

SPECIAL REPORT

THE MECHANICS OF WORKERS' COMPENSATION PAYROLL CAPPING IN MICHIGAN

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The Michigan Workers' Disability Compensation Act (the "WDCA") provides employees with payment of medical expenses and wage loss benefits associated with work-related injuries. Any employer subject to the WDCA is required to maintain financial security, such as insurance, to guarantee payment of benefits. Insurance companies determine their premium for Workers' Compensation policies based on an employer's annual payroll. Some states allow insurance companies to cap or otherwise limit individual employee payrolls depending on the employee's position within the organization.

The Compensation Advisory Organization of Michigan (CAOM)¹, is the non-profit corporation responsible for the administration of the Workers' Compensation insurance rating and premium structure for the State of Michigan. The CAOM has established a Basic Manual (the "Manual") in order to standardize Workers' Compensation rating and policy coverage forms. Part One of the Manual includes a number of rules governing premium computation and payroll capping.

The purpose of this Special Report is to review each of the premium capping rules² as well other statutory provisions³ that may effect premium capping efforts within various business and corporate structures.

¹ The "Michigan Workers' Compensation Placement Facility" is a division of the CAOM responsible for administration of the assigned risk Workers' Compensation pool for non-standard workers compensation risks.

² For purposes of this discussion, all CAOM rules are indicated by a double-lined caption

³ For purposes of this discussion, all Michigan statutes are indicated by a single lined caption.

I. PAYROLL CAPPING FOR OFFICERS OF A CORPORATION

As authorized under Rule Nine of the Manual, payroll capping for purposes of premium determination applies to certain officers within a corporation.

MICHIGAN WORKERS' COMPENSATION PLACEMENT FACILITY BASIC MANUAL FOR WORKERS' COMPENSATION AND EMPLOYERS' LIABILITY INSURANCE

PART ONE - RULES

RULE NINE - SPECIAL CONDITIONS OR OPERATIONS AFFECTING COVERAGE AND PREMIUM

* * *

A. EXECUTIVE OFFICERS

1. Definition.

"Executive officers" of a corporation are the President, Vice President, Secretary, Treasurer, any other officer appointed or elected in accordance with the charter or bylaws of the corporation.

2. Law and Status

Executive officers of a corporation are covered under the Workers' Compensation law in Michigan. When executive officers are covered under the law, they have the same status as employees under the policy.

3. Exclusion

An executive officer may elect not to be subject to the law if the corporation has ten or fewer stockholders and the officer owns at least ten percent of the stock. To exclude such officers attach the Standard Partners, Officers and Others Exclusion Endorsement (WC 00 03 08).

4. Premium Determination

Premium for executive officers shall be based on their total payroll, subject to the minimum and maximum payroll limitations found under "Miscellaneous Values" on the rate pages and the requirements of Rule Five. F.

The payroll limitations apply to the average weekly payroll of each executive officer for the number of weeks the officer was employed during the policy period.

5. Assignment of Payroll

Payroll of executive officers shall be assigned to classifications and rates under the rules which apply to employees.

(Emphasis added)

In order to determine which individuals qualify as corporate officers under Rule Nine, we must analyze the enabling provisions within the Business Corporations Act⁴ (the “BCA”).

Officers

The officers of a corporation consist of a president, secretary, treasurer, and, if desired, a chairman of the board, one or more vice-presidents, and such other officers as may be prescribed by the bylaws or determined by the board. Note that the statute does not distinguish between executive officers and non-executive officers.

450.1531 Officers of corporation; ... authority and duties.

(1) The officers of a corporation shall consist of a president, secretary, treasurer, and, if desired, a chairman of the board, 1 or more vice-presidents, and such other officers as may be prescribed by the bylaws or determined by the board. Unless otherwise provided in the articles of incorporation or bylaws, the officers shall be elected or appointed by the board.

* * *

(3) An officer elected or appointed as herein provided shall hold office for the term for which he is elected or appointed and until his successor is elected or appointed and qualified, or until his resignation or removal.

(4) An officer, as between himself and other officers and the corporation, has such authority and shall perform such duties in the management of the corporation as may be provided in the bylaws, or as may be determined by resolution of the board not inconsistent with the bylaws.

(Emphasis added)

⁴ MCL 450.1201 et seq

Assuming that the employee meets the statutory qualification of an officer, the next step is to calculate the payroll cap. The amount of the cap varies by carrier.

The following table indicates the minimum and maximum payrolls for organizations *insured through the Michigan Workers' Compensation Placement Facility* (the "Facility"), sometimes referred to as the insurer of last resort.

Appendix A to this document describes the minimum and maximum payroll amounts for all other standard market insurance companies.

Effective January 1, 2009

MISCELLANEOUS VALUES

Remuneration for Executive Officers and Active Members LLCs:

Minimum \$409

Maximum \$1,500

Remuneration for Spouse of Sole Proprietors - fixed amount:
\$16,700/yr

Remuneration for Partners - fixed amount:
\$16,700/yr

Based on the 2009 values, the payroll figures for an officer of a corporation insured thru the Facility is limited to \$1,500 per week or \$78,000 per year.

In addition to the preliminary qualifications discussed above, employers must also comply with the requirements of Rule Five F regarding payroll limitations.

F. PAYROLL LIMITATION

1. When Payroll Limitation Applies Payroll limitation applies after any deductions of extra pay for overtime.
2. How Payroll Limitation Applies For Executive Officers, Elected

Public Officials (who are treated in the same manner as Executive Officers) athletic teams and traveling carnivals or circuses, the payroll on which premium is based shall exclude that part of the employee's average weekly pay in excess of the applicable weekly limitation, provided:

- a. Books and records are maintained to show separately the total payroll earned by each employee whose average weekly pay for the total time employed during the policy period exceeds the weekly payroll limitation, and
- b. Separate records are maintained in summary by classification for such employees.

3. Partial Week

A part of a week shall be treated as a full week in determining average weekly pay.

4. Executive Officer's Payroll

- a. The remuneration of an executive officer shall not be included with the payroll of the risk for premium computation purposes, provided:

- (1) That such officer is elected for the value of his or her name or because of stock holdings, has no duties, and does not come on the premises, except perhaps to attend director's meetings;
- (2) That such officer ceases to perform any duties and does not come on the premises, except perhaps to attend director's meetings;
- (3) That such officer has been specifically excluded from coverage under the policy by endorsement.

- b. **The remuneration of an executive officer shall be included with the payroll of the risk for premium computation purposes, subject to the minimum and maximum provision of the Basic Manual, provided:**

- (1) That such executive ceases to perform any duties, but nevertheless frequently visits the premises of the risk;
- (2) **That such officer frequently visits the premises of the risk for business conferences, or similar duties, although also an officer or employee of another risk in the operations of which he takes an active interest.**

- c. Under the following conditions, the amount of remuneration of executive officers that shall be included with the payroll of the risk for premium computation purposes, subject to the

minimum and maximum amounts of the Basic Manual, shall be as indicated below:

- (1) Where the officer draws no salary in fact, but a regular salary is credited to him or her on the books, the amount so credited shall be included in the payroll of the risk as his or her remuneration.
- (2) Where the officer draws no salary in fact, but a regular salary is credited to him or her on the books and subsequently charged back to such officer, the amount so credited shall be included in the payroll of the risk as his or her remuneration regardless of such charge-off.
- (3) Where the officer draws no regular salary, but draws such various sums as his or her needs or the conditions of the business dictate, the actual amount drawn shall be included in the payroll of the risk as his or her remuneration.
- (4) Where the officer receives no salary in fact, either drawn or credited, or where the records presented to the auditor fail to disclose the salary, the amount to be included in the payroll of the risk shall be the applicable manual minimum per week.

5. Bonuses

For the purpose of applying the payroll limitation rule, bonuses paid during the policy term shall be considered as earned during the policy term and prorated for the period of employment during the policy term.

* * *

6. Period of Employment

For the purpose of applying the payroll limitation rule, "total time employed during the policy period" of any employee shall be construed as the sum of the portions of all contracts of employment of such employee falling within the policy period.

(Emphasis added)

II. PAYROLL CAPPING FOR LIMITED LIABILITY COMPANY MEMBERS AND MEMBER/MANAGERS

Similar to officers, members and member/managers of an LLC are also eligible for payroll capping for purposes of premium determination. Rule Nine provides as follows:

C. MEMBERS OF LIMITED LIABILITY COMPANIES

Members of limited liability companies are covered under the Workers' Compensation law in Michigan. They have the same status as employees under the policy.

Active *member/managers* of limited liability companies may elect to be excluded from coverage under the Workers' Compensation policy in Michigan provided the total number of members does not exceed ten, and the member/manager owns at least ten percent of the company. Attach the Standard Partners, Officers, and Others Exclusion Endorsement (WC 00 03 08).

If not excluded, the premium for active members of limited liability companies is determined using the same minimum and maximum payroll limitations as for executive officers of corporations. Refer to Rule 9 subparagraph A.] (above)

* * *

(Emphasis added)

The Michigan Limited Liability Company Act⁵ (the MLLCA") defines both members and managers for purposes of an LLC as follows:

450.4102 Definitions.

"Manager" or "managers" means a person or persons designated to manage the limited liability company pursuant to a provision in the articles of organization stating that the business is to be managed by or under the authority of managers.

"Member" means a person who has been admitted to a limited liability

⁵ MCL 450.4101 et seq

company as provided in section 501, or, in the case of a foreign limited liability company, a person who is a member of the foreign limited liability company in accordance with the laws under which the foreign limited liability company is organized.

(Emphasis added)

A. Member

Under the MLLCA, a member of an LLC can be appointed in a number of ways. In order to qualify for the payroll cap, the member must satisfy one of the following statutory elements:

450.4501 Members; admission; liability for acts, debts, or obligations.

- (1) A person may be admitted as a member of a limited liability company in 1 or more of the following ways:
- (a) In connection with the formation of the limited liability company, by signing the initial operating agreement.
 - (b) After the formation of the limited liability company, in 1 or more of the following ways:
 - (i) In the case of a person acquiring a membership interest directly from the limited liability company, by complying with the provisions of an operating agreement prescribing the requirements for admission or, in the absence of provisions prescribing the requirements for admission in an operating agreement, upon the unanimous vote of the members entitled to vote.
 - (ii) In the case of an assignee of a membership interest, as provided in section 506.
- (2) A limited liability company *may* admit a person as a member who does not make a contribution or incur an obligation to make a contribution to the limited liability company.
- (3) Unless otherwise provided by law or in an operating agreement, a person who is a member or manager, or both, of a limited liability company is not liable for the acts, debts, or obligations of the limited liability company.

(Emphasis added)

B. Member/Manager

The MLLCA also allows members to act as managers. These individuals are referred to in the rules as “member/ manager.”

The member/manager enabling statute provides as follows:

450.4401 Management vested in members.

Unless the articles of organization state that the business of the limited liability company is to be managed by managers, the business of the limited liability company shall be managed by the members, subject to any provision in an operating agreement restricting or enlarging the management rights and duties of any member or group of members. If management is vested in the members, both of the following apply:

- (a) The members are considered managers for purposes of applying this act, including section 406 regarding the agency authority of managers, unless the context clearly requires otherwise.
- (b) The members have, and are subject to, all duties and liabilities of managers and to all limitations on liability and indemnification rights of managers.

Members can be appointed as managers in one of the following ways:

450.4402 Managers; delegation; qualifications; number; notice of delegation.

- (1) The articles of organization may provide that the business of the limited liability company shall be managed by or under the authority of 1 or more managers. The delegation of the management of a limited liability company to managers is **subject to any provision in the articles** of organization or in an operating agreement restricting or enlarging the management rights and duties of any manager or group of managers.
- (2) An operating agreement may prescribe qualifications for managers, including a requirement that the managers be members.
- (3) The number of managers shall be specified in or fixed in accordance with an operating agreement.

(4) If the articles of organization delegate management of a limited liability company to managers, the articles of organization constitute notice to third parties that managers, not members, have the agency authority described in section 406.

450.4403 Managers; selection;...

(1) A vote of a majority in interest of the members entitled to vote in accordance with section 502(1) is required to select managers to fill initial positions or vacancies.

* * *

(Emphasis added)

It is important to note that LLC payroll capping only applies to members. A manager of an LLC, that is not a member, is not eligible for the payroll cap. By way of example, assume that an LLC is entirely owned by one individual, thus there is only one member. Further assume that this LLC has appointed a number of individual managers to head up certain departments and run the day to day operations of the company (similar to vice-presidents of a corporation). Under the current rules, these LLC managers are not eligible for premium capping. Assuming the employee satisfies the requirements of either a member or member/manager of the LLC, the employer may then apply the payroll capping benefit as defined in Subsection A of the Rules.

III. PAYROLL CAPPING FOR PARTNERSHIPS

Partners of a partnership are covered by the WDCA and eligible for payroll capping as defined in the table of Miscellaneous Values for that particular insurance carrier.

D. PARTNERS

The partners of a partnership, whether general, limited or limited liability, are covered under the policy. They may be specifically excluded by endorsement. Attach the Standard Partners, Officers, and Others Endorsement (WC 00 03 08).

The fixed amount of payroll to be used for a partner is found under "Miscellaneous Values" on the rate pages. A partner who is inactive

in the operations of the business and who does not come on the premises of the insured shall not be included in the premium base for the employer.

Payroll of partners shall be assigned to classifications and rates under rules which apply to employees.

(Emphasis added)

IV. PAYROLL CAPPING FOR SOLE PROPRIETORS

Although sole proprietors are not covered by the WDCA, their spouses, parents and children are covered. Of these, the spouse of the sole proprietor is the only individuals eligible for payroll capping as defined in the table of Miscellaneous Values for that particular insurance carrier.

E. SOLE PROPRIETORS

An employer who is a sole proprietor is not covered by the policy. The spouse of a sole proprietor who is regularly employed on a full-time basis having a specified rate of pay is covered by the policy. Parents and children of a sole proprietor are also covered by the policy.

However, the spouse, parents, and children of a sole proprietor may be specifically excluded by endorsement. Attach the Standard Partners, Officers, and Others Endorsement (WC 00 03 08).

When the spouse is not excluded from coverage, a fixed payroll amount is used as the premium base for that spouse. The amount of this fixed payroll is found under "Miscellaneous Values" on the rate pages.

Payroll for spouses, children, and parents of sole proprietors shall be assigned to classifications and rates under rules which apply to employees.

(Emphasis added)

V. CONCLUSION

An analysis of payroll capping in Michigan requires an understanding of the applicable statutes governing business organization as well as the relevant portions of the CAOM Basic Manual and rules. Depending on the details of the business structure, articles of incorporation, and/or bylaws, employees may or may not be eligible for payroll capping for purposes of premium determination.

In order to avoid unanticipated increases in premium as a result of an insurance company's payroll audit, we encourage policyholders to review the details of their business structure to ensure that all payroll caps are being applied appropriately.

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