Three Workers' Compensation Mistakes Small Businesses with Independent Contractors Can Avoid

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Many business owners assume that once they've purchased a workers' compensation policy, they've adequately managed their risk.

Unfortunately, some of the most significant exposures arise not from the absence of insurance, but from misunderstandings about who is covered, whether independent contractors are properly classified, and whether coverage remains in place when an injury occurs. A workplace injury can quickly lead to disputes over worker status, insurance responsibility, and employer liability.

The good news is that many of these risks are preventable. A few proactive steps can significantly reduce your company's legal and financial exposure.

Don't Assume Your Independent Contractors Have Workers' Compensation Coverage

Many businesses hire independent contractors with the expectation that the contractor is responsible for maintaining their own workers’ compensation insurance.

That assumption can become costly.

If a contractor is injured and does not maintain valid workers' compensation coverage, the hiring business may face more than a dispute over insurance obligations. In some cases, the injured worker may contend that he or she was actually an employee rather than an independent contractor. If a state’s Workers' Compensation Commission agrees, the business may become responsible for a workers' compensation claim despite having treated the individual as an independent contractor. The business may also face additional insurance premiums, audits, and scrutiny regarding worker-classification practices.

Just as importantly, insurance status and worker classification are separate issues. A signed independent contractor agreement and a contractor's certificate of insurance do not necessarily determine whether the individual will be treated as an independent contractor under a state’s workers' compensation law. When evaluating workplace injuries, agencies and commissions often look beyond labels and examine the actual working relationship, including the degree of control exercised by the hiring entity.

Businesses should periodically evaluate contractor relationships to ensure the classification remains defensible and consistent with day-to-day operations.

Build a Process to Verify and Continuously Monitor Coverage

Insurance verification should be an ongoing process, not a one-time administrative task.

Many businesses obtain a certificate of insurance when a contractor is first engaged and never look at the file again. Months later, the policy may have expired without anyone noticing.

Consider implementing a standard contractor onboarding and renewal process that includes:

- Obtaining current proof of workers' compensation coverage, including declarations pages or other documentation confirming active coverage
- Collecting certificates of insurance for applicable policies
- Recording policy effective and expiration dates
- Calendaring renewal dates and requesting updated documentation before policies expire
- Requiring contractors to notify your business if coverage is cancelled or allowed to lapse
- Periodically auditing contractor files to confirm documentation remains current

Verifying coverage before work begins is an important first step, but it should not be the only step. Businesses should also periodically evaluate whether the contractor relationship is structured and administered in a manner consistent with independent contractor status. An expired policy creates risk, but so does a contractor relationship that may not withstand scrutiny if an injury occurs.

Workers' compensation should not be reviewed in isolation. Where appropriate, contractor agreements should also require commercial general liability coverage naming your business as an additional insured. While workers' compensation policies generally do not provide additional insured status in the same manner, verifying both types of coverage helps create a more comprehensive risk-management program.

Contracts Matter, Too

Insurance verification works best when paired with well-drafted contractor agreements.

Depending on your business and industry, contracts should address insurance requirements, require contractors to maintain coverage throughout the engagement, obligate them to provide updated proof of insurance upon renewal, require notice of any lapse or cancellation, and include appropriate indemnification provisions where legally appropriate.

While strong contracts are important, they do not guarantee that a worker will be treated as an independent contractor following an injury. Courts and administrative agencies generally examine the substance of the relationship rather than the title used in the agreement. For that reason, businesses should view a contractor agreement as just one component of a broader compliance strategy.

Don't Overlook Owner Coverage Elections

Another frequently overlooked issue involves business owners themselves.

Whether an owner is automatically covered under a workers' compensation policy, or may exclude themselves from coverage, often depends on the state law’s requirements, the company's legal structure, and the owner's role. Depending on the state, sole proprietors, corporate officers, LLC members, and partners may be treated differently.

As your business grows or ownership changes, it is worth confirming that your insurance policy accurately reflects your intentions.

At least annually, review:

- Whether owners are currently included in the policy
- Whether any available elections or exclusions have been properly completed
- Whether changes in ownership or business structure require updates to your coverage

A short annual review can help prevent misunderstandings after a workplace injury.

A Five-Minute Annual Compliance Check

Once a year, ask yourself:

- Have I verified that every contractor currently maintains workers' compensation coverage
- Do I have current declarations pages or other proof of active coverage on file
- Am I tracking policy renewal dates
- Do my contractor agreements require continuous insurance coverage
- Have I confirmed appropriate commercial liability insurance and additional insured endorsements where applicable
- Have I reviewed whether owner coverage elections still reflect my business structure
- Have I evaluated whether each independent contractor relationship remains properly classified
- Are my managers treating contractors differently from employees in day-to-day operations
- Would the facts of the relationship support independent contractor status if reviewed by my state's Workers' Compensation Commission

If any answer is "no," now is the time to update your procedures. Not after someone gets hurt.

In sum, workers' compensation risk management with your independent contractors is more than just collecting certificates of insurance. Businesses should verify contractor coverage, maintain current insurance documentation, periodically review worker classifications, and use carefully drafted agreements that align with actual business practices. Taking these steps can help reduce the risk of unexpected workers' compensation liability, classification disputes, insurance audits, and related litigation.