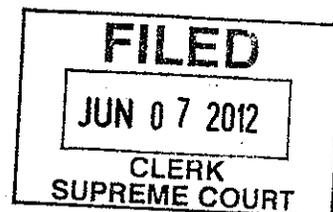


COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2012-SC-000008
DWC No. 08-96697



UNINSURED EMPLOYERS' FUND

PETITIONER

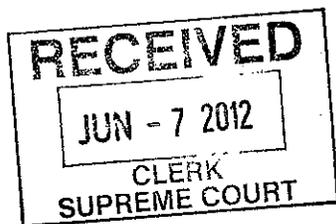
VS.

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

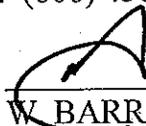
RESPONDENTS

BRIEF OF THE APPELLEE,
KENTUCKY EMPLOYERS' MUTUAL INSURANCE

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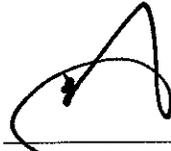


BY:


W BARRY LEWIS

CERTIFICATE OF SERVICE

I hereby certify that on June 6, 2012, the original and nine copies of this Brief were delivered via regular mail to Ms. Susan Stokley Clary, Clerk, Kentucky Supreme Court Room 235 Capitol Bldg, 700 Capitol Avenue, Frankfort, KY 40601-3415; and copies were served via regular mail on Hon. Dennis Stutsman, Counsel for Uninsured Employers' Fund, 1024 Capital Center Drive, Frankfort, Kentucky 40601; Hon. Alan S. Rubin, Counsel for Julian Hoskins, 231 S. Fifth Street, Suite 200, Louisville, Kentucky 40202; Hon. Terrance J. Janes, Counsel for Beacon Enterprises, Inc. and Better Integrated Systems, Inc. P.O. Box 52, Hopkinsville, Kentucky 42241-0052; Four Star Transportation, Inc., 2305 Ralph Avenue, Suite 1, Louisville, Kentucky 40216, the Workers' Compensation Board, Appeals Branch, Department of Workers' Claims, Prevention Park, 657 Chamberlain Avenue, Frankfort, Kentucky 40601; and Hon. R. Scott Borders, ALJ, Department of Workers' Claims, 8120 Dream Street, Florence, Kentucky 41042.



W. BARRY LEWIS

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STATEMENT CONCERNING ORAL ARGUMENT

The Appellee does not believe that oral argument before the Court is necessary.

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THE RULINGS OF THE BOARD AND THE COURT OF
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COUNTERSTATEMENT OF THE CASE

KEMI does not accept the statement of facts contained in the Petition for Review of the Uninsured Employers' Fund. The following facts are necessary, in the view of KEMI, for a full review of the record in resolution of the issues on appeal.

Julian Hoskins (hereinafter "Hoskins") testified that he was hired by Four Star Transportation, Inc. (hereinafter "Four Star") on or about November 2, 2007, and that he was injured on January 31, 2008. Hoskins depo., May 28, 2009, p. 4-5. He testified that he was a truck driver, and applied for a job after seeing a "Help Wanted" sign at 2305 Ralph Avenue in Louisville, Kentucky. Id., p. 6. Hoskins testified that Four Star operated out of a large truck terminal occupying about two acres, and that there were approximately 100 truck drivers employed by Four Star during the time he was employed. Id., p. 7. He was supervised by an individual named Sean Green.

Hoskins testified that he never contracted with or even heard of Better Integrated Systems, Inc. (hereinafter "Better Integrated"). Id., p. 15. Hoskins also testified that he never contracted with Beacon Enterprises or Beacon Industrial Staffing. Id., p. 25. Hoskins testified that he was unaware that he was being leased from Better Integrated to Beacon Enterprises or to Four Star Transportation. Id., p. 26. Hoskins testified that his paychecks were not from Beacon Enterprises. Transcript of Hearing, October 19, 2010, Exhibits 1 and 2.

Joe Peters (hereinafter "Peters"), the Coverage Branch Manager of the Department of Workers' Claims (hereinafter "DWC"), testified that Four Star Transformation was operating without workers' compensation insurance on the date of Hoskins' January 31, 2008 injury. DWC records show that on January 15, 2006, Beacon Enterprises filed an EL-1 with the DWC, and an EL-2 indicating it was sending or leasing employees to Rush Trucking Company. Peters deposition, Exhibits 1 and 2. Peters explained that an EL-1 Form is an employee leasing company registration form which a leasing company must file if it is doing business in Kentucky. The EL-2 Form is to inform the state where the employee leasing company is sending employees. The only EL-2 filed with the state by Beacon Enterprises prior to Hoskins' injury was the EL-2 dated January 15, 2006, which notified the state and all interested parties that Beacon Enterprises was sending employees to Rush Trucking Company, of 3001 Chamberlin Lane, Louisville, Kentucky.

Peters testified that Better Integrated did not file an EL-1 registration with the state until April 25, 2008. Peters depo., Exhibit 6. This was the first EL-1 filed by Better Integrated in Kentucky. Peters also testified that it was not until April 25, 2008 that Beacon Industrial Staffing filed an EL-1. Peters depo., Exhibit 3. That EL-1 indicated Beacon Industrial had the same address as Beacon Enterprises and Better Integrated. The owners of Beacon Industrial were listed as follows:

Vincent Manzo - 25.5%

Rosaria Manzo - 25.5%

Salvatore Manzo – 49%

Also Beacon Enterprises and Beacon Industrial Staffing have different federal identification numbers.

Peters stated the first EL-2 from Better Integrated and Beacon Industrial was filed on April 25, 2008, which was several months after Hoskins' accident. Peters depo., Exhibit 4. Peters testified that on May 15, 2008, the DWC received another EL-1 from Beacon Industrial which listed the same three owners but indicating the worker's compensation insurance carrier was Amerisure Mutual Insurance. Peters depo., Exhibits 5 & 7. Peters testified that on June 13, 2008, the department received an EL-2 from Beacon indicating it was leasing employees to Four Star. Peters depo., Exhibit 8.

On July 20, 2009, the deposition of Charles L. Garavaglia (hereinafter "Garavaglia") was taken. Prior to the deposition, the ALJ, over KEMI's objections, permitted Garavaglia to be present at the depositions of other witnesses the same day. Garavaglia stated he was the designated representative of both Beacon Enterprises and Better Integrated. However, Garavaglia is not an employee of either Better Integrated or Beacon Enterprises. Garavaglia depo., pps. 8-9. Garavaglia testified he is the owner and representative of C & G Consultants, Inc. He described his business as a consulting firm, dealing with "labor issues, insurance issues, civil rights complaints, Department of Labor complaints, unemployment complaints, et cetera." Garavaglia testified that he was an outside "consultant" to numerous companies which have the initials "BIS", he was not an employee of any of them. Garavaglia asserted

that Hoskins was the subject of a series of leasing transfers in Kentucky. *Id.*, p. 18. Garavaglia's testimony was that there was a tripartite transaction, sending Plaintiff from (1) Better Integrated to (2) Beacon Enterprises to (3) Four Star Transportation.

Salvatore Manzo (hereinafter "Salvatore") testified that he is the director of operations for Beacon Industrial, and that he owns Beacon Enterprises. The business address for both is 51332 Oro Road, Shelby Township, Michigan. Beacon is a Nevada corporation, Rosaria Manzo is the president, Salvatore is the Secretary, and Vincent Manzo is the treasurer. Salvatore testified his father is Vincent Manzo (hereinafter "Vincent"). Salvatore believed he is also the president of Beacon Industrial. Salvatore testified Four Star Transportation is a client of Beacon. Salvatore testified that Hoskins became an employee after Better Integrated came to him indicating Four Star was expanding in Kentucky and needed Beacon to "handle those Kentucky people" in late 2007. He alleged that a decision was then made for Beacon Enterprises to accept the lease of employees from Better Integrated. Salvatore indicated the documentation of this arrangement was a contract between Better Integrated and Beacon, but this was never provided in the record.

Salvatore testified that the way the arrangement worked was that Hoskins became an employee of Better Integrated, a Nevada corporation, and was leased to Beacon Enterprises which leased him to Four Star. He explained Beacon only became involved with Hoskins and Four Star "when the Kentucky operation began" in late 2007. However, when asked about whether Beacon Enterprises paid Hoskins, Salvatore testified:

Q. And the pay of Julian Hoskins was that on a bank account of Beacon Enterprises, Inc.?

A. No.

Q. It was on some other company's payroll account with the bank?

A. Not on a company's payroll account. But it was on our paying agent's account.

Q. This guy Julian Hoskins says that he starts work for these people, whether it be Four Star or Better, in the fall of 2007, approximately.

A. Okay.

Q. He said that his paychecks kept coming in with the name Better on them. Is that the way it went?

A. Yes.

Q. So Beacon Enterprises, Inc. did not do the payroll to the plaintiff Julian Hoskins?

A. Not that I'm aware of.

Sal Manzo depo., p. 40; Transcript of Hearing, October 19, 2010, Exhibits 1 and 2. Salvatore testified Hoskins was paid by Better Integrated, and somehow Beacon Enterprises made a profit by leasing Hoskins to Four Star. He stated once "payroll and taxes and everything else were calculated, we would invoice." Better Integrated "would do the same" and it would derive money off Beacon's portion.

Vincent Manzo testified that he is associated with Better Integrated. It was not until April 17, 2008 that a Certificate of Authority was filed by Better Integrated with the Kentucky Secretary of State's office. Vincent Exhibit 2. On April 25, 2008 an EL-1 was filed by Better Integrated. Exhibit 2. Vincent testified he is not familiar with an EL-1 or an EL-2; and that he did not know who prepared and filed the EL-2. Vincent testified Hoskins was originally leased from Better Integrated to Four Star. He stated that Hoskins was in Kentucky and working out of Kentucky he was "transferred into the Beacon Enterprises

account.” Vincent testified that Better Integrated leased Hoskins to Beacon Enterprises, and Beacon Enterprises then leased Hoskins to Four Star. He did not know if an EL-2 had been filed indicating Beacon was leasing employees to Four Star prior to Hoskins’ date of injury. He acknowledged Better Integrated wrote Hoskins’ paychecks, and Beacon Enterprises had no check writing duties.

When asked the number of employees Four Star had at the Kentucky terminal, Vincent testified: “Again, Kentucky was a very small operation. He probably had five to ten people working out of Indiana working in Kentucky. They were domiciled in Indiana.” He also denied Better Integrated ever had an operation in Kentucky before the Hoskins accident. Hoskins was originally employed by Better Integrated and leased directly to Four Star. That changed when Four Star told him it was starting an operation in Kentucky. He explained that meant he had to have “coverage in Kentucky for Better Integrated.” Vincent testified since “he” had coverage for Beacon, in order to protect himself, his employees, and his clients, “we arranged” a lease where Beacon would “lease to Four Star these Kentucky employees.”

Jeremy Terry, underwriting manager of KEMI, testified that Beacon Enterprises is KEMI’s policyholder. KEMI issued three policies to Beacon Enterprises covering the period of time from November, 2005 through November, 2008. Better Integrated Systems is not and never was a KEMI policyholder. Terry depo., April 19, 2010, p. 15, p. 20. Attempts by Better Integrated Systems to obtain coverage through KEMI were rejected on three different

occasions including as recently as January 25, 2008, some six days before Plaintiff's January 31, 2008 accident. Terry depo., p. 15; Ex. 37, Ex. 45, and Ex. 47.

Terry was informed that six days later Hoskins was injured. Terry indicated, prior to Hoskins' injury, KEMI was unaware Beacon Enterprises was sending people to Four Star. KEMI had never heard of Four Star Transportation until then. KEMI was only aware of Beacon Enterprises' employee leasing to Rush Trucking.

Terry reiterated Peters' testimony about the significance of EL-1 and EL-2 forms for the insurance carrier of a leasing company. The EL-2 is significant because it provides the list of clients to which a company is leasing employees. He explained in order for Four Star to have been provided workers' compensation coverage it would have to be registered by a client with an EL-2. The only EL-2 which was received by KEMI from Beacon was for Rush Trucking. Terry depo., Exhibit 12.

In regard to the 2305 Ralph Avenue, Louisville, Kentucky, address, Terry explained KEMI did not provide coverage for a specific address. Rather, it provided coverage for "the named insured of the policy" which "is not specific to a particular address." Terry further explained "it is specific to the employees of that particular named insured."

Terry testified that KEMI had audited Beacon. Terry depo., Exhibit 71. In determining Beacon's premium, KEMI never used the payroll of Better Integrated, only Beacon Enterprises' payroll. Likewise, KEMI never used the claims experience information of Better Integrated. Terry was asked about a payroll increase of Beacon Enterprises from

approximately two million to over five million dollars. Terry explained that Beacon Enterprises' payroll had been under-reported, and in conducting the audit of the 2006 to 2007 policy period, KEMI only used the earnings or wages of Beacon Enterprises' employees. No premium charges were assessed or made to Beacon Enterprises based upon payroll or any information from Better Integrated or Beacon Industrial.

Terry testified that Better Integrated never had coverage with KEMI prior to Hoskins' accident. In fact, KEMI was not aware of the arrangement between Better Integrated, Beacon Enterprises and Four Star Transportation until after Hoskins' injury. Further, KEMI did not have any EL-1's or EL-2's indicating any leasing arrangement was ongoing.

Summary of Decisions Below

The Workers' Compensation Board reversed the administrative law judge's (ALJ's) determination that Kentucky Employers' Mutual Insurance (KEMI) was the insurance carrier at risk for injuries sustained by Hoskins in the course of his employment with Four Star Transportation, Inc., and, consequently, the Kentucky Uninsured Employers' Fund (UEF) was held statutorily liable for paying Hoskins' benefits. On December 9, 2011, the Court of Appeals affirmed. The UEF again appeals.

ARGUMENT

THE RULINGS OF THE BOARD AND THE COURT OF APPEALS ARE SUPPORTED BY SUBSTANTIAL EVIDENCE AND ARE IN ACCORDANCE WITH LAW, AND MUST BE AFFIRMED.

The issue in this appeal is whether KEMI had workers' compensation insurance coverage for a Four Star Transportation employee, Hoskins. The advent of employee leasing companies and the complexities such businesses bring to the traditional employer/employee relationship led the General Assembly to enact KRS 342.615. The statute defines employee leasing, the employing unit, the relationships between business, and the criteria for determining workers' compensation insurance coverage for employees. The statute states, in relevant part, as follows:

(1) As used in this section:

(a) 'Employee leasing company' or 'lessor' means an entity that grants a written lease to a lessee pursuant to an employee leasing arrangement.

(b) 'Lessee' means an employer that obtains all or part of its workforce from another entity through an employee leasing arrangement.

(c) 'Leased employee' means a person performing services for a lessee under an employee leasing arrangement.

(d) 'Employee leasing arrangement' means an arrangement under contract or otherwise whereby the lessee leases all or some of its workers from an employee leasing company. Employee leasing arrangements include, but are not limited to, full-service employee leasing arrangements, long-term temporary arrangements, and any other arrangement which involves the allocation of employment responsibilities among two (2) or more entities. For purposes of this section, 'employee leasing arrangement' does not include arrangements to provide temporary workers.

...

(2) A corporation, partnership, sole proprietorship, or other business entity which acts as an employee leasing company shall register with the executive director in the manner as prescribed by administrative regulations.

(3) Any lessor of employees whose workers' compensation insurance has been terminated within the past five (5) years in any jurisdiction due to a determination that an employee leasing arrangement was being utilized to avoid premiums, taxes, or assessments otherwise payable by lessees shall be ineligible to register with the executive director or to remain registered, if previously registered.

(4) A lessee shall fulfill its statutory responsibility to secure benefits for leased employees under this chapter by purchasing and maintaining a standard workers' compensation policy approved by the executive director of the Office of Insurance. A lessee may fulfill that responsibility by contracting with an employee leasing company to purchase and maintain the required insurance policy. In either event, it shall be the responsibility of the lessee to maintain in its files at all times the certificate of insurance, or a copy thereof, evidencing the existence of the required insurance. The exposure and experience of the lessee shall be used in determining the premium for the policy and shall include coverage for all leased employees.

The statute sets forth the legal requirements that must be followed in an employee leasing arrangement. The Kentucky DWC enforces the statute through administrative regulations contained in 803 K.A.R. 25:230. The statute gives Kentucky Department of Workers' Claims officials the authority to implement and enforce its regulations. The regulations state, in relevant part, as follows:

KRS 342.260 requires the executive director to promulgate administrative regulations necessary to implement the provisions of KRS Chapter 342. KRS 342.615 requires the executive

director to promulgate an administrative regulation to establish the manner of regulation for an employee leasing company with the executive director. This administrative regulation establishes the manner in which an employee leasing company shall register with the executive director.

Section 1. Registration.

(1) To be eligible to conduct business in Kentucky, a corporation, partnership, sole proprietorship, or other business entity which provides staff, personnel or an employee to be employed in this state to a business pursuant to a lease arrangement or agreement shall register with the executive director in the manner established in this section of the administrative regulation. The registration shall:

(a) Be on form EL-1, Employee Leasing Company Registration Form;

(b) Be filed with the Division of Security and Compliance, Kentucky Office of Workers' Claims; and

...

c. Applicant shall:

(i) Notify the executive director of a change in the information provided in the registration; and

(ii) Provide information regarding workers' compensation coverage of a leased employee within ninety (90) days of approval on Form EL-2.

...

Section 2. Lessee Information Form.

An employee leasing company shall file a Lessee Information Form, Form EL-2, for each Kentucky lessee for whom the company or a related entity provides the workers' compensation insurance coverage. The form shall:

(1) Be:

- (a) Filed within ninety (90) days of the initial registration of the employee leasing company;
- (b) Updated every six (6) months; and
- (c) Considered filed upon receipt of the form at the Division of Security and Compliance, Kentucky Office of Workers' Claims; and
- (2) Include the:
 - (a) Name of the employee leasing company and the lessee;
 - (b) Address of the principal place of business of the lessor and the address of each office it maintains within this state;
 - (c) Lessor's taxpayer or employer identification number;
 - (d) Effective date of the workers' compensation coverage, the policy number, and the name of the issuer of the policy; and
 - (e) Termination of coverage date.

The employee leasing statute creates a co-employment relationship between the employee leasing company and the client. The relationship involves a contractual allocation and sharing of employer responsibilities between the employee leasing company and the client. The employee leasing company becomes the administrative employer and the client becomes the day-to-day employer. The client retains supervision for the day-to-day activities and responsibilities of running its business, while the employee leasing company assumes many of the responsibilities for human resources. The employee is an employee of the employee leasing company and is assigned to work at the client's location.

The facts of Hoskins' case in no way satisfy the legal definition of a leased employee contained in the statute or under applicable law. Beacon Enterprises never recruited Hoskins, hired Hoskins, paid Hoskins, or assigned him to a registered client's workforce. Hoskins testified that he had never even heard of Beacon Enterprises. The Kentucky DWC regulates Kentucky employee leasing companies. Employee leasing companies generally provide the

services such as payroll administration, payment of employment taxes; and reporting, collecting and depositing withholding and other employment taxes with state and federal authorities. Beacon Enterprises did not provide any of these services in this case to Hoskins.

Further, a written employee leasing form, the EL-2, must document the terms of an employee leasing arrangement. No such EL-2 existed in this case. There was no employee leasing agreement in this case that restated specific statutory language contained in the Kentucky Revised Statutes. Although there were allegations and testimony about alleged employee leasing, there really was no such agreement at all. In its brief, the UEF, like the ALJ's opinion in this matter, points to no evidence indicating that Hoskins ever formed a contract of hire with Beacon Enterprises. No one can find any such evidence, as no such evidence exists.

Beacon Enterprises was an employee leasing company registered in Kentucky, and it had a workers' compensation insurance policy with KEMI. On the contrary, Better Integrated was a business apparently located in Michigan. If Better Integrated really is an employee leasing concern, it was not registered with the Commissioner of the Department of Workers' Claims as required by KRS 342.615 and that statute's enabling regulations. For that reason, Better Integrated was not even eligible to conduct employee leasing business in Kentucky.

Despite the undisputed fact that Better Integrated was not registered with the Commissioner as required by statute, the UEF asserts that Better Integrated was the first link

in a three business employee leasing transaction that should be recognized by this Court. The UEF contends that Better Integrated leased Hoskins to KEMI's policyholder, Beacon Enterprises. If this was true, it was in violation of 803 KAR 25:230 Section 1(1). The UEF then asserts that Beacon Enterprises leased Hoskins to Four Star Transportation. If this was true, it was in violation of 803 KAR 25:230 Section 2. The testimony upon which the UEF's arguments are predicated is neither credible nor probative nor supported by any documentary evidence. There was no contract of employment between Hoskins and Beacon Enterprises.

A. Hoskins Never Entered into a Contract of Hire with Better Integrated or Beacon Enterprises.

There was no documentary or written evidence of any of the purported employee leasing arrangement. While Garavaglia indicated a billing document might exist that described the lease of Hoskins from Better Integrated to Beacon Enterprises, no such documents were ever introduced as evidence. Hoskins testified that he had no idea these businesses had leased him to and from each other. It is undisputed that if the testimony from Beacon Enterprises' designated representative was true, it violated every important provision of 803 KAR 25:230. There was a default in the payment of compensation due to the failure of Hoskins' employer, Four Star Transportation, to provide insurance or security as required by K.R.S. 342.615. The UEF therefore was properly assigned liability to pay income and medical benefits for the injured employee. K.R.S. 342.760.

The record established no employer-employee relationship, or special employer-special employee relationship between Hoskins and KEMI's policyholder, Beacon

Enterprises. The UEF, in its appeal, advances the employee leasing arrangement described by testimony. In an effort to escape liability for Hoskins' claim against his uninsured employer, the UEF argues in this appeal that substantial evidence supported the original decision of the ALJ below, and that the Board and the Court of Appeals took on the ALJ's role as fact finder by superimposing their own appraisals of the weight and the credibility to be assigned to the evidence. Appellant's Brief, pps. 5-6. However, as the Board remarked, the testimony about employee leasing of Hoskins was nothing more than a sham concocted to obtain workers' compensation coverage for Hoskins' injury.

In rendering a decision, KRS 342.285 grants an ALJ as fact finder the discretion to determine the quality, character, and substance of evidence, Square D Co. v. Tipton, 862 S.W.2d 308 (Ky. 1993). This was not a routine case of conflicting expert medical opinion evidence. The testimony asserting there was employee leasing of Hoskins produced the effects of fraudulent action. The standard of review of a decision of an administrative agency is centered on the issue of arbitrariness, due to the state constitution's prohibition against arbitrary actions. Com. Transp. Cabinet Dept. of Vehicle Regulation v. Cornell, 796 S.W.2d 591, 594 (Ky. App. 1990). This Court only reverses an administrative agency's decision "if the agency acted arbitrarily or outside the scope of its authority, if the agency applied an incorrect rule of law, or if the decision itself is not supported by substantial evidence in the record." Lindall v. Kentucky Retirement Systems, 112 S.W.3d 391, 394 (Ky.

App.2003). Due to the ALJ's failure to implement and enforce Kentucky law, the original ruling was properly reversed by the Board.

Accordingly, where an ALJ's finding is unsupported by substantial evidence and ignores the law, it is well within the province of the Board and the Court of Appeals to reverse. Due to the complete absence of any substantial evidence establishing that Hoskins ever attained the status of a leased employee, the decisions of the Board and the Court of Appeals were proper. Hoskins' testimony and all the documentary evidence establishes he was hired by Four Star Transportation. Hoskins testified that he had no contract of hire, much less even any knowledge of, Better Integrated or Beacon Enterprises. Hoskins testified that he was employed by and paid by Four Star Transportation. Signs at the trucking terminal where he worked were those of Four Star Transportation. Hoskins testified that he never entered into a contract of hire with Four Star Transportation as his second or third employer. Hoskins testified that he never even knew anything about the allegations of Better Integrated and Beacon Enterprises. The record established that Hoskins had only one employer, Four Star Transportation.

The scheme in this appeal was that Better Integrated leased Hoskins to Beacon Enterprises, which then leased Hoskins to Four Star Transportation. While the UEF promotes the legitimacy of this scheme, it simply was not believable. It was a pretense invented to obtain workers' compensation insurance coverage from KEMI, which had workers' compensation insurance coverage for one of the three businesses involved in this

case, none of which was Hoskins' employer. The Board and the Court of Appeals have held the record is absent any evidence to support a finding that KEMI had workers' compensation coverage for Beacon Enterprises that would provide insurance coverage for Hoskins' injury. Citing the record, the Board held the alleged transaction involving Hoskins was a sham and that KEMI's policy for Beacon Enterprises did not provide coverage for Hoskins' injury.

The reasons reversal was required were first, there was no written evidence establishing leasing of Hoskins by Beacon Enterprises. Second, the Board noted that Better Integrated and Beacon Enterprises were in violation of applicable Kentucky statutory and regulatory provisions regarding employee leasing. Third, it is uncontradicted that KEMI gave notice to Better Integrated on three separate occasions that it would not provide insurance coverage. All KEMI insurance policies, and all documents in KEMI's underwriting file, were made a part of the record. It is undisputed that Four Star Transportation and Better Integrated were never KEMI policyholders.

Mr. Terry explained that policyholder premium was calculated by multiplying Beacon Enterprises' payroll against the work classification. Payroll is the first element in the formula for determining the insurance premium. Beacon Enterprises never paid Hoskins. Beacon Enterprises never filed the required official EL-2 form with the Kentucky Department of Workers' Claims documenting leasing of employees such as Hoskins to Four Star Transportation. Terry explained the significance of the EL-1 and EL-2 forms to the workers' compensation insurance carrier of an employee leasing company. The EL-2 is crucial,

because it provides the insurance carrier with the list of clients to which a policyholder is leasing employees. Terry testified that in order for Hoskins' employer, Four Star Transportation, to have been provided workers' compensation coverage through KEMI, it would have to be registered by Beacon Enterprises with an EL-2. The only EL-2 in this case was for Rush Trucking, not Four Star Transportation. Terry depo., Exhibit 12. Mr. Terry testified that prior to Hoskins' injury, KEMI was unaware Beacon Enterprises was sending any employees to Four Star Transportation. He testified that KEMI had never heard of Four Star Transportation until after Hoskins' accident. KEMI was only aware that Beacon Enterprises was leasing employees to Rush Trucking, the only company that had an EL-2.

Additionally, Hoskins testified that his paychecks were not issued by KEMI's policyholder, Beacon Enterprises. Hoskins' pay stub, attached to his deposition as Exhibit 1, contained the following information: "Paying Agent For: Better Integrated Systems, Inc." Hoskins testified he had "never heard of" or "ran across" Beacon Enterprises. The only time he saw the name Better Integrated was on his pay stub. He was never aware nor had he been consulted about being leased from Better Integrated to Four Star Transportation. He also testified he had no contact of any kind with Better Integrated or Beacon Enterprises. Thus, it would have been impossible for KEMI to discover this scheme in audits since KEMI's policyholder, Beacon Enterprises, never paid Hoskins.

Despite the absence of the documentary evidence of Hoskins' leasing, or the required official EL-1 and EL-2 forms for this alleged lease, the UEF continues to seek relief from

liability, hoping this Court will sanction the scheme concocted below to obtain insurance. No one every produced any documentary evidence of the leasing transaction, because it never happened. The state had no forms documenting this leasing transaction. Better Integrated was even not legally authorized to operate in Kentucky as a leasing company since it had no EL-1. Beacon Enterprises was not legally authorized to lease Hoskins to Four Star Transportation as it filed no EL-2. Better Integrated, not KEMI's policyholder Beacon Enterprises, paid Mr. Hoskins.

Unless this Court holds that Garavaglia's testimony was binding on the Board, the UEF cannot prevail in this appeal. This Court should not permit such a result. Joe Peters, the insurance coverage branch manager of the Kentucky Department of Workers' Claims, testified that Four Star Transportation was an uninsured employer on the date of Hoskins' January 31, 2008, injury. The state's records establish that on January 15, 2006, Beacon Enterprises filed an EL-1 with the Department of Workers' Claims. Peters depo., Exhibit 1. On that same date, Beacon also filed an EL-2 indicating it was leasing employees to Rush Trucking Company. Peters depo., Exhibit 2. Mr. Peters testified that leasing to Rush Trucking was the only leasing activity registered with the state involving Beacon Enterprises prior to Hoskins' accident date.

On or before Hoskins' accident date, the state had no documentation of the alleged tripartite employee leasing. Mr. Peters testified that Better Integrated had no EL-1 on file registering it as a leasing company in Kentucky until April 25, 2008, several months after

Hoskins' accident. Peters also testified that it was not until June 13, 2008, approximately six months after Hoskins' accident, when the DWC received an EL-2 from Beacon Enterprises indicating it was leasing employees to Four Star Transportation. Peters depo., Exhibit 8.

Therefore, since Hoskins was not even aware he was an employee of Better Integrated, he never entered into a contract of hire with Better Integrated or Beacon Enterprises. The Board and the Court of Appeals properly held that no evidence exists to support the ALJ's finding that Hoskins had an employment relationship with Beacon Enterprises. As such, the Board and the Court of Appeals would have been remiss if they did not reverse.

In its brief, the UEF argues that the Board and the Court of Appeals erroneously found it significant that Hoskins did not know about his alleged leasing. Appellant's brief, p. 8. This argument is preposterous for several reasons. The fact that Hoskins knew nothing about the sham compelled a finding that Hoskins was never leased in the first place. Second, the fact that Hoskins knew nothing about it is the hallmark of a fraud concocted after the injury to obtain insurance coverage that was not provided. Hoskins' lack of knowledge of being a party to a contract is powerful evidence of the fraud that was attempted below. Hoskins' pay stub was a part of the record. Hoskins depo., June 16, 2009, Exhibit 1. In addition to providing the relevant financial information, the stub also contained the following information: "Paying Agent For: Better Integrated Systems, Inc." The documentary evidence that Beacon Enterprises did not furnish Hoskins' payroll was an important fact regarding

employment status. The fact that Hoskins did not even know about his being leased in particular provided additional proof that entitled the Board to find that there was no purported leasing contract.

Thus, the UEF's continued argument that there was an employment relationship between Hoskins and Beacon Enterprises can prevail only if this Court determines there was a true employment relationship between the parties. The testimony about leasing of Hoskins was deceitful, and never supported by any documentary evidence. The Board found that there were many facts in the record concerning the work relationship which diverged from the allegations of the Manzos and Garavaglia. While the UEF, in its brief, wishes the Board had upheld the ALJ's decision that Hoskins was an employee of Beacon Enterprises, the Board was entitled to hold that the testimony about a leasing agreement was a sham that did not describe or represent the true intentions and expectations of Hoskins. There was an attempt below to portray a false picture as to the real employment relationship, and the Board put a stop to it.

Further, any contract of employment would be invalid for lack of consideration because Beacon Enterprises did not pay Hoskins. There was no actual transfer of the payroll liability to Beacon. Therefore, there was no legally recognizable lease of Hoskins from Better Integrated to Beacon Enterprises, or from Beacon Enterprises to Four Star. Contrary to the UEF's arguments, Hoskins was not an employee of Beacon Enterprises. Hoskins' pay stubs prove it. Since Hoskins was not paid by Beacon Enterprises, Hoskins could not have

been leased by Beacon Enterprises to Four Star Transportation. Since KEMI's policyholder, Beacon Enterprises, never even paid Hoskins, KEMI had no liability.

B. The Board and the Court of Appeals acted within authority in reversing the ALJ.

KRS 342.285 confers authority upon the Board to review the decision of an ALJ, and to ensure that it conforms to the provisions of the Act. In order to carry out this duty, the Board is obligated to determine whether an ALJ acted without or in excess of his or her powers, and whether or not the decision is clearly erroneous on the basis of the evidence contained in the record, or whether the decision is arbitrary, capricious, or characterized by an abuse of discretion. Brasch-Barry General Contractors v. Jones, 175 S.W.3d 81 (Ky. 2005).

In reviewing Workers' Compensation Board decisions, the function of the Court of Appeals is to correct the Board where it perceives that the Board has overlooked or misconstrued controlling statutes, or committed an error in assessing the evidence so flagrant as to cause gross injustice. Western Baptist Hospital v. Kelly, 827 S.W.2d 685, 687-88 (Ky. 1992). Moreover, an ALJ's decision can only be affirmed if it is supported by substantial evidence under a correct interpretation of the law. Sweeney v. King's Daughters Med. Ctr., 260 S.W.3d 829, 830 (Ky. 2008).

The Board and the Court of Appeals properly held that the ALJ's opinion was not supported by such evidence in this instance. In its brief, the UEF makes the argument that the Board "re-weighed the evidence and substituted its opinion for that of the ALJ."

Appellant's Brief, p. 6. This was not a case involving conflicting expert medical opinion evidence. Rather, there was a dispute as to the genuineness of testimony about a contract that was never produced. The focus of the Board in such a case would by necessity involve examining all the relevant evidence. The Board carefully reviewed and recited all the evidence of record in an extensive decision. The Board concluded that nothing supports the ALJ's puzzling determination that Hoskins was a leased employee. Further, nothing supports the determination that KEMI had insurance coverage for the benefits that were awarded in this case.

The Board pointed out that the ALJ's award was supported by no evidence of substance, which is among the Board's functions. See Snowder v. Stice, 576 S.W.2d 276, 279 (Ky. App. 1979). In the context of a workers' compensation claim, "it is the responsibility of the ALJ to determine whether a violation of a statute or administrative regulation has occurred." Brusman v. Newport Steel Corporation, 17 S.W.3d 514, 520 (Ky. 2000). Therefore, the UEF's argument that the Board exceeded the scope of its review by reversing the ALJ must be rejected. Indeed, it is within the Board's purview on appeal to ensure that orders and awards of an ALJ are in conformity with Chapter 342. Whittaker v. Reeder, 30 S.W.3d 138, 145 (Ky. 2000). As this Court has noted:

Workers' compensation is a creature of statute. As set forth in Chapter 342, workers' compensation proceedings are administrative rather than judicial. Although the principles of error preservation, res judicata, and the law of the case apply to workers' compensation proceedings, they apply differently than in the context of a judicial action.

Id. at 143. Where, as here, an ALJ fails carry out essential functions under Chapter 342, the Board does not exceed the scope of its authority by reversing the ALJ to ensure rulings are in compliance with the Chapter. As there is no evidence of substance to support the ALJ's assignment of liability to KEMI, reversal of the ALJ was proper.

C. Beacon Enterprises' failure to follow Kentucky statutory and regulatory guidelines relating to employee leasing arrangements invalidated any part of its insurance policy that might have provided workers' compensation insurance coverage.

It is important for this Court to remember that even if the testimony of Garavaglia and the Manzos was true, it still described illegal transactions under Kentucky law. Despite the stinging rebuke of Garavaglia by the Board, the UEF continues to argue to this Court that the ALJ's decision to credit the testimony of Garavaglia was acceptable. Without ever mentioning Garavaglia by name in its brief, the UEF's entire appeal is predicated on the legitimacy of Garavaglia's assertions. Only if Garavaglia's testimony about the purported employee arrangement was true, and Hoskins was really employed by Beacon Enterprises, and Beacon Enterprises then really leased Hoskins to Four Star Transportation, could the UEF prevail.

However, Beacon Enterprises' failure to follow Kentucky statutory and regulatory guidelines relating to employee leasing arrangements invalidated any part of KEMI's policy with Beacon Enterprises that might have obligated it to provide workers' compensation benefits to Hoskins. Due to the absence of an EL-2, Four Star Transportation could not possibly have contracted with Beacon Enterprises to purchase and maintain a policy of

workers' compensation insurance covering Hoskins per KRS 342.615(4). KEMI's policy with Beacon was never implicated because the only contract of hire Hoskins entered into in this matter was with Four Star Transportation.

The UEF claims the Board erroneously held that the ALJ was "legally not permitted to rely on competent evidence produced by Beacon in reaching a decision regarding insurance coverage." Appellant's Brief, p. 7. It is astonishing that the UEF contends that the testimony of Beacon's designated representative was "competent evidence". Over the objections of KEMI, and for reasons unspecified by the ALJ, the ALJ permitted Garavaglia to listen in on and attend the depositions of both Salvatore Manzo and Vincent Manzo as the designated representative of both Beacon Enterprises and Better Integrated. Garavaglia is not employed by either one. Further, in United States v. Garavaglia, 5 F.Supp.2d 511, 520, 522 (E.D.Mich.1998), aff'd, 178 F.3d 1297 (6th Cir.1999), the United States Court of Appeals for the Sixth Circuit stated as follows:

Garavaglia owned a series of employee-leasing companies and participated in a scheme to defraud workers' compensation insurance companies and the United States government wherein he would underpay premiums to the insurance companies, yet report a larger insurance premium payment to the Internal Revenue Service ("IRS") on the corporate tax returns. Under this scheme, the insurance companies would issue policies which covered all of the employees of his corporations although the premiums were underpaid, and this would greatly increase their risk above that for which they had contracted. Garavaglia's overstatements of insurance expenses would cause his corporations' taxable income to be understated, which would in turn result in an understatement, and therefore underpayment, of corporate tax liability. He collected the full amount of

workers' compensation premiums from his client businesses, but withheld a portion of the monies and did not report those amounts on his individual income tax returns.

Thus, the individual who provided this "competent evidence" for the record, as portrayed by the UEF, is a convicted felon who previously owned a series of employee leasing companies and used them in a scheme to defraud workers' compensation insurance companies and the United States government. Regardless, given the absence of Kentucky EL-1 registration of Better Integrated, the absence of any documentary evidence of the alleged tripartite leasing arrangement from Beacon Enterprises to Four Star Transportation, the absence of Hoskins' knowledge of any such leasing activity, and the absence of an EL-2 documenting leasing by Beacon Enterprises to Four Star Transportation, the Board and the Court of Appeals acted properly in the decisions below.

The UEF next argues that Four Star Transportation had insurance coverage with KEMI under K.R.S. 342.615. Appellant's Brief, p. 7. Apparently the UEF is unconcerned with the fact that if Beacon Enterprises really had leased Hoskins to Four Star Transportation, it did so without an EL-2 in violation of 803 KAR 25:230 Section 2. Similarly, if Better Integrated was leasing employees in Kentucky, it was doing so illegally. 803 KAR 25:230 Section 2. It is uncontradicted that Better Integrated had no EL-1 authorizing it to even do business in Kentucky on the date of Hoskins' accident. As such, contrary to the UEF's arguments on appeal, the alleged leasing of Hoskins by Better Integrated would not be legally recognizable in Kentucky even if it had happened. Since Better Integrated had no EL-1

registering it as a leasing company in Kentucky, the testimony that Better Integrated was operating in Kentucky still could not properly be accepted by an ALJ. Even assuming *arguendo* that the testimony of leasing of Hoskins actually took place, it still involved prohibited and illegal transactions for which KEMI had no insurance coverage.

The UEF argues that “Four Star Trucking is entitled to satisfy its obligation to secure workers’ compensation coverage” under the policy of insurance issued by KEMI to Beacon Enterprises. This Court must examine the policies themselves, in the context of the regulations, to determine coverage. Beacon Enterprises only had one EL-2 permitting it to lease employees to Rush Trucking. The Kentucky administrative regulation addresses the responsibility of employee leasing companies to provide workers’ compensation insurance to their employees. Section 2 of the regulation states that an employee leasing company “shall file a Lessee Information Form, Form EL-2, for each Kentucky lessee for whom the company or a related entity provides the workers’ compensation insurance coverage.”

This regulation was drafted to ensure that any entity which is defined as an employee leasing company properly obtains workers’ compensation coverage for itself and all of its employees leased to another entity, and that premium paid for the coverage for such leased employees is commensurate with the exposure. K.R.S. 342.615(4). Moreover, the statute states: “In either event, it shall be the responsibility of the lessee to maintain in its files at all times the certificate of insurance, or a copy thereof, evidencing the existence of the required insurance.”

Beacon Enterprises' policy of workers' compensation insurance issued by KEMI provided coverage only for employees sent to Rush Trucking. Mr. Peters and Mr. Terry testified that the only registered leasing activity of Beacon Enterprises in Kentucky on or prior to Hoskins' accident date was to Rush Trucking. This statutory and regulatory language leaves no doubt that the insured is to be the leasing company and that the policy is intended to cover leased employees injured in the course of employment at the client company. Since there was no required EL-2, KEMI's policy provided no coverage to Four Star Transportation.

KRS 342.615 and 803 KAR 25:230 only provide for insurance coverage for businesses engaged in employee leasing activity that have EL-1 and EL-2 forms on file with the state. Further, unless the leasing activity is documented by an EL-2, it is not covered under an employee leasing company's workers' compensation insurance policy. There is no authority for the UEF's claim that illegal or prohibited leasing transactions are still covered under an employee leasing company's workers' compensation insurance policy.

If the UEF's arguments in this appeal were accepted, employee leasing companies would easily be able to defraud their insurance carriers. This Court should not encourage disregard of state regulations and statutes, which would carry the consequences of increased insurance fraud. KEMI had no liability since its policy for Beacon Enterprises only provided coverage for employees of Beacon Enterprises leased to Rush Trucking, not Four Star Transportation.

D. The UEF's argument relating to K.R.S. 342.375 was not preserved below and cannot be raised for the first time on appeal.

The UEF next argues that K.R.S. 342.375 provides for insurance coverage by KEMI. Appellant's brief, p. 7. This argument was not made below. The Supreme Court should not hear arguments made for the first time on appeal. Fischer v. Fischer, 348 S.W.3d 582, 588 (Ky. 2011), quoting Springer v. Commonwealth, 998 S.W.2d 439, 446 (Ky. 1999); see also Hutchings v. Louisville Trust Co., 276 S.W.2d 461, 466 (Ky. 1954) (“[I]t is the accepted rule that a question of law which is not presented to or passed upon by the trial court cannot be raised here for the first time.”).

Even if the UEF's argument could be considered, the UEF fails to cite any authority for the argument that K.R.S. 342.375 applies to workers' compensation insurance policies for employee leasing companies. Such a contention is groundless, as the only EL-2 on file with the state as of Hoskins' accident date was for Rush Trucking. Jeremy Terry depo., Exhibit 12. The UEF's argument that K.R.S. 342.375 mandates that an insurance policy for an employee leasing company provides coverage for illegal employee leasing activity is not presented with sufficient clarity and completeness, and is lacking in merit.

E. KEMI provided no insurance coverage to Better Integrated or Four Star Transportation.

The UEF next argues that KEMI had knowledge that Beacon Enterprises and Better Integrated are related companies, and that Beacon Enterprises had sought listing of Better Integrated as an additional insured on their policy. Appellee's Brief, p. 7. Insurance

coverage for obligations assumed by employee leasing companies under law is limited to the employees documented on an EL-2. In this case, that is Beacon Enterprises and the employees leased to Rush Trucking. It is undisputed there was no proper EL-2 documentation for Hoskins' employer. The UEF's argument in this regard it is inconsistent basic tenets of Kentucky insurance coverage law. Insurance policies are simply contracts between an insurer and an insured. See Haney v. Yates, 40 S.W.3d 352, 354 (Ky.2000); Buck Run Baptist Church, Inc. v. Cumberland Sur. Ins. Co., 983 S.W.2d 501, 504 (Ky.1998); City of Louisville v. McDonald, 819 S.W.2d 319, 320 (Ky.Ct.App.1991).

In addition, there was no coverage for the Louisville location of Four Star Transportation. First, Beacon Enterprises did not have offices in Louisville, but, rather, only Rush Trucking, a trucking company to which Beacon was supplying employees, had a Louisville office. This was established by the EL-2 which Beacon Enterprises filed in 2006 with regard to Rush Trucking. Second, prior to Hoskins' injury, no EL-2 had been filed reflecting Beacon Enterprises was sending employees to Four Star at any location in Kentucky.

The record reflects that on November 30, 2006, an additional location was added to the policy covering the period from November 1, 2006, through November 1, 2007. In adding that location, no document indicated Four Star was the entity conducting business at that new location. There is an absence of evidence in the record establishing that KEMI

knew or should have known that Four Star Transportation, using Beacon Enterprises' employee, was operating at this second location.

Likewise, the UEF cannot simply ignore underwriting documents and disregard insurance policy provisions that provide no coverage for Better Integrated or Four Star Transportation. The UEF cites Labor Ready, Inc. v. Johnston, 289 S.W.2d 200 (Ky. 2009) for the proposition that Hoskins was in a "leased employee situation." Appellant's Brief, p. 9. This opinion does not support the UEF's contentions in its brief. It concerns whether a contractor's permanent employee could maintain a tort action against the temporary labor service and its employee for an injury that occurred while working for the contractor.

In United States Fidelity & Guaranty Company v. Technical Minerals, Inc., 934 S.W.2d 266 (Ky. 1996), the court held that a company that contracted with a temporary labor service for temporary employees was a contractor for the purposes of Chapter 342. Thus, KRS 342.690(1) immunized the contractor from a temporary employee's tort action. Labor Ready had the converse situation. The trial court granted summary judgment to Labor Ready, noting that KRS 342.690(1) would deem the workers to be co-employees if the temporary employee were injured and limit the temporary employee's remedy to workers' compensation. The Court of Appeals reversed on the grounds that no statute immunizes a subcontractor and its employees from a tort claim by an up-the-ladder contractor's employee, and that the temporary employee and contractor's employee were not co-employees because KRS 342.615(5) deems a temporary help service to be a temporary employee's employer.

This Court affirmed. This Court held that the appeal concerned the application of four statutes, one of which was KRS 342.615. The Court noted that it had refused to extend employer immunity except in instances where the loaned servant (i.e. , loaned employee) doctrine applies. This Court stated that KRS 342.640(1) bases a worker's status as an employee on the existence of an express or implied contract of hire between the worker and putative employer. The loaned employee doctrine permits the direct employee of one business (general employer) to be considered an employee of another business (special employer) and, thus, a co-employee of its employees if three basic tests of an employment relationship are present: 1 .) an express or implied contract of hire exists between the employee and the special employer; 2.) the employee performs work for the special employer; and 3.) the special employer has the right to control the work that the employee performs. It has long been recognized under Kentucky workers' compensation law that whenever a general employer sends a worker to assist a special employer that worker may become a "loaned employee" of the special employer. In such cases, the special employer becomes the "statutory employer" within the meaning of K.R.S. 342.700. See Rice v. Conley, 414 S.W.2d 138 (Ky., 1967); Allied Machinery, Inc. v. Wilson, 673 S.W.2d 728 (Ky. App., 1984).

In the present case, these test were not met. Hoskins was not a temporary worker. Second, Hoskins still did not know he was purportedly a party to an express or implied contract of hire between Better Integrated or Beacon Enterprises. Third, there was no

documentary evidence, i.e. a contract, of any leasing of Hoskins. Fourth, Better Integrated and Beacon Enterprises were in violation of KRS 342.615 and 803 KAR 25:230 for not filing EL-1 and EL-2 forms.

Labor Ready, supra, does not support the UEF's request for a determination of an implied contract of hire between Better Integrated and Hoskins, or Beacon Enterprises and Hoskins. In fact, it would support rejection of the UEF's arguments in the present case. Rice v. Conley, supra. KRS 342.615(4) requires a lessee, which in this case would be Four Star Transportation, to secure workers' compensation coverage for all leased employees, or contract with the employee leasing company to do so. The statute requires the insurance premium to be based on the lessee's exposure and experience. Since an EL-1 and EL-2 had not been filed by either Better Integrated or Four Star, the entire argument of the UEF presumes violations of the Kentucky statute and regulation are irrelevant. This Court should not sanction such a result.

Four Star Transportation in no way fulfilled its statutory responsibility to secure benefits for leased employees under K.R.S. Chapter 342. If Four Star Transportation contracted with an unregistered employee leasing company, Better Integrated, and Better Integrated never purchased and maintained the required insurance policy, then Four Star Transportation was uninsured. The UEF's arguments at page 9 of its brief disregard the regulation, which clearly states: "it shall be the responsibility of the lessee to maintain in its files at all times the certificate of insurance, or a copy thereof, evidencing the existence of

the required insurance.” Four Star Transportation failed in its responsibility to maintain in its files at all times the certificate of insurance, or a copy thereof, evidencing the existence of the required insurance.

This is not a case where the UEF can cite evidence of coverage on which reasonable minds could differ. In fact, by considering all evidence properly before the ALJ in this matter, even drawing all reasonable inferences from that evidence in favor of the UEF, the Board and the Court of Appeals still held that there is a complete absence of proof of any leasing or insurance coverage for Hoskins. KEMI had no insurance coverage as a matter of law.

Under applicable principles of Kentucky workers’ compensation insurance law, the ALJ was charged with the responsibility to issue an order, decision, or award in conformity with the Chapter. For this reason, the ALJ’s failure to issue an order in conformity with Chapter 342 was reversible error. See, e.g., Whittaker v. Reeder, supra (the Workers’ Compensation Board may review question of law, such as whether opinion or award is in conformity with Chapter 342, sua sponte). See also, Brasch-Berry General Contractors v. Jones, supra. No reasonable fact finder could, after full consideration of the evidence presented in this case, possibly make any other conclusion than a finding of no insurance coverage by KEMI for Four Star Transportation or Better Integrated. The rulings of the Board and the Court of Appeals were proper and must be affirmed.

If the UEF's arguments were to be accepted, an insurance carrier that issued a policy for an employee leasing company would have coverage for companies that were not named insureds, for companies that did not provide the payroll of employees, and for companies with no EL-2 forms on file with the state. This is absurd. The uncontradicted payroll evidence proves that he was paid by Better Integrated, which was not KEMI's policyholder. In such a case, here is no coverage. See Hazard Coal Corp. v. Knight, 325 S. W.3d 290, 298 (Ky. 2010); 3D Enterprises Contracting Corp. v. Louisville & Jefferson Co. Metropolitan Sewer District, 174 S.W.3d 440, 448 (Ky. 2005); Morganfield National Bank, v. Damien Elder & Sons, 836 S.W.2d 893 (Ky. 1992); Cantrell Supply, Inc. v. Liberty Mutual Insurance Co., S.W.3d 381 (Ky. App. 2002). The UEF's argument for coverage of a great increase in KEMI's risk, far above that for which KEMI had contracted, is without merit.

The UEF argues that documents from a 2005 to 2006 audit that KEMI conducted indicated that effective December 2006, Beacon Enterprises would have two new clients operating in Louisville both of which were trucking companies, and that somehow this is sufficient to establish insurance coverage by KEMI. However, the auditor made a note that his contact at Beacon Enterprises was unsure how to predict the annual payroll generated from these clients. Contrary to the UEF's contentions, Beacon Enterprises still had the responsibility for notifying KEMI of the new client to which it would be supplying employees in Kentucky, and more importantly, had a legal duty to file the appropriate EL-2. 803 KAR 25:230 Section 2 ("An employee leasing company shall file a Lessee Information

Form, Form EL-2, for each Kentucky lessee for whom the company or a related entity provides the workers' compensation insurance coverage"). Beacon Enterprises did no such thing. Mr. Terry testified that notation in the final audit report dealing with the policy which expired on November 1, 2006, was merely a notation of Beacon's future plans. Therefore, Four Star never satisfied its obligation to secure worker's compensation coverage by leasing employees from an employee leasing company which had such coverage, pursuant to KRS 342.615(4).

The UEF next argues that since an address is mentioned in underwriting materials, which was subsequently shown in discovery to be the address of Four Star Transportation, KEMI had coverage. Brief, p. 10. No authority is cited for this argument. Contrary to the contentions of the UEF, a contract of workers' compensation insurance for a leasing company in Kentucky does not cover an address. Rather, such a policy only covers a business and its employees. In an employee leasing case, the policy only covers employees sent to other businesses that are properly documented with an EL-2 as required by the leasing regulations.

The named insured in this case has a clear and explicit meaning in the policy. It is the business who is listed on the declarations page. The words employed in insurance policies, if clear and unambiguous, should be given their plain and ordinary meaning. Buckingham Life Insurance Company v. Winstead, 454 S.W.2d 696, 697 (Ky., 1970). Policies should be interpreted according to the parties' mutual understanding at the time they

entered into the contract and “[s]uch mutual intention is to be deduced, if possible, from the language of the contract alone.” Simpsonville Wrecker Service, Inc. v. Empire Fire and Marine Insurance Company, 793 S.W.2d 825, 828-829 (Ky., 1990). Contrary to the UEF’s arguments, KEMI had no coverage for an address being used by businesses that were not named insureds on the policy. Contrary to the UEF’s argument, KEMI was not required to investigate this second address in Louisville since no new client was identified to KEMI by Beacon Enterprises, and an EL-2, as required by regulation, was not filed by Beacon Enterprises identifying a new client in Kentucky to which it was leasing employees.

Beacon Enterprises, not KEMI, had the obligation to file an EL-2 with the Department of Worker’s Claims, which would notify KEMI that it was supplying employees to a business in Kentucky in addition to Rush Trucking. The record establishes that Beacon Enterprises violated its duty under the Kentucky regulation to file an EL-2. In effect, all the ALJ’s order did was accept assertions about employee leasing in violation of KRS 342.615 and 803 KAR 25:230. In the June 23, 2011 ruling, the Board referred this case to the Security and Compliance section of the Department for Workers’ Claims and to the Department of Insurance to investigate the infractions of the workers’ compensation statutes and regulations by Beacon Enterprises, Inc., Better Integrated Systems/Services, Inc., and Four Star Transportation, Inc. The UEF’s contention that an ALJ’s decision in a case with these facts still should have been affirmed under the rule of deference accorded to fact finders

effectively condones violations of Kentucky law. The UEF should not support violations of the law, even if doing so could provide it relief from liability for an uninsured employer.

The UEF next argues that the risk insured by KEMI covers this claim, because the evidence reflects an increase in payroll of Beacon Enterprises from \$2,000,000.00 to \$5,073,459.00, with a corresponding increase in annual premiums from \$299,653.62 to \$749,001.72. Appellant's Brief, p. 11. The problem with the UEF's argument is there is no evidence from anyone that KEMI knew the increase was for payroll of Better Integrated. On the contrary, Mr. Terry testified that KEMI based premium on Beacon Enterprises' exposure, experience, and payroll. Exhibit 3 to Terry's deposition rebuffs the UEF's argument. This document compels a finding that the increase in Beacon Enterprise's premium for the policy in question, instead of being due to the addition of a new location, was due to the following payroll of Beacon:

- 1) \$5,073,459 for "7229-000 Trucking; Long Distance Hauling and Driver";
- 2) \$321,934.00 for "8810 clerical office employees NOC."

There is no evidence establishing the additional premium increase, from \$299,635.62 to \$749,001.72, was the result of adding Better Integrated or the 2305 Ralph Avenue location to Beacon Enterprises' policy. Mr. Terry testified the increase in premium was due to the fact the audit revealed Beacon's "wages that were originally reported were underestimated." There simply was no evidence below to support the UEF's argument that KEMI received

additional premiums as a result of the adding of an address which in discovery turned out to be a location of Four Star Transportation.

In fact, before adding Better Integrated to its policy, KEMI had the right to obtain the necessary information it needed, including accurate payroll records from Better Integrated, in order to determine the increase in premium. There is no evidence establishing KEMI ever was the carrier on the risk for Better Integrated, or that KEMI had any idea that Beacon Enterprises was supplying employees to Four Star Transportation. In fact, one of the grounds KEMI stated in its December 1, 2006, e-mail to Sandra Gulick, with AON, for its refusal to add Better Integrated as an insured on Beacon Enterprises' policy was that Better Integrated had no Kentucky clients. The e-mail went on to state that if Better Integrated obtained a Kentucky client, KEMI would add it to the policy provided it was given the necessary and required information. Terry deposition, Exhibits 36 & 37. This was never done.

Simply put, before adding those two entities, Better Integrated and Four Star Transportation, to Beacon's policy, KEMI had the right to know of the purported tripartite leasing arrangement. KEMI knew nothing of the matter. KEMI had the right to know about Better Integrated's payroll records and to be provided with all other necessary information. KEMI was given nothing by Better Integrated. In fact, Exhibits 45, 46, and 47 of the deposition of Mr. Terry clearly establish there was ongoing correspondence between KEMI, Salvatore Manzo, and Kate Graves of Wells Fargo, relating to the attempt to add Better Integrated to Beacon Enterprise's policy with KEMI. Those exhibits include correspondence

spanning from January 4, 2008 through January 25, 2008, and these documents reflect that KEMI continued to request certain information but was never given information as to whether Better Integrated had clients in Kentucky. Those exhibits also reflect KEMI sought copies of EL-1 and EL-2 forms, which were never filed or provided by Better Integrated. Finally, on January 25, 2008, six days before the accident, KEMI indicated it had not received requested documents and that it was “closing out this request without binding coverage.” KEMI indicated it would further consider adding and binding the additional named insured when EL-1 and EL-2 forms as well as other information for Better Integrated and Beacon Industrial was supplied. This was never done.

Thus, the record does not establish a factual basis for the UEF’s argument that the workers’ compensation policy issued by KEMI to Beacon Enterprises covered employees, including Hoskins, purportedly leased by Beacon Enterprises to Four Star. The testimony of Garavaglia was wholly insufficient to support a finding of insurance coverage by KEMI as asserted by the ALJ. Rather, the evidence compelled a finding the workers’ compensation policy issued by KEMI did not cover Hoskins’ injury.

The UEF next argues an insurance company should not be allowed to treat an insurance contract as valid for the purpose of collecting the premium and invalid for the purpose of paying the indemnity. Appellant’s Brief, p. 12. KEMI never did that, and Better Integrated was never an insured on KEMI’s policy. There was never any acceptance of premium payments based on payroll from Better Integrated, much less earnings of Julian

Hoskins. As such, nothing estopped KEMI from denying liability for coverage to Better Integrated, since this company was not even its policyholder. Spurlin v. Ranier, 457 S.W.2d 491, 492 (Ky., 1970), the case cited by the UEF in support of this argument, is inapplicable.

The UEF next argues that there are no “consequential remedies” for the violations of KRS 342.615 and 803 KAR 25:230 by the businesses in this case. The UEF claims that KEMI underwriters did an unsatisfactory job, and that the “misrepresentation or fraudulent acts” of Beacon Enterprises did not warrant imposition of liability to the UEF. The UEF’s admission that there were misrepresentations or fraudulent acts should lead this Court to reject the UEF’s earlier argument in its brief that the ALJ’s ruling was a permissible exercise of discretion. Apparently the UEF alternatively contends that even if witnesses in this case provided fraudulent testimony, KEMI should still be deemed to be the carrier on the risk. The UEF claims that KEMI should “assess retroactive premiums and/or seek contribution from its insured, Beacon Enterprises”, citing U.S. v. Simpson, 538 F.3d 459 (6th Cir. 2008). Appellant’s Brief, p. 13.

Simpson was a federal criminal case that has did not involve employee leasing. In this case, the defendant pleaded guilty to mail fraud for under reporting the payroll information for his businesses to his worker’s compensation insurance carrier. The district court found that the proper measure of loss was the unpaid premium for unreported employees, and that the fair market value of the insurance coverage the defendant took was the amount of those

unpaid premiums. As this is neither an employee leasing case or an insurance coverage case, it is neither persuasive nor binding precedent.

The UEF then argues that KEMI should not have renewed the policy for Beacon Enterprises, after an audit revealed “additional unknown clients of Beacon”. Appellant’s Brief, p. 13. The UEF then claims that KEMI should have paid Hoskins’ claim, then sought reimbursement from Beacon Enterprises under K.R.S. 342.310(2). Appellant’s Brief, p. 14. The UEF apparently believes that KEMI had no right to litigate the issue of insurance coverage, and that a carrier should simply tolerate an unjustified direct pecuniary loss then attempt to recover those losses from the business that caused it. The obvious defect in the UEF’s argument is that Better Integrated and Four Star Transportation are not even KEMI policyholders. The UEF presumably harbors the belief that insurance companies should provide insurance coverage to non-policyholders, and that if they they actually have to pay on a claim, they can then get some of their money back. The UEF’s unrealistic visions of how insurance policies should apply are inconsistent with the rule that a court must enforce an unambiguous insurance contract strictly, according to the ordinary meaning of its terms and without resort to extrinsic evidence. Frear v. P.T.A. Industries, Inc., 103 S.W.3d 99, 105-06 (Ky. 2003).

It is a fundamental rule of insurance law that, by agreeing to provide coverage, a carrier obligates itself to pay claims arising during the period of coverage for its policyholders. Insurance coverage, by its very nature, is forward-looking, and cannot be

provided to non-policyholders and then recovered later using some type of after-the-fact analysis advocated by the UEF. Moreover, in employee leasing cases, insurance coverage is not provided to non-policyholders that have violated KRS 342.615 and 803 KAR 25:230. A carrier is not required to provide coverage and pay on claims for injuries to undocumented, non-policyholder employees. The UEF's argument that there should somehow be insurance coverage available for undeclared workers from businesses that have fraudulently evaded detection is absurd. Kentucky employee leasing regulations prevent this, because they require that the employer list the names of the specific company or a related entity for which it provides the workers' compensation insurance coverage. 803 K.A.R. 25:230 Section 2.

If the UEF's arguments at pages 13 and 14 of its brief were accepted, once purchased, an employee leasing company could wait to report a lessee company's existence until an employee is injured, and then explain the discrepancy by claiming there was an oral leasing contract not on file with the state. Permitting such a system in Kentucky would thwart the fundamental requirements of 803 KAR 25:230. Instead, the amount of premium used to calculate risk comes from documented compliance with 803 KAR 25:230. The premium increase is tied to the harm risked only from businesses that are documented under Kentucky law. Apparently the UEF believes there is no link between risk and premium. Rather, the UEF thinks loss is determined using the amount of claims paid out based on the fortuity of whether leased employees are injured and thus discovered. It cannot be, however, that the regulations are as meaningless as the UEF suggests.

As a final ground for challenging the decisions of the Board and the Court of Appeals, the UEF claims that the avoided premiums represent a case for sanctions against Beacon Enterprises, but cannot be the basis for a finding of no insurance coverage by KEMI. Contrary to the UEF's argument, an insurance company is entitled to the benefit of their bargain, based first on the amount of money they charged to insure the actual, known risk. KEMI charged premium based on known risk that Beacon Enterprises presented. Kentucky statutory provisions indicate that this is the law.

Three provisions, K.R.S. 342.310, 342.335, and 342.990, deal specifically with payroll under-reporting and the consequences of such under reporting. K.R.S. 342.335 makes it illegal for an employer to "knowingly . . . make[] any false representation, including misrepresentations of hazards, classifications, payrolls or other facts . . . that are designed to cause a reduction in the employer's premium." K.R.S. 342.990 then provides for civil fines as well as criminal fines or imprisonment for violation of K.R.S. 342.335. However nowhere in their treatment of fraudulent reporting do these provisions state that a carrier is bound to pay on claims for unregistered non-policyholder employees, something that one would expect had the General Assembly intended a departure from the common law principles governing insurance coverage, such as the UEF suggests.

This Court has previously stated that an insurance carrier may be made a party to the workers' compensation proceeding, and that the Department of Workers' Claims has jurisdiction to decide questions concerning the insurer's obligation to pay workers'

compensation benefits on behalf of its insured. Custard Ins . Adjusters, Inc. v. Aldridge, 57 S.W.3d 284, 287 (Ky. 2001). In addition, once made a party, that insurer can question whether or not it had issued a valid policy that covered the employer at the time of the injury. Lawrence Coal Co . v. Boggs, 218 S.W.2d 670, 671-72 (Ky. 1949). When a business violates Kentucky's employee leasing regulations, it under-reports its payroll. Such a business is attempting to take coverage by depriving a carrier of premiums directly. This is prohibited by K.R.S. 342.615(4), which clearly states that the exposure and experience of the lessee shall be used in determining the premium for the policy. If the lessee is undocumented with no EL-2, then the purposes of the statute are frustrated.

The only result that can be permitted under the facts of this case is that there was no coverage by KEMI. Such a result is completely consistent with the purpose of 803 K.A.R. 25:230, which is to ensure that leasing companies are (1) properly registered as doing business in Kentucky and (2) properly documenting where they are sending employees. Violation of these regulations precludes coverage under an employee leasing workers' compensation insurance policy. The purpose of these regulations is to ensure that insurance carriers can calculate the risk and to safeguard the public. The conclusion that KEMI had no coverage for the loss in this case is further consistent with the Board's duty regarding the integrity of the system of workers' compensation. The Board has the inherent power to determine that its rulings reflect the truth, a power that extends not only to fraud but also to deception of the court, and lack of candor to the court. Potter v. Eli Lilly and Co., 926

S.W.2d 449, 455 (Ky. 1996). The rulings of the Board and the Court of Appeals were necessary to prevent parties from benefitting from their intentional misconduct. Conduct that works a fraud is relevant to the determination of whether an employer has obtained appropriate coverage pursuant to KRS Chapter 342. See General Elec. Co. v. Cain, 236 S.W.3d 579 (Ky. 2007).

CONCLUSION

For the foregoing reasons, the decisions of the Board and Court of Appeals should be affirmed.

Respectfully submitted,

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