

Workers' Comp for Owner-Employees Poses Challenge

Small businesses and sole proprietors have been greatly affected by the post-9/11, post-Katrina insurance market. The growing temptation and need for these businesses to cut corners on insurance coverage creates the potential for errors and omissions claims against insurance agents. Here are some examples that illustrate the challenges for insurance professionals related to workers' compensation coverage for the sole proprietor or owner-employee.

Case 1: A small business owner approaches the insurance agent for workers' compensation coverage for his one or two employees, but wants to exclude himself from coverage as the owner or as a director/officer.

The agent should carefully consult the workers' compensation rules in the relevant state regarding the kinds of exemptions allowed and the requirements of state or carrier. Some states allow a small number of owners to exempt themselves, but that exemption does not extend to other types of employees. Many states, like Texas, require a specific form to exclude directors or officers from workers' compensation coverage; otherwise they may be automatically covered potentially resulting in additional premium assessments and fines or penalties.

Premium audits commonly lead to errors/omissions claims, and this is certainly true when a business owner who elected no coverage for himself ends up having to pay premiums for the coverage he didn't want because the exemption paperwork was not properly completed. The business owner then makes a claim against the agent for the additional premium assessed to him, alleging that the agent failed to properly process the exemption. While these claims may be reasonably small and defensible, they are also avoidable. At the outset, agents should consider how much involvement, if any, they should have in completing and filing exemption forms for the client. The agent's role will vary by jurisdiction, but regardless of the state in which the agent practices, it behooves the agency to consistently implement clearly defined agency-wide protocols for handling and documenting exemption requests, including documenting communication to the client about the client's role in completing the required exemption process.

Case 2: A sole proprietor with a seasonal business uses the agent for all of his general commercial insurance needs and is always trying to save premium. The client currently does not purchase workers' compensation insurance because he is exempt as a sole proprietor and, in high season, he uses independent contractors and temporary employees rather than regular employees.

Aside from the issues already discussed above, this example presents additional issues for the insurance agent who is trying to service a small client. Where do these temporary employees and contractors come from, and what kind of work are they performing? Is their work being performed in one state or across borders, and who has their workers' compensation coverage? Most agencies have questionnaires to cover these necessary topics for "new clients," but the process may be less thorough for renewals of existing clients. Failing to obtain appropriate workers' compensation coverage exposure creates significant exposure. The key to minimizing that exposure is to confirm and document your client's description of his entire employee and contractor base, and then confirm that each employee or contractor has the necessary coverage, if required. Determining which individuals do and do not require workers' compensation coverage should be made only by agents who are highly trained and keep current on workers' compensation issues.

It is possible to assist the small client with his goal of saving precious profit margin by avoiding unnecessary workers' compensation premium. Sole proprietors who elect to exempt themselves from coverage, in effect, choose to self-insure for the risk of otherwise compensable injuries. The agent should make sure the client's choice is well informed, and document the client's choice to prevent the client from shifting the risk of self-insuring to the agent's E&O carrier. [T](#)

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Get It in Writing

If you don't think documentation is important, consider this example: An insurance agent properly obtains a workers' comp policy for a sole proprietorship without coverage for the owner per the owner's request. The owner is later injured on the job and has no coverage. Defending the claim requires the agent to demonstrate that the coverage was not purchased at the client's request, most easily done if the documentation clearly reflects the client's choice. In states where the duty of the agent is higher than just an "order taker," (e.g. New Jersey) the agent should consider further advising the client about the ramifications of excluding himself from coverage and the benefits the owner-employee may not be fully considering. Going that next step and documenting it thoroughly not only fulfills the agent's legal duty but assists the client in making an informed decision, which may result in the client purchasing the additional insurance.

—J.B.