

# SENATE BILL REPORT

## SB 5527

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As of January 18, 2018

**Title:** An act relating to simplifying and enforcing employee status under employment laws to ensure fairness to employers and employees and address the underground economy.

**Brief Description:** Simplifying and enforcing employee status under employment laws to ensure fairness to employers and employees and address the underground economy.

**Sponsors:** Senators Frockt, Chase, Keiser, Kuderer and Conway.

**Brief History:**

**Committee Activity:** Commerce, Labor & Sports: 6/28/17.  
Labor & Commerce: 1/17/18.

**Brief Summary of Bill**

- Creates the Employee Fair Classification Act (EFCA), which prohibits misclassification of employees as independent contractors and creates remedies, including civil penalties and damages.
- Defines independent contractor for purposes of the EFCA and establishes the same definition for purposes of the Minimum Wage Act, unemployment insurance, industrial insurance, and other employment laws.

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### SENATE COMMITTEE ON COMMERCE, LABOR & SPORTS

**Staff:** Jarrett Sacks (786-7448)

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**Background:** Employment standards and benefits generally apply only if an employer-employee relationship exists, rather than an independent contractor relationship. Various multipart tests are used to determine whether an individual is an independent contractor. For purposes of prevailing wage, industrial insurance, and unemployment insurance, a six-part statutory independent contractor test is applied. This test requires that:

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- the individual has been and will be free from direction and control, both under the contract and in fact;
- the individual's services are outside the usual course of business for which the service is performed, or outside all the places of business, or the individual must pay the costs of the principal place of business where the services are performed;
- the individual has an independently established business, or a principal place of business that qualifies for an Internal Revenue Service (IRS) deduction;
- the individual is responsible for filing a schedule of expenses with the IRS;
- the individual has a separate set of books and records that reflect all items of income and expenses; and
- the individual has an active and valid registration with the Department of Revenue (DOR), has a Unified Business Identifier (UBI) number, and has any other required state accounts for the payment of taxes.

In the construction industry, a seventh required element is that the individual be registered as a contractor or licensed as an electrical contractor. For industrial insurance, a threshold question is whether a person under contract brings more than their personal labor to the job. For unemployment insurance, persons outside construction may also be independent contractors under an alternative three-part test.

For purposes of the Minimum Wage Act (MWA), which also addresses overtime, a common law economic dependence test applies. The inquiry under this test is whether the worker is economically dependent on the alleged employer or is instead in business for themselves. Other wage laws also do not have statutory tests. These include the Wage Payment Act, which provides for an administrative or court action to collect wages under the MWA and other wage laws, as well as establishes other requirements. Other laws address deductions from wages and otherwise address failure to pay wages.

**Summary of Bill:** The bill creates the Employee Fair Classification Act (EFCA).

Prohibitions and Requirements. Under the act, the following actions by employers or other persons are prohibited:

- willfully misclassifying an employee as an independent contractor;
- charging a misclassified employee a fee or making unlawful deductions from compensation;
- requiring or requesting an employee to agree or sign a document that results in misclassification;
- forming, assisting in, or inducing the formation of a business entity, or paying or collecting a fee for the use of a business entity, for the purposes of facilitating or evading detection of a violation of the EFCA; and
- conspiring with, aiding and abetting, or advising an employer with the intent of violating the EFCA.

Misclassification is designating an employee as a nonemployee. Willful is a knowing and intentional action that is not accidental or the result of a bona fide dispute.

Employers who engage independent contractors must post a notice stating that a worker has a right to be classified as an employee if the worker does not meet independent contractor

requirements, and that a complaint may be filed with the Department of Labor and Industries (L&I) or in a court if a person believes misclassification occurred.

Definition of Independent Contractor. The EFCA's independent contractor tests apply to prevailing wage, wage deductions, the WPA, the MWA, unemployment insurance, and industrial insurance. An independent contractor is an individual who performs labor or services under either of two tests. One test requires that:

- the individual is and will continue to be free from control or direction, both under the contract and in fact. Control or direction includes the right to control or direct, as well as general control or direction over, the individual's physical activities;
- the labor or service is either outside the usual course of business for which the labor or service is performed or outside of all the places of business of the enterprise for which the labor or service is performed;
- the individual is customarily engaged in an independently established trade, occupation, business, or profession that is of the same nature as that involved in the contract;

An alternative test requires that:

- the individual is and will continue to be free from control or direction, both under the contract and in fact. Control or direction includes the right to control or direct as well as general control or direction over, the individual's physical activities;
- the individual's business is not financially dependent on the relationship with the party engaging the individual and the business continues after the relationship ends;
- the individual has a substantial investment of capital in the business;
- the individual gains profits and bears losses as a result of managerial skills and capital investment;
- the individual makes his or her labor or services available to the public or business community on a continuing basis;
- the individual files a schedule of expenses with the IRS;
- the party engaging the individual does not represent the individual as an employee;
- the individual has the right to perform similar labor or services for others;
- the individual has an active and valid registration with DOR and any other state agencies for purposes of taxes; and
- the individual has a separate set of books and records.

Existing statutory independent contractor tests are repealed.

Employer-Employee Relationship. An employer-employee relationship exists when an individual performs labor or services for an employer. Proof that an individual is not an employee must be established by a preponderance of the evidence. A person may be an employee of two or more employers at the same time. Bona fide independent contractors, commissioned outside salespeople, individuals employed on a casual and sporadic basis, and volunteers are not employees under the EFCA.

Enforcement. L&I may investigate violations and for any of the prohibited acts may order payment of:

- a civil penalty of \$1,000 to \$10,000 per employee, or \$10,000 to \$25,000 if the person engaged in a pattern or practice;

- damages of three times the wages and benefits denied or withheld and reimbursement for taxes and the value of benefits paid by the employee. Liability is joint and several for employers and other persons; and
- taxes owed.

Individual and class actions are authorized. If the court determines that a person, including an employer, engaged in any of the prohibited acts, the court must order payment of damages of:

- The greater of:
  1. three times the wages and benefits unlawfully denied or withheld; or
  2. statutory damages of \$1,000 to \$10,000 per employee or \$10,000 to \$25,000 per employee if a pattern or practice is shown.
- Attorneys' fees and costs.

A three-year statute of limitations for both administrative and court actions is tolled during any period that an employer deterred an action. A pattern or practice means that within the previous ten years, the employer was convicted for nonpayment of wages or delinquent in payment of a court-ordered or administrative assessment for nonpayment of wages.

A general construction contractor is liable for violations of an independent contractor or subcontractor only when the general exerts substantial control over the day-to-day work of the subcontractor or independent contractor.

The EFCA Account (Account) is created. Civil penalties must be deposited into the Account, which is appropriated, and monies in the Account may be used only for enforcement of the EFCA.

**Appropriation:** None.

**Fiscal Note:** Available.

**Creates Committee/Commission/Task Force that includes Legislative members:** No.

**Effective Date:** Ninety days after adjournment of session in which bill is passed.

**Staff Summary of Public Testimony:** PRO: Current law on independent contractors is confusing and needs standardization, especially with more people working as independent contractors. Misclassification denies workers access to the social safety net, places a burden on workers, and is harmful to good businesses that follow the law. The bill takes out elements of the current test that are subject to abuse. Misclassification affects low income workers and people of color disproportionately.

CON: The bill switches the presumption and puts the burden on employers to prove a negative. The bill should focus on specific industries rather than revamping the whole thing. This does not simplify the test. There are factors that employers do not have control over or cannot know, such as whether the contractor has filed taxes or has a separate set of books. The bill ignores legitimate disputes and captures workers that are usually considered

independent contractors. The bill was not presented to the Underground Economy Task Force, which focuses on these issues.

**Persons Testifying (Labor & Commerce):** PRO: Joe Kendo, Washington State Labor Council, AFL-CIO; Rebecca Smith, National Employment Law Project; Andrea Schmitt, Columbia Legal Services.

CON: Mark Johnson, Washington Retail Association; Bob Battles, AWB; Tom Kwieciak, Building Industry Association of Washington; Patrick Connor, NFIB Washington.

**Persons Signed In To Testify But Not Testifying (Labor & Commerce):** No one.