

**WORKING DRAFT**

**Proposed Employee Misclassification Workers' Compensation Coverage Model Act**

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*To be considered by the NCOIL Workers' Compensation Insurance Committee at the 2009 Annual Meeting.*

**Sponsored for discussion by Rep. Charles Curtiss (TN) and Sen. Ralph Hudgens (GA)**

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**Section 1. Summary**

This Act will establish clear definitions of an employee and an independent contractor for purposes workers' compensation benefits. The model sets a nine-point test to define an independent contractor; mandates workers' compensation coverage in the construction industry, with certain exemptions; establishes insurer application and auditing procedures; provides penalties for employee misclassification and insurance fraud; and provides strict enforcement powers.

**Section 2. Definitions**

- A. 1. "Affiliated" means and includes one or more corporations or entities, under the same or substantially the same control of a group of business entities which are connected or associated so that one entity controls or has the power to control each of the other business entities.
- 2. "Affiliated" includes, but is not limited to, the officers, directors, executives, shareholders active in management, employees, and agents of the affiliated corporation. The ownership by one business entity of a controlling interest in another business entity or a pooling of equipment or income among business entities shall be *prima facie* evidence that one business is affiliated with the other.
- B. "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.

*Drafting Note: The [Insert Appropriate State Department] could, by rule, establish standard industrial classification codes and definitions thereof which meet the criteria of the term "construction industry" as set forth in this section.*

- C. "Corporate officer" or "officer of a corporation" means any person who fills an office provided for in the corporate charter or articles of incorporation filed with the *[Insert State Division of Corporations]* under *[Insert State Chapter Relating to Corporations]*. As to persons engaged in the construction industry, the term "officer of a corporation" includes a member owning at least 10 percent of a limited liability company created and approved under *[Insert State Chapter Relating to Limited Liability Companies]*.
- D. 1. "Employee" means any person who receives remuneration from an employer for the performance of any work or service while engaged in any employment under any appointment or contract for hire or apprenticeship, express or implied, oral or written, whether lawfully or unlawfully employed, and includes, but is not limited to, aliens and minors. "Employee" includes:
- a. Any person who is an officer of a corporation and who performs services for remuneration for such corporation within this state, whether or not such services are continuous. Services are presumed to have been rendered to the corporation if the officer is compensated by other than dividends upon shares of stock of the corporation which the officer owns.
  - b. A sole proprietor or a partner who is not engaged in the construction industry, devotes full time to the proprietorship or partnership, and elects to be included in the definition of employee by filing notice thereof as provided in *[Insert Appropriate State Statute]*.
  - c. All persons, including independent contractors and sole proprietors who are being paid by a construction contractor as a subcontractor, unless the subcontractor has validly elected an exemption as permitted by *[Insert Appropriate State Statute]*, or has otherwise secured the payment of compensation coverage as a subcontractor, consistent with Section 3(A)(2), for work performed by or as a subcontractor.
2. "Employee" does not include:
- a. Any state-specific exemptions.
- Drafting Note: Each state exempts certain types of jobs from its workers' compensation statutes. These exemptions include, among others, newspaper deliverymen, real estate agents, taxi cab drivers, and professional athletes.*
- b. An independent contractor as defined in Section 2(F)(2) who is not engaged in the construction industry.
- E. 1. "Employer" means the state and all political subdivisions thereof, all public and quasi-public corporations therein, every person carrying on any employment, and the legal representative of a deceased person or the receiver or trustees of any person. "Employer" also includes employment agencies and Professional Employer Organizations (PEOs) as defined and regulated by *[Insert State Chapter Relating to Employee Leasing Companies]*. If the employer is a corporation, parties in actual control of the corporation, including, but not limited to, the president, officers who exercise broad corporate powers, directors, and all shareholders who directly or indirectly own a controlling interest in the corporation, are considered the employer for the purposes of this Act.

2. 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.
- F.
  1. Except as provided in Section 2(F)(2), an "independent contractor" is, for the purpose of this Act, an employee of any employer under this Act for whom he or she is performing service in the course of the trade, business, profession or occupation of such employer at the time of the injury.
  2. An "independent contractor" is not an employee of an employer for whom the independent contractor performs work or services if the independent contractor is not engaged in the construction industry and meets the following nine criteria:<sup>1</sup>
    - a. The independent contractor maintains a separate business with his or her own office, equipment, materials, and other facilities.
    - b. The independent contractor maintains or has applied for a federal employer identification number with the federal internal revenue service or has filed business or self-employment income tax returns with the federal internal revenue service based on that work or service in the previous year.
    - c. The independent contractor operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls, under contract and in fact, the performing of the services or work.
    - d. The independent contractor incurs the main expenses related to the service or works that he or she performs under contract.
    - e. The independent contractor is responsible for the satisfactory completion of work or services that he or she contracts to perform and is liable for a failure to complete the work or service.
    - f. The independent contractor receives compensation for work or service performed under a contract on a commission or per job or competitive bid basis and not on any other basis.
    - g. The independent contractor may realize a profit or suffer a loss under contracts to perform work or service.
    - h. The independent contractor has continuing or recurring business liabilities or obligations.
    - i. The success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.
  3. Notwithstanding anything to the contrary in this subparagraph, an individual claiming to be an independent contractor has the burden of proving that he or she is an independent contractor for purposes of this Act.
- G. "Partner" means any person who is a member of a partnership that is formed by two or more persons to carry on as co-owners of a business with the understanding that there will be a proportional sharing of the profits and losses between them. For the purposes of this Act, a partner is a person who participates fully in the management of the partnership and who is personally liable for its debts.

H. "Sole proprietor" means a natural person who owns a form of business in which that person owns all the assets of the business and is solely liable for all the debts of the business.

### **Section 3. Coverage Requirements**

- A. 1. Every employer coming within the provisions of this Act shall be liable for, and shall secure, the payment of workers' compensation benefits for its employees.
- a. Any officer of a corporation may elect to be exempt from this Act by filing written notice of the election with the *[Insert Appropriate State Agency]* as provided in *[Insert Appropriate State Agency]*.
  - b. As to officers of a corporation who are engaged in the construction industry, no more than three officers of a corporation or of any group of affiliated corporations may elect to be exempt from this Act by filing written notice of the election with the *[Insert Appropriate State Agency]* as provided in *[Insert Appropriate State Statute]*. Officers must be shareholders, each owning at least 10 percent of the stock of such corporation and listed as an officer of such corporation with the State, in order to elect exemptions under this Act.
  - c. An officer of a corporation who elects to be exempt from this Act by filing a written notice of the election with the *[Insert Appropriate State Department]* as provided in this section is not an employee.
2. 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.
3. 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.
- B. 1. If a contractor becomes liable for the payment of compensation to the employees of a subcontractor who has failed to secure such payment in violation of Section 3(A)(3), the contractor or other third-party payor shall be entitled to recover from the subcontractor all benefits paid or payable plus interest unless the contractor and subcontractor have agreed in writing that the contractor will provide coverage.
2. If a contractor or third-party payor becomes liable for the payment of compensation to the corporate officer of a subcontractor who is engaged in the construction industry and has elected to be exempt from the provisions of this Act, but whose election is invalid, the contractor or third-party payor may recover from the claimant or corporation all benefits paid or payable plus interest, unless the contractor and the subcontractor have agreed in writing that the contractor will provide coverage.
- C. A subcontractor providing services in conjunction with a contractor on the same project or contract work is not liable for the payment of compensation to the employees of another subcontractor or the contractor on such contract work and is protected by the exclusiveness-of-liability provisions of *[Insert State Statute Relating to Exclusiveness of Liability]* from any action at law or in admiralty on account of injury to an employee of another subcontractor, or of the contractor, provided that:

1. The subcontractor has secured workers' compensation benefits for its employees or the contractor has secured such benefits on behalf of the subcontractor and its employees in accordance with Section 3(A), and
2. The subcontractor's own gross negligence was not the major contributing cause of the injury.

#### **Section 4. Employer/Contractor Disclosure Requirements**

- A. Employers shall make available all records necessary for the payroll verification audit and permit the auditor to make a physical inspection of the employer's operation.
- B. A contractor shall require a subcontractor to provide evidence of workers' compensation insurance. A subcontractor who is a corporation and has an officer who elects to be exempt as permitted under this Act shall provide a copy of his or her certificate of exemption to the contractor.
- C. Each employer must submit a copy of the quarterly earning report at the end of each quarter to the insurance carrier and submit self-audits supported by the quarterly earnings reports and the rules adopted by the state agency providing unemployment tax collection services. The reports must include a sworn statement by an officer or principal of the employer attesting to the accuracy of the information contained in the report.
- D. A contractor shall require a subcontractor, including independent contractors and sole proprietors working in the construction industry, to have available at all times, information required by Section 4(B).

#### **Section 5. Application Requirements**

- A. Applications by an employer to a carrier for coverage required by Section 3 must be made on a form prescribed by the *[Insert State Insurance Department]*. The *[Insert State Insurance Department]* shall adopt rules for applications for coverage required by Section 3. The rules must provide that an application include information on the employer, the type of business, past and prospective payroll, estimated revenue, previous workers' compensation experience, employee classification, employee names, and any other information necessary to enable a carrier to accurately underwrite the applicant. The rules must 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.
- B. The application must contain a statement that the filing of an application containing false, misleading, or incomplete information provided with the purpose of avoiding or reducing the amount of premiums for workers' compensation coverage is a felony of the second degree.
- C. The application must contain a sworn statement by the employer attesting to the accuracy of the information submitted.
- D. The application must contain a sworn statement by the agent attesting that the agent explained to the employer or officer the classification codes that are used for premium calculations.

#### **Section 6. Payroll Audit Procedures**

- A. The *[Insert State Workers' Compensation Department]*, in consultation with the *[Insert State Insurance Department]*, shall establish by rule minimum requirements for audits of payroll and classifications in order to ensure that the appropriate premium is charged for workers' compensation coverage. The rules shall ensure that audits performed by both insurance carriers and employers are adequate to provide that all sources of payments to employees, subcontractors, and independent

contractors have been reviewed and that the accuracy of classification of employees has been verified.

- 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.
- 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.
- D. Payroll verification audit rules must include, but need not be limited to, the use of state and federal reports of employee income, payroll and other accounting records, certificates of insurance maintained by subcontractors, and duties of employees.
- 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.
- 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.

## **Section 7.      Penalties**

- A. For the purposes of this section, "securing the payment of workers' compensation" means obtaining coverage that meets the requirements of Section 3. However, if at any time an employer materially understates or conceals payroll, materially misrepresents or conceals employee duties so as to avoid proper classification for premium calculations, or materially misrepresents or conceals information pertinent to the computation and application of an experience rating modification factor, such employer shall be deemed to have failed to secure payment of workers' compensation and shall be subject to the sanctions set forth in this section.
- B. If an employer fails to secure compensation as required by Section 3 of this Act, the *[Insert State Workers' Compensation Department]* shall assess against the employer a penalty not to exceed \$5,000 for each employer that fails to properly classify an individual as an employee.
- C. In addition to any other penalty prescribed by this section, the department shall assess against any employer who has failed to secure the payment of compensation as required by Section 3 a penalty equal to 1.5 times the amount the employer would have paid in premium when applying approved manual rates to the employer's payroll during periods for which it failed to secure the payment of workers' compensation required by this section within the preceding 3-year period or \$1,000, whichever is greater.
- D. If an employer fails to provide reasonable access to payroll records for a payroll verification audit under Section 4, the employer shall pay a premium to the carrier or self-insurer not to exceed three times the most recent estimated annual premium.
- E. Submission of an application that contains false, misleading, or incomplete information provided with the purpose of avoiding or reducing the amount of premiums for workers' compensation coverage is a felony of the second degree.
- F. If the employer fails upon request of the auditor to provide access to the documents specified in Section 4 and the carrier cannot complete the audit as a result, the employer shall pay \$500 to the carrier to defray the costs of the audits.

- G. 1. Whenever the *[Insert State Workers' Compensation Department]* determines that an employer who is required to secure the payment to his or her employees of the compensation provided for by this Act has failed to secure the payment of workers' compensation required by this Act or to produce the required business records under Section 4 within five (5) business days after receipt of the written request of the *[Insert State Workers' Compensation Department]*, such failure shall be deemed an immediate serious danger to public health, safety, or welfare sufficient to justify service by the *[Insert State Workers' Compensation Department]* of a stop-work order on the employer, requiring the cessation of all business operations. If the *[Insert State Workers' Compensation Department]* makes such a determination, the *[Insert State Workers' Compensation Department]* shall issue a stop-work order within 72 hours.
2. In addition to serving a stop-work order at a particular worksite which shall be effective immediately, the department shall immediately proceed with service upon the employer which shall be effective upon all employer worksites in the state for which the employer is not in compliance; provided that, if the employer cannot be found and served under due diligence the department may execute service by publishing the stop work order for one week in a news publication having general circulation in the *[names of cities]* metropolitan areas.
3. A stop-work order may be served with regard to an employer's worksite by posting a copy of the stop-work order in a conspicuous location at the worksite. The order shall remain in effect until the *[Insert State Workers' Compensation Department]* issues an order releasing the stop-work order upon a finding that the employer has come into compliance with the coverage requirements of this Act and has paid any penalty assessed under this section.
4. The *[Insert State Workers' Compensation Department]* may issue an order of conditional release from a stop-work order to an employer upon a finding that the employer has complied with coverage requirements of this section and has agreed to remit periodic payments of the penalty pursuant to a payment agreement schedule with the *[Insert State Workers' Compensation Department]*. If an order of conditional release is issued, failure by the employer to meet any term or condition of such penalty payment agreement shall result in the immediate reinstatement of the stop-work order and the entire unpaid balance of the penalty shall become immediately due.
5. The *[Insert State Workers' Compensation Department]* may require an employer who is found to have failed to comply with the coverage requirements of Section 3 to file with the *[Insert State Workers' Compensation]*, as a condition of release from a stop-work order, periodic reports for a probationary period that shall not exceed 2 years that demonstrate the employer's continued compliance with this section. The *[Insert State Workers' Compensation Department]* shall by rule specify the reports required and the time for filing under this subsection.
- H. Stop-work orders and penalty assessment orders issued under this section against a corporation, partnership, or sole proprietorship shall be in effect against any successor corporation or 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 and are engaged in the same or equivalent trade or activity.
- I. It shall be unlawful for any person to knowingly violate a stop-work issued by the *[State Workers' Compensation Department]* and punishable by a felony of the third degree.
- J. The *[Insert State Workers' Compensation Department]* shall assess a penalty of \$1,000 per day against an employer for each day that the employer conducts business operations that are in violation of a stop-work order.

- K. Any agency action by the department under this section, if contested, must be contested as provided in [*Insert State Chapter Relating to Judicial Review*].

**Section 8. Enforcement**

- A. The [*Insert State Workers' Compensation Department*] shall enforce workers' compensation coverage requirements, including the requirement that the employer secure the payment of workers' compensation, and the requirement that the employer provide the carrier with information to accurately determine payroll and correctly assign classification codes. In addition to any other powers under [*Insert State Statute*], the [*Insert State Workers' Compensation Department*] shall have the power to:
1. Conduct investigations for the purpose of ensuring employer compliance.
  2. Enter and inspect any place of business at any reasonable time for the purpose of investigating employer compliance.
  3. Examine and copy business records.
  4. Administer oaths and affirmations.
  5. Certify to official acts.
  6. Issue and serve subpoenas for attendance of witnesses or production of business records, books, papers, correspondence, memoranda, and other records.
  7. Issue stop-work orders, penalty assessment orders, and any other orders necessary for the administration of this section.
  8. Enforce the terms of a stop-work order.
  9. Levy and pursue actions to recover penalties.
  10. Seek injunctions and other appropriate relief.
- B. The [*Insert State Workers' Compensation Department*] shall designate representatives who may serve subpoenas and other process of the [*Insert State Workers' Compensation Department*] issued under this Act.
- C. The [*Insert State Workers' Compensation Department*] shall specify by rule the business records that employers must maintain and produce to comply with this Act.
- D. Any law enforcement agency in the state may, at the request of the [*Insert State Workers' Compensation Department*], render any assistance necessary to carry out the provisions of this section, including, but not limited to, preventing any employee or other person from remaining at a place of employment or job site after a stop-work order or injunction has taken effect.
- E. The [*Insert State Workers' Compensation Department*] shall adopt rules to administer this section.

**Section 9. Severability**

If any section, paragraph, sentence, clause, phrase, or any part of this Act passed is declared invalid, the remaining sections, paragraphs, sentences, clauses, phrases, or parts thereof shall be in no manner affected and shall remain in full force and effect.

**Section 10. Effective Date**

This Act shall take effect immediately.

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