



*“The Voice of Business on Unemployment & Workers’ Compensation”*

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Jordan T. Estey  
National Conference of Insurance Legislators (NCOIL)  
Director of Legislative Affairs & Education  
Life, Health & Workers’ Compensation Insurance  
385 Jordan Road  
Troy, New York 12180

Dear Mr. Estey:

Thank you for the opportunity to comment on the “Proposed Employee Misclassification Workers’ Compensation Coverage Model Act”. UWC – Strategic Services is a national organization that focuses on Workers’ Compensation. We represent employers large and small in every industry and many national and state business trade organizations that are impacted by determinations of employer status and liability as well as determinations of employee status of those performing services.

UWC members favor sound state workers’ compensation and unemployment compensation systems that are properly administered in an even handed manner. Certainty of definition is extremely important to businesses seeking to determine current and future operating costs and risks associated with the employment of workers.

The definition of “employer” and “employee” have long been the subject of debate at the federal and state level with reference to an array of programs and with varying tax and administrative cost ramifications for employers. However, efforts to harmonize definitions across the states and across program areas often produce unintended consequences and may result in yet another layer of definitions for employers to sort out.

A Model Act has the potential of providing guidance and best practices that may be valuable to individual states as they consider legislation to address these issues. However, Model Acts may also be used as vehicles to press a particular point of view that is not widely shared.

I offer the comments below in the interest of developing a Model that is helpful in crafting provisions to promote even handed and consistent application of state workers’ compensation laws and reflect broadly held views about best practices that may be of value to individual states and employers.

**Definitions**

Before adopting a model set of definitions there should be a review of existing state definitions to determine what the impact of model provisions if adopted would be on the existing system. The definitions provided in this draft model are based on only two states (Florida and Wisconsin), and are not necessarily representative of all state definitions. The model also addresses the construction industry for special definition and treatment although the issue of proper classification is one which emerges in many other industries as well.

**Construction Industry**

Other states already have definitions of “construction industry” that have been agreed to through extensive legislative discussion and are similar but not identical to Florida’s. Is there a reason why the definition of “construction industry” applies only to for-profit activities? This special distinction suggests that the nature of the employer-employee relationship is different just because the employing entity is not for-profit? Misclassification in the construction industry may occur whether or not the individuals are employed in for-profit businesses.

The proposed definition also would establish an exception for a homeowner's acts of construction or the result of 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. Again this definitional exception creates more complications rather than streamlining determinations and introduces not only the determination of when construction has resulted on an individual's own property, but the difficult standard of determining the intent of the home owner with respect to future use of property. Also, the use of the modifier "substantial" creates an invitation to bickering over magnitude of work, and whether the contractor's efforts are or are not "substantial" enough to cause application.

The model suggests that the appropriate state department could, by rule, establish standard industrial classification codes and definitions thereof which meet the criteria of the term "construction industry". There are already codes established by the US Bureau of Labor Statistics (BLS) that have been accepted across the country. Model language should be clear in addressing the relationship between state determined industrial classification codes for the limited purpose of classifying individuals as employees under state workers' compensation law from those as defined by BLS.

### **Affiliated**

The term "affiliated" as proposed would include relatively minor connections between business entities including the pooling of equipment. Such connections between employers may serve to improve the operations of separate entities, but should not create a presumption that the business entities are "affiliated" for purposes of sharing liability with respect to alleged misclassification of workers as appears to be suggested by the model language.

### **Corporate Officer**

The definition of "Corporate officer" as suggested would provide a special definition for the construction industry that members of a limited liability company owning at least 10 percent of the company are "officers of a corporation". Of course limited liability companies are not corporations by definition, and unlike corporations, LLCs permit members to contribute their labor as well as other non-cash assets as well as cash as their contributions to the LLC. The members of limited liability companies may not be engaged in the operations of the entity at all, and in fact members may themselves be business entities. A provision deeming a member owning 10% of an LLC as an officer of a corporation" would be inconsistent with many state laws defining LLCs and inconsistent with the treatment of such members of LLCs for tax and reporting purposes and for programs other than workers' compensation.

The definition would also be limited to persons who fill offices provided for in the corporate charter or articles of incorporation filed with the state entity responsible for the determination and reporting of Corporations. As a practical matter this definition will make it more difficult for auditors to determine whether individuals who are serving as officers pending the determination by the state agency should be treated as officers or employees while they wait for determinations from another state agency. In some cases this will result in questions as to whether determinations of whether individuals are corporate officers for purposes of workers' compensation may be determined retroactively.

If the purpose of the definition is to pierce the corporate veil and determine that individuals are not in fact serving as corporate officers, then authority for that is better addressed as part of the definition in terms of the activities of and services provided by the individuals rather than relying on the determination of another agency that was made for a purpose not specific to workers' compensation.

### **Employee**

The definition is very broadly written, and will be in conflict with a number of existing state laws. Although the model language notes that state specific exemptions would not be included, it suggests that the model definition of "employee" should not provide for such exemptions. A better approach would be to identify the provisions that are universally or commonly included in state laws and suggest changes based on best practices rather than effectively establishing a presumption against deviations from the "model" definition.

The definition establishes a presumption that if an officer is compensated by other than dividends upon shares or stock of the corporation which the officer owns that the officer is an employee. This presumption is impractical as a general rule as it does not address the variety of ways in which individuals may be compensated and does not specifically address LLC officers that were included in the definition of corporate officer.

The definition would include sole proprietors or partners if they were not engaged in the construction industry and devoted full time to the proprietorship or partnership, and elect to be included in the definition of employee by filing notice thereof. This provision would exclude sole proprietors or partners who were engaged in the construction industry from the option of being treated as employees while extending this option to all other sole proprietors and partners. This appears to presume that sole proprietors and partners in the construction industry would be misclassified if this option were extended to them without first making any finding as to the facts of individual requests. A more even handed approach would be to describe conditions under which the option could be exercised and apply the conditions to all sole proprietors and partners.

The definition also creates a presumption that all persons, including independent contractors and sole proprietors who are being paid by a construction contractor as a subcontractor are to be employees without a review of the services performed or a review as to whether the individuals are in fact under the direction or control of an employer.

### **Employer**

The definition of “employer” is broader than many state definitions, and would include parties deemed to be in “actual control” of the corporation, including those who may indirectly own a controlling interest in the corporation. In many cases, individuals and entities may own significant shares of stock but not be involved in the operations of a company and the question of whether such investors have a controlling interest is very difficult to determine.

Unlike the “model” language providing for exceptions to accommodate existing state exemptions, this definition would seek the broadest definition of “Employer” without accommodating individual state exceptions.

The definition does suggest an exception for homeowners for 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. This special provision is consistent with the exception in the “construction industry” definition and would raise the question as to how to determine “intent” and the other issues identified with that definition above.

### **Independent Contractor**

The definition sets forth a presumption that independent contractors are employees unless the independent contractor is not engaged in the construction industry and meets nine criteria that are lifted from the Wisconsin statute.

This standard would differ significantly from the definitions currently in many state laws as well as the IRS and other definitions of “employee” and/or “employment”, and severely limits the circumstances under which individuals could not be employees.

It appears that all of the nine criteria are required to be met in order for an independent contractor who is not performing work or services in the construction industry to not be deemed to be an employee, even if the individual would not be determined to be an employee using a common law test or the IRS twenty questions for determination of direction or control.

The definition further would establish a new burden on the independent contractor to “prove” that he or she is an independent contractor for the purposes of the Act. This is a radical departure from the normal agency objective of the determination of employer status based on facts.

## **Coverage Requirements**

The coverage requirements would treat the officers of corporations who are engaged in the construction industry differently from officers of corporations in other industries and provides that no more than three officers of a corporation or of any group of affiliated corporations may elect to be exempt from the Act. It further limits those who may be officers to those who are shareholders, each owning at least 10 percent of the stock of such corporation and listed as an officer with the State. This special definition excludes the option to choose not to be covered to individuals who are legitimately working as officers in the construction industry who do not happen to have 10 percent of the stock of the corporation. What is the basis for this bright line absent any finding of fact that the individual was misclassified?

## **Application Requirements**

The model would include a provision that a carrier or self-insurance fund may require that an employer update an application monthly to reflect any change in the required application information. As written it appears that the monthly report could be required even if there were no change in the required application information. Monthly report requirements where there has been no change in application information increase administrative cost for employers and insurers. A revision to be clear that the reports may be required if there is a change in the required application information would be helpful.

A review of penalties for filing false, misleading, or incomplete information provided with the purpose of avoiding or reducing the amount of premiums under existing state law should be reviewed to determine whether a felony of the second degree is the appropriate criminal penalty to assure reporting compliance.

## **Payroll Audit Procedures**

The suggested requirements that employers in all classes other than construction be audited not less frequently than biennially and that employers in the construction industry be audited physically onsite annually impose significant administrative burdens for insurance carriers and employers and should be compared with current practices before setting such auditing standards.

The frequency of audits and detail required may not be feasible, particularly with respect to onsite audits and the expense of visiting multistate jobs and the fact that the jobsite may be completed at the time of the audit.

The model would require that upon conclusion of an employer audit, the insurance carrier would have the duty to report any employee or independent contractor misclassification, any uncovered or unreported employees, and any other violation of the Act. This potentially places the insurance carrier in a position of reporting "violations" before there has been resolution of issues identified in the audit. For example, failures to make payment may be resolved before billing.

## **Penalties**

The suggested Model would impose a \$5,000 per employee penalty on employers that fail to properly classify an individual as an employee. This fine seems excessive, particularly since the determination of whether an individual is an employee or independent contractor or an employee in the new dynamic workforce may be very difficult and subject to good faith argument. At a minimum there should be a determination of intent on the part of the employer to misclassify an individual before a penalty is imposed. The amount of the penalty should be determined based on a review of state practice and whatever is needed to assure proper compliance.

The penalty to be assessed by the department against an employer who fails to secure payment of compensation should also be compared against current state practice before setting a model penalty.

Likewise, penalties for failing to provide reasonable access to payroll records should be reviewed against current statutory provisions with a view to set penalties that will encourage compliance without being overly punitive.

Consultation with employers, insurance carriers and self-insurers should be conducted before setting penalties in statute for failure of an employer to provide information to its own insurance carrier

Although failure of a corporation, partnership, or sole proprietorship to secure workers' compensation coverage is a serious matter to be dealt with immediately and stop-work orders may be appropriate, the model language would extend the effect of a stop-work order not only to any successor corporation, but also to any business entity that has one or more of the same principals or officers as the corporation or partnership against which the stop-work order was issued if they are engaged in the same or equivalent trade or activity. This extension of the stop-order could very well extend to other entities that may have fully complied with the workers' compensation requirements. As a result, innocent employers could be adversely affected only because they share an officer with another employer that has failed to comply.

Penalties assessed against employers operating in violation of a stop-work order should be reviewed against current state laws to determine an appropriate penalty to assure compliance without unduly penalizing employers.

Thank you for the opportunity to submit comments.

I look forward to further review and discussion about this important topic.

Sincerely,

Douglas J. Holmes  
President  
UWC- Strategic Services on Unemployment  
& Workers' Compensation