Testimony of
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Committee on Education and Labor
Subcommittee on Workforce Protections

Hearing on the Payroll Fraud Prevention Act of 2019

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Introduction

Chair Adams, Ranking Member Byrne, members of the Subcommittee, I appreciate the opportunity to testify before you today on the Payroll Fraud Prevention Act of 2019 (PFPA).

My background informs my comments on this proposed legislation. I graduated from law school in California, clerked for a federal judge, and have spent my entire legal career practicing employment law in California. I am a Shareholder in the law firm of Ogletree, Deakins, Nash, Smoak & Stewart, P.C. In that capacity, I help businesses comply with federal and state wage laws, including determining whether to classify workers as employees or independent contractors in California and throughout the United States. I litigate a significant number of cases involving the question of employee status, as well as claims for unpaid wages and other benefits. I use the term "wage-and-hour" to broadly describe this area of the law. My practice requires me to regularly appear in federal court, including matters that are pending before the four districts that comprise California—the Southern District, Central Districts, Eastern District, and Northern District of California. I also appear frequently before California state courts in cases involving wage-and-hour claims asserted under California state law.

As discussed at further length below, the PFPA seeks to import into the Fair Labor Standards Act (FLSA) aspects that already exist under California state law. As a result of my litigation practice, I see—on a daily basis—the impact that legislation like the PFPA has already had in California. I wish to share my thoughts regarding the likely consequences—intended and unintended—of the PFPA. While I do bring extensive experience as an employment law practitioner, I am not testifying today on behalf of my law firm or clients.

Scope Of Anticipated Testimony

In deciding whether the PFPA is necessary, this Committee and the Congress will need to consider whether workers are routinely misclassified as independent contractors and, if so, the effects of such misclassification on our society. My comments do not focus on those preliminary questions, which may be more appropriate for labor economists or

other persons who have studied the relevant issues. Instead, I seek to answer the following two questions:

> Question 1 – Assuming that the misclassification of workers poses a major issue, will the PFPA help to "ensure that employees are not misclassified," as stated in the Act?
>
> Question 2 – What impact, if any, will the PFPA have beyond its stated goal of "ensur[ing] that employees are not misclassified"?

Consequently, I offer my thoughts as to whether the PFPA will be effective in addressing the misclassification of workers as independent contractors, as well as other likely consequences of the Act.

I note at the outset that I believe in a measured approach to the issue of employment classification. I agree that independent contractors should satisfy criteria in order to fall within the category of "non-employee," and both the FLSA and many states already impose substantive requirements limiting who can be an independent contractor.[1] While there need to be restrictions, I also believe there is a place in our economy for genuine independent contractors. Independent contractors are found in nearly every industry, across all sectors, and encompass both "blue-collar" and "white-collar" occupations including financial advisors, information technology specialists, physicians, truck drivers, athletes, authors, artists, accountants, consultants, and lawyers.

While we should endeavor to minimize the misclassification of workers, we also need to offer a path for the many businesses who utilize genuine independent contractors. This is not only important to the businesses that rely on independent contractors, but to the independent contractors themselves (many of them small business owners), who need flexibility to grow their own businesses and to provide their services outside the confines of a traditional employer/employee relationship. Legislation premised on the belief that all or nearly all independent contractors are misclassified is, in my view, a mistake, as are bills that seek to effectively outlaw the use of independent contractors, including California's recently passed Assembly Bill 5[2] or the Protecting the Right to Organize Act of 2019 currently under consideration by this Committee.

The businesses that I represent rely on independent contractors to varying degrees. They also utilize independent contractors for different reasons, including the desire for specialized skills and/or equipment, short-term help, controlling costs, and enlisting small businesses with an entrepreneurial bent. I have found that companies are generally doing their best to classify workers properly as either an employee or independent contractor. There are always bad actors (just as there are employers who fail to pay minimum wage or overtime to persons who are classified as employees), but that is the exception and not the rule in my experience.

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[1] *See, e.g., Fact Sheet 13: Employment Relationship Under The Fair Labor Standards Act (FLSA)*, https://www.dol.gov/whd/regs/compliance/whdfs13.htm.

[2] *See* https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=201920200AB5.

Individual Elements Of The Payroll Fraud Prevention Act

In my opinion, the following elements of the PFPA deserve particular attention:

1. The requirement that businesses provide detailed notice to all workers of their employment status;

2. The presumption of employee status if the notice is not provided; and

3. Liquidated damages and civil penalties for violations of the statute.

Notice And Recordkeeping Requirements

The PFPA proposes to add a "Recordkeeping; Classification; Notice" section to the FLSA at 29 U.S.C. § 211(c). This would require every employer to provide written notice to each "individual providing labor or services for remuneration for such employer or enterprise and engaged in commerce or in the production of goods for commerce." Such notices would be provided to all existing workers (whether employee or non-employee), at the time of any change in status, and to new workers at the start of the engagement.

The required notices must: (i) inform the individual of his/her classification as employee or non-employee; (ii) direct the individual to a newly created Department of Labor (DOL) website; (iii) include the address and telephone number "for the applicable local office of the Department of Labor"; and (iv) include language advising the individual of his/her rights and directing them to contact the U.S. DOL with any questions or concerns related to their employment status. The person issuing the notices must also maintain copies of the notices or risk severe consequences, as discussed below.

The potential impact of the notice and recordkeeping requirements on employers will be significant. As currently drafted, the PFPA would obligate businesses to issue notices numbering in the tens of millions. This is not hyperbole; the PFPA expressly requires that notices be provided to all workers, including both employees and independent contractors. If not amended, the PFPA could also require businesses to issue millions of notices with minimal, if any, notice.[3]

[3] Section 3 of the PFPA proposes that, "[n]ot later than 180 days after the date of the enactment of this Act, the Secretary of Labor shall establish a single webpage on the Department of Labor website" containing certain information. Section 2 of the PFPA similarly requires that existing workers receive the required notices "not later than 6 months after the date of enactment" of the Act. Those notices must, among other information, direct individuals "to the Department of Labor website established under section 3" of the Act. Read in conjunction, these provisions preclude businesses from issuing notices until after the DOL establishes the necessary webpage. If the DOL does not do this promptly and instead waits until the end of the six-month period (as permitted under the current version of the Act), businesses would be required to issue the notices on

Not only is the sheer volume of the notices immense, the notices must be customized for each jurisdiction. For example, a business with operations across the United States would need to issue several dozen different versions of the notice identifying each local DOL office. Indeed, a company with operations in California would be obligated to provide eight (8) different versions of the notice just to California workers.[4] Because workers are entitled to tailored versions of the notices, businesses would also need to verify—prior to providing any notice—the location where each employee or non-employee performs services. Businesses would have to regularly scrutinize the address and telephone notice of each DOL office, since any change in the address or telephone number would require that businesses immediately update the notices. Businesses would also be obligated to maintain copies of tens of millions of notices, with particular diligence paid to the millions of notices provided to independent contractors, and without any limitation on how long the notices must be maintained. This is on top of the significant regulatory burdens that are already placed on businesses, and which smaller companies particularly struggle to comply with.

A few thoughts regarding the notice and recordkeeping requirements:

The notices apply to all persons providing services, regardless of the duration or scope of those services. The PFPA, by its terms, applies to every worker engaged by every employer. The scope of the notice requirement is enormous. For example, a business that contracts with a plumber to fix its toilets would be obligated to provide notice. In that same vein, businesses would need to provide notices to gardeners, electricians, florists, caterers, and any other vendors that they use, even if the services provided are episodic and unrelated to the contracting entity's normal business operations. A small business that hires an accountant to do its taxes would be presumed to be the employer of that accountant, unless notice is provided. Likewise, a dentist who runs a small practice and who asks another dentist to handle emergency appointments during her vacation would also be presumed to be the employer of that dentist, despite him or her holding an advanced degree. Other examples abound.

The notices may impose significant costs on businesses. As noted above, the PFPA will force businesses to issue customized notices to large swaths of the American workforce. The cost of the notices may be one of the topics that Congress wishes to investigate further and before taking action on the Payroll Fraud Prevention Act. If you assume that each notice costs only $.25 to create and maintain, however, the cost would be $37,500,000.00.[5] I suspect that the actual cost in resources and payroll hours would be far higher than that.

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an incredibly short time frame. To avoid these issues, the PFPA should be amended, at a minimum, to give businesses more than six months to issue notices to existing workers.

[4] There are presently eight offices of the DOL in California: Fresno Area Office, Los Angeles District Office, Sacramento District Office, San Diego District Office, Orange Area Office, San Francisco Area Office, San Jose District Office, and West Covina District Office. *See* *https://www.dol.gov/whd/local/index.htm*.

[5] Assuming at least 150 million persons in the United States workforce and one notice per person: 150,000,000 x $.25 = $37,500,000.

Federal and state law already impose onerous notice requirements. The notice requirement under the PFPA would add to a lengthy list of other notices required under federal and state law. For example, a business in California is already obligated to provide more than ten separate notices regarding various legal requirements.[6]

The notices are unnecessary as to employees. The vast majority of persons who receive the notices will already be classified as employees. It is unclear what incremental benefit, if any, will accrue from providing notices to persons who are not classified as independent contractors.

The notices may be unnecessary as to independent contractors. It is also unclear to me whether the notices will benefit people who are classified as independent contractors. I understand that the notices contain information informing each independent contractor of his or her classification, and advising them where to report any concerns related to that classification. To achieve any real benefits, the following would need to happen: (1) significant numbers of workers must read the notices; (2) these workers would need to realize that they are classified as independent contractors and not employees; (3) they would contact the local DOL office to complain about their classification; (4) those queries would result in a DOL investigation into the matter; and (5) those investigations must result in a change of status for these workers (after all, if the employer was correct in concluding that the worker was an independent contractor, the entire exercise will have been a waste of time and resources). Whether any, let alone all, of those prerequisites will occur is uncertain.

The effectiveness of the first step—*i.e.*, whether independent contractors will actually read the notices—is hard to predict. Perhaps some will, but likely many will not. As for the second step, I have found that the vast majority of independent contractors already understand that they are classified as independent contractors. Many businesses enter into written agreements with independent contractors that memorialize their status. Indeed, in determining whether an independent contractor relationship exists, the Internal Revenue Service examines, among other things, if there are "[w]ritten contracts which describe the relationship the parties intend to create."[7] Thus, businesses that seek to use independent contractors are strongly incentivized under current law to inform persons of their classification, and routinely do so. Finally, it is unclear whether independent contractors will actually contact the DOL's offices, or whether imposing further and additional notice requirements will instead cause confusion. I discuss below the next steps in the required causal chain.

The notices direct persons to contact the United States DOL. As noted above, notices under the PFPA must contain contact information for the local DOL office, along with instructions to contact that office "[i]f you have any questions or concerns about how you have been classified or suspect that you may have been misclassified. . . ." The PFPA does not address how such questions or concerns will be addressed, or whether Congress will provide additional funding that will enable the DOL to respond to such

[6] A partial list of these requirements is found here: https://www.dir.ca.gov/wpnodb.html.
[7] *See* https://www.irs.gov/newsroom/understanding-employee-vs-contractor-designation.

inquiries. As such, the bill will create enormous loads of paperwork for government agencies at great cost, all the while providing little or no evidence that such efforts will address the perceived problem.

The Presumption Of Employee Status If Notice Is Not Provided

To the extent that a business cannot prove that notice was provided to an independent contractor, the PFPA establishes a presumption that the worker is an employee, which can be rebutted "only through a presentation of clear and convincing evidence that a covered individual . . . is not an employee of the person or enterprise."

Based on the statutory language, even hyper-technical violations of the statute would result in the presumption of employee status. For example, a plaintiff could argue that he or she is presumed to be an employee in any of the following scenarios:

1. The notice was not provided;
2. The notice was provided but it listed the wrong office for the DOL;
3. The notice was provided and listed the applicable local office of the DOL but the address and/or telephone number was incorrect; or
4. The notice was provided and contained all of the necessary information but now cannot be located by the business.

When the PFPA's detailed notice and record keeping requirements are combined with the presumption of employee status and extensive remedies available under the Act, plaintiffs' attorneys will have a powerful cudgel to yield against employers, whether or not those businesses have in fact misclassified any workers as independent contractors, and even if those businesses made a good-faith effort to comply with the FLSA.

Additional Liquidated Damages And Civil Penalties

Perhaps most troubling is that the PFPA seeks to impose enhanced damages and penalties for violations of the statute, including hyper-technical violations of the notice requirement.

Under the current version of the FLSA, a worker who is improperly classified as an independent contractor can recover "the amount of their unpaid minimum wages, or their unpaid overtime compensation" and "an additional equal amount as liquidated damages."[8] In other words, a plaintiff can recover any wages that were unpaid, along with an equal amount in liquidated damages. Section 216(b) also authorizes a court to, "in addition to any judgment awarded to the plaintiff or plaintiffs, allow a reasonable attorney's fee to be paid by the defendant, and costs of the action."

The PFPA seeks to further increase the remedies available under the FLSA. This includes language providing that "liquidated damages are doubled," *i.e.*, that a plaintiff could effectively recover treble (triple) damages.

[8] 29 U.S.C. § 216(b).

The Act also authorizes a "civil penalty" that is "not to exceed $1,100" or, "in the case of a person who has repeatedly or willfully committed such violation, not to exceed $5,000." This penalty would be imposed for "[a]ny person who violates section 6, 7, 11(c), or 15(a)(6)." Thus, the penalty could be applied against persons who fail to pay minimum wage[9] or overtime[10] or who "wrongly classify an employee of the persons as a non-employee . . . ."[11] The penalty, however, could also be applied against persons who do not comply with the notice requirement, which the PFPA seeks to add at 29 U.S.C. § 211(c).

Here are several reasons why the PFPA's dramatic increase in damages and penalties is concerning:

The PFPA authorizes penalties for hyper-technical violations of the notice requirement. As noted above, the PFPA authorizes a civil penalty of up to $5,000 for each violation of the FLSA, as amended. This includes violations of the notice requirement, *e.g.*, a business that fails to inform an independent contractor of his or her employment would be liable for the civil penalty. But, it would also permit the same penalty if a business provides the required notice but cannot subsequently locate that notice, or where a business "violates" the statute by listing the incorrect address or telephone number for the local DOL office. Most astoundingly, the PFPA requires that businesses issue tens of millions of notices to employees. Consequently, a business could be deemed to have violated the notice requirement and exposed to considerable amounts of civil penalties even if the company engages zero independent contractors. As this illustrates, the ability of plaintiffs or the DOL to pursue hyper-technical violations will do nothing to solve any underlying issues related to the misclassification of some workers.

The threat of immense penalties will compel businesses to settle lawsuits regardless of their merit. By allowing not only treble damages for unpaid wages but up to $5,000 in civil penalties per person, the PFPA would allow the DOL to seek crippling penalties against alleged wrongdoers. For example, a business with only 1,000 workers could face millions of dollars in unpaid wages and up to $5,000,000 in civil penalties. I am familiar with such situations, because these types of civil penalties are regularly sought by private plaintiffs in California pursuant to the Private Attorneys General Act of 2004 (PAGA).[12] I have litigated dozens of cases involving claims under the PAGA. I know from firsthand experience that the immense exposure from PAGA claims—often reaching into the tens of millions of dollars—can drive businesses to settle claims that they might otherwise litigate to trial, since an adverse outcome would cripple or even bankrupt the business.

[9] Pursuant to Section 6 of the FLSA, 29 U.S.C. § 206.
[10] Pursuant to Section 6 of the FLSA, 29 U.S.C. § 207.
[11] Pursuant to Section 15(a)(6) of the FLSA, if amended in the manner sought under the PFPA.
[12] Labor Code § 2698 *et seq.*

The FLSA already provides remedies for violations of the statute. Significantly, a business that misclassifies workers as independent contractors risks significant financial exposure under the current version of the FLSA. Even without the PFPA, a prevailing plaintiff can recover double damages, along with their attorneys' fees and costs.[13] Therefore, the FLSA not only discourages businesses from misclassifying their workers, it contains strong financial incentives for plaintiffs—and attorneys—to file civil lawsuits. Authorizing yet more damages and penalties will only encourage more class action lawsuits, many of which will do little to benefit the workers on whose behalf the cases are pursued. Rather, these additional amounts are piling on and imposing crushing liability in the event that workers are found to be employees, even in close cases.

Cautionary Tale No. 1 – Notice Requirements Under The Fair Credit Reporting Act

As noted above, the PFPA imposes detailed notice and recordkeeping requirements, with even hyper-technical violations exposing a business to severe consequences. In evaluating the potential negative impacts of the PFPA, Congress may wish to consider analogous notice requirements under the Fair Credit Reporting Act (FCRA).[14]

Under the FCRA, employers who obtain a consumer report on job applicants must disclose that process "in a document that consists solely of the disclosure."[15] The FCRA does not provide any other guidance as to what does, or does not, satisfy the requirement of a stand-alone disclosure. It does, however, establish a penalty of $1,000 for each willful violation of the statute.[16]

Plaintiffs' firms have filed numerous lawsuits under the FCRA. Without showing any actual harm to consumers, these plaintiffs have sought millions of dollars in statutory penalties. They routinely allege that employers have violated the FCRA's notice requirement by including "extraneous" information in the disclosure. This includes hyper-technical violations including situations where an employer has presented the disclosure at the same time as other new hire documents, or where the disclosure is stapled together with other documents.[17]

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[13] The current version of the FLSA also authorizes civil penalties "not to exceed $1,100 for each such violation" of the minimum wage and overtime provisions. 29 U.S.C. § 216(e)(2).

[14] 15 U.S.C. § 1681 *et seq.*

[15] 15 U.S.C. § 1681(b)(2)(A).

[16] 15 U.S.C. § 1681n.

[17] *See Woods v. Caremark PHC, L.L.C.*, No. 4:15-cv-00535-SRB, 2015 WL 6742124 at *2 (W.D. Miss. Nov. 2, 2015) (denying motion to dismiss where plaintiff alleged that defendant violated the stand-alone disclosure requirement by including "1) an overbroad authorization for third parties to provide information to Defendant and its consumer reporting agency, 2) state-specific notices that did not apply to Plaintiff, and 3) that the form was 'part of a five-page stapled packet of three documents.'").

Unless the PFPA is amended, it will similarly allow plaintiffs to seek severe penalties—including a presumption of employee status and treble damages—based on hyper-technical violations of the Act.

Cautionary Tale No. 2 – California's Private Attorneys General Act

Another cautionary tale is presented by California's PAGA statute.[18] The Golden State's experiences with PAGA over the last 15 years illustrate some of the potential unintended consequences of the PFPA, including the following.

Government Agencies Cannot Keep Pace With Complaints. Although the PFPA presumes that the DOL's local offices will have the resources to handle any and all complaints, PAGA illustrates the pitfalls of this approach.

Prior to initiating a PAGA lawsuit, a plaintiff is required by statute to send a letter outlining the alleged violations to a California state agency, the Labor & Workforce Development Agency (LWDA).[19] The LWDA is then given 60 calendar days to decide whether to investigate the complaint.[20]

Because of the statutory requirement, thousands of PAGA notices are submitted to the LWDA each year.[21] In practice, "less than half of [the] PAGA notices were reviewed [in recent years], and [the] LWDA estimates that less than 1 percent of PAGA notices have been reviewed or investigated since PAGA was implemented" in 2004.[22]

I am concerned that persons who contact the DOL pursuant to the PFPA will find it is similarly non-responsive.

PAGA Authorizes Crippling Civil Penalties. Another similarity to the PFPA are the civil penalties authorized by PAGA, though the California statute permits private plaintiffs and attorneys (rather than the DOL) to seek those penalties. As mentioned above, the prospect of a PAGA plaintiff recovering a crippling amounts of penalties regularly force defendants to settle cases, regardless of how strong their defenses are or whether they actually broke the law.

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[18] PAGA allows private persons to sue to collect civil penalties for violations of the California Labor Code. Similarly to a collective action under the FLSA, a PAGA plaintiff can seek these penalties on behalf of themselves as well as other allegedly "aggrieved employees." PAGA penalties are assessed per "aggrieved employee," per pay period, for each allegedly violated statute. The default penalty amount under PAGA is $100 per employee per pay period for the initial violation, and $200 for each subsequent violation.
[19] Labor Code § 2699.3(a)(1)(A).
[20] *Id*. at § 2699.3(a)(2)(A).
[21] *The 2016-2017 Budget: Labor Code Private Attorneys General Act Resources*, https://lao.ca.gov/publications/report/3403 (identifying 6,047 PAGA notices in 2012, 7,626 PAGA notices in 2013, and 6,307 PAGA notices in 2014).
[22] *Id.*

PAGA Has Led To A Flood Of Litigation. Federal and state courts in California are groaning under the weight of wage-and-hour lawsuits, including claims based on the misclassification of workers as independent contractors. In 2018, plaintiffs filed nearly 2,500 class actions in California state courts alleging violations of PAGA and similar statutes.[23] In comparison, less than 1,000 class actions involving employment claims were filed in the state courts of the 49 other United States combined.[24] I am concerned that other jurisdictions will witness similarly staggering numbers of lawsuits if the PFPA is passed.

Conclusion

While I appreciate and share the concerns surrounding the use of independent contractors, further enforcement in this area should be balanced and narrowly tailored to reduce incidences of misclassification, while minimizing the harm to businesses and others who lawfully partner with independent contractors. As presently drafted, the PFPA undermines this balance and risks imposing severe penalties without any demonstrated benefit. I appreciate the opportunity to submit my comments and I look forward to discussing these items with you further at the hearing.

[23] Based on data collected from the Courthouse News Service, https://www.courthousenews.com/.
[24] *Id*.