HB 465

Department of Legislative Services
Maryland General Assembly
2024 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 465 (Delegate Boafo, *et al.*)
Economic Matters Finance

Workplace Fraud and Prevailing Wage - Violations - Civil Penalty and Referrals

This bill increases the maximum civil penalty from $5,000 to $10,000 for each employee that an employer is found to have knowingly failed to properly classify under the Workplace Fraud Act. On a showing of clear and convincing evidence that a relevant Workplace Fraud Act or State Prevailing Wage Law violation has occurred, the Commissioner of Labor and Industry must refer any complaint that alleges a violation of specified tax withholding and tax fraud provisions in the Tax-General Article to the Comptroller, the State's Attorney with jurisdiction over the alleged violation, the U.S. Department of Justice, the U.S. Department of Labor (USDOL), and the U.S. Department of the Treasury.

Fiscal Summary

State Effect: General fund revenues may increase beginning in FY 2025 due to the bill's increased penalty provision, increased compliance with the Workplace Fraud Act, and additional tax compliance referrals, as discussed below. General fund expenditures may also increase due to tax compliance referrals beginning in FY 2025.

Local Effect: The bill does not materially affect local government finances or operations.

Small Business Effect: Potential meaningful.

Analysis

Current Law:

Workplace Fraud Act

Chapter 188 of 2009 (the Workplace Fraud Act) established, for the purpose of enforcement only, a presumption that work performed by an individual paid by an employer creates an employer-employee relationship, subject to specified exemptions. It prohibits construction companies and landscaping businesses from failing to properly classify an individual as an employee and establishes investigation procedures and penalties for noncompliance.

The "ABC test" incorporated in the Workplace Fraud Act is used by the Maryland Department of Labor (MDL) to establish whether an employer-employee relationship exists for the purpose of determining whether an employee has been misclassified under the Act. While only used to detect workplace fraud in the specified industries, MDL is required to use the ABC test in determining whether an individual is an employee in any industry for the purpose of determining whether the employer should pay unemployment insurance for the individual. The ABC test has three components, all of which must be met to establish that an individual is an independent contractor and not an employee:

A. the individual is free from control and direction over his or her performance both in fact and under the contract (Alone);
B. the individual customarily is engaged in an independent business or occupation (Business); and
C. the work performed is outside the usual course of business, or outside the place of business, of the person for whom work is performed (Control).

The Act distinguishes between an employer who improperly misclassifies an employee and an employer who knowingly misclassifies an employee, and civil penalties are more severe for an employer who is guilty of knowingly misclassifying an employee. The maximum penalty for a knowing violation is a $5,000 fine for each employee who was not properly classified. The Commissioner of Labor and Industry or the administrative law judge must consider specified factors when determining the penalty amount. Penalties can be doubled for employers who have previously violated the Act's provisions. An employer who has been found to have knowingly misclassified employees on three or more occasions may be assessed an administrative penalty of up to $20,000 for each misclassified employee.

Prevailing Wage

Contractors and subcontractors working on eligible public works projects in Maryland must pay their employees the prevailing wage rate. "Public works" are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money.

The commissioner has the authority to enforce contractors' compliance with the prevailing wage law, including assessing liquidated damages of $250 per day per employee that is not paid the proper prevailing wage. See the **Appendix – Maryland's Prevailing Wage Law** for additional information.

Penalties for Specified Tax Violations

Among other related penalties, a person who is required to withhold income tax and who willfully fails to withhold the tax as required under Title 10 of the Tax-General Article is guilty of a misdemeanor and subject to a maximum penalty of a $10,000 fine and/or five years imprisonment.

Generally, a person who willfully or with the intent to evade payment of a tax under the Tax-General Article, or to prevent the collection of the tax, fails to provide information as required or provides false or misleading information is guilty of a misdemeanor and subject to a maximum penalty of a $5,000 fine and/or 18 months imprisonment.

Joint Enforcement Task Force on Workplace Fraud

Executive Order 01.01.2024.04, dated January 9, 2024, establishes the Joint Enforcement Task Force on Workplace Fraud to coordinate the investigation and enforcement of workplace fraud. Among its charges is to facilitate data sharing among task force members, including maintaining an inter-agency online platform to share such information. The task force must report to the Governor by December 31 of each year as specified in the executive order; the report must, among other things, identify successful strategies for preventing workplace fraud that reduce the need for greater enforcement.

State Fiscal Effect: General fund revenues may increase minimally beginning in fiscal 2025 from increasing the civil penalty for knowingly misclassifying employees. To the extent that increasing the penalty strengthens its deterrent effect, increased compliance with the Workplace Fraud Act may generate increased tax revenues, thereby increasing general fund revenues. Any increase in unemployment trust fund contributions from increased compliance likely does not materially affect the Unemployment Insurance Trust Fund.

The bill does not substantively change the inspection process or the method by which wage and hour inspectors enforce the prevailing wage or worker classification laws. MDL has a portal to refer Workplace Fraud violations to the Comptroller for investigation, and MDL is working with the Joint Enforcement Task Force on Workplace Fraud to develop a protocol for these referrals. MDL already has an established referral/escalation process with USDOL and can create and implement a new referral process with the other federal agencies with existing resources.

While the bill may increase compliance with the Workplace Fraud Act due to strengthening the civil penalty for a knowing violation, any violations that do occur must be referred to the Comptroller, along with Prevailing Wage violations. Thus, if the bill results in additional violations being referred to the Comptroller, then the Comptroller would require at least one additional compliance-related staff, at an annual general fund cost, per staff, of approximately $88,000 to $100,000 over the next five years. In that case, general fund revenues may also increase to the extent that additional tax audits result in additional assessments and collection of unpaid income taxes. However, MDL advises that it is already strengthening enforcement of the Workplace Fraud Act independent of the bill, so it is unclear if any future increase in referrals to the Comptroller would be attributable to the bill or to current efforts.

Small Business Effect: Small businesses covered under the Workplace Fraud Act are subject to an increased civil penalty for knowing violations. At a minimum, this may provide additional incentive for such businesses to remain in compliance with the law.

Additional Information

Recent Prior Introductions: Similar legislation has been introduced within the last three years. See SB 838 and HB 1261 of 2023.

Designated Cross File: SB 436 (Senator Gile, *et al.*) - Finance.

Information Source(s): Office of the Attorney General; Comptroller's Office; Judiciary (Administrative Office of the Courts); Maryland State's Attorneys' Association; Department of General Services; Maryland Department of Labor; Board of Public Works; Maryland Insurance Administration; Workers' Compensation Commission; Department of Legislative Services

Fiscal Note History:	First Reader - January 28, 2024
rh/mcr	Third Reader - March 21, 2024
	Revised - Amendment(s) - March 21, 2024
	Revised - Updated Information - March 21, 2024

Analysis by: Heather N. MacDonagh

Direct Inquiries to:
(410) 946-5510
(301) 970-5510

Appendix – Maryland's Prevailing Wage Law

Contractors and subcontractors working on eligible public works projects in Maryland, including mechanical service contractors that are part of public works projects, must pay their employees the prevailing wage rate. "Public works" are structures or works, including a bridge, building, ditch, road, alley, waterwork, or sewage disposal plant, that are constructed for public use or benefit or paid for entirely or in part by public money.

Eligible public works projects are:

- those carried out by the State;
- any public work for which at least 25% of the money used for construction is State money;
- specified projects in tax increment financing districts if the local governing body approves of the application of prevailing wages; and
- construction projects by investor-owned gas and/or electric companies involving any underground gas or electric infrastructure.

Applicability in Maryland

Generally, any public works contract valued at less than $250,000 is not required to pay prevailing wages. However, the prevailing wage law was amended in 2022 to include mechanical service contracts valued at more than $2,500. Mechanical service contracts are defined as contracts for (1) heating, ventilation, and air conditioning, including duct work; (2) refrigeration systems; (3) plumbing systems, as specified; (4) electrical systems, as specified; and (5) elevator systems, as specified.

The State prevailing wage rate also does not apply to (1) any part of a public works contract funded with federal funds for which the contractor must pay the prevailing wage rate determined by the federal government; (2) specified construction projects carried out by public service companies under order of the Public Service Commission (except the underground projects mentioned above); or (3) local House or Senate initiatives that receive State funds in the capital budget.

Prevailing wages are wages paid to at least 50% of workers in a given locality who perform the same or similar work on projects that resemble the proposed public works project. If fewer than 50% of workers in a job category earn the same wage, the prevailing wage is the rate paid to at least 40% of those workers. If fewer than 40% receive the same wage rate, the prevailing wage is calculated using a weighted average of local pay rates. The State Commissioner of Labor and Industry is responsible for determining prevailing wages for each public works project and job category based on annual wage surveys, in which contractors and subcontractors working on both public works and private construction projects may participate.

The University System of Maryland (USM), Morgan State University (MSU), St. Mary's College of Maryland, and the Maryland Stadium Authority (MSA) are all exempt from the prevailing wage law. However, USM and MSU advise that they voluntarily comply with prevailing wage requirements for contracts that exceed the $250,000 threshold. MSA largely administers its own prevailing wage program, using wage rates borrowed from the commissioner's annual wage survey.

Enforcement

The commissioner has the authority to enforce contractors' compliance with the prevailing wage law, including issuing a stop work order if the commissioner makes an initial determination that a contractor or subcontractor may have violated the prevailing wage requirements. Contractors found to have violated the prevailing wage law must pay restitution to the employees and liquidated damages to the public body in the amount of $20 a day for each worker who is paid less than the prevailing wage, or $250 per worker per day if the employer knew or reasonably should have known of the obligation to pay the prevailing wage. If an employer fails to comply with an order by the commissioner to pay restitution, either the commissioner or an employee may sue the employer to recover the difference between the prevailing wage and paid wage. The court may order the employer to pay double or triple damages if it finds that the employer withheld wages or fringe benefits willfully and knowingly or with deliberate ignorance or reckless disregard for the law.

The Governor must include at least $385,000 in the budget each year for the Prevailing Wage Unit within the Maryland Department of Labor (MDL).

The number of prevailing wage projects rose dramatically following the Great Recession and has remained high each year since. MDL advises that, during fiscal 2023, its Prevailing Wage Unit monitored 913 projects, consistent with 921 projects in fiscal 2022, but significantly higher than the 496 projects in fiscal 2014. To accommodate the increase in projects, the number of prevailing wage investigators increased in fiscal 2016 from three to six; as of January 2024, there are five investigators in the unit. In fiscal 2024, the legislature provided five new wage and hour investigators to the division, three of which were designated to the Prevailing Wage Unit and are under active recruitment. This brings the total number of field investigator positions to eight.

History of the Prevailing Wage

The federal Davis-Bacon Act, originally enacted in 1931, requires contractors working on federal public works contracts valued at more than $2,000 to pay their employees the prevailing local wage for their labor class, as determined by the U.S. Secretary of Labor. The general intent of the law, and similar state and local laws, is to stabilize local wage rates by preventing unfair bidding practices and wage competition. Thirty-two states and the District of Columbia currently have prevailing wage laws; since 1979, nine states have repealed their prevailing wage laws.

Maryland adopted a prevailing wage law in 1945 (Chapter 999), but it only applied to road projects in Allegany, Garrett, and Washington counties. In 1969, the statute was amended to include State public works contracts of $500,000 or more. There have been periodic changes to the law and the definition of "prevailing wage." In 1983, the law was broadened to include public works projects in which the State funds 50% or more of the total project costs and 75% or more in the case of public schools. Chapter 208 of 2000 reduced the prevailing wage threshold for public schools from 75% to 50% of construction costs, thereby bringing school construction projects in line with prevailing wage requirements for other public works projects. Chapters 281 and 282 of 2014 further lowered the State funding threshold for school construction projects to 25% of total construction costs, thereby requiring the vast majority of public school construction projects in the State to pay the prevailing wage, subject to the $500,000 contract value threshold. Chapters 57 and 58 of 2021 lowered the State funding threshold for all public works projects (including school construction) to 25% of total construction costs and lowered the contract value threshold for payment of prevailing wages to $250,000; however, legislative bond initiatives that receive State funds in the capital budget are exempt from the requirement to pay prevailing wages. As noted above, Chapter 51 of 2022 extended the prevailing wage requirement to mechanical service contracts valued at more than $2,500.

Six Maryland jurisdictions – Allegany, Baltimore, Charles, Montgomery, and Prince George's counties and Baltimore City – have local prevailing wage laws requiring public works projects in the jurisdiction to pay prevailing wages.

Research on the Effects of Prevailing Wage on Contract Costs

The Department of Legislative Services (DLS) has reviewed research on the effect of prevailing wage laws on the cost of public works contracts and has found inconsistent and/or unreliable results. The primary challenge confronted by all prevailing wage researchers is identifying an appropriate "control group" consisting of projects of similar type, timing, and location that do not pay the prevailing wage. In most jurisdictions that require a prevailing wage, all projects of a specified type and size are subject to it, so there is no natural control group. Some researchers have compared project costs in states or localities before and after they adopted prevailing wage requirements, but their findings are clouded by the difference in time, during which construction costs changed and other factors were not consistent. Another deficiency in the research is that it almost always relies on project bid prices (*i.e.*, the anticipated cost prior to the beginning of construction) rather than actual final costs. As most construction projects experience change orders or cost overruns affecting their cost, reliance on bid prices negatively affects the validity of the findings. Therefore, research findings related to the effect of the prevailing wage on project costs are inconsistent and often inconclusive. A similar review of research conducted by MDL (at the time, the Department of Labor, Licensing, and Regulation) for the Task Force to Study the Applicability of the Maryland Prevailing Wage Law also concluded that "data limitations create difficulty for researchers on both sides of the issue."

Local school systems occasionally solicit side-by-side bids with and without prevailing wages to help them decide whether they want to accept the full State match (and, thus, be subject to the prevailing wage) or a lesser State match without being subject to the prevailing wage. Data provided to the Public School Construction Program by Anne Arundel, Carroll, Frederick, Howard, and Washington counties, from 2012 through 2015, shows that the cost differential between bids with and without prevailing wages for 266 individual bids submitted for 26 different school construction and renovation projects averaged 11.7%, with a range from 0% to 49%. As with other research data, these represent bid prices, not actual construction costs. An independent analysis of the Maryland side-by-side bid data concluded that factors other than prevailing wages, including bid timing and the level of competition for the bids, accounted for most of the differences between the prevailing wage and nonprevailing wage bids.

One area of the research in which there is a general consensus, and which is supported by the U.S. Bureau of Labor Statistics, is that labor costs represent between 20% and 30% of construction costs (with materials and site costs making up most of the rest). Therefore, a 10% gap between prevailing wages and market wages could theoretically increase total contract costs by about 2.5%, and a 20% gap in wages could increase total contract costs by about 6%. Given the empirical evidence that prevailing wages tend to be higher than nonprevailing wages and that labor costs are a significant portion of overall project costs, DLS believes that it is reasonable to expect that the prevailing wage requirement adds between 2% and 5% to the cost of a public works project. Given the inconsistency and inconclusiveness of the empirical research, however, actual effects may vary by project, with some projects exhibiting higher cost differences and others experiencing negligible differences.