

# Contractors Insurance

## Survival Guide – Issue Three

Patrick O'Toole, AU

With insurance for contractors difficult to place, and the restrictions that go along with offering coverage getting tighter, are builders simply at the mercy of the insurance industry?

As a company underwriter, I often saw situations where both insurers and their construction customers viewed each other with suspicion. Yet, there were some construction accounts which, from the insurer's point of view, "got it". These customers received more expansive terms, and favorable premium pricing. They also got free consulting services from their insurance company.

The insurers viewed these customers as "partners" in the process of managing risk. And they weren't all large contracting firms, either. If I had to name a single factor that contributed most to viewing a construction risk favorably, it was what I call a "safety culture". A strong and stable commitment to providing the safest workplace for employees and subs possible, and to the idea that accidental losses can almost always be prevented.

This series seeks to provide some insight to construction firms about the way construction insurance works. I offer what are sometimes technical discussions about the issues that can either be bones of contention between insured and insurer, or – perhaps – opportunities for cooperation. This month, I'm taking on a big one:

### **Worker's Compensation for Independent Contractors**

There is a large subcontracting firm in Maine, which will remain nameless, and which gives its employee's a choice. They can earn one hourly rate as an employee, where they will receive the protection of the firm's worker's compensation insurance, and the withholding of income and payroll taxes. Or, they can earn a different, significantly higher hourly rate, if they declare their Independent Contractor status, show evidence of Liability insurance, and agree to declare and pay their own estimated taxes to the government.

There is no requirement, however, that they show evidence of *Workers Compensation* insurance.

In the unhappy event that one of these Independent Contractors is seriously injured at work and, as a result, unable to work, what happens, if anything, to the firm that hired him or her?

The situation has been crafted so that the employee will be unable to seek workers comp benefits from the employer, because he agreed not to accept coverage under their policy. The assumption is that the employee will either go get worker's comp coverage for himself, or that he will take advantage of the exemption of a business owner from the mandatory nature of worker's comp coverage. The different rate of pay, in the firm's view, justifies the assumption that the employee will pay the added costs of business ownership as part of their "overhead".

Sounds like a good way around Workers Comp, doesn't it?

## **A Dicey Scheme**

Except that, when push comes to shove, the employee is still an employee. He is under the sole direction and supervision of a foreman of the contracting firm. The firm is his sole or primary source of revenue. The firm provides most or all of the materials and tools used by the employee. All these things are taken into account by the Worker's Compensation Board when determining whether a person is an employee or an independent contractor, which happens either before an accident, when the worker applies for pre-determination of Independent Contractor status, or after an accident, when the injured worker seeks compensation from the employer under the workers compensation laws, but the employer claims that the worker is not entitled to coverage due to his Independent Contractor status.

When one or more of the above factors – direct control by the employer, primary or sole source of revenue, or provision of materials and tools – is present, want to guess whether the Board will find that the injured worker is entitled to benefits? How about whether the workers comp insurer for the contracting firm is going to revisit payrolls that year?

## **A Growing Trend**

One insurer that Smithwick and Mariners represents – Guard Insurance – has taken a proactive approach to this situation. They would not insure the contracting firm I refer to above, because they now insist on including all the costs of Independent Contractors as part of the payroll on which worker's comp premiums for the firm are based. Since they are paying these so-called Independents a higher hourly rate than employees, and the worker's comp premiums charged would be based on these higher rates, there would not only be no premium savings by using this scheme – there would actually be a penalty. The only exception to charging Independent Contractor costs as payroll is when the Independent can produce written confirmation from the Workers Comp board that he is, in fact, an Independent.

Other insurers in our market are trying, but the weight of history – and often the size of the account – makes it hard to eliminate this loophole. I believe, though, that it is in *everyone's* interest to lay all the cards on the table. If someone is being paid as an Independent Contractor, but that Independent does *not* have *both* employees of his own, *and* control over his work schedule, then he should seek pre-determination from the Workers Comp board. Until he gets it, he should be regarded as an employee for insurance purposes, his imputed wages declared as payroll to the workers comp insurer, and deducted from costs declared to the liability carrier.

## **No Middle Ground**

Obviously, the nameless firm above is saving workers comp premium dollars by calling employees “contractors”, and paying lower liability rates instead of comp rates for these workers. But continuing the practice indefinitely depends on a lot of luck. You have to hope no one gets hurt, and if they do, you have to hope they won't call you on it. If you're luck runs out, you are in for a big adjustment to your audited payrolls as your “Independents” suddenly get re-classified as employees, and premium charged for their pay. And don't expect your Liability carrier to help you offset this by reclassifying sub costs. Distrust runs high when an insurance company is called upon to pay a worker's comp claim for someone you told them was not an employee.

In fact, if your business plan involves saving on workers comp premiums and payroll taxes this way, even if there hasn't been a claim yet, your insurer is probably aware of the practice. It really isn't hard to figure out. And while some insurers do "go along" with the scheme, they are not likely to also give you favorable pricing on your premium rates. In fact, when the claim does come (and it probably will) you're problem may not be the premiums associated with Worker's Comp insurance. You might find you have a problem of *availability*.

I recommend an open approach with your workers and your insurance company. Ask the comp carrier to let you speak to an auditor at the company about the proper way to classify workers. Help those workers who really do qualify as Independents under the Comp laws, to apply for a Status Pre-Determination, and make it a part of the insurance underwriter's file. Ask the workers who insist on retaining their independent status to provide evidence of their own Worker's Comp insurance – and if you have a fairly large operation don't be afraid to use your leverage with your insurance company. Will *they* offer reasonable comp rates for the independents you hire on the job?

### **Have a Friend in the Trenches**

Insurance is not the business you're in. But you *are* in an industry where the risk and insurance requirements are complex, and they are an essential part of your operation. I'm sure you can think of other areas like this – specialty trades for example – where you see the value of sub-contracting the work to someone who has made a specialty of it. So think of your insurance agent as a subcontractor for your risk management needs. When they do their job right, they add value to the project, and let you focus on what your real business is.

And in the construction industry, that job isn't finished when the policy gets bound. If you can give some time to your agent and your carriers each year – time to review and adjust values and exposures for such things as properly classified workers comp payrolls, and jobsite safety management – *and* if your agent is one who will take and use that time to good advantage – then *your* firm can develop the kind of relationship with your carriers where mutual trust and cooperation are the order of the day.

That kind of relationship starts with an open approach, and with choosing the right agent.