

SPECIAL REPORT

EMPLOYEE LEASING – PROCEED CAUTIOUSLY BEFORE YOU EMBARK ON THIS POTENTIALLY DANGEROUS ARRANGEMENT

(08-28-2014)

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A. INTRODUCTION TO EMPLOYEE LEASING

Employee leasing companies, also known as Professional Employer Organizations (“PEOs”), offer employee leasing as a major cost reduction alternative to employers. PEOs purport to reduce expenses in a variety of areas, such as single business tax, unemployment taxes, Workers’ Compensation premiums, health insurance premiums and administrative expenses in managing employees. They promise to provide many services that the employer might not otherwise be able to afford.

Because the supposed savings can appear to be many thousands of dollars, too little consideration is given to the long-term expense and the risks associated with these arrangements. Additionally, the services offered by PEOs appear attractive as presented in the sales process, but often prove to be illusory in actual practice.

The purpose of this report is to examine in some detail many of the problems in employee leasing, the negotiation of employee leasing contract provisions, the long term liabilities you will incur if you enter into this agreement, the benefits of having or not having a PEO, and other alternatives. Extreme caution must be used when considering these agreements, and they should only be entered into after careful examination and analysis by knowledgeable advisors.

B. WHAT IS EMPLOYEE LEASING?

Under the employee leasing concept, all or most of the employees of a given business are terminated and re-hired by another company that leases them back to the former employer. The new employees are now paid by the leasing company and are hired, terminated and controlled by the leasing company. The leasing company, of course, then provides all benefits including Workers' Compensation and it is the leasing company's unemployment rate that applies, and their Workers' Compensation rates and modifications apply as well as group insurance benefits.

C. LABOR AND EMPLOYMENT LAWS

The process of transferring some or all employees to a PEO and then leasing them back does not relieve the former employer of its obligations under federal and state labor and employment laws, and the former employer will likely remain liable for noncompliance with these laws.

Some PEO arrangements provide that the PEO is the sole employer of the leased employees. Others provide that the PEO is a co-employer, along with the "host" or former employer at whose facilities the work is done. Where the PEO is designated as the sole employer, it may be contractually responsible for compliance with federal and state labor laws, including laws relating to recruitment, hiring, discipline and termination of the leased employees. This scenario can create the mistaken impression that the former employer does not need to worry about complying with federal and state labor and employment laws. This is not the case.

Under US Department of Labor regulations, "joint employment" may exist where (1) there is an arrangement between employers to share the employee services; (2) one employer is acting in the interest of another employer in relation to the employee; and (3) the employers may be "deemed to share control" of the employee. In a joint employment situation, both employers can be held liable under the Fair Labor Standards Act as to their joint employee.

The Equal Employment Opportunity Commission has issued enforcement guidance regarding the application of EEO laws, including

Title VII, the Americans with Disabilities Act, the Age Discrimination in Employment Act and others, to the employee leasing situation. The analysis is fact specific as to whether the worker is an employee of the leasing company or the former employer; however, there is a strong possibility that both entities would be considered joint employers of the leased worker. In a joint employment situation, the EEOC has indicated that both entities are jointly and severally liable for wages and other compensatory damages under EEO laws.

The best practice is to ensure compliance with federal and state labor and employment laws and to ensure that all workers, regardless of the existence of an employee leasing agreement, are treated in a nondiscriminatory manner.

D. WORKERS' COMPENSATION ISSUES

Adverse Experience Modifications

Because the leasing company may, in total, pay higher premiums to one insurance company based on the number of employees that it maintains, the leasing company may be able to secure lower rates and its experience modification may, at least initially, be lower than the former employer's.

Of course, there is no free lunch. Employee leasing attracts many companies with adverse experience modifications. The employees that developed the high experience modification for the original employer will eventually create the same or a higher modification for the leasing company. It stands to reason that multiple employers with bad experience modifications will create bad experience modifications with the leasing company. This is adverse selection. The unfavorable experience generated by a group of companies with poor loss experience will increase your long term Workers' Compensation costs.

Fluctuating Experience Modifications

Another issue related to Workers' Compensation is how long the proposed Workers' Compensation premiums will last. A leasing company, for example, may quote based on a .90 experience modification as of January 1st; however, their modification may revert to

a 1.20 modification as of February 1st. The cost, of course, is passed on to their clients. The modification used by a leasing company is modified every 12 months based upon prior losses.

In other words, there is no guarantee in a leasing company's proposal as to how long a modification will last and the employer considering transferring employees to a leasing company should ask for a copy of the experience modification worksheet being utilized by the leasing company's Workers' Compensation insurance company to see when the anniversary date is and to verify the actual modification.

Cancellation of Policies

Of course, a problem also arises when the former employer pays the leasing company for Workers' Compensation and those premiums are not passed on to the insurance company and the policy is cancelled. The former employer may not be notified that the policy has been cancelled because it is not the insured employer under that policy. It is imperative that the Workers' Compensation carrier be required to provide at least 30 days notice to the former employer in the event of cancellation.

Retroactive Premium Charges Based on Audits

In addition, leasing companies may charge a Workers' Compensation premium based upon inappropriate classifications. At the time of audit the insurance carrier can use the correct classification and, because the client has agreed to reimburse the leasing company for all Workers' Compensation costs, the client could receive a substantial retro-active premium charge.

Re-entering the Standard Market

It is typically difficult to obtain a summary of Workers' Compensation losses from leasing companies which creates major problems when the former employer terminates the leasing contract and tries to return to the standard market. This could result in assigned risk Workers' Compensation rates as well as loss of a favorable experience modification and dividend plans.

Covering Non-Leased Employees

It is important that a Workers' Compensation policy be maintained by the former employer to cover non-leased employees, such as the executive officers or clerical individuals in the company. Such coverage is also important in the event a leased employee is able to successfully make a Workers' Compensation claim against the former employer. This will also cover uninsured independent contractors working for the former employer.

E. LIABILITY INSURANCE AND INDEMNIFICATION ISSUES

Under the typical leasing arrangement, the leasing company requires that the lessee, that is the former employer, maintain general liability insurance covering all of the leased employees and the leasing company is required to be added as additional insured and proof of insurance must be provided to the leasing company. Few insurers will do this leaving the client open to damages that may not be insured.

At the same time, the former employer must maintain safe premises and must comply with all governmental safety regulations. Governmental regulations aside, the former employer is now liable under a negligence theory for injury to anyone on the premises, such as former employees, being leased back.

In a typical leasing arrangement there is an indemnification agreement. Under such an indemnification agreement, the former employer has to defend and indemnify the lessor, the leasing company, from any claims made by employees resulting from any actions or conduct of the former employer. On the surface this does not appear to be much of a problem, inasmuch as it limits the indemnification to actions or conduct by the former employer.

However, in reviewing other parts of the typical agreement, the leasing company is responsible only for "administrative employment matters..." to be carried out by it pursuant to the terms of the agreement, such as the payment of all wages and fringe benefit programs for its employees. This means that the former employer has agreed to assume the responsibility for the employee injured on the former employer's

premises arising out of the failure by the former employer to maintain safe premises. As a result, the leasing company's Workers' Compensation insurance company could sue the former employer to recover claims it pays for employee injury.

This presents a significant problem because the commercial liability policy used by many liability carriers excludes injury to leased workers creating a major coverage gap.

Furthermore, even without this exclusion, indemnification agreements such as this are not fully covered by the commercial general liability insurance maintained by the lessee, the former employer. For example, insurance for indemnity agreements under a standard general liability policy covers only bodily injury and property damage and not such claims as libel, slander, defamation, false arrest, wrongful discharge, sexual harassment, etc.

The typical leasing arrangement does not require that the leasing company provide any liability insurance whatsoever. Any company seriously looking at employee leasing should insist that the leasing company provide general liability insurance for its activities, including employment practices and errors and omissions.

F. LIABILITY INSURANCE

It is critical that in the employee leasing arrangement the former employer maintains liability insurance and, indeed, this is required by the leasing contract. This is because, as previously indicated, the leasing company is being held harmless for any claims arising out of injury to employees based on the failure of the employer to provide a safe premises.

That liability carrier is assuming a greater risk because it now may have the responsibility for paying for any employee injuries if the former employer was negligent. Previously, the employees could not make a claim because they were blocked under the Workers' Compensation statute and were required to make only Workers' Compensation claims. Under the leasing arrangement they can make both claims. For this reason, liability insurance carriers almost always exclude claims made by leased employees.

If you can convince the carrier to waive this exclusion, the liability insurance company may require higher premiums. Furthermore, in the event the leasing company cannot provide evidence that it has liability insurance, the general liability carrier for any former employer that has its premium rated on a payroll basis could pick up that exposure at the time of audit and charge for it totally.

G. INABILITY OF THE FORMER EMPLOYER TO CONTROL LOSSES

The insurance companies that were previously retained by the former employer presumably did loss control for Workers' Compensation and general liability purposes. Where a PEO is utilized, loss control will hopefully be done by the insurance company for the leasing company; however, with many employee leasing companies it is unlikely that any practical loss control will be done. Lack of meaningful loss control will, in the long run, increase claims and insurance expense.

H. HEALTH INSURANCE

Because of volume purchasing, leasing companies can usually offer greater health insurance benefits at lower costs. These plans, however, must be examined to be certain that they are carried with a standard insurance company and not under a self-insured plan whereby the leasing company pays the smaller claims with large claims being paid by a re-insurer. Under those circumstances, the leasing company may not have sufficient funds to pay the smaller claims, leaving the employees without coverage. When this happens, the former employer will have to assume these claims in order to maintain employee morale. Even when it appears that a standard insurance company is being utilized for this, under a self-insured arrangement the new health insurance carrier may well be fronting the claims and only pays the claims that it can be reimbursed for from the leasing company.

We recommend that the health insurance carrier be contacted directly and the policy should be examined to be certain that it is not a self-insured arrangement and that the insurance company will be obligated to pay all claims. At the same time, it is critical that the premium payments to the health insurance carrier be paid to a trust or be paid by a third party. The premiums that are paid to the leasing company may

not ultimately be paid to the insurance company, leaving the employees without coverage and perhaps no notice to the former employer or to the employees.

Also, it is critical to inquire regarding pre-existing condition clauses. Under these clauses, new employees may be required to complete health questionnaires and may not be covered for a certain period of time for any pre-existing condition. Inasmuch as the former employees are now new employees to the leasing company, the pre-existing condition clause may apply immediately. Any uncovered claims by the leasing company under these circumstances may result in a lawsuit for employee benefits against the former employer for depriving them of their benefits.

Of course, a related issue applies when the leasing arrangement fails. All of the employees must now go to a new insurance company, presumably arranged by the former employer as the employees return to employee status, and that plan may have a pre-existing condition clause and may have higher rates than offered by the leasing company, depending on the number of employees now in the plan. Some employees may be without coverage, particularly in small groups. A related problem exists relative to health insurance and also to Workers' Compensation, and that is the inability of the leasing company to provide segregated claims information so that the former employer can purchase competitive Workers' Compensation and health insurance when the leasing arrangement fails.

This should be discussed with the leasing company's health insurance company prior to entering into the agreement.

I. OTHER EMPLOYEE BENEFIT PLANS

If the former employer had pension or profit sharing plans or 401(k) plans, those plans could see a depletion of their assets because employees will now be able to withdraw the money because they are no longer employed by that company. This may be beneficial in the short term to the employees who need the money; however, in the long term it certainly can impact their retirement and destroy the plans that the employer has maintained. Early withdrawal often carries adverse tax

consequences to those employees who have not reached retirement age.

J. CRIME INSURANCE AND EMPLOYEE DISHONESTY

The former employer should now note that employees are no longer its employees and some employee dishonesty policies will not cover any claims arising out of employee dishonesty such as embezzlement. At the same time, the typical property insurance policy, which normally would cover theft, excludes dishonest or criminal acts by anyone to whom you entrust the property for any purpose. This could negate coverage for fires or other dishonest or criminal acts that the former employee, now the employee of the leasing company, may engage in because it would appear that property has been entrusted to those former employees.

K. WRONGFUL DISCHARGE

The leasing arrangement requires that the employer terminate all of its employees. This, of course, may create in itself wrongful discharge claims because of promises that may have been made by the former employer for long-term employment of some or all of its employees.

A leasing arrangement should only be entered into when there is a clear-cut "at will" employment relationship between the employer and its employees allowing them to be discharged. At the same time, once the leasing arrangement has been entered into, the former employer could still be liable for sexual harassment claims as well as wrongful discharge or discrimination claims by the leasing company. The employee would allege that the leasing arrangement was merely a ruse to reduce taxes and insurance expense and that the former employer continued to be the actual employer. In that situation it is liable for claims of this nature but may not have real control.

Furthermore, the former employer's liability insurance probably does not cover sexual harassment, discrimination or wrongful discharge claims and it is unlikely that the leasing company will carry insurance for such claims although at least one leasing company offers some legal defense coverage for employment practices claims if all of the leasing company's procedures have been followed by the former employer.

L. DOUBLE SOCIAL SECURITY TAX

Because the employees have a new employer, social security will be charged again in full with no credit for social security that may have been contributed under the old employer's payroll. This, of course, will be adjusted when the tax is ultimately filed. However, in the meantime, highly compensated employees will have a double tax creating more morale problems.

From an employer standpoint, there is no adjustment for its obligations. The original employer will have paid social security taxes on wages up to the current federal threshold. Then, because the leasing company is deemed to be a new employer, social security taxes must again be paid on wages up to the current federal limits. This expense is, of course, passed on to the original employer.

M. MICHIGAN EMPLOYMENT SECURITY COMMISSION TAX

Leasing companies initially may have a lower employment tax until its unemployment claims catch up to the formula. The same concept as in Workers' Compensation applies here. Eventually, the employer that has a high MESC rate will pay that same rate by way of a pass-through to the leasing company because its rate will eventually reach the same level; however, in the short term there may be a savings. MESC rates should be examined carefully to see how the rate has been determined. Often times the leasing company will mark up lower actual MESC rates.

N. ACTUAL CONTROL

The leasing agreements typically provide that the leasing company will employ an agent to oversee the day-to-day management of the leased employees. The ability of a leasing company to control the employees can create havoc in the employment arrangement. On the other hand, if the former employer exercises too much control, the leasing arrangement could be challenged as a tax avoidance scheme or the former employer could be increasing its liability for employee injury or wrongful discharge.

O. SAVINGS IN ADMINISTRATIVE EXPENSE

The employee leasing proposal typically indicates that an employer will save a great deal of money because it will now be doing the payroll and bookkeeping. A close examination of this will indicate that the former employer will not be able to eliminate any administrative expense; certainly the handling of payroll and employee benefits is not a full-time job and usually payroll is handled by outside service companies. To claim that there will be a savings because the leasing company will be assuming these responsibilities is illusory.

P. THE DIFFERENCE BETWEEN INDEPENDENT CONTRACTOR STATUS AND EMPLOYEE LEASING

Some of the same advantages that are proposed by leasing companies can be achieved by subcontracting out certain operations. This eliminates the disadvantages of the leasing arrangement. For example, an employer that has seasonal employees may want to subcontract out that activity whereby another company provides that same service and provides Workers' Compensation and general liability insurance, and indemnifies the employer from any claims arising out of that activity.

Typically, in the subcontract situation payment is made after the services are rendered, complete control over the subcontracting operations is assumed by the subcontractor, and the employees are always the subcontractor's employees. The cost of such an arrangement will be similar to a leasing arrangement inasmuch as the subcontractor will still, in essence, pass through in the subcontract the cost of Workers' Compensation, unemployment taxes, employment taxes, health insurance, administrative expenses and a markup for profit.

This is the ideal arrangement and, of course, has historically been a common practice in business and is agreeable to all insurance companies. Again, it is important that the independent contractor provide evidence of Workers' Compensation and liability insurance with limits equal to what the employer has. If they do not, there could be a double claim.

Q. EMPLOYEE MORALE

A former employer has built up relationships with its employees and, in essence, the former employer is now throwing away those relationships by terminating the employees. This certainly cannot engender goodwill with the employees. This may be reflected in reduced productivity, increased injuries and increased potential for unionization, employee lawsuits against the former employer for injuries, wrongful discharge, sexual harassment, etc.

R. PROBLEMS IN THE EVENT OF DEFAULT BY THE LEASING COMPANY

The leasing arrangement typically provides for a substantial deposit that must be paid by the former employer to be utilized in the event of default by the former employer in paying Workers' Compensation, health insurance premiums, salaries, etc. Of course, the loss of use of this money must be factored into the overall consideration of employee leasing.

Leasing companies typically are service organizations with no significant assets and will not disclose their financial information and will not post a bond to guarantee its performance. They are typically uncollectable in the event of a default. In the event that payments made to the leasing company are not ultimately passed through to the government for tax withholding or to the insurance companies for Workers' Compensation premiums or for health insurance premiums, there is no ability to recover from the leasing company because it has no assets and has not posted a performance bond, etc.

The former employer must then make these payments again and incur the expense of the changeover whereby the former leased employees now return to the fold. The employer must arrange for health insurance, Workers' Compensation insurance at a high modification, and so forth. Any company considering the employee leasing arrangement should insist on complete audited financial information from the leasing company and a performance bond equal to the amount of funds that the leasing company will be holding on its behalf at a minimum.

Another alternative is to require that all payments be made to a third party, such as a trustee for pass-through for taxes and insurance, with its fee for services as the only fee being paid to the leasing company. It is unlikely that a leasing company can comply with this provision, inasmuch as it counts on the float that it holds until it pays the insurance vendors or tax authorities.

In reviewing the lease agreement, careful attention should be paid as to the right of the former employer to terminate the agreement. Many agreements do not allow for termination during the first 12 months.

S. SUMMARY

Employee leasing is a potentially volatile arrangement whereby the former employer incurs a great deal of hidden liabilities and problems as a result of the leasing arrangement. Such an arrangement must be examined very carefully by the employer in conjunction with its attorneys, accountants and insurance counselors. Many of the same savings can be accomplished by utilizing independent contractors or other entities controlled directly or indirectly by the insured.

If an employer insists on an employee leasing arrangement, the following checklist should be used as a guide in negotiating the leasing agreement.

1. Ask for Workers' Compensation documents including a copy of the insurance policy in order to verify the name of the insurance company, the expiration date of the policy, and the rates that are currently being used. This will allow you to predict when the rates are going to change and when the experience modification is going to change. At the same time, ask for a copy of the experience modification worksheet to obtain more information on the experience modification and its anniversary date. This would not necessarily be apparent by looking at the policy itself.
2. Determine what loss control services the insurance company will be offering. Also inquire as to whether or not the Workers' Compensation is with Assigned Risk rates or with an insurance company using its own rates.

3. Obtain an agreement by the Workers' Compensation carrier to waive its rights of subrogation against the former employer. This agreement should be by way of an endorsement to the policy. You could also ask for an alternate employer endorsement on the leasing company's policy in some states.
4. Obtain an agreement from the Workers' Compensation carrier to provide at least 30 days prior written notice in the event of cancellation. Be certain that the word "endeavor" is not used in this notification clause.
5. Obtain a hold harmless agreement from the leasing company that it will hold the client harmless from any liability claims arising out of injury to its employees arising out of the leasing company's actions.
6. Obtain a copy of the liability insurance maintained by the leasing company to be certain that the above stated hold harmless clause will be covered.
7. Be certain that the liability insurance is not written on a claims-made basis.
8. Verify that the liability insurance has limits equal to the limits that the former employer carried and in no event less than \$1,000,000 combined single limit bodily injury, property damage and personal injury.
9. Verify that the liability policy maintained by the leasing company includes "assumed personal injury." Standard liability policies do not cover indemnification for personal injury such as libel, slander, defamation of character, etc.
10. Establish a trust arrangement whereby the Workers' Compensation premiums are either paid directly to the insurance company or paid to a trustee for payment to the insurance company.
11. Obtain an agreement from the Workers' Compensation insurance company for the leasing company that, in the event of a cancellation because of nonpayment by another employer or by the leasing company itself, Workers' Compensation will be rewritten at the same rates for the former employer.

12. In reviewing health insurance, make a determination as to whether the insurance is being written by a standard insurance company or under a self-insured plan. If it is written under a self-insured plan, determine whether or not the fronting insurance company will guarantee the payment of claims even if they are not reimbursed by the leasing company.
13. Determine if there is a pre-existing condition clause for the employees that are being transferred to the leasing company and to any new employees that are being hired.
14. Establish a trust arrangement for payment of the health insurance premiums or make arrangements to pay the premiums directly to the insurance company.
15. Obtain an agreement from the health insurance carrier that, in the event it cancels its coverage for the leasing company, it will rewrite coverage with the same rates and same conditions for the former employer who is re-employing the previously terminated individuals.
16. Obtain an agreement by the health insurance carrier that the benefits that are being provided equal or exceed the benefits that were previously provided by the former employer.
17. Obtain an agreement from the health insurance carrier that, in the event of cancellation, the former employer will receive at least 30 days prior written notice of cancellation.
18. Obtain an agreement from the Workers' Compensation carrier that it will maintain segregated claims information and will provide same upon request of the former employer.
19. Do not agree to a leasing arrangement whereby the former employer agrees to hold the leasing company harmless. Just the reverse should be true: the leasing company should hold the former employer harmless from any claims arising out of injuries to employees or its activities.

20. Obtain an agreement from the leasing company that it will purchase employee benefit legal liability coverage covering mistakes in administering the employee benefit plans covering both the leasing company and former employer.
21. Obtain an agreement from the leasing company that it will maintain wrongful discharge, discrimination, sexual harassment and other employment practices liability insurance with limits of at least \$1,000,000 and preferably higher to insure against such claims that may be made against it by the leased employees. The former employer should be an additional insured.
22. Obtain an opinion from your attorney that all employees are “at will” employees and that any termination by the employer will not result in wrongful discharge claims. In the alternative, obtain an agreement from each of the employees that they consider themselves to be “at will” employees and no promises have been made to them regarding future employment. Another alternative is to obtain a hold harmless from the leasing company holding the former employer harmless from such claims. Such a hold harmless, however, is only as good as the leasing company is collectable.
23. Examine the experience of the supervisor to be designated by the leasing company and the experience of the leasing company itself in performing the administrative tasks required under the leasing agreement. Do they have a computer system? Do they have systems for providing COBRA notifications to terminated employees? Do they have an employee manual that complies with current employment law?
24. Can the leasing arrangement be terminated with minimal notice by the former employer?
25. Will the leasing company agree to either waive its deposit or allow the deposit that is required to be paid to a trustee?
26. Will the leasing company be able to provide a bond to assure performance or to assure payment of its obligations for taxes, etc. under the leasing arrangement?

27. Insist that the leasing company provide an audited financial statement.
28. Make an arrangement for taxes to be paid either directly to the IRS or to be paid to a trustee.
29. Insist that the leasing company provide a fidelity bond covering dishonesty of its employees. Such a bond should cover losses to third parties, such as the former employer, arising out of those acts and should cover embezzlement of money as well as theft of property, fires, vandalism, etc.
30. Examine your employee benefit plan and whether the termination of your employees will result in a depletion of the assets in that plan. Take steps to advise employees of the impact of plan terminations.
31. Examine the potential savings in administrative expenses. Will you, the current employer, be able to reduce the number of employees that you have because a leasing company will be assuming certain administrative responsibilities?
32. Obtain data regarding the Michigan Employment Security Commission tax being paid by the leasing company, a tax that is passed through to the former employer.
33. Examine carefully the reputation of the leasing company and its longevity in business.
34. Consider the timing of the switch to the leasing company to minimize the payroll tax consequences to both employer and employees.
35. Obtain full opinions from your attorney, accountant and insurance advisors regarding the final document before signing.
36. Be certain that you receive Workers' Compensation claims reports monthly showing your loss experience.

Beginning on the next page is an additional checklist to use when considering employee leasing.

EMPLOYEE LEASING CHECKLIST

WORKERS' COMPENSATION

- 1. Ask for Workers' Compensation documents, including a copy of the insurance policy, in order to verify the name of the insurance company, the expiration date of the policy, and the rates that are currently being used. This will allow you to predict when the rates are going to change and when the experience modification is going to change. At the same time, ask for a copy of the experience modification worksheet to obtain more information on the experience modification and its anniversary date. This would not necessarily be apparent by looking at the policy itself.
- 2. Obtain an agreement by the Workers' Compensation carrier to waive its rights of subrogation against the former employer. This agreement should be by way of a waiver of subrogation endorsement to the policy. You should also ask for an Alternate Employer Endorsement on the leasing company's policy.
- 3. Obtain an agreement from the Workers' Compensation carrier to provide at least 30 days prior written notice in the event of cancellation. Be certain that the word "endeavor" is not used in this notification clause.
- 4. Obtain an agreement from the Workers' Compensation insurance company for the leasing company that, in the event of a cancellation because of nonpayment by another employer or by the leasing company itself, Workers' Compensation will be rewritten at the same rates for the former employer.
- 5. Obtain an agreement from the Workers' Compensation carrier that it will maintain segregated claims information and will provide reports on a regular basis. Without this information, it will be difficult to return to standard insurance carriers.
- 6. How do the leasing company's rates compare to the standard market? If substantially higher, has coverage been placed in the Assigned Risk? If substantially lower, have the employees been misclassified?

- 7. Will the leasing company guarantee the classifications used or is this subject to a change at the time of audit retroactively?
- 8. Establish a trust arrangement for payment of Workers' Compensation premiums or have them paid directly to the insurance company or obtain a performance bond.
- 9. Are the Workers' Compensation rates established by the leasing company or by an insurance company? Would this mark-up be approved by state insurance authorities?
- 10. Have you purchased a Workers' Compensation policy covering you as the former employer?

LIABILITY INSURANCE

- 11. Obtain a copy of the liability insurance maintained by the leasing company to be certain that the indemnification agreement will be covered. Obtain an agreement that you will be notified in the event of cancellation.
- 12. Be certain that the liability insurance is not written on a claims-made basis.
- 13. Verify that the liability insurance has limits equal to the limits that the former employer carried and in no event less than \$1,000,000 combined single limit bodily injury, property damage and personal injury.
- 14. Verify that the liability policy maintained by the leasing company includes "assumed personal injury". Standard liability policies do not cover indemnification for personal injury such as libel, slander, defamation of character, etc.
- 15. The former employer should be additional insured on the leasing company's liability policy as respects the leasing company's operations.

16. Verify with your insurance carrier that it knows your employees are leased, that they have covered any indemnification agreement you have made in the leasing agreement in favor of the leasing company, and that it will add the leasing company as additional insured, if that is required, and that it has waived the leased employee exclusion so that tort claims by the leasing company's employees against you as the former employer will be covered.

17. If your liability policy is rated based on payroll, the payroll of the leased employees will be used just as if they are direct employees. The liability insurance rules provide that if payroll is unavailable, 100% of the contract for leased employees will apply. Some leasing companies charge an overall percentage of payroll for the contract amount which is higher than pure payroll. Negotiate a leasing agreement that itemizes payroll.

PROPERTY

18. How will your business interruption coverage respond to maintaining the payroll of your former employees now working for a leasing company in the event of a shut-down caused by a covered loss? Business interruption will not pay the payroll of non-employees unless the leasing agreement is deemed a continuing expense. This requires attention to the provisions of the leasing document to be certain that the payments under the leasing agreement continue to the extent recoverable under business interruption insurance and that employees will continue to be paid.

CRIME

19. How will your employee dishonesty coverage respond to claims resulting from the actions of your former employees? The typical definition of "employee" for employee dishonesty includes "any natural person employed by an employment contractor while that person is subject to your direction and control and performing services for you . . ." The leasing agreement needs to reflect this requirement of direction and control which may negate some of the advantages of leasing. You may also obtain an endorsement to the crime policy which includes leased employees under the definition of employee.

EMPLOYEE BENEFITS

- 20. In reviewing health insurance, make a determination as to whether the insurance is being written by a standard insurance company or under a self-insured plan. If it is written under a self-insured plan, determine whether or not the fronting insurance company will guarantee the payment of claims even if they are not reimbursed by the leasing company.
- 21. Determine if there is a pre-existing condition clause for the employees that are being transferred to the leasing company and to any new employees that are being hired.
- 22. Establish a trust arrangement for payment of the health insurance premiums or make arrangements to pay the premiums directly to the insurance company or obtain a performance bond.
- 23. Obtain an agreement from the health insurance carrier that, in the event it cancels its coverage for the leasing company, it will rewrite coverage with the same rates and same conditions for the former employer when it re-employs the previously terminated individuals.
- 24. Obtain an agreement by the health insurance carrier that the benefits that are being provided equal or exceed the benefits that were previously provided by the former employer.
- 25. Obtain an agreement from the health insurance carrier that, in the event of cancellation, the former employer will receive at least 30 days prior written notice of cancellation.
- 26. Obtain an agreement from the leasing company that it will purchase employee benefit legal liability coverage covering mistakes in administering the employee benefit plans and that the former employer will be an additional insured.
- 27. Examine your employee benefit plans, including pension profit sharing plans, and determine if the termination of your employees will affect the plan and their benefits. Take steps to advise employees of the impact of plan terminations.

EMPLOYMENT PRACTICES

- 28. Obtain an agreement from the leasing company that it will maintain wrongful discharge, discrimination, sexual harassment and other employment practices liability insurance with limits of at least \$1,000,000 and preferably higher to insure against such claims that may be made against it by the leased employees. The former employer should be an additional insured.
- 29. Obtain an opinion from your attorney that all current employees are “at will” employees and that any termination of employees by the employer will not result in wrongful discharge claims. In the alternative, obtain an agreement from each of the employees that they consider themselves to be “at will” employees and no promises have been made to them regarding future employment. Another alternative is to obtain a hold harmless from the leasing company holding the former employer harmless from such claims. Such a hold harmless, however, is only as good as the leasing company is collectable.
- 30. You must send a termination letter to all employees and also negotiate a termination of other than at-will employment contracts.
- 31. You must send COBRA letters to employees just as you would in the ordinary termination situation.

DEPOSITS AND PAYMENTS

- 32. Establish a trust arrangement whereby the Workers’ Compensation and health premiums are either paid directly to the insurance company or paid to a trustee for payment to the insurance company.
- 33. Will the leasing company agree to either waive its deposit or allow the deposit that is required to be paid to a trustee?
- 34. Will the leasing company be able to provide a bond to assure performance or to assure payment of its obligations for taxes, etc. under the leasing arrangement?

- 35. Insist that the leasing company provide an audited financial statement up front and at least annually thereafter.
- 36. Make an arrangement for taxes to be paid either directly to the IRS or to be paid to a trustee.
- 37. Insist that the leasing company provide a fidelity bond covering dishonesty of its employees. Such a bond should cover losses to third parties, such as the former employer, arising out of those acts and should cover embezzlement of money as well as theft of property, fires, vandalism, etc.
- 38. Insist that payroll payments be handled by a third party trustee.

SERVICES

- 39. Determine what loss control services the leasing company or the insurance company will be offering.

INDEMNIFICATION

- 40. Obtain a hold harmless agreement from the leasing company that it will hold you, the client, harmless from any liability claims arising out of injury to employees arising out of the leasing company's actions.
- 41. Do not agree to a leasing arrangement whereby the former employer agrees to hold the leasing company harmless. Just the reverse should be true: the leasing company should hold the former employer harmless from any claims arising out of injuries to employees or its activities.

SYSTEMS

- 42. Examine the experience of the supervisor to be designated by the leasing company and the experience of the leasing company itself in performing the administrative tasks required under the leasing agreement. Do they have a computer system? Do they have systems for providing COBRA notifications to terminated employees? Do they have an employee manual that complies with the Americans with Disabilities Act (ADA)?

NOTICE

- 43. Can the leasing arrangement be terminated with minimal notice and without penalty by the former employer?

ADMINISTRATION

- 44. Examine the potential savings in administrative expenses. Will you, the current employer, be able to reduce the number of employees that you have because a leasing company will be assuming certain administrative responsibilities?

TAXES

- 45. Obtain data regarding the Michigan Employment Security Commission tax being paid by the leasing company, a tax that is passed through to the former employer.
- 46. Consider the timing of the switch to the leasing company to minimize the payroll tax consequences to both employer and employees.

GENERAL

- 47. Examine carefully the reputation of the leasing company and its longevity in business. Does it have multiple entities? If so, why?
- 48. Have your attorney check court records for a history of litigation against the leasing company. Check all related entities.
- 49. Will the termination of your employees and re-hiring by the leasing company create morale problems with your employees?
- 50. Obtain a list of current and former leasing clients to verify satisfaction or lack thereof.
- 51. Do not release information regarding your former employees to the leasing company without the written permission of the employee.

FINAL DOCUMENT

- 52. Obtain full opinions from your attorney, accountant and insurance advisors regarding the final document before signing.
- 53. Does the agreement comply with the guidelines for a “co-employer” arrangement as established by Kidder v. Miller-Davis? If so, this may block tort claims by employees against the former employer.
- 54. By creating a co-employer arrangement, have you negated the tax benefits of going to employee leasing?

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