



Misclassification is
more dangerous than you think.

Unlawful Denial of Workers' Compensation Coverage

Report on the Employee Misclassification &
Uninsured Employer Initiatives

Tennessee Bureau of Workers' Compensation, Compliance Program
Annual Report | February 3, 2020

Photo by Dilip Rathod



The Honorable Paul Bailey, Chairman,
**Senate Commerce & Labor
Committee**

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The Honorable Clark Boyd, Chairman,
**House Consumer & Human
Resources Committee**

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Dear Chairmen Bailey and Boyd:

The General Assembly passed legislation in 2010 that established an Employee Misclassification Advisory Task Force and required it to submit a report annually by February of each year. In June 2014, the law establishing the Task Force and the annual report requirement sunsetted. Although the law no longer requires it, the Bureau of Workers' Compensation has continued to provide a report annually that contains information regarding the progress made toward reducing misclassification and failure to provide legally-required workers' compensation insurance.

This report provides insight into the challenges faced by the Bureau in assuring compliance by Employers along with potential ideas for improvement.

The Bureau appreciates the assistance of the Office of the Attorney General, other state agencies, businesses, insurance companies, members of the Employee Misclassification Advisory Committee, and members of the public who have shown an interest in workers' compensation.

We hope that you find this report informative. If you have questions, we would be happy to answer them.

Sincerely,



Amanda Terry
Bureau of Workers' Compensation
Director of Compliance

Executive Summary

The Bureau of Workers' Compensation Compliance Program is responsible for two key areas of compliance with the workers' compensation law. The **Uninsured Employers Fund (UEF)** program identifies and penalizes employers who fail to provide any workers' compensation coverage to employees despite the law's requirements. **The Employee Misclassification Education and Enforcement Fund (EMEEF)** program identifies and penalizes construction industry employers who misclassify and deny employees coverage to avoid paying the appropriate workers' compensation insurance premiums. Both of these programs were established by bills passed by the General Assembly out of concern for the harm that non-compliant businesses cause employees and businesses that conduct their businesses lawfully. To learn more, visit <https://www.tn.gov/workforce/injuries-at-work/employers/employers/compliance.html>.

Failure to comply with workers' compensation laws has gained renewed interest in the past year as the consequences of noncompliance affects more and more people. That interest was highlighted by a report on News Channel 5 on January 27, 2020 (youtu.be/x5ujzGdGURE). This report will provide information about ways dishonest employers attempt to evade the law, suggest approaches that may increase compliance, and discuss what the Compliance program is currently doing within these two areas of workers' compensation laws. The staff of the Compliance Program heard from and discussed this problem with more employers, constituents, and members of the legislature than in previous years. These groups have concerns about those employers who are evading the law to the detriment of responsible employers. They want to make sure all employers are staying compliant with the workers' compensation laws by maintaining the proper insurance coverage.

The Compliance Program encounters many ways in which dishonest employers attempt to avoid the law. Some of the ways include:

- failure to provide coverage for out-of-state workers
- closing their businesses when their practices are uncovered or when an employee is hurt and reopening under a different name to avoid penalties
- disregarding notices of assessment from the Compliance Program penalties
- disappearing
- utilizing labor brokers (discussed later in this report)

The primary advantage to non-compliant employers is that they gain the ability to underbid businesses that are in compliance with workers' compensation laws. They also save money by refusing to be financially responsible for the compensable injuries of their employees. The sections below provide information on what the Compliance Program is doing to combat misclassification and what additional actions might provide positive results.

Approaches to Eradicate Misclassification

The Compliance Program uses a variety of approaches to address misclassification. It investigated 77 employers and assessed over \$4.5 million in penalties during 2018/2019 fiscal year. Most of the penalties assessed were for lack of workers' compensation insurance coverage for employees. To help employers and employees understand the importance of workers' compensation coverage, the Compliance Program provided education outreaches for the community.

Staff conducted educational outreaches for stakeholders interested in learning about workers' compensation compliance in Nashville, Knoxville, Jackson, and Gray.



Investigator, Rick Day, speaking to students at a Tennessee College of Applied Technology

The Compliance Program conducted seminars for vocational college students, who are learning a specific trade, about workers' compensation and prepare them for the future as an employer or employee. In addition to these efforts, the Director of Compliance began a group with other states to discuss the problems pertaining to misclassification faced by the different states and share their successes.

Combatting Misclassification through Collaboration

Office of the Attorney General

The Compliance Program has a two-pronged system for collecting penalties assessed against non-compliant employers. The internal system consists of a past-due notice. If the bill is not paid, then a letter from a staff attorney regarding payment of the penalty is sent to the employer. If these approaches are unsuccessful, the file is referred to an external system—the

state-contracted collections agency if the penalty is under \$10,000.00 or the Attorney General's office if it exceeds that amount.

Collecting penalties that have been assessed is difficult. The only two recourses for collecting the penalties that have been assessed to non-compliant employers is the process described above. The Compliance Program assessed over \$4.5 million in penalties, but only collected \$1.8 million in assessments. Enforcement through legal collection methods including liens against property, levies, and garnishment require first obtaining a civil judgment against the employer. Other state agencies have statutory rights to collect some debts without the need of judicial intervention.

The Office of the Attorney General and the Compliance Program work closely together to recoup penalties and prosecute illegal activity. In addition to civil penalties, another way to enforce the requirement to maintain appropriate coverage is through criminal prosecution. The Attorney General's office is assisting the Compliance Program with criminal prosecution of claims that arise to the statutory standard. If these types of cases are successfully prosecuted, it will deter other business from the temptation to cut their business costs by not providing workers' compensation and properly classifying their workers.

The decision to prosecute these matters ultimately lies with the local District Attorney, however. Last year, the Compliance Program and the Tennessee Attorney General's office began working together to pursue criminal referrals through the local District Attorney. This will help the program build relationships with local prosecutors so that all three organizations can work together to fight misclassification.

Employee Misclassification Advisory Committee

An important part of the Bureau of Workers' Compensation's program to stop businesses from evading workers' compensation laws is the Employee Misclassification Advisory Committee (EMAC). This committee is the outgrowth of the Employee Misclassification Education and Enforcement Task Force that was established by statute in 2010. During the past year the Compliance Program and EMAC identified solutions for some of the areas of noncompliance where legislation may provide solutions. These areas and the proposed solutions are below.

2020 Legislation Recommendations

When Employers Disappear

Sometimes noncompliant employers leave the state or otherwise disappear when their noncompliance comes to light. The penalties that are assessed against these employers go unpaid and, on some occasions, the employers continue their practices of non-compliance in other states. It is a common practice for some non-compliant employers to change their business names, return to Tennessee, and continue to violate workers' compensation laws. It is a revolving door for these employers who cheat the system.

These employers obtain profitable advantages in the market. They do not have to include the cost of workers' compensation coverage into their bid and thus win bids to the disadvantage of employers who obey the law. To combat these practices, a change in the law is needed. A "successor in interest" law, which will be discussed in the section below, would make this type of noncompliance more difficult.

Successor in Interest

When employers shut down their businesses, but reopen doing substantially the same work under a new Federal Employer Identification Number (FEIN), they avoid paying penalties assessed by the Bureau. This is especially true in the construction industry. In most cases, the owner shuts down the business, and then reopens the business under a different business name and FEIN, but actually continues to operate the same business. By reopening under a new name, business owners avoid assessed monetary penalties for non-compliance with workers' compensation laws.



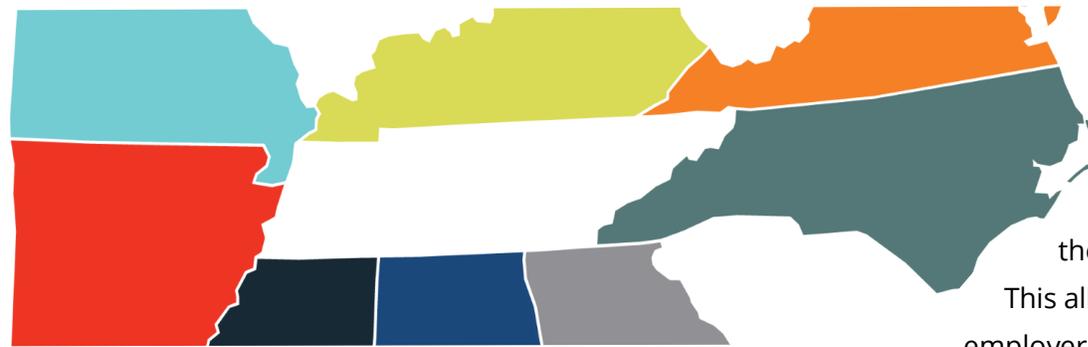
Laws designed to eliminate this practice in Tennessee would benefit all citizens of the state. Penalties assessed by the Compliance Program for not providing workers' compensation or misclassifying employees should remain in effect against the business's successor in interest.

The new legislation means that a successor in interest would be responsible for any previously assessed penalty, if the new business meets certain criteria. This legislation holds a successor in

interest accountable for penalties assessed against the prior employer, so long as the successor was a successor in ownership of all, or substantially all, of a business or enterprise that is carried on and controlled in substantially the same manner as the penalized construction services provider. A successor in interest would be liable for a penalty assessed against a construction services provider.

Coverage for Out-of-State Workers

Coverage for out-of-state workers is a problem. Out-of-state businesses often perform work in Tennessee for long periods of time, but they claim the work is only temporary. Tennessee shares a border with eight states, which makes it a convenient target for out-of-state employers to send workers to Tennessee on a regular basis.



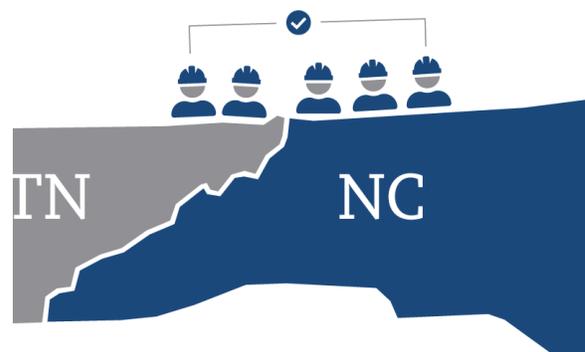
Under the current law, classification depends upon the status of each individual employee, not the status of the employer. This allows an out-of-state employer to send teams of different

employees to work in Tennessee for short periods of time, which do not exceed the current statutory limit, while maintaining a consistent presence on a construction site for long periods of time. This practice permits employers to exploit a provision of the law that was never intended.

CURRENT
coverage for out-of-state “temporary” workers could vary from employee to employee.



RECOMMENDING
primary coverage at a company-level policy.



Out-of-state employers should provide benefits to all of their workers in the state where work is performed. Employers should not be able to use this loophole to conduct business in Tennessee and avoid costs other Tennessee employers must bear. Insurance carriers provide coverage on injuries for states listed in the primary section of a policy. Carriers vary on whether or not they will cover injured employees who are not listed in the primary endorsement section.

Legislation that bases “temporary” work by an out-of-state employer on the status of the employer, rather than individual employees, would help reduce or eliminate this problem. The Bureau would be able to verify coverage for people performing work in this state and ambiguity would be removed when coverage is required for employers. Additionally, a competitive business environment would be maintained for Tennessee businesses.

Insurance for Work Conducted in Tennessee

This legislation would not mean that the out-of-state contractor could not maintain primary workers' compensation insurance coverage in another state. The change would only require that Tennessee be listed as a primary state in their workers' compensation insurance policies. This requirement should apply regardless of the employee's state of residence, the employer's location, the duration, or nature of the work performed.

These changes would increase the number of out-of-state employers who provide workers' compensation coverage for employees performing construction work in Tennessee. Other states have already enacted similar laws. For example, the Florida Statute 440.10(g) states that “any employer who has employees engaged in work in this state shall obtain a Florida policy or endorsement for such employees which utilizes Florida class codes, rates, rules, and manuals that are in compliance with and approved under the provisions of this chapter, and the Florida Insurance Code.”

A bill has recently been introduced to help combat this problem. A construction services provider who is performing work in this state would be required to maintain workers' compensation insurance coverage throughout the duration of that work. Additionally, if the legislation is passed, a construction services provider must designate "Tennessee" in section 3A of a construction service provider's workers' compensation insurance policy or endorsement. If the construction services provider fails to do so, they subject themselves to a potential penalty.

Move the Exemption Registry

In 2010, construction services providers were required by law to carry workers' compensation insurance, even if the company was just one person. Small construction services providers were concerned that the law would have a negative impact on the construction industry. To combat this concern, the General Assembly created the Exemption Registry in 2010 and placed the administration of the Exemption Registry within the Secretary of State's office. The Exemption Registry allows a business owner to exempt himself or herself from the requirement to carry workers' compensation insurance. Exemption is only available to individual business owners engaged in the construction services industry and applies only to the owners themselves.

Investigations revealed troubling cases where some employers and insurance agents were inappropriately signing employees up for the Exemption Registry without their knowledge. If the employees are injured on the job, there is a chance their injury will not be paid by the employer.

The secretary of state's office currently oversees the Exemption Registry but is proposing legislation to move the administration of the Exemption Registry to the Bureau. Since the Bureau is mandated to enforce the exemption and to prosecute those that violate the rules, it is logical that the Bureau should oversee the application process rather than the Secretary of State. This legislation would allow the Bureau to verify that applicants meet the qualifications set out in the workers' compensation code.

Remaining obstacles to the eradication of misclassification

Consequences for Noncompliance with Investigations

The nature of the Compliance Program's investigations requires the employers' cooperation with the investigation. Having the necessary information to determine compliance with workers' compensation laws requires employers to disclose payroll information, tax documentation, and other financial information. The employers are essentially providing information that determines whether or not a penalty will be assessed. Therefore, many employers do not provide the information. Currently, the statutory language does not provide consequences for an employer who fails to comply with a Compliance investigation. The Compliance Program is studying this matter and will consider proposing legislation to address the problem for the 2021 session.

There is a shortage of laborers and the cost of construction workers is rising. Responding to those pressures is a type of subcontractor known as a “labor broker” who provides a certain number of laborers on specified dates to a general contractor or subcontractor for work on large construction projects. The contractor pays the labor broker for the labor. The labor broker takes his share and then pays the workers. Usually, there is no paper trail on these workers. Worse, no one pays workers’ compensation insurance on the worker.

Labor Brokers

During the course of investigations, Compliance Program staff discovered some employers use “labor brokers” to meet business needs. Similarly, utilizing labor brokers allows the employer to avoid paying premiums on employees. It is estimated that insurance carriers lost as much as \$296.1 million in 2016 as a result of uncollected workers’ compensation premiums.¹ The state also loses premium taxes of 4.4% when premiums are not paid. The use of labor brokers often creates compliance issues because no one pays workers’ compensation on the worker.

These labor brokers are more likely to engage in employee misclassification, either by underreporting the number of workers on their payroll or by misrepresenting the work being done by employees. The Compliance Program checks for labor brokers by utilizing the vendor lists provided by general contractors for jobsites. If labor brokers are found to be in violation of the workers’ compensation law, the program penalizes the labor broker. This is another area where successful criminal prosecution, in conjunction with the Office of the Attorney General, would be helpful.

¹ William Canak and Randal Adams, *Misclassified Construction Employees in Tennessee*, (January 15, 2010), updated data as of 2016 provided by Chris Acuff.

Collections & Assessments

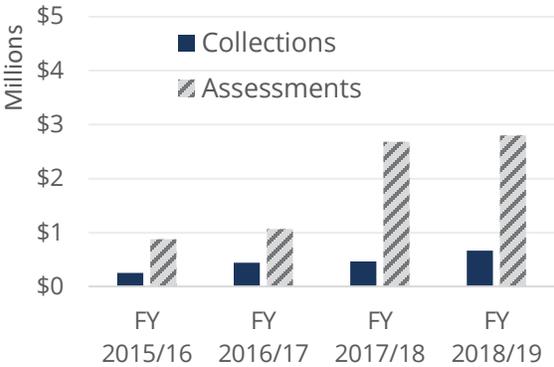
Collections reflect the ongoing payments received from employers via payment plans. Assessments made against non-compliant employers reflect the amount of new penalties assessed. The numbers represented below are from fiscal year 2018/19.

EMEEF <i>Construction services providers who misclassify either the amount of payroll, number of employees or employee's duties.</i>	Collections	\$17K West TN	\$364K Middle TN	\$247K East TN	\$29K Out-of-State
	Assessments	\$1.5K West TN	\$1.2M Middle TN	\$1.5M East TN	\$66K Out-of-State

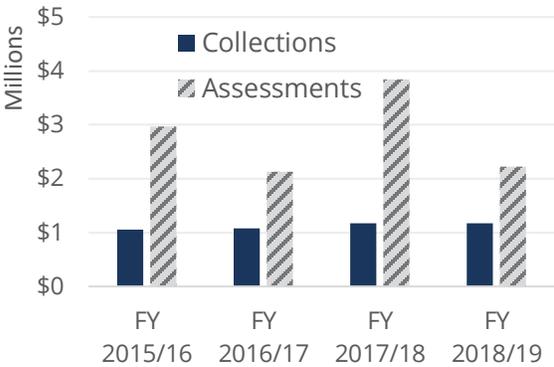
UEF <i>Employers who should have workers' compensation insurance coverage who do not have coverage or have a lapse in coverage.</i>	Collections	\$275K West TN	\$226K Middle TN	\$607K East TN	\$69K Out-of-State
	Assessments	\$278K West TN	\$717K Middle TN	\$1.19M East TN	\$11K Out-of-State

Collection and Assessment Efforts

per fiscal year

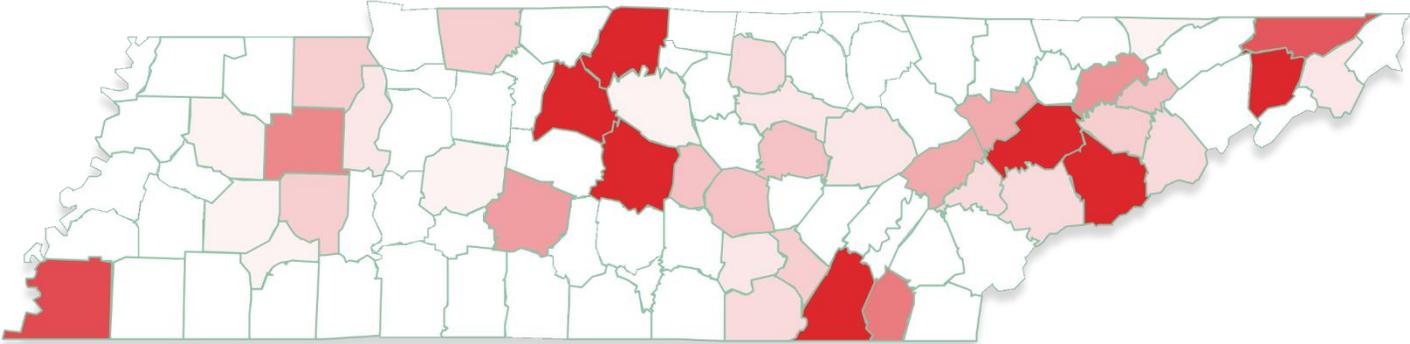


EMEEF



UEF

Counties with the Highest Dollar Amount in Penalties Assessed



County	Penalty Assessed
Knox	\$1,596,211.35
Davidson	\$1,022,670.51
Rutherford	\$376,006.31
Sumner	\$321,287.28
Hamilton	\$216,318.51
Washington	\$147,908.95
Sevier	\$119,869.00
Shelby	\$81,904.47
Sullivan	\$78,937.26
Bradley	\$63,435.93

Conclusion

The purpose of the Bureau of Workers' Compensation Compliance Program is to bring employers into compliance with Tennessee workers' compensation laws. Dishonest employers attempt to evade the laws to gain monetary benefits. When employers disregard their penalties or disappear, they escape consequences of their failure to comply with the law and leave employees and law abiding employers with the consequences of their actions. Insurance companies lose hundreds of millions of dollars in insurance premiums which increases the amount that lawful insureds must pay.

Although some employers find ways to get around the laws, enacting legislation for successors in interest and the coverage for out-of-state workers will help the Compliance Program in its fight against misclassification. The Compliance Program is educating the public with community outreaches. Talking to stakeholders and future employees and employers about complying with the law will help them understand the importance of workers' compensation. We will continue to educate the public about misclassification and employers about their responsibilities for providing workers' compensation coverage. We also anticipate that the work in conjunction with the Office of the Attorney General will serve as a strong warning to those employers who consider misclassifying their employees.

The Compliance Program is also joining forces with other states who are combatting misclassification to learn from each other and increase each state's effectiveness. All of these initiatives provide answers, but significant obstacles to eliminating misclassification still exist. Even so, the Compliance Program along with the Employee Misclassification Advisory Committee, interested stakeholders, and partners in other agencies are committed to eradicating workers' compensation compliance violations.

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William Canak

Larry Scroggs
Matthew Capece
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