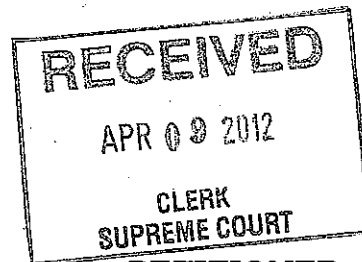


COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2012-SC-000008
WCB NO. 2008-96697



UNINSURED EMPLOYERS FUND

PETITIONER

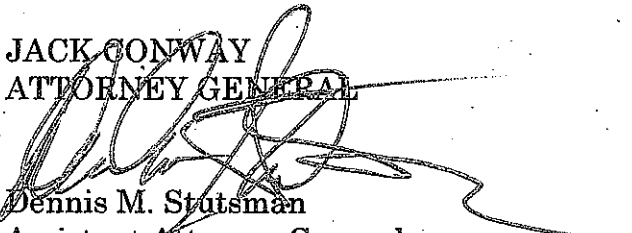
v. **UNINSURED EMPLOYERS' FUND
PETITION FOR REVIEW**

JULIAN HOSKINS;
FOUR STAR TRANSPORTATION, INC.;
BETTER INTEGRATED SERVICES, INC.;
BEACON ENTERPRISES, INC.;
KENTUCKY EMPLOYERS' MUTUAL INSURANCE;
WORKERS COMPENSATION BOARD;
And HON. R. SCOTT BORDERS, ALJ

RESPONDENTS

Respectfully submitted,

JACK CONWAY
ATTORNEY GENERAL


Dennis M. Stutsman
Assistant Attorney General
Uninsured Employers' Fund
1024 Capital Center Drive, Suite 200
Frankfort, Kentucky 40601-8204
502-696-5321

CERTIFICATE OF SERVICE

This is to certify that the foregoing has been mailed to the following on
this the 9th day of April 2012.

Workers Compensation Board
Department of Workers' Claims
657 Chamberlin Avenue
Frankfort, Kentucky 40601

Honorable Barry Lewis
P. O. Box 800
Hazard, Kentucky 41702

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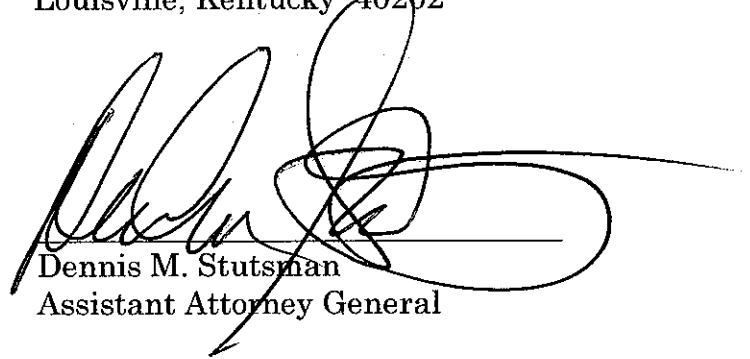
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Honorable Terrance J. Janes
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Honorable R. Scott Borders
Administrative Law Judge
8120 Dream Street
Florence, Kentucky 41042

Honorable Alan Rubin
231 South Fifth Street, Suite 200
Louisville, Kentucky 40202



Dennis M. Stutsman
Assistant Attorney General

INTRODUCTION

This case concerns the Workers Compensation Board's reversal of the ALJ's determination that the evidence in the record supported a finding that Kentucky Employers' Mutual Insurance is the carrier on the risk for the injuries sustained by Julian Hoskins working for Four Star Transportation through KEMI's insured, Beacon Enterprises, Inc., an employee leasing company.

STATEMENT CONCERNING OTHER LITIGATION

The UEF represents that there is no other litigation between the parties other than this appeal.

STATEMENT CONCERNING ORAL ARGUMENT

The UEF does not request oral argument.

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STATEMENT OF THE CASE

Beacon Enterprises, Inc. ("Beacon") is an employee leasing company insured by KEMI to lease, inter alia, drivers to trucking companies operating in Louisville Kentucky under a policy beginning November 1, 2005. KEMI Policy, Exhibit No. 1, Jeremy Terry Deposition. Beacon shared common ownership and business relationships with Better Integrated Systems, Inc. ("Better").

Better and Beacon had a written operating agreement effective January 1, 2006 and continuing annually thereafter whereby Better leased employees to Beacon. Jeremy Terry Dep., Ex. No. 73; Sal Manzo Dep., Ex. 3. Effective the same date, Beacon had an agreement to lease employees to Better. Sal Manzo Dep., Ex. 4. Effective the same date, Beacon had a written operating agreement to lease employees from Beacon to Four Star Transportation. Garavaglia Dep., Ex. 1. Salvatore Manzo testified that Beacon leased Julian Hoskins from its sister company, Better, and in turn leased Mr. Hoskins to Four Star Trucking as a driver. Manzo deposition, p. 38-9; 45.

Beacon, on the date of injury alleged by Mr. Hoskins, January 31, 2008, was insured for workers compensation purposes by KEMI Policy No. 342470, originally issued on November 1, 2005, and renewed on November 1, 2006 and November 1, 2007 through November 1, 2008. The original policy Schedule of Named Insureds and Workplaces listed Beacon Enterprises, 3001 Chamberlain, Louisville, Kentucky 40241. Notably, 3001 Chamberlain, Louisville, Kentucky 40241 was the business address for Beacon Enterprises' original Kentucky client, Rush Trucking, and not Beacon Enterprises.

KEMI had actual knowledge that Beacon and Better were related companies and that Beacon sought listing of Better as an additional insured on such policy. See Terry Dep., Ex.11, KEMI General Supplemental Application; ERM-14, dated 10/17/2005; Terry Dep., Ex. 35, Email exchange from Sandra Gulick, October 3, 2006 through November 30, 2006.

Further, from the outset of issuance of the policy on November 1, 2005, KEMI knew that Beacon did not have a business presence or employees in Kentucky other than leased employees working from the business location of its original sole lessee, Rush Trucking, which Beacon sought to insure. See Terry Dep., Ex. 14, KEMI New Business Worksheet Review. Nonetheless, the policy was issued with a general endorsement, Schedule of Named Insureds and Workplaces effective on November 1, 2005 identifying Beacon Enterprises at the business address of its then sole lessee, Rush Trucking, i.e., 3001 Chamberlain, Louisville, KY 40241.

Renewal of the policy on November 1, 2006 resulted in coverage for Beacon at a second location effective November 30, 2006, namely 2305 Ralph Avenue, Suite 1, Louisville, Kentucky (the same address as Four Star Trucking). The record does not reflect any attempt by KEMI to determine the nature of Beacon's operations at this second location. In December 2006, KEMI's audit indicated actual knowledge by KEMI that Beacon had "new clients operating in Louisville...both are trucking companies. Contact was unsure how to predict the annual payroll generated from these clients." Terry Dep. Ex. 38, KEMI Premium Audit December 2006 Worksheet, Special Notes or Instructions, Auditor Chadley Ladd, Underwriter M. Huff. That audit

included the Workers Compensation claims experience of Better in auditing and assessing the risk underwritten for Beacon. Better's claims history is also included in the KEMI underwriting file as Terry Dep. Ex. 39.

Following this disclosure by Beacon, and presumably without further inquiry by KEMI into the identity or nature of these two additional clients of Beacon (since no documents were provided documenting any such inquiry between December 20, 2006 and November 1, 2007), the policy was renewed for third year on November 1, 2007. Notably, the risk insured by KEMI increased effective November 1, 2007 as the policy noted an increase in payroll from \$2,000,000 to \$5,073,459, and an annualized premium increase from \$299,635.62 to \$749,001.72. Presumably, this increase was a result of Beacon's expansion to two lessee clients in Kentucky, as the named insured and workplace policy endorsement reflected Beacon Enterprises continuing to operate at Rush Trucking's 3001 Chamberlin Avenue, Louisville, Kentucky address and additionally, identified Beacon Enterprises as continuing to be insured at the address of Four Star Trucking, i.e., 2305 Ralph Avenue, Suite 1, Louisville, Kentucky. Policy No. 342470, effective 11/01/07 through 11/01/08.

On February 13, 2008 (and following the date of alleged injury of Julian Hoskins) KEMI Underwriter William Underwood corresponded with Beacon claiming surprise that Beacon was leasing employees to other entities than Rush Trucking. This correspondence began KEMI's after-the-fact attempt to create a record denying responsibility for the risk it knew it insured, but had failed to diligently investigate after renewing Beacon's policy at an increased rate until KEMI began receiving claims

under the policy.

The ALJ found credible the uncontroverted evidence that Beacon leased employees to Four Star, and that Beacon also used an employee leasing arrangement with Better to handle Beacon's payroll. The Board reversed the ALJ's fact finding, and applied the common law "loaned servant" doctrine, without reference to or analysis of KRS 342.615, to conclude that as a matter of law, the evidence upon which the ALJ relied could not serve as competent evidence since Hoskins never knew he worked for Better in order to be "loaned" to Four Star through Beacon.

The Board further found that there was no substantial evidence to support the ALJ's conclusion that KEMI's policy insuring Beacon as an employee leasing company at the same location from which Four Star operated afforded coverage on this claim. It thus reversed the ALJ and determined that Hoskins was merely an employee of the uninsured Four Star Trucking¹. The Kentucky Court of Appeals affirmed this relevant holding of the Board.

¹ The Board opinion also addressed an issue of sanctions it believed the ALJ should have assessed for witness behavior in deposition testimony, remanding with instructions for the ALJ to follow to address this conduct. The Court of Appeals reversed the Board on this issue, finding the matter to be within the discretion of the ALJ. The UEF takes no position on this issue and does not contest the Court of Appeals' resolution of it.

ARGUMENT

SUBSTANTIAL EVIDENCE SUPPORTS THE ALJ'S FINDING THAT PLAINTIFF SUSTAINED A COMPENSABLE INJURY AS AN EMPLOYEE LEASED TO FOUR STAR TRUCKING BY BEACON ENTERPRISES, INC. AS INSURED BY KEMI.

Since KEMI was unsuccessful in convincing the ALJ to rely on its proof, the question on appeal is whether the evidence compels a finding in KEMI's favor. Wolf Creek Collieries v. Crum, 673 S.W.2d 735 (Ky. App. 1984). Compelling evidence is defined as evidence that is so overwhelming, no reasonable person could reach the same conclusion as the ALJ. REO Mechanical v. Barnes, 691 S.W.2d 224 (Ky. App. 1985).

The ALJ, as fact finder, has the sole discretion to determine the quality, character, and substance of the evidence. Square D Company v. Tipton, 862 S.W.2d 308 (Ky. 1993). An ALJ may draw reasonable inferences from the evidence, reject any testimony, and believe or disbelieve various parts of the evidence, regardless of whether it comes from the same witness or the same adversary party's total proof. Jackson v. General Refractories Co., 581 S.W.2d 10 (Ky. 1979); Caudill v. Maloney's Discount Stores, 560 S.W.2d 15 (Ky. 1977).

Although a party may note evidence that could have supported a different outcome than that reached by the ALJ, such proof is not an adequate basis to reverse on appeal. McCloud v. Beth-Elkhorn Corp., 514 S.W.2d 46 (Ky. 1974). The Board, as an appellate tribunal, may not usurp the ALJ's role as fact finder by superimposing its

own appraisals as to the weight and credibility to be assigned to the evidence or by noting other conclusions or reasonable inferences that could have been drawn from the evidence. Whittaker v. Rowland, 998 S.W.2d 479 (Ky. 1999). So long as the ALJ's ruling with regard to an issue is reasonable under the evidence, it may not be disturbed on appeal. Special Fund v. Francis, 708 S.W.2d 641 (Ky. 1986).

A.

The Workers Compensation Board and Court of Appeals Erred as a Matter of Law in Applying the Common Law "Loaned Servant" Doctrine to Exclude Evidence of an Employee Leasing Arrangement.

In reversing the ALJ, the Board essentially impermissibly reweighed the evidence and substituted its opinion of the credibility and weight of the evidence for that of the ALJ. In doing so, the Board purported to rely on Larson's Workers' Compensation Law Sections 67.01 through 67.03 to conclude that as a matter of law, no "lent employee" relationship could exist and thus none of the evidence proffered by Beacon could legally constitute "substantial evidence" upon which the ALJ could rely.

The Board, however, did not discuss Larson's Section 67.05[3] which notes:

The closest cases are those in which the business of the general employer consists largely of the very process of furnishing equipment and employees to others [footnote omitted]...

If, however, the general employer merely arranges for labor without heavy equipment, the majority of the cases hold that the worker becomes the employee of the special employer, although there is substantial contra authority [footnote omitted]...Incidentally, most of these cases arose in the contest of summary judgment motions against injured workers who were attempting to sue the borrowing

employer in tort. [footnote omitted] Note, finally that some jurisdictions may address this whole question by statute. [footnote omitted] (emphasis added).

Thus, the critical legal issue of interpreting Kentucky's statute governing employee leasing companies and the allocation of responsibility was not addressed by Board in its determination that the ALJ was legally not permitted to rely on competent evidence produced by Beacon in reaching a decision regarding insurance coverage. Four Star Trucking leased its employee drivers. As a lessee employer, Four Star Trucking is entitled to satisfy its obligation to secure Workers Compensation coverage by leasing employees from an employee leasing company ("lessor") which has such coverage. KRS 342.615(4).

KRS 342.375 further provides that "[e]very policy or contract of workers' compensation insurance under this chapter, issued or delivered in this state, shall cover the entire liability of the employer for compensation to each employee subject to this chapter, except..." (exceptions not applicable herein, emphasis added). Salvatore Manzo testified that Beacon leased Julian Hoskins from its sister company, Better Integrated Systems, Inc., and in turn leased Mr. Hoskins to Four Star Trucking as a driver. Manzo deposition, p. 38-9; 45. This testimony is not controverted and provides sufficient evidence to support the ALJ's finding of fact.

Further, KEMI had actual knowledge that Beacon and Better Integrated Services, Inc. were related companies and that Beacon sought listing of Better Integrated Services, Inc. as an additional insured on such policy.

The Board (and the Court of Appeals in affirming the Board) placed substantial emphasis on Hoskins' testimony that he did not know anything about Beacon or Better, only knew that he worked for Four Star, and did not understand why his paycheck included initials consistent with Better. Accordingly, applying traditional common law notions of "loaned servant", they concluded that Hoskins had to know he was being loaned to a second or third employer. This analysis would be correct if the facts were different.

Specifically, KRS 342.615 (as noted by Larson) statutorily addressed two different loaned servant circumstances: employee leasing companies and temporary help service[s]. In the context of a temporary service, the Board and Court of Appeals analysis is accurate. An unemployed person knowingly applies for work with the temporary service (for example, "Manpower"), anticipating that through the temporary service s/he will be placed (loaned) to a second employer. However, the typical employee leasing arrangement is merely a matter of contract between employers to allocate "employment responsibilities among two (2) or more entities." KRS 342.616(1)(d). Because this method is often the manner of securing payroll and benefits services for the benefit of an employer which lacks the expertise or ability to obtain workers compensation insurance directly, the employee in these situations does not have knowledge of these arrangements. KRS 342.615(4). Often, the only knowledge the employee has (as did Hoskins in this case) is that his/her payroll and/or benefits do not bear the identifying information of the direct employer for whom s/he works.

This Court has recognized the two separate sets of employment circumstances covered by 342.615:

“Although KRS 342.615(4) may permit a leased employee to be viewed as being the lessee’s employee rather than the employee leasing company’s employee, KRS 342.615(5) does not permit a temporary employee to be viewed as being the client’s employee. Hudson clearly was a temporary worker rather than a leased employee and KRS 342.316(5) clearly required him to be considered Labor Ready’s employee rather than Mid-America’s employee.”

Labor Ready, Inc. v. Johnston, 289 S.W.3d 200, 207 (Ky. 2009).

Here, the evidence clearly supports a leased employee situation. KEMI knew from the outset of insuring Beacon that Beacon was an employee leasing company with first one, then additional clients operating in Kentucky. Hoskins’ paystub supports the testimony regarding the leasing arrangement between Beacon, Better and Four Star.

Unlike a temporary agency employee, a trucking company employee like Hoskins where (for the convenience of the employer and to secure payroll and benefits services including workers compensation insurance for the employee) would not knowingly enter into a contractual relationship with any entity other than Four Star Trucking. Had Hoskins been curious and asked why his paycheck did not say “Four Star Trucking”, he might have learned of the employee leasing arrangement permitted under KRS 342.615, but the law does not require him to be so inquisitive nor does it render uninsured every trucking or construction employee whose employer avails itself of the opportunity to secure workers compensation insurance through an employee leasing company.

B.

The Board Usurped the Fact Finding Function of the ALJ in Concluding that No Substantial Evidence Supported the ALJ's Finding that KEMI's Coverage of Beacon Extended to Four Star Trucking

Renewal of the policy on November 1, 2006 resulted in coverage for Beacon at a second location effective November 30, 2006, namely 2305 Ralph Avenue, Suite 1, Louisville, Kentucky (the same address as Four Star Trucking). In December 2006, KEMI 's audit indicated knowledge by KEMI that Beacon had "new clients operating in Louisville...both are trucking companies". Contact was unsure how to predict the annual payroll generated from these clients." Following this disclosure by Beacon, and without further inquiry by KEMI into the identity or nature of these two additional clients of Beacon (since no documents were provided documenting any such inquiry between December 20, 2006 and November 1, 2007), the policy was renewed for its third year on November 1, 2007.

The Board adopted KEMI's argument that characterized as a "misrepresentation" of the evidence the assertion that this circumstantial evidence permitted a reasonable inference that KEMI knew that Beacon was leasing employees to Four Star. In support, the Board in its substitution of its judgment for that of the ALJ, chose to rely on KEMI's representative's testimony that it did not insure "locations" but rather "business entities." While this may technically be correct, from the outset KEMI insured Beacon doing business as a known employee leasing company at the address of its insured, Rush Trucking (i.e., 3001 Chamberlin Avenue, Louisville,

Kentucky) without the prior filing of an EL-2, and without identifying "Rush Trucking" as the lessee insured on the Schedule of Named Insured.

The Board asserts that when the policy was amended 14 months before Mr. Hoskins' injury to add a second "risk location" there is no evidence in KEMI's underwriting file directly identifying that location to KEMI as that of Four Star Trucking. However, there is likewise no evidence in the record identifying that additional risk location as some second location for Rush Trucking. As the finder of fact, it is the ALJ's (and not the Board's) discretion to draw reasonable inferences from the record to conclude whether such circumstantial evidence supports a conclusion that KEMI knew it was insuring leased employees from Beacon to Four Star after KEMI learned that Beacon had new clients in Louisville, increased the premium due to increased payroll from Beacon, and added another risk location to the policy without requiring proof of any EL-2. While there may be alternate inferences which the ALJ might have drawn, the Board is not permitted to substitute its judgment regarding those inferences for that of the ALJ.

Notably, the risk insured by KEMI increased effective November 1, 2007 as the policy noted an increase in payroll from \$2,000,000 to \$5, 073,459, and an annualized premium increase from \$299,635.62 to \$749,001.72. Presumably, this increase was a result of Beacon's expansion to two lessee clients in Kentucky, as the named insured and workplace policy endorsement reflected Beacon Enterprises continuing to operate at Rush Trucking's 3001 Chamberlin Avenue, Louisville, Kentucky address and additionally, identified Beacon Enterprises as continuing to be

insured at the address of Four Star Trucking, i.e., 2305 Ralph Avenue, Suite 1, Louisville, Kentucky. Policy No. 342470, effective 11/01/07 through 11/01/08.

An insurer may not treat a policy as valid for collecting a premium and invalid for purposes of paying an indemnity. Spurlin v. Ranier, 457 S.W.2d 491 (Ky. 1970). Here, KEMI knew from the outset of issuing WC Policy No. 342470 in November 2005 that it was insuring an out-of-state employee leasing operation for long haul trucking operations conducted through lessee clients in Kentucky, and where Beacon did not have a business presence in Kentucky. It audited the policy holder once and increased its payroll (and adjusted its premium) from \$1,500,000 to \$2,000,000. It audited the policy holder a second time and determined that "two new clients" would be operating in Kentucky after December 2006, noting two separate Kentucky business operations in the 2006-7 policy. KEMI apparently conducted no further investigation regarding these new clients but renewed the policy for a third year on November 1, 2007, again listing a second Louisville business location, and vastly increasing the premium it collected to cover KEMI's risk. While producing no documents relating to this assessment, apparently KEMI was satisfied that this premium increase covered its exposure until such time as it elected to conduct further inquiry or otherwise audit its policy holder.

C.

Kentucky Law Does Not Permit Voiding a Workers Compensation Policy as the Remedy for Failing to Register an Employee Leasing Company with the Commonwealth.

While it may appear to the Board that it is unfair for the Kentucky legislature and the Commissioner through administrative regulation to have failed to provide adequate consequential remedies for the failure of an employee leasing company to comply with the requirements of KRS 342.615 and 803 KAR 25:230, it is not the purview of the Board to remedy such oversight. KEMI's remedy, whether its exposure is higher than it anticipated either through the negligence of its own underwriters in failing to adequately investigate the identity of Four Star Trucking and the number of employees leased by its insured Beacon to Four Star Trucking, or as it asserts, as a result of the misrepresentation or fraudulent acts concealing the full extent of the exposure by Beacon, is to assess retroactive premiums and/or seek contribution from its insured, Beacon. See, e.g., U.S. v. Simpson, 538 F.3d 459, 466-9 (6th Cir. 2008). As noted by the U.S. Court of Appeals for the Sixth Circuit in its survey of Kentucky statutory and Workers Compensation caselaw, KEMI's lawful remedy is NOT to accept premiums and deny coverage as if it never carried any risk in this matter, and shift the expense on the Kentucky Uninsured Employers Fund.

Instead, KEMI could have refused to renew the policy when its audit disclosed additional unknown clients of Beacon whose payroll its auditor acknowledged Beacon had difficulty in quantifying. Id. at 469. Instead, KEMI renewed the policy but

chose to increase the premium. KEMI might have elected to seek an award of restitution for claims paid on a fraudulently obtained policy. KRS 342.310(2) Or it might have attempted to obtain the payment of the unpaid premiums.

KEMI has relied throughout this claim on its assertion that it does not have exposure until its insured complies with 803 KAR 25:230 and files appropriate EL-1 and EL-2 forms. However, the regulation itself does not absolve carriers of legal responsibility for policies issued by carriers to cover leased employees in Kentucky as a result of any failure to comply with the regulation by the insured. Further, the record does not reflect that KEMI ever provided notice of this requirement to Beacon until after the claim for this injury when it decided that it faced a greater risk that it believed it had assessed in the policy renewal and premium quote. In fact, Jeremy Terry admitted that the policy was initially issued without the filing of an EL-1 or EL-2 with KDWC, as those forms were returned to its insured with instructions to file them with KDWC after the policy was issued. Terry Dep. p. 23. Notably that communication to KEMI's insured did not communicate that any future coverage would be contingent upon a previously filed EL-1 or EL-2 forms pursuant to 803 KAR 25:230. Terry Dep. Exh. 26.

Further, following KEMI's discovery in the December 2006 audit that Beacon had two additional trucking company clients in Louisville the record does not contain any communication from KEMI to Beacon requesting proof of the filing of any EL-1 or EL-2 forms (as it does not contain any request for the identity of the clients). Rather the record reflects that the policy was ultimately renewed with an additional

location from which Beacon conducted its employee leasing business in Louisville, Kentucky (which matched the business address of Four Star Trucking, as the previous policies had reflected Beacon's address at its original client, Rush Trucking's, business location).

Consequently, any failure of Beacon to comply with 803 KAR 25:230 may result in sanctions by the KDWC against Beacon, but has no legal effect regarding KEMI's liability on the policy it issued. Had KEMI chosen to determine that Beacon had failed to adequately provide, consistent with the regulation, sufficient evidence for it to determine an experience modification factor for each lessee, KEMI might have elected to not renew the policy on November 1, 2007. Having elected to renew the policy at an increased premium, however, KEMI cannot now remedy its own negligence by avoiding liability pursuant to a policy it issued for injury to an employee in the class of risk it insured who it had reason to know was working through its insured for a trucking company (Four Star) at a known location in Louisville, Kentucky when it renewed the policy.

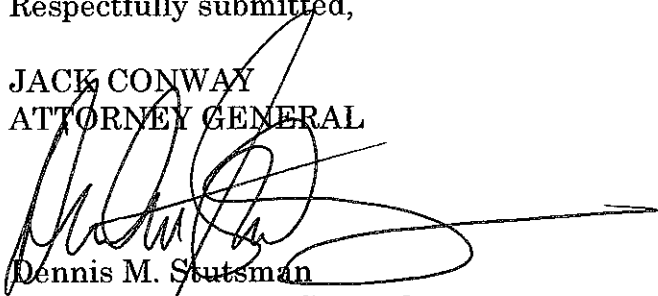
CONCLUSION

Sufficient evidence supports the ALJ's findings of fact and subsequent conclusion as a matter of law that Beacon Enterprises, Inc., as insured by KEMI on the date of alleged injury, is responsible for any claim determined to be compensable by Julian Hoskins, leased from Better to Beacon to Four Star Trucking. Accordingly, the decision of the Court of Appeals affirming the Board's substitution of its evaluation of the evidence for that of the ALJ on the issues of employment relationship and

insurance coverage should be reversed, with directions to affirm the opinion and award issued by the ALJ.

Respectfully submitted,

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APPENDIX

INDEX

1. Opinion, Order and Award of Administrative Law Judge R. Scott Borders dated December 17, 2010.
2. ALJ Order on Petition for Reconsideration dated January 11, 2011.
3. Workers' Compensation Board Opinion Reversing in Part and Remanding dated June 23, 2011.
4. Kentucky Court of Appeals Opinion Affirming In Part and Vacating in Part dated December 9, 2012
5. KEMI Auditor's Note Dated December 21, 2006 (Jeremy Terry Dep. Ex. No. 38)
6. Better Integrated Systems NCCI Workers Compensation Experience Rating 1/1/2006 and 1/1/2007, KEMI Underwriting file (Jeremy Terry Dep. Ex. No. 39)
7. KEMI Policy No. 342470 Endorsement Schedule of Named Insureds and Workplaces, 11/1/2007 (Jeremy Terry Dep. Ex. No. 43)
8. KEMI Policy No. 342470 General Endorsement Changing Premium from \$299,635.62 to \$749,001.72, dated 6/2/2008 eff. 11/1/2007 (Jeremy Terry Dep. Ex. No. 43)