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## WORKERS' COMPENSATION

# The Legal and Financial Ramifications of Uninsured Status in Workers' Comp Claims

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*Special to the Legal*

Hiring independent contractors is a growing practice for many businesses, allowing them to take on work larger in scope without all of the associated costs involved in hiring full-time employees—including the expense of workers' compensation insurance.

However, the use of independent contractors may also lead to the unforeseen risk for businesses of being deemed an uninsured employer or statutory employer under the Pennsylvania Workers' Compensation Act (the act), which can expose businesses to significant expense and criminal prosecution under the act, as well as liability under the Construction Workplace Misclassification Act (CWMA). Similarly, insured out-of-state employers may be uninsured for their Pennsylvania employees' claims if their out-of-state policies do not provide coverage for Pennsylvania claims.

Given the financial and criminal risks facing an uninsured employer, companies doing business in Pennsylvania should take care to understand the law and the financial and legal ramifications they face.



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### AN INDEPENDENT CONTRACTOR CHANGES EVERYTHING

An uninsured business who hires an independent contractor faces financial and criminal exposure if the independent contractor is not considered as such under Pennsylvania law or as statutory employer because the independent contractor is uninsured:

- If a contractor does not meet the criteria of an independent contractor, the uninsured business that hired him/her could be legally responsible as their employer. The uninsured "employer" risks exposure for personal responsibility for wage-loss benefits and medical treatment, as well as fines and criminal penalties under the act. If the independent contractor worked in the construction industry, there could be additional

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fines and criminal penalties under the CWMA.

In distinguishing an employee from an independent contractor, the court does not elevate form over substance as dispositive, e.g., use of 1099s. Under the traditional analysis, the court considers well-established common law factors such as control over the work, nature of the work, skill required, and tools, among others. However, if the independent contractor was performing services in the construction industry, the CWMA applies.

The CWMA was passed in 2010 to prohibit the misclassification of employees for purposes of workers' compensation and unemployment claims, which often left workers

without a remedy. The CWMA provides specific criteria for someone to be an independent contractor:

- A written contract for services, which must be signed before the injury.
- The person doing the work is free from control or direction by the other party, both in the contract and “in fact.”
- The person doing the work is “customarily engaged in an independently established trade, occupation, or business.”

The CWMA specifically excludes the failure to withhold income taxes or to pay workers’ compensation and unemployment insurance as criteria to be considered. The CWMA also sets forth criteria to define “customarily engaged,” which are analogous to the factors used in common-law, and adds a requirement that the independent contractor maintain at least \$50,000 in liability insurance during the life of the contract. If there is no insurance and no contract, there is no independent contractor under the CWMA.

In *Staron v. Workers’ Compensation Appeal Board (Farrier)*, the Commonwealth Court found that a worker was an employee under the CWMA when he signed a contract for services after the injury occurred. However, in *Hawbaker v. Workers’ Compensation Appeal Board (Kriner’s Quality Roofing Services)*, the injured worker was an independent contractor under the CWMA even though he had not signed a contract before the job where he was injured. In *Hawbaker*, the parties had a signed contract for a previous job, which was silent on contract’s duration but stated how it could be terminated. The court found that since neither party had terminated the contractor according to its terms, the contract was still in effect when the worker was injured.

However, the CWMA does not apply to all claims involving construction activities. The person has to perform services in the construction industry. Construction is defined as “erection, reconstruction, demolition, alteration, modification, custom fabrication, building, assembling, site preparation and repair work done on any real property or premises under contract ...” However, the CWMA provides no guidance for how broadly to interpret “in the construction industry.”

In *Department of Labor & Industry v. Workers’ Compensation Appeal Board (Lin & Eastern Taste)*, a worker was hired to do remodeling for a restaurant, Eastern Taste. Under a traditional analysis, the worker was found to be an independent contractor. The Pennsylvania Supreme Court also found the CWMA did not apply. The court rejected the workers’ argument that the CWMA applied because he was performing construction activities. The court explained that “[t]he construction activity must be analyzed and considered in the context of the putative employer’s industry or business.” In the claim, the court noted that the relationship between the worker and Eastern Taste was analogous to that between a homeowner and contractor hired for work, and concluded that since Eastern Taste was a restaurant, the worker did not perform services “in the construction industry.”

• Even though an independent contractor meets the legal definition, an uninsured business faces exposure for claims if the independent contractor has employees but is uninsured. The independent contractor is primarily liable for the claim, but under Section 302 of the Act, the uninsured business could be secondarily liable as a statutory employer.

Statutory employer status can be perplexing because responsibility for an injury is being transferred to a

party in the absence of an employment relationship with the injured worker. A statutory employer is created by the Act to protect a subcontractor’s employees under certain situations, and “to prevent general contractors from getting a ‘free walk’ if they did not require their subcontractors to carry workers’ compensation insurance.” *Six L’s Packing v. Workers’ Compensation Appeal Board (Williamson)*, 44 A.3d 1148, 1154 (Pa. 2012.)

The definition of statutory employer under Section 302(a)(2) is not as narrow as other sections of 302, and only requires that a business contract out a “regular or recurrent” part of its business. The court does not just consider the activity that was contracted out; it looks at the business as a whole. For example, in *Six L’s Packing v. WCAB*, Six L’s business involved growing, harvesting, processing, and distributing produce; however, it did not own trucks or hire drivers but contracted with an uninsured transportation company. When a driver was injured, Six L’s was legally determined to be the statutory employer. The Pennsylvania Supreme Court rejected Six L’s argument that its business was not transportation, because it determined transportation was an essential part of Six L’s business.

## INSURANCE COVERAGE IN OTHER STATES

An insured out-of-state employer or putative statutory employer may also be deemed uninsured and face personal responsibility under the act if coverage is denied by the terms of the out-of-state policy. Before starting work in Pennsylvania, an out-of-state employer should be familiar with the relevant provisions of its policy to ensure Pennsylvania workers’ compensation claims are covered to avoid future disputes and the risk of personal liability as an uninsured employer.

One area of dispute concerns “other states” coverage. Although the employer’s policy may provide coverage for claims in other states, there may be notice requirements that could be a basis to exclude coverage if not followed.

## **PAYMENTS, FINES AND CRIMINAL PENALTIES**

The uninsured employer is the first party responsible for an injured worker’s claim. The statutory employer faces secondary responsibility if the uninsured employer does not pay or defaults. If insured, the statutory employer’s policy will cover the claim, but if uninsured, he/she faces personal responsibility for payment. Both the carrier and uninsured statutory employer can seek reimbursement of payments and expenses from the uninsured employer.

The Uninsured Employer Guaranty Fund (UEGF) is responsible if the uninsured employer and statutory employer do not pay or default. The UEGF will then seek reimbursement from any responsible party for benefits paid and other payments, which under Section 1605 includes costs, interests, penalties and attorney fees, plus costs and attorney fees to seek reimbursement of its payments.

The uninsured employer also faces fines and criminal penalties under the act. Under Section 305 of the act, failure to maintain insurance is a third-degree misdemeanor or a third-degree felony if failure to insure was intentional. The fines and jail time range from up to a \$2,000 fine and one year in jail for the misdemeanor, up to a \$15,000 fine and seven years in jail for the felony. Each day an employer is uninsured is a separate offense; however, under Section 1112, prosecutions are subject to a five-year statute of limitations.

If the CWMA applies, there are additional administrative fines and

criminal penalties. A violation of the CWMA occurs when a company misclassifies workers’ as independent contractors and fails to maintain workers’ compensation insurance. A first offense is a third-degree misdemeanor and each subsequent offense is a second-degree misdemeanor; both carry jail time and fines.

Misclassification can be negligent and subject to a fine as a summary offense, but prior convictions for negligence shall be evidence of intent in criminal proceeding proceedings for misclassification. An employer can also be fined if it requires employees to sign a document that results in them being misclassified.

A statutory employer could also be subject to the penalties and fines under the CWMA if it knew the contractor misclassified employees. Under the CWMA, a party who intentionally contracts with an employer it knows intends to misclassify employees is subject to the same fines and penalties as the employer who misclassified the worker.

## **RECOMMENDATIONS**

Businesses that are uninsured and hire independent contractors face substantial financial and criminal exposure under the act and the CWMA, they need to be proactive:

- Examine business practices to ensure independent contractors meet the criteria under the law. If the CWMA applies, the contractor must sign the contract before the job begins and have the required insurance. If the business has employees, it must have insurance.

- Do not misclassify workers under the CWMA and do not intentionally contract with a party who intends to misclassify workers. Require the contractor to acknowledge in the contract that it will not misclassify workers’ under the CWMA and that they will provide the business with

copies of contracts and proofs of insurance for independent contractors hired during the life of the contract.

- Contractually obligate the contractor to maintain workers’ compensation insurance if it has employees at any time during the life of the contract, and to name the business as an additional insured on the policy, as well as include an indemnification provision with personal guaranty if the contractor fails to maintain such insurance.

- In the contract, be sure to include the business’ rights and remedies as allowed by law for the contractor’s misclassification of workers and failure to maintain workers’ compensation insurance. For example, the business may terminate the contract or pay the premiums for the duration of the job, then deduct the cost from the final payment to the contractor. If the contract involves a private construction project, ensure all terms comply with the Contractor and Subcontractor Payment Act as revised in 2018.

- Before doing work in Pennsylvania, an insured out-of-state employer should confirm with the carrier or agent that injuries in Pennsylvania will be covered and the steps required to ensure coverage – and confirm in writing. Be sure to obtain any separate coverage that is needed.

While all risks cannot be eliminated, these are some of the steps a business can take to reduce their exposure related to independent contractors and uninsured status. •