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Contractors and Worker's Compensation Insurers Beware: Subcontractors Found Not Responsible for Paying Worker's Compensation Premiums for Additional Workers

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The recent decision from the Wisconsin Supreme Court in *Acuity Insurance v. Olivas*, 2007 WI 12, highlights the importance of the distinction between classifying workers as either independent contractors or employees for purposes of setting worker's compensation premiums. In its decision, the Supreme Court held that employers are not responsible for paying worker's compensation premiums for workers found to be "independent contractors" or for "employees" where there is no employment relationship between those employees and the employer. Unfortunately, the decision from the Supreme Court left unanswered the question of *who* would be responsible for paying the worker's compensation benefits in the event of a work-related injury.

This was not a traditional worker's compensation claim in which an injured employee sought benefits under the Act. Rather, the case involved a dispute between a worker's compensation insurance carrier and one of its insureds concerning the payment of insurance premiums. Steve Tenpas, the owner of a drywall contracting and painting business named Tenpas Drywall, contracted with Miguel Olivas to perform drywall services. Desiring to minimize his own liability, Tenpas informed Olivas that before he would hire him as a subcontractor, Olivas would need to secure his own worker's compensation insurance. Olivas purchased a liability and worker's compensation insurance policy from Acuity Insurance. Olivas was a named insured in his capacity as "sole proprietor" and there were no additional employees named as insureds. Olivas' worker's compensation premiums were set at approximately \$3,500 annually based on estimated annual earnings by Olivas of \$25,000.

Worker's compensation premiums are based on an employers' payroll during a specific policy period. When Acuity audited Olivas in 2003, it was discovered that Olivas had received approximately \$190,000 from Tenpas and that he had paid a crew of five Spanish speaking workers more than initially estimated. Acuity took the position that these workers were employees of Olivas and raised Olivas' premiums by an additional \$32,000 annually. When Olivas refused to pay, Acuity terminated the policy of insurance and sued Olivas for the additional premiums.

The Wisconsin appellate court ruled in favor of Olivas by concluding that Acuity failed to establish that the workers were employees under the common law standard; a less stringent standard than the one contained in the Worker's Compensation Act. On appeal to the Wisconsin Supreme Court, Acuity argued that the workers were not independent contractors and therefore they must be employees of Olivas. Acuity further asserted that in the event one of the workers were injured in the course and scope of their employment, it would be liable for benefits under Olivas' policy. Olivas countered that the workers did not meet the statutory definition of "employee," but even if they did, there was no employment relationship between him and the five workers.

The Supreme Court was first required to determine whether the workers at issue were, for purposes of setting worker's compensation premiums, independent contractors or employees of Olivas. In so doing, the Court rejected the common law test applied by the Court of Appeals and determined that the correct standard was found in the Worker's Compensation Act in Sec. 102.07(8)(b), Wis. Stats. In applying that standard, the Court concluded that:

"the workers in the present case failed the seventh and ninth parts of the test. Each worker in the present case supplied only labor and simple tools like hammers that do not require frequent repair or replacement. The workers at issue did not have to purchase their own drywall sheets. There was no risk that the workers would suffer a loss on any of the jobs. They were paid only for the labor they put in, and they did not control any of the other costs involved with the project. Their success was not related to the relationship of business receipts to expenditures, but rather to how much labor they were willing to provide."

Olivas, 2007 WI 12, ¶ 71. The Court thus agreed with Acuity that the workers did not meet the nine-part statutory test required for independent contractors.

Although the Court decided that the workers were not independent contractors, the Court nevertheless rejected Acuity's contention that the workers were employees for whom Olivas owed increased premiums. The precise issue was whether Olivas *employed* the workers within the meaning of the Worker's Compensation Act. The Court concluded that the workers were

not employees of Olivas because he did not set their pay; he did not profit off the workers; he did not tell them when to start and stop working; he did not pay them benefits; he did not provide them with any tools; and he had no power to hire or fire the workers. In finding that no employment relationship existed between the five workers and Olivas, the Court held that Acuity could not take them into account when setting premiums for Olivas' worker's compensation insurance premiums.

This decision creates a rather bizarre dichotomy in which the workers were neither independent contractors nor employees of Olivas, even though he was the only person who paid them and the only person who communicated with them concerning the performance of their duties. In the event one of these five workers is injured, it is unclear who would bear the legal responsibility for that injury. As noted in a dissenting opinion of the Court, although not specifically addressed, the majority opinion appears to assign legal responsibility for any worker's compensation claims of the five undocumented workers to Tenpas. This result is incongruous with established worker's compensation law -- Tenpas did not retain the workers; he did not exercise any control over their work; and he did not furnish any equipment or tools to the workers. This decision creates great uncertainty for employers, workers and insurers. It also potentially requires contractors to assume legal responsibility for risks they took careful steps to avoid and may require insurers to provide coverage for risks for which they have not been paid.

If you have any questions about the issues raised by this e-alert, please feel free to contact Oyvind Wistrom or Daniel Pedriana at (414) 273-3910 or by e-mail at owistrom@lindner-marsack.com or dpedriana@lindner-marsack.com.

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