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May 16, 2016

The Honorable Lawrence J. Hogan, Jr.
Governor of Maryland
State House
100 State Circle
Annapolis, Maryland 21401

RE: Senate Bill 777, "Unemployment Insurance – Exemption From Covered Employment – Messenger Service Business"

Dear Governor Hogan:

We have reviewed for constitutionality and legal sufficiency Senate Bill 777, "Unemployment Insurance – Exemption From Covered Employment – Messenger Service Business." The U.S. Department of Labor ("DOL") advised the Maryland Department of Labor, Licensing and Regulation ("DLLR") that Senate Bill 777 will put Maryland out of compliance with federal law if enacted. Based on this correspondence, the Secretary of DLLR, in a letter dated April 20, 2016, provided assurances to DOL that she will instruct her staff to "construe, interpret, and apply [the bill] in a manner that ensures full conformity with Federal law." Today DOL accepted Maryland's assurances, see attached letter, and as a result, we can hereby approve Senate Bill 777 for constitutionality and legal sufficiency so long as DLLR meets its assurances. We recommend, however, that the General Assembly amend the provisions next session to bring State law in conformity with federal unemployment insurance law.

Current Law Applicable to a Messenger Service Business

Current State law contains a limited exemption to covered employment applicable to drivers working for certain messenger service businesses. Labor and Employment Article ("LE"), § 8-206(d). For purposes of the exemption, "messenger service business" offers expedited, time critical delivery; may not make, produce, or distribute what it sells; and, may not have an exclusive contractual delivery arrangement with an individual or a commercial establishment. LE § 8-206(d)(1). Further, exempt drivers must be working

under a written agreement providing that drivers are free to work for more than one person engaged in the messenger service business, free to accept or reject delivery jobs, provide their own vehicles, be paid by commission only, set personal work hours, and acknowledge through the written agreement that the work is not covered employment and that there are State and federal tax consequences as a result of this status. LE § 8-206(d)(2).

Current law also outlines parameters of the actual work performed by exempt messenger service companies. The work is exempt for drivers providing services for a business meeting the other conditions of the statute if the driver is delivering “to the public or commercial establishment on foot, by bicycle, or by motor vehicle” the following:

- (i) individually addressed mail, messages, and documents in paper or magnetic format; and
- (ii) emergency medical supplies, records, parcels, or similar items if the messenger service business provides to the Secretary evidence of a worker status determination from the Internal Revenue Service or other evidence that the messenger service driver is excluded from coverage under the Federal Unemployment Tax Act.

LE § 8-206(d)(3).

Changes Proposed by Senate Bill 777

Senate Bill 777 expands the exemption in current law two ways. First, it broadens the scope of businesses to which the exemption applies by eliminating the requirement found in current law that a messenger service business may not “have an exclusive contractual delivery arrangement with an individual or a commercial establishment.” Second, the bill specifies certain payment arrangements to be “payment by commission only” meeting the requirements of LE § 8-206(d)(2)(v).

In addition, Section 2 of the bill requires retroactive application of the changes. Section 2 states:

That § 8–206(d) of the Labor and Employment Article, as enacted by Section 1 of this Act, shall be construed to apply retroactively and shall be applied to and interpreted to affect all determinations by the Secretary of Labor, Licensing, and Regulation of:

- (1) rates of contributions for employing units for all calendar years beginning on or after January 1, 2013; and
- (2) benefit charges for unemployment insurance claims for benefits based on work performed on or after January 1, 2013.

Federal Law Conformity Issues

The DOL notified DLLR in a letter dated March 4, 2016, that Senate Bill 777, if enacted, would put Maryland out of conformity with federal law because the bill exempts from State law coverage government and nonprofit workers who are required by federal law to be covered. DOL's concerns were reiterated in an email dated March 24, 2016. On April 11, 2016, DOL sent an additional email to DLLR again noting its concerns about the application of Senate Bill 777 to government and nonprofit workers and raising, for the first time, a second conformity issue involving the retroactive effect of Senate Bill 777. With regard to the retroactive application of the bill, DOL noted that it would permit the removal of benefit charges for benefits paid to messenger service drivers working in covered employment under the law at the time the benefits were paid, but who would be subsequently exempt from coverage by the retroactive reach of the bill, in violation of federal law requirements for experience rating. If Maryland does not conform to the requirements of federal law, the result is the loss of certification for tax credits for all employers (mostly private sector) liable for the § 3301 Federal Unemployment Tax Act ("FUTA") tax. In addition, there is a potential for loss of all federal administrative funding provided to the State to administer the unemployment insurance program if DOL were to initiate conformity proceedings resulting in a determination that State law does not conform to federal law. FUTA § 3303(a)(1).

Federal law requires that all services performed by workers of state and local entities, certain nonprofits organizations, and federally recognized Indian tribes must be covered by State law unless specifically exempted by Federal law. FUTA § 3304(a)(6)(A). If a state law contains an exclusion from employment not found in the FUTA, then that exclusion may not be applied to § 3304(a)(6)(A) services. Likewise, if a state law definition of employee results in more exclusions from coverage than would occur under the federal common law test, then the state may not apply that test to § 3304(a)(6)(A) services. This means that states are free to enact exemptions from state unemployment insurance coverage applicable to private companies, but workers performing services for state and local entities, certain nonprofits organizations, and federally recognized Indian tribes must be covered if the services would be covered by federal law.

Senate Bill 777 does not remove individuals performing services for state and local entities, certain nonprofits organizations, and federally recognized Indian tribes from the scope of the bill. Nor does the bill provide for a determination for these types of workers whether they are working in covered employment with the definition of employment under the FUTA. As a result, if state law does not cover services performed by state and local entities, certain nonprofits organizations, and federally recognized Indian tribes as required by federal law, all employers liable for the § 3301 FUTA tax (mostly private sector) lose certification for tax credits. Additionally, the State could lose all federal administrative funding provided to administer the unemployment insurance program if DOL initiates conformity proceedings which result in a determination that State law does not conform to federal law requirements for administration of the unemployment insurance program.

In addition, DOL raised a serious concern about the retroactive language in Section 2 of Senate Bill 777. Federal law imposes a payroll tax on every employer equal to a percentage of a specified amount of wages per calendar year. FUTA § 3301. When a state has established an unemployment insurance program that meets the requirements of federal law, employers paying into the state system receive two credits toward the FUTA tax owed. The first credit is the “normal credit,” which is the dollar for dollar reduction of FUTA tax liability based on monies paid into the state system. FUTA § 3302(a)(1). The second credit is available under FUTA § 3302(b). The additional credit allows employers to credit the difference between 90% of the FUTA tax owed and the amount actually paid into the state system. For a state’s employers to qualify for the additional credit, state law must have been certified by the Secretary of DOL to the Secretary of the Treasury under FUTA § 3303(b)(1) for a 12-month period ending on October 31 of a taxable year, based on a finding “that reduced rates of contributions were allowable with respect to such 12-month period, only in accordance with the provisions of” § 3303(a)(1). That provision requires a reduced rate of contribution to be based on factors bearing a direct relation to the employer’s experience with unemployment risk.

According to the DOL, the retroactivity language would permit the removal of benefit charges for benefits paid to message service drivers working in covered employment under the law at the time the benefits were paid, but who would be now exempt from coverage under Senate Bill 777. Simply put, DLLR would remove charges for retroactively exempt drivers, resulting in reduced rates for employers that do not reflect the employers’ actual experience with unemployment risk. While federal law does not prohibit states from exempting services performed for private employers from unemployment insurance coverage under state law, once benefits are actually paid to workers for work in covered employment, these benefits must be charged and reflected in assigned rates. The retroactivity provisions in Senate Bill 777 will mean that Maryland will

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not have an experience rating system that provides for reduced rates only with respect to factors reflecting an employer's actual experience with unemployment risk. As a result, DOL could determine that Maryland is out of conformity with federal law, causing the State to lose the additional credit for all Maryland employers.

The Secretary of DLLR has written to DOL assuring the agency that DLLR will interpret Senate Bill 777 in conformity with federal law. Based on DOL's acceptance of Maryland's assurances, we can hereby approve Senate Bill 777 for constitutionality and legal sufficiency. We recommend, however, that the General Assembly amend the provisions next session to bring it in conformity with federal unemployment insurance law.

Sincerely,

A handwritten signature in cursive script, reading "Brian E. Frosh".

Brian E. Frosh
Attorney General

BEF/SBB/kk

cc: The Honorable John C. Wobensmith
Joseph M. Getty
Warren Deschenaux

U.S. Department of Labor

Employment and Training Administration
200 Constitution Avenue, N.W.
Washington, D.C. 20210



Ms. Kelly M. Schulz
Secretary of Labor
Department of Labor, Licensing
And Regulation
500 N. Calvert St. Room 401
Baltimore, Maryland 21201

Dear Secretary Schulz:

I received your letter dated April 20, 2016, regarding Senate Bill (SB) 777 that would amend Maryland's unemployment insurance law by expanding an exemption from covered employment applicable to certain messenger service drivers working for certain messenger service companies. Additionally, the bill contains uncodified language giving it retroactive effect. We are aware that this legislation has been enrolled and that Maryland no longer has an opportunity during this legislative session to amend or make changes to the bill.

In your letter, you provide assurances that if SB 777 is enacted, you will instruct your staff to "construe, interpret, and apply it in a manner that ensures full conformity with Federal law." You note that Maryland law expressly requires you to interpret the law in a manner that ensures conformity with Federal law.

The U.S. Department of Labor accepts Maryland's assurance that if enacted, Maryland will interpret its law, as amended by SB 777, in accordance with the requirements of Federal UC law. We look forward to working with Maryland during the 2016-2017 session of the legislature to amend the law and resolve any potential future issues.

Please contact Paul Fox, your Regional Office's legislative liaison, at (215)-861-5292, or by e-mail at Fox.Paul@dol.gov should you have any questions regarding this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Gay M. Gilbert".

Gay M. Gilbert
Administrator
Office of Unemployment Insurance

cc: Leo Miller
Regional Administrator
Philadelphia