Workers' Compensation AND THE Independent Contractor

FIELD NATION

Whitepaper

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Introduction

In today's gig economy individual workers seek to maximize their income and manage their own careers. This trend is expected to grow well into the future. Companies that want to compete need to shift and embrace these workers and the special regulations that govern them.

This whitepaper dives into the world of workers' compensation from its inception to the present day with a focus on how independent contractors fit into the workers' compensation scheme.

What's Workers' Compensation?

Traditional workers' compensation provides medical and wage replacement benefits for injured employees. When an employee is injured in the course of employment, they are generally covered by an employer's workers' compensation insurance subject to a few exceptions. If the injured worker is not an employee but an independent contractor, traditional workers' compensation may not apply unless the contractor purchased their own workers' compensation insurance.

History & Purpose of Workers' Compensation

Prior to the enactment of workers' compensation, employees were forced to sue their employer for negligence to collect damages. The negligence standard is a high bar for an employee to prove, so the process was ineffective. Many employees could not win their cases and ended up relying on state social security and unemployment benefits to get by. As a result, states began passing workers' compensation legislation throughout the 20th century to create a balance between worker and employer rights.

Wisconsin passed the first comprehensive workers' compensation law in 1911, while Mississippi was the last state in 1948. These early laws require employers to provide medical and wage replacement benefits for injured on-the-job workers. If the injured employee accepted these benefits, they forfeit their right to sue the employer – what is referred to as an "exclusive remedy." In other words, an injured worker who seeks workers' compensation gives up their right to recover tort damages for negligence or other claims for a "lesser" recovery of workers' compensation.

Basic Workers' Compensation Requirements

In the majority of states, coverage under the workers compensation statute is required for private and public employments. Each state enacts their own statutes, rules and regulations, and vary on what thresholds of coverage are required. States also offer exceptions to workers' compensation. Many states provide exceptions for sole proprietors–people who own their own business– or casual employees such as seasonal workers.

There are two ways to ensure workers' compensation is administered–by private insurance or collective funding. Most states allow for private insurance while some states/ jurisdictions are monopolistic fund states such as North Dakota, Ohio, Washington, Wyoming, Puerto Rico, and the U.S. Virgin Islands. In these jurisdictions, the states' administers exclusively fund the workers' compensation program. To determine what each state requires, look to each state's statutes.

Workers' Compensation and the Gig Economy

Workers' compensation functioned as planned when a conventional employer-employee relationship existed. But, the 21st century brought about a new relationship for workers. Technology created a new type of on-demand workforce - what industry experts call the gig economy.

Instead of traditional nine-to-five jobs, workers began turning to software platforms to find well-paying jobs that provide the worker with flexibility. Companies retain a worker to do a one-time assignment or task instead of hiring a W2 employee. This helps companies reduce costs and allows workers to pick up work when and where they need it.

Companies find that the gig economy is more efficient and helps reduce operating costs associated with full-time employees. As a result, there are a growing number of workers who are not participating in the traditional workers' compensation system. This is partly due to many workers no longer qualifying as an "employee" under state statutes, so they are not covered by a company's workers' compensation requirements.

Relationship of Gig Workers and Independent Contractors with Workers' Compensation

To avoid buying workers' compensation coverage, some companies - especially in high risk occupations - sought to retain independent contractors to avoid paying the high workers' compensation rates. This practice became pervasive within the long haul trucking industry.

Most states allow sole proprietors to "opt out" of the workers' compensation system. Some trucking firms allowed (encouraged) their drivers to declare themselves "independent contractors" and opt out of the workers' compensation system. The drivers would lease the tractor from the trucking company who would arrange for each load, instruct the driver where to go and when, and contract them to the trucking company on a full time basis. By using independent contractors the trucking firms reduced their personnel costs by 20% (the workers' compensation rate). The independent contractor driver would receive slightly higher pay and everyone was happy...until a driver had a claim.

As an employee of the trucking firm, the driver would have received workers' compensation benefits including wage replacement and medical costs. But by opting out, the driver commonly had no wage replacement and relied upon their personal health insurance plan for medical costs. If the driver was providential, the accident was caused by a third party, who had adequate automobile liability and the driver could recover/sue for damages. The problem was that it often took years for a lawsuit to be concluded, meanwhile the driver would file bankruptcy and end up relying upon the social welfare safety net programs of the state.

The second problem was that after an injury the independent contractor would attempt to renounce their independent contractor status and assert employee standing if they did not have medical and disability insurance. In addition to the contractor or the contractor's family, the assertion may come from third parties subrogated to the workers' compensation benefits such as health insurers, governmental entities who fund the social safety net. These risks were likely not contemplated by the organization that contracted with the independent contractor.

States soon took action to avoid the "independent contractor" scheme and enacted rules to determine if a person really was a "de facto" employee or a bona fide independent contractor.

Independent Contractor or Employee: The Control Issue

As more companies hired independent contractors, legislators had growing concerns for tax payments, misclassification, health insurance requirements and workers' compensation requirements. So, states created a

fig. 1-1 **Employee or Independent Contractor?**

For example, Minnesota developed a five factor test[1] to determine if a worker is an employee or independent contractor. The test involves analyzing the following five factors:

01	The right to control the means and manner of performance
02	The mode of payment
03	The furnishing of tools and materials
04	Control over the premises where the work was done
05	The right of discharge

framework to include people who may classify themselves as an independent contractor as an employee.

The degree of control one party has the right to exert over another has become the primary factor to consider and is the prime indication the individual is an employee and not an independent contractor.

To analyze the control factor in a particular situation, courts weigh multiple factors such as: if the worker is required to comply with instructions such as when, where and how the work is to be done; if the person was trained by the employer; if there is a continuing relationship; if the employer pays for travel, supplies, or tools; if the relationship is sporadic or frequent; if the worker is required to report to the employer, and so forth.

The Internal Revenue Service (IRS) also published guidelines concerning what is or what is not an independent contractor. The general rule is that an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done. However, whether a work relationship is considered to be an independent contractor or de facto employee depends on the facts in each case.

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State Opt-Out Provisions

Workers' compensation insurance is not required for people excluded under state law. Each state sets certain types of workers who are excluded from workers' compensation requirements. These categories are numerous, detailed, and vary greatly by state. Thoroughly review the workers' compensation law in your state to determine whether any of these categories apply to your particular situation.

Alternate Employer: Hiring Contractors through Third Parties

Companies can also retain the independent worker through a third party, who acts as contractor and subsequently sub-contracts with the on demand worker. Albeit, slightly more of a risk, the worker obtains an occupational accident insurance policy (wage replacement program), and the third party has a workers' compensation policy that provides a certificate of insurance along with an alternate employer endorsement naming the company as an insured. In the rare occasion the worker attempts to bring a workers' compensation claim to the purchasing company, the third party contractor workers' compensation coverage would provide the protection.

The alternate employer endorsement is an important element in the risk management program. The alternate employer endorsement affords the alternate employer both workers' compensation and Employers' Liability coverages. Workers compensation coverage protects the alternate employer in the event it is required to pay benefits to an injured on demand worker. Employers' liability coverage insures the alternate employer against lawsuits brought by injured workers.

Election and termination of coverage

A company can elect to provide workers' compensation coverage for individuals who would otherwise automatically be excluded under the law. When workers' compensation coverage is elected, the insured person becomes a "covered employee" as defined in the statute. The company may also terminate coverage of individuals for whom they had elected to provide coverage. When coverage is elected or terminated, the company must give written notice to the insurer. Coverage becomes effective the day after the insurer receives notice, or on the date stated in the notice. The person for whom coverage is elected will be listed on the workers' compensation insurance policy.

If a business functions as a general contractor or otherwise contracts with subcontractors, a general contractor is liable to the injured employee of the subcontractor if the subcontractor does not have workers' compensation insurance. Therefore, when a business analyzes its insurance needs, it needs to consider its potential exposure for injuries to subcontractors' employees, even if the business is exempted and not otherwise required to have workers' compensation insurance. The business itself must provide workers' compensation for its employee regardless if the owner of the business can opt-out.

Workers' Compensation Premium Audits

For companies who use independent contractors and issue 1099s, they encounter another issue. Workers' compensation insurance companies routinely undertake a workers' compensation premium audit to determine all persons who may be entitled to file a claim under the policy to be contemplated in the workers' compensation insurance premium.

Understandably, insurers want to collect premium for those who may give rise to a claim. Companies, on the other hand, equally fervent in minimizing their costs do not want to include those who should not be covered.

Standard payroll audit rules are any independent contractor without evidence of workers' compensation the contract price is included as payroll in the carriers workers' compensation payroll audit.

But, look to the rules in each state regarding opt-out provisions for sole proprietors or partners. In some states the independent contractor may formally opt out of coverage requirements or include a certificate of insurance for employers to avoid being charged for the exposure.

fig. 1-2 **Employer Reported Workplace Injuries and Illness 2016**[2]

2.9 million
nonfatal workplace injuries reported in 2016

2.9 cases
per 100 full-time employees

890,000+
work injuries resulted in days away from work

Most impacted Industries[3]

Health care

Manufacturing

Retail

Agriculture

What is the solution for hiring temporary workers?

The past ten years have reinvented a number of occupations into independent workers who control when and how they work. Increasing amounts of jobs are not location dependent, completed at home or with a worker's own tools. Local taxi services have been revolutionized with companies like Uber and Lyft. Other industries are also undertaking a transformation on how business is conducted such as Airbnb or TaskRabbit.

The insurance community, insurance regulators and state legislatures are adapting laws and regulations to address "gig economy" workers to reduce the adverse effect of an injured worker not having adequate wage replacement and medical coverage for an on the job injury.

While insurance companies and regulations catch up with the by-the-job worker, what can companies do to mitigate the risk of hiring such workers? There are essentially three approaches companies can take to minimize work related injury costs.

Low Risk:

Require independent workers to purchase workers' compensation for themselves and not "opt-out" of the workers' compensation system even if eligible, before work begins.

Medium Risk:

Retain the independent worker through a third party, who acts as contractor and subsequently sub-contracts with the on demand worker.

High Risk:

Contract with an on demand worker and either not require any indication of workers' compensation or "opt-out" arrangement. If the on demand worker has any employee or attempts to pursue renouncing their independent contractor status, the company may be required to provide the worker with workers' compensation benefits. In addition, the workers' compensation premium auditor may include the 1099 compensation as workers' compensation payroll in the company's audit.

Conclusion

The contingent workforce and use of independent contractors is becoming the regular course of business. As the gig economy continues expanding, companies that want to compete need to shift and embrace contingent workers and the special regulations that govern them.

About Field Nation

Field Nation connects businesses with service providers and partners with them to complete projects. Field Nation combines marketplace coverage with project management tools to deliver on-site expertise anytime, anywhere. Whether companies of 1 or 1,000 need to manage internal staff projects, contingent workforce tasks, or source local service providers for immediate needs, Field Nation is the number one choice to get work done.

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Manage.
Engage.

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SOURCES

1. Newland v. Overland Express, Inc., 295 N.W.2d 615 (Minn. 1980); Werneke v. Lakeside Lawn & Landscape, 65 W.C.D. 615 (2005).
2. https://www.bls.gov/news.release/archives/osh_11092017.pdf
3. https://www.bls.gov/iif/osch0060.pdf

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