



Property Casualty Insurers
Association of America

Shaping the Future of American Insurance

July 7, 2009

NCOIL Workers' Compensation Insurance Committee
c/o Jordan Estey
Director of Legislative Affairs & Education
National Conference of Insurance Legislators
601 Pennsylvania Avenue N.W.
Suite 900, South Building
Washington, D.C. 20004

RE: NCOIL's Proposed Employee Misclassification Workers' Compensation
Coverage Model Act

Dear Jordan:

The Property Casualty Insurers Association of America (PCI) is a property and casualty trade association representing more than 1,000 member companies, representing the broadest cross-section of insurers of any national trade association. PCI members write over \$176 billion in annual premium, 35.9 percent of the nation's property/casualty insurance. Our members write 38.4 percent of the private workers compensation market.

PCI believes that the misclassification of workers impacts all workers compensation stakeholders and is one of the most serious issues impacting the states today. Because of the concern that some employers to avoid their compensation obligation require employees to label themselves as independent contractors, state agencies and courts have been reluctant to rely on labels and have tended to make their own determination on a case-by-case basis.

Adding to the uncertainty is that the status can change over time or with the job being performed. One day a person can hold himself out as a sole proprietor acting as an independent contractor. The next day he has two employees working for him. A couple of days later while still holding himself out as an independent contractor he is working on a job site being paid on an hourly basis, subject to direction by the person who hired him, and using that person's tools. Establishing criteria for independent contractor status has been a challenging issue for the states.

Legislation pertaining to the independent contractor issue has been and continues to be introduced and enacted across the states. States are taking action to address this issue based on their individual state laws. For example in 2009, revisions to laws or new laws pertaining to independent contractors have been enacted in Arkansas, Minnesota,

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Montana and West Virginia. PCI commends NCOIL for developing a proposed model, which includes a number of very positive provisions. A more in-depth review of how the states handle this issue may be beneficial to the development of an effective model.

Due to the complexity of this issue, PCI believes that a longer vetting process with input from the stakeholders is needed to ensure that all concerns and potential impacts are identified. PCI would be willing to participate in this effort. Our members understand the wide variation and complexity in criteria, which leads to inadvertent errors, abuse and litigation. Without a doubt, clear legal standards for independent contractor status in statute and significant penalties should help to address the misclassification problem that has troubled the workers compensation system for years.

PCI conducted a member call to gather input and recommendations on this proposed model. We need more time to truly do a comprehensive review of the proposal. Following are some of our initial comments:

Section 2. Definitions

Definition of Construction Industry: In 2 (B), the term construction industry is defined as follows: "Construction industry" means for-profit activities involving any building, clearing, filling, excavation, or substantial improvement in the size or use of any structure or the appearance of any land. "However, "construction" does not mean a homeowner's act of construction or the result of a construction upon his or her own premises, provided such premises are not intended to be sold, resold, or leased by the owner within one year after the commencement of construction."

PCI questions the limitation to only for-profit activities; there may be non-profits that have employees engaged in construction. Further review is needed.

In addition, this definition is very expansive, which could include all landscape operations and home repair operations on residences that will be sold or leased within a year of commencement as part of the construction industry. The term "substantial" is a very vague term and will create issues in real-life application.

- The term "substantial improvement in the appearance of the land" could eliminate existing exemptions for certain agricultural operations in some states. By including improvement in the appearance of any land in the definition, regular landscaping (adding shrubbery, cutting the lawn, etc.) could be deemed as improvement in the appearance of the land. Is the intent of this proposed model to eliminate the agricultural exemptions that may include some landscape operations?
- In the course of preparing to sell or rent a home, a homeowner may have a painter paint a room, a plumber fix a drippy faucet, etc. Is the intent to include these types of home repairs in the definition of construction industry and ultimately, require the homeowner to secure workers compensation coverage? How would one determine the intent of the homeowner? This provision will only generate additional complications and uncertainties.

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Definition of Employer/Homeowner: In E (2), a homeowner can be defined as an employer per the following: “A homeowner shall not be considered the employer of persons hired by the homeowner to carry out construction on the homeowner's own premises if those premises are not intended for immediate lease, sale, or resale.” PCI opposes the intent of the proposed model to include homeowners preparing their homes for sale or lease in the definition of employer. It is the responsibility of the individual business to provide workers compensation coverage in these types of situations, not the homeowner. The following discussion points reflect the unreasonableness of such a requirement:

- Based on the proposed definition, a homeowner could be considered as an employer, thus, requiring workers compensation coverage. During these hard economic times, why would we want to subject home sellers (who may be selling at an economic loss) to additional costs? The homeowner is not the employer in this type of situation.
- If an individual owns a rental property, is he/she considered to be in the "construction industry" when maintenance or updates are done?
- In the definition of construction industry, it is specifically stated that it does not include homeowners, unless they intend to lease or sell their homes within one year of commencement of the construction work. In the definition of employer, a homeowner is not considered an employer for construction work if the home is not intended for immediate sale or lease. The definitions are inconsistent and confusing. This approach needs to be reconsidered.

Definition of Employee: In D (2), it is indicated that specific state exemptions are still valid in this proposed model. Does NCOIL support numeric state exemptions for contractors and subcontractors involved in public and private construction? A review of the current numeric exemptions should be done to understand the scope of this issue.

Definition of Independent Contractor: In F (2), independent contractor status in all other industries except for construction is based on the Wisconsin workers compensation statute, which provides a very specific set of requirements. In Wisconsin, very few classification cases end up in disputes. However, we must note that this low dispute ratio is also due to the fact that similar requirements are used in Wisconsin for determining independent contractor status for unemployment insurance, which reduces confusion from an employer and employee perspective. The proposed model only addresses the workers compensation statute.

Also, in the nine point test to qualify as an independent contractor, a number of the requirements are vague and will be difficult to verify:

- a. The independent contractor maintains a separate business with his or her own office, equipment, materials, and other facilities. What constitutes an “office” and how do we verify? The term “materials” is included; does this mean office supplies and construction tools?
- c. The independent contractor operates under contracts to perform specific services. What about verbal contracts? Do all contracts have to be written?

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- d. The independent contractor incurs the main expenses related to the service or works that he or she performs. What constitutes "main expenses"?
- h. The independent contractor has continuing or recurring business liabilities or obligations. In the underwriting and auditing functions, will insurers actually have to review the contractor's records for this information? How can this be verified?
- i. The success or failure of the independent contractor's business depends on the relationship of business receipts and expenditures. How can this be verified?

There is no indication in the proposed model that an individual must meet all criteria or only a certain number to qualify as an "independent contractor." There is no reference to how this provision would work in conjunction with individual state criteria for unemployment insurance and for determination of independent contractor status under the IRS's "twenty-factor test."

In F (3), it is stated that the person claiming to be independent has the burden of proving that they're independent. At times, shouldn't the hiring or general contractor have some responsibility as well?

Section 3. Coverage Requirements

(A) 2 states that any contractor or subcontractor who engages in any public or private construction in the state shall secure and maintain workers' compensation benefits for his or her employees under this Act. PCI supports this provision from a public policy perspective.

Under (A) 3, the following is stated: "In case a contractor sublets any part or parts of his or her contract work to a subcontractor or subcontractors, all of the employees of such contractor and subcontractor or subcontractors engaged on such contract work shall be deemed to be employed in one and the same business or establishment, and the contractor shall be liable for, and shall secure, the payment of compensation to all such employees, except to employees of a subcontractor who has secured such payment."

- This means for some reason a subcontractor fails to obtain the required coverage, the general contractor becomes the statutory employer of the subcontractor's employee and is responsible for providing any benefits owed if the subcontractor's employee is injured on the job. The hiring or general contractor needs to know his/her potential liability when entering into subcontracts. Likewise, insurance companies that insure general contractors need to properly assess the exposure for employees of subcontractors. However, PCI believes that these provisions need to be reviewed in context of the existing state statutory employer provisions to ensure that there are no unintended consequences. The majority of the states have statutory employer provisions and the proposed model needs to reference how existing statutory employer provisions will work with (A) 3. Is the intent of these provisions to replace the existing statutory employer provisions?

Also, in 3 C, it is explicitly stated that a subcontractor is not liable for the payment of compensation to the employees of another subcontractor or the contractor provided that

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the subcontractor has secured workers compensation benefits and the subcontractor's own gross negligence was not a major contributing cause of the injury.

- This seems to contradict the "sole remedy" system and could result in litigation to determine "gross negligence" in many construction claims. Also, no protection is provided to the contractor, who is the statutory employer. This provision may be in conflict with existing statutes in some states where a subcontractor is not protected by the exclusiveness of liability provisions of the law from suit on account of injury to an employee of another subcontractor. PCI suggests that further review is needed on 3 (C).

Section 4. Employer/Contractor Disclosure Requirements

PCI recommends changes to 4 (C) to reflect that insurers *may* request earning reports from an employer/contractor on a quarterly basis. We do not support mandatory quarterly reports on every policy. It is adding unnecessary requirements for the employer. Depending on the risk, there may not be a need to submit reports on a quarterly basis. PCI would prefer that there is flexibility in this requirement.

Section 5. Application Requirements

PCI does not support the mandatory inclusion of employees' names on applications for workers compensation insurance because employers' workforces are constantly changing. PCI would prefer that there is flexibility in this requirement.

Section 6. Payroll Audit Procedures

Section 6 provides a number of positive audit provisions. PCI would like to point out that the National Council on Compensation Insurance's Basic Manual and the independent state bureau manuals provide for very specific audit procedures and require an insured to provide all necessary records to complete audit. PCI questions the need for this specific section.

PCI does not support the following:

6 (B) The rules shall provide that employers in all classes other than the construction class be audited not less frequently than biennially and may provide for more frequent audits of employers in specified classifications based on factors such as amount of premium, type of business, loss ratios, or other relevant factors.

- PCI is assuming that the model is calling for a physical audit on these types of policy. This would be too difficult and expensive to regulate and require. Today, insurers are using self-audits, electronic audits, etc. This requirement is adding more process without any discernible benefit and will be expensive to require and regulate.

6 (C) In no event shall employers in the construction class, generating more than the amount of premium required to be experience rated, be audited less than

annually. The annual audits required for construction classes shall consist of physical onsite audits.

- We strongly support the need for insurers to have the flexibility to conduct physical policy audits on an annual basis based on risk characteristics and other requirements. For example, an insurer may want to establish procedures to annually audit policies that have been in-force for only one year and to require annual audits on policies with specific construction classes. On the other hand, an insurer may not want to conduct a physical audit on a policy that they have written for over five years where other processes are in place and are working effectively. Also, what do the drafters have in mind for the location of a physical audit – the company headquarters or the transitory worksites? As previously indicated this type of mandate will only add costs for the employers, insurers and the regulators.

6 (E) At the completion of an audit, the employer or officer of the corporation and the auditor must print and sign their names on the audit document and attach proof of identification to the audit document.

- PCI does not believe it is necessary to require signatures and identification on every audit by both the insured and auditor. Further, with most audits being done electronically, this would require electronic signatures and photocopies of an employer's ID.

6 (F) Upon conclusion of an employer audit, the insurance carrier shall report to the [Insert State Workers Compensation Department or Appropriate Agency] any employee or independent contractor misclassification, any uncovered or unreported employees, and any other violation of this Act.

- PCI strongly questions the need for reporting all errors related to misclassification including unreported employees. For example, an employer has added staff toward the end of the policy period, which was noted during the audit and was billed accordingly after the audit. Per this requirement, an insurer would be required to report to the state -- Would the state regulator be required to investigate this employer from a compliance perspective? This requirement will be exceptionally burdensome on employers, insurers and regulators and will only cause problems for all stakeholders. It places insurers in a difficult and tenuous position.

Section 7. Penalties

There are a number of excellent penalty provisions that should act as a deterrent for misclassifying employees including monetary penalty provisions and stop-work orders.

In (F) 2, it is stated that an employer is required to pay the insurer a penalty of \$500 for failing to provide access to the documents requested during the audit process. Since the employer has failed to cooperate with the insurer on the audit, it would be highly unlikely

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that the employer will be willing to pay the insurer the \$500. Will the state regulator collect the \$500 from the “uncooperative employer” and forward to the insurer to help defray the cost of the audit?

Section 8. Enforcement

PCI believes that enforcement is the key to addressing misclassification issues. From a state perspective, Florida had been very successful in identifying employer compliance problems by dedicating staff resources to identify non-compliant employers. The enforcement provisions 1- 8 are excellent tools, however, in some states additional staffing resources may be required. While new legislation is welcome for strengthening laws and creating more enforcement tools, that legislation and existing laws are of no use without adequate funding for the enforcement personnel needed to get the job done. Unfortunately, due to current economic issues, state budgets have been adversely impacted.

Also, PCI would like to suggest for consideration to allow states to compare data from different state agencies to help in identifying non-compliant employers. For example, a simple compare between companies registered with unemployment tax to those with workers compensation coverage may help to identify problem employers.

PCI believes that NCOIL’s Proposed Employee Misclassification Workers’ Compensation Coverage Model Act should be considered as a first step in developing an appropriate model. We are more than willing to work with NCOIL on this endeavor. Please do not hesitate to contact PCI for further input and assistance.

Sincerely,



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