Approved Arthur Douville 3-30-88
Date

MINUTES OF THE House COMMITTEE ON Labor and Industry.

The meeting was called to order by Representative Arthur Douville at
Chairperson

9:06 a.m./~~p.m.~~ on March 15, 1988 in room 526-S of the Capitol.

All members were present except:
Representative Cribbs - Excused

Committee staff present:
Jerry Ann Donaldson, Kansas Department of Legislative Research
Jim Wilson, Revisor of Statutes' Office
Juel Bennewitz, Secretary to the Committee

Conferees appearing before the committee:
Don Schnacke, Kansas Independent Oil and Gas Association
Paul Bicknell, Chief of Contributions, Department of Human Resources

Minutes of the February 24, February 25, March 1 and March 2, 1988, meetings were presented to the committee. If no objections are heard by Thursday, March 17, 1988, the minutes will stand approved.

re: S.B. 564
Don Schnacke spoke in support of the bill, attachment #1. He stated the same experience under the federal I.R.S. auditing procedure and some progress has been noted in the last year. He cited a December, 1987, letter to Congressman Glickman from the Department of the Treasury which stated several alternative standards that constitute safe havens from auditing in determining whether a taxpayer has a reasonable basis for not treating an individual as an employee. Reasonable; reliance is sufficient in any of three areas and he cited only number three which he said is the one most helpful to the operators in Kansas:
"A longstanding recognized practice of a significant segment of the industry in which the individual was engaged."

Representative Patrick asked to be furnished a copy of the opinions of the Department of Human Resources (DHR). attachment 2

Chairman Douville cited an example: A property owner anticipates he has some oil on his land and enters into a contract with ABC Oil Company. The oil company agrees to certain terms in exchange for which the property owner will receive a royalty. The company sends an independent contractor to work on the property. He is hurt. Who pays his worker's compensation? Mr. Schnacke's response was he is "clearly an independent contractor servicing and running his own business. He is hired by the oil company because it does not have enough business in the area to justify hiring a full time employee. He carries his own insurance.

The chairman gave a second example: A person contracts with a painting company to paint his house. The company sends an individual contractor. That individual contractor is an employee in the eyes of the law regarding worker's compensation. If a principal does work and has it done through someone else and that individual is hurt, the principal is responsible for the worker's compensation. Mr. Schnacke concurred with the chairman's example and stated a contract pumper with several of his own employees has a contract pumper principal who has the responsibility of covering his employees doing the pumping services.

Chairman Douville stated there seems to be a growing tendency for many companies to use independent contractors rather than employees so they don't; have to pay employee benefits such as worker's compensation. Mr. Schnacke responded the heart of the problem is the interpretation of the control element between the person hiring the independent contractor and DHR. He reiterated the I.R.S.' safe havens provision and stated the industry knew of no other way around the problem.

Representative Hensley recognized the points made by the chairman and asked if these individuals would be exempted from the Worker's Compensation Law. The response was they would pay their own workmens compensation - would have to seek their own insurance coverage. They are individual contractors with their own tools, equipment, transportation and often logos and telephone numbers. He contended the difficulty comes in the auditing process and the department's definition of the control process.

The representative cited the new language added by the senate committee on page 14, stated it appeared to be some sort of exclusion from the exemption and asked for an explanation. Mr. Schnacke responded it was done at the request of the U.S. Department of Labor for conformity of federal versus state. He read from the letter, "Second, in the circumstances that any of the excluded services are performed for a governmental entity or non-profit organization whose exclusion would raise an issue of consistency with the coverage requirement of section of the F.U.G.A. (sections cited). As you aware, these sections require that services for governmental agencies or non-profit organizations must be covered under the same terms and conditions as other covered services under state law. If this proposed legislation further advances, we recommend an additional clause stating that the exclusion would not apply to services performed by governmental organizations and non-profit organizations."

Representative Buehler asked if there were other industries which might want to be included or were already exempt? The response was an assumption that some of the others in the "pecking order" which would fit into the category. The representative asked if there were any that were exempt now. Mr. Schnacke stated he could not answer.

Representative Holmes stated his area included those whose principal income was farming but individual oil companies have paid some of those farmers a daily rate to check their wells on the property. Mr. Schnacke recognized the situation but stated his primary reference is to those who are legitimate contract pumpers whose income is derived from same.

Representative Mead asked if it was standard practice for the employing company to require proof of insurance before hiring the contract workers. The response was affirmative. Mr. Schnacke stated it was provided either orally or written and was fairly clear the insurance would be covered by the independent contractor. The representative called it a fairly good test if the individual or company provides the insurance they are paying the fee. He cited the building industry with its problems with the pass through provisions regarding going through the subcontractor to the primary contractor for settlement.

Representative Webb expressed concern over independent contractors who receive a check from a company, move area to area, and in addition to not paying worker's compensation or having insurance, do not pay income or state tax. He strongly favored an interim study of the independent contractors law. He stated personal knowledge of people operating as individual contractors who pay on an hourly basis but do not withhold state or federal income tax, social security or insurance. He advocated tightening the law in this area.

Representative Mead referred to form 1099 and asked if there was a dollar limit under which they are not necessary and if filling out this form included roustabout crews. Mr. Schnacke was unsure of the exact dollar figure but thought it to be $1,000.00. He stated he did not believe so as these independents are working under the "strict supervision of employers" and do what is asked of them. He claimed no knowledge of independent contract roustabouts but would not state they do not exist.

Representative Hensley stated the definition of independent contractors seems to be an issue which is dealt with perennially and supported Representative Webb's suggestion that it be the subject of an interim study as it relates to the Employment Security Law or the Workers Compensation Law.

Mr. Schnacke stated that approximately one-fourth of the total category in Kansas, called pumpers, are affected by this act. The rest are clearly employer employee relationships.

Representative Green asked how many contractors have two or more pumpers leased out other than the individual pumper. Mr. Schnacke's response was he did not have a good survey but quite a number. The representative stated he felt there was a lack of understanding regarding the pumpers. In his constituency, a pumper is usually one person paid by the month to pump a well. He may add another well or two but he is an individual operating on an individual basis not a business agent with several pumpers working for him.

Representative Bideau added some information on the insurance aspect. An oil company's primary carrier tells it that if anyone comes on the lease to do anything, unless that person has a certificate of insurance of their own, the oil company will be charged for workers compensation. He stated there would be no gap in workers compensation premium payment. In the event of a claim, it will be decided on the issue of whether or not the person is in fact an independent contractor. He stated this bill would constitute no change in workers change but to correct what the oil industry feels is an improper interpretation on the "control issues" in the unemployment insurance laws.

The chairman asked if the insurance policy covered workers compensation if the independent contractor was injured, or just his employees. Representative Bideau responded if the individual is truly an independent contractor, he is not going to have coverage unless he purchases his own. There is a $10,000.00 payroll exclusion. A principal, in business, can elect coverage. If it is determined in a hearing the individual is an employee, not a general contractor, then the oil company's carrier will have to pay. That is the reason they make a premium charge - this refers to the major oil companies.

Representative Patrick asked Mr. Schnacke's opinion of adding language in lines 0087-0088 to the effect of "services performed under the terms of the worker's contract" so something would be recorded in writing not on a verbal basis to balance the interest of the company and the employer. The response was a guess that half the current operators do not have a contract and a reiteration of the department's interpretation of control. However, Mr. Schnacke stated he was for saving the bill and didn't think that language would harm it.

Representative Green stated an insurance company would have to cover a pumper for each lease he had where an independent contractor would have his own coverage. The chairman asked if there were some oil companies that had regular employees that were sent out, to which there was an affirmative response. Mr. Schnacke said it was not intended to try and eliminate the entire classification of pumpers as 3/4 of them are covered in a regular employer/employee relationship. The chairman asked if passage of this bill would be an incentive for a number of employers with employees and contracts to use the bill as a means to avoid paying benefits such as social security and workers compensation and do away with the entire contract. Mr. Schnacke's response was this is proceeding under something with a long time status and didn't think it would change much but would be helpful in the auditing process. He did perceive it to be an incentive to employers.

Using his area as an example, Representative Bideau stated pumping oil and gas leases amounts to a cottage industry allowing people to be self-employed on a small basis. Many of them have five leases to a site and cannot afford employees. They meet all the other "laundry list" tests of independent contractors except the control test of the unemployment insurance law.

Paul Bicknell stated it was not apparent how the current language of the bill would alter the unemployment security law as it is administered. If they are, in fact, independent contractors they are already excluded from the law. Non independent contractors are also covered under the current law as well as in this bill. Controversy arises when a person considered by the industry

to be an independent contractor is unemployed and files a claim for unemployment benefits, claiming to have worked for a company as a pumper. There would be no wage credits for that person and an investigation is initiated to determine if there should be wage credits for the plaintiff. They are then claiming to be an employee not an independent contractor. There are twenty common law factors used to determine whether there is a right and direction coexisting. The chairman asked if the point being made was that passage of this bill would not change anything. Mr. Bicknell's response was the language of the bill is to exclude an independent contractor involved with the gas and oil industry. Current law excludes a person free from direction and control. The chairman asked if nothing is affected, why the bill is being presented. Mr. Schnacke responded the bill will be a helpful tool in determining whether this classification within the industry is going to be excluded. He called it an expression from the legislature that defines same and will aid in litigation.

Representative Green asserted the way a contractor pumper turned in his wages would reflect whether or not he was an independent contractor or an employee.

The meeting adjourned at 9:49 a.m. Next meeting of the committee will be March 16, 1988, 9:00 a.m., Room 526-S.

GUEST LIST

COMMITTEE: House Labor and Industry DATE: March 15, 1988

NAME	ADDRESS	COMPANY/ORGANIZATION
Henrik Jonne	Sweden	Fort Scott High
John Harding	315 Clairmont	Ft Scott High
Mark Friend	8 N. Crawford	" "
Brad Allison	R.R. # 3	Ft. Scott High
Robert Anderson	Ottawa	Mid Cont Oil & Gas
Jim McHaff	Topeka	KS AFL-CIO
Harry Nelson	Wichita	" " "
Wayne Marshall	Topeka	" " "
Walter Dunn	"	E. KOGA
Rolf Trojer	Ulysses	Close-Up KS
Hunter Goldsby	"	"
Matt Jones	Ulysses	"
Bill Clawson	TOPEKA	DHR
PAUL BICKNELL	"	"

KIOGA
KANSAS INDEPENDENT OIL & GAS ASSOCIATION
500 BROADWAY PLAZA • WICHITA, KANSAS 67202 • (316) 263-7297

March 15, 1988

TO: House Committee on Labor and Industry

RE: SB 564 – Independent Contract Pumpers

We are appearing in favor of SB 564 and ask that this Committee recommend it for passage.

SB 564 would amend the Kansas Employment Security Law to exclude services performed by oil and gas contract pumpers from the definition of "employment" under the law. Thus, SB 564 would have the effect of removing oil and gas contract pumpers from the parameters of the Employment Security Law.

The Kansas Employment Security Law defines employment under KSA 44-703(i)(1) as follows:

> "Subject to the other provisions of this subsection, service, including service in interstate commerce performed by (A) Any active officer of a corporation; or (B) Any individual who, under the usual common law rules applicable in determining the employer-employee relationship has a status of an employee;..."

Additionally, KSA 44-703(i)(3)(D) states:

> "The term 'employment' shall also include: ... services performed by an individual for wages or under any contract of hire shall be deemed to be employment subject to this act unless and until it is shown to the satisfaction of the secretary that: (i) such individual has been and will continue to be free from control or direction over the performance of such services, both under the individuals' contract of hire and in fact; and (ii) such service is either outside the usual course of the business for which such service is performed or that such service is performed outside of all the place of business of the enterprise for which such service is performed."

Under the law, all services performed by an individual for wages or under any contract of hire are deemed to be employment unless an employer can demonstrate that the individual is not a common law employee and that the individual is free from control or direction over the performance of his services. Thus, the law clearly provides for a distinction between employees and independent contractors. The problem, however, is that in order to determine whether an individual is a common law employee or an independent

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contractor, the Kansas Department of Human Resources has created a nearly insurmountable test that essentially does away with independent contractors in the State of Kansas.

In the oil and gas industry, it is common for small and medium-sized businesses to retain, on a contractual basis, oil and gas pumpers to service and maintain oil and gas leases. These oil and gas contract pumpers generally work for multiple businesses and travel from lease site to lease site to perform their work. These individuals are in no other way associated with the businesses with which they are contracted, and work independent from the general operation of those businesses.

The leading case on point concerning whether or not an employer-employee relationship exists is Wallis v. Secretary of Kansas Department of Human Resources, 236 Kan. 97 (1984). In Wallis, the Supreme Court held that the primary test used to determine whether the employer-employee relationship exists is whether the employer has the right of control and supervision over the work of the alleged employee and the right to direct the manner in which the work is to be performed, as well as the result that is to be accomplished. The Court stated that it is not the actual interference or exercise of control by the employer, but the existence of the right or authority to interfere or control, which renders one a servant rather than an independent contractor. 236 Kan. at 102-03; See also, Jones v. City of Dodge City, 194 Kan. 777 (1965).

An independent contractor has been defined to be 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 results of his work. Read v. Warkentin, 185 Kan. 286 (1959). It has been recognized, however, that while there can be no absolute rule for determining whether an individual is an independent contractor or an employee, it is the facts and circumstances in each case that determine whether one is an employee or an independent contractor. Wallis, 236 Kan. at 102.

In the oil and gas industry, the independent contract pumper is paid an agreed-upon fee to perform service and maintenance tasks on oil and gas lease sites. The individual is expected to perform his work in a professional manner and on a timely basis.

It has been the experience of KIOGA that the Kansas Department of Human Resources has created a "control test" that literally makes all oil and gas independent contract pumpers employees and subject to the provisions of the Employment Security Law. The effect of this is to make the various oil and gas businesses that utilize independent contract pumpers liable for back employment security contributions for each independent contractor utilized. When coupled with the invariable claim for interest and penalties, this can result in liability in the tens of thousands of dollars to small and medium-sized oil and gas companies.

In one specific example, the Department of Human Resources essentially ruled that merely by enforcing the work contract, a company turns an independent

contractor into a common law employee. For instance, in one KDHR opinion, it was held that "the control factor is present if the employer has the right to require compliance with the instructions." In other words, merely enforcing the contract turns an individual into a common law employee. In that same opinion, it was held that "a requirement that each well must be serviced daily is an element of control." Thus, any work to be performed on a daily basis, under this rationale, would create a common law employee-employer relationship.

Even more ludicrous is a KDHR ruling that found oil and gas well sites to be "the the employer's premises" and holding that since the work was performed on the employer's premises, the employer has control over the individual. Additionally, a contract requirement that had the independent contract pumper submitting reports concerning production figures was found by the KDHR to show "that the person is compelled to account for his/her actions."

What these examples show is that the Kansas Department of Human Resources has been directly confronting the oil and gas industry's use of independent contract pumpers in an effort to administratively outlaw the practice. The only apparent reason for the KDHR's actions is to increase revenue for the employment security fund. Certainly, this action is undertaken without legislative approval.

The purpose of subsection (i)(4)(S) of SB 564 is to remove services performed by an oil and gas contract pumper from the definition of employment under the Employment Security Law. The amendment is not intended to have an impact on oil and gas pumpers who are legitimate employees of a company. Instead, SB 564 is intended only to apply to those independent contract pumpers who perform their services pursuant to contract and are free to perform those same services for more that one business at a time. Due to the fact that the traditional control test has been misapplied by the KDHR to independent oil and gas contract pumpers, it is necessary that the legislature make a definitive statement concerning the fact that independent oil and gas contractors have a right to exist and are not to be administratively outlawed by the Department of Human Resources.

Donald P. Schnacke

DPS:pp

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Attachment #1
03/15/88

U.S. Department of Labor

Employment and Training Administration
911 Walnut Street
Kansas City, Missouri 64106

Reply to the Attention of: 7TGU

March 4, 1988

Copy to Siehndel Snider

Mr. Dennis Taylor
Secretary
Department of Human Resources
401 S.W. Topeka Boulevard
Topeka, KS 66603-3182

Dear Mr. Taylor:

We have reviewed Kansas SB 564, a legislative proposal to amend Section 44-703 of the Kansas Employment Security Law, which has recently advanced out of Committee.

The proposal would exclude services performed by oil and gas contract pumpers from the definition of employment in the Kansas Law. We have the following concerns about SB 564:

First, this proposed exclusion could affect the Federal tax liability of private-for-profit employers subject to the Federal Unemployment Tax Act (FUTA). Section 3306(c), FUTA, provides the definition of employment which is subject to FUTA. The exceptions to this required coverage are contained at Section 3306(c)(1)-(20) of FUTA.

If an individual is an employee of a private-for-profit employer, the individual may be excluded from State UI coverage (and the employer relieved of State UI contributions) without violating any Federal requirement. However, relieving the employer of State contributions does not exempt the employer from the FUTA tax on wages paid for services subject to FUTA. The employer would be liable for the full FUTA tax (currently 6.2 percent) on such wages and would not qualify for the tax credits available under Sections 3302(a)(1) and 3302(b), FUTA. In effect, the employer would be paying a Federal tax on the wages with no benefit to the State unemployment fund and no UI coverage for the worker involved.

Second, in the circumstances that any of the excluded services are performed for a governmental entity or nonprofit organization, the exclusion would raise an issue of consistency with the coverage requirement in Sections 3304(a)(6)(A) and 3309(a)(1), FUTA. As you are aware, 3304(a)(6)(A) requires that services for governmental entities and nonprofit organizations must be covered under the same terms and conditions as other covered services under State law.

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If this proposed legislation further advances, we would recommend an additional clause stating that the exclusion would not apply to services performed for governmental entities or nonprofit organizations.

Questions concerning the above should be directed to Richard Alberhasky at 816-374-3796.

Sincerely,

PATRICK BRAZIL
Acting Regional Administrator

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