Approved: 2/17/98
Date

MINUTES OF THE HOUSE COMMITTEE ON BUSINESS, COMMERCE & LABOR.

The meeting was called to order by Chairman Al Lane at 9:04 a.m. on February 4, 1998 in Room 526-S of the Capitol.

All members were present except: Rep. David Adkins - excused

Committee staff present: Bob Nugent, Revisor of Statutes
Bev Adams, Committee Secretary

Conferees appearing before the committee: Janet Stubbs, Kansas Building Industry Association
Phil Harness, KDHR
Dick Cook, Kansas Insurance Department
Roland Smith, WIBA

Others attending: See attached list

Hearing on: **HB 2591 - Exempting self-employed subcontractors from workers compensation.**

Janet Stubbs continued her testimony from the February 3rd meeting. (See Attachment 6, February 3, 1998) She explained one of the uninsured claims that the association is trying to deny. It concerns a cabinet maker, hired by a sub-contractor, who lost his thumb building cabinets at home. He had no workers compensation coverage and the general contractor is being held accountable.

Ms. Stubbs stated that a resolution to the problem of worker compensation coverage for sub-contractors needs to be found so there is no unfunded liability. She does not want small businesses to suffer because of the high premiums, but also believes that everyone needs to pay their own costs of doing business. She concluded her testimony by answering questions from the committee.

Phil Harness, Workers Compensation Division, Kansas Department of Human Resources, answered the question asked, does the law specify who pays the workers comp premiums? The department concluded that the sub-contractors would pay their own premiums. He stated that the statute is not perfectly clear, but decided that based on the language that was adopted, it was probably the intent of the law. If the general contractor agrees, the sub-contractor can be added to the general contractor's coverage, and it would still be within the law.

Dick Cook, Assistant Director of the Property and Casualty Division, Kansas Insurance Department, answered the question if there was pro-rated coverage available to sub-contractors. He stated that the premiums for sub-contractors are based on a set fixed payroll of $26,800. The Insurance Department has asked the National Council on Compensation Insurance (NCCI) to come back with some options to the set fixed payroll for sub-contractors and perhaps the option of insuring on a per week basis or per job basis.

Roland Smith, Consulting Director for the Wichita Independent Business Association (WIBA), appeared as a proponent of **HB 2591** which would repeal the section of **HB 2011** passed last year that requires workers compensation for self employed sub-contractors. The WIBA believes that the measure passed last year was another example of Government intrusion in business that was not needed. (See Attachment 1)

John M. Ostrowski, Kansas AFL/CIO and a member of the Workers Compensation Advisory Council, submitted written testimony in opposition to **HB 2591**. In it he states that the Kansas AFL/CIO stands by its support of the legislation passed last year. (See Attachment 2)

Phil Harness answered the question if larger fines or penalties are needed for failure to obtain coverage. He said larger fines were suggested by the Assistant Attorney General before the advisory council. The rational of the fine is to make it large enough that it is easier to comply with the law than not comply with the law, then people will comply with the law.

No others were present to testify for or against the **HB 2591** and the hearing was closed.

Chairman Lane announced the appointment of a sub-committee that would further discuss and bring back to

the full committee a report on **HB 2591**. He appointed Rep. Boston, Chairman, and Rep. Geringer, Rep. Pauls, Rep. Mason and Rep. Grant as members of the sub-committee. The full committee will be on call next week to give the sub-committee time to discuss and work out a recommendation.

Chairman Lane adjourned the meeting at 9:55 a.m.

The next meeting is scheduled for February 5, 1998.

HOUSE BUSINESS, COMMERCE & LABOR COMMITTEE
GUEST LIST

DATE: February 4, 1998

NAME	REPRESENTING
Roland Smith	WIBA
Dick Cook	KS Ins. Dept.
Randy Valdez	KAIA
Kevin Davis	Am. Family Ins
Susan Anderson	Hein + Weir
Martha Jen Smith	KMHA
Teresa Sittenauer	State Farm
Linda DeCoursey	KS Insurance Dept
Debbi Smith	KBIWCF
Terry Leatherman	KCCI
Wayne Maichel	AFL-CIO
Bert Brown	Mid-America Lumbermen
Jim DeHoff	KS AFL-CIO

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February 3, 1998

STATEMENT TO THE HOUSE BUSINESS, COMMERCE AND LABOR COMMITTEE IN SUPPORT OF HB2591

By Roland Smith, Consulting Director for the Wichita Independent Business Association

The measure passed last session regarding workers compensation for the self employeed sub-contractors was far more reaching than was intended and caused unmeasurable problems as it was far more reaching than the building trades.

I personally receive a rash of calls wanting to know what is was all about from some very upset member businesses. We have 250 to 300 self-employed members of WIBA out of over 900 member with a minority number in the construction business. As I read the language in HB 2011, all of these persons would be affected in certain circumstances. It indeed was a mistake and needs to be repealed. After hearing the testimony before the joint Economic development committee I am more convinced it was not even needed. All the contractor has to do is agree to cover the self-employed sub-contractor in the contract or require the self-employed sub-contractor to carry workers compensation or he or she doesnot get the contract. It does not have to be mandated by the state to get this done.

WIBA supports HB 2591 that repeals the section of HB 2011 passed last session that requires workers compensation for self-employeed sub-contractors. This was another example of Government intrusion in business that was not needed.

THANK YOU! ...and I will be glad to answer any questions.

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TESTIMONY IN OPPOSITION TO
HB 2591
KANSAS AFL-CIO
JOHN M. OSTROWSKI
HOUSE LABOR & INDUSTRY COMMITTEE
February 3, 1998

Thank you Mr. Chairman. My name is John Ostrowski, and I appear as the registered lobbyist for the Kansas AFL-CIO. I am also a member of the Advisory Council created by K.S.A. 44-596. I appear today in opposition to House Bill 2591.

Last legislative session, HB 2011 was passed. This bill had the full support of the House, Senate, the Governor, and the Advisory Council. The Kansas AFL-CIO stands by its support of HB 2011. Additionally, this Committee should be aware that the Advisory Council *unanimously voted* against the provisions of HB 2591.

Regarding the issue of self-employed subcontractors, it would appear that a three step analysis is appropriate. The first question to be asked is, **Who does the legislature believe should be in the system?** Last year, as a policy matter, it was determined (unanimously ?) that self-employed subcontractors should be included within the system. Was this a correct policy decision? The Kansas AFL-CIO believes that it was: ABSOLUTELY. There are multiple reasons that we believe this to be the correct policy choice. For example,

a) The very concept of "insurance" is "spreading the losses of a few to the many." Social policy legislation and social policy insurance (which workers' compensation is) cannot arguably be good for some and bad for others such that we arbitrarily pick and choose the participants. We do not give the employee the choice of receiving an additional $1.00 per hour and opting out of the work comp system. The employees so opting out would expose the employer to tort lawsuits, and the worker and his family to the tragedy of becoming a burden on the system should injury occur. This is simply not allowed because of a belief in the system.

b) Fairness in business competition requires all to play by the same rules. Employers with fully covered employees on a work site should not be forced to bid against employers with no coverage. Such is patently unfair.

c) Coverage for all will drive the prices down. That is, those who are currently insuring are paying a higher premium because there are fewer participants in the purchasing pool. Additionally, those not purchasing insurance at this time are simply shifting their losses

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elsewhere, including to society as a whole, and/or the Workers Compensation Fund.

d) With the passage of HB 2011, there became certainty in coverage situations. Uniform application has a tendency to drive down litigation and costs in general.

e) General contractors receive the benefit of insulation from tort actions. Without HB 2011, a high level of sophisticated action is necessary for the general contractor to be protected.

f) HB 2011 will lead to more stability in the employment market. In other words, marginal employers operating on shoestring budgets are the most notorious for leaving behind indebtedness when injuries occur. Requiring this protection will make these employers more stable.

The legislature having decided that self-employed subcontractors should be in the system, the second question is, **Who should pay the premium?** Again, it was decided by HB 2011 that the self-employed subcontractors should pay their own freight. Does this decision remain correct? Of course. It is totally illogical to charge the general contractors for coverage of those choosing to operate their own business. Again, if this additional expense, which provides far reaching protection to workers and their families is too burdensome, these individuals can become employees. That is, the decision to enter business for oneself includes certain expenses. No one is forcing these business owners to be self-employed. They simply should not be given a special set of rules relative to workers' compensation.

The final question is, **What should be the cost?** It is here where this body is receiving the complaints and negative feedback. The central problem, as discussed by the Advisory Council, appears to be the "arbitrary and artificial rate" set by the NCCI through *their own created regulation*. Some self-insureds are charged too much for coverage, and some are charged too little. The ease of administration does not justify this result. Quite frankly, it was not well known how the NCCI set rates in these instances.

For this reason, the Advisory Council decided (and the Kansas AFL-CIO agrees) that this is a <u>pricing problem</u> which needs to be studied. Some areas which need to be studied, and which remain in their embryonic state include:

a) Consider alternatives for price fixing with a view toward the premium being based, as much as possible, on the actual earnings of the self-employed subcontractors.

b) Consider some type of subsidy for new businesses to allow an easing into the marketplace.

c) Consider some type of pooling for self-employed subcontractors.

d) Strengthen enforcement procedures to be certain that it is much cheaper to pay the proper premium than to try to cheat the system.

CONCLUSION

In conclusion, the Kansas AFL-CIO does not believe that simple repeal of sections of HB 2011 through HB 2591 will solve the problem.[1] As noted by the Division of Workers Compensation in reflecting on HB 2011: "The bottom line is that the intent of the Workers Compensation Act and 1997 House Bill 2011 is to provide most injured workers with a remedy under the Workers Compensation Act regardless of the type of contractual relationship in which they are engaged."[2]

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[1] There are also multiple problems which would arise through simple repeal because of tail coverage. These problems have not been fully explored.

[2] Attached is a three page article by Director Harness, and Assistant Directors Shufelt and Avery. It is believed that the same presents an appropriate summary, and explanation of the problem and some discussion of the solution.

WORKERS COMPENSATION

Volume 9 Number 1 NEWS AND VIEWS November 1997

SELF-EMPLOYED SUBCONTRACTORS IN 1997

By Philip S. Harness, Director; David A. Shufelt, Assistant Director; and Brad E. Avery, Assistant Director

INSIDE

KANSAS DEPARTMENT OF HUMAN RESOURCES

One of the most talked about parts of 1997 House Bill No. 2011, the omnibus workers compensation bill for the 1997 legislative session, is that containing the changes affecting self-employed subcontractors. The Kansas Legislature, in reaction to a decision by the Kansas Supreme Court in *Aetna Life & Casualty v. America's Truckway Systems*, Case Number 74,721, citing with approval the holding of the Kansas Court of Appeals in the case of *Allen v. Mills*, 11 Kan.App.2d 415 (1986), made a far-reaching policy decision to bring subcontractors fully within the provisions of the Workers Compensation Act.

The need for these amendments was brought into sharp focus in these two (2) cases. In *Allen v. Mills*, supra, briefly stated, the plaintiff, a self-employed sawmill owner, sued a wood plant owner for injuries arising out of an accident wherein the plaintiff was driving the defendant's truck to deliver wood. The defendant alleged and the trial court ruled that the incident was covered by workers compensation and that the plaintiff was a statutory employee of the defendant. As such, workers compensation was the plaintiff's exclusive remedy. On appeal, the Court of Appeals reversed, holding that the self-employed sawmill owner could not be an employee of himself as a subcontractor for the defendant, was not a "statutory employee" under K.S.A. 44-503, was not a "worker" as defined by K.S.A. 44-508, and was not covered by the Workers Compensation Act.

Contractors are not interested in being exposed to general liability in a tort for injuries arising in the workplace. K.S.A. 44-503 was enacted to provide workers compensation coverage for a subcontractor's employees under circumstances where the subcontractor has not purchased a policy of coverage. The trade-off was that in exchange for providing coverage to this class of worker, the contractor was protected from unlimited general liability.

However, the *Allen* decision, while a correct interpretation of the statutes, has given rise to a great deal of confusion and inconsistent application. The best way to illustrate the problem is to consider the hypothetical case of a self-employed subcontractor who has a part-time (annual salary less than $20,000) employee working with him, for whom he has not purchased a policy of workers compensation coverage. The law did not require him to carry insurance on himself or his employee. Assume they are doing a subcontracting job for a

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contractor at a job site and are both injured when a roof truss falls on them. Without the amendments in House Bill 2011, their respective remedies would have been very different. The employee of the subcontractor would be covered by the contractor's workers compensation insurance policy under the "statutory employee" provisions of K.S.A. 44-503. The self-employed subcontractor employer would not have been covered under workers compensation at all and could have sued the contractor in a tort for the same injuries because he was not deemed to be an employee of the contractor.

The amendments make it clear that a self-employed subcontractor performing work for a contractor will now fit the definition of a "worker" under K.S.A. 44-508. General tort liability for the contractor will be eliminated (for injuries occurring after June 30, 1997). The burden would be on the self-employed subcontractor to secure coverage for his or her employees (regardless of the size of the payroll), but if the self-employed subcontractor fails to secure insurance, there is still coverage for the employees under K.S.A. 44-503 (the employees may look to the general contractor).

It is hoped the amendments help to remove doubt about whether the Workers Compensation Act applies to certain situations as well as remove the unintended exposure that contractors have to general tort liability for injuries in the workplace. Self-employed subcontractors are now covered as employers by the Workers Compensation Act, irrespective of the $20,000 payroll limitation, and must cover all their employees, under Section 2 of the bill. Previously, a subcontractor who fell outside the minimum payroll provisions ($20,000) was not an employer for purposes of the Workers Compensation Act, and if the same self-employed subcontractor had not elected into the Act pursuant to K.S.A. 44-542a (by filing an election form and securing insurance), he or she was not an employee either.

The question which seems to be asked most often is "who has to buy the insurance policy under the new law?" If a self-employed subcontractor has employees, the "sub" is now required to purchase workers compensation coverage for those individual employees regardless of the size of the payroll (under circumstances wherein K.S.A. 44-503 would otherwise apply). Prior to the 1997 amendments, K.S.A. 1996 Supp. 44-508 provided that the terms "workman," "employee," or "worker" did not include individual employers, limited or general partners, or self-employed persons, unless an election was filed to be covered by the Workers Compensation Act. Such an election required that insurance be secured to cover the party. If the qualification or condition of f[illegible] an election and securing insura[illegible] coverage was met, then the statutory terms "workman," "employee," or "worker" would include the electing party.

A self-employed subcontractor is now considered to be a "workman," "employee," or "worker" under Section 3 of the bill, which amended K.S.A. 1996 Supp. 44-508. Section 3 of the bill simply eliminated the necessity for a self-employed subcontractor performing work for a contractor to file the election to be covered. It has been determined that the status of an electing self-employed person is in the nature of dual persona; he or she is both employer and employee for the purposes of the act and for those purposes that person is deemed to have an employer and employee relationship with himself/herself. This legal fiction is reached because of what the act says. *Miller* v. *Miller*, 13 Kan.App. 2d 262, 768 P.2d 308 (1989). The act further requires an employer to secure the payment of compensation to the employer's employees by insuring the payment of such compensation with an insurance carrier. Therefore, the self-employed subcontractor performing work for a contractor is deemed to have elected to be covered by the act and must secure insurance for himself or herself.[1] Under K.S.A. 44-503, not amended in 1997, it is provided that no insurance

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[1]This matter may not be fully resolved until an appellate court renders a decision and/or the legislature clarifies the law. The court may interpret the changes in K.S.A. 44-508 to require the contractor to provide workers compensation insurance to a subcontractor by virtue of the fact that a subcontractor is performing a "contract of service" for the contractor and therefore may be regarded as an employee of the contractor. As has been noted, previous case law has held that non electing self-employed persons cannot be employees of themselves (Allen v. Mills, op.cit.). While self-employed subcontractors performing work for contractors are not employees in the traditional sense, the question is whether they become such by operation of law because of the elimination of their ability to elect.

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company shall charge a contractor a premium for any liability for which the "sub" has already insured, leading one to the conclusion that if a "sub" has insured himself, then that should be sufficient under the law.

The next question is more complicated, "who or what precisely is a self-employed subcontractor?" Although the legislature was careful to use the term "self-employed subcontractor," it is commonly believed that most subcontractors are indeed self-employed. But, there are some subcontractors who may have incorporated, own in excess of 10 percent of the stock, entered into an employment contract between the corporation and the individual, and "elected out" of the Workers Compensation Act pursuant to K.S.A. 44-543. If so, those stockholder individuals may still be able to proceed against a contractor in a tort, subject to the common law defenses available to the contractor pursuant to K.S.A. 44-545. The legislature did not provide a specific answer or test for what constitutes a subcontractor, and all such questions, if litigated, will be answered relative to the individual facts of the case. However, K.S.A. 44-503 comes the closest to helping to define the relationship, albeit in different terms. This statute uses the terms "principal," which is analogous to a contractor and "contractor," which is analogous to a subcontractor.

K.S.A. 44-503 states in part: "Where any person (in this section referred to as principal) undertakes to execute any work which is a part of the principal's trade or business or which the principal has contracted to perform and contracts with any other person (in this section referred to as the contractor) for the execution by or under the contractor of the whole or any part of the work undertaken by the principal . . ."

The essence of the contractor and subcontractor relationship, then, is the former contracting out a portion (or all) of a principal's trade or business to the latter.

Although this type of relationship occurs most often in the construction business, it could and does arise in all types of enterprises. Some examples of working relationships which are unclear may be: the following: an attorney in private practice who is not an employee of a law firm, but who is engaged to research or handle a portion of a case for the firm; or a governmental entity which uses private entities to perform all or part of its work. Questions may still arise whether a person is a self-employed subcontractor or a self-employed independent contractor. Suffice it to say that if the individual is executing any work which is a part of the payor's trade or business for which the payor has contracted to perform, then you probably have a subcontractor relationship. However, if the individual is doing work for a payor who is not in that particular trade or business or where the payor has not entered into a separate agreement with somebody else whereby the payor would be paid by that other person, then you probably have an independent contractor relationship. A typical example might be where a homeowner hires a drywaller to fix a hole in the plasterboard of her home. Although the construction trades are usually loosely described as subcontractors, in this example the homeowner is not in the "trade or business" of building houses or repairing walls. This relationship does not fit the definition of contractor/ subcontractor under K.S.A. 44-503, and therefore would lead one to believe that this is an independent contractor relationship.

The bottom line is that the intent of the Workers Compensation Act and 1997 House Bill No. 2011 is to provide most injured workers with a remedy under the Workers Compensation Act regardless of the type of contractual relationship in which they are engaged.

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