

Contractors Beware:

Recent Regulatory Enactments Require Additional Compliance

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I. Introduction

Before the conclusion of last year, two laws were enacted that profoundly impact the construction industry in general, and contractors involved in public contracts, in particular. The first item, the Construction Industry Independent Contractor Act, P.L. 2007, c. 114 (the "Act") was adopted by the New Jersey Legislature and establishes in the state of New Jersey criminal penalties and debarment for misclassifying a worker as an independent contractor rather than an employee and creates a presumption that workers are employees. The other regulation, amendments to Parts 2, 3 and 52 of the Federal Acquisition Regulation, 72 Fed. Reg. 65873, requires that any federal contract having a value of \$5,000,000 or more and performance period of 120 days or more, contain the newly issued Federal Acquisition Regulation (FAR) ethics clauses.

II. Construction Industry Independent Contractor Act

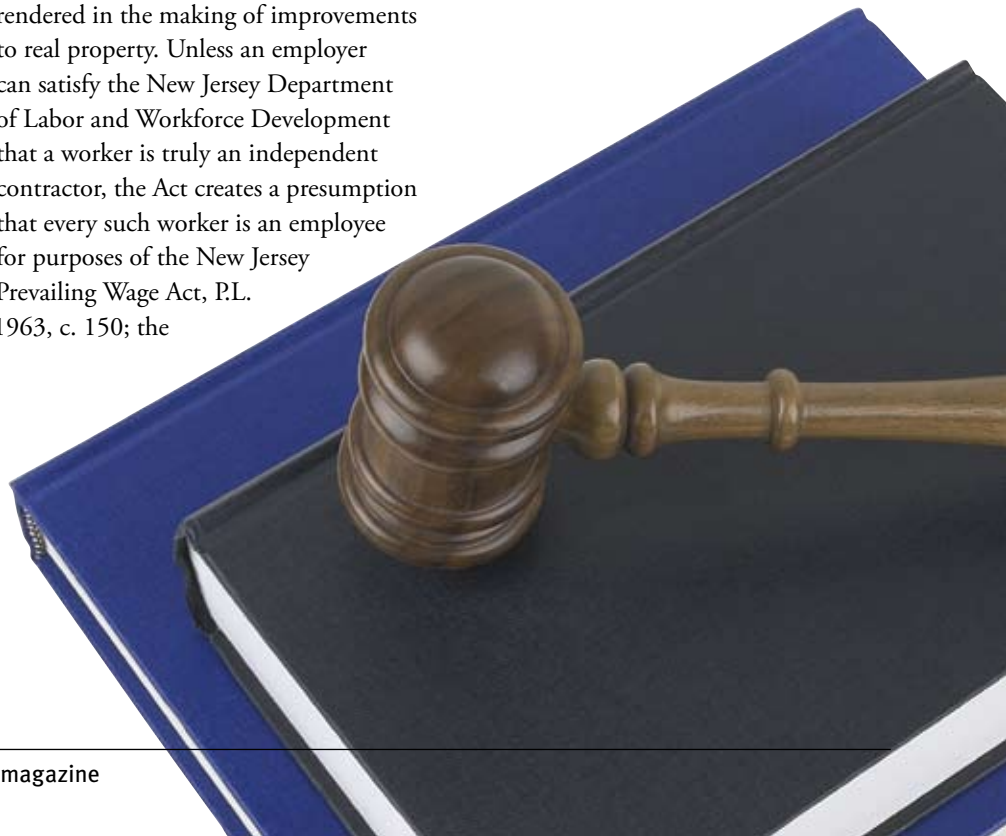
The New Jersey State Legislature passed the Act to remedy a perceived avoidance by employers of employment and tax laws and to fill gaps in those laws the Legislature has found to exist. The thrust of the Act is to deter employers from withholding from employees their prevailing wages, Social Security and other employment benefits and circumventing tax obligations. The Act also purports to level the playing field between employers who fully comply with employment and tax laws and those employers who do not.

The Act covers employers who compensate workers for services rendered in the making of improvements to real property. Unless an employer can satisfy the New Jersey Department of Labor and Workforce Development that a worker is truly an independent contractor, the Act creates a presumption that every such worker is an employee for purposes of the New Jersey Prevailing Wage Act, P.L. 1963, c. 150; the

Unemployment Compensation Law, R.S. 43:21-1 *et seq.*; the Temporary Disability Benefits Law, P.L. 1948, c. 110; the New Jersey Gross Income Tax Act, N.J.S.A. 54A:1-1 *et seq.*, or other applicable state tax laws, P.L. 1965, c.173; and the New Jersey State Wage and Hour Law, P.L. 1966, c. 113. An employer can demonstrate that a worker is an independent contractor by showing that:

1. the individual has been and will continue to be free from control or direction over the performance of his services, both under the contract governing his work and in fact;
2. the service is either outside the employer's usual course of business or the service is performed

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outside of all of the employer's places of business; and

3. the worker is customarily engaged in an independently established trade, occupation, profession or business.

Moreover, the Act expressly provides that whether an employer withholds income taxes on behalf of the worker or pays unemployment compensation contributions or workers' compensation premiums, will not be considered in determining whether a worker is an independent contractor or employee.

Any employer, or any of its officers, agents, superintendents, foremen, or even employees, who fail to properly classify a worker as an employee for purposes of the above-mentioned employment and tax laws, and fails to pay wages, benefits or taxes required by any of those laws, may be subject to any of the following penalties:

Being found guilty of a disorderly persons offense and fined an amount ranging from \$100 to \$1,000 and/ or imprisonment for between 10 and 90 days per offense, each week of continuing noncompliance being deemed a separate offense.

For a *knowing* failure to properly classify workers under the Act, being convicted of a crime of the fourth degree if the contract amount is for \$2,500 or less; a crime of the third degree for a contract amount exceeding \$2,500 but less than \$75,000; and a crime of the second degree for a contract amount of \$75,000 or greater; plus liability to

workers for unpaid amounts resulting from the misclassification resulting in any of these crimes.

Administrative penalties instead of or in addition to the other penalties and fines, of up to \$2,500 for a first violation and up to \$5,000 for each subsequent violation.

Debarment from contracting with a public body or otherwise taking part in any public works for a period of three (3) years if the Commissioner of the Department of Labor and Workforce Development (the "Commissioner") determines that the failure to properly classify was done knowingly or if the employer is convicted of a crime as described in paragraph 2 of this section.

Immediate suspension of an employer's contractor registration.

Issuance of a stop-work order requiring the cessation within 72 hours of all business operations.

Fines of \$5,000 per day for violating a stop-work order.

Fines of \$5,000 per worker improperly classified.

The language of the Act suggests that while disorderly persons' citations, criminal convictions, and debarment upon criminal conviction will automatically be invoked, debarment resulting from the Commissioner's determination of misclassification, civil penalties, and suspension of contractors' licenses are imposed at the discretion of the Commissioner. Stop-work orders will only be issued upon a second and each subsequent violation.

Additionally, any worker who claims to be misclassified as an independent contractor may commence a civil action for damages against his or her employer if that employer had knowledge of the misclassification.

The Act expressly prohibits taking any retaliatory action or discriminating against a worker for exercising their rights under the Act, including the right to file a complaint or inform someone of an employer's noncompliance. The Act creates a rebuttable presumption that an employer's adverse action toward a worker, taken within 90 days after the worker has exercised his rights under the Act, is retaliatory.

III. Federal Acquisition Regulation

The final rule amending Parts 2, 3, and 52 of the FAR (the "Rule") was issued by the Civilian Agency Acquisition Council and Defense Acquisition Regulations Council (collectively the "Councils") on Nov. 23, 2007. The Rule requires that federal contracts having a contract value over \$5,000,000 and a performance period of 120 days or more, contain the newly issued FAR 52.203-13 and FAR 52.203-14.2 clauses. These new FAR clauses require that the contractor:

Maintain or issue a written code of business ethics and conduct.

Provide a copy of the code to each employee engaged in the performance of the contract.

Promote compliance with the code.

For other than "small business concerns" for purposes of the contract, establish a business ethics and conduct awareness program (i.e., a formal training program) and an internal control system. Generally, in connection with government contracts, employers must implement measures to timely discover and correct improper conduct, devise an internal reporting mechanism, establish disciplinary procedures, and perform periodic reviews and audits. The exception from this requirement

for small business concerns applies to a business entity that, including its affiliates, is independently owned and operated, is located in the United States, pays taxes to the United States, and is for-profit (to the individual or the business). A concern can be an individual, partnership, corporation, or joint venture, but can have no more than 500 employees and cannot dominate its field of operation to qualify. The U.S. Small Business Administration has established a table of small business sizes that sets forth dollar limits for particular business types.

Display certain agency fraud hotline posters unless specific exceptions apply.

Even though as a small business concern a contractor may be exempt from the training and internal control system requirement; subcontractors who do not qualify as small business concerns will still be subject to the requirement; substantive requirements cover subcontractors on subcontracts (including purchase orders) valued over

\$5 million and extending more than 120 days unless the subcontract is for the acquisition of a commercial item or involves performance entirely outside the United States.

Although the Rule does not specify penalties for non-compliance, the Councils' introductory provisions make clear that a failure to comply with the required contract provisions constitutes material breach of the subject contract.

It should also be noted that on Nov. 14, 2007, the Councils proposed a rule that would require a contract clause mandating that a contractor notify the Office of the Inspector General, with a copy to the contracting officer, whenever the contractor has *reasonable grounds* to believe that a principal, employee, agent, or subcontractor of the contractor has committed a violation of federal criminal law in connection with the award or performance of the contract or any subcontract thereunder. The proposed rule provides as an express cause for debarment and license suspension, the "knowing

failure to timely disclose an overpayment on a Government contract or violation of Federal criminal law in connection with the award or performance of any Government contract performed by the contractor or any subcontract thereunder." The comment period for this proposed rule concluded on Jan. 14, 2008, and as of the date of this writing no further action has been taken.

These two relatively recent legal developments, the Act and the FAR amendments, impose additional burdens on contractors and force them to be even more cautious when hiring their employees or retaining independent contractors, drafting employment contracts and contracts governing the work, and maintaining internal controls within their companies. The penalties for noncompliance, including debarment, fines and forced withdrawal from a job, are potentially significant, especially to those engaged in the construction industry in the state of New Jersey or with the federal government. ■