

January 6, 2014

Little Hoover Commission
925 L St., Suite 805
Sacramento, CA 95814

RE: Written testimony for hearing on the Underground Economy to be held January 23, 2014

Dear Commissioners,

Thank you for the opportunity to provide written and oral testimony on an issue of significant importance to the construction industry in California, the underground economy.

1. How does the underground economy and semi-underground economy affect the construction industry, and what are the trends?
 - a. The underground economy usually occurs where a contractor works for a homeowner, or smaller property owner. In these cases, the contractor usually has no license, no workers' compensation coverage for employees, and is not in compliance with safety, wage and hour, and permit laws and regulations.
 - A. Employees are disadvantaged by not being protected from safety hazards, often being paid in cash without minimum wage or overtime protections, and are driven underground by having no wage statements or taxes withheld.
 - B. Underground contractors often employ and take advantage of undocumented workers, who are afraid to complain to governmental agencies.
 - C. Deadbeat parents often find a safe haven working for underground employers, as their income is not reported, or wages garnished. Children and spouses of these deadbeat parents pay a significant price for this problem.
 - D. Homeowners and small property owners are unfairly advantaged, as well as disadvantaged. They usually pay less for the services of an underground contractor, by taking lower, unrealistic bids. They take significant risk, however, for shoddy workmanship, responsibility for injuries to employees of the underground contractor; or having an improperly permitted project performed. Some of these unpermitted projects are life safety hazards for the occupants of the structures.
 - E. Compliant contractors in this arena are disadvantaged by having to compete with unsustainable pricing levels, or losing the work entirely.
 - F. The underground economy in construction has a larger number of underground contractors, although less in volume as compared to the semi-underground economy.
 - b. The semi-underground economy occurs where a contractor works on a larger residential, commercial, institutional, or public works project. The contractor may work directly as a contractor for the owner of the project, or as a subcontractor to a general contractor on the project. These types of projects are almost always competitively bid.
 - A. The semi-underground contractor usually is licensed, has a certificate of workers' compensation, and often has taken appropriate permits for the



California Professional Association of Specialty Contractors

- project. They often utilize an illegitimate or illegal subcontractor entity to hide their illegal activities.
- B. For private works projects, whether they are residential, commercial, or institutional; cheating by semi-underground contractors takes several forms. It appears that once these contractors go rogue, they throw caution to the winds, and use most every form of cheating.
 - C. This cheating can consist of avoiding expensive safety equipment and processes such as trench shoring and fall protection. It includes cash or partial cash pay, which automatically defrauds the workers' compensation carrier, and the government in unreported and unpaid payroll and other taxes.
 - D. Cheating on public works projects usually revolves around failure to pay prevailing wage rates. By improperly classifying employees, underreporting hours worked, or not paying overtime rates, the semi-underground contractor pays a significant amount less than required. There is again the underpaid workers' compensation premiums and taxes that go along with the underreported wages.
 - E. Semi-underground contractors in both private and public works projects have actually increased market share over the last decade. As costs for compliance with laws and regulations have increased, these contractors can underbid projects by substantial amounts, while still leaving a healthy profit margin.
 - F. Employees of semi-underground contractors are disadvantaged by exposure to unsafe hazards, and being driven underground by filing false tax returns due to substantial unreported income.
 - G. Legitimate contractors have lost substantial volume of work to the semi-underground contractors, which has driven some legitimate contractors out of business entirely, or the reduced volume and profit margins has put many legitimate contractors on the brink of financial ruin.
2. How was the coalition we represent established, what efforts has it made, and what progress have we noticed?
- a. The Construction Enforcement Coalition was established in 2010, as compliant contractors were losing more and more work to the underground and semi-underground economy. The Coalition grew rapidly, with more than 40 trade associations and unions supporting the efforts.
 - b. The Coalition began holding meetings across the state, having various state agencies participating, along with the compliant contractors, and association and union representatives. At first, the meetings were quite contentious. The construction industry discussed how they felt let down by the state requiring compliance at a costly level, but not having effective enforcement to stop those who cheated the system. It became apparent that many state agencies were operating in silos, each doing what they thought was effective, but with very little coordination and sharing of valuable information.
 - c. There has been significant progress over the last three and a half years. Christine Baker as Director of the Department of Industrial Relations, and Julie Su, Labor Commissioner, have done very good work, attempting to change the culture of the enforcement community. They are using much better targeting, data matching, and analytics to streamline efforts. There is much more cooperation between various state agencies than in the past. The focus has been much more on the serial violator, whether in the underground

- or semi-underground economy, to either bring them in to compliance, or remove them from the construction industry.
- d. Several of the Coalition participants, including myself, have presented at training programs for various enforcement agencies. There has been a change in understanding, that those enforcement personnel can help protect employees, by protecting the ongoing viability of compliant contractors.
3. What enforcement recommendations do we have?
 - a. Continue the efforts begun by Christine Baker and Julie Su, and seek even more innovative ways to target serial violators.
 - b. Continue to review MOUs between agencies, to promote proper cooperation to reform the serial violators, while maintaining appropriate privacy of information.
 - c. Between state agencies and local District Attorney offices, there are a significant number of enforcement personnel available to combat the underground economy. More study should be given how to best utilize and streamline these resources, to maximize the impact.
 4. What reforms may better enable agencies' regulatory efforts?
 - a. Legislative or regulatory reforms that focus on the parties who enable the underground or semi-underground contractors, those who hire them. Currently, many public agencies, property owners, and developers take unrealistic low bids, and have very little risk for doing so. Legitimate contractors and employees are disadvantaged, but the party who takes the low bid is not. Avenues should be explored requiring more due diligence and risk for those who take unsustainable low bids. One of the biggest changes to combat the underground economy would be for those who take bids, to award the work to legitimate contractors in the first place.
 5. What barriers have restricted enforcement efforts in the past?
 - a. Limited MOUs between agencies, as well as turf wars, have hampered efforts in the past. State and local agencies need to understand how badly the underground and semi-underground economy hurts everyone; and put cooperation at the head of the list.
 6. What reforms would improve the experiences of the businesses who wish to comply?
 - a. Providing a de minimus protocol for most enforcement agencies. Legitimate contractors get very frustrated when enforcement personnel spend time with them over very minor infractions. Those legitimate contractors know that is time spent not going after the serial violators. Allowing enforcement personnel to minimize the resolution of a minor violation for an otherwise compliant contractor, would be very helpful
 - b. The Little Hoover Commission could educate and remind the legislature and regulatory bodies to take a second look at new laws or regulations that cost time or money to comply with. The legitimate contractor will spend that time or money, the serial violator won't. Any unnecessary cost gives greater advantage in underbidding, to the serial violator. Deliberations over new laws or regulations should include a component of whether that law or regulation will help employees of legitimate contractors, or hurt them by giving more advantage to the underground and semi-underground contractors.



I have also attached a copy of the most recent letter our Coalition has sent to the Governor.

Thanks again for the opportunity to provide testimony to you on this very important topic.

Sincerely,

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We Support the Propositions of Construction Enforcement – To Level the Playing Field

The Honorable Edmund G. Brown
Governor of California
State Capitol, Suite 1173
Sacramento, CA 95814

January 10, 2013

c.c. Labor and Workforce Development Agency Secretary Marty Morgenstern; State and Consumer Services Agency Secretary Anna Caballero; Insurance Commissioner Dave Jones

Subject: Construction enforcement 2013 – level the playing field, THIRD YEAR

Dear Governor Brown:

This is follow-up to a letter we sent you, dated January 25, 2012. We are a growing coalition of businesses, associations, and labor representatives, focused on effective but fair enforcement of key California laws and regulations regarding construction. The goal is to provide public protection and level the playing field for law-abiding construction contractors. We appreciate the interest your administration has taken to address the matter. Unfortunately, since we formed this coalition in December of 2010, the State continues to lose billions of dollars in revenue while noncompliant construction contractors develop even greater market share in this struggling economy. When this happens, not only do legitimate contractors go out of business and the state loses revenue... employees are not compensated fairly, safety is at risk and quality construction is compromised.

Our coalition is grateful of the attention that you and California State agencies have provided our efforts and we look forward to a continued partnership to further address the problem. They are making some headway. But the mantra from the legitimate construction contractors is **WE NEED ENFORCEMENT FASTER!** Your cooperation to allow and encourage these agencies to comport with the following propositions of our coalition is appreciated:

1. **Comprehensive strategies.** Serial Violators operate in many areas of construction in California, and it takes a variety of comprehensive strategies to effectively enforce all these areas.
2. **Specific laws.** There are specific regulations and laws that protect employees, which must be effectively enforced. These include complying with wage and hour laws, providing workers' compensation coverage and paying the appropriate amount for that coverage, being properly licensed and/or utilizing legitimate subcontractors, complying with prevailing wage provisions; and providing Cal/OSHA mandated safety protections. Enforcement agencies in California need to focus on those employers who consistently and flagrantly violate these important regulations and laws. We call these "serial violators". Targeted resources that bring these parties to justice provide a win-win proposition. Serial violators can't just be targeted for occasional inspections, follow through needs to be forceful, bringing them either into compliance, or out of construction in California.
3. **Types of violators.** There are two types of serial violators.
 - a. One is in the so called "underground economy". These employers are often unlicensed, do not provide workers' compensation coverage, pay cash to employees, and fail to follow Cal/OSHA safety regulations.
 - b. The other type is in the "semi-underground economy". These employers in construction disguise themselves by being licensed, and have a certificate of workers' compensation coverage. They violate important laws by utilizing unlicensed subcontractors, or subcontractors who may be licensed but have no workers' compensation coverage for their employees. They also often pay half cash, avoid Cal/OSHA safety regulations such as fall protection or trench protection, commit workers' compensation premium and payroll fraud; and misclassify employees or otherwise falsify records on prevailing wage jobs.

We Support the Propositions of Construction Enforcement – To Level the Playing Field

4. **Serial violators.** In order to maximize the efficiency of California enforcement agencies, they should focus on serial violators, whether they are part of the “underground” or “semi-underground” economy. In instances where good employers are working hard to be in compliance with the myriad of California regulations and laws, the inspecting agency should spend little time and resources. Every hour of time an enforcement person spends with a compliant contractor, means one hour less to go after the serial violators. California enforcement agencies do not have the personnel, time, or resources to go after good contractors with de minimus violations.
5. **Interagency cooperation.** We appreciate the steps taken to improve interagency cooperation, which are making more efficient use of state resources to track down contractors who are typically in violation of laws that encompass more than one agency. By all agencies making a claim against a serial violator, we would hope for results that either bring that violator into compliance, or force them out of business. We believe that the Labor Enforcement Task Force (LETF) has been a significant step forward in the battle. This group uses resources wisely, and effectively. This model can be used in other areas of enforcement, emphasizing targeting and follow through of serial violators, as well as having dedicated personnel to the strategy. The Joint Enforcement Strike Force (JESF) has also been helpful, partnering enforcement agencies with one another for maximum effectiveness, to identify all the potential violations in which the serial violators may be criminal. Not only are these State agencies under your administration helpful, but the Department of Insurance and the county district attorney offices who take this matter seriously are also making an impact. The more cooperatively these various agencies work with one another, the better. Recognize construction. Construction should receive a commensurate amount of enforcement resources. It is a large sector of the economy, and if properly enforced, can help bring the economy back on track.
6. **Existing laws.** Focused enforcement efforts are needed to enforce current laws, rather than creating additional regulations and laws in California. If new enforcement laws are considered, they should be to reinforce an existing law that does not have sufficient consequences to motivate the violators to comply (whether they be subcontractors, general contractors, builders, owners, awarding authorities).
7. **Publish violations.** The nature of investigations is understandably confidential. But an effort to readily and overtly publish who the serial violators are as soon as possible will serve as a detractor to others who might otherwise try to cheat and it will serve as a warning to those who suggest they might unknowingly hire cheaters.
8. **Expose criminals.** Underground construction contractors have become a safe haven for many unscrupulous people to work, e.g. “deadbeat parents” and those who prey on unsuspecting victims like the elderly, and others trying to escape the law. Focused enforcement will expose and catch criminals.

In summary, the urgency of this issue cannot be overstated. The recession in construction has created much greater incentive for cheating in construction and legitimate construction employers are on the ropes. ***The state must continue to try and make a dramatic impact in construction enforcement right now.*** We recognize the strains on your time; however, our mutual needs are so urgent that time is of the essence. Please continue to help level the playing field. Thank you for your consideration.

Sincerely: *Please see the attached list of coalition partners.*

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Our sectors and industries represent thousands of companies and employees making up the California economy who will be irreparably harmed if contractors who flagrantly violate the laws are not stopped.

List of Coalition Partners (as of 1/10/13):

California Professional Association of Specialty Contractors
California Spa and Pool Industry Education Council
California Association of Sheet Metal and Air Conditioning Contractors
Western Electrical Contractors Association
California Fire Training Alliance
Northern California Contractors Association
Roofing Contractors Association of California
Painting and Decorating Contractors Association of California
California Framing Contractors Association
Plumbing Heating and Cooling Contractors of California
Engineering Contractors' Association
Marin Builders' Association
California Fence Contractors Association
Flasher/Barricade Association
California Chapter of the American Fence Association
Associated Roofing Contractors of Bay Area Counties
Union Roofing Contractors Association
Air Conditioning Trade Association
National Association of the Remodeling Industry of Greater Sacramento
American Subcontractors Association of California
California Landscape Contractors Association
Roofing Contractors Association of Southern California
Institute of Heating & Air Conditioning Industries, Inc.
California Conference of Mason Contractor Associations, Inc.
Associated Tile Contractors of Northern California
Northern California Electrical Construction Industry – LMCT
Sacramento Regional Builders Exchange
Northern California Painting and Finishing Contractors Association
Northern California Glass Management Association
Pacific Rim Drywall Association
California Landscape & Irrigation Council, Inc.
Northern California Carpenters Regional Council
Desert Contractors' Association
California Sign Association
Valley Contractors Exchange
Golden State Builders Exchanges
National Plasterers Council
Most Wanted Deadbeats
National Electrical Contractors Association Northern California Chapter
Northern California Tile Industry Labor Management Cooperation Committee (NCTI LMCC)
National Association of the Remodeling Industry Silicon Valley Chapter
Associated Builders and Contractors of California
Independent Roofing Contractors of California, Inc.
California American Fire Sprinkler Association
Stucco Manufacturers Association
Plastering Contractors Association of Southern California
California Construction Compliance Group

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