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Commonwealth of Kentucky

Court of Appeals

NO. 2011-CA-001322-WC

UNINSURED EMPLOYERS' FUND — APPELLANT

v.

PETITION FOR REVIEW OF A DECISION
OF THE WORKERS' COMPENSATION BOARD
ACTION NO. WC-08-96697

JULIAN HOSKINS; FOUR STAR TRANSPORTATION, INC.; BEACON ENTERPRISES, INC.; BETTER INTEGRATED SYSTEMS, INC.; KENTUCKY EMPLOYERS' MUTUAL INSURANCE COMPANY; HON. R. SCOTT BORDERS, ADMINISTRATIVE LAW JUDGE; AND WORKERS' COMPENSATION BOARD — APPELLEES

OPINION
AFFIRMING IN PART AND VACATING IN PART

** ** ** ** **

BEFORE: MOORE, STUMBO, AND WINE, JUDGES.

MOORE, JUDGE: The Workers' Compensation Board reversed an administrative law judge's (ALJ's) determination that Kentucky Employers' Mutual Insurance

(KEMI) was the insurance carrier at risk for injuries sustained by Julian Hoskins in the course of his employment with Four Star Transportation, Inc., and, consequently, the Kentucky Uninsured Employers' Fund (UEF) became statutorily liable for paying Hoskins' benefits. The Board further directed the ALJ to sanction Beacon Enterprises, Inc., and its co-appellee, Better Integrated Services, Inc.—two companies that allegedly leased Hoskins to Four Star—for discovery violations relating to the deposition testimony of an authorized representative of those two entities, Charles Garavaglia. The UEF now appeals. We affirm the Board's decision, but vacate that part of its decision, discussed below, relating to the Board's additional finding of discovery violations.

I. LIABILITY FOR HOSKINS' BENEFITS

As noted, the focus of this appeal is a workers' compensation insurance coverage dispute between KEMI and the UEF,[1] and it specifically concerns the issue of whether an employer-employee relationship and a "special employer"-"special employee" relationship were established in the context of an alleged employee leasing arrangement. We will briefly review the meaning of these legal terms before delving into the facts.

[1] *See, e.g., Custard Insurance Adjusters, Inc. v. Aldridge*, 57 S.W.3d 284, 287 (2001) ("[T]he fact-finder has jurisdiction to decide questions affecting the insurer's obligation to pay workers' compensation benefits on behalf of its insured. Furthermore, having been made a party, an insurer may question whether or not it had issued a valid, outstanding policy that covered the employer at the time of the worker's injury." (Internal citations omitted.) *See also Larson's Workers' Compensation Law*, Vol. 9 § 92.40 at 92.41 (1997).

"Employee leasing" is a permitted practice in Kentucky governed largely by KRS 342.615. Per that statute, an "employee leasing company" is defined as "an entity that grants a written lease to a lessee pursuant to an employee leasing arrangement." KRS 342.615(1)(a). A "lessee" is "an employer that obtains all or part of its workforce from another entity through an employee leasing arrangement." KRS 342.615(1)(b). "Employee leasing arrangements," such as the leases that allegedly occurred herein, are

> [A]rrangements 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.

KRS 342.615(1)(d).[2] The legal effect of a valid employee leasing arrangement under KRS 342.615 "permit[s] a leased employee to be viewed as being the lessee's employee rather than the employee leasing company's employee[.]" *Labor Ready, Inc. v. Johnston*, 289 S.W.3d 200, 207 (Ky. 2009). But, KRS 342.615(4) also provides, in relevant part, that a lessee may "fulfill its statutory responsibility to secure benefits for leased employees . . . by contracting with an employee leasing company to purchase and maintain the required insurance policy."

[2] The remainder of KRS 342.615(1)(d) provides that "For purposes of this section, 'employee leasing arrangement' does not include arrangements to provide temporary workers." This latter portion is not relevant to our analysis because no argument is made and no facts support that Hoskins was a temporary worker for Four Star or any other party in this matter.

Moving on, the terms "special employer" and "special employee" derive from the "loaned employee doctrine." As adopted by the former Court of Appeals in *Rice v. Conley*, 414 S.W.2d 138, 140 (Ky. 1967),

> This doctrine is found in Larson's works, The Law of Workmen's Compensation, section 48[3], and reads as follows:
>
> 'When a general employer lends an employee to a special employer, the special employer becomes liable for Workmen's Compensation [and thus immune from liability for tort actions brought by the special employee] only if (a) the employee had made a contract of hire expressed or implied with the special employer, (b) the work being done is essentially that of a special employer, (c) the special employer has the right to control the details of the work. When all three of the above conditions are satisfied in relation to both employers, both employers are liable for Workmen's Compensation.'

As an aside, the law of employee leasing must be interpreted in conjunction with the rest of Kentucky's Workers' Compensation Act, including KRS 342.640(1), which bases a worker's status as an "employee"—including those employed by an employee leasing company (*e.g.*, a general employer) or its lessee (*e.g.*, a special employer)—upon the existence of an express or implied contract of hire between the worker and putative employer. The contract of hire, in turn, must contain all of the elementary ingredients of a contract, *Rice*, 414 S.W.2d 138, 141 (Ky. 1967); and, it is axiomatic that "a meeting of the minds" is among

[3] *Rice* does not provide a complete citation to Professor Larson's work. However, the above-referenced quote appeared in 1A Larson, *Workmen's Compensation*, § 48.00 (1966).

those ingredients. *See generally* Restatement (Second) of Contracts §§ 18, 19, and 22 (1981).

Stated differently, one of the most basic rules of workers' compensation in Kentucky is that "[a]n employee, for compensation purposes, cannot have an employer thrust upon him against his will or without his knowledge." *See Rice*, 414 S.W.2d at 141. And, the loaned employee doctrine is simply an extension of that rule; it "was instituted to protect injured workers and does not permit a special employer to be thrust upon them against their will or without their knowledge, thereby depriving them of the right to sue for damages." *Johnston*, 289 S.W.3d at 206.

Thus, to determine whether a purported employee leasing arrangement exists, and, by extension, whether the insurance carrier of the purported employee leasing company could be held liable for a leased employee's workers' compensation benefits per KRS 342.615(4), a court must begin its analysis by determining as threshold matters: 1) whether the purported employee leasing company formed an express or implied contract of hire with the employee that it purports to have leased out to a special employer (because an employee leasing company cannot lease out a worker that it does not employ); and 2) whether the purported special employer, in turn, formed an express or implied contract of hire with the employee that it purports to have leased.

Turning to the relevant facts in this matter, the parties herein concede that Hoskins sustained a work-related injury while employed by Four Star as a

truck driver. In particular, Hoskins testified that on January 31, 2008, he was at a truck stop in Pittsburgh, Pennsylvania, slipped on some ice that had formed on the running board of his truck, landed on and injured his back and hip area, and thereafter applied for workers' compensation benefits. The parties also take no issue with the ALJ's determination that Hoskins' injury entitled him to benefits and a permanent partial disability award of 3.25%. The parties further concede that Four Star maintained no policy of workers' compensation covering Hoskins.

The issue in dispute is whether Hoskins was also employed by Beacon Enterprises, an alleged employee leasing company, and whether Beacon had leased Hoskins to Four Star. The UEF asserts that at the time of his injury, Hoskins was actually employed by Better Integrated, which is another alleged employee leasing company; he was being leased by Better Integrated to Beacon Enterprises; he was being subleased to Four Star by Beacon Enterprises; Four Star had indeed contracted with Beacon Enterprises to purchase and maintain a policy of workers' compensation insurance covering Hoskins per KRS 342.615(4); and Beacon Enterprises' carrier, KEMI, is therefore liable for paying Hoskins' benefits. KEMI, on the other hand, asserts that its policy with Beacon was never implicated because the only contract of hire Hoskins entered into in this matter was with Four Star.[4]

[4] In addition, KEMI argued that Beacon Enterprises' failure to follow several Kentucky statutory and regulatory guidelines relating to employee leasing arrangements invalidated any part of its policy with Beacon Enterprises that might have obligated it to provide workers' compensation benefits to Hoskins. We need not address the merits of this argument because, as explained below, we agree with the Board's conclusion that Hoskins was never Beacon Enterprises' employee.

In concluding that an employer-employee relationship existed at all relevant times between Hoskins, Four Star, and Beacon, the ALJ found that it was "undisputed that [Hoskins] was hired by Better Integrated Services, was leased to Beacon Enterprises, and then leased to Four-Star Transportation as a truck driver."

KEMI subsequently appealed to the Workers' Compensation Board, and the Board reviewed the record and revisited the issue of whether Hoskins shared an employer-employee relationship with Beacon Enterprises. The Board correctly summarized the evidence in that regard:

> The June 16, 2009, deposition of Hoskins was introduced. Hoskins testified he believed his employer was Four Star. After he was injured, he never returned to work for Four Star. He indicated his job title was truck driver. Hoskins explained he obtained his job when he saw Four Star's "help wanted" sign on Ralph Avenue at Four Star's terminal. At that time, he went in and filled out an application. Hoskins was called two or three days later for an interview and was then hired. Four Star's terminal was located at 2305 Ralph Avenue, Louisville, Kentucky. The terminal was located on approximately two acres and the loading docks had anywhere from ten to twelve trucks lined up at any one time. Hoskins believed Four Star had approximately one-hundred drivers working there. When he went into the office at the terminal he spoke to Sean Green, the supervisor, who took his application and hired him. He underwent two weeks training and one week later was on his own. He explained Four Star has terminals in Louisville, Detroit, and East Chicago. Everything relating to his hiring was done at the Ralph Avenue terminal. Of the parties involved, only Four Star had a sign at that terminal.[5]
>
> . . .

[5] Hoskins also testified that Four Star's name was on the doors, trucks, and trailer.

> Hoskins explained his main contact with Four Star was Sean Green. The business card Hoskins received from Sean Green, introduced as Exhibit 2, reflects Sean Green was the terminal manager for Four Star Transportation Company. Although Hoskins testified he was paid by check from Better Integrated, he stated as follows: "I didn't know nothing about who they were or what." He believed he had a job with Four Star and Four Star hired him. Sean Green handed out the paychecks in a Four Star envelope. The application he received from Four Star did not have Better Integrated's name on it. During the hiring process Hoskins did not sign any documents bearing the name Better Integrated. He believed Better Integrated may have been printed on his health "insurance card," but he could not specifically recall who was on it because "it never did work." The fuel card he was provided bore the name of Four Star.
>
> Hoskins' pay stub, attached as Exhibit 1, was introduced. In addition to providing the relevant financial information, the stub also contained the following information: "Paying Agent For: Better Integrated Systems, Inc." Hoskins stated when he was injured he reported the injury to Sean Green at the Louisville terminal. Hoskins testified he had "never heard of" or "ran across" Beacon. The only time he saw the name Better Integrated was on his paycheck. He was never aware nor had he been consulted about being leased from Better Integrated to Four Star. He also testified he had no contact of any kind with Better Integrated.
>
> Hoskins later reaffirmed this testimony in a subsequent deposition of

April 19, 2010. Moreover, the Board noted that

> At the hearing [before the ALJ], Hoskins testified he received the paperwork telling him where to pick up a load at the Louisville location. For the first time he stated he had never been dispatched from the Indiana office. He stated he had only been to Four Star's Louisville, Detroit, and East Chicago terminals. Hoskins explained Sean Green, at the Louisville dispatch terminal, was the individual who called and "got your loads" and told him

> where he was going to be going next. He testified he had never received any wages from Beacon. It was his opinion Sean Green was also an employee of Four Star. He believed Four Star had approximately thirty drivers in Louisville. He explained Four Star was the only name seen on the bills or logbooks.

As to how Better Integrated and Beacon factored into this matter at all, the Board reflected upon the testimony of Salvatore Manzo, the owner of Beacon Enterprises:

> Salvatore testified Four Star is a client of Beacon. He acknowledged that there was a business relationship between Beacon and Four Star on the date of Hoskins' injury.
>
> . . .
>
> Salvatore acknowledged Four Star had signs advertising it was looking for drivers at the Louisville location. Salvatore explained 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." Salvatore believed the expansion in Kentucky occurred in late 2007. The person he dealt with at Four Star was Pete Kearney, the controller at the Melvindale, Michigan office. His father[6] told him Four Star was expanding and he needed him to handle the Kentucky employees "under Beacon Enterprises." The decision was then made for Beacon to undertake the lease of employees from Better Integrated to Beacon. Salvatore indicated the documentation of this arrangement was a contract between Better Integrated and Beacon.
>
> . . .

[6] As noted below, Vincent Manzo is Salvatore's father, the treasurer of Beacon Enterprises, and an employee of Better Integrated.

> Salvatore explained the way the arrangement worked was that Hoskins became an employee of Better Integrated, a Nevada corporation, and was leased to Beacon 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. Salvatore testified Beacon did not pay Hoskins.
>
> . . .
>
> Salvatore acknowledged no documents existed which would reflect an agreement between Beacon and Better Integrated after Hoskins' date of hire.[7]
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> . . .
>
> Salvatore testified Hoskins was paid by Better Integrated, and Beacon 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 make money off Beacon's portion.

In addition to Salvatore's testimony, the Board also reflected upon the testimony of Vincent Manzo with regard to the matter of Hoskins' employment:

> [Vincent] acknowledged Better Integrated has a lease agreement with Beacon, and Four Star also had an agreement with Beacon. Since Hoskins was in Kentucky and working out of Kentucky he was "transferred into the Beacon Enterprises account." Vincent acknowledged Better Integrated leased Hoskins to Beacon, and Beacon then leased Hoskins to Four Star.
>
> . . .
>
> Significantly, he denied Better Integrated ever had an operation in Kentucky before the Hoskins accident. Hoskins was originally employed by Better Integrated

[7] A designated representative of both Beacon Enterprises and Better Integrated, Charles Garavaglia, indicated the only document that might exist which described the lease of Hoskins from Better Integrated to Beacon would be the billings between those companies.

> 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."

In light of the above, the Board disagreed with the ALJ's conclusion that Better Integrated or Beacon qualified as Hoskins' employers for purposes of workers' compensation coverage, stating:

> In the case *sub judice*, we believe there is no evidence establishing Hoskins ever attained the status of a leased employee as defined by Larson's, supra [*e.g.*, the loaned employee doctrine]. Hoskins' testimony and all other evidence establishes he was hired by Four Star in Louisville. Hoskins had no interaction with or knowledge of Better Integrated. All of the information he received, except for his health insurance card which may have had Better Integrated printed on it and the statement on his pay stub which reads "Paying Agent For: Better Integrated Systems," indicated he was employed and paid by Four Star. The signs and terminal all bore Four Star's name. Clearly, there is no evidence which establishes Hoskins made a contract of hire with Four Star as his second or third employer. Hoskins never realized or believed he had a second employer, much less a third employer. Pursuant to the cited sections of Larson's, supra, since Hoskins was only aware of one employer, Four Star, Better Integrated could not have legally leased Hoskins to Beacon. In order to meet the standard set forth in Larson's, supra, Hoskins must have known he was employed by Better Integrated and made subsequent contracts of hire with Beacon and Four Star. In the case *sub judice*, there is no evidence the above occurred. Hoskins was not aware he was an employee of Better Integrated, he did not make a separate contract of hire with Beacon, and although he entered into a contract

> of hire with Four Star, he did not enter into a contract with Four Star as his special employer.

In short, the Board agreed with KEMI's contentions that Hoskins was not an employee of Beacon Enterprises, and that Hoskins could not, therefore, have been leased by Beacon Enterprises to Four Star. Moreover, the Board concluded that "the evidence, including the testimony of the Manzos and Garavaglia, compel[led] a finding the alleged agreement involving Hoskins was nothing more than a sham concocted to obtain workers' compensation coverage for Hoskins' injury." With that being said, the Board found the ALJ's contrary findings to be unsupported by any evidence and unreasonable, and reversed the ALJ's decision in this respect. Consequently, the UEF became statutorily liable for paying Hoskins' benefits.

The UEF now appeals, arguing that the Board was not authorized to set aside the ALJ's findings on this issue because the ALJ's findings were supported by substantial evidence of record. However, the UEF, like the ALJ's prior opinion in this matter, points to no evidence indicating that Hoskins ever formed a contract of hire with Beacon Enterprises; nor, for that matter, have we discovered any such evidence in our own review of the record.

Our standard of review of a decision of an administrative agency is centered on the issue of arbitrariness because of our constitution's prohibition against arbitrary actions. *Com. Transp. Cabinet Dept. of Vehicle Regulation v. Cornell*, 796 S.W.2d 591, 594 (Ky. App. 1990). Under this standard, we can only

reverse 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). Substantial evidence means "evidence of substance and relevant consequence having the fitness to induce conviction in the minds of reasonable men." *Owens-Corning Fiberglas Corp. v. Golightly*, 976 S.W.2d 409, 414 (Ky.1998). Thus, where an ALJ's finding is unsupported by substantial evidence, it is well within the province of the Board and this Court to reverse the ALJ.

Here, because no substantial evidence supports the ALJ's finding that Hoskins had an employment relationship with Beacon Enterprises, the Board acted within its authority in reversing the ALJ. We find no error in this respect.

II. DISCOVERY SANCTIONS AGAINST BETTER INTEGRATED AND BEACON ENTERPRISES

On an unrelated note, the Board also addressed whether it had the authority to issue discovery sanctions for conduct that occurred exclusively before the ALJ. In relevant part, the Board held:

> Finally, although not raised by either party, we feel compelled to address the July 20, 2009, deposition testimony of [Charles] Garavaglia. First, we believe a fair reading of Garavaglia's testimony establishes his responses to questions from KEMI's counsel were evasive, belligerent, and on one occasion inappropriately obscene, rude, utterly disrespectful to the attorney and the proceedings and, therefore, contemptuous. We believe the ALJ, to a limited extent, has inherent contempt powers which should have been exercised, or at

> a minimum, entertained and addressed sua sponte concerning Garavaglia's demeanor and conduct toward KEMI's counsel and tribunal.

The Board further held that KRS 342.230(3), in conjunction with KRS 342.310, authorized both the ALJ and the Board to "sanction disrespectful and contemptuous behavior either on the part of a witness, party, or an attorney." As such, the Board then ordered the ALJ, on remand, to

> [R]eview Garavaglia's entire testimony, and specifically that contained on page 63 of his deposition, and determine the appropriate monetary sanctions to be imposed against Beacon and Better Integrated. Such sanctions are appropriate against Better Integrated and Beacon since they sought and successfully obtained Garavaglia's presence at the deposition as their designated representative.

As a preliminary matter, administrative agencies are creatures of statute. They "have no inherent authority and may exercise only such authority as may be legislatively conferred." *Herndon v. Herndon*, 139 S.W.3d 822, 826 (Ky. 2004) (citing *Linkous v. Darch*, 323 S.W.2d 850 (Ky. 1959); *Robertson v. Schein*, 305 Ky. 528, 204 S.W.2d 954 (1947)); *see also Custard*, 57 S.W.3d at 287 (explaining that the subject matter jurisdiction of administrative agencies, such as the Office of Workers' Claims and the Workers' Compensation Board, extends only to those matters that are delegated to them by the legislature); *Department for Natural Resources and Environmental Protection v. Stearns Coal & Lumber Co*., 563 S.W.2d 471, 473 (Ky. 1978) (citing 2 Am.Jur.2d. Administrative Law § 70

(1962)); *see also Kerr v. Kentucky State Board of Registration for Professional Engineers and Land Surveyors*, 797 S.W.2d 714, 717 (Ky.App.1990).

Moreover, "the judiciary sanctions strict adherence to the legislatively defined roles of the fact finder (administrative law judge) and the appellate body (Workers' Compensation Board)." *Osborne v. Pepsi-Cola*, 816 S.W.2d 643, 644 (Ky. 1991) (citing *Nord v. City of Cook*, 360 N.W.2d 337 (Minn. 1985)). And, "It is well-established that the issue of subject matter jurisdiction"—which necessarily includes the matter of the Board's legislatively defined role—"can be raised at any time, even *sua sponte*, as it cannot be acquired by waiver, consent, or estoppel." *Doe v. Golden & Walters, PLLC*, 173 S.W.3d 260, 269 (Ky.App.2005).

That said, we agree that in proceedings before the ALJ, the ALJ has the authority to sanction parties for committing certain discovery violations. *See, e.g., City of Louisville v. Slack*, 39 S.W.3d 809, 812 (Ky. 2001) ("[T]he proceedings before the ALJ include procedural safeguards" including "The right to discovery and to depose witnesses according to certain Kentucky Civil Rules of Procedure."). In particular, we would refer to the discovery sanctions described in CR[8] 37, which the Executive Director of the Office of Workers' Claims adopted by promulgating 803 KAR 25:010 § 17(1) pursuant to his statutory authority. *See, e.g.*, KRS 342.260(1) ("The executive director shall prepare administrative regulations as he considers necessary to carry on the work of the office and the work of the administrative law judges. . .").

[8] Kentucky Rule of Civil Procedure.

However, the Workers' Compensation Board is an administrative appellate body. KRS 342.285(1). KRS 342.285(2) confines the Board's scope of review to determining whether:

> (a) The administrative law judge acted without or in excess of his powers;
> (b) The order, decision or award was procured by fraud;
> (c) The order, decision or award is not in conformity to the provisions of this chapter;
> (d) The order, decision or award is clearly erroneous on the basis of the reliable, probative and material evidence contained in the whole record; or
> (e) The order, decision or award is arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

No part of KRS 342.285(2) grants the Board any authority to order an ALJ, upon remand, to sanction a party for a discovery violation that occurred exclusively during proceedings before the ALJ, prior to when the Board's appellate jurisdiction was even invoked. Indeed, KRS 342.230(3) provides that "supervis[ing] the presentation of evidence" is the duty of the ALJ, not the Board.

Similarly, while KRS 342.310 does state several bases upon which "any administrative law judge, the [B]oard, or any court before whom any proceedings are brought under [Kentucky's Workers' Compensation Act]" may issue sanctions, those bases do not include a witness's "evasive, belligerent, and on one occasion inappropriately obscene, rude, utterly disrespectful" conduct during depositions. *See, e.g.*, KRS 342.310(1) and (2). Rather, sanctions relating to such behavior properly derive from CR 37, as adopted by the Executive Director in 803 KAR 25:010 § 17(1).

In the Courts of Justice, it is the trial court that has wide discretion in applying the sanctions provided by CR 37. *Benjamin v. Near East Rug Co., Inc.*, 535 S.W.2d 848 (Ky. 1976). In light of the ALJ's role in supervising the presentation of evidence and as the fact-finder in workers' compensation disputes, the same rule must also apply to the ALJ, rather than the Board. As such, the Board had no authority to direct the ALJ in this manner, and, consequently, this part of the Board's directions to the ALJ, upon remand, must be vacated.

III. CONCLUSION

For these reasons, the opinion of the Workers' Compensation Board is hereby AFFIRMED IN PART and VACATED IN PART.

ALL CONCUR.

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