

James R. Favor & Company

Sigma Alpha Mu Fraternity Risk Management & Insurance Program

Independent Contractors

A Review of Exposures

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Risk Management Recommendations

Since 1979 James R. Favor & Company has been developing and providing effective risk management and insurance programs for Fraternities and Sororities. This brochure was developed to assist Fraternity and Sorority officers, house corporations, chapters and volunteers in reviewing their Independent Contractors exposures, establishing sound risk management procedures and, as necessary, revising their insurance programs to help them reduce their exposures to Independent Contractors and potential uninsured losses.

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Questions and Additional Help

Our staff is always available to answer your questions, discuss your individual circumstances or needs, and assist you in establishing or making adjustments in your insurance program. Please contact us at James R. Favor & Company, 14466 East Evans Avenue, Aurora, Colorado 80014-1409. WATS (800) 344-7335 • TEL. (303) 750-1122 • FAX (303) 745-8669.

1) Independent Contractor Basics: Are Independent Contractors what they may first appear to be or are they really employees? What exposures exist related to their status? **Written Agreements are essential in defining and controlling Independent Contractor exposures. In reality, Independent Contractors create a variety of risks for Fraternities and Sororities.**

In at least one way, the 1986 Tax Reform Act made Independent Contractor status more attractive. It established that self-employed persons could deduct 25% of their medical insurance premiums from gross income rather than as an itemized deduction. The Independent Contractor status may be appealing to some persons for other reasons. They may have medical insurance available through a spouse. **Usually, it's the thought of getting paid without "all those deductions" that the Independent Contractor finds most appealing.**

2) Management's Interests: Management's interest in utilizing Independent Contractors is usually, primarily driven by an employer attempting to avoid ever-increasing employee costs. The costs of insuring employees and providing competitive benefits are significant. In recent years, these costs have been driven most by increased employee benefits and the related costs of Worker's Compensation and Medical Insurance. **Employee benefit costs today are estimated to represent between 30%-40% of payroll. When every payroll dollar means up to \$1.40 in total expense, the incentive to cut costs is strong.**

If these people are not classified as employees and that position is sustained if later challenged, a Fraternity or Sorority may be spared these costs. **Under typical Independent Contractor agreements, the Fraternity or Sorority does not withhold income taxes, FICA, or unemployment taxes. The agreement should also provide that the Independent Contractor is not entitled to Worker's Compensation or other Employee Benefits that are normally provided to employees by the Fraternity or Sorority.**

3) Identifying Hidden Risks: A Fraternity or Sorority considering the use of Independent Contractors should look at a broad range of issues. If ignored, these issues can expose the Fraternity or Sorority to potentially huge financial and legal penalties. **Improperly undertaken, Independent Contractor relationships with prior or potential employees can create employer liabilities that greatly exceed potential savings. Some of the key issues to be considered by Fraternities and Sororities include:**

a) Enforcement agencies or the courts can look beyond the Independent Contractor agreements. A 20-Factor Test is commonly used to determine whether the substance matches the form of the relationship described in the agreement and if the contractor is truly "independent".

b) If enforcement agencies or the courts determine that an Independent Contractor is actually an employee, not only the corporation, but top management and others may all be liable for back wages, payroll taxes, and/or penalties.

c) Workers' Compensation savings may well be offset by increased liability exposures. Statutory Limits under Workers' Compensation are lost when an individual is no longer an employee.

d) If injured, an Independent Contractor can sue the Fraternity or Sorority on the same basis as any other member of public.

e) If the Independent Contractor proves to be an employee, the exposure exists for additional premium costs being charged to the Fraternity or Sorority for Workers' Compensation.

f) While costly, Employee Benefits do provide a powerful incentive to remain with an employer. Independent Contractors are usually considered to be less loyal than employees.

g) Clearly the use of Independent Contractors must be approached with care and caution.

4) Independent Contractor Exposures: For Fraternities and Sororities today, perhaps the most frequent Independent Contractor exposure is the use of “outside” bartenders and/or security personnel commonly required for Fraternity or Sorority sponsored events involving alcohol. Other examples include cooks, housekeepers, party planners, entertainment, catering or food services, and transportation providers. **Based on past experience, we urge you to be especially cautious of Independent Contractors who provide “handyman” maintenance or repair services to your chapters and housing corporations.**

5) Contractor Claim Examples: The frequent and informal use of so called Independent Contractors presents especially difficult exposures for Fraternities and Sororities. **Several Fraternities and Sororities have been without insurance coverage or have sustained significant losses when Independent Contractors were injured or caused injuries to others.**

In the largest suit known to us (\$10,000,000), two Independent Contractor students were hired as “cheap summer help” to repaint a chapter house. They were killed when their aluminum ladder came in contact with the electrical power lines servicing the chapter house. In another serious claim, overcrowding at a function led to the loss of three fingers by a security guard when a heavy chapter house door was slammed closed on his hand.

6) Workers’ Compensation Exposures: State Workers’ Compensation statutes impose a great and ever increasing burden on Fraternity and Sorority employers for injuries to Independent Contractors. **In almost every case, the Fraternity or Sorority employer will be held responsible for Workers’ Compensation benefits unless the Independent Contractor is properly insured.**

The failure to maintain Workers’ Compensation coverage at every House Corporation, chapter or location exposes the Fraternity or Sorority to potentially serious uninsured losses.

7) Using Written Contracts Is Essential: **Effective Risk Management procedures for your Independent Contractor exposures begin with written agreements.** Some groups have even developed standard agreements for use with the most common exposures such as Bartenders, Security Guards, or the Rental of Facilities for functions or events. We will be pleased to assist by reviewing Risk Management considerations. **Your legal counsel should draft or review all Independent Contractor Agreements.**

Your Independent Contractor agreements should include Hold Harmless and Indemnity Clauses in your favor. They should make the Independent Contractor responsible for any losses that may arise out of their acts or omissions. **Hold Harmless and Indemnity Clauses are of greatest value only when supported by insurance or significant assets.** Don’t forget to require, ask us to review, and retain the evidence of insurance materials provided by your Independent Contractors to support their agreements. **Properly developed, written agreements have been proven very effective in accomplishing risk reduction and transfer for Fraternities and Sororities.**

8) Should You Be An Additional Insured? Being an Additional Insured under the Independent Contractors insurance establishes a limited but valuable measure of protection. **Being an Additional Insured can be of particular value if your Hold Harmless or Indemnity Clauses are challenged or invalidated by the courts.** In order to secure defense and coverage as an Additional Insured, **it may be necessary to allow the Independent Contractor’s insurer to choose defense counsel and control your defense.**

Additional Insureds have other important benefits. They have direct rights under the Independent Contractor’s insurance to submit suits or claims directly to the insurer for handling. **If you are an Additional Insured, the contractor’s insurer may not be able to subrogate against you if a claim payment arises out of your acts or omissions.**

9) Whose Insurance Is Primary? The Additional Insured Risk Management technique can give rise to other difficulties. **When two insurance policies potentially apply to the same claim, the question of which policy is primary or first to pay usually arises.** Failure to anticipate and address this topic can result in unexpected losses. **Your insurer may have to respond to a claim against you for risks that you thought had been transferred to others.**

To avoid unexpected losses and potential problems in this area we recommend that your **Hold Harmless or Indemnity Clauses, Additional Insured arrangements, and the related insurance coverage address the following points.**

- a) **If a claim is presented, the Independent Contractor's insurance will be Primary. (Pay First). Your own insurance will be excess and non-contributory. (Pay claims only after the Independent Contractor's Insurance).**
- b) **If a claim is presented, the Independent Contractor's insurer will defend you and provide coverage on your behalf.**
- c) **If your legal advisors feel that legal conflicts exist, then the Independent Contractor's insurer will arrange to provide or pay for separate counsel to protect your interests.**

10) Final Thoughts: Independent Contractors are a frequent source of exposure and potentially significant losses for Fraternities and Sororities. **When carefully approached and planned, however, they can also be an effective method of risk reduction and transfer.** The Independent Contractor topic increases the importance of employment practices as a source of potential losses for Fraternities and Sororities. **Fraternities and Sororities should devote increased Risk Management attention to this area to review the various issues and exposures, analyze and address the associated risks, and monitor the ongoing effectiveness of their programs.**

**Risk Management Recommendations
for
Independent Contractors**

To minimize your Independent Contractor exposures and reduce the potential for uninsured losses, we recommend that Fraternities and Sororities implement the following risk management actions:

- 1) **As employers may be held responsible for Workers' Compensation benefits if an injured Independent Contractor is not properly insured. Workers' Compensation should be maintained by the National Organization and every Chapter, House Corporation, or other potential employer.**
- 2) **Independent Contractors should only be used subject to the terms of a written contract that has been reviewed by both your legal counsel and insurance advisors.**
- 3) **Hold Harmless and Indemnification Clauses that make the Independent Contractor pay for any losses that may arise out of their acts or omissions should be included in your contracts.**
- 4) **To further insulate yourself, require that the Independent Contractors provide you with Additional Insured status under their insurance.**
- 5) **Require that the Independent Contractor and their insurer specifically agree that their insurance will be primary while your insurance will be only excess and non-contributory.**
- 6) **Before any work is performed, require written evidence of insurance to support the indemnification agreement and verify that your insurance requirements are being met.**
- 7) **Require that the Independent Contractor's insurance may not be cancelled or non-renewed without providing you with at least (30) thirty days prior written notice via certified mail.**

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Minimum Insurance Requirements for Independent Contractors

Before Independent Contractor agreements are finalized and any work is performed, Written Evidence of Insurance, as illustrated by the attached Specimen Certificate of Insurance, should be obtained from all Independent Contractors.

Independent Contractors are a frequent source of problems and potentially significant losses for Fraternities and Sororities. When their use is carefully planned, they have also been proven to be a very effective method of risk reduction and transfer for fraternities and sororities.

ADDITIONAL RISK MANAGEMENT TIPS

- 1) Independent Contractors should only be used subject to a written contract that has been reviewed by both your legal counsel and insurance advisors.
- 2) Hold Harmless and Indemnification Clauses that make the Independent Contractor responsible for any claims or losses that may arise out of their acts or omissions should be included in your contracts.
- 3) To further protect yourself, require that the Independent Contractor provide you with Additional Insured status under their insurance.
- 4) As an Additional Insured, require that the Independent Contractor and their insurer agree that for your benefit, their insurance will be primary and your insurance will be excess and non-contributory.
- 5) Require that the Independent Contractor's insurance may not be cancelled or non-renewed without providing you with at least (30) thirty days prior written notice via certified mail.
- 6) Independent Contractors providing or serving alcohol should be properly licensed and provide proof of both Host Liquor and Liquor Legal Liability at limits of not less than \$1,000,000 per occurrence.
- 7) Independent Contractors providing legal age identification checks, security or crowd control services for events should provide proof of Personal Injury Liability coverage for Assault and Battery, False Arrest, and Invasion of Privacy with limits of not less than \$1,000,000 per occurrence.
- 8) Higher limits and other coverages, such as Property, Builders Risk or Performance Bonds, may be needed based on the work to be performed.
- 9) For more information regarding Independent Contractors exposures, request our brochures: 1) "Workers' Compensation", 2) "Independent Contractors", both of these provide a Review of Exposures & Risk Management Recommendations.

Questions & Additional Help

Our staff is always available to answer your questions or assist your legal counsel in reviewing Independent Contractor agreements, or reviewing the insurance certificates provided by Independent Contractors. Please contact us at James R. Favor & Company, 14466 East Evans Avenue, Aurora, Colorado 80014-1409. WATS (800) 344-7335 • TEL. (303) 750-1122 • FAX (303) 745-8669.

INDEPENDENT CONTRACTORS OR EMPLOYEES?

THE 20 FACTOR TEST

The Internal Revenue Service (coordinating closely with the respective state agencies charged with payroll tax compliance enforcement in each state) applies a 1987 Revenue Ruling (87-4) known as the “20 Factor Test” to determine if workers are employees or Independent Contractors. A “yes” answer to any of the 20 questions would indicate that the person is an employee and not an Independent Contractor. The detailed discussion of each of these factors clearly demonstrates the rigorous standards that must be met in order to lawfully classify a worker as an Independent Contractor.

The message that runs throughout the 20 Factor Test is that the right to control is critically important in determining whether an individual is an employee or an Independent Contractor. If control by the Fraternity or Sorority can be demonstrated in any of these 20 areas, then the governing authority will possibly find an Employer / Employee relationship exists. While the 20 Factor Test is a measure of Independent Contractor status, many states have the definition of Employee or Independent Contractor written into the Worker’s Compensation statutes or other separate laws dealing with employment.

1) Instructions – Is the person required to comply with instructions about when, where and how the work is to be done? If a person is required to comply with instructions as to when and how to perform the work, that person is likely an employee.

2) Training – Is the person provided training? Is the individual receiving training by an experienced employee working with him or her? Training points to employee status, since it indicates that the employer wants the services to be performed in a particular manner and is exerting control.

3) Integration – Are the services for the operations of the company? The more integrated the individual’s task is, the more likely the company has control – making the individual an employee.

4) Service Rendered Personally – Are the services provided personally by the individual? If the service must be rendered by a particular individual, then the employer likely has control, meaning the individual is likely an employee.

5) Hiring, Supervising and Paying Assistants – Does the company hire, supervise or pay assistants to help the person? If the company controls these activities, employee status is indicated.

6) Continuing Relationship – Is there a continuing relationship between the person and the company? An ongoing relationship with an individual in a company tends to indicate the existence of an employer/employee relationship.

7) Set Hours of Work – Does the company set work schedules? If the company can set specific hours as to when the individual must be on the job, the person will likely be considered an employee.

8) Full Time Required – Does the person devote his or her full work time to the company? If the company requires an individual to devote full time to the business, the individual is likely an employee.

9) Location Of Work – Is the work performed at the company’s place of business or at specific places designated by the company? Control is the key word. Control over the place of work, on company premises or a site determined by the company, indicates an employee relationship.

10) Order Or Sequence Of Work – Does the company direct the sequence of the work performed? If the employer can set the sequence in which services are to be performed, then control is being exercised, and the individual providing services is an employee.

11) Oral Or Written Reports – Are reports regularly given to the company? If oral or written reports are required by the company, then control and an employer/employee relationship is indicated.

12) Payment By Hour, Week or Month – Is the person paid hourly, weekly or monthly (as opposed to “by the job”)? An Independent Contractor is normally paid by the job or on a commission basis, rather than on a schedule or by a guaranteed amount.

13) Payment Of Business or Travel Expense – Does the company reimburse the person for business or travel expense? The fact that the employer will pay for an individual’s work-related expenses is indicative of control and employee status.

14) Tools And Materials – Does the company supply materials or tools to the person? Providing tools and materials to an individual suggests that a company is exercising control, which means that the individual is an employee.

15) Significant Investment – Does the person have equipment or facilities to perform services? If a person has investment in facilities or equipment, that person is likely an Independent Contractor.

16) Profit Or Loss Potential – Is there an exposure to loss, or the potential of profit for the individual? A person who is in a position to realize a profit or suffer a loss as a result of the service provided is likely an Independent Contractor.

17) Working For More Than One Firm – Does the person work exclusively for the company? If the person works for more than one company at the same time, he can be an Independent Contractor.

18) Making Service Available To The General Public – Does the individual make his services available to the public? Advertising to the general public the availability to perform a particular service indicates an Independent Contractor.

19) Right To Discharge – Can the worker be dismissed for reasons other than non-performance of contract specifications? The right to discharge an individual is clearly an act of control and is indicative of an employer/employee relationship.

20) Right To Terminate – Can the person terminate his relationship with the company without liability for failure to complete the job? Employees can usually terminate the relationship with the employer at any time without incurring any liability.

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ITEMS FOR REVIEW
With
Legal Counsel / Insurance Representative
