DAVID Y. IGE
GOVERNOR

SHAN S. TSUTSUI
LIEUTENANT GOVERNOR

ELAINE N. YOUNG
ACTING DIRECTOR

LATE

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
830 PUNCHBOWL STREET, ROOM 321
HONOLULU, HAWAII 96813
www.labor.hawaii.gov
Phone: (808) 586-8844 / Fax: (808) 586-9099
Email: dlir.director@hawaii.gov

February 25, 2015

To: The Honorable Rosalyn H. Baker, Chair,
The Honorable Brian T. Taniguchi, Vice Chair, and
Members of the Senate Committee on Commerce and Consumer Protection

Date: Thursday, February 26, 2015
Time: 9:30 a.m.
Place: Conference Room 229, State Capitol

From: Elaine Young, Acting Director
Department of Labor and Industrial Relations (DLIR)

Re: S.B. No. 1219SD1 Relating to Employment Security

I. OVERVIEW OF PROPOSED LEGISLATION

SB1219SD1 proposes to replace the criteria commonly referred to as the "ABC test" in section 383-6, Hawaii Revised Statutes (HRS), with a new definition of "independent contractor." Services performed for remuneration are considered to be in employment under section 383-2, HRS, unless and until the three prongs of the test are met in the conjunctive. The ABC test, a statutory requirement since the beginning of the unemployment insurance (UI) program in 1939, has been essential in determining whether an individual is an employee or self-employed as an independent contractor.

Although SD1 addressed the department's objection to deleting the ABC test in the original measure by including the IRS test in presuming independent contractor status, the department remains strongly opposed to this proposal, which would raise conformity issues with federal laws. Failure of state law to conform with provisions of the Federal Unemployment Tax Act (FUTA) and the Social Security Act will result in the loss of federal administrative grants ($14,000,000) to operate the UI program and subject all employers to the full 6% of the FUTA payroll tax instead of .6%.

In recognition of some challenges in making these determinations, in February 2014 a committee was formed to develop written guidelines when examining

coverage cases (employment versus non-employment). The committee is still in the process of developing policies and procedures.

Further, once the concern was raised through the Circuit Court decision, the department took several steps to address the situation. The auditors that perform the work were provided legal training. The Administrator for the Employment Security Appels Referees' Office (ESARO), which reviews the appeals coming from the UI Division, has begun reviewing all decisions pertaining to coverage issues at the appeal level.

II. CURRENT LAW

Section 383-6, HRS, provides that services performed by an individual for wages or under any contract of hire shall be deemed to be employment subject to chapter 383, HRS, irrespective of whether the common law relationship of master and servant exists, unless it is shown to the department that the following criteria have been met in the conjunctive:

1. The individual has been and will continue to be free from control or direction over the performance of such service, both under the individual's contract of hire and in fact, and

2. The service is either outside the usual course of the business for which the service performed or that the service is performed outside all the places of business of the enterprise for which the service is performed, and

3. The individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the contract of service.

III. COMMENTS ON THE SENATE BILL

The Department opposes SB 1219SD1 because of the potential for increased FUTA payroll taxes for all employers and withholding of UI administrative grants to operate Hawaii's UI program if state law is not consistent with federal law.
The ABC test has been challenged over the years, but has remained undisturbed in the Hawaii Employment Security Law since its adoption in 1939 and its amendment in 1941 adding language to further expand coverage beyond where the common law relationship of master and servant exists. The Circuit Court decision in the Envisions case, which was the genesis for this measure, did not question the integrity of the ABC test as the legitimate method and means to determine the existence of employment.

Rather, the judge ruled that, in this factual situation, the department erred by not

doing its due diligence in applying its own regulations (§12-5-2, Administrative Rules) implementing section 383-6, HRS. Yet, based on the outcome of a single court case, SB1219SD1 deliberately deletes the ABC standard, the very foundation of the UI program, and proposes to replace it with a new definition that has yet to be tested and, in fact, continues to raise federal conformity issues.

This bill proposes to replace the ABC test with an optional certification and circumstantial presumption of independent contractor status. It provides that an individual who meets the four conditions may apply to the department for certification, which will be prima facie evidence of an independent contractor status, regardless of the circumstances under which services are performed for other individuals/employers. To be consistent with the requirements of Federal law, each employment relationship must be determined by the facts of each situation, not by a predetermined blanket certification that an individual possesses.

Should the certification process advocated in this measure result in exemption of services performed for government agencies, nonprofit organizations and tribal entities, a conformity issue may be raised with the United States Department of Labor (U.S.DOL). The sanctions for failure of state law to conform to federal statutes are decertification for employers to receive the FUTA tax offset credits and withholding of federal administrative grants to operate the state's UI program. Consequently, the FUTA payroll tax for all employers will increase tenfold, from .6% to the full 6.0%, and by losing over $14,000,000 in federal UI funds, no local offices will be functional to process benefits to eligible individuals.

Subsection (d) of the bill states that if a UI claim is filed, the burden shall be on the certified independent contractor to prove that an employer-employee relationship exists. This requirement raises a potential conformity issue with section 303(a)(1) of the Social Security Act which has been interpreted by the U.S.DOL as requiring states to take the initiative in discovering information regarding the circumstances surrounding an individual's unemployment and to obtain all the facts necessary to make a determination. Where the department does not fulfill its responsibility to make the determination and shifts that burden to the individual filing a claim for benefits, the state will jeopardize receipt of $14,000,000 in federal UI administrative grants.

Additionally, if the requirement of an independent contractor certification prevents or frustrates claimants from filing for UI benefits, another conformity issue with section 303(a)(1) Social Security Act would be raised.

The stability and strength of the UI program lies in its historical significance as remedial legislation to provide financial security to all workers suffering from loss of job income and serves to generate economic activity during recessionary periods. Although the department was ultimately reversed in the Envisions situation, the

determination that the services performed for that employer was considered "wages" resulted in increasing his UI benefit amount by $24 per week, or a total of $624 on his entire claim. While the purported intent of this measure is to clarify independent contractor status for employers who want to hire only those individuals who are certified by the department, it may seriously erode the protection of workers whose livelihoods may depend on a legitimate employment relationship and who truly benefit from that safety net when they find themselves out of work.

While proponents of this bill insist that UI coverage should be a matter of choice, a decision made by mutual agreement between an employer and an individual who will enter into agreement for performance of services. Though reasonable and logical on its face, there is a strong possibility that individuals who become certified as independent contractors may not fully realize the tax consequences and added out-of-pocket costs of paying 100% FICA taxes, medical coverage, liability insurance or other expenses related to being an independent contractor that an employer would normally cover. In addition, these persons will not have access to UI compensation, or potentially other benefits provided under existing labor laws, when most needed.

LATE

MAUI CHAMBER OF COMMERCE

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TESTIMONY IN SUPPORT OF SB1219 SD1
RELATING TO EMPLOYMENT SECURITY

TO THE SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION

Hawaii State Capitol, Conference Room 229
February 26, 2015
9:30am

Aloha Chair Baker, Vice Chair Taniguchi, and Members of the Committee:

I am writing to share our strong support of SB1219 in its original form to clarify who qualifies as an independent contractor with some amendments, which will strengthen the bill and address concerns raised by the Acting Director of the Department of Labor Director (DLIR) in a letter received from the US Department of Labor (USDoL).

Our intent is to protect legitimate independent contractors and those that hire them. We feel there are simple fixes to SB1219 that could be made to resolve the concerns raised by DLIR and information provided by the USDoL. The USDoL response raises two concerns:

- First, concern was raised with respect to Section 3309 entities. It appears the DLIR is extending USDoL's concern beyond the scope of 3309 entities (governmental entities, certain 501(c)(3) nonprofit organizations and Indian tribes), which we feel is misleading and incorrect. To address the concern regarding 3309 entities, SB1219 could except or exclude FUTA, Section 3309 entities from the Bill's application.
- Second, there is a concern of control, however, SB1219 does not eliminate the states test for independent contractor status and therefore does not conflict with Federal Law. It simply requires that DLIR follow the regulations they promulgated. Please see attorney Anna Elento-Sneed's Memorandum of February 8, 2015.

Therefore, we recommend the following modifications to the original form of SB1219:

- Reinstate the ABC test in sub-section (a) – to address DLIR and USDoL comments;
- Leave sub-section (b), (c) and (d) intact;
- Add a Section to SB1219 to specifically exclude FUTA, Section 3309 entities from the Bills application to address USDoL comments;
- Eliminating (b) (2) – In our efforts to clarify who is an independent contractor for DLIR purposes, the DCCA registration requirement in (b)(2) of the Bills (SB1219 and HB1213) have raised some unintended concerns and confusion by sole proprietors who are not currently required to "register" with the DCCA. To some sole proprietors, this criteria appears to add yet another requirement to existing law. Therefore, we recommend removing this requirement from sub-section (b) as will not affect current business filing requirements, or dilute the objective of the Bill.
- Amending Section (c) to: (c) An individual who meets the requirements for independent contractor status under SUBSECTION (A) OR SUBSECTION (B) OF this section shall be certified by the department as an independent contractor. The individual shall provide a written copy of the certification to each customer to whom the individual provides service. - The additional language would clarify that subsection (a) (the department test) and subsection (b) (the new, feasible factor test) are alternative tests that each establish a separate, legally-recognized basis for IC certification.

TESTIMONY TO THE SENATE COMMITTEE ON COMMERCE AND CONSUMER PROTECTION
By the Maui Chamber of Commerce
Hawaii State Capitol, Conference Room 229
February 26, 2015
9:30am

- Amending Section (d) to: (d) If a certified independent contractor files a claim for unemployment insurance benefits against a customer pursuant to this chapter, the burden shall be on the certified independent contract OR to prove that an employer-employee relationship exists BY CLEAR AND CONVINCING EVIDENCE. - While the proposed legislation attempts to address a "presumption" of IC status via shifting the burden to prove employment status to the person claiming that the IC certificate should not be valid, it does not prohibit the claimant or the state from attempts to overcome the presumptive IC status within the certification process where the agency deems that the facts of a case involving a certificated IC warrant a finding of employment status. By including within the legislation a greater standard of proof (i.e., clear and convincing evidence) must be met by the claimant and/or the agency in order to overturn a claimant's IC certification under Section (a) or (b), the greater threshold of proof would discourage frivolous claims. It also offers additional protection from attempts to usurp the certification process.
- Adding an effective date of January 1, 2016.

By passing this bill with these amendments, we can address concerns so that all parties can move forward with the business relationships they agree to, knowing at the outset where they stand with the State and avoid unintended consequences.

Mahalo nui loa for the opportunity to provide testimony on this bill. We ask for your strong support of SB1219 to clarify who is an independent contractor and rectify ongoing problem of improper rulings by DLIR.

Sincerely,

Pamela Tumpap

Pamela Tumpap
President

LATE

Chamber of Commerce HAWAII
The Voice of Business

Testimony to the Senate Committee on Commerce and Consumer Protection
Thursday, February 26, 2015 at 9:30 A.M.
Conference Room 229, State Capitol

RE: SENATE BILL 1219 SD1 RELATING TO EMPLOYMENT SECURITY

Chair Baker, Vice Chair Taniguchi, and Members of the Committee:

The Chamber of Commerce of Hawaii ("The Chamber") **supports the intent of** SB 1219 SD1, which allows the department of labor and industrial relations to set criteria for independent contractor status and establishes criteria for when the department shall presume an individual is an independent contractor. Further requires the department to certify independent contractors and allows the independent contractors to provide a written copy of certification to each customer. Also places the burden of proving an employer-employee relationship on the certified independent contractor if the contractor files an unemployment insurance benefits claim against a customer.

The Chamber is the largest business organization in Hawaii, representing about 1,000 businesses. Approximately 80% of our members are small businesses with less than 20 employees. As the "Voice of Business" in Hawaii, the organization works on behalf of members and the entire business community to improve the state's economic climate and to foster positive action on issues of common concern.

The Chamber believes independent contractors are an important part of Hawaii's business community and economy. We have seen too much of a broad interpretation in the current law as to who qualifies as an independent contractor vs. an employee of a company. As more independent contracts are emerging in the ever-changing economic environment, clarification of who qualifies as an independent contractor would offer proper protection to legitimate independent contractors and the business that they contract with.

Thank you for the opportunity to testify.

1132 Bishop Street, Suite 2105 • Honolulu, Hawaii 96813 • Phone: (808) 545-4300 • Facsimile: (808) 545-4369