



National Association of Insurance Commissioners

# **An Overview of Workers' Compensation Independent Contractor Regulatory Approaches**

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**NAIC/IAIABC Joint Working Group of the  
Workers' Compensation (C) Task Force**

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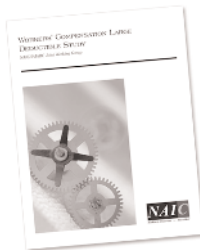
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## ***Executive Summary***

Because it is social insurance, universal coverage of employees is a cherished principle of workers' compensation. Yet, from the beginning, workers' compensation laws exempted certain workers. The subject of this paper is the exemption commonly given to "independent contractors." Establishing criteria for an independent contractor vis-a-vis an employee has proven to be very challenging to jurisdictions.

In the review of state criteria and their administration, we find a wide range of approaches. Indeed, a key finding of this paper is that "control" of the work is a core principle that government programs continue to honor as the key principle defining employment versus contracting. Yet control is hard to measure and can be easily feigned. Seeking more certainty in the application of the law, states have developed an abundant range of other criteria and screens to more easily and clearly separate employees from contractors.

The paper discusses the ramifications of different laws and procedures. Equity and economic freedom are considered. The paper stresses the impact of different screening systems on the administration of the workers' compensation system.

The paper takes no specific position on which class of regulatory system a state should use. But it does offer several recommendations for improving the smooth and fair application of exemptions for independent contractors. These recommendations stress clarity in the criteria and a vigorous educational campaign by states and insurers to help employers understand the criteria and how they will be applied by state enforcement agencies and insurers at time of audit.

## ***Purpose***

The basic premise of the workers' compensation system is that employers assume financial responsibility for paying or insuring the statutory benefits for work-related injuries to their employees. But, as we discuss below, there is often a clash in social values between universal protection for employees and individual freedom to make a living as a self-employed person.

Workers' compensation laws typically address this tradeoff by making coverage optional for self-employed workers, working owners of closely held business entities, and their immediate family members. However, this exemption creates other problems. On one hand, employers wishing to evade their workers' compensation responsibilities can try to pass their employees off as self-employed independent contractors. On the other hand, insurers wishing to maximize premium collection or uncertain about the employment status of individuals (and therefore about the insurer's potential liability to pay them benefits in case of injury), may characterize legitimate independent contractors as employees. The integrity of the workers' compensation system depends on having effective mechanisms in place to deal with the potential for abuse by employers or insurers. The integrity and efficacy of the system are also promoted by minimizing insurer-policyholder conflicts over employment status and related premium determination and collection issues.

Perceptions of abuse and imbalance in regulating the status of independent contractor exemptions are increasingly in the news. Within the last 12 months, Connecticut, New Hampshire, New York, New Jersey and Michigan are among the states passing new legislation or announcing administrative crackdowns on misclassification of independent contractors. In Congress, the *Employee Misclassification Act of 2008* was introduced to fight deliberate misclassification to avoid unemployment insurance and payroll taxes.

This paper describes the various approaches jurisdictions have taken to address these problems. There is significant educational and reference value in describing and comparing these approaches, but more importantly, this process will shed light on the public policy goals of various laws and provide ideas and models for policymakers seeking to improve their systems. In studying how these laws are actually administered and enforced, we can learn about their effect on the costs to government agencies, employers and insurers. Finally, this paper will help workers' compensation regulators and insurance regulators better understand each other's issues and perspectives when presented with questions about independent contractors. Based on the findings of this comparative study, six recommendations are proposed at the conclusion of this paper that should assist regulators in learning about best practices of other jurisdictions.

## ***Background***

Throughout the United States and Canada, an employer covered by the workers' compensation act is responsible for guaranteeing payment of workers' compensation benefits to employees who sustain compensable injuries, i.e., injuries that arise out of and in the course of their employment. In exchange for this guaranteed benefit, the employer is immunized from a tort suit for negligence in causing or contributing to the injury. However, if the injured person is an independent contractor,

not an employee, the business that hired the independent contractor is not liable for benefits under workers' compensation laws, and it is not immune from a suit alleging its negligence in causing the injury. While some recourse for an injured independent contractor may occasionally be available in tort, the uncertainty and inadequacy of tort compensation is exactly the reason jurisdictions have embraced near universal coverage of work situations under workers' compensation.

"Independent contractor," as used in this report, means an individual who has no legally defined employment relationship (for purposes of workers' compensation) with the entity for which he/she performs paid services. As we will describe in detail, establishing workable tests for when a person qualifies as an independent contractor is difficult. Allowing a business and a worker simply to declare by contract that the worker is not an employee would erode the universal coverage principle of the workers' compensation system and leave an unacceptable number of workers vulnerable to catastrophic loss of income and huge medical bills. This would lead in turn to family hardship, bankruptcy and the shifting of support to other social safety nets. Moreover, in an optional system, legal protections given to employees would be compromised whenever the employer has enough bargaining power to dictate independent contractor status as a condition of hiring.<sup>1</sup>

For these reasons, jurisdictions generally prohibit a worker from waiving the legal right to file a workers' compensation claim merely by agreeing in advance to be treated as an independent contractor rather than as an employee. This gives rise to a second problem—renouncing the declaration of independence after an injury. A contractor who is seriously injured and does not have medical and disability insurance may have second thoughts about their declaration of independence. After consulting with an attorney, they might find grounds for asserting employment status. Such a claim might be filed personally by the worker, or might be filed on his or her behalf by a third party subrogated to the worker's rights, such as a health insurer, a governmental benefit program, or the alleged employer's general liability insurer. This puts the hiring employer and that employer's insurer at risk for exposures to workers' compensation loss that were not thought to exist.

At this point, the worker's employment status will become a contested issue to be decided by the state's process for resolving disputed claims. Because an assertion that a worker is an independent contractor might not even be recognized as a disputed issue until after an injury has been sustained and a claim filed, the result can be a significant uncertainty in the calculation of fair and reasonable insurance premiums.

Most states require employers responsible for workers' compensation to purchase a workers' compensation insurance policy to ensure delivery of benefits for compensable claims. In exchange for unknown future risks, the insurance carrier receives consideration in the form of premium. To be fair to both insurers and policyholders, and to reduce the overall cost of the system, the determination of exposures to claims and recovery of premium for these exposures must be fair and efficient. The National Council on Compensation Insurance (NCCI) *Basic Manual* Rule 2-A states: "Premium is calculated on the basis of the total payroll paid or payable by the insured for services of individuals who could receive workers [sic] compensation benefits for work-related injuries as provided by the policy."<sup>2</sup>

Premium is estimated at the inception of the policy based on projected payroll, with the final premium determined by audit of actual payroll after the policy period has ended. The problem arises because of the difficulty in determining individual status to receive workers' compensation benefits as provided by the policy. Since the employer's insurer is only responsible for injuries to employees, independent contractors are not counted when determining the employer's payroll for purposes of calculating estimated premiums at the time of policy inception. At the time of audit, insurers will attempt to identify whether there are any individuals who are uninsured subcontractors, and to charge for those who do not appear to be independent contractors under the jurisdiction's laws. In most states, the practice of insurers is to charge premium for individuals who are employees of uninsured subcontractors, as these individuals are typically considered employees of the policyholder and thus able to collect benefits from the policyholder's insurer. However, because the final decision regarding independent contractor status cannot be definitively made until after a worker is injured and files a claim, this is often too late to be reflected accurately in the premium. In addition, even if the exposure is captured in the premium for the policy that covers the claim, insurers will still suffer from an inequitable situation, in that there may be prior policies for the employer, or policies for other employers with similar situations, where the insurer does not collect any premium at all for the exposure that it is (unknowingly) insuring against.

Thus, even if every claim is resolved in time to be able to adjust the employer's payroll on audit, an insurer simply cannot afford to do business if it is only able to collect premium when there is an injury. On the other hand, if the insurer responds

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<sup>1</sup> Of course, this same problem of waiver of rights pertains equally for unemployment insurance and other statutory rights for employees.

<sup>2</sup> As noted below, California has an independent rating bureau (Workers Compensation Insurance Rating Bureau of California—WCIRB) and does not use the NCCI manual. Moreover, the WCIRB manual (Uniform Statistical Reporting Plan) is limited to insurer data reporting requirements. This data is used only for loss-cost (pure premium) ratemaking purposes and for experience rating. In California, premium determination is a matter of private contract between the insurer and employer.

by routinely including independent contractors in the payroll for rating purposes, the policyholder will rightfully object, and matters will be complicated further by the likelihood that a dispute over premium rates will be decided by the insurance regulator (with appeal to the courts)—a process involving different officials with different backgrounds and expertise than those who would decide the claim in the event that the worker were injured.<sup>3</sup>

Another complication is that the answer to the independent contractor question is not the same for every application. Employment can have different legal meanings in different contexts. For example, the term “employee” can be construed differently for unemployment insurance, federal and state tax withholding, group health insurance, and workers’ compensation. A worker may be an independent contractor for one job on Monday, but be an employee on another job on Tuesday (although this should be rare). Note also that the terms “independent contractor” and “subcontractor” are used interchangeably by some writers, but a subcontractor could be a business entity rather than an individual, or could be a sole proprietor with other employees. In either case, a subcontractor with employees would be required to purchase insurance, which reduces, but does not eliminate, the problems discussed in this report.

In real life situations, there are many relationships between organizations and individuals that have elements of independence and at the same time characteristics legally associated with employment. For example, consider an independent contractor who publicly represents himself as a business, works from his home, uses his own office equipment, and sets his own hours or chooses not to work at all. Some states would hold that this person is not legally independent unless he has a record of earning income during the past year from more than one source. Thus, employment status is determined differently from place to place and situation to situation.

The following discussion weighs the strengths and weaknesses of alternative approaches to defining and applying a workers’ compensation act to parties alleging to be, or desiring to be, legally qualified as independent contractors. As with many aspects of workers’ compensation law, one size does not fit all systems. How a jurisdiction chooses to deal with the issue is a product of:

- Labor markets and industry mix.
- Insurance system.
- Regulatory resources available.
- Political philosophy of the lawmakers.
- Size of the problem.

In the next section of this report, we will elaborate on the above five issues before moving to a detailed comparison of criteria for independent contractor status.

### *Labor and Industry*

Certain industries are more prone than others to businesses that share the characteristics generally describing independent contractors. Trucking, logging and construction are three major industries in which there are many individuals working on their own for a variety of clients. Their clients are accustomed to dealing with these solo agents on an ad hoc basis with short-term relationships. Also, in highly unionized sectors, there is less likelihood of an employer or general contractor using labor described as independent contractors.

A state with a large volume of small, independent businesses may feel greater pressure to allow them to opt out of the workers’ compensation system.

### *Insurance System*

Small contractors without true employees can reap a competitive advantage in the marketplace by avoiding some taxes and insurance expenses, especially workers’ compensation. Removing a large pool of workers engaged in relatively risky employment would obviously have an effect on the premiums collected and risks faced by the insurance industry. We cannot say *a priori* what the net effect of the exclusion of independent contractors is on the class rates faced by insured employers. It could benefit the insured employers if their competitors that escaped the system were more accident-prone than insured employees in the same occupation. One should also recognize that a sole practitioner without insurance who suffers a serious

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<sup>3</sup> In California, no administrative remedy is available to resolve employment status disputes for workers’ compensation premium determination; in 2005, the California Department of Insurance announced that neither it nor its licensee, the WCIRB, would henceforth hear these disputes. Consequently, they require litigation or private resolution through “ADR” (alternative dispute resolution, such as mediation or arbitration).

injury is more likely than other businesses to default on clients, go bankrupt and/or require uncompensated medical care. The social costs of uninsured workers will be touched on again later in this paper.

The nature of the insurance mechanism in a jurisdiction will promote or discourage claims of independent contractor status. The most important insurance factor is the cost of insurance, including not just workers' compensation, but also health, disability and unemployment insurance. Where insurance rates are relatively high, there is a greater incentive to seek immunity from this operating cost by encouraging workers to assert that they are independent and have no employment relationship and by preferring to use workers who operate in this manner.

Also, where insurers are diligent in conducting premium audits, there will be less incentive to "game" the system—that is, employers will be less likely to falsely claim some workers as independent contractors in order to reduce their payroll and hence insurance premium.

### *Regulatory Resources*

States are quite different in how well they are staffed and equipped with information technology. These varying resources explain why some states apply much more scrutiny and control than others over claims of independent contractor status.

Also, in jurisdictions where insurance requirements are strictly enforced, there is less incentive to take a shot at avoiding the costs of workers' compensation by false or dubious claims regarding employment status. Enforcement that raises the probability of detection and routinely imposes significant sanctions removes some or all of the economic gain from trying to avoid the cost of insurance. There can be significant differences between states in the effectiveness of their regulatory systems.

### *Political Philosophy*

Equity and freedom of choice are important values that come to bear on how the law treats a person who asserts independent contractor status. Equity demands that under similar circumstances, the insurance and enforcement system will arrive at the same determination of the status of a worker. This is quite important in industries where the cost of workers' compensation insurance is a significant portion of operating cost. If a competitor evades insurance through false representations, the social insurance cost (unemployment insurance and workers' compensation) savings can allow them to compete unfairly by lower price quotes or bids.

Freedom, on the other hand, argues for expanding the ability of individuals to renounce the protection of workers' compensation law if they freely and rationally choose to earn a living outside of any employment relationship. In the U.S., economic freedom is a prized value. Thus, Americans might be more prone than most people to allow individuals to earn and spend their incomes in a manner they see best. A good example of the downside of economic freedom is the fact that each year a high percentage of single-proprietor businesses go bankrupt. Society accepts this risk.

However, there is a danger in that workers who do not want to waive their rights will be compelled to do so by employers—particularly in markets where unemployment is high, the workforce is transient, and/or there is an influx of undocumented workers. A related issue is universal coverage, which is often listed as an ideal goal of a workers' compensation system. It is one of the principles of the Meredith Commission in Canada and was recommended by the 1972 Federal Workers Compensation Study Commission. The motive behind universal coverage is to ensure that workers have protection against medical expenses and wage loss.

Uninsured workers, particularly in a small, poorly capitalized business, run a high risk of becoming a burden on society following a serious injury and/or inflicting financial hardship on their dependents. Medical providers are at risk of providing emergency care without payment. Thus, allowing individuals to remove themselves from the protection of workers' compensation without protection against the loss of income and medical cost of injury can place third parties at risk.

As we will document below, some states allow the balance of these competing goals to tip in favor of allowing workers to take these personal and family risks. Other states take a more protective view and stress universal coverage.

### *Size of the Problem*

Several recent studies have quantified the magnitude of the problem of misclassification of employees as independent contractors. Most of this research is sponsored by national organizations or the federal government. Some of it deals

exclusively with income and unemployment tax evasion issues. Taken together, these studies suggest that misclassification is a large and growing problem for workers' compensation and other government programs.

According to the Government Accountability Office, there were 10.3 million independent contractors in the total workforce in 2005, growing from 6.7 percent of the workforce in 1995 to 7.4 percent in 2005.<sup>4</sup> According to this report, the greatest concentration of independent contractors is in the construction industry, followed by miscellaneous services.

A 2007 Staffing Buyers Survey estimates that the contingent workforce is expected to grow to 10 percent of the entire U.S. workforce within two years. According to the survey, 77 percent of companies expect to grow their contingent workforce.

A 2004 study by Harvard researchers for the State of Massachusetts is one of the few state studies focusing on workers' compensation. They found unpaid workers' compensation premiums of \$91 million a year due to independent contractor misclassification; \$7 million of those unpaid premiums were in construction. This touched off a legislative call for a special study commission.<sup>5</sup>

A 2007 study by the University of Maine examined the extent to which employers in the construction industry misreported employees as independent contractors. That study, based on an earlier survey by Harvard, estimated that 11 percent of Maine's construction workers were misclassified as independent contractors.<sup>6</sup>

- A study done by University of Missouri–Kansas City researchers found an 18 percent rate of misclassification in Illinois.<sup>7</sup>
- New Jersey's Labor Department audits about 2 percent of employees for unemployment insurance, and in 2005 it found more than 26,000 misclassified.<sup>8</sup>
- A 2007 report by Cornell University estimated that 704,000 private-sector workers had been wrongly classified as independent contractors, and at least 39,500 employers mislabel workers annually. Conservative estimates suggest that between 500,000 and 1 million New York workers who should be covered by workers' compensation are not. To put this in perspective, approximately 10.3 percent of private-sector workers are misclassified as independent contractors (about 14.8 percent in construction).<sup>9</sup>
- AFL-CIO Legislative Director Bill Samuel is reported to have estimated that 10 million workers were classified as independent contractors in 2006, an increase of more than 2 million workers over the previous six years. Writing in support of the Independent Contractor Proper Classification Act of 2007, he states:

Other studies have found that as many as 30 percent of the employers misclassify their workers as independent contractors, with higher misclassification rates in particular states and particular industries. Misclassification is especially common in the construction industry and is a growing problem in high-tech, communications, trucking and delivery services, janitorial services, agriculture, home health care, child care, and other industries.<sup>10</sup>

The studies mentioned above, and public outcries over abuse of the independent contractor status, seem to be concentrated in large states (New York, New Jersey, Illinois). Are larger states particularly vulnerable to abuse of independent contractor status because of the difficulties of enforcement? Are workers' compensation misclassifications as common a problem as unemployment insurance misclassification (which has been the focus of audits and research)? This paper does not attempt to

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<sup>4</sup> Nilsen, Sigurd. Employee Misclassification, GAO-07-859T. Testimony before House of Representatives, May 2007.

<sup>5</sup> Bernard and Herrick. "The Social and Economic Costs of Employee Misclassification in Construction." A report of the Construction Policy Research Center at Harvard Law School and Harvard School of Public Health (December 2004), at p. 2.

<sup>6</sup> Murphy, William. "Stretching the Law, Stressing the State—Misclassified Workers in Maine's Construction Industry." Bureau of Labor Education, University of Maine, March 2007.

<sup>7</sup> Kelsay, Michael, James Sturgeon and Kelly Pinkham. "The Economic Costs of Employee Misclassification in the State of Illinois." Department of Economics, University of Missouri–Kansas City, December 2006.

<sup>8</sup> Greenhouse, Steven. "Investigating Mislabeled Workers," *New York Times*, June 9, 2007. <[www.nytimes.com/2007/06/09/nyregion/09contractor.html](http://www.nytimes.com/2007/06/09/nyregion/09contractor.html)>.

<sup>9</sup> Linda Donahue, James Ryan Lamare and Fred B. Kotler. "The Cost of Worker Misclassification in New York State." Cornell University, School of Industrial and Labor Relations, 2007. <<http://digitalcommons.ilr.cornell.edu/reports/9/>>.

<sup>10</sup> Hall, Mike. AFL-CIO weblog news, September 2007. <<http://blog.aflcio.org/2007/09/14/bill-would-end-employers-worker-misclassification-scam/>>.

identify the level of abuse of independent contractor status in any jurisdiction, nor does it necessarily advocate raising this as a priority public policy issue. Rather, it is a resource for those jurisdictions whose stakeholders have identified this as a serious issue needing regulatory attention.

### Criteria for “Independence”

The principal reason for this paper is that there is no generally accepted test for determining whether a worker is an employee or an independent contractor. Market, insurance, regulatory and political differences across jurisdictions make this inevitable. Although there are common principles, the specific criteria used vary not only from jurisdiction to jurisdiction, but also according to the purpose for which the determination of “independence” is made. For example, the IRS traditionally used a 20-point test,<sup>11</sup> and the Fair Labor Standards Act has its own criteria. Likewise, within a state, a person could be classified as an independent contractor for fair labor standards and unemployment insurance, but as an employee for workers’ compensation coverage requirements. Vermont, for example, cites three criteria in its unemployment and workers’ compensation laws, but the wording and scope of the criteria are different, as is the case law interpreting these criteria.

A common law principle at the heart of most federal and state tests for determining employment status hinges on the following test: does the hiring entity have the right to control or direct only the *result of the work* done by the worker, or does the hiring entity also control the *means and methods* of accomplishing the result (see IRS guidance at [www.irs.gov/businesses/small/article/0,,id=99921,00.html](http://www.irs.gov/businesses/small/article/0,,id=99921,00.html)). Independent contractors may be told by their employer when and how work products must be delivered but are free to devise their own plan and means for achieving their obligations.

If the control test is ambiguous or inconclusive, a second common test—the economic reality test—looks to the dependence of the worker on the hiring entity for his/her income. An independent contractor would be expected to have multiple sources of income, at least over the span of a year or two.

State workers’ compensation systems are quite varied in the number and specificity of criteria used to determine the status of a party performing paid services for another party. In some jurisdictions, workers’ status does not depend at all on whom they work for, but only on how they do the work. Some states rely exclusively on the nature of the work. Others weigh multiple factors, including but not limited to the right of control and method of payment.

Although no one state uses all of the criteria below, and the language in which a particular standard is phrased may vary from state to state, versions of the following criteria are often enumerated in statutes:

- 1) The right to control the means and the method by which the work is done.
- 2) The right to terminate the relationship without liability.
- 3) The existence of a contract between the worker and the hiring entity and the terms of that contract.
- 4) The method of payment, whether by time, job, piece, or other unit of measurement.
- 5) Control over the hours of work.
- 6) The furnishing, or the obligation to furnish, the necessary tools, equipment, and materials.
- 7) Whether the worker is engaged in a distinct occupation or business.
- 8) The skill required in a particular occupation.
- 9) Whether the worker’s business or occupation is typically of an independent nature.
- 10) Whether the worker hires others.
- 11) Whether the worker carries his or her own workers’ compensation policy.
- 12) Whether the worker pays taxes as a business and has a Federal Employer Identification Number.
- 13) Whether the worker maintains a separate office and incurs business-related expenses.
- 14) The number of different hiring entities for whom the worker performs services.
- 15) Whether the worker can realize a profit or suffer a loss.
- 16) Whether the work is an integral part of the regular business of the hiring entity.
- 17) Whether the worker can refuse to perform tasks without penalty.
- 18) Whether the worker holds a state license for the type of work performed.
- 19) The length of time for which the person is hired.

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<sup>11</sup> In June 2006, the IRS modified their test to consideration of the balance of facts in three areas: behavioral, financial and type of relationship. See [www.irs.gov/businesses/small/article/0,,id=99921,00.html](http://www.irs.gov/businesses/small/article/0,,id=99921,00.html).

The meaning and application of any of these criteria in real world situations inevitably must be tested in court. For example, the California Appeals Board has found that, even in an absence of control over work details, an employer-employee relationship exists if: (1) the principal retains pervasive control over the operation as a whole; (2) the worker's duties are an integral part of the operation; and (3) the nature of the work makes detailed control unnecessary.<sup>12</sup>

Sometimes the law evolves as case law fills voids left by extremely general statutes. For example, a major Arkansas case, *Franklin v. Arkansas Kraft, Inc.*, 5 Ark. App. 264, 635 S.W. 2d 286 (1982), reinstated a claim and ordered further proceedings due to concerns that the Workers' Compensation Commission might have relied exclusively on the "right of control" test in determining that the claimant, a logger, was not an employee of the paper company for which he was cutting timber. The court set out nine factors that could be weighed when making a determination regarding whether the injured person is an employee or an independent contractor, while noting that all of the factors need not be considered in each case, and that other factors beyond the nine listed could conceivably be material in other cases. This case, like many other court tests, placed emphasis on the right of control. But the above criteria also seek to establish "economic independence," i.e., does the worker's source of income seem to be derived substantially from activities beyond the immediate job done for a particular entity paying them at the point of the injury claim.

Several states have established licensing as a necessary and/or sufficient condition for defending one's status as an independent contractor. Courts have considered the holding of a license as one factor to be weighed in establishing the independence of a worker. For example, licensed landscapers in Oregon are given a presumption of independent contractor status, and licensed real estate agents are statutorily exempt from needing workers' compensation coverage for themselves in Wisconsin. In South Carolina, licensed real estate agents and drivers owning their own trucks are exempt from the workers' compensation act if they sign an independent contractor agreement with the firm hiring them. Notwithstanding these specific carve-outs for particular licensed professions, most experts warn that holding a license is not a *per se* proof of independence in most states and work relationships.

Some regulatory systems can be classified as either:

- Bright line—a specific and binding set of criteria that must be proven to gain IC status.
- Weight of evidence—a number of criteria must be considered and balanced in evaluating the weight of evidence on whether a particular party is an independent contractor.

Some systems, however, could be considered hybrids of the above categories. For example, the weight of evidence criteria could be very formidable and the burden of proof quite high for independent contractor status. Likewise, the bright-line test could be blurred by the consideration of subjective or interpretive criteria.

Another example of a hybrid system is to define a bright-line presumption that expressly exempts a wide variety of job classes from employment status under workers' compensation law, such as ministers, newspaper carriers, volunteers, etc. Examples of such carve outs tied to a license status include:

- Hawaii: Licensed real estate agents who performed sales activities pursuant to independent contractor agreements were independent contractors, and not employees.
- Oregon: If an individual is licensed with the Construction or Landscape Contractors Boards, there is a conclusive presumption of independence when the licensed contractor is involved in activities subject to and working under that license.

Table 1 shows how a select sample of jurisdictions fit into the above categories and summarizes the criteria used. The column headed "presumption employee status" indicates whether state law presumes that anyone receiving compensation for services is an employee unless it is affirmatively proven that the standard for independent contractor status is satisfied. "Special carve outs" refers to unusual statutes that apply to specific industries that control their status as contractors.

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<sup>12</sup> *Yellow Cab Cooperative v. Workers Compensation Appeals Board* (1991) 226 Cal.App.3d 1288.

**Table 1**  
**Standards Used to Determine Independent Contractor Status**

State	Class Standard	Presumption employee status	Special Rules Specific Occupations	General Description of Criteria
AK				The definition of an employee is broad. An employer trying to determine whether a worker is an employee or independent contractor should first consult the Department of Labor. Courts typically try to find coverage for an injured worker. Verbal and written contracts between employers and workers are unenforceable and invalid if they are counter to existing state and federal regulations. Often an injured worker will exhaust all means of redress when they are unable to work and generate an income.
AL				The exemption from workers' compensation applies to subcontractors with less than five (5) employees. The subcontractor has to work directly for a residential builder in the construction of single-family dwellings. The independent contractor exemption is valid for one year.
AZ				Contractors and subcontractors who perform work separate from client's normal work and who are not supervised by client during execution of that work are considered independent contractors, not employees for purposes of workers' compensation insurance.
CA	WE	Yes		<p>"...any person who renders service for a specified recompense for a specified result, under the control of his principal as to the result of his work only and not as to the means by which such result is accomplished."</p> <p>1. That the individual has the right to control and discretion as to the manner of performance of the contract for services in that the result of the work and not the means by which it is accomplished is the primary factor bargained for.</p> <p>2. That the individual is customarily engaged in an independently established business.</p> <p>3. That the independent contractor status is bona fide and not a subterfuge to avoid employee status.</p>
CO	WE	Yes		Case law has given greatest weight to the right to control. Nine points as guides, not all of which must be met. Control is a key issue, but other points deal with the nature of the business, e.g., "business does not combine the business operations in any way with the individual's business operations instead of maintaining all such operations separately and distinctly."
CT				<i>Hynd v. General Electric Co.</i> , 10 Conn. Workers' Comp. Rev. Op. 77, 1151 CRB-4-90-12 (April 3, 1992). "Our courts have long recognized that independent contractors are not within the coverage of the Workers' Compensation Act. The determination of the status of an individual as an independent contractor or employee is often difficult and, in the absence of controlling considerations, is a question of fact. The fundamental distinction between an employee and an independent contractor depends upon the existence or nonexistence of the right to control the means and method of work. For purposes of workers' compensation, an independent contractor is defined as one who, exercising an independent employment, contracts to do a piece of work according to his own methods and without being subject to the control of his employer, except as to the result of his work." (Citations omitted; internal quotation marks omitted). <i>Chute v. Mobil Shipping &amp; Transportation Co.</i> , 32 Conn. App. 16, 19-20, cert. denied, 227 Conn. 919 (1993).
DE	WE	No		No formal criteria in law



FL		Yes	An independent contractor working or performing services in the construction industry is considered an employee [Sec. 440.02 (15) (c), F.S.].	<p>In other than the construction industry, the definition of independent contractor in Florida may be satisfied provided at least four of the following criteria are met [Sec. 440.02 (15) (d), F.S.]:</p> <ol style="list-style-type: none"> <li>1. The independent contractor maintains a separate business with his or her own work facility, truck, equipment, materials, or similar accommodations;</li> <li>2. The independent contractor holds or has applied for a federal employer identification number, unless the independent contractor is a sole proprietor who is not required to obtain a federal employer identification number under state or federal regulations;</li> <li>3. The independent contractor receives compensation for services rendered or work performed and such compensation is paid to a business rather than to an individual;</li> <li>4. The independent contractor holds one or more bank accounts in the name of the business entity for purposes of paying business expenses or other expenses related to services rendered or work performed for compensation;</li> <li>5. The independent contractor performs work or is able to perform work for any entity in addition to or besides the employer at his or her own election without the necessity of completing an employment application or process; or</li> <li>6. The independent contractor receives compensation for work or services rendered on a competitive-bid basis or completion of a task or a set of tasks as defined by a contractual agreement, unless such contractual agreement expressly states that an employment relationship exists.</li> </ol> <p>If four of the criteria above do not exist, an individual not in the construction industry may still be presumed to be an independent contractor and not an employee based on full consideration of the nature of the individual situation with regard to satisfying any of the following conditions:</p> <ol style="list-style-type: none"> <li>1. The independent contractor performs or agrees to perform specific services or work for a specific amount of money and controls the means of performing the services or work.</li> <li>2. The independent contractor incurs the principal expenses related to the service or work that he or she performs or agrees to perform.</li> <li>3. The independent contractor is responsible for the satisfactory completion of the work or services that he or she performs or agrees to perform.</li> <li>4. The independent contractor receives compensation for work or services performed for a commission or on a per-job basis and not on any other basis.</li> <li>5. The independent contractor may realize a profit or suffer a loss in connection with performing work or services.</li> <li>6. The independent contractor has continuing or recurring business liabilities or obligations.</li> <li>7. The success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.</li> </ol> <p>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 chapter.</p> <ol style="list-style-type: none"> <li>1. The extent of control which the employer may exercise over the details of the work;</li> <li>2. Whether the one employed is engaged in a distinct occupation or business;</li> <li>3. Whether the work performed is normally performed under supervision of the employer or by a specialist who needs no supervision;</li> <li>4. The skill or expertise required in performing the work;</li> </ol>
GA	WE	No		

IA	WE				<p>5. Whether the alleged employer supplies the tools and/or place for the work to be performed;</p> <p>6. The duration of time for which the person is engaged in performing the contract;</p> <p>7. The method of payment for the job;</p> <p>8. Whether the work to be performed is part of the regular business of the alleged employer;</p> <p>9. The intent of the parties, specifically whether they intended to create an employer/employee relationship or that of an independent contractor;</p> <p>10. Whether the work of the alleged employee is part of the regular business of the employer.</p> <p>See <i>R.E. Moss v. Central of Georgia Railroad Co.</i>, 135 Ga.App. 904, 219 S.E.2d 593 (1973).</p> <p>“Although no one factor is determinative, the following factors should be considered:</p> <ol style="list-style-type: none"> <li>1. The existence of a contract for the performance by a person of a certain piece or kind of work at a fixed price.</li> <li>2. The independent nature of the business or of a distinct calling.</li> <li>3. The employment of assistants, with the right to supervise their activities.</li> <li>4. The obligation to furnish necessary tools, supplies and materials.</li> <li>5. The right to control the progress of the work, except as to final result.</li> <li>6. The time for which the worker is employed.</li> <li>7. The method of payment, whether by time or by job.</li> <li>8. Whether the work is part of the regular business of the employer.”</li> </ol> <p>—<i>Bumann, Maryellen v. Rasmussen-Ford Mercury</i>, Nov. 19, 2001</p>
ID KY	WE				<p>Four main criteria and 22 specific indicators</p> <p>KRS 342.640 lists the employees covered under the Workers’ Compensation Act. Every person, including a minor, who is employed in the service of the employer is entitled to workers’ compensation coverage, unless exempted under KRS 342.650. Covered workers include the following:</p> <ol style="list-style-type: none"> <li>1. Every person employed in the service of the employer under any contract for hire, apprenticeship, expressed or implied, and all helpers and assistants of employees, whether paid or unpaid by the employer if employed with knowledge of the employer;</li> <li>2. Every executive officer of a corporation;</li> <li>3. Every person in the service of the state or any of its political subdivisions, whether elected or appointed will be considered an employee of the state. Members of volunteer emergency services (fire, police, EMS) will be considered an employee of a subdivision within that state. Members of the National Guard (while on active duty) and regularly enrolled members of emergency management agencies are considered employees of the state;</li> <li>4. Any person who is performing a service in the course of trade, business, profession or occupation of the employer at the time of the injury; and</li> <li>5. Newspaper distributors are deemed employees of an independent news agency or of the publisher of the newspapers distributed. A minor who is employed by the employer and less than 16 years of age is entitled to workers’ compensation benefits with the written consent of parents or guardians.</li> </ol> <p>“Independent Contractor means any person who renders service, other than manual labor, for a specified recompense for a specified result either as a unit or as a whole, under the control of his principal as to results of his work only, and not as to the means by which such result is accomplished, and are expressly excluded from the provisions of this Chapter (on Worker’s Compensation) unless a substantial part of the work time of an independent contractor is spent in manual labor by him in carrying out the terms of the contract, in which case the independent contractor is expressly covered by the provisions of this chapter.”</p>
LA					

MA	BL	Yes	<p>In 2004, statute was strengthened to “consider as employees” any persons that did not meet three criteria:</p> <ol style="list-style-type: none"> <li>1. The worker must be free from the presumed employer’s control and direction in performing the service, both under a contract and in fact.</li> <li>2. The service provided by the worker must be outside the employer’s usual course of business.</li> <li>3. Third, the worker must be customarily engaged in an independent trade, occupation, profession or business of the same type.</li> </ol> <p>Although many factors are considered, and no one factor by itself is controlling, the following basic principles often apply in determining whether a worker is an employee or an independent contractor: Generally, the employer/employee relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee, and not an independent contractor, is subject to the will and control of the employer not just as to “what” shall be done, but “how” it shall be done. The right to discharge is also an important factor indicating that the person possessing that right is an employer, and the person subject to it is an employee. Other factors characteristic of an employer-employee relationship are the furnishing of tools, materials and a place to work to the individual who performs the services.</p> <p>Independent contractors are persons who are in business for themselves. Their business is usually different from the business of the person for whom the work is performed. Generally, those who follow an independent trade, business or profession in which they offer their services to the public, and who may be in a position to suffer financial loss rather than a guaranteed wage, are independent contractors and not employees. Persons involved in certain professions and occupations are often conducting business as independent contractors. These include physicians, lawyers, dentists, veterinarians, construction contractors and subcontractors, certified public accountants, etc. However, many persons with these occupations work for firms, associations, institutions, leasing companies or organizations and, in those cases, may be employees and not independent contractors.</p> <p>Ultimate test is whether worker is “under the essential control or superintendence of” hiring entity. Statute establishes eight-factor test and provides that, “In applying these factors, the board may not give any particular factor a greater weight than any other factor, nor may the existence or absence of any one factor be decisive. The board shall consider the totality of the relationship in determining whether an employer exercises essential control or superintendence of the person.” Any party can request predetermination of status by the Maine Workers’ Compensation Board.</p> <p>Controlled by a body of case law called the “economic reality test.” Courts consider the following kinds of proof:</p> <ol style="list-style-type: none"> <li>1. The Federal Identification Number of the sole proprietorship.</li> <li>2. A copy of the written contract between the sole proprietorship and the general contractor.</li> <li>3. A list of other general contractors for whom the sole proprietorship has worked recently and/or is currently working for.</li> <li>4. A copy of the assumed name certificate which the sole proprietorship has on file with the county.</li> <li>5. Proof that the sole proprietorship is paid by the job and an IRS 1099 form is given to the sole proprietorship by the general contractor at the end of the year.</li> <li>6. A sworn statement from the sole proprietor that he or she has no employees.</li> <li>7. An advertisement that shows the sole proprietorship is available to work for others.</li> </ol>
MD			
ME	WE	No	<p>Predetermination is binding for wood harvesting contractors with proof of insurance</p>
MI	WE	No	

MN	Depends on occupancy	Yes	In addition to standards for construction workers described at right, there are detailed trade-specific criteria for 34 occupations.	<p>For construction there is a strict nine point test: An independent contractor, as described in subdivision:</p> <p>Is not an employee of an employer for whom the independent contractor performs work or services if the independent contractor meets all of the following conditions:</p> <ol style="list-style-type: none"> <li>maintains a separate business with the independent contractor's own office, equipment, materials, and other facilities;</li> <li>holds or has applied for a federal employer identification number 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;</li> <li>operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls the means of performing the services or work;</li> <li>incurs the main expenses related to the service or work that the independent contractor performs under contract;</li> <li>is responsible for the satisfactory completion of work or services that the independent contractor contracts to perform and is liable for a failure to complete the work or service;</li> <li>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;</li> <li>may realize a profit or suffer a loss under contracts to perform work or service;</li> <li>has continuing or recurring business liabilities or obligations; and</li> <li>the success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.</li> </ol> <p>For other occupations generally: "...a five-factor test has developed through case law that generally allows an employer or employee to make some judgments concerning the appropriate characterization. This test involves analyzing the following five factors:</p> <ol style="list-style-type: none"> <li>the right to control the means and manner of performance;</li> <li>the mode of payment;</li> <li>the furnishing of tools and materials;</li> <li>control over the premises where the work was done;</li> <li>the right of discharge (<i>Guhlke v. Roberts Truck Lines</i>, 128 N.W.2d 324 (1964)); and</li> <li>the degree of control one party has the right to exert over another has become the primary factor to consider." Minnesota Department of Labor Web site.</li> </ol> <p>The certification uses a very comprehensive list of characteristics with point values attached to each; to qualify as an independent contractor, an applicant must receive 15 points.</p> <p>While the Act does not define "independent contractor," case law provides several factors to consider when determining whether a worker is an employee or an independent contractor. This decision is made on a case-by-case basis, and no single factor is determinative. The Nebraska Supreme Court applies a ten-factor test.</p> <p>An independent contractor must meet the criteria defined in <a href="#">RSA 281-A:2 VI</a>. This includes possession of a federal employer identification number, having control over the performance of the work and the time the work is performed. An independent contractor is not required to work exclusively for one employer.</p> <p>No formal criteria in statute; relies on case law.</p>
MT	BL	Certification drives the status.		
NE	WE			
NH				
NJ	WE	No		

NY				<p>Whether a person is an independent contractor or an employee, or is otherwise exempt from the definition of employee under the Workers' Compensation Law, are questions for the Workers' Compensation Board to determine. There is case law to support an insurer's right to charge premiums for independent contractors of an employer "if there is reasonable risk that the [Workers'] Compensation Board would hold persons to be employees rather than independent contractors." <i>Commissioners of the State Insurance Funds v. Rivington Farm Dairy, Inc.</i>, 16 A.D.2d 58, 225 N.Y.S.2d 486 (1st Dept. 1962). But see <i>Matter of For-Med Medical Group v. New York State Insurance Fund</i>, 207 A.D.2d 300, 615 N.Y.S.2d 399 (1st Dept. 1984) (holding that there was no reasonable risk that 35 doctors who maintained offices at petitioner's premises would be deemed employees rather than independent contractors by the Workers' Compensation Board).</p> <p>Case-by-case determination focusing on which party had the right to direct and control the work applying common law test.</p>
OH	WE			<p>Following is the criteria for affidavit to help determine if an applicant is exempt from workers' compensation. To qualify as exempt, at least six criteria must describe their business.</p> <p>1. The nature of the contract between you and the contractor shows you are independent from the contractor. For example: Is there a written contract where you agree that you are an independent contractor? Are you a corporation or limited liability company? Do you maintain commercial general liability insurance or other business insurance?</p> <p>2. The contractor exercises very little control over your work. For example: By the agreement, can the contractor exercise control on the details of the work or your independence? Do you exercise control over most of the details of the work? Do you create plans or specifications for the job? Do you set your own work hours?</p> <p>3. You are engaged in a distinct occupation or business for others. For example: Do you work for companies or individuals other than the contractor? Do you work for competitors of the contractor? Does your business have a logo or uniform?</p> <p>4. Your job is the kind of occupation where the work is usually performed by a specialist without supervision, and not under the direction of the contractor. For example: Is your work supervised by the contractor?</p> <p>5. Your occupation requires special skills, license, education or training.</p> <p>6. The contractor does not supply the things needed to perform your job such as the tools and the place of work. For example: Do you supply any of the materials or tools for the work? Do you operate a vehicle owned by the contractor? Was the work performed at your business or the contractor's business location or jobsite? Do you wear a uniform supplied by the contractor?</p> <p>7. The length of the job and how long you have worked for the contractor does not show that you are really an employee. For example: Is this a one-time job, or will you be doing this for the contractor regularly?</p> <p>8. You are paid as a separate contractor, not as an employee. For example: Do you invoice the contractor for your services? Are you paid by the job? Do you file a federal income tax return for your business? Do you expect to receive an IRS Form 1099 from the contractor? Does the contractor pay your expenses?</p> <p>9. Your work is not the regular business of the employer. For example: Is your work customarily done in the contractor's line of business or as part of the contractor's daily work? Have you ever been an employee of the contractor? Do you work with other people hired by the contractor on the work you perform?</p> <p>10. You do not consider yourself an employee of the contractor. For example: Will the contractor withhold taxes or monies from your payment? Have you ever been an employee of the contractor? Have you or your employees ever filed an insurance claim against the contractor?</p> <p>11. You do not have the right to terminate the relationship without liability. For example: If you quit before the job is finished, is there a penalty?</p>
OK	WE	Affidavit drives status		

OR	WE	No	Certain holders of professional licenses	“Tests” collectively used:
				<ul style="list-style-type: none"> <li>• Free from direction and control;</li> <li>• Engaged in an independently established business;</li> <li>• Licensed under ORS 671 or 701 (Construction Contractors Board, State Landscape Architect Board, State Landscape Contractors Board, or State Board of Architect Examiners) if required for the service;</li> <li>• Responsible for other licenses or certificates needed to do work; and</li> <li>• Common law standards on direction and control are considered in any disputed case</li> </ul> <p>One whose employment is not in the usual course of trade, business, occupation or profession of the employer (independent contractor). This includes real estate agents, and owner-operators of trucks who are certified as independent contractors by the Department of Labor; certain elected officials of the state or subdivision of government; and Workfare participants.</p>
SD				No formal criteria in statute.
UT	WE	No		The status of an independent contractor, a subcontractor, and an employee must be determined based upon the facts of each case. Considerations are: (1) the right to hire, (2) the power to dismiss, (3) the obligation to pay wages, and (4) the power to control. See <a href="http://www.vwc.state.va.us/employers_guide.htm">www.vwc.state.va.us/employers_guide.htm</a> .
VA	WE			13 criteria on “right to control” and two criteria for “nature of business.” “Totality of responses” determines whether test was met.
VT	WE	Yes		There are three elements that must be satisfied to be considered an independent contractor under the Washington statute:
WA				<ol style="list-style-type: none"> <li>1. The individual has been and will be free from control over performance of services, both under the contract and in fact.</li> <li>2. The service is either outside the course of business or performed outside the place of business.</li> <li>3. The individual is customarily engaged in an independently established trade of the same nature as that under the contract. Some factors: Worker has separate office or place of business outside the home. Worker has investment in the business. Worker provides supplies and equipment. The employer does not provide protection from injury or non-payment.</li> </ol> <p>Worker works for others and has individual business cards. Worker is registered as independent business with the state. Worker can continue in the business if the relationship with the employer ends.</p>
WI	BL	Yes		<p>Nine criteria, all of which must be met:</p> <ol style="list-style-type: none"> <li>1. Maintains a separate business with his or her own office, equipment, materials and other facilities.</li> <li>2. Holds or has applied for a federal employer identification number with the IRS or has filed business or self-employment income tax returns with the IRS based on that work or service in the previous year.</li> <li>3. Operates under contracts to perform specific services or work for specific amounts of money and under which the independent contractor controls the means of performing the services or work.</li> <li>4. Incurs the main expenses related to the service or work that he or she performs under contract.</li> <li>5. 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.</li> <li>6. 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.</li> </ol>

				<p>7. May realize a profit or suffer a loss under contracts to perform work or service.</p> <p>8. Has continuing or recurring business liabilities or obligations.</p> <p>9. The success or failure of the independent contractor's business depends on the relationship of business receipts to expenditures.</p>
WY	WE			<p>The Wyoming Supreme Court defined "employee" as "any person who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." An independent contractor, on the other hand, is one whom someone hires to undertake a specific project, but is generally free to do the assigned work and to choose the method of accomplishing it. The Wyoming Supreme Court in <i>Diamond B Services</i> defined an independent contractor as "one who, exercising an independent employment, contracts to do a piece of work according to his own methods and without being subject to the control of his employer except as to the result of the work."</p> <p>In <i>Fox Park Timber Co. v. Baker</i>, the Wyoming Supreme Court set down a set of guidelines or tests for determining whether one being hired is an employee or an independent contractor. Summarized, they are as follows:</p> <ol style="list-style-type: none"> <li>1. Retention of the right of control whether the work is done by the piece or done for a fixed lump sum.</li> <li>2. Control of the premises where the work is done. Another test is whether either of the employers possess the right to terminate the services at will without incurring liability to the workers. This test embraces, of course, the right of an employer at any time to discharge the party performing the work, an affirmative answer establishing the status of master and servant.</li> </ol> <p>In a more recent decision, the Wyoming Supreme Court in <i>Cline v. State, Dept. of Family Services</i> held that "[t]he control of the work reserved in the employer which effects a master-servant relationship is control of the means and manner of performance of the work, as well as of the result[.]" Again in 2004, the Court in <i>Coates v. Anderson</i> stated: "Such a right to control is a prerequisite of the master-servant relationship. Conversely, the absence of such a right of control is a prerequisite of an independent contractor relationship. Master-servant and independent contractor are thus opposite sides of the same coin; one cannot be both at the same time with respect to the same activity; the one necessarily negatives the other, each depending on opposite answers to the same right of control inquiry."</p>

WE = Weight of evidence on criteria; BL = bright line; Cert = formal certification filed.

An important distinction is whether the jurisdiction is attempting to establish a bright-line standard or a preponderance of evidence standard. The former seeks specificity in the criteria and the ability to objectively determine coverage on the basis of compliance with the criteria.

Massachusetts strengthened its already rigorous test in 2004, which created an even stronger presumption of employment unless three criteria can be proven, as explained in the following advisory opinion by the Attorney General:

The Independent Contractor Law creates a presumption that a work arrangement is an employer-employee relationship unless the party receiving the services can overcome the legal presumption of employment by establishing that three factors are present. First, the worker must be free from the presumed employer's control and direction in performing the service, both under a contract and in fact. Second, the service provided by the worker must be outside the employer's usual course of business. And, third, the worker must be customarily engaged in an independent trade, occupation, profession or business of the same type.<sup>13</sup>

Moreover, according to the above advisory by the Attorney General, the law requires proof that the worker meets all three of its requirements; otherwise, the worker is deemed an employee. The subjective beliefs of the employer or employee are not relevant to the determination in Massachusetts.<sup>14</sup>

Wisconsin is another state with a bright-line standard. All nine specific criteria in statute must be met and documented if a party is to qualify as an independent contractor. New Hampshire has a 13-point test (many of which overlap the Wisconsin criteria). Failing to meet all of the points, the party is presumed to be an employee, and insurance is required of the hiring authority.

Even in states that try to establish a bright line to guide prospective independent contractors, some of the "objective" tests cannot be unambiguously met in the real world. For example, the Wisconsin bright line requires that "the independent contractor controls the means of performing the services or work." Does this mean that the contractor cannot use any specialty tools, power, blueprints, phones, etc., owned by the hiring entity? Massachusetts and New Hampshire both have a similar requirement that "the worker must be free from the presumed employer's control and direction in performing the service." This raises very difficult interpretations that have been argued in myriad court cases.

Perhaps the biggest drawback to bright-line standards is that real world work situations do not conform to simple bright lines between employees and independent contractors. There are many gradations between the classic employee paradigm at one end of the spectrum, with a steady job and a steady wage, and the freelance professional or tradesperson running a classic small business. This does not necessarily make line-drawing inappropriate, since the law often must set bright-line standards where nature does not; for example, there is nothing magical or preordained about 18 years as the age of legal majority, or the age of 21 to purchase alcoholic beverages.

One problem with the all-purpose standard enunciated in Massachusetts and Wisconsin is that it forces all fact situations and trade patterns to follow a single rule. For example, a person who moonlights as a carpenter might work only in customers' houses and not maintain any office or fixed address for his business. If the "own office location" requirement is taken literally, each homeowner would be deemed to be the carpenter's employer. Or a lawyer in private practice might do transactional work that is in the usual course of the clients' business, and thus be deemed to be an employee of his or her clients. Even for a litigator, there might be factual questions whether suing and being sued is part of the "usual course of the client's business."

Minnesota took an approach that represents the opposite extreme. Although the broad standard used in Wisconsin was applied to all construction trades in Minnesota, custom-made standards were mandated by the legislature for 34 specific trades. The Minnesota Department of Labor did this by a very detailed rule (Ch. 5224). The criteria for barbers illustrates the trade-specific detail they prescribed:

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<sup>13</sup> Statement contained in "An Advisory from the Attorney General, Chapter 193 of the Acts of 2004 Amendments to Massachusetts, Independent Contractor Law, M.G.L. c. 149 sec. 148 2004/2," undated.

<sup>14</sup> The Attorney General has been unusually proactive in enforcement of independent contractor law and has published lucid opinions on interpretation of the law and enforcement policy, which make good reading for any serious study of the independent contractor issue.



## 5224.0030 BARBERS

Subpart 1. Definition. Barbers are persons registered to practice barbering pursuant to Minnesota Statutes, chapter 154. A registered barber's apprentice is not an independent contractor.

Subp. 2. Independent contractor. A barber is an independent contractor if all of the following criteria are substantially met.

- A. The barber rents a barber chair from the purported employer for a flat sum per week, month, or similar time basis.
- B. All payments by customers for services are retained by the barber.
- C. The barber furnishes his or her own tools, but need not furnish linens or supplies.
- D. The purported employer does not have the right to control the means and manner of the barber's performance of services such as haircuts, shaves, shampoos, scalp treatments, and facial massages.
- E. A written agreement between the parties provides that the barber is an independent contractor.

Subp. 3. Employee. A barber is an employee if all of the following criteria are substantially met.

- A. The barber is paid on a salary basis, though tips may be retained by the barber, or the employer retains a set percentage of the money taken in by the barber's services, excluding tips.
- B. The employer furnishes equipment and supplies other than razors, combs, scissors, and similar items.
- C. The employer furnishes uniforms if uniforms unique to the employer are required.
- D. The barber does not advertise.
- E. The employer may terminate the barber's employment for noncompliance with rules including hours of work, smoking, or wasting time.
- F. A written employment agreement states that the parties are not independent contractors.
- G. The employer has the right to control the means and manner by which the barber performs services such as haircuts, shaves, shampoos, scalp treatments, and facial massages.

Subp. 4. Factors excluded. The fact that barber associations or unions fix hours of work or other conditions of business operation indicates neither employment nor independent contractor status. Rules prescribed with respect to sanitary conditions by the state or city health departments are not to be considered in determining independent contractor or employment status.

The highly specific tests used in Minnesota for 34 occupations certainly help tie down whether a particular fact situation justified independent contractor status, but this approach has some drawbacks:

- It is difficult to write and sell to stakeholders in the rulemaking process.
- It complicates the educational message to employers and potential contractors about the nature of the standard.
- When standards are developed independently, there may be inconsistencies with no basis in the differences between the underlying occupations.
- The standards are voluminous, yet they only address a fraction of the overall labor market.

The "weight of the evidence" (or "preponderance") approach lists a number of factors that state and federal agencies have traditionally associated with an employment relationship. The determination of status is open-ended because it requires a judgment over whether a case meets the overall test. The "right to control" is the most common and seemingly most important test for independence. But the preponderance of evidence approach seldom prioritizes the criteria for control or specifies a minimum number that must be met. Nor does control necessarily trump other criteria like the nature of the employment.

An important public policy issue here concerns the level of documentary evidence or burden of proof the state should impose on an individual who is truly operating as an independent business entity. Too strict a standard would force some self-employed individuals to purchase a workers' compensation "personal election" policy, or others might purchase an "if any" policy for a minimum premium to satisfy general contractors or purchasers of their labor services. However, while the first covers the self-employed individual and any possible employees, the latter covers only the self-employed individual's employees. These policies would reduce the individual's customers' or clients' exposure to unforeseen liability, but could result in burdensome insurance costs and recordkeeping requirements for the self-employed individual.

In many states, employers, particularly in the construction, trucking and logging industries, compel their “contractors” to obtain certificates of non-coverage, which purport to prove that the individual is not an employee. Forcing workers to make such waivers of rights for workers’ compensation when the facts do not convincingly support true independence can become an abusive practice that defeats the purpose of workers’ compensation.

Several states use a certification process to establish a safe harbor for the alleged independent contractor and the organization that hires him/her. These certifications run the gamut from simple self declarations (Rhode Island and Texas) to detailed tests to prove the status of the applicant (Montana).

Some employers have found to their dismay that private certifications via contracts between the hiring entity and the self-declared independent contractor have been ignored by courts if other statutory or common law criteria counter the claim of independence. Microsoft’s use of so-called “permatemp” agreements with software “contractors” was overturned by the Ninth Circuit Court of Appeals in *Vizcaino v. Microsoft*.<sup>15</sup> The court found that the workers were common-law employees despite signed written agreements in which the workers declared that they were independent contractors. Similarly, FedEx was stung by a California Court ruling that drivers who owned their trucks and were working under a contract explicitly declaring their freedom from control were employees because the company did in fact control their routes, working hours, dress code, etc.<sup>16</sup>

In cases of coercion by the employer or incompetence by the worker, courts would be prone to void the declarations. Changed circumstances from the original time of declaration are also considered. For example, the Tennessee Supreme Court has ruled that a properly filed certification (Tennessee Form I-18) is not the ultimate determinant of employment status:

The Form I-18 is not a contract defining the relationship between the parties, but rather it is a notice that an independent contractor has not elected to be covered by workers’ compensation. The purpose of the form cannot be to declare the status of the worker as an independent contractor, as one must already be an independent contractor in order to be eligible to use it. (*Warner vs. Potts*, 2005)

The Rhode Island declaration makes an interesting study because it is a relatively simple process and very frequently used. It appears that many of the individuals filing as independent contractors with the Department of Labor would be considered employees in other jurisdictions, e.g., delivery drivers working for a local pizza shop. Yet, properly filed declarations have proven to be “very durable” when tested by the Rhode Island courts.<sup>17</sup>

### *Carve Outs*

It should be noted that the majority of states have special provisions to exclude particular industries or professions from the coverage of workers’ compensation. Near universal exemptions from coverage are:

- Household domestics.
- Partners in a partnership.
- “Small” or “custom work” farm operations.
- Officers of closely held corporations.

In addition to these, most states have more specific carve outs for particular professions or classes of workers. For example:

- Oregon has a special test for landscape contractors.
- Maine for certain loggers.
- Hawaii for ministers, day care workers and other charitable employment.
- Colorado for “volunteers” at ski resorts.
- Several states exempt real estate agents and newspaper deliverers.

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<sup>15</sup> *Vizcaino v. Microsoft Corp.*, 173 F.3d 713 (9th Cir. 1999)

<sup>16</sup> *Estrada v. FedEx Ground Package System, Inc.*, No. B189031, Cal. App. 2 Dist. 8/13/07.

<sup>17</sup> In the past five years of experience with the certification law, only a few cases have been tested in court and only one has been voided (due to employer coercion). The durability of the agreement has discouraged individuals from trying to renounce the agreement and claim workers’ compensation benefits. This has been a welcome reduction in caseload to the Rhode Island Workers’ Compensation Court (Matthew Carey, Assistant Director Workers’ Compensation & Self Insurance, Rhode Island Department of Labor & Training, Personal Communication, May 25, 2007).

Where the profession, or class of work, is carved out, all other considerations, such as direction and control, become moot for determining the status of the worker for workers' compensation.

### *Administration of the Standards*

A major purpose of this paper is to shed light on how these different laws complicate or ease the administration of the workers' compensation system. Left to their own self-interests, many employers would be very expansive on their interpretation of independent contractor relationships.<sup>18</sup> Likewise, many workers would go along with the designation of independent contractor status to achieve desirable contracts with hiring entities. This section discusses how the laws constrain or check these impulses to utilize the designation of independent contractor status. It also discusses how much friction is created in enforcing the law, specifically administrative determinations or hearings by state regulators. The application of the law must be resolved at three places in the operation of the workers' compensation system:

- Determination of the need for workers' compensation insurance.
- Determination of the appropriate premium.
- Compensability of claims of injury under workers' compensation.

Before delving into the three issues above, it is worth noting that determination of independence for purposes of workers' compensation does not govern many other legal processes with its own criteria for independence. Hence a person might meet the standard for independence and fully escape the orbit of the workers' compensation system for insurance and potential injury claims. Yet that same person might be deemed an employee for state or federal taxes, unemployment insurance, equal rights law or other important employment issues.<sup>19</sup>

### *Determination of Status for Insurance*

Ordinarily, challenges over the need for an entity to carry workers' compensation insurance arise from two situations. First, in course of routine coverage enforcement searches, the state may detect a business that has no workers' compensation insurance.<sup>20</sup> It must then determine if it is excused from obtaining insurance, e.g., due to the fact that it has no employees or less employment than would trigger the need for coverage.

Second, insurers routinely audit policyholders to make sure that all persons who would be entitled to file claims for injury under the policy have been included in the exposures used to compute premium.<sup>21</sup> Justifiably, insurers want to collect the entire premium they are entitled to for exposures subject to loss payments. On the other hand, employers do not want to be surprised by audit findings declaring their payments to contractors to be payroll subject to additional premium collection.

The degree to which the premium auditor has a clear and enforceable set of criteria has a tremendous impact on the smoothness of the audit process. In many jurisdictions, insurance audits are the primary source of enforcement of the rules defining independent contractors.<sup>22</sup> However, the audit determination of independence is not an impervious barrier to claims. Parties accepted as independent contractors may file claims if the injury is serious and the insurer risks workers' compensation benefits being awarded based on a finding of employment status.

Vagueness in the law may invite aggressive interpretations by employers, particularly if assertions of independent contractor status are seldom audited and false claims of independence are seldom sanctioned. If employers have a safe bet in making a judgment call insulating themselves from an employment relationship, they have ample economic incentive to exploit a significant business advantage against a low risk of being penalized. Conversely, some insurers apply inappropriate standards and/or burdens upon employers who assert that their contractors are independent. For example, an insurer may refuse to recognize this status in the absence of separate workers' compensation insurance, even for bona-fide solo-practitioners. Or,

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<sup>18</sup> The many labor laws, taxes and assessments avoided have been discussed above.

<sup>19</sup> For a good survey of legal doctrines that shows how tests vary by government program, see National Employment Law Project, Employment Relationship Checklist (2000), found at [www.nelp.org/docUploads/pub8%2Epdf](http://www.nelp.org/docUploads/pub8%2Epdf).

<sup>20</sup> In some states this coverage enforcement is done in concert with the state unemployment insurance agency. While the coverage for workers' compensation is slightly broader than for unemployment insurance, sharing information on suspected violators is quite useful for both agencies.

<sup>21</sup> It is interesting to note that abuse of independent contractor status was so rampant among California roofing contractors that a trade association representing roofers successfully lobbied for a law (effective 2007) that requires all roofing contractors, with or without employees, to be insured for workers' compensation. Furthermore, it requires insurers to conduct annual audits of their roofing customers' payrolls. See Report: Kathy Robertson, "Workers' comp fraud rampant, Underreporting of high-risk jobs costs honest employers," *Sacramento Business Journal*, Aug. 10, 2007.

<sup>22</sup> False claims for independent contractor status are frequently uncovered in the course of compliance activities by workers' compensation agencies in connection with complaints regarding illegally uninsured employers. Also, states like Montana and Kentucky have active field investigation programs to enforce both coverage and proper application of independent contractor exemption.

the insurer may simply charge premium for all workers, canceling the policy (or threatening to do so) if the employer does not pay the additional premium while employment status is contested in court.

Bright-line criteria or conclusive certifications certainly reduce the scope of dispute about the status of an individual at time of premium audit. Other states with a “weight of evidence” standard have more disputes on audit results. Typically audit disputes are adjudicated by the state insurance department, or by a private rating bureau subject to insurance department review. Wisconsin and Minnesota, with rigidly enforced bright-line standards, report very few appeals of audits to the rating bureaus. California—with the largest amount of workers’ compensation premium of any jurisdiction—is an important exception: Neither its insurance department nor its rating bureau will resolve these disputes, even though employment status impacts both premium determination and data used for regulatory ratemaking and experience rating.

#### *Determination of Status: Claims Disputes*

A likely time for a dispute to arise regarding the true legal status of a worker-contractor is at the time of a serious injury. A serious injury to the person claiming independent contractor status leaves them open to large medical expenses and lost income. Notwithstanding previous representations about their status as independent contractors, some workers will claim employee status after incurring a serious injury while performing services for another business. This change of heart may be the result of consultation with an attorney about the facts of employment law. If the business targeted as the employer denies any employment relationship, there will generally be an application for a hearing to resolve the coverage issue.

Given the complexity of applying employment law to real world situations, case law in each state largely determines how strictly or liberally statutory standards are interpreted. Bright-line standards have stood the test of court challenges in Massachusetts and Wisconsin and are strictly enforceable. The Rhode Island declaration of independent contractor status has been upheld by that state’s Supreme Court. However, the case law in most states is quite varied in how statutory criteria are applied in the myriad real word situations where contractors are used.

As stated above, there are three ways worker-contractors can immunize the party that hires them from assuming claims liability for themselves and their “accidental” employees: 1) insurance certificates such as an “if any” policy that will cover the contractor’s possible employees but does not cover the contractor; 2) a formal declaration of independent contractor status, provided that such declaration has meaningful status under the workers’ compensation law; or 3) voluntarily electing to be covered by the workers’ compensation law and obtaining insurance coverage that covers both the worker-contractor and any employees. In principle, the first two may only forestall disputes over status at premium audit or at the time of an injury. In practice, injured parties can still make claims for workers’ compensation benefits despite prior representations as independent contractors.

#### **Predeterminations of Status**

Several jurisdictions have sought to ease the burdens of disputes at point of audit and injury claims by determining the legal status of a worker in advance. As shown in Table 2, a wide range of certification mechanisms have been devised.

Montana seems to have the most detailed standards and application, thorough review by agency staff, and aggressive field investigations of businesses without workers’ compensation coverage. Perhaps because of the careful and rigorous approach to qualifying contractors, the number of applications has gone down from the period before the new law. Also, Montana stakeholders seem to be reasonably satisfied with the fairness and utility of the program. The clear downside of the program is the personnel cost to maintain and enforce the system (both for the state and employers).

Most case law has held that the mere issuance of a certificate is not dispositive. The inquiry must focus on the actual status of the worker at the time of the injury. Some certificates have been held invalid because the worker had moved from the fact situation at time of filing to a new relationship with the hiring entity. When challenged in court, the “rebuttable presumption” established by the filing of a precertification agreement can be a strong defense, as in Rhode Island, but have less weight in most other jurisdictions. Maine (for loggers only) and Montana have statutes that make the presumption difficult to rebut.

An important public policy issue that needs to be considered is how much latitude the state should give to a person in signing away his/her rights as an employee. There is virtually a universal ban on allowing employees that normally fall under workers’ compensation coverage to waive their rights under the Workers’ Compensation Act. These statutes protect workers from poor judgment or employer coercion. They also protect the mentally deficient and minors from losing the protection of workers’ compensation.

However, similar strong protections are usually not afforded to bad judgment or misguided reasoning by a person renouncing their right to workers' compensation coverage as an independent contractor. The state's role in protecting those who cannot protect themselves changes depending on the political philosophy.

It is worth noting that if an employer hires a party under an express precertification declaring independent contractor status, that employer loses the exclusive remedy of workers' compensation to the extent this precertification is enforceable. The prospect of being sued in tort for negligence does not seem to be a strong deterrent to the use of independent contractors.<sup>23</sup>

**Table 2**  
**Methods of Pre-Certification of Independent Contractor Status**

State	Certification Process	Effect of Certification
Arkansas	Worker can file a declaration opting out of the workers' compensation system.	
Colorado	Sole proprietors/partners working in construction can submit a formal "rejection of coverage" under the Workers' Compensation Act. The election to reject must be voluntary and cannot be a condition of your employment.	
Indiana	Affidavit must be filed with the Department of Revenue, which "verifies" status. In it the named person "desires to be exempt from workers' compensation coverage and foregoes the right of recovery under the Workers' Compensation Act from anyone for whom this person works as an independent contractor."	Hiring contractor is free of liability to the certifying party, but not their employees if that person does not have insurance.
Maine	At request of worker or hiring entity, Workers' Compensation Board decides whether worker is independent contractor.	Rebuttable presumption in any claim for benefits that Board's determination was correct.
Minnesota	Beginning 2009, a person working in the construction industry can apply for an exemption certification. They must document that they meet the statutory nine-point test and identify the services for which the individual is seeking an independent contractor exemption certificate. The applicant must give a sworn statement as to the accuracy of the application.	Provided that the application for an exemption certificate is honestly presented and duly approved by the agency, it appears to be a safe harbor. Without the certification, employment status is assumed.
Montana	Very rigorous process involving detailed declarations and filing of proof. Application is reviewed by state specialist and some facts are verified. Inspectors also do field audits of job sites to verify validity of independence.	The certification is a safe harbor against any enforcement actions by the state until the date the certification is revoked or expires.
North Dakota	If the Department of Labor finds the worker to be an independent contractor (using the IRS 20-point test), both the worker and firm are notified of the affirmative verification in writing, and a certificate is issued to the worker.	The benefit of an affirmative independent contractor verification is the reduced potential for future liability for taxes and premiums from other state agencies, including the state workers' compensation fund.
Oklahoma	Worker may sign the Affidavit and Fact Sheet to declare that they meet at least six of the 11 stated criteria.	The Affidavit and Fact Sheet creates a rebuttable presumption of independence.

<sup>23</sup> British Petroleum paid a heavy toll for its extensive use of independent contractors at one of its Texas refineries. After an explosion in 2005 that killed 15 and injured over 170 workers, settlements with the estates of independent contractors killed during the incident reportedly exceeded the statutory death benefits by a factor of 10. For an account, see [www.workerscompinsider.com/archives/000313.html](http://www.workerscompinsider.com/archives/000313.html).

Rhode Island	<p>Notice of designation as independent contractor: (a) A person will not be considered an independent contractor unless that person files a proper notice of designation form with the director. The filing of the notice of designation shall be a presumption of independent contractor status, but failure to file shall not preclude a finding of independent contractor status by the court when the notice is not filed with the director.</p> <p>That designation shall continue in force and effect unless the person withdraws that designation by filing a notice with the director, in writing, on a form provided by the director, that the person is no longer an independent contractor. Designations or withdrawals are public information.</p>	There is presumption of independent contractor if the form is properly filed.
Texas	For certain building and construction workers, a simple certification filed with the Commission and kept on file with the hiring contractor is sufficient to protect the hiring contractor from being charged premium and bar claims from the certifying independent contractor.	

### **“If Any” Insurance Policies**

If a business has no employees, then it has no workers’ compensation exposure. However, as discussed earlier, someone hired as an independent contractor might get injured on the job, file a workers’ compensation claim, and obtain a ruling that he or she was actually an employee and is therefore entitled to benefits. This means a business cannot always know for certain whether it has employees until it is too late.

To protect against this risk, a business with no known employees (other than working owners who are exempt from participation in the workers’ compensation system) can, in most states, obtain a policy providing workers’ compensation coverage on a contingent basis. Terminology varies from state to state, but for the purposes of this paper we will call these contingent policies “if any” policies, because they provide coverage for work-related injuries during the policy period “to the policyholder’s employees, if any.”

Since a policy with zero estimated payroll will always be rated at the minimum premium for the relevant business classification, these policies are sometimes also referred to as “minimum premium” policies. That is not entirely accurate, however, because at least in some classifications, it is possible for a policy to have nonzero payroll and still pay the minimum premium, though that usually means there is only a single part-time employee. Under NCCI assigned risk plan rules, an “if any” policy is initially charged the minimum premium for the policyholder’s governing classification, but if the audited payroll remains at zero, the final premium will be the minimum premium for Code 8810 (Clerical) and the difference is refunded. Rating plans in most states follow similar rules, although Code 8810 does not always have the lowest rate, and at least one state uses the lowest minimum premium then in force rather than specifying a particular classification.

Usually, the holder of an “if any” policy is not the primary hiring entity, but rather is someone working for the hiring entity as an independent contractor. Multiple tiers of contracting are common in the construction industry, and can be used in other contexts as well. When hiring entity H hires worker W as an independent contractor, H faces the risk that not only W, but any other worker hired by W as a subcontractor, might be found to be H’s employee if there is an accident on the job. Uninsured subcontractor laws could make H responsible for all injuries to W’s employees unless W has a policy of his or her own. For this reason, businesses routinely request and receive evidence of workers’ compensation insurance from any contractors they hire.

If the contractor has no payroll and does not choose to be covered personally, this policy will be an “if any” policy. These policies are contingently rated, assuming no payroll and thus a minimum premium is charged. This will protect the hiring entity (and its own insurer) from exposure for injuries to workers hired as lower-tier subcontractors, since that is the exposure that will be covered by such a policy. It will not protect the hiring entity from having its insurer impute the earnings of the “if any” policyholder as payroll if the auditor believes the state tests for independence have not been met.

Insurance typically has three advantages to the contractors:

- It customarily satisfies the demands for insurance by potential clients.
- It provides disability and medical coverage for employees in the event of an occupational injury.

- It insures against claims from people who inadvertently become statutory employees for workers' compensation purposes, e.g., occasionally hiring a person to help unload a truck or clean up after a job.

Although it must be emphasized that an “if any” policy protects neither the contractor nor the hiring entity from responsibility for injuries to the contractor, these policies do create protection for contractors, hiring entities and insurers from some dangerous hidden exposures, such as unknown employees of the policyholder. Hence, many jurisdictions promote them as risk management tools. The Oregon Small Business Ombudsman sums up the use of “if any” policies as follows:

You can see that securing an “if any” policy has advantages for protecting your business and satisfying contractual provisions. It's easy to apply for and relatively inexpensive.<sup>24</sup>

A third use of “if any” policies is more problematic—when workers hired as independent contractors purchase them for the sole purpose of demonstrating that they are in business for themselves and that the independent contractor relationship is genuine. A more sophisticated variant on this transaction occurs when the worker hires a family member as a part-time clerical employee and pays for a minimum premium policy covering only that family member.

One could argue that, if anything, such devious shows of independence tend to prove the opposite, since genuine businesses purchase insurance to protect themselves, third parties or the public from risks that are covered by the policy. If the policy provides no real coverage because the policyholder is not exposed to the kinds of risks an “if any” policy protects against, then the policy is a sham and one might suspect that the independent contractor relationship papered over by the policy could also be a sham. The purchase of the policy does represent concrete evidence, backed up by the expenditure of time and money necessary to obtain coverage, that the worker has knowingly waived his or her rights to workers' compensation benefits (unless the worker can argue persuasively that he or she did not know the policy provided no personal protection), but it does not necessarily prove the waiver was truly voluntary.

Furthermore, the question of waiver is beside the point if the hearing officer rules that the worker was in fact an employee who never had the power to waive the right to benefits in the first place, and the misuse of these policies is most likely to occur in high-risk industries such as roofing and trucking, where the cost is insignificant compared to the cost of covering the worker on the hiring entity's policy. Thus, a policy that does not cover an injury to the worker does not really provide any meaningful protection to the hiring entity or its insurer if the worker is injured, and the hiring entity's insurer should not be required to treat it as proof that the worker does not belong on the hiring entity's payroll.

Furthermore, even when “if any” policies are used appropriately, some purchasers feel cheated if they are injured and have no recourse to their insurer for benefits. Such complaints about gaps in coverage arise often in property and casualty insurance, partly from poor explanation by the agent selling the policy and sometimes from selective memory, language barriers, poor business knowledge, or naïveté on the part of the purchaser. Both policyholders and insurers have also voiced dissatisfaction with the pricing. On one hand, it is understandable for policyholders to object to paying for coverage when the likelihood of a claim is extremely remote when the policy is purchased in good faith. On the other hand, when a claim does occur, it is almost certainly a costly one, and filed by someone who would not otherwise have shown up on the payroll at audit. Because of the high severity of these claims and the low premium on the policies, pricing tends to be inadequate for “if any” policies, unless the policy is a sham with no real insured exposure at all, purchased only to get the certificate of coverage. Another reason for the inadequacy is that insurers may be forced to try to collect premiums if a claim arises after the end of the policy period. For these reasons, insurers report that “if any” policies run very high loss ratios and frequently are only available from the state's residual market mechanism. Despite low claim frequency, they are reluctant to write this coverage.<sup>25</sup> Losses on these policies are exacerbated by the requirement to return almost everything but the expense constant if no payroll is found at audit, regardless of the policyholder's line of work.

## **Enforcement**

In principle, abusive practices could be grounds for prosecuting an employer for fraud or initiating disciplinary action against an insurer. However, the facts are rarely so clear-cut as to support enforceable punitive measures. When an employer tries to pass employees off as independent contractors, the most likely avenues for corrective action would be a premium audit by the insurer, a claim filed by the worker if there is an injury, or an investigation initiated in an area unrelated to workers' compensation, such as taxation or unemployment insurance. Conversely, if an insurer improperly seeks to classify

<sup>24</sup> Waki, David. “No employees: Why an “if any” policy is a good idea,” Small Business Ombudsman, Department of Consumer and Business Services, found at [www.oregon.gov/DCBS/SBO/docs/ifanypolicy\\_10\\_05.pdf](http://www.oregon.gov/DCBS/SBO/docs/ifanypolicy_10_05.pdf).

<sup>25</sup> Personal communications with Ralph Hermann, CEO, Wisconsin Compensation Rating Bureau, and Tim Wisecarver, CEO, Pennsylvania/Delaware Rating Bureau, May 25, 2007.

independent contractors as employees, the employer's remedy would be to dispute the premium charge, either in an administrative hearing or in court, depending on the applicable state law.

Jurisdictions vary on the number of complaints and contested cases they receive about independent contractor status, and how they resolve them. As stated above, this is partly due to differences in the relative objectivity and clarity of the criteria used. It is also a function of the staff and information technology resources available to the workers' compensation and insurance regulatory agencies.

It seems that most states cannot afford to employ in-office or field investigators to ferret out false claims of independent contractor status. Florida seems to set the high water mark for enforcement effort. According to a report for the State of New York by the Fiscal Policy Institute:

The State of Florida presents a sharp contrast to the generally weak state of workers' compensation enforcement in New York. In the midst of a housing construction boom in 2003, the State of Florida reformed its workers' compensation system and launched an aggressive program to combat workers' compensation fraud. Florida now has nearly 100 investigators in its anti-fraud campaign that targets employers who attempt to evade the legal mandate to provide their employees with workers' compensation coverage, including those who claim their workers are "independent contractors." In its latest fiscal year report on workers' compensation fraud enforcement, Florida reports that 2,693 stop work orders were issued, \$58.8 million in penalties were levied; \$30.5 million in additional workers' comp premium payments were collected; and that enforcement caused 12,366 new employees to be covered by workers' comp insurance. Florida's enforcement efforts involved 224 arrests and 85 convictions of employers working without workers' comp insurance.<sup>26</sup>

Education of employers and notice of the law is also influential in the outcomes of the law. Some states (e.g., Minnesota, Montana, and Wisconsin) take a proactive approach in explaining the law and warning employers of the negative consequences of being wrong about the status of a person who they assume is, or portray as, an independent contractor.

The Cornell University study, cited above, urged the State of New York to clarify its definitions of an independent contractor. When the Attorney General of New York investigated two large grocery chains for abuse in this area, he encountered plausible defenses. As one news commentator urged: "Clarity, in short, must come before a crackdown."<sup>27</sup>

## **System Outcomes**

This section evaluates the various systems in terms of their workload impacts on state agencies and other stakeholders in the administration of the workers' compensation system. It will quantify and compare administrative systems in terms of three case studies. Each case represents a discretely different approach to the regulation of independent contractors, and each demonstrates a fairly different set of workloads on stakeholders and costs to employers/contractors.

### Arkansas

In Arkansas, there is no fixed formula for determining whether an injured worker is an employee or an independent contractor, and the determination must be based on the particular facts of each case.<sup>28</sup> The resolution of whether an individual is an independent contractor or an employee requires an analysis of the factors related to the employer's right to control and of factors related to the relationship of the work to the asserted employer's business. The factors defining control were articulated in by the Arkansas Supreme Court:<sup>29</sup>

- (a) The extent of control which, by the agreement, the master may exercise over the details of the work.
- (b) Whether or not the one employed is engaged in a distinct occupation or business.
- (c) The kind of occupation, with reference to whether in the locality, the work is usually done under the direction of the employer or by a specialist without supervision.
- (d) The skill required in the particular occupation.

<sup>26</sup> Florida Department of Financial Services, Division of Insurance Fraud and Division of Workers' Compensation, "Joint Report to the President of the Florida Senate and the Speaker of the Florida House of Representatives," Jan. 1, 2007. [www.fldfs.com/WC/pdf/01-01-07\\_Joint\\_report.pdf](http://www.fldfs.com/WC/pdf/01-01-07_Joint_report.pdf). For a summary of coverage requirements under Florida's workers' compensation law, see Florida Department of Financial Services, Division of Workers' Compensation, "Key Coverage and Exemption Eligibility Requirements" found at [www.fldfs.com/wc/keycoverage.html](http://www.fldfs.com/wc/keycoverage.html).

<sup>27</sup> Times Union, "Mislabeling Workers," June 18, 2007, found at <http://timesunion.com/AspStories/storyprint.asp?StoryID=598437>.

<sup>28</sup> *Franklin v. Arkansas Kraft, Inc.*, 5 Ark. App. 264, 635 S.W.2d 286 (1982).

<sup>29</sup> *D.B. Griffen Warehouse, Inc. v. Sanders*, 336 Ark. 456, 986 S.W.2d 836 (1999).



- (e) Whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work.
- (f) The length of time for which the person is employed.
- (g) The method of payment, whether by the time or by the job.
- (h) Whether or not the work is a part of the regular business of the employer.
- (i) Whether or not the parties believe they are creating the relation of master and servant.
- (j) Whether the principal is or is not in business.

These are not all of the factors which may conceivably be relevant in a given case, and it may not be necessary for the Workers' Compensation Commission to consider all of these factors in some cases. The relative weight to be given to the various factors must be determined by the Commission.<sup>30</sup> However, the Arkansas Supreme Court has stated that the "right of control" is the "principal factor" in determining whether the relationship is one of agency or independent contractor.<sup>31</sup>

To add more certainty to the dividing line between contractors and employees, Arkansas created in 2001 a process for "Certification of Non Coverage" (CNC). The process is relatively easy and inexpensive. The certification fee is \$50 for two years, and the AR-A form is easy to complete. It is basically a sworn assertion of independence, without any enumeration of facts or demonstrated compliance with criteria. This CNC has proven to be quite popular, as shown by the growth in the cumulative number of CNCs since its inception:

<u>Year</u>	<u>Issued</u>
2001 (beginning August)	4,019
2002	13,265
2003	12,237
2004	16,180
2005	19,186
2006	19,339
2007	18,039
2008 (through Sept.)	19,339

The number of CNCs seems to have leveled off in recent years. This may be due to many factors, such as: 1) reaching a plateau of those individuals who want or need a CNC, and of businesses which want or need for persons to obtain them; 2) implementation by the Contractor's Licensing Board of a rule which requires contractors holding a Residential Contractor's License to provide proof of workers' comp coverage at the time they renew their license; and 3) giving low weight to the CNC in recent Commission hearings and court cases if the judge finds that the preponderance of evidence meets the court tests for employee status.

No CNC has been revoked for particular work situations, or in total. But, the Commission has begun to investigate multiple applications being paid for by the same enterprise.

Advantages of this system:

- Does not force all contractors to adhere to a rigid standard for proving their independence. Requires only reasonable evidence to support the claim of independence.
- Does not force all contractors to purchase insurance for themselves, thus saving them considerable cost. Residential construction contractors must purchase at least an "if any" policy, which, as noted above, excludes coverage for the purchaser.

Disadvantages:

- Increases the number and scope of disputes at time of premium audit.
- Increases the potential for workers filing applications for hearings for acceptance of claims after serious injury motivates them to reconsider their claims of independence.

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<sup>30</sup> *Franklin*, supra.

<sup>31</sup> *Sanders*, supra.

- Does not provide a safe harbor for a person who clearly meets any standard for being an independent contractor. Without this safe harbor it is more likely that many independents would be forced to buy insurance, particularly in the building trades.

### Montana

The state has long used a precertification of independent contractors. Reforms that took effect in April 2005 made the process far more rigorous and legally certain. We know of no state that has a more detailed and carefully specified set of declarations that must be made as part of the state review. The application includes a very novel point system to determine if a sufficient basis had been reached for awarding the certification. A total of 15 points are needed from 25 criteria having point values ranging from 1.5 to 6 points each. Thus, there is no specific fact situation that must be met. The exact nature of the work being done must be described. The application also makes it very clear what the consequences of false statements might be. The department staff also does computerized audits of all applications for certification and field investigations of certifying parties. About 60 applications have been denied or revoked, and after investigation, about a dozen certifications are modified each year to exclude specific job site relationships. In addition, the Department engages in a proactive educational campaign to make certain hiring agents and parties seeking independent status understand the law and the consequences of the certification.

Following are the numbers of certified independent contractors:

FY	2002-03	29,000
	2003-04	33,000
	2004-05	26,000
	2005-06	14,000
	2006-07	17,000
	2007-08	17,000
	2008-09	17,000 (projected)

The program appears to have had a dramatic effect on the number of parties willing to offer themselves in the marketplace as independent contractors. It also seems to have defined a stable core of independent contractors.

In short, it is a rigorous process that forces the applicant to consider their status very carefully, and attempts to validate applications to ensure that they were done with a good factual foundation.

Advantages of this system:

- Offers a reasonable degree of warning to applicants against making hasty or uninformed waivers of their rights to workers' compensation.
- Sets very clear criteria for enforcement of law at time of audit or in the event of a claim. There is reportedly no question about exposure and premium for parties with a valid certification on file.
- Criteria have a clear legislative mandate and good stakeholder buy-in. In contrast to states where the precertification process is advisory in nature, to date no court challenges have been made by parties that sought to void their certification after an injury.
- Presents a moderate costs to contractors: \$125 fee for a two-year certification and a rather lengthy application form.
- Creates a very clear safe harbor for hiring agents against claims from their certified contractors as long as a valid certification is in place.<sup>32</sup>

Disadvantages:

- Requires nine full-time staff and a split-function program manager to administer the certifications, conduct investigations, and engage in outreach and education—three internal staff to process the applications and respond to

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<sup>32</sup> According to staff, even if the contractor began to work exclusively for one hiring agent and fell under their daily control, the certified independent contractor would not be eligible for workers' compensation benefits for the term of the certification, or until the department revoked the certification for cause.

questions, plus six auditors located throughout the state who visit job sites to verify the actual contractor/hiring agent working relationship. If they conclude that the hiring agent is exerting control over the independent contractor, the exemption is suspended for that working relationship.

- Leaves certifying contractors exposed to liability if they inadvertently pick up workers' compensation exposures, e.g., employ a third party to assist them on a part-time basis not knowing that this triggers the need for insurance.
- No strong alignment with other criteria for independent contractor status. Hence, a party could be "independent" for workers' compensation purposes, but remain a statutory employee for unemployment insurance or other legal purposes. SB 270 Stakeholders Group has been satisfied with the performance and has only recommended minor changes to the administrative rule.

### Wisconsin

Since the mid-1980s, Wisconsin has used the same nine-point test for determining the status of a contractor. All nine points must be met and documented or the worker is deemed to be a statutory employee for workers' compensation purposes. Insurance company audit is the primary enforcement mechanism. Auditors strictly treat contractor fees as equivalent of wages if the policyholder cannot document compliance with all nine points. A second enforcement mechanism is the Wisconsin Division of Worker's Compensation's coverage enforcement program. If the Division detects a business entity without workers' compensation insurance, it pursues the matter with an automatic series of investigation letters. A business claiming to be a sole proprietor operating as an independent contractor must document his or her compliance with the nine-point test. Failing this, provisional penalties are assessed for the estimated extent of the breach of insurance coverage, followed by a vigorous collection routine. It so happens that many parties concede their failure to meet the test quite quickly because they do not have a Federal Employer Identification Number or file taxes as an independent business (IRS Schedule C filings). Very few cases end up with disputes over the adequacy of evidence over the other eight points.

Disputes over the application of the premium for contractors must be brought first to the Wisconsin Compensation Rating Bureau (statutorily created statistical agent and rating-setting organization). In Wisconsin, there were fewer than 10 disputed cases of premium classification brought to the Wisconsin Compensation Rating Bureau in the past three years. These were all quickly decided by the Rating Committee of the Rating Bureau, and none was appealed to the Office of the Commissioner of Insurance. This is a remarkably low level of disputed cases, considering that there are about 130,000 insured employers in the state and roughly 20,000-30,000 insurance company audits per year. Because there is no certification of independent contractor status, there are not estimates of the total number of businesses operating—within the nine-point criteria or otherwise—as independent contractors.

Advantages of this system:

- Sets very clear criteria for enforcement of law at time of audit or in the event of claim. There is reportedly no question about exposure and premium at time of audit.
- Requires few state employees to enforce. The primary enforcement is the insurance audit process.
- Virtually no disputes about the application of premium audit rules and premium charges.

Disadvantages:

- Forces all contractors to adhere to a rigid standard even though the clear nature of their behavior is to be an independent business person.
- Forces all contractors to purchase insurance to satisfy the demands of potential clients.
- Leaves open the possibility of abuse of "if any" insurance by unscrupulous hiring contractors, especially for very small operators that are able to avoid on-site premium audits of their books and records.

The success of the test depends on a "common sense" approach that might not be replicable in other states. For example, two of the Wisconsin factors require an independent contractor to "control the means of performing the services or work" and to be compensated "on a commission or per job or competitive bid basis and not on any other basis." Although Wisconsin

successfully treats the first factor as an objective test, it could give rise to disputes in more litigious environments, as noted below in the Recommendations. The second factor could be problematic if interpreted too literally in some lines of business. For example, in auto repair and the practice of law, billing on an hourly basis as work is being performed is customary.

## Summary

The original *raisons d'être* of the workers' compensation system were, and continue to be: 1) protecting injured employees and their families by ensuring the injured party access to good medical care and disability payments while they are off work, regardless of fault; and 2) protecting employers from unpredictable tort liability. As costs of insurance coverage have increased, more and more employers have searched for ways to reduce their labor costs by shedding non-wage benefit costs, such as workers' compensation.<sup>33</sup> While legitimate independent contractor status remains an important and viable element of national commerce, the illegitimate characterization of employees as purported independent contractors subverts the principle of "universal coverage" in the workers' compensation social compact.

The treatment of persons professing to be "independent contractors" is very different from state to state. Many political, economic and bureaucratic reasons account for this disparate treatment of contractors. But, as shown here, different policies can have a substantial effect on the administrative costs of policing independent contractors, upon employer and insurer costs, and upon entrepreneurs' freedom to select their preferred business model.

The state mechanisms range from rigorously applied bright-line tests to more open-ended and subjective criteria. On top of the criteria may rest differing systems for certification or declaration of independent contractor status. As we have discussed here, the more rigorous, objective systems constrain contractor options, but seem to result in fewer disputes at audit or time of injury. The more open-ended systems are more flexible in considering specific fact situations, but for that reason, create more disputes and adjudication costs.

## Recommendations

### 1. *Clarify the legal standards for independent contractor status in statute.*

As noted above, there are strong financial incentives for employers to recast employment into an independent contractor relationship. This is especially true in industries with very high workers' compensation insurance costs. The incentives for workers to go along with the attempt to label them contractors may be additional compensation or a desire to "get along" with the employer and keep working.

The issue of "employer control" has been the primary test in case law. Employers have shown themselves to be creative in portraying the work as being under the control of the worker. This leads to laborious investigations of fact circumstances in individual cases. Thus, the state should articulate as many objective tests of economic independence as possible to replace or supplement the control criteria. Also, by requiring concurrent satisfaction of multiple standards, many clearly superficial or weak claims of independence can be defeated early in the process. For example, the absence of tax records of a self-employed person or the fact that the worker does not incur the majority of expenses related to his/her work are objective tests that could obviate the need to delve into the more subjective and context-driven issue of control.

Certain rebuttable presumptions would help in litigating disputes. For example, regular payments for work done that is similar to work done by employees in that industry might create a rebuttable presumption of employee status. This would address some of the common areas of dubious contracting, such as delivery drivers and construction craftsmen.

### 2. *Promote vigorous employer education of the risks of independent contractors being deemed employees.*

News about the independent contractor issue and state enforcement of standards varies tremendously from state to state. For example, Massachusetts and Montana have benefited from considerable outreach by employer groups and attorneys in publicizing the independent contractor issue.

With rigorous standards and good employer education, many employers that might take a chance at making ill-founded claims of independence for their workers will see the risks of such behavior. The risk should include substantial fines to offset the potential savings from recklessly and deviously avoiding employment relationships with workers.

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<sup>33</sup> Health insurance coverage is an even greater issue in this regard. The growth of Professional Employer Organizations is, at least in part, driven by this compulsion to reduce labor costs.

3. *Strengthen penalties for employer actions to incite or coerce employees to waive their rights to workers' compensation coverage through claims of independent contractor status.*

Employers should not coerce current or potential employees to sign certifications of independent contractor status—either to public agencies or private contracts. Such certifications must be undertaken by a person without any pressure, especially if they are uncomfortable about representations being made regarding their status. In some cases and situations, where histories of abuse are widespread, consideration should be given to elimination of such procedures.

4. *Increase education regarding insurance issues, especially the use of “if any” policies. Strengthen penalties for the abuse of “if any” insurance policies.*

“If any” policies can be a beneficial tool to control the risk of hiring contracts and to ease transaction costs of ensuring coverage. However, the very low premium of these policies may invite abuse by employers who attempt to portray employees as independent contractors and who use “if any” policies as smoke screens to conceal their employee status. Individuals with language and cultural disadvantages are particularly vulnerable to abusive manipulation. Hiring entities should not purchase or arrange for the purchase of such policies by parties they will be paying for services. However, the hiring party may insist on a valid certificate of insurance.

5. *Clarify audit procedures and standards.*

Many insurers, rating bureaus and state regulatory agencies provide advice to policyholders on the nature and procedures of premium audits. For example, the Michigan Insurance Bureau Bulletin 89-03 (published in 1989) provides some of the above guidance, at least for residual market policyholders. Kentucky Employers Mutual offers its policyholders a detailed questionnaire that employers can use to document the status of contractors in preparation for premium audit.

If a state is experiencing friction between auditors and policyholders about the inclusion of payroll for contractors, that state might consider publishing a guidance bulletin. This bulletin could be used by agents and insurers to educate businesses, particularly small employers, about audit standards. Such a bulletin could review statutes, rules and case law regarding tests for affirming the status of an independent contractor. Common questions could be addressed and examples given for common areas of dispute, e.g., delivery drivers and construction trade workers. Most important, business owners could be told what sort of documentation they would need to have on hand at time of audit to prove their case that contract payments should not be included as payroll for workers' compensation. Finally, the guidance should describe the employer's right of appeal to audit findings.

6. *Coordinate with Unemployment Insurance.*

Connecticut, Oregon and Wisconsin have identical statutory criteria for their workers' compensation and unemployment insurance. On the other hand, most other states appear to have differences, though sometimes minor, in criteria defining independent contractors in the two programs. Employers would benefit if these criteria were synchronized. This would ease the hiring entity's burden in understanding legal obligations. The state's educational efforts to explain the law would be simplified.

In addition, it is extremely useful to have agencies administering workers' compensation and unemployment insurance share data files. Such data sharing has been a very useful enforcement tool in many states. Despite this potential to serve both programs, some state unemployment insurance programs will not allow sharing of their files for this purpose.

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