured workers onto taxpayer-funded social safety nets, while fueling tax fraud, wage theft, labor trafficking, and other serious crimes. In my experience it is not uncommon for misclassified workers to labor ten hours a day, six days a week doing framing and drywall work several stories above the ground. They often lack any safety equipment. When they are injured on the job and must get treatment, these people cannot afford to pay for it. There is no insurance or workers' compensation to cover the costs. So the costs are borne by public hospital emergency rooms and other taxpayer-funded programs, including Medicaid.

Candidly, I find it hard to see how this situation will change in my industry unless the federal government takes action to better deter, detect, and punish those who attempt to gain a competitive edge over honest employers by willingly victimizing vulnerable workers and the American taxpayer through misclassification. It may be too much to ask for additional funding for more Wage and Hour investigators. But maybe clear direction can be given to those who are already on the job to focus their limited investigative and audit resources on industries like construction, in which rampant misclassification is threatening to make honest entrepreneurship economically infeasible. Additionally, the federal government could follow the lead of some states by increasing penalties for repeated or willful misclassification. The handful of bad actors who are caught flagrantly disregarding the law should pay a price that does not allow them to view the penalties as an acceptable cost of doing business. It is also clear that workers must be better educated about their rights and what they stand to lose when they are misclassified. Any such education, however, will be of little value if workers do not feel protected against retaliation when they do step forward to assert their rights.

As I said at the outset, SWACCA members and other honest employers in the construction industry do not want to be complicit in the misclassification racket in order to compete. But this business model poses daunting challenges for law-abiding entrepreneurs in my industry across the country. It also causes real and serious harm to workers and taxpayers. So on behalf of SWACCA's members and other law-abiding, responsible employers seeking to grow their businesses by taking risks, applying knowledge, and deploying innovation, I thank you for drawing attention to this issue. I hope that the spotlight you are shining today is just the start of a larger conversation leading to meaningful action that addresses the increasingly pervasive misclassification of workers in my industry. I welcome any questions you may have.

[4] Last accessed September 21, 2019 at http://stoptaxfraud.net/wp-content/uploads/2019/03/Estimating-the-Construction-Tax-Gap-SCP-2-19.pdf