



Ramifications of Hiring a Sole Proprietor on Your Workers Compensation Premiums

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A client asked me, “How does hiring a subcontractor who is a sole proprietor without the need for workers comp insurance affect one’s audit and future comp rates?” This is a well-phrased question. My clients question went right to the heart of the matter, which is, if the law does not require a sole proprietor (SP) to have Workers Compensation (WC) coverage what are the ramifications to his (the hiring contractor’s) insurance program?

There are several aspects to answering this question. Let’s begin with what the Commonwealth of Massachusetts has to offer in terms of guidance. The Massachusetts WC Bureau dictates through its Procedures manual if someone is a SP with no employees, they are not required to carry WC coverage in Massachusetts. While this seems clear cut, contractors who hire SPs have more with which to contend.

MASS law GL149, c148B assumes everyone is an employee of the hiring contractor unless they can be shown to be an Independent Contractor (IC). The law imposes a three-part test and for the SP to be considered an IC must pass all three parts. These are:

- The SP must be in contract and in fact free from the hiring contractor’s control.
- The SP must be performing activity outside the scope of the activity of the hiring contractor’s company. (The SP and the hiring contractor cannot be performing the same jobs, such as a plumber hiring another plumber.)

- The SP must be performing the same activity as they perform for the hiring contractor for the majority of the workweek and when they work for others. (A fireman five days a week that acts as an electrician for the hiring contractor would not qualify as an IC.)



Therefore, when hiring a SP with no employees and one that qualifies as an IC, the hiring contractor’s carriers should not charge for the exposure (the cost) of the SP and there should be no impact on the hiring contractor’s WC program.

However, when a SP is injured while working for the hiring contractor, he or she, or their heirs, may try to make a claim against the hiring contractor’s WC policy regardless of the understanding that the SP was not an employee.

As a matter of course, the hiring contractor’s WC carrier will deny coverage stating the SP is or was not an employee. Once the claim is denied, the injured SP may retain an attorney who will then take the claim to the next level and file a lawsuit against the hiring contractor. The suit will try to establish that there was an employer-employee relationship and therefore benefits are due to the SP. These law suits are defended by the hiring contractor’s WC carrier and settled by a Department of Industrial Accidents (DIA) Judge.

Here is where things begin to turn against the hiring contractor. The DIA Judge, despite all that was previously discussed, may instruct the carrier to pay the claim, as there is no other insurance in play. This is not fair to the hiring contractor or the WC carrier, but the hiring contractor and its’ WC carrier are saddled with the claim.

The carriers’ knowledge that they may be forced to pay these claims / suits affects the behavior of the WC carriers in Massachusetts and it is in the carriers’ reaction that we find the answer to my client’s question of the effect on one’s audit and future comp rates.

AUDITS

Carriers may try to collect premium on the cost of work of the SP, as the carrier is aware that if that person is injured, a claim may ensue and be paid. This additional premium will be added to the hiring contractor's audit. The carrier will use Mass GL 149, c148's three-part test wherever possible to defend their actions. This additional premium can be appealed and overturned although the process can be arduous. If the carrier stands firm, an appeal will have to be made to the DIA for resolution.



The best approach to this problem is to avoid it. To avoid additional premium due at audit, additional losses on your record and higher WC premiums in the future due to increased Experience Modification factors and ARAP penalties, hire only SP's that carry WC coverage and provide evidence that the SP has "opted-in" on their WC coverage. In addition, it is wise to have a written risk transfer agreement between the hiring contractor and the SP that includes a statement that the SP is an IC and is not an employee of the hiring contractor organization.

As always, I hope this information is helpful in keeping your insurance program stable and lowering the cost of your risk.

FUTURE PREMIUMS

When a WC carrier defends and or pays a claim on the hiring contractor's behalf, even if wrongly ordered to by the DIA, it goes on the hiring contractor's loss records and then into the hiring contractor's experience modification and ARAP factors. The loss will have a negative effect on the hiring contractor's WC and Umbrella premiums for three policy periods.

SUMMARY

The system is confusing and seemingly unfair, but it is predictable. The carriers feel the system is unfair as well. Not only does the Commonwealth set the WC rates, while it is the carriers who pay the claims, the Commonwealth at times will overlook its own rules and force carriers to pay claims they should not. As such the carriers try to protect themselves by charging for SPs with no WC coverage. This results in a relationship between a policyholder and an insurer that is adversarial. In fact, carriers and policyholders are in this together.

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