Q&A on California Assembly Bill 2883

Editor's Note: The following questions and answers are intended for general educational purposes. Nothing herein is intended to serve, or should be relied upon, as legal advice for any particular issue of interpretation or compliance. The application of these laws can involve highly complicated and individualized fact patterns; the answer for one employer may be different than the answer for other employers. In addition, it is possible that changes to the law, or modifications in the enforcement philosophy by one or more state agencies, could result in changes to the answers suggested below. Broker-agents with specific questions are encouraged to obtain direction from their insurers or counsel from appropriate professionals.

IIABCal gratefully acknowledges Mr. Mark Webb for his indispensable role in the preparation of this Q&A. Mr. Webb, a recognized expert on California workers' compensation law and practice, is the founder of and principal in ***Prop. 23 Advisors.*** *More information on Mr. Webb and the services his firm provides is available at: www.proposition23workerscomp.com.*

Q. How does this legislation change current law?

A. An "employee," as defined by provisions in the California Labor Code prior to 1/1/17, includes officers and members of boards of directors of corporations while rendering actual service for the corporations for pay. Officers and directors who are the sole shareholders of the corporation, as well as working partners or members of a partnership or limited liability company, are exempt from workers' compensation requirements unless they elect to be covered.

AB 2883 amends the applicable definitions in California Labor Code §§ 3351 & 3352, effective 1/1/17, to apply workers' compensation requirements to corporate officers and directors while rendering actual service for pay—unless they own at least 15 percent of the issued and outstanding stock, AND execute a written waiver under penalty of perjury. In addition, working members of a partnership or limited liability company who receive wages are also required to comply with the workers' compensation laws—unless they are a general partner or managing member, and execute a written waiver under penalty of perjury.

AB 2883 applies to all policies that are in-force on policies as of (in addition to all policies sold or renewed after) January 1, 2017. Unless a duly executed waiver is received and accepted by the insurance carrier on or before 1/1/17, any previously exempt person must be added to the coverage provided by the insurer until such time as a duly executed waiver is received and accepted by the insurer.

Q. How does this new law affect a business that is owned by a revocable family "trust?" Four members of the family are the "trustees." They also work for, and are paid as, employees of the trust. Can they be excluded from the comp requirement?

A. No. The trust designation was relevant only because current law required 100% ownership of the closely held business. Since that criterion has been eliminated in AB 2883, they are not eligible to execute a waiver.

Q. Could a husband and wife (as the two trustees of a family trust that owns an LLC) identify themselves as "managing members" of the LLC, or does the existence of the trust and its ownership interest preclude them from exempting themselves? Does a different result obtain if the same trust owned a corporation, rather than an LLC? In both scenarios, the husband and wife are paid employees.

A. The answer will depend on what is in the underlying LLC documents. A "member" can be, "an individual, partnership, limited partnership, trust, a trustee of a trust, including, but not limited to, a trust described under Division 9 (commencing with Section 15000) of the Probate Code, estate, association, corporation, limited liability company, or other entity, whether domestic or foreign. Nothing in this subdivision shall be construed to confer any rights under the California Constitution or the United States Constitution," per Corporations Code Sec. 17701.02(v). Since the trust can be a "member," the "trustees" can be managers. The underlying organization documents, however, need to be examined to determine whether the LLC is member-managed or manager-managed. Per Corporations Code Sec. 11701.02(n), the manager designation only applies to a manager-managed LLC.

Q. Is there any distinction to be drawn between a "revocable" trust and an "irrevocable" trust for AB 2883 purposes? Can the sole trustee of a revocable trust, who is also an employee, exempt herself? Can a trust itself be deemed a "managing member" of an LLC, whose trustees may exempt themselves?

A. At this point, it appears that the nature of the trust is not relevant. Labor Code Sec. 3351 does not apply to trusts, per se. It applies arguably only when the trust has an ownership in one of the three types of business entities that can have officers, directors, general partners, or managers who waive compensation coverage. The trust may be a "manager" if the LLC is manager-managed.

Q. If a corporation is owned by a trust, and the individual controlling the trust is an employee of the corporation and paid by the corporation, is he eligible for a waiver? Is he regarded a "natural person," notwithstanding the trust ownership?

A. Doubtful. The waiver may be executed by an officer or director of the corporation. The ownership of the corporation is not relevant. If the corporate documents have the individual as an officer or director and is receiving compensation, then the person may execute a waiver.

Q. Does the 15-percent ownership requirement (in order to be exempt from the w/c requirement) apply to a limited liability company or limited liability partnership?

A. No. The percentage-of-ownership requirement applies only to corporations and not to LLCs, LLPs or partnerships. In order to qualify for exemption as an LLC, LLP or partnership, the "owner" must be a general partner or managing member, and certify their qualification for the exemption in the written waiver under penalty of perjury.

Q. Is there any limitation on the number of general partners or managing members (in a partnership, or in an LLC/LLP, who can qualify for the exemption? Are LLCs and LLPs treated identically under the new law? If an LLP is organized so that no partner is titled "general partner" or "managing member," etc…, do all partners qualify for exemption?

A. There is no statutory limitation. The leadership and management structure would be governed by the written partnership or operating agreements. Remember the distinction between member-managed and manager-managed, however, as set up in the organizational documents of an LLC. AB 2883 states that all working members of a partnership or LLC are employees. The exemption is for "general partners" which under the Corporations Code is a designation only for limited partnerships and not LLPs or partnerships governed by the Uniform Partnership Act, and for "managers" of an LLC, which only applies to manager-managed LLCs per the Corporations Code.

Q. Can a working (non-managing) member of an LLC exempt himself from comp requirements if he receives no salary for his work, but does receive distributions (profits) from LLC operations?

A. Probably not. "Remuneration" has been defined to mean, "all substitutes for money," and an LLC distribution would likely fall within that definition.

Q. When a corporation is owned by an LLC, is the exemption process handled the same as any other LLC (i.e., where only managing members of the LLC are eligible to exempt themselves)?

A. Yes; there is no difference.

Q. How are exemptions handled where a workers' compensation policy covers multiple corporations as "named insureds," and the extent of ownership varies between and among the different corporations (an individual owns 15 percent of the stock of some, but not all, of the corporations)?

A. It is important to remember that officers and directors are employees only "while rendering actual service for the corporations for pay" (Labor Code §3351). The answer to this question is, therefore, completely dependent on the facts—whether they are providing services for pay to each of the corporate entities, and what percentages of the stock they own therein.

In cases where a waiver is permitted, the payroll for that corporation would be excluded from rate-making calculations.

Q. We often see policies issued to businesses that have multiple entity types and are combinable for experience rating. Do individuals need to qualify for eligibility for all entity types in order to be excluded from the policy?

A. The answer depends upon the facts; see the immediately preceding question.

Q. In the past, officers working at a corporation had to own 100% of the shares between them in order to be exempt. With the new 15 percent individual ownership requirement, does the total percentage of shares owned by all working officers still have to total 100%?

A. No. The 100% requirement is no longer applicable. It is important to note that AB 2883 applies to all quasi-public and private corporations, not just closely-held ones. This means that officers and directors who were previously employees because they were not part of a closely held corporation can now sign a waiver, provided they own 15% or more of the stock.

Q. One of our policyholders is headquartered out of state and has employees in multiple states, including California. Does AB 2883 apply to their corporate officers?

A. Yes. AB 2883 redefines "employee" for workers' compensation purposes. The state of domicile of the corporation is not relevant.

Q. How does this law apply to joint ventures? And to co-ops?

A. Technically, it does not apply to either. If an entity has employees, then everyone receiving remuneration will be regarded as an employee.

Q. What is the application of this law, if any, to sole proprietorships with no employees? Is the answer different if the sole proprietor does have one or more employees?

A. A sole proprietor without employees is not an "employer" by definition. Labor Code § 3300(c) defines an employer as "Every person including any public service corporation, which has any natural person in service." So unless there is an employee, the sole proprietor is not an "employee" because he or she is not an "employer".

As the California Division of Workers' Compensation has put it: "Sometimes a business owner (sole proprietor) may desire to purchase workers' compensation insurance to cover himself/herself only. The inclusion of a sole proprietor must be clearly stated in the workers' compensation policy or must be added as a coverage endorsement to the policy. Since workers' compensation insurance is a type of liability insurance where the employer assumes complete liability for all worker injuries, a workers' compensation policy for a sole proprietor may not be the best choice."

Q. How does AB 2883 affect charitable, non-profit, or similar corporations that have not issued any stock and technically have no "owners?"

A. Because of the stock ownership requirement for exemption, any corporate form that does not issue shares will not be able to have its officers and directors execute waivers.

Q. We insure a small law firm. One of the members of the firm is on the board of directors and is paid a fee for services rendered to the firm, but is not an employee. He resides in Canada. In addition, the wife of one of the lawyers works at the firm, but is not paid. And the firm also has a retired one-percent shareholder. Are all exempt from workers' compensation requirements?

A. It might be advisable to get a signed waiver from the director in Canada, assuming he has the requisite amount of stock ownership. If he does not, then he would be an employee. As to the spouse, there is no exemption for spouses and as such she would be considered an employee for workers' compensation purposes even though no wages are paid. Finally, unless the retired one-percent shareholder is performing services for pay then he/she is not an employee. If the retired shareholder is performing services for pay then he/she is.

Q. Some of our carriers are not telling us whether the new waiver form has been signed, returned and accepted by them. This puts in a horrible position, not knowing how to advise our clients. What can we do?

A. Some carriers are "acknowledging" the waiver when they bind with the exclusion. That would seem to be consistent with the fairly broad language in a recent California Department of Insurance Notice; however, that notice doesn't specify the way the carrier has to acknowledge the waiver and when and how that needs to be communicated to the producer. The Notice also required carriers to, "Provide as soon as possible, but in no event later than November 15, 2016, an advisory/explanatory notice, with a copy of the waiver form to each employer that may have employees who are currently excluded from coverage and may be affected by this change in law." If the insured received the notice from the carrier, and assuming you have it as well, then that should be retained. While not optimal, when the policy is delivered you will be able to see whether the exclusion was applied and thus the waiver was "accepted". If it was not, and you think that was erroneous, then assuming the waiver was executed prior to the inception of the policy you will need to go back to the carrier and get an endorsement retroactive to the inception date.

Q. The new law apparently requires an insurer to not only receive, but also "accept" the executed waiver form. What is the difference? And can an existing policyholder (or the insurer) back date the waiver on an existing policy if it is not received and accepted before 1/1?

A. If the waiver was executed prior to 1/1/2017, then the endorsement excluding the person should be effective on January 1. This is not back dating. The waiver is effective the date it is executed, if after 1/1. There is no clarity about what constitutes acceptance by an insurer, but acceptance should not mean that the date of the waiver is the date of acceptance notwithstanding the language in new Labor Code Sec. 3352. To the extent there is a gap between "receipt" and "acceptance," the insurer needs to be questioned as to why there is a delay.

Q. What is our obligation, if any, if a corporate owner's percentage of ownership changes during the year?

A. It would be advisable to make sure that the corporate owner understands the consequences when an excluded employee drops below the ownership requirement to execute a waiver. This is something that requires clarification since the statute says the waiver is effective until withdrawn and the attestation under penalty of perjury appears to apply only when the initial waiver is executed.

Q. We provide general liability and other coverages—not including comp—to a business that has no employees currently, and does not expect to have any in 2017. Does AB 2883 impose any new obligations on such businesses?

A. If the business had individuals who were not defined as employees under current Labor Code Sec. 3351 then they will need to execute waivers under new Sec. 3352 because they will be deemed employees as a matter of law.

Q. Whose responsibility will it be to evaluate the honesty and accuracy of the signed waivers? What is the penalty for misrepresenting one's eligibility for the exemption? Could a broker-agent be liable for a false statement an insured has made?

A. AB 2883 does not address any of those issues. Presumably, false waivers would be investigated and enforced in the same manner as any other type of insurance fraud. It is difficult to see how a broker-agent could be held liable for any intentional or negligent misrepresentation by a client—except, possibly, in a highly unlikely fact pattern involving independent criminal activity by the broker-agent (such as forging the client's signature on the form without the knowledge and consent of the applicant or insured, or conspiring with the consumer to defraud the insurer, …).

Q. Is there any reasonable prospect for an immediate "clean-up" bill to lessen the impact of these changes, or resolve any of the ambiguities in the enacted bill?

A. Probably not—at least not in any form that would provide immediate relief. "Urgency" legislation, which takes effect immediately upon signature into law by the Governor, is very difficult to enact because it requires a two-thirds "supermajority" in both houses of the Legislature. Immediate action is also unlikely in January because a new legislative session (with many new members) is about to commence, and a "new" Legislature is rarely situated to do anything quickly. Most importantly, though, most of the "heavy lifting" AB 2883 requires on policies already in-force on 1/1 will already have occurred before the effective date, thereby providing little relief anyway. The prospects for a "clean-up" bill that works its way through the Legislature more conventionally (and far more slowly) are perhaps better.

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Editor's Note: The questions and answers that appear below, on workers' compensation requirements generally, were prepared by the California Department of Industrial Relations.

Q. Do I have to have Workers' Compensation Insurance?

A. Yes, every California employer using employee labor, ***including family members***, must purchase Workers' Compensation Insurance (Labor Code Section 3700). If you fail to have Workers' Compensation Insurance for your employees, it can be expensive as the DLSE is required to issue and serve a stop order/penalty assessment prohibiting further use of employee labor until you do purchase Workers' Compensation Insurance. Effective January 1, 2011, the penalty assessed for failure to have Workers' Compensation Insurance is based upon the greater of (1) twice the amount the employer would have paid in workers' compensation insurance premiums during the period the employer was uninsured, or (2) $1,500 per employee. However, there are exceptions for partnerships, if the only persons performing labor are the partners and corporations where the corporate officers are the sole shareholders; in which case, the corporation, officers and directors come under the Workers' Compensation provisions only by election.

Q. My niece helps in my business for a few hours a day, but I don't consider her an employee. Is that correct?

A. No, under the labor law she is considered an employee. An employee is defined as someone you engage or permit to work. Even though your niece is part of your family, she is considered an employee and you, as the employer, must provide Workers' Compensation Insurance to cover her in case of a work-related injury. In addition, you are also required to pay the minimum wage unless the employee is your spouse, parent or child and you are a sole proprietor or partnership. Corporations do not have children and therefore, no family relationship to the officers of the corporation can be exempt from these requirements.

Q. I employ persons classified as independent contractors. What obligations do I have to purchase Workers' Compensation Insurance or comply with other labor laws?

A. Employers often improperly classify their employees as independent contractors to avoid paying payroll taxes, minimum wage or overtime, or complying with other wage and hour requirements such as providing meal periods and rest breaks, etc. Additionally, employers do not have to cover independent contractors under Workers' Compensation Insurance. However, because potential liabilities and penalties are significant it is important that each working relationship be thoroughly researched and analyzed before classifying an individual as an independent contractor and not an employee. You should understand that the DLSE presumes that the worker is an employee (Labor Code Section 3357). However, the actual determination of whether a worker is an employee or independent contractor depends upon a number of factors which must be considered. Consequently, it is necessary to closely examine the facts of each relationship and then apply the law to those facts. The most significant factor to be considered is whether the person to whom service is rendered (the employer or principal) has control or the right to control the worker, the work to be done and the manner and means in which it is performed. For further information on this subject, please visit the DLSE website at www.dir.ca.gov/dlse/FAQ_IndependentContractor.htm