

Employee Misclassification Advisory Task Force (EMATF)

2013 Annual Report



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Tennessee Department of Labor and Workforce Development
Employee Misclassification Advisory Task Force

January 7, 2013

The Honorable Jack Johnson
Chairman, Senate Commerce, Labor and Agriculture Committee
11 Legislative Plaza
Nashville, TN 37243

The Honorable Jimmy Eldridge
Chairman, House Consumer and Employee Affairs Committee
208 War Memorial Building
Nashville, TN 37243

Dear Chairman Johnson and Chairman Eldridge:

The Employee Misclassification Advisory Task Force is pleased to present its Second Annual Report which is submitted pursuant to Tenn. Code Ann. § 50-6-919(g). In this report, the Task Force focuses on joint investigation results, progress in other states, efforts taken to study fraud detection software systems, and recommendations for legislative initiatives to enhance enforcement.

During its first year, the Task Force provided three recommendations to your committees for review. The recommendations included: (1) enhanced enforcement through increased personnel; (2) authorized administrative penalties; and (3) authorized stop work orders directed at noncompliant employers.

In the future, the Task Force will continue to study and make recommendations; undertake additional research; educate employers and employees; improve execution of Tennessee's employment, tax, and licensing laws; and target accurate exposure to ensure proper assignment of workers' compensation premiums.

Your leadership and vision in providing an opportunity for state agencies, business entities, and the general public to collaborate to ensure stronger compliance with Tennessee's employment, tax, licensing, and insurance laws is appreciated. Collaborative efforts will enable us to treat responsible employers fairly, impede the spread of the underground economy, and curb unlawful practices.

There is still a great deal of work ahead, and member agencies are committed to building on our current efforts, standing for law abiding employers, and continuing to combat illegal practices in the construction industry. Our Legislative Liaisons will contact you to schedule a meeting in mid-January 2013 to discuss the 2012 and 2013 recommendations.

Sincerely,

A handwritten signature in black ink, appearing to read "Karla Davis".

Karla Davis
Commissioner, Department of Labor and Workforce Development
Chairman, Employee Misclassification Advisory Task Force



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Committee Reports can be found at:
<http://www.tn.gov/labor-wfd/EMEEF/>

EXECUTIVE SUMMARY, RECOMMENDATIONS & FUTURE ACTION

On June 4, 2010, the General Assembly passed Public Chapter No. 1149 creating the Employee Misclassification Advisory Task Force (“EMATF” or “Task Force”) within the Workers’ Compensation Division of the Tennessee Department of Labor and Workforce Development (“TDLWD”). The purpose of the Task Force is to study and make recommendations regarding employee misclassification in the construction industry by seeking public input, holding public hearings, and creating committees to study and make recommendations relative to statutory issues identified in Tenn. Code Ann. § 50-6-919(b). The 2012 EMATF Annual Report addressed items (1) through (6) of the statutory issues identified in Tenn. Code Ann. § 50-6-919(b). This report addresses items (7) through (13) of the statutory issues identified in Tenn. Code Ann. § 50-6-919(b).

Problems in Tennessee:

“Employee misclassification” occurs when an employer classifies employees as independent contractors or pays the employees “off the books” or in cash. Employers who misclassify their employees do not pay unemployment insurance premiums. Furthermore, they either do not have workers’ compensation coverage or they pay substantially lower premiums because of fraudulent underreporting of payroll and/or misrepresenting the number of employees and/or the type of work performed. This practice of “premium avoidance” is prevalent in the construction industry. In many instances, the behavior is deliberate and constitutes insurance and tax fraud.

Noncompliant employers do not deduct federal taxes (e.g., income, Social Security, Medicare) from their employees’ pay. Further, they do not pay overtime as required by the federal Fair Labor Standards Act. These practices create an unfair competitive advantage over employers who comply with federal and state employment and tax laws.

Over 34 states have enacted legislation in attempts to locate noncompliant employers and deter this unlawful behavior. Such conduct harms honest employers, mistreats workers, and costs the treasury uncollected revenue. In some cases these dishonest employers have been found working on state-funded projects.

Financial Impact:

Based on estimates using 2006 data, Tennessee lost between \$2.1 million and \$3.7 million in uncollected workers’ compensation premium taxes.¹ Tennessee’s estimated losses from unpaid unemployment insurance premiums range from \$8.4 million to \$14.9 million.²

Workers’ compensation insurers lost an estimated \$52.1 million to \$91.6 million in unpaid workers’ compensation premiums.³

¹ A 4% tax is imposed on workers’ compensation insurance premiums. *Misclassified Construction Employees in Tennessee*. Dr. William Canak and Dr. Randall Adams, 2010.

² Based on current rates of 1.1% to 10.6% on first \$9,000.00 in wages. *Id.*

³ *Id.*

2012 Recommendations:

The Task Force made the following recommendations in its 2012 Annual Report in response to the issues raised in Tenn. Code Ann. § 50-6-919(b)(1)–(6):

1. Enhanced Enforcement

The Workers' Compensation Division has only seven investigators dedicated to employee misclassification investigation. Three investigators are funded through the Employee Misclassification Enforcement and Education Fund ("EMEEF"). The remaining four investigators are funded through the Workers' Compensation Division's Uninsured Employers Fund ("UEF"). At least four additional investigators are needed in each grand division of Tennessee, with at least one per grand division having interpretation/translation skills.

2. Authorize Administrative Penalties

Current law does not grant authority to issue administrative penalties for employers who have committed workers' compensation insurance premium avoidance. Such penalties would be consistent with the practices of other states.

3. Authorize Stop Work Orders Directed at Noncompliant Employers

Current law does not grant authority to issue stop work orders as part of enforcement capabilities. The authority to issue orders that stop the offending employer(s) would significantly improve enforcement capabilities and are not intended to shut down an entire jobsite. Such measures would be consistent with the practices of other states.

2013 Recommendations:

The Task Force makes the following recommendations in its 2013 Annual Report in response to the issues raised in Tenn. Code Ann. § 50-6-919(b)(7)–(13):

1. Civil Penalties for Fraud

Enact legislation granting TDLWD's Workers' Compensation Division authority to assess civil monetary penalties against employers found to have committed workers' compensation insurance premium avoidance/fraud.⁴

2. Stop Work Orders to Offending Contractors

Enact legislation granting the Workers' Compensation Division authority to issue and enforce stop work orders against offending contractors.

3. Fraud Detection Software

Provide funding for fraud detection software that is crucial to enforcing the legislation proposed above.

4. Investigators

Provide funding to hire 12 additional investigators (four in each grand division of Tennessee), with at least one per grand division having interpretation/translation skills.

⁴ Thirty-four (34) states have adopted pro-law enforcement measures to address payroll fraud, including stop work orders, penalties for failure to classify employees, administrative penalties for workers' compensation premium avoidance, funding for special prosecutors, and penalties for money service businesses linked to payroll fraud.

Future Action:

The Task Force will continue to study the statutory issues raised in the Tenn. Code Ann. § 50-6-919(b) and will consider making the following recommendations in the future:

1. Increase effective investigation and enforcement by adopting integrated data management and by promoting sharing between Tennessee agencies and external sources.
2. Include the State Building Commission, Tennessee Department of Transportation (“TDOT”), Department of General Services, and other necessary agencies on the Task Force to assist with enforcement on state funded construction projects. Also, include the Tennessee Department of Financial Institutions on the Task Force to assist investigations involving check cashing services.
3. Establish a public awareness campaign targeted toward employers and employees in the construction service industry.
4. Develop contacts and working relationships with officials, including law enforcement officials, of surrounding states who investigate and enforce their laws against employee misclassification.
5. Enter into a Memorandum of Understanding (“MOU”) with the federal Department of Labor (“USDOL”) to foster joint investigative and enforcement action.
6. Explore the possibility of entering into a MOU with the Internal Revenue Service to obtain information on employers filing form 1099 (independent contractor).
7. Implement TDLWD speaking tour and make representatives from TDLWD and Commerce & Insurance available to speak at conferences, etc.
8. Include links to educational materials on the EMATF website.
9. Invest in communication and educational strategies to draw public awareness to misclassification practices and incentivize reporting to appropriate state agencies. Incentives for reporting should include guarantees of protection and immunity, particularly given that misclassified employees may have an undocumented work status that presents disincentives to reporting.
10. Study social media as a methodology for increasing public awareness of misclassification’s illegal and harmful economic and social impact on Tennessee.
11. Add a test question to the contractor’s licensing exam and include this question on the licensing application. This format would be consistent with other questions on the Licensing Board applications.
12. Create a fact sheet for the “employee and/or anyone hired” similar to the employment package with the W2 form. This would parallel current Tennessee Occupational Safety & Health Administration (“TOSHA”) posting requirements and could be provided at a minimal cost since the forms may be duplicated using current photocopy technology.
13. Make the resource website accessible for educational purposes by Tennessee officials. Also, as permitted by law, provide Tennessee law enforcement personnel appropriate materials to the website to assist their colleagues in other states.

Other Considerations:

1. Provide funding for continued research by objective academic researchers to determine the extent of misclassification and under reporting of employees throughout the Tennessee economy.
2. Enact legislation modeling states that have made significant progress in identifying misclassification, reducing payroll fraud, and increasing state revenues previously lost due to fraud. Florida and Louisiana are states that have made significant strides here.
3. Extend the Task Force's current mandate to address issues related to employee misclassification in industries other than construction.

LEGISLATIVE HISTORY

- Public Chapter 1149, which became effective on March 1, 2011, was the result of a compromise between the implementation of Public Chapter 1041 on December 31, 2009 (suspended after three weeks), and the need to account for every construction owner and executive on the jobsite.
- Legislators across the state heard complaints that the requirement to purchase workers' compensation coverage would put many construction industry employers out of business at a time when the industry was facing enormous economic challenges.
- The commercial construction industry agreed that only three direct laborer exemptions should be permitted, while under Public Chapter 1041 all laborers on a jobsite were required to be covered. Business owners and executives wishing to be exempt from Workers' Compensation laws were given the option to apply for an exemption through the Secretary of State's office for a fee.
- For non-commercial (i.e., small commercial and residential) contractors, there is no jobsite exemption limitation for owners and executives.
- The decision to include business owners and executives in the definition of employee was a significant step by the legislature. Provisions of Public Chapter 1149 resolved the contentious debate between policyholders and insurance carriers as to who was legally required to be covered. Historically, the "seven factors" test as listed in Tenn. Code Ann. § 50-6-102(10)(D) or the common law test ("ABC" test) as listed in Tenn. Code Ann. § 50-7-207(e)(1) was used in determining work relationships to classify individuals either as employees or independent contractors.
- Business and employee groups alike attempted to draw the legislature's attention to the growing problem of employee misclassification and its devastating impact on uninsured employees. These effects are especially harmful to non-English speaking workers and law-abiding contractors who find themselves at a distinct competitive disadvantage.
- Pursuant to their study, Dr. William Canak and Dr. Randall Adams supplied several questions that the legislature deemed worthy of study. The legislature created the EMATF to study these questions and make recommendations.

Update:

- Pursuant to Public Chapter 1030 of the Public Acts of 2012, which took effect January 1, 2013, the fee structure for workers' compensation exemption registrations and renewals decreased. For specific details refer to the Revenue and Expenditure Section of the 2013 EMATF Annual Report page 13.

EFFORTS & PROGRESS

The Task Force met in July 2012, August 2012, September 2012, and October 2012. Full transcripts of all Task Force meetings may be found on the EMATF website. Additionally, the various Task Force committees met during the summer and fall months. The 2012 annual report identified five future action items. Outlined below is the progress made on each item.

1. Educated Employers and Employees

A website was established and became operational in mid-2012. The link is <http://www.tn.gov/labor-wfd/EMEEF/>. The website provides distinctions between employees and independent contractors, includes a tip form and a toll free number, and makes available transcripts of Task Force meetings and committee reports.

2. Trained Investigators

Certified training on both civil and criminal investigative techniques was provided to six investigators in May 2012 to ensure that investigators performed thorough and complete investigations that meet industry-recognized standards.

3. Collaborated Investigations and Hosted Round Table Discussions

Investigators from the various divisions within TDLWD met monthly to share investigative strategies and techniques. Joint investigations were performed and participating agencies and other entities were encouraged to work together to make referrals, contact insurance carriers, report fraud, and coordinate efforts with the Tennessee Department of Commerce and Insurance.

*See Unemployment Insurance and Workers' Compensation Data, page 20

4. Leveled the Playing Field

The Task Force has worked and continues to work to develop reliable methods to encourage fair competition to assist Tennessee in restoring competitive equality for law abiding employers, particularly on publicly-funded construction projects such as those on public college and university campuses, hospitals, institutions, and other public buildings.

5. Studied Fraud Detection Software

Effective technology is needed to identify potential suspects who may be engaged in fraudulent misclassification activity in Tennessee. Software applications are currently available to cross-reference several different databases to aid investigators in the apprehension and punishment of employers who are likely engaging in employee misclassification. Such software will help TDLWD's investigators to work more efficiently and to cover more territory.

Various vendors made presentations to the Task Force in 2012. The Task Force thoroughly studied fraud detection software and made recommendations. The information was provided to TDLWD for the purpose of making a decision on the most efficient and effective technology and the preferred vendor. The Task Force will continue to research the feasibility of obtaining fraud detection software and related databases and offer suggestions and recommendations to TDLWD.

Issued Warning Letters

Although warning letters were not discussed in the 2012 Annual Report, the Program has begun issuing notices to employers who were suspected of engaging in employee misclassification. After statutory authority is granted, these files will be revisited in order to determine if employers are compliant with the new law.

LEVELING THE PLAYING FIELD AND ENCOURAGING FAIR COMPETITION

- **Facilitating the Filing of Complaints:**

Representatives of the construction industry believe that effective enforcement by TDLWD will lead to increased reporting within the industry of contractors who misclassify their workers. This has been the experience of other states that have increased enforcement efforts. TDLWD's current legal authority to penalize non-compliant contractors is limited to contractors who fail to carry workers' compensation insurance or fail to pay unemployment insurance premiums. These non-compliant contractors misclassify workers as independent contractors and/or pay their employees "off the books." TDLWD currently has no statutory authority to issue stop work orders to non-compliant contractors or assess monetary penalties against contractors who commit workers' compensation insurance premium fraud. Until TDLWD is granted this enhanced statutory authority, compliant contractors will not likely bother filing complaints.

- **Misclassification is often a component of other forms of illegal activity that have been identified and prosecuted in other states.**

Florida Check Cashing Scheme

Florida officials shared a scheme that is rampant in the Florida construction industry. Under this scheme, a person (called an "Originator"), using a fictitious name or name of another person, sets up a shell company with no employees and gives the company a generic name that does not identify with any type of construction service. The Originator then purchases several minimum premium workers' compensation policies in the name of the shell company and rents those policies to construction service contractors for a percentage of the profits. The construction service subcontractor bids jobs in the name of the shell company and uses the rented workers' compensation policy to show proof of coverage. The general contractor issues a business-to-business check to the shell company for the work performed by the construction service provider who rented the policy. The Originator has an arrangement with a check cashing service provider, which is part of the conspiracy, to cash the business-to-business check for a percentage of the check amount. The person who supposedly owns the shell company or who is the principal owner of the shell company usually never sets foot in the check cashing service provider. The check cashing service uses a rubber stamp of the supposed owner's signature and thumb print. The Originator, or someone on his/her behalf (called a "Facilitator") cashes the business-to-business check at the co-conspiring check cashing service and pays the workers of the subcontractor posing as the shell company in cash. The shell company usually dissolves within a year, just prior to the annual audit by the issuer of the workers' compensation policy. The Originator then sets up a new shell company (or companies) after dissolving the first one, and continues the illegal conspiracy. According to Florida officials, the investigation progresses rapidly once they identify the check cashing service and subpoena its records.

Through its employee misclassification task force and sub-task force on check cashing services, Florida enacted legislation to assist its enforcement efforts. It is a felony under Florida law for a checking cashing service to possess the tools of the conspiracy, such as an endorsement stamp and thumb print stamp of the supposed shell company owner (usually a fictitious person). It is also a felony in Florida for an employer not to report to its workers' compensation carrier within seven days of any changes to the employer's operations that would affect the employer's policy. Florida officials have the authority to issue stop work orders to contractors that are non-compliant with the workers' compensation statute. Florida law provides for civil fines or criminal sanctions for violating the stop work order.

Tennessee Check Cashing Services

Check cashing services in Tennessee are regulated by the Department of Financial Institutions ("DOFI"). The Tennessee Check Cashing Act (Tenn. Code Ann. § 45-18-101 *et seq.*) establishes the licensing requirements for check cashing service providers and provides the Commissioner of DOFI the authority to periodically examine such service providers. Under the statute, it is a Class E felony to knowingly and willfully make a false statement in any document that is required to be filed, such as a cash transaction report, but Tennessee law does not prohibit check cashing services from possessing signature or thumb print stamps.

EXPOSING THE UNDERGROUND ECONOMY AND EDUCATING THE GENERAL WORKFORCE

In an effort to raise public awareness of employee misclassification, resources must be targeted toward educating employees and employers about their rights and responsibilities. Being mindful of budgetary constraints, the Task Force identified the following low-cost means to disseminate educational information:

- The educational process should begin with printed posters, brochures and postcards that are cost-effectively produced through the Department of General Services Printing and Media Services Division.
- TDLWD has created an informational website (<http://www.tn.gov/labor-wfd/EMEEF>) that describes in plain language the differences in employee and independent contractor relationships. The website also provides a toll-free tip line for public complaints and a form to lodge complaints against any employer suspected of misclassification. Already, TDLWD is receiving tips and complaints from the public that are being investigated. The website is presently available only in English. It is critical to obtain funding to translate the site first into Spanish and then into other languages (e.g., Kurdish, Arabic, and Laotian) that are spoken in the Tennessee workforce.
- TDLWD has created a tri-fold brochure that distinguishes “employees” from “independent contractors” and that provides contacts for various government resources. However, funding is needed to print the brochure, and also to translate it. This brochure could be used and distributed by Compliance Field Investigators as well as at TDLWD career centers, job fairs, local codes and building permit departments, licensing boards, state offices, and chambers of commerce.
- Enhancing the TDLWD’s current curriculum is another effective and low-cost way to educate the public, state employees and employers on issues of unemployment insurance, career development, workplace safety, and workers’ compensation. No-cost educational tools included webinars, PowerPoint presentations, and social media. Also, public service announcements may be broadcast free of charge or at a low cost if the radio or television stations believe they would benefit their listeners.
- Social media networks present a low-cost, high-impact opportunity for Tennessee to incorporate developing non-traditional media for communicating laws and regulations relevant to misclassification practices. Social networking media have high currency with target populations most likely to be aware of employers engaging in payroll fraud. Facebook presents one opportunity; Twitter offers another low-cost information medium.
- Quotes for a public awareness campaign prepared in detail for 2011 have been updated in 2012. However, the Task Force has agreed to delay recommending funding of a public awareness campaign since the limited funds were determined to be more useful at this initial stage of development for enforcement purposes. A public awareness campaign, ranging from \$91,000 - \$351,000, depending on the scope and magnitude of the desired campaign, has been determined to be secondary to the investment of hiring multi-lingual enforcement agents now. The Task Force agreed that education regarding the misclassification problem, without the proven ability to enforce and correct the problem, would not be well-received by the business community. Tennessee’s responsible employers need to see action/enforcement being taken against those who skirt the system to their benefit.

COMBATING THE UNDERGROUND CONSTRUCTION ECONOMY

- Employee misclassification in the construction industry typically involves two criminal offenses: (1) the commission of a “fraudulent insurance act” in violation of the Workers Compensation Fraud Act (Tenn. Code Ann. § 56-7-103); and (2) misrepresentations made to avoid premium payment in violation of the Employment Security Act (Tenn. Code Ann. § 50-7-711). According to the Administrative Office of the Courts (“AOC”), only one criminal case has been filed in the last four years against an employer for violation of the Employment Security law. That case is presently set for trial in May 2013. While there have been 24 cases filed for fraudulent insurance acts during the past four years, most of those are believed to have been filed against employees, and only two are known to have been filed against employers. Of those, one resulted in the employer receiving a ten year sentence (nine years suspended; one year to be served on weekends) and an order to pay restitution to the defrauded insurance companies.
- EMEEF focuses on civil litigation but can refer cases to the proper criminal law enforcement and prosecutorial agencies when it has reason to suspect that criminal investigation and prosecution is necessary. To date, no cases have been referred for criminal prosecution by EMEEF. No thresholds or guidelines for determining which cases warrant prosecution have been suggested by the member agencies.
- EMEEF currently investigates employers who misclassify employees as independent contractors, underreport the number of employees, underreport the amount of payroll, and/or misrepresent the type of work performed. During the investigation, inspectors interview relevant parties, gather evidence, prepare investigation reports, send warning letters, and make referrals to other participating agencies and insurance carriers. At this time, there are no administrative penalties for workers’ compensation insurance premium avoidance or fraud. This legislation was requested in the 2012 EMATF Annual Report. EMEEF lacks effective enforcement authority without such legislation.

EMEEF can refer cases of suspected workers’ compensation insurance premium fraud and unemployment insurance premium fraud to the appropriate local District Attorney (“DA”), who has discretion to request an investigation by the Tennessee Bureau of Investigation (“TBI”). If the DA decides to request a TBI investigation, the TBI may assign an agent to investigate. After the investigation is completed, the DA would determine whether there is sufficient evidence to establish probable cause to believe a crime has been committed and to identify the person or persons who committed the criminal offense. If such evidence exists, the DA would have to decide if the evidence were sufficiently compelling to justify prosecution either by direct presentment to the county grand jury or by filing criminal warrants. If charges are filed, the accused person would be arrested and the case would then proceed through the criminal courts.

Currently, nothing in the law prohibits Task Force member agencies from referring matters to other participating agencies for potential liability under the other agencies’ statutory or administrative enforcement mechanism.

EMPLOYEE MISCLASSIFICATION TECHNOLOGICAL SUPPORT: REVIEW AND PROPOSALS

Using technology that identifies employers who exhibit illicit behavior is a critical strategy to aid investigators. The Task Force researched software solutions for cross checking databases to identify fraudulent misclassification activity in Tennessee and evaluated whether investing in such software would aid investigators in the apprehension and punishment of fraud perpetrators. Vendor feedback with corresponding system costs follow:

➤ **Risk Metrics & Insurance TechKNOWLEDGEy Joint Venture (“RMIT”)**

According to an October 24, 2012, web presentation, RMIT would form a joint venture to deliver its software package to TDLWD. As part of this process, RMIT would run extensive matching programs against third-party data sets such as Experian, Dun & Bradstreet (“D&B”) and others. In cases where policy information exists and TDLWD is pursuing employee misclassification, the following applies:

- When a policy is written, the carrier reports number of employees and payroll;
- Required as part of the proof of coverage record the TDLWD processes;
- Comparing data from third parties to that reported on the policy is relatively easy with the right matching algorithms/programs;
- When the policy shows three employees, a payroll of \$60,000, but outside business credit bureaus reports annual sales of \$4 million and 60 employees you have a good suspect;
- Ratios and benchmarks (e.g., sales per employee, average weekly payroll, etc.) are well defined by each of over 600 worker class codes and are used to locate suspects; and
- Utilizing records found in existence at Experian, D&B, and other providers, they are cross matched and may contradict the number of employees reportedly covered on a policy.

Fees: Annual costs for licensing data such as this ranges from \$700,000 - \$750,000 for full data inclusion. This would be a turn-key operation, with the system housed in Boca Raton, Florida. It is iPad and iPhone compatible for convenient field access.

➤ **SAS**

In Tennessee, SAS currently provides services for numerous agencies, including the TBI, Bureau of TennCare, and the Department of Education.

- SAS’s success has come from exploring data points from different angles. One of their main objectives is to eliminate false positives;
- High sales tax revenues are red flags for low number of employees; and
- Craigslist and LexisNexis are good additional sources of data that can offer leads.

The State of Washington has an impressive 100% success rate. Washington used Memoranda of Understanding with all of the agencies with which they dealt. In the past, some agencies have resisted providing their data. SAS challenged agencies that claimed they could not provide the data to show them the law that prohibits data sharing.

- Washington likely has an advantage in detecting and controlling fraud since all their policies are managed by the state, as opposed to Tennessee where over 300 companies write workers’ compensation coverage.

What seems to be effective is to use integrated tasks with different disciplines. One of the keys to narrowing down the leads is utilization of a “learn and improve” cycle, which is embedded in the SAS solution. The SAS system used by Washington uses data from 15 programs, encompassing five agencies, and the IRS.

- With respect to return on investment, Washington recovered the cost of the SAS program within the first year, although there is no guarantee that they would produce similar results in Tennessee;

- SAS also provides fraud detection services to Louisiana; and
- SAS has a statewide contract in Tennessee, and the TDLWD could procure their services without a Request for Proposal (“RFP”).

Fees: Initial fees to secure the SAS system are \$550,000 for workers’ compensation only, and \$895,000 for workers’ compensation and unemployment tax service. Annual fees after the first year are \$107,800 and \$175,420, respectively. Hardware costs are \$118,950 annually, plus an information technology (“IT”) technician to manage the system. For SAS to host the project, costs would be \$160,000 - \$200,000 annually.

➤ **On Point Technology, Inc. (“On Point”)**

The final system the Task Force explored was On Point, which currently provides a software package to the Unemployment Benefits division of TDLWD. If TDLWD is interested in this vendor, their services may be procured without having to go through a formal RFP process, since it could be included as an “add on” to their current contract. On Point “specializes exclusively in Unemployment Insurance” and will provide the “Aware Enterprise” for misclassified workers application. According to On Point, their software will:

- uncover misclassified worker fraud schemes;
- offer advanced query and analytic capabilities via one-click audits via Fraud IT;
- allow non-technical users to turn workforce data into industry intelligence via the Workforce Reported;
- deliver next-generation data mining through the innovative InfoBase™ technology;
- conduct audits and peruse data based on any data characteristics; and
- export data results into Microsoft Office applications.

On Point can typically “go live” within six months.

On Point has not provided data mining for Workers’ Compensation policies, but it is in the process of working with the state of Ohio to do just that. In its proposal, On Point indicated it will allow “an additional 15 tables [that] can be imported into Workforce Reporter with Aware Enterprise for Misclassified Workers,” thus accommodating our need to include the National Council on Compensation Insurance (“NCCI”) and “Exemption” data.

Fees: On Point has proposed an initial software fee of \$485,000 with hardware and related costs estimated to be \$68,316. The Assurance and Certification Plan membership is \$50,000 for year two and an increase of 5% annually thereafter. This offer is valid through June 30, 2013.

INITIATIVES OF VARIOUS STATE GOVERNMENTS

- **New Strategies for Systematically Investigating Employee Misclassification:**

Numerous states have utilized reputable academic researchers as a means to develop comprehensive descriptions of employee misclassification and underreporting. Additionally, this research includes estimates of the impact these practices have on state revenues for unemployment insurance, workers' compensation premiums and taxes. Using multiple empirical research methods, these studies provide a rich comparative body of objective data on the extent of misclassification.

States implementing multi-agency fraud detection data sharing and data mining methods, such as Washington and Louisiana, have demonstrated their value for identifying the extent of employer misclassification. Also, they have confirmed the practicality of these methods for identifying individual employers and broader networks of systematic illegal activity linked to payroll fraud.

- **Improvements to Facilitate the Filing of Complaints and Identify Potential Suspects:**

States making substantial improvements to complaint filing procedures have experienced marked improvements in identifying employers who practice misclassification. Incorporation of economic incentives and aggressive use of multiple modes of reporting, including social media and internet domains, facilitate existing agency-based resources for identifying misclassification practices. Improved communication with local government officials presents a significant opportunity for inter-governmental cooperation and collaboration. Local knowledge of construction activity and incentives to local officials can provide a more extensive use of trained and experienced local officials at low cost and higher reliability than other sources of information.

- **Necessary Legislative Changes:**

Thirty-four (34) states have adopted measures to address payroll fraud, including stop work orders, penalties for failure to accurately classify employees, administrative penalties for workers' compensation premium avoidance, funding for special prosecutors, and penalties for money service businesses linked to payroll fraud.

At present, Tennessee's lack of administrative monetary penalties makes curbing employee misclassification difficult. Current Tennessee law does not authorize TDLWD to assess administrative monetary penalties against employers for workers' compensation premium avoidance or to issue stop work orders to offending employers.¹⁰

- **Other Issues Relative to Misclassification in the Construction Industry:**

Columbia University Law School National State Attorneys General Program is collecting resource materials from investigators and prosecutors familiar with payroll fraud cases. They are planning to assist law enforcement by providing access to those materials on a dedicated website.

A significant aspect of employee misclassification originates with construction contractors from other states (e.g., Georgia), who work in Tennessee and violate Tennessee law.

¹⁰ See 2012 Annual Task Force Report.

REVENUE & EXPENDITURES

Tenn. Code Ann. § 50-6-913 created the Employee Misclassification Education and Enforcement Fund (“EMEEF”). The fund shall be administered by the Commissioner of TDLWD.

Any fees collected pursuant to the fee schedule for Workers’ Compensation Exemption Registrations outlined in Tenn. Code Ann. § 50-6-912 must be deposited into the fund. Monies in the fund must also be invested by the State Treasurer in accordance with provisions of Tenn. Code Ann. § 9-4-603.

The statute further stipulates that all costs of the Secretary of State associated with the administration of the Workers’ Compensation Exemption Registry shall be paid by the Commissioner of TDLWD. Monies remaining in the fund after such payment may be expended, subject to appropriation by the General Assembly, at the direction of the Commissioner for education of employers and employees regarding the requirements of this part and in support of the ongoing investigation and prosecution of employee misclassification. Any amount in the fund at the end of any fiscal year shall not revert to the general fund but shall remain available for payment of costs of administering the registry or for education or enforcement.

The chart below outlines the revenue, expenditure, and fund balances since the fund’s inception on January 1, 2011. This revenue was generated from Workers’ Compensation Exemption applicant registrations, amendments and copy fees. Revenue collections and Expenditures in FY2012-13 are through November 2012 as reported by TDLWD.

FISCAL YEAR	REVENUE	EXPENDITURES	ENDING BALANCE
2010-11	\$2,177,741.50	\$424,293.33	\$1,753,448.17
2011-12	1,555,008.50	368,496.01	2,939,960.66
2012-13 YTD	522,448.00	133,127.23	3,329,281.43
TOTAL	\$4,255,198.00	\$925,916.57	

Calculations are based on figures reported by TDLWD Fiscal Division in January 2013. Information was transferred into the report by Task Force members. In the event there are inaccuracies, please contact the TDLWD Fiscal Division for clarification.

Pursuant to Public Chapter 1030 of the Public Acts of 2012, which took effect January 1, 2013, the fee structure for workers' compensation exemption registrations and renewals changed as outlined below:

Type of Registration	Current Fee	New Fee
Workers' Compensation Exemption Registration for Non-Licensed Contractor	\$100	\$ 50
Construction Service Provider Registration for Non-Licensed Contractor	100	50
Workers' Compensation Exemption Registration for Licensed Contractor	100	50
Workers' Compensation Exemption Renewal for Non-Licensed Contractor	100	50
Construction Service Provider Renewal For Non-Licensed Contractor	100	50
Workers' Compensation Exemption Renewal for Licensed Contractor	100	50

Outlined in the chart below is the estimated number and revenue for renewals only of Workers' Compensation Exemption Registrations.

Fiscal Year	Estimated # of Renewals	Renewal Fee (Minimum)	Estimated Renewal Revenue
2012-13	3,140	\$50	\$157,000
2013-14	14,939	50	746,950
2014-15	7,170	50	358,500

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Task Force Committees:

Legal Committee
Dan Bailey, Chair

Education Committee
Lynn Ivanick, Chair

Enforcement Committee
Martha Campbell, Chair

Research and Resource Committee
William Canak, Chair

Insurance Committee
Mike Shinnick, Chair

The entire Task Force extends special thanks to everyone who participated and contributed their time and efforts toward encouraging fair competition among employers and eliminating employee misclassification in the construction industry. The Task Force could not have prepared the 2013 Annual Report without your assistance.

Tenn. Code Ann. § 50-6-913

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*** Current through the 2012 Regular Session ***

Title 50 Employer And Employee
Chapter 6 Workers' Compensation Law
Part 9 Construction Services Providers

Tenn. Code Ann. § 50-6-913 (2012)

50-6-913. Creation of employee misclassification education and enforcement fund -- Costs of administration.

(a) There is created a fund to be known as the "employee misclassification education and enforcement fund." Any fee collected pursuant to § 50-6-912(a) shall be deposited in the employee misclassification education and enforcement fund. Moneys in the fund shall be invested by the state treasurer in accordance with the provisions of § 9-4-603. The fund shall be administered by the commissioner of labor and workforce development.

(b) All costs of the secretary of state associated with the administration of this part shall be paid by the commissioner of labor and workforce development from the employee misclassification education and enforcement fund. Moneys remaining in the fund after such payment may be expended, subject to appropriation by the general assembly, at the direction of the commissioner of labor and workforce development for education of employers and employees regarding the requirements of this part and in support of the ongoing investigation and prosecution of employee misclassification.

(c) Any amount in the employee misclassification education and enforcement fund at the end of any fiscal year shall not revert to the general fund, but shall remain available for the purposes set forth in subsection (b). Interest accruing on investments and deposits of the employee misclassification education and enforcement fund shall be credited to such account, shall not revert to the general fund, and shall be carried forward into each subsequent fiscal year.

HISTORY: Acts 2010, ch. 1149, § 13.

Tenn. Code Ann. § 50-6-919

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*** Current through the 2012 Regular Session ***

Title 50 Employer And Employee
Chapter 6 Workers' Compensation Law
Part 9 Construction Services Providers

Tenn. Code Ann. § 50-6-919 (2012)

50-6-919. Employee misclassification advisory task force.

(a) There is created the employee misclassification advisory task force to study and make recommendations regarding issues relative to employee misclassification in the construction industry.

(b) The task force shall study issues relative to employee misclassification in the construction industry, including, but not limited to:

(1) The impact of employee misclassification on state and local governments of this state and the amount of state revenue, if any, that is lost or not collected due to employee misclassification;

(2) The lost earnings of the insurance industry due to employee misclassification;

(3) The estimates of the frequency of occurrence and economic impact of employee misclassification and whether particular industries are more likely to engage in the misclassification of employees;

(4) Whether state law should specify a uniform definition of the employment relationship and, if so, how it should be defined;

(5) Whether existing Tennessee laws aimed at preventing, investigating and taking enforcement action against the failure of employers to properly classify individuals as employees are effective;

(6) Whether there are ways to facilitate the sharing of information among agencies represented by task force members relative to violations of laws by employers who fail to classify individuals as employees;

(7) Whether there are new ways to pool, focus and target investigative and enforcement resources relative to employee misclassification;

(8) New strategies for systematically investigating the failure of employers to properly classify individuals as employees;

(9) Whether improvements are needed to facilitate the filing of complaints and identify potential violators, including, but not limited to, soliciting referrals and other relevant information from the public;

(10) Changes in the law, if any, that need to be made in order to ensure that agencies represented by task force members investigating the failure of employers to properly classify individuals as employees under their own statutory or administrative enforcement mechanism have the authority to refer a matter to other participating agencies for assessment of potential liability under the other agencies' relevant statutory or administrative enforcement mechanisms;

(11) Innovative ways to prevent misclassification of employees by employers, such as through disseminating

educational materials regarding the legal differences between independent contractors and employees;

(12) Methods by which public awareness of the illegal nature and harms inflicted by the failure of employers to properly classify individuals as employees can be increased; and

(13) Any other issues relative to employee misclassification in the construction industry.

(c) The task force shall seek public input and may conduct public hearings or appoint study groups as necessary to obtain information necessary to conduct its study.

(d) Membership on the task force shall be as follows:

(1) The commissioner of labor and workforce development or the commissioner's designee;

(2) The commissioner of commerce and insurance or the commissioner's designee; and

(3) The executive director of the board for licensing contractors or the director's designee.

(e) The secretary of state or the secretary of state's designee, the attorney general and reporter or the attorney general's designee, the chairman of the advisory council on workers' compensation or the chairman's designee, the executive director of the district attorneys general conference or the director's designee, and the director of the Tennessee bureau of investigation or the director's designee shall all serve as ex officio nonvoting members of the task force. The task force may appoint additional ex officio nonvoting members as it deems appropriate.

(f) The commissioner of labor and workforce development shall convene the first meeting of the task force on or after February 1, 2011, at which meeting the task force shall elect its officers from the voting members and otherwise organize itself as it deems appropriate.

(g) On or before February 1, 2012, and on or before February 1 annually thereafter, the task force shall submit a report on its findings and progress to the commerce, labor and agriculture committee of the senate, and the consumer and employee affairs committee of the house of representatives.

(h) To the extent permitted by law, every agency, department, office, division or public authority of this state shall cooperate with the task force and furnish such information that the task force determines is reasonably necessary to accomplish its purposes.

(i) In accordance with procedures set forth in the Uniform Administrative Procedures Act, compiled in title 4, chapter 5, part 2, the department of labor and workforce development, the department of commerce and insurance, and the board for licensing contractors may individually implement recommendations of the task force; provided, that such implementation is authorized under the existing statutory authority of the respective departments or board.

HISTORY: Acts 2010, ch. 1149, § 13.

Employee Misclassification Findings Provided by The Travelers Insurance Companies

There has long been much inconsistency with businesses in Tennessee as to how to classify its workers, be it an employee or an independent contractor.

The following table shows this inconsistency and the need for Tennessee to become more aggressive in its investigations of businesses from both a workers' compensation and unemployment insurance standpoint. The table represents businesses where workers' compensation audits were performed for the 12 month period October 1, 2011 to September 30, 2012.

Business Sector	Businesses w/ Workers' Comp	Businesses w/ State Unemployment Tax Filing	Percentage Properly Classified
Restaurants	6	6	100
Manufacturing	47	47	100
Mercantile	33	33	100
Trucking	14	7	50
Residential Construction	197	24	12.18
Commercial Construction	138	121	87.68
Healthcare	25	22	88
Other	79	78	98.79
TOTAL	539	338	62.71

These numbers are based on the work of only one auditor for a large insurance company. However, they should provide a glimpse of how businesses in the State of Tennessee are operating.

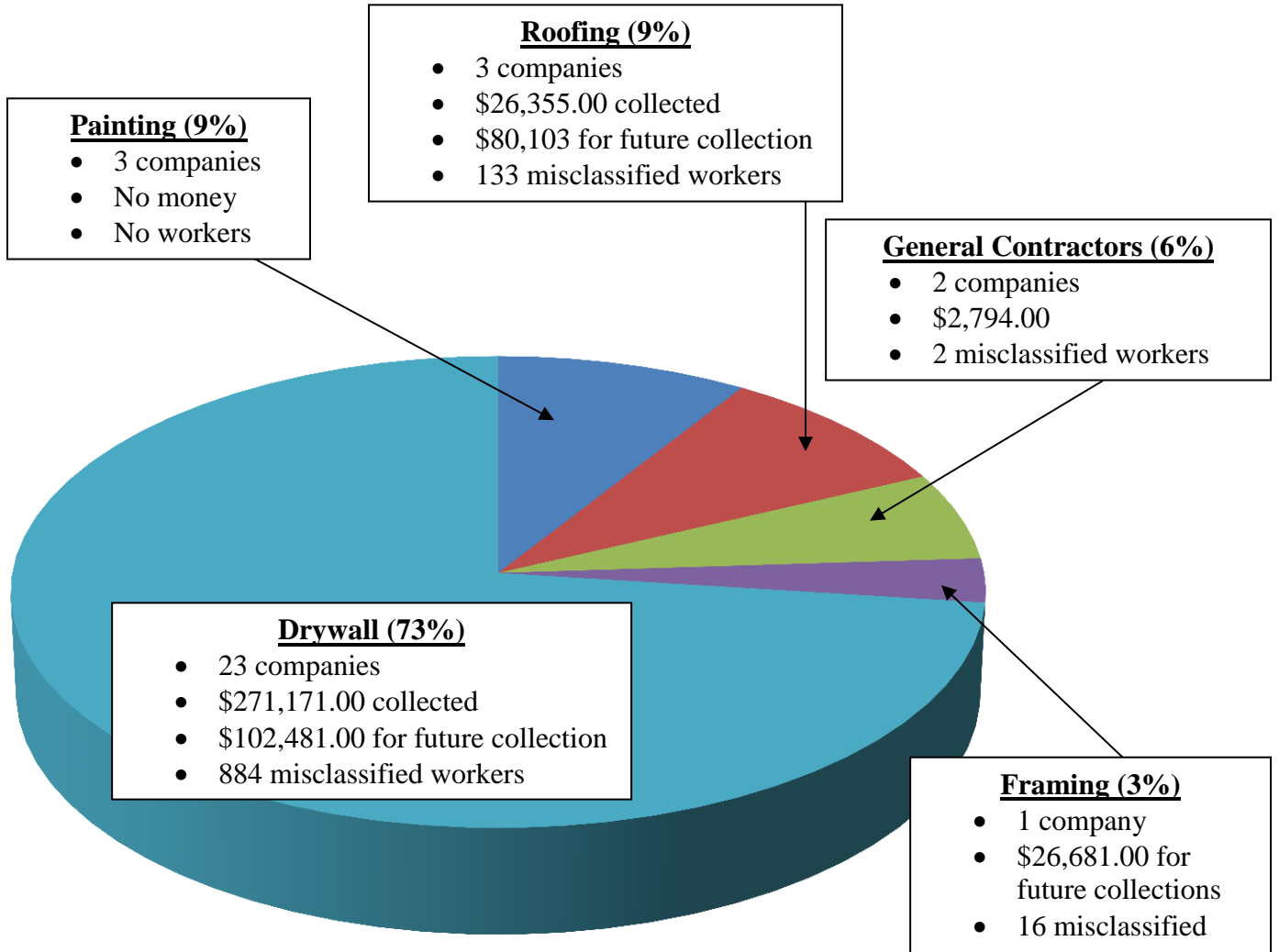
The Task Force has determined the need for state investigators to have computer software programs to enable them to access data that would allow them to identify employers that may not be classifying workers properly.

The above figures entitled "Percentage Properly Classified" represent the proportion of businesses that are classifying workers as employees for both workers' compensation and unemployment purposes that have been insured by Travelers. If a business has workers and has obtained a workers' compensation insurance policy to provide coverage to those workers, the same workers should be eligible for unemployment insurance, and the business should pay unemployment taxes in addition to workers' compensation insurance premiums. The table suggests that the trucking industry and the residential construction industry are not consistent. It should be noted that the majority of businesses misclassifying workers are smaller businesses. It is at this "grass roots" level that the misclassification begins and finds its way to the other business sectors such as commercial construction. If the state's investigators had the proper tools, they could easily identify the businesses that are not consistently classifying employees. If anything, the table above suggests that there is a problem with the misclassification of employees in Tennessee.

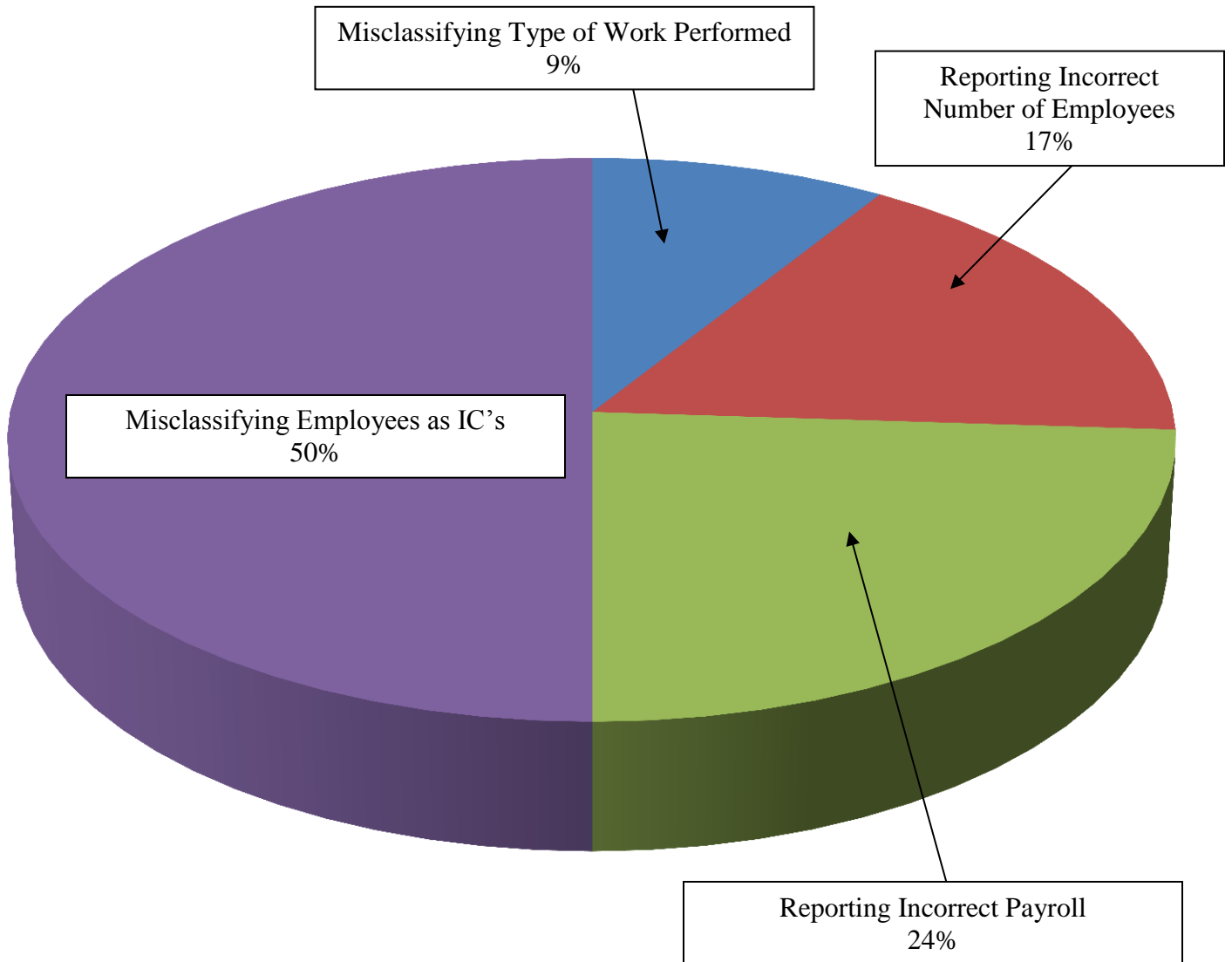
The above information was provided by Randy Thomas who has been a premium auditor for The Travelers Insurance Companies for 26 years.

Shared Investigations Results for Past 12 Months

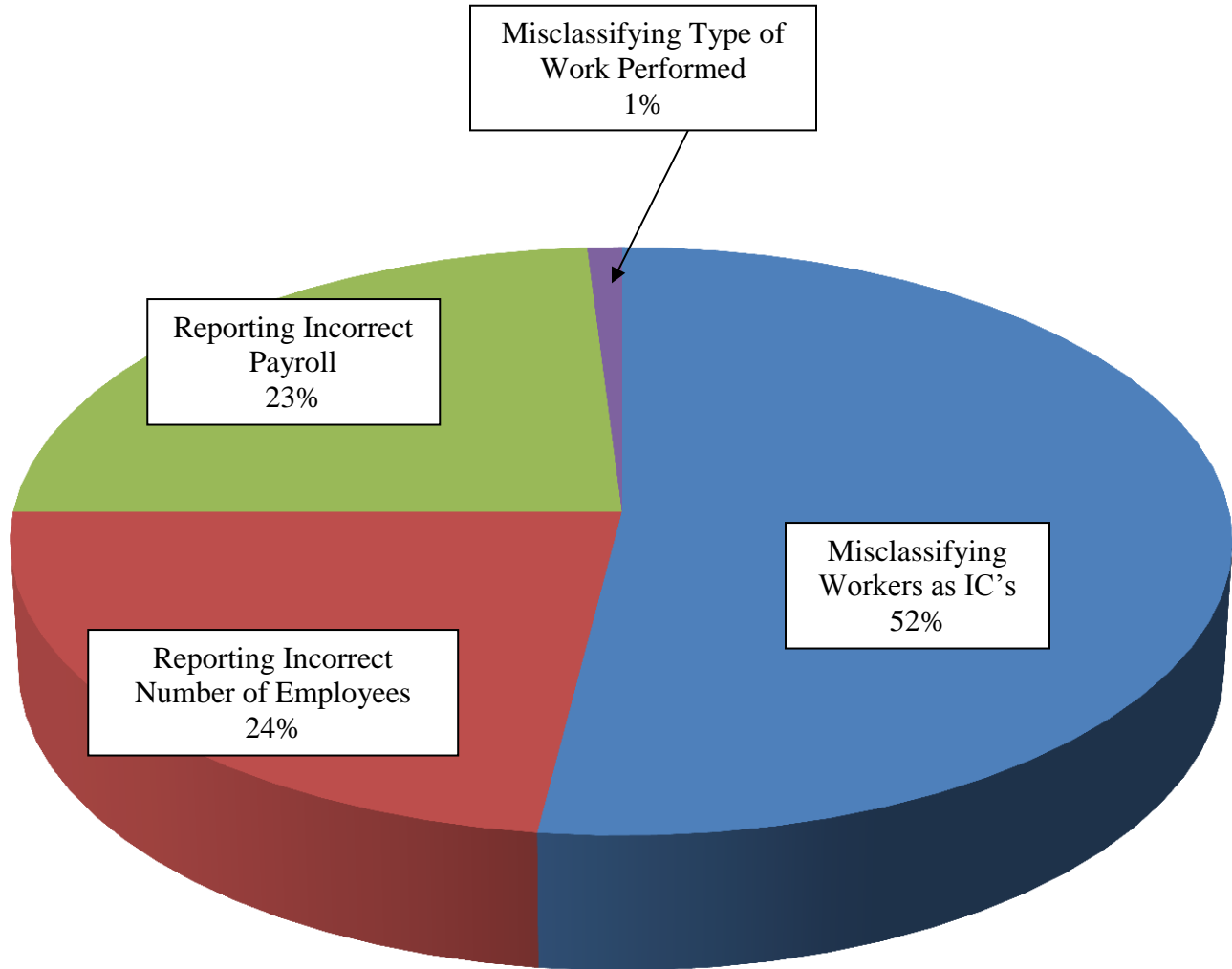
Middle TN Region
(July 2011 through July 2012)



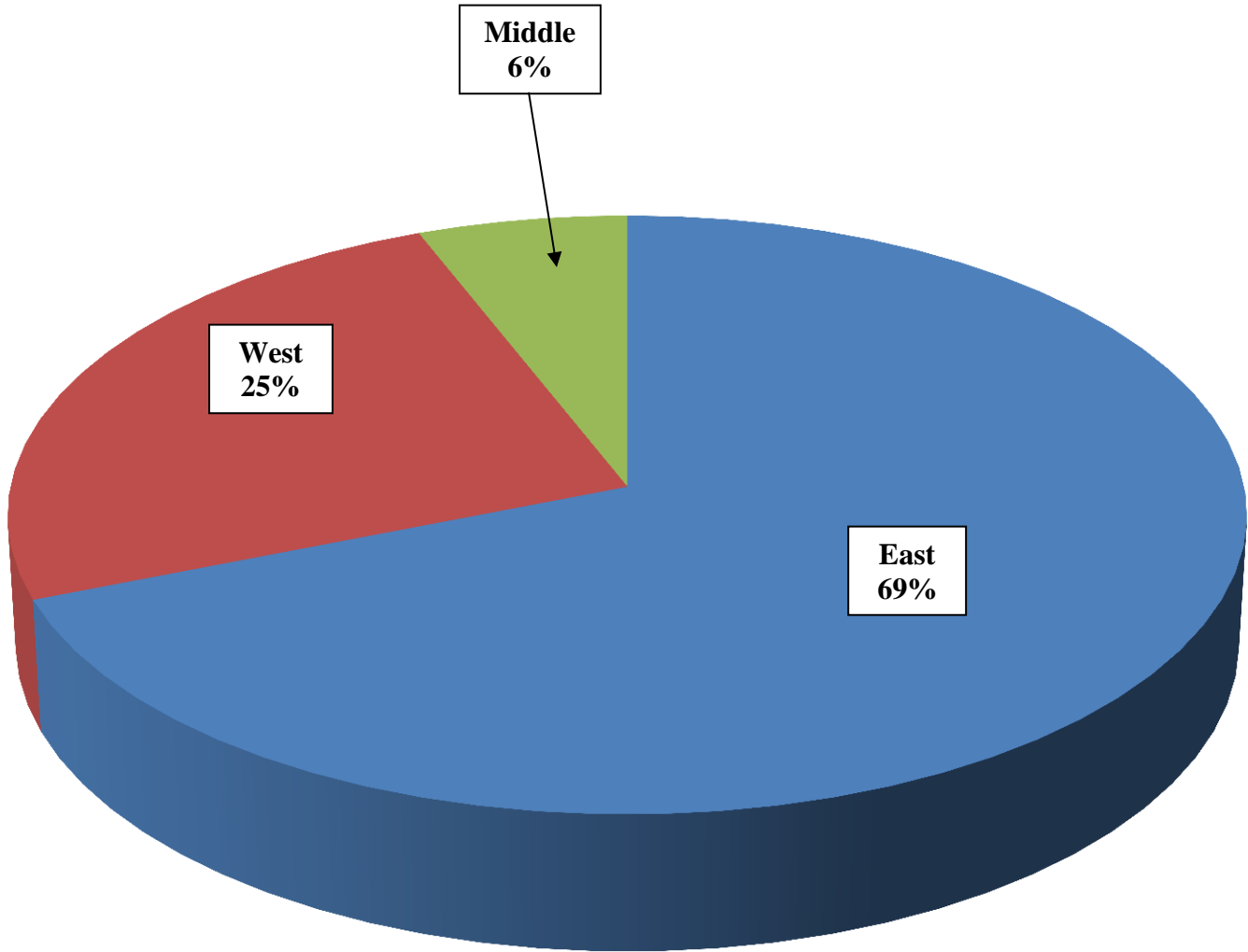
EMEEF Investigations (July 1, 2011 - June 30, 2012)



EMEEF Investigations (July 1, 2012 - October 31, 2012)

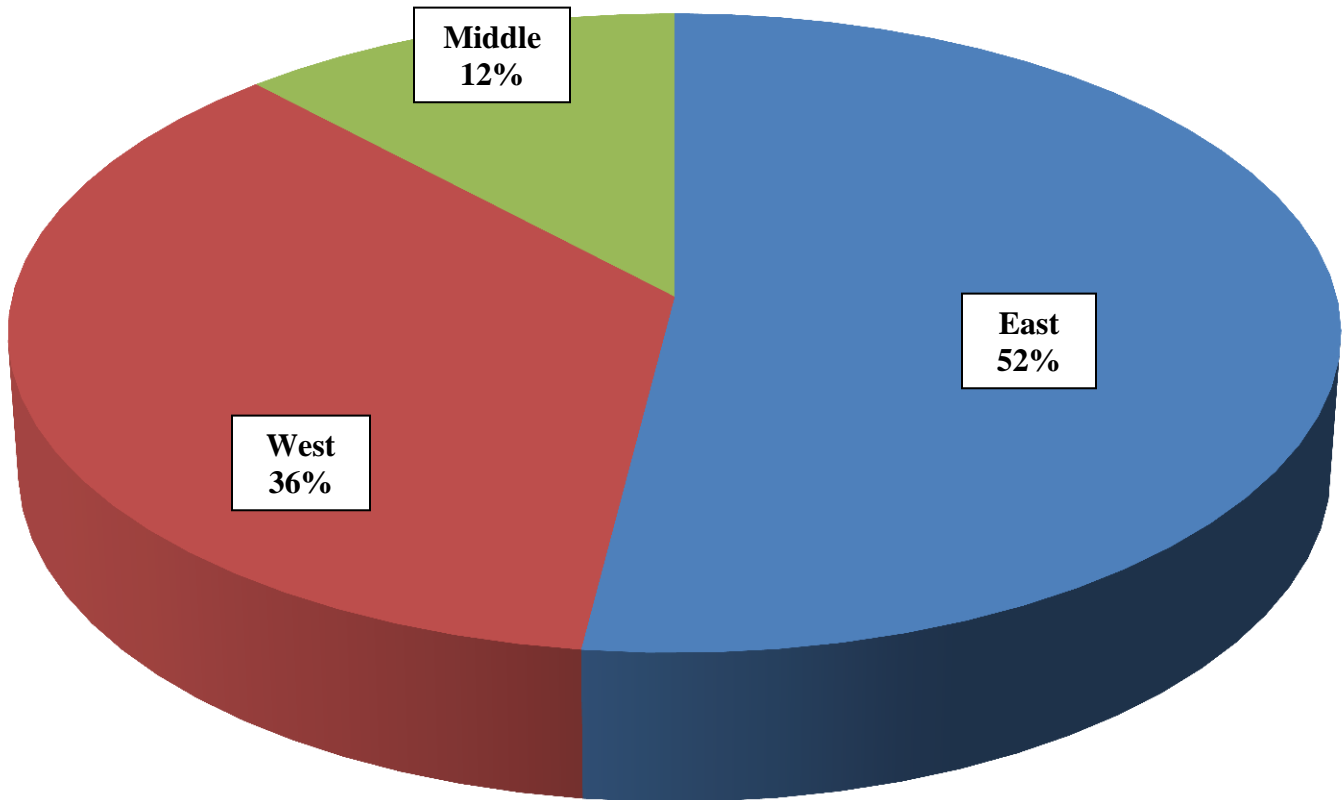


EMEEF Investigations by Territory (July 1, 2011 - June 30, 2012)



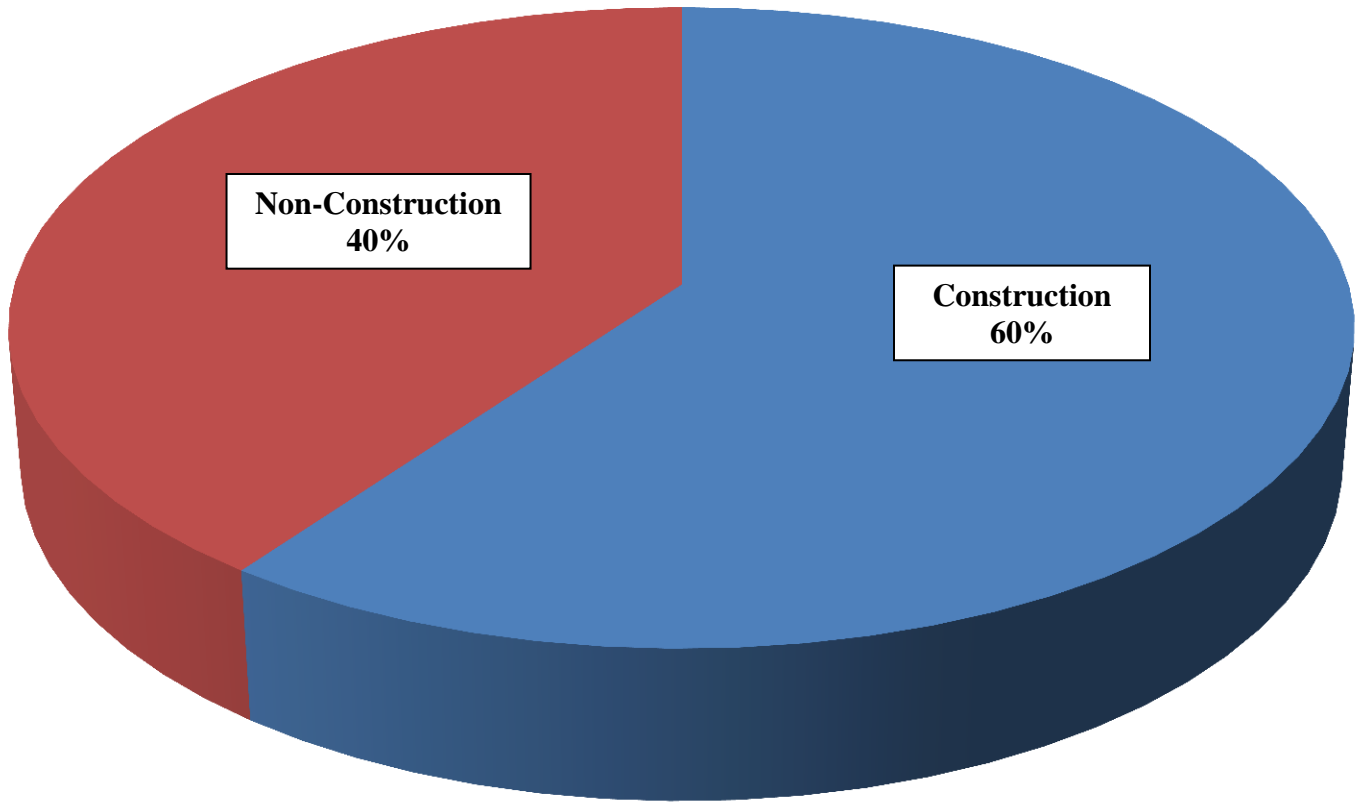
There are currently three investigators in the East Territory. However, there are only two each in the West and Middle Territories.

EMEEF Investigations by Territory (July 1, 2012 - October 31, 2012)

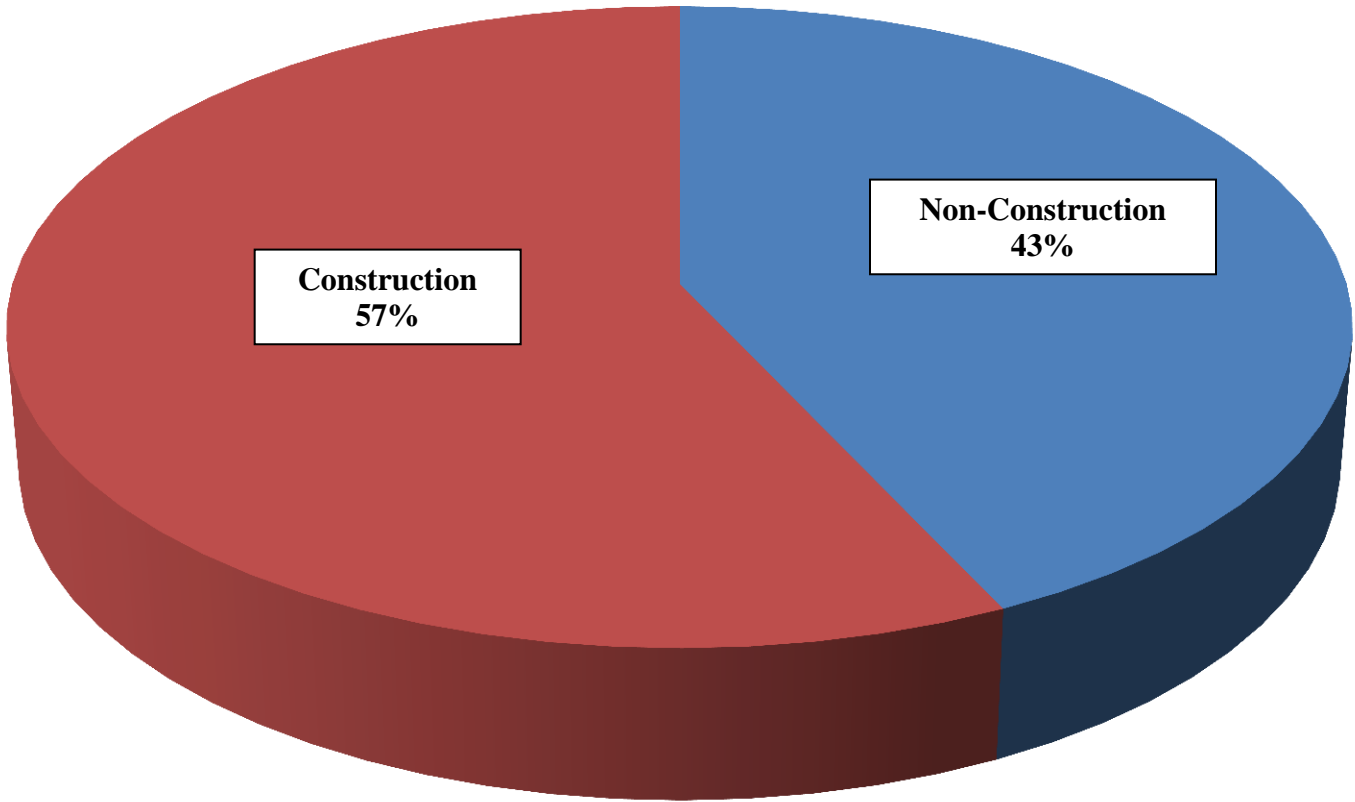


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EMEEF Industry Breakdown (July 1, 2011 - June 30, 2012)



EMEEF Industry Breakdown (July 1, 2012 - October 31, 2012)



The Tennessee Department of Labor and Workforce Development is committed to principles of equal opportunity, equal access, and affirmative action. Auxiliary aids and services are available upon request to individuals with disabilities.



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