A Timely Analysis of Legal Developments

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Maryland's Department of Labor is preparing to enforce new regulations that will affect businesses in the construction and landscaping industries that use independent contractors and will likely begin to target businesses in other industries, in a push to identify and penalize employers misclassifying employees as independent contractors.

Independent Contractors Targeted by Maryland Enforcement Efforts

By H. Tor Christensen and Steven E. Kaplan

On August 28, 2009, the Maryland Department of Labor, Licensing, and Regulation (DLLR) published its proposed regulations to implement the recently enacted Workplace Fraud Act of 2009 (the Act), which takes effect on October 1, 2009. While the Act and regulations currently affect primarily those employers in the construction and landscape industries, all Maryland employers should pay close attention because all employers are covered under the law for unemployment insurance (UI) purposes. The state's UI division investigates employee classification through both random and targeted audits and when a person claims UI benefits but is not listed as a covered employee. In addition, Governor Martin O'Malley has made it very clear that he hopes to target other industries as soon as possible. To further this goal, the governor has recently issued an Executive Order to create a task force to begin targeting employers in other industries that purportedly regularly misclassify employees as independent contractors.

This article provides a summary of the Act, highlights some of the DLLR's proposed regulations and suggests how employers can take affirmative steps to ensure they are in compliance. In brief, the Act changes the standards by which employers in the construction and landscaping industries classify employees as independent contractors. The Act also awards back pay to employees who were misclassified and provides for substantial additional penalties for those employers that "knowingly" misclassify employees. Notably, even before the Act takes effect, employees in these (and other) industries already had protections against misclassification under the Fair Labor Standards Act (FLSA), the Maryland Wage & Hour Law, and the Maryland Wage Payment and Collection Law for these same purported violations. This new Act simply complicates employer compliance and will have the intended effect of increasing fines and penalties paid to the State of Maryland.

The Act creates a rebuttable presumption that all workers, including bona fide independent contractors, are employees. The existence of an independent contractor agreement between the employer and the independent contractor appears to be only a minor consideration. If challenged, the employer must demonstrate that:

- the individual is free from control and direction over the performance of the work both in fact and under the contract;
- the individual is customarily engaged in an independent business or occupation of the same nature as that involved in the work; and
- the work is outside of the usual course of business of the person for whom the work is performed.

This test appears to be more stringent than other similar tests, such as the "economic reality test" under FLSA, because there does not appear to be any flexibility in these requirements. If an employer fails to rebut the presumption of an employee/employer relationship, the DLLR can impose a penalty of up to $1,000 per misclassified employee and order restitution to any individual not properly classified. Under the Act, the DLLR is required to adopt regulations to provide further guidance on this section, which it has not yet done.

Significantly, if the DLLR can prove that there was a knowing violation of the Act, an employer can be subject to a penalty of up to:

- $5,000 per misclassified employee;
- $10,000 if the employer previously has been found in violation by a final order of a court or administrative unit; and
- $20,000 per misclassified employee for third time offenders.

In determining whether an employer "knowingly" violated the Act, the DLLR will consider, among other factors, the gravity of the violation, the size of the employer's business, the employer's good faith, and the employer's history of similar violations.

Under these regulations, the DLLR also will consider previous violations of state or federal law that involve misclassification, the employer's assistance in the investigation, and evidence of retaliation, among other factors. The proposed regulations also place affirmative duties on an employer when it contracts with an independent contractor. For example, a bona fide independent contractor agreement must now contain the following information:

- A statement by the employer that the independent contractor will perform the work according to the independent contractor's own means and methods, free from control of the employer in all details connected with the performance of the work, except as to its product and result;
- Notification that the individual's classification as an independent contractor means that they are not eligible for protection under protective laws, including, but not limited to, employment discrimination and anti-retaliation laws, occupational safety and health laws, living wage and prevailing wage laws, and wage and hour laws; and
- Notification that the independent contractor or exempt person is obligated to provide a "Notice to Independent Contractors and Exempt Persons" for independent contractors or exempt person with whom they contract.

Furthermore, employers in these affected industries must now create and maintain a recordkeeping system, which requires that employers track and maintain several different categories of information. Significantly, the Act mandates that each employer keep, for three years, a record of the hours that each independent contractor works each day and each workweek. This provision is particularly onerous because independent contractors are typically paid a flat fee, and the number of hours actually worked by an independent contractor is generally difficult, if not impossible, to monitor. Other recordkeeping requirements include a record of all licenses held by an individual classified as an independent contractor, as well as an acknowledgment form signed by the independent contractor that the employer provided all of the applicable notices required by the proposed regulations.

What Employers Should Do to Ensure Compliance

There are many other provisions in the Act that are of critical importance to employers in the landscaping and construction industries. To that end, every affected employer should review the Act and proposed regulations and monitor the DLLR's website for other developments and additional proposed regulations. In addition, an employer may want to consider conducting an audit of their independent contractors

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using DLLR's test as set forth in the Act to ensure their independent contractors are properly classified. This audit also should ensure that their recordkeeping systems and independent contractor agreements are in compliance with the final regulations.

If an employer is contacted by the DLLR, it is recommended that labor and employment counsel be contacted because a prompt and thorough response is required. Indeed, the DLLR may require an employer to identify and produce all records relevant to the classification of each alleged misclassified individual within 15 business days, may enter a place of business or work site without any prior notice, and may interview individuals at the work site or observe work being performed.

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