



**2008-2009 Progress Report**

**of the**

**Workers' Compensation Employee  
Classification, Coding, and Fraud  
Enforcement Task Force**

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### ***Part I. Statutory Authority and Responsibilities of the Workers' Compensation Task Force***

The Workers' Compensation Employee Classification, Coding, and Fraud Enforcement Task Force (task force) was created by the general assembly in 2008 (Act 208) to investigate and analyze misclassification and miscoding of employees, occurrences of fraud in the Vermont workers' compensation program, and offer recommendations to the general assembly. (See Appendix #1)

The ten task force members include representatives of the general assembly, the administration, labor, management, insurance, and the attorney general's office. Pursuant to its charge, the task force presents its interim progress report. The final report is due November 15, 2009.

### ***Part II. Summary of 2008–2009 Task Force and Related Activities***

To date, the task force has met eight times and taken testimony from a variety of individuals and organizations representing a broad spectrum of perspectives and interests. (See Appendix #2) Topics addressed by the task force include:

- Inter- and intra-departmental coordination and investigation
- The scope of misclassification and miscoding in Vermont
- Penalties and enforcement, including enforcement efforts in other states
- State and federal unemployment tax avoidance (SUTA and FUTA)
- State-administered reporting hotline
- State contracts and “responsible contractor” guidelines
- Definitions of “employee” and “independent contractor”
- Public outreach and education
- Workers' compensation insurance carriers and their audit procedures
- Systemic regulatory reform options garnered from other states, such as precertification programs
- Effectiveness of existing compliance statements
- Status of legitimate independent contractors

A list of reports received by the task force is attached. (See Appendix #3)

### ***Part III. Summary of Task Force Findings***

Vermont law requires all employers to have workers' compensation coverage for their employees. Workers' compensation is a statutorily mandated no-fault insurance system that provides various benefits to an employee who suffers a work-related injury or occupational disease. The benefits include wage replacement, medical treatment, and vocational rehabilitation. Workers' compensation benefits are limited by law, but the program assures that injured or sick employees receive basic remedies for work injuries while avoiding costly negligence suits.

For purposes of this report, “*misclassification*” means classifying a worker as an independent contractor when the worker otherwise meets the criteria of an employee under Vermont workers’ compensation law or unemployment insurance laws; and “*miscoding*” means incorrect job coding of an employee for the purposes of calculating the employer’s workers’ compensation premium. Misclassification and miscoding may result from ignorance or confusion about the legal requirements, but also may be intentional fraud by an employer in an attempt to lower workers’ compensation premiums and other employment expenses in order to lower the cost of doing business.

Working as an independent contractor is a legitimate alternative to being an employee, and use of independent contractors is a legal means of doing business. These business relationships and opportunities should remain viable and strong options in Vermont.

In Vermont and nationally, there appears to be an ongoing problem caused by those employers that attempt to avoid or minimize workers’ compensation premiums and avoid paying unemployment insurance taxes by treating workers as independent contractors rather than employees in contravention of legal requirements or by incorrectly coding employees in the workers’ compensation job classification system.

The compelling testimony provided to the task force thus far affirmed the principal finding in the report issued by the Vermont Department of Labor in 2007 pursuant to Act 57; namely, that misclassification of workers in Vermont’s workers’ compensation system is a problem. (This finding is consistent with the insurance industry’s perspective, as detailed by BISHCA in the same report.) The Department of Labor estimates that between 10 and 14 percent of Vermont employers misclassify their employees.

Employee status engenders very different obligations and rights under the workers’ compensation law and the unemployment law than does independent-contractor status. Misclassification, in particular, has important implications for employers, workers, and governments. For example, workers’ compensation and unemployment insurance programs, occupational safety and health laws, and labor standards (such as wage and hour laws) generally apply to employees but may not apply to independent contractors. In addition, employers are legally required to pay certain payroll taxes and withhold state and federal income taxes from wages paid to employees, but need not do so when paying independent contractors.

Audits and reports prepared in other states suggest that revenue losses due to misclassification and miscoding may be significant. When employers fail to make lawful contributions, employees may lose benefits provided by the workers’ compensation laws and unemployment insurance laws, and the state may lose revenues from taxes and fees. Furthermore, misclassification and miscoding undermine the basis of fair competition among businesses and put law-abiding employers at a disadvantage when bidding on contracts.

All of state government suffers from a lack of resources to improve enforcement in order to recapture revenues that may be lost from misclassification, such as income taxes. Specifically, the Vermont Department of Labor has limited enforcement capabilities due, in part, to statutory restrictions. Although the department would benefit from additional enforcement tools, a quick no-cost improvement would be to eliminate the statutory prohibition on sharing information among divisions within the department. For example, the workers' compensation division has only one full-time investigator while the unemployment division has ten full-time auditors who also investigate and discover classification violations. The department's enforcement capabilities would be expanded by permitting the investigator and auditors to share information.

#### *Part IV. Preliminary Recommendations*

Overall, members of the task force were united in their belief that assuring a level playing field for law-abiding businesses is long overdue.

The task force agreed that the following are high priority items that would benefit from immediate attention:

- Amend 21 V.S.A. § 1314 to improve sharing of information among divisions in the department.
- Consider developing “responsible employer” guidelines to apply to state contracts with oversight by the Agency of Administration.
- Consider expanding state-contract review by Agency of Administration to include VDOL and BISHCA to assure potential state contractors are in good standing with these agencies.
- Consider disqualifying businesses found to have committed fraud or classification violations from bidding on state contracts or state-funded projects.
- Implement modest increases to penalties and fines in current law as an enhanced deterrent in keeping with current enforcement efforts.
- Hold officers and directors liable for fines and penalties incurred by a business.
- Improve publication of existing telephone numbers for the Vermont Department of Labor (VDOL) and the Department of Banking, Insurance, Securities, and Health Care Administration (BISHCA) for making complaints and raising concerns.
- Improve the effectiveness of compliance statements.
- Increase and improve enforcement.

The task force agreed on the following long-term goals:

- Further exploration, by either the task force or by the legislative committees of jurisdiction, of the extent the financial costs to the state, employers, and employees are caused by misclassification and miscoding, and consider the issues of unreported wages, underpayments owed to workers, per diems paid in lieu of wages, overtime payments, uncollected workers' compensation, and unemployment insurance penalties.
- Clarification of audit procedures and standards.
- Development and funding for an intensive one-year education plan, involving VDOL, the Department of Taxes, BISCHA, the Agency of Commerce and Community Development, and the Attorney General, that is geared specifically to small businesses.
- Performing a cost/benefit analysis of a state-administered certification program enabling annual registration for independent contractors. Examine the best location for such a program.

The task force agreed to address at least the following items, which have not been acted on by the General Assembly, at future task force meetings:

- Consider input from the Vermont trial lawyers association and the Vermont Bar Association regarding improvements to the current fraud statutes.
- A comprehensive review of existing fines and penalties for misclassification and miscoding, with the ultimate intent of increasing both.
- Possible funding sources to enhance fraud enforcement investigations and where to house those efforts.
- Internal Revenue Service (IRS) estimates of lost revenue caused by the evasion of federal payroll taxes due to worker misclassification.
- Clarify independent-contractor status so legitimate independent contractors are not considered employees under existing law.
- Determine the most appropriate and efficient types of enforcement/auditing: on-site investigations; book audits; and plenary investigations (workers' compensation and wage and hour compliance).
- Whether to amend existing law to eliminate the "willful" requirement with regard to making false statements and representations for the purpose of obtaining a lower workers' compensation premium (21 V.S.A. § 708(b)).
- Creating a single definition for "businesses required to procure workers' compensation insurance coverage."
- Designing a precertification process.
- Require insurance companies to report to BISHCA when an audit requires an adjustment of 20 percent or more of an annual premium and the reasons for that adjustment.

### Possible Sources of Funding for Enforcement

Evidence in other states strongly suggests that monetary investments in enforcement yield a strong return in terms of state revenue and reinforcement of fair business dealings. The task force is not in agreement about the best source of funding for improving and increasing enforcement.

While there may be many appropriate funding sources, one financing proposal presented to the task force was to increase the contribution by employers to the workers' compensation administration fund (21 V.S.A. §711). This is a fee charged to employers as a percentage of an employer's workers' compensation insurance premium. The amount of this fee for FY 2009 was 0.81 percent of the direct calendar year premiums paid for workers' compensation insurance. The monies in this fund are used to pay for the administration of Vermont's workers' compensation program. An additional increase in this fee of one-tenth of one percent would raise roughly an additional \$183,000.00, which could be used to pay for two additional enforcement positions. Proponents of this method of funding enhanced enforcement point out that: (1) according to the 2007 BISHCA survey, insurers indicated that misclassification is costing employers more in premiums; and (2) given this year's workers' compensation rate reduction, a nominal increase in the workers' compensation premium assessment may still provide an overall workers' compensation premium decrease for most employers.

Nevertheless, some members of the task force maintain the view that even a modest increase in the assessment is too much to impose on Vermont businesses during the current recession and in light of the historical trend in increasing rates. Moreover, new hiring is simply not feasible in light of the additional impending layoffs in state government.

Other financing options include general fund appropriations and a bill-back authority applicable to workers' compensation carriers.

### Single Definitions of "Employee" and "Independent Contractor"

To date, the task force has not reached consensus about the benefit of developing universal definitions for "employee" and "independent contractor" to be used throughout all the state programs, such as workers' compensation, tax, wage, hour, and unemployment insurance.

Some task force members feel that developing universal definitions should be a "top priority" for the task force. (See Appendix #4) As expressed in the executive consensus memorandum from the Commissioner of Labor, Pat Moulton Powden, and the Deputy Commissioner of Insurance at BISHCA, Michael Bertrand, the fact that there are at least five definitions of these terms has created considerable confusion for employers and independent contractors. Advocates assert that common definitions are

key to consistency and improving enforcement and prosecution for violations. As a result, they advocate rewriting those definitions as part of the ongoing work of the task force.

Others members are wary about developing common definitions without first considering whether improved enforcement of existing laws would effectively address the problem. They have expressed the concern that a definitional fix may have the effect of diluting current standards used to determine employee or independent contractor status. There is a substantial body of Vermont case law regarding the definition of “employee” and, which, for the most part, is consistent with only nuanced differences. The primary focus of the decisions is who controls the work. The long-standing and relatively consistent case law in this area suggests that people who fail to pay their legally required employer expenses do so not because of confusion, but because of a conscious intention to avoid paying those expenses in order to gain a competitive advantage. However, if the task force decides to develop a common definition, the members who remain skeptical about the benefit of single definitions encourage using existing definitions in order to preserve well-established legal precedent.

## Appendix #1. Charge of the Workers' Compensation Task Force

NO. 208. AN ACT RELATING TO LOWERING THE COST OF WORKERS' COMPENSATION INSURANCE.

(S.345)

It is hereby enacted by the General Assembly of the State of Vermont:

\* \* \*

### Sec. 5. WORKERS' COMPENSATION EMPLOYEE CLASSIFICATION, CODING, AND FRAUD ENFORCEMENT TASK FORCE

(a) There is created a workers' compensation employee classification, coding, and fraud enforcement task force to be composed of ten members to include the following:

(1) The commissioner of labor or designee.

(2) The commissioner of banking, insurance, securities, and health care administration or designee.

(3) The attorney general or designee.

(4) Two members of the house to be appointed by the speaker.

(5) Two members of the senate to be appointed by the committee on committees.

(6) A member from the insurance industry appointed by the American Insurance Association.

(7) Two members appointed by the employer and employee members of the department of labor advisory council established in 21 V.S.A. § 1306 as follows:

(A) One member who represents labor.

(B) One member who represents management.

(b) The task force shall meet as needed, and the legislative council shall provide administrative support.

(c) For attendance at a meeting when the general assembly is not in session, the legislative members shall be entitled to the same per diem compensation and reimbursement of necessary expenses as provided to members of standing committees under 2 V.S.A. § 406.

(d) The task force shall:

(1) Investigate and analyze misclassification and miscoding of employees and occurrences of fraud in the workers' compensation program and offer recommendations to address the following:

(A) Coordination, speed, and efficiency of communication among appropriate governmental entities and law enforcement organizations in the prevention, investigation, and enforcement of actual and suspected fraud and employee misclassification and miscoding.

(B) Ways to improve outreach to and public education for businesses and labor to promote wider understanding of and compliance with the requirements for classifying and coding employees. This outreach and education shall identify costs associated with misclassification and miscoding, help businesses identify incidents of

misclassification and miscoding, and encourage filing of complaints and identification of potential violators.

(C) In consultation with the Vermont trial lawyers association and the Vermont bar association, ways to improve the effectiveness and enforcement of the current fraud statutes, including specific recommendations for improving enforcement, stimulating interagency cooperation, including information sharing, prosecution and creating a fraud unit with proposals for staffing, reporting, structure, and funding.

(2) Issue a progress report on or before February 15, 2009, and a final report on November 15, 2009. Both reports shall be provided to the house committee on commerce and the senate committee on economic development, housing and general affairs. The progress report shall outline the progress of the investigation, and the final report shall outline the task force's findings and recommendations regarding the following:

(A) A description of progress made by state government to reduce workers' compensation fraud and the frequency of employee misclassification and miscoding, including the number of employers cited for violations, a description of the types of fraud, misclassification and miscoding cited, the approximate number of employees affected, and the amount of wages, premiums, taxes, and other payments or penalties collected.

(B) Administrative, legislative, or regulatory changes designed to reduce fraud and employee misclassification and miscoding by improving public and business education, sharing information, and increasing the cooperation and efficiency of enforcement of employee misclassification.

(C) A consistent, workable, and fair method for determining independent contractor status both in regard to workers' compensation and unemployment compensation.

(D) Any other issue relevant to reducing the incidences of workers' compensation fraud and employee misclassification and miscoding, including a recommendation as to whether the task force should continue meeting and, if so, for how long.

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Approved: June 11, 2008

## **Appendix #2. 2008-2009 List of Witnesses**

Jennifer Brand, Executive Director, New York State Joint Enforcement Task Force on Employee Misclassification  
George Copadis, Commissioner of Labor, State of New Hampshire  
Deb Damore, Vermont Department of Buildings and General Services  
Damon Hall, Business Agent/Industry Analyst, Iron Workers Local 7  
Neil Johnson, Liberty Mutual  
Greg Krohn, Executive Director, International Association of Industrial Accident Boards & Commissions  
Nick Lopez, DMS Machinery & Fabrication  
Gerry Meyers, Commissioner, Vermont Department of Buildings and General Services  
Scott Miller, Department Director, Premium Audit, Acadia Insurance  
George Noel, Director, Massachusetts Department of Labor  
Susan Noyes, Northern Gas Transport, Inc.  
Jim Parker, Dakotas Welding & Fabrication  
Valerie Rickert, Director of Unemployment Insurance and Wages, Vermont Department of Labor  
Peter Rousmaniere, Consultant and Journalist, Risk Management  
Brenda Vovakes, Vermont Department of Taxes  
Matt Zambarano, East Shore Drywall  
Susan Zeller, Deputy Commissioner, Vermont Department of Finance and Management

### **Appendix #3. List of Reports Received by the Task Force**

*Biennial Report on the Oregon Workers' Compensation System*, Oregon Department of Consumer and Business Services, December 2008.

*The Cost of Worker Misclassification in New York State*, School of Industrial and Labor Relations, Cornell University, February 2007.

*Misclassification of Employees as Independent Contractors*, Office of the Legislative Auditor, State of Minnesota, November 2007.

*The Misclassification of Workers in Vermont's Workers' Compensation System*, Vermont Department of Labor and the Vermont Department of Banking, Insurance, Securities, and Health Care Administration, 2007.

*Overview of Workers' Compensation Independent Contractor Regulatory Approaches*, NAIC/IAIABC Joint Working Group of the Workers' Compensation (C) Task Force, October 24, 2008.

*Report to Governor Chet Culver*, Iowa Misclassification Task Force, December 17, 2008.

*Report of the Joint Enforcement Task Force on Employee Misclassification to Eliot Spitzer, Governor, State of New York*, February 1, 2008.

*Report to Governor Jennifer M. Granholm*, Michigan Interagency Task Force on Employee Misclassification, July 1, 2008.

*The Social and Economic Costs of Employee Misclassification in Construction*, Françoise Carre, Ph.D. and Randall Wilson, a report of the Construction Policy Research Center, Labor and Worklife Program, Harvard Law School, and Harvard School of Public Health, December 2004.

*The Social and Economic Costs of Employee Misclassification in the Maine Construction Industry*, Françoise Carré, Ph.D. and Randall Wilson, a report of the Construction Policy Research Center, Labor and Worklife Program, Harvard Law School, and Harvard School of Public Health, April 2005.

## Appendix #4. Memo to the Misclassification Task Force

### MEMORANDUM

TO: Misclassification Task Force

FROM: Pat Moulton Powden, Commissioner  
Vermont Department of Labor

Michael Bertrand, Deputy Commissioner  
Dept. of Banking, Insurance, Securities and Health Care Administration

DATE: 2/6/09

SUBJECT: Interim report.

Below are recommendations for inclusion in the interim report from the Department of Labor and the Banking, Insurance, Securities and Health Care Administration. These are consensus recommendations from the two departments.

We believe a top priority for the Task Force is to develop a single definition of employee and independent contractor within labor, workers compensation insurance and unemployment insurance law. At this time no fewer than five definitions exist leading to confusion amongst employers and independent contractors. As we examined possible penalty and fines revisions and other possible changes, it was clear that developing a single definition is crucial to future enforcement and prosecution. While current law is and will continue to be enforced, enforcement of multiple standards creates confusion to the employer and business community. The Task Force should use future meetings to begin this work of re-writing a definition.

The departments recommend the following in addition to the single definition work:

- 1) **Penalties/enforcement:**
  - a. Implement modest increases to penalties and fines in current law as enhanced deterrent to current enforcement efforts.
  - b. Undertake a comprehensive review of existing fines and penalties with the intent of increasing both.
  - c. Implement new fines and penalties one year after implementing a new definition and a one year comprehensive education program.
  - d. Hold officers and directors liable for fines and penalties incurred by a business.
  - e. Examine possible funding sources for additional fraud enforcement investigation and the best place to house such efforts.
- 2) **Hotline:**
  - a. Highlight existing phone numbers for the Dept. of Labor and BISHCA for making complaints and concerns.

- 3) **State contracts:**
  - a. Investigate a “responsible employer” guideline for use by the Department of Buildings and General Services and for all construction programs with state funding.
  - b. Engage BGS in discussions about expanding state contracting review to include VDOL and BISHCA to assure potential state contractors are in good standing with these agencies.
  - c. Consider a “black list” from state contracting or state funded projects for contracts found guilty of fraud and/or misclassification.
- 4) **Inter and intra departmental coordination/investigation:**
  - a. Pursue legislation to allow departments within state government to share information and cooperate toward prosecution of violators caught misclassifying or miscoding employees.
  - b. Enact changes to VSA title 21, § 1314 to enable sharing of investigative information between workers compensation and unemployment insurance.
  - c. Clarify audit procedures and standards (VDOL and BISHCA).
- 5) **Education:**
  - a. Develop and fund an intensive one year education plan after clarifying and adopting a single of employee and independent contractor.
- 6) **Insurers:**
  - a. Require insurance companies to report back to BISHCA when audits require a bill back of 20% or more of an annual premium and the reason for that bill back.
- 7) **Systematic reform:**
  - a. Perform a cost/benefit analysis of developing a state administered certification program for independent contractors to enable an annual registration. Examine the best location for such a program.

**2008–2009 Progress Report of the Workers’ Compensation Task Force**

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Senator Douglas Racine

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Representative Warren Kitzmiller, Chair

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Senator Mark McDonald

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Representative Michael Obuchowski

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Commissioner Pat Moulton Powden

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Deputy Commissioner Michael Bertrand

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Deputy Attorney General Janet Murnane

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Carol Presley, Acadia Insurance Company

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Ron Rabideau, Teamsters Local 597

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Ernest Smalley, Smalley Contractors