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STRENGTH IN PARTNERSHIP

ALERT

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NEW YORK'S NEW WORKER CLASSIFICATION RULES IMPOSES STRICT RULES ON BOTH GENERAL CONTRACTORS & SUBCONTRACTORS

The New Law May Pave The Way For Strict Classification Rules On Other Industries As Well

Effective October 26, 2010, the "New York State Construction Industry Fair Play Act" (the "Act") dramatically alters worker classification rules in the construction industry, and creates severe potential civil and criminal penalties for those subject to it who misclassify their workers as independent contractors rather than employees. Although the new statute is limited to the construction industry, given its legislative purpose, it may presage the introduction of similar legislation governing industries where independent contractors and casual labor are traditionally used. This Client Alert summarizes some of the dramatic changes in the law created by the Act.

Legislative Purpose of the Act

The Legislature's findings underscore the seriousness of the problem the Act addresses:

> The legislature hereby finds and declares that recent studies of New York City's construction industry alone suggests that as many as fifty thousand New York City construction workers -- nearly one in four – are either misclassified as independent contractors or are employed by construction contractors completely off the books. Construction industry fraud reduces government revenue, shifts tax and workers' compensation insurance costs to law-abiding employees, lowers working conditions and steals jobs from legitimate employers and their employees.

Requirements of the Act

To address these concerns, the Act creates a rebuttable "presumption" that "any person" performing services for a "Contractor" is an employee of that Contractor and not an independent contractor. A "Contractor" is defined as a general contractor or subcontractor "permitted by law to do business within the state who engages in construction." "Construction" is broadly defined to mean "constructing, reconstructing, altering, maintaining, moving, rehabilitating, repairing, renovating or demolition of any building, structure, or improvement, or relating to the excavation of or other development or improvement to land." The definition of "Construction" is not limited to commercial projects, but includes residential or home improvement projects as well.

The "presumption" that all persons working for a general contractor or subcontractor are employees of that Contractor can only be overcome if the person is a "separate business" entity or if all of the following criteria are met:

- The worker is "free from control and direction in performing the job, both under his or her contract and in fact;"
- The work provided is "performed outside the usual course of business for which the service is performed;" and
- The worker is "customarily engaged in an independently established trade, occupation, profession or business that is similar to the service at issue."

Thus, for example, if a framing subcontractor hires casual laborers to do the actual hammering, those laborers may be deemed employees despite any contract between the subcontractor and the laborers to classify them otherwise, because their services are not outside the "usual course of business" of the framing subcontractor, nor are they continuously engaged in an independently established trade or business, or, perhaps, free from the Contractor's "control and direction". A Contractor's failure to withhold federal or state income taxes, or to pay unemployment insurance contributions or workers' compensation premiums "shall not be considered" in determining whether the worker is an employee or an independent contractor.

In addition to affecting the relationship between entities and individuals hired by such entities, the statute also sets down rules which affect the relationship between a Contractor and its subcontractors, who, the Contractor believes, are or are intended to be treated as a "separate business entity." To qualify as a "separate business entity", i.e. separate from the Contractor, the Act sets forth 12 separate criteria, all of which must be satisfied. Among these criteria are:

- The business entity must perform the service "free from the direction or control over the means and manner of providing the service, subject only to the right of the contractor for whom the service is provided to specify the desired result;"
- The business entity "has a substantial investment of capital in the business entity beyond ordinary tools and equipment and a personal vehicle;"
- The business entity "makes its services available to the general public or the business community on a continuing basis;"
- The business entity "includes services rendered on a federal income tax schedule as an independent business or profession;"
- If necessary, the business entity "hires its own employees without contractor approval, pays the employees without reimbursement from the contractor and reports the employees' income to the Internal Revenue Service;"

The Act does not create an exception for a Contractor who believes (erroneously, but in good faith) that the business entity satisfies these requirements. Thus the burden will be on the Contractor to ensure that its subcontractors are indeed legitimate independent

entities who meet all of the listed criteria and not straw men. In addition to a lengthy checklist, the statute requires that the Contractor have a significant depth of knowledge about other entities with which it contracts. For example, the Contractor will be charged with knowledge of the level of capital investment in the subcontractor, knowledge of whether its income is reported for federal tax purposes, whether the subcontractor has provided or will provide like services to other customers on a continuing basis and whether its employees are carried as such on its own books. The danger to a Contractor who uses a subcontractor that is not recognized as a "separate business entity" because it failed to satisfy one or more of the above criteria (such as using laborers "off the books") is that if the subcontractor is using laborers who are misclassified, the consequences of this misclassification will be charged to the Contractor. One unintended effect of the statute may be to force Contractors to use recognized, established companies as subcontractors, thereby preventing new and small closely held companies from entering the subcontractor market.

Enforcement of the Act

The Act specifies civil and criminal penalties for those Contractors who violate its requirements. Contractors who innocently run afoul of the Act are, nonetheless, subject to civil penalties of up to $1,500 for a first violation and up to $5,000 for each subsequent violation within a five-year period. If a "willful" violation occurs, the Contractor is liable for enhanced civil penalties. In addition, where a violation is "willful", a Contractor may also be subject to criminal penalties including imprisonment and fines ranging from $25,000 to $50,000. Any officer or a shareholder who controls at least 10% of the outstanding stock of a corporation "who knowingly permits the corporation to willfully violate the provisions of the Article shall also be in violation of this article and the civil and criminal penalties herein shall attach to such officer upon conviction." Further, under the Act, any officer or any person who owns 10% or more of a corporation which has been convicted of a misdemeanor for violation of the Act shall be ineligible to bid on a public works contract for one year in the case of a first conviction and up to five years for repeat offenders. Oddly, or perhaps indicative of the haste with which this statute was drafted, there are no similar provisions concerning violations by non-corporate entities, such as personal liability of a member of a Contractor that is organized as a limited liability company.

The term "willfully violates" is defined to mean that a Contractor "knew or should have known" that his or her conduct was prohibited. Thus, as written, the Act could theoretically subject a Contractor to severe civil and criminal penalties despite its good faith. Moreover, a shareholder owning 10% or more of a corporate violator may similarly be liable if he or she knew of facts which would have put a reasonable person on notice that employees were being misclassified.

The Act also contains broad anti-retaliation provisions, applicable to an employer "or any agent of any employer," who "retaliate[s] through discharge or in any other manner against any person in the terms of conditions of his or her employment for exercising any rights granted" under the statute. The statute also requires Contractors to post "in a prominent and accessible place on the site where the construction is performed" certain

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information specified in the statute, "in English, Spanish or other languages required by the Commissioner [of Labor]."

The Act creates significant challenges to New York Contractors who fall within the Act's broad definition of the "Construction" industry. The Act may well be just the "tip of the iceberg" of New York's effort to obtain better control over the classification of workers and the tax revenues that correct classification will provide. New York Contractors, as well as employers using similar labor, are strongly encouraged to revisit their classification policies and procedures to ensure compliance with the Act or future legislation which may follow.

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We can assist you in understanding and addressing these issues, including reviewing your policies concerning worker classification.

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