

Special liability of general contractors

Liability for uninsured subcontractors' employees

Generally, an employer is responsible for providing workers' compensation benefits only to its own employees. However, there is at least one very important exception to this rule. According to Minn. Stat. §176.215, where a subcontractor fails to obtain workers' compensation coverage, the general contractor (or any intermediate contractor) is liable for payment of all workers' compensation benefits due an injured employee of the uninsured subcontractor, so long as the injury occurs on a job that is included within the scope of the subcontract.

Unfortunately, the general contractor's liability may not end with the payment of compensation benefits. Under Minnesota law, an employer who provides workers' compensation benefits to an injured employee cannot be sued by the employee for damages in a civil suit (e.g., for negligent supervision or failure to maintain a safe worksite). Obtaining compensation benefits is the employee's "exclusive remedy" against his or her employer. In the 1988 case of *Klemetsen v. Stenberg Construction Company, Inc.*, however, the Minnesota Supreme Court ruled that an uninsured subcontractor's employee who was seriously injured on the job could bring a civil lawsuit for damages against the general contractor, even though the general contractor was directly liable for paying the employee's workers' compensation benefits under §176.215 because the subcontractor had neglected to obtain coverage. There is no statutory or other limitation on the general contractor's potential liability in this situation.

Subrogation rights against an uninsured subcontractor

Under §176.215, subd. 2, a general contractor (or, more likely, its workers' compensation insurer) who pays compensation benefits to the employee of an uninsured subcontractor is entitled to bring an action against the subcontractor to recover all benefits paid. Nevertheless, this right of subrogation might not be worth much because:

- A subcontractor that is operating without workers' compensation coverage is probably operating without much capital and has minimal attachable assets. In other words, collection may be a problem.

- Although most subcontractors carry no less than \$300,000 (aggregate limit) in general liability insurance coverage (even if they don't carry workers' compensation coverage), commercial general liability policies typically contain a general exclusion with respect to liability for injuries arising out of or related to employment matters and workers' compensation matters.¹

Ways to reduce general contractor's exposure

Although it is sometimes difficult or impractical to impose conditions on doing business with subcontractors, especially in today's tight labor market, contractors should require the following as a condition to hiring any subcontractor or "independent" contractor:

- A current certificate of insurance reflecting both workers' compensation and appropriate general liability coverages; and, if possible,

¹ One frequent exception to this exclusion is for liability assumed under contract. For example, if the general contractor had a written agreement with the subcontractor requiring the sub to maintain workers' compensation insurance, the general exclusion would probably not apply.

■ That the subcontractor sign a subcontract containing language similar to the following:

The subcontractor is required to obtain, maintain and pay for such insurance as may be required by the general contractor and to furnish the contractor satisfactory evidence that it has complied with this paragraph, and to obtain and furnish the contractor an agreement by the insurance company issuing each such policy that such policy will not be cancelled except after 15 days' notice to the contractor of its intention to do so.

Dealing with small business owners and “independent contractors”

The only exception to these requirements should be for subcontractors who qualify for the small business owner's exemption from workers' compensation coverage. This exemption is available to the owners of very small businesses and their immediate family members.² Coverage must be provided for all other employees of qualifying small businesses.

Some subcontractors may contend that any workers hired by them are independent contractors for whom they are not required to provide coverage. Keep in mind that, for purposes of workers' compensation liability, an independent contractor working in the commercial or residential construction business is deemed to be an employee of any employer for whom he or she is performing services at the time of an injury, UNLESS the alleged independent contractor meets every one of nine conditions listed in Minn. Stat. §176.042, Subd. 2, including that the individual:

- Maintains a separate business with the independent contractor's own office, equipment, materials and other facilities;
- Incurs the main expenses related to the service or work that is performed under the contract.
- Holds or has applied for a federal employer identification number; and
- May realize a profit or suffer a loss under contracts to perform work and receives compensation on a commission or per job basis rather than on any other basis.

In other words, very few individuals are independent contractors if they are injured on a job site;

instead, they are deemed to be employees of the contractor or subcontractor who hired them. Having a written contract stating that the worker is an independent contractor, not withholding taxes and issuing the worker a Form-1099 at the end of the year, and not providing employee health, vacation and retirement benefits to the worker will not, alone or together, make him an independent contractor unless he meets all nine conditions. And, if someone does actually qualify (e.g., a plumber who is operating as a sole proprietor) make sure that he or she provides proof of workers' compensation coverage or that he or she qualifies for the small business owner exemption.

Role of insurance agents

Insurance agents working with general contractors and subcontractors should be familiar with these issues when advising clients about the need to purchase workers' compensation coverage and about the potential hazards of not demanding proof of appropriate insurance coverages from all subcontractors and independent contractors. If there is any doubt about whether a contractor or subcontractor is hiring employees during the year, an agent should strongly advise his or her client to obtain an “if any” policy from the Assigned Risk Plan.

If you have any questions about the issues addressed in this *Legal Advisory*, please call Lynn, Scharfenberg & Associates at (952) 838-4450 or download SFM's *CompTalk*, “Hiring subcontractors” and *Determination of independent contractor status* form from SFM's website, www.sfmic.com.

² The exemption is available for sole proprietors, the partners of a partnership and the executive officers who own at least 25 percent of the capital stock of a closely held corporation having less than 22,880 hours of payroll each year. The small business owner exemption is discussed in detail in SFM *Legal Advisory* titled, “Small business owner exemptions.”

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