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M E M O R A N D U M

To: Senate Committee on Economic Development, Housing and General Affairs
CC: Senator Richie Westman, Chair of the Senate Transportation Committee
Senator Wendy Harrison, Chair of the Senate Institutions Committee
Wanda Minoli, Commissioner of Building General Services
From: Commissioner Michael Harrington, Vermont Department of Labor
Date: March 24, 2025
Subject: Overview of misclassification as it relates to S.125 and prevailing wage

While we understand the Committee voted out language on certified payroll on March 21st, we hope that this memo is still a helpful reference for any further deliberations. Should the goal of this legislation be to combat the improper coding of employees using the prevailing wage occupational scale, it is important to note that the use of the term employee misclassification denotes a very different and highly contested process of determining the relationship between employers and employees, and when an individual should be considered an employee or an independent contractor.

If the intent is to combat true employee misclassification for State-funded construction projects, the information below explains how the Vermont Department of Labor (VDOL) currently understands the term 'misclassification' and what we currently do to combat it.

I would like to reiterate from our memo sent on March 13th that this change will place a significant administrative burden on contractors and state government to accomplish the frequent reporting, prescribed recordkeeping, and regular evaluation of weekly wages by occupational code that would be required to address miscoding concerns. Overarchingly, we do not have the scale of other states who may have similar systems in place, and share the concerns of our sister Agencies – Transportation and Building and General Services – that this measure would likely significantly limit the number of contractors willing to bid on state contracts.

Summary

Employee misclassification, as opposed to miscoding,[1] is used by VDOL and is generally understood to be the practice of purposefully treating individuals who ought to be, by law, employees of a business but instead are classified as independent contractors. By so doing, a business avoids the time and expense of putting the individual on payroll, withholding deductions mandated by law, and assuming certain liabilities

[1] Miscoding, as opposed to misclassification, is the practice of improperly assigning the wrong NAICS code to a business's employees to obtain a lower workers' compensation insurance rate. The insurance industry combats miscoding through annual audits of its insureds.

such as unemployment insurance contributions and workers' compensation premiums. This can work to the detriment of the individual worker should they get laid off, fired, or injured at work.

In acknowledging the problem of employee misclassification, the General Assembly created the Employee Misclassification Task Force and vested joint enforcement authority with the Attorney General through Act 85 of the 2019 Adjourned Session.

Statutory Tests

The statutes enforced by VDOL to combat misclassification differ based on the program. Both the Unemployment Insurance Division and the Wage and Hour Program rely on the so-called "ABC Test," set forth in 21 V.S.A. §§ 341 and 1301(6)(B):

Services performed by an individual for wages shall be deemed to be employment subject to this chapter unless and until it is shown to the satisfaction of the Commissioner that:

> (i) The individual has been and will continue to be free from control or direction over the performance of the services, both under the individual's contract of service and, in fact;
>
> (ii) The service is either outside the usual course of the business for which the service is performed, or the service is performed outside of all the places of business of the enterprise for which the service is performed; and
>
> (iii) The individual is customarily engaged in an independently established trade, occupation, profession, or business.

The Workers' Compensation Act recognizes that a sole proprietor or a partnership can be treated as an independent contractor and not an employee if it meets the requirements of 21 V.S.A. § 601(F):

> (i) The individual performs work that is distinct and separate from that of the person with whom the individual contracts.
>
> (ii) The individual controls the means and manner of the work performed.
>
> (iii) The individual holds themselves out as in business for themselves.
>
> (iv) The individual holds themselves out for work for the general public and does not perform work exclusively for or with another person.
>
> (v) The individual is not treated as an employee for purposes of income or employment taxation with regard to the work performed.
>
> (vi) The services are performed pursuant to a written agreement or contract between the individual and another person, and the written agreement or contract explicitly states that the individual is not considered to be an employee under this chapter, is working independently, has no employees, and has not contracted with other independent contractors. The written contract or agreement shall also

> include information regarding the right of the individual to purchase workers' compensation insurance coverage and the individual's election not to purchase that coverage. However, if the individual who is party to the agreement or contract under this subdivision is found to have employees, those employees may file a claim for benefits under this chapter against either or both parties to the agreement.

However, in 21 V.S.A. § 601(3), the Workers' Compensation Act recognizes the concept of a 'statutory employer,' meaning that a general contractor may assume workers' compensation liability for any uninsured subcontractor working for them.

The Workers' Compensation Act also allows up to four corporate officers or up to four LLC members to exclude themselves from the Act's provisions by filing for such exclusions with VDOL.

Enforcement

VDOL enforces misclassification in several ways. The Unemployment Insurance Division has a staff of eight auditors who conduct annual audits of approximately 2% of Vermont employers annually. The Wage and Hour Program has two claims examiners who respond to complaints of unpaid or underpaid wages. Finally, the Workers' Compensation Division has three field investigators who cite employers for failure to carry valid workers' compensation policies. The number of audits and investigations conducted, the amount of misclassification identified, and the monetary penalties assessed are contained in the Annual Worker Misclassification Report of the Attorney General, filed with the General Assembly on January 15, 2025: https://legislature.vermont.gov/assets/Legislative-Reports/AGO-2025-Act-85-Misclassification-Report-1-10-25.pdf

From October 2023 through September 2024, the Workers' Compensation Division opened 131 misclassification investigations and issued 35 citations totaling $168,710.00. During the same period, the Unemployment Insurance Division conducted 306 investigations and 61 audits, identified 49 separate instances of misclassification affecting 301 employees, assessed unpaid UI contributions in the amount of $25,332.00, and assessed interest and penalties for violations in the amount of $44,871.00.

Conclusion

VDOL is actively working to reduce employee misclassification by dedicating staff to investigating complaints, performing targeted audits, and monitoring NCCI reports of dropped or canceled policies. In addition, VDOL's website contains resources to help employers educate themselves on the risks of misclassification, and the Department is working on increasing public awareness around employee classification.