



Worker Misclassification and Wage Theft in Philadelphia Construction. Testimony of Stephen Herzenberg, Philadelphia City Council, February 21, 2020.

Keystone Research Center • 412 North 3rd St., Harrisburg, PA 17101 • 717-255-7181

Council President Clarke and members of the Philadelphia City Council, thank you for the opportunity to testify today on the issue of worker misclassification and other labor standards violations in the Philadelphia construction industry. My name is Stephen Herzenberg. I am an economist and executive director of the Keystone Research Center (KRC) and hold a PhD in economics from MIT. The first part of my remarks today is based on a KRC report, “Illegal Labor Practices in the Philadelphia Regional Construction Industry,” supplemented by additional research and data made public since we published that report.¹ The last part of my testimony argues that the time is ripe in Pennsylvania for a systemic, coordinated strategy to rid the city, region, and state construction industries of illegal labor practices.

The main finding of our report on illegal practices in the region’s construction industry is straightforward: labor law and labor standards are routinely violated by many construction contractors in Southeast Pennsylvania and in the city of Philadelphia. These violations victimize workers and their families, taxpayers, law-abiding contractors, and construction customers, including state and local government. They have brought “destructive” competition to the Philadelphia-area construction industry—competition based on stealing a portion of workers’ wages, investing little in workers skills, and in some cases operating unsafely.

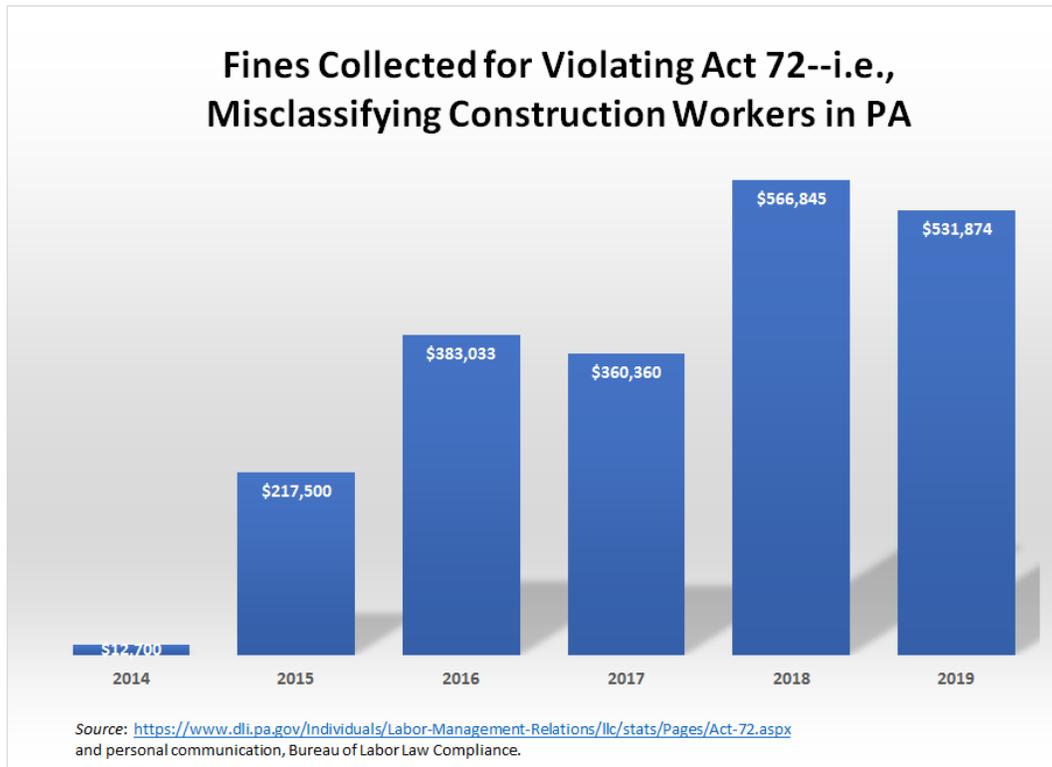
Multiple Data Sources Document Pervasive Wage Theft and Worker Misclassification in the Construction Industry

In our report and in this testimony, I triangulate multiple sorts of data—that is, use many different sources of information—to explore the issue of labor standards violation. The commonsense idea behind triangulation is that if several different kinds of data point in the same direction, we can have greater confidence in the accuracy of a finding. In this case, our different sources of information all point to a significant and growing problem of construction worker misclassification and of labor standards violation.

- Commonwealth of Pennsylvania data on the enforcement of Act 72, the Construction Worker Misclassification Act, shows significant and growing incidence of misclassification. Even though the state provides the Bureau of Labor Law Compliance with too-few investigators, 79 cases of potential construction worker misclassification as independent

¹ Stephen Herzenberg and Russell Ormiston, “Illegal Labor Practices in the Philadelphia Regional Construction Industry: an Assessment and Action Plan,” January 2019; <https://www.keystoneresearch.org/sites/default/files/KRC%20Illegal%20Labor%20Con%20Final.pdf>

contractors were investigated in the Philadelphia five-county area in 2017 and 2018 combined.² This was up from 50 cases statewide in 2014. The money collected in fines because of violations of Act 72 has grown from \$12,700 in 2014 to over half a million in each of 2018 and 2019 (see chart below). In 2019, more than a quarter of the fines (\$137,960) were a result of violations in the five-county Philadelphia area.



- Settled wage theft cases document widespread underpayment of overtime hours. In a series of class-action suits filed over the past dozen years, a Montgomery County law firm, Winebrake and Saltillo, LLC (previously the Winebrake Law Firm, LLC) documented pervasive wage theft in the regional construction industry as a result of overtime violations (and, in some cases, failure to pay prevailing wage and benefit rates on public construction jobs). In each case, described in detail with complete sourcing in our report, the complaints filed described violations of the Pennsylvania Minimum Wage Act (PMWA), Pennsylvania Wage Payment and Collection Law (PWPCCL), and/or the federal Fair Labor Standards Act.
- Interviews with a dozen electricians corroborate the existence of widespread violations of labor standards, including wage theft due to underpayment of overtime pay and worker underpayment on prevailing wage jobs. It was these interviews that led us to the settled

² 2019 figures in this paragraph provided by Bryan Smolock, Director, Bureau of Labor Law Compliance, Pennsylvania Department of Labor & Industry. See also Pennsylvania Department of Labor & Industry, *Administration and Enforcement of the Construction Worker Misclassification Act March 1, 2019*; online at <https://www.dli.pa.gov/Individuals/Labor-Management-Relations/lrc/act72/Documents/2018-Act-72-Report.pdf>

wage-theft cases. The fact that just a few interviews in a trade less well known for violations than, say, drywallers, revealed repeated examples of the kinds of violations acknowledged by contractors in settled lawsuits corroborates that these types of violation are endemic throughout the regional industry.

- Interviews with 96 workers found that the “small-scale contractors and free-lance ‘flippers’” who dominate residential housing construction and renovation in the city of Philadelphia rely on a labor market that operates outside the boundaries of U.S. labor law.³ In the city residential construction industry, workers in crews of two to six may receive materials at the beginning of the day and be told, “I’ll be back in six hours. I’ll give you \$X.”⁴ Some workers live in unfinished buildings in exchange for rehabbing them. For these workers, minimum wage and overtime laws, and health and safety standards simply do not apply. This research also documents high rates of injury on the job in city residential construction. One third of workers interviewed suffered injuries on the job that took them out of work for a week or more. Injuries resulted partly from the use of unfamiliar power tools and partly from inadequately designed scaffolding.

Parts of the city of Philadelphia residential construction industry represent an extreme degree of informalization of the industry labor market. But studies across the country show labor standards violations to be the rule rather than the exception in typical construction industry sub-contracting chains. A study of 71 residential construction drywall contractors in Southwest Michigan, for example, found that:⁵

- Nearly three quarters of workers (73%) were misclassified as independent contractors.
- Misclassified workers each lost an estimated \$6,000 annually because of the loss of overtime pay (\$7.9 million total).
- Contractors underpaid state workers’ compensation and unemployment insurance by an estimated \$9.5 million and Social Security and Medicare by an estimated \$8.8 million.

Studies based on large-sample interviews with workers in big cities—Chicago, Los Angeles, New York City—also found that about 70% of workers experienced nonpayment of overtime and reported “off-the-clock” violations (i.e., work without pay).⁶ A Texas study surveyed 1,194 workers on projects spanning five of the largest cities in the state, including non-residential

³ Natasha Iskander and Nichola Lowe, “The Transformers: Immigration and Tacit Knowledge Development,” NYU Wagner Research Paper No. 2011-01, p. 17. See also Natasha Iskander and Nichola Lowe, “Building Job Quality from the Inside-Out: Mexican Immigrants, Skills, and Jobs in the Construction Industry,” *Industrial and Labor Relations Review*, Vol. 66, No. 4, Special Issue on Job Quality (July 2013), pp. 785-807.

⁴ The rest of this paragraph is based on Natasha Iskander and Nichola Lowe, “Turning rules into resources: Worker enactment of labor standards and why it matters for regulatory enforcement,” paper prepared for the Cornell ILR/Rutgers SMLR symposium on Federalism in U.S. Work Regulation, November 8-9, 2018.

⁵ Russell Ormiston, Dale Belman, Julie Brockman, and Matt Hinkel. “Improving Job Quality in the Residential Construction Industry,” in P. Osterman (Ed.), *Creating Good Jobs: An Industry-Based Strategy* (Cambridge, MA: MIT Press, 2020).

⁶ Annette Bernhardt et al., *Broken Laws, Unprotected Workers: Violations of Employment and Labor Laws in America’s Cities*; <https://cloudfront.escholarship.org/dist/prd/content/qt1vn389nh/qt1vn389nh.pdf?t=nya8l1>.

construction projects.⁷ Fifty percent of workers reported nonpayment for earned overtime, 22% reported work without any payment, and 52% reported wages below the federal poverty limit.

The Economics of Worker Misclassification

The misclassification of workers is driven by economic incentives. A September 2019 report by the attorney general of the District of Columbia is just the most recent effort to gauge the size of these incentives. The report estimates that operating legally costs:

- 17% more than misclassifying workers because of savings on wages and taxes and social insurance;
- 27% more when you add a “modest amount” of wage theft likely in conjunction with misclassification;
- 48% more when you add the full cost of employee benefits (e.g., health care and pensions) often avoided by misclassifying workers.

Based on three state-level studies summarized in Table 1 of our report, misclassifying construction employees in Pennsylvania saves annually as much as \$200 million in federal taxes, \$83 million in workers compensation premiums, \$47 million in state income taxes, and \$11 million in unemployment compensation taxes. These state studies were conducted 15-20 years ago when misclassification may have been less widespread than it is today. These studies may therefore underestimate the lost tax revenue and social insurance payments.

Solutions: Policy and Enforcement Can Rein in Misclassification and Wage Theft in Construction

We need not simply throw up our hands about worker misclassification and wage theft in the construction—solutions do exist, as a growing number of cities and states demonstrate.

We divide our discussion of solutions into two broad approaches, which complement one another.

The first approach takes off from the simple idea that an ounce of prevention is worth an ounce of cure—i.e., the city should seek to ensure that contractors that misclassify workers and steal from them cannot operate in Philadelphia in the first place, and certainly cannot perform work paid for or provided with tax incentives or other subsidies by the city. Mechanisms to accomplish this could include requiring registration or licensing of contractors, or a “responsible contractor ordinance.” In Philadelphia’s neighboring state of Delaware, [Delaware Senate Bill 95](#) passed nearly unanimously last year and was signed by the governor on July 30. The law requires construction contractors and subcontractors to register in order to perform public work (<https://legiscan.com/DE/bill/SB95/2019>). Alaska also requires construction contractors

⁷ Workers Defense Project, “Building a Better Texas: Construction Conditions in the Lone Star State,” 2013; http://www.workersdefense.org/Build%20a%20Better%20Texas_FINAL.pdf.

to have a license; the application for the license specifically asks if the contractor has workers' compensation insurance or uses independent contractors. A "responsible contractor ordinance" could also be used to restrict public work in the city to contractors that have not been charged with violations of worker protections and fair contracting laws legislation (e.g., ERISA, FLSA, OSHA, ADA, ADEA, NLRA, Fraudulent Claims Act, city, state, and federal prevailing wage laws).

The second basic approach is to effectively enforce labor laws, including against worker misclassification. New York State's Joint Enforcement Task Force on Employee Misclassification, or JETF, (in multiple industries including construction) provides one model. Established by executive orders signed in 2007 (#17), 2008 (#18), and 2011 (#2), the Task Force carries out its mission through coordination across multiple state agencies; joint enforcement sweeps; data sharing between agencies; and making strategic referrals to law enforcement. As of the latest report online (2015), Task Force activities from 2007 to 2015 identified nearly 140,000 instances of employee misclassification and discovered nearly \$2.1 billion in unreported wages. In 2014 alone, the JETF conducted 83 coordinated visits and inspection of a worksite by investigators from multiple agencies (including unemployment insurance, labor standards bureaus, the DOL Office of Special Investigations, the Workers' Compensation Compliance Bureau, and the Workers' Compensation Office of the Fraud Inspector General). Completed sweeps that find misclassification lead to referrals to the state tax department. Completed unemployment audits are referred to the U.S. Internal Revenue Service. The Pennsylvania Department of Labor & Industry (L&I) has an internal interagency committee that includes three agencies UI, workers' compensation, and labor law compliance. This group represents a possible steppingstone to the New York approach. The L&I committee needs more resources and a clear charge to aggressively enforce the law.

Recent example of effective enforcement come from the District of Columbia and from Minnesota. In Washington DC, the attorney general reached a \$2.75 million settlement in January 2020 with an electrical contractor (Power Design, Inc.) and a subcontractor (JVA Services, LLC.). The fees included \$879,056 in back pay to workers; \$1,820,944 to D.C. to resolve hundreds of allegations of worker misclassification and other forms of wage theft; and \$50,000 to support apprenticeships or other workforce programs. The D.C. complaint alleged that the defendants misclassified workers; failed to pay minimum wage, overtime, or sick pay; and failed to pay employer contributions to the unemployment compensation system.

In Minnesota, contractor Ricardo Batres last year pled guilty to labor trafficking in a case brought to light and to the Hennepin County district attorney's office (which prosecuted the case) by both a worker center (Centro de Trabajadores Unidos en la Lucha (CTUL)) and the Carpenters Union.⁸

⁸ On the Minnesota case, see <https://www.mprnews.org/story/2019/11/18/contractor-ricardo-batres-pleads-guilty-in-rare-labor-trafficking-case>. For another example, in this case of combined federal-state enforcement in the construction sector, see <https://www.dol.gov/newsroom/releases/whd/whd20150518>. As well as providing penalties, the settlement in this second case required reclassifying misclassified independent contractors as employees.

In the now-large research literature on effective labor law enforcement in the United States, the commonsense ingredients of effective enforcement include: public agencies committed to upholding the law; industry-specific enforcement informed by data and by the specific ways employers violate the law in a particular sector; and partnerships between public agencies and industry stakeholders (worker centers, union, law-abiding contractors and their associations) in what some researchers call “co-enforcement.” Written testimony submitted by the National Employment Law Project (NELP) highlights the “community partnerships” used for effective enforcement in Seattle, San Francisco, and Los Angeles and includes citations where more information can be found. The Council could also reach out to Janice Fine, not far away at Rutgers University, who is an authority on co-enforcement.

In Philadelphia, the situation is ripe for effective enforcement. City government and City Council are united in support of effective enforcement. Both Attorney General Josh Shapiro and District Attorney Larry Krasner have created new offices of labor law enforcement (<https://www.inquirer.com/news/district-attorney-larry-krasner-employer-crimes-prosecution-wage-theft-20191008.html>). (The DA hired a lawyer who, as a college student, was briefly a KRC intern some 15 years ago.) The state’s Bureau of Labor Law Compliance within the Pennsylvania Department of Labor & Industry has enforced Act 72 more effectively over time and sought to increase its partnership with responsible private stakeholders to buttress enforcement further.

To capitalize on the consensus support for better enforcement, we recommend that state and local enforcement authorities come together into a formal partnership with private stakeholders and philanthropy. These parties should develop an enforcement plan that can drive compliance toward 100% and document annual progress towards that goal. Keystone Research Center would welcome an opportunity to assist and to recruit other technical assistance, research, and evaluation capacity.