



Labour Only Subcontractors and Bona Fide Subcontractors



Labour Only Subcontractors and Bona Fide Subcontractors: Determining their Status

One of the most frequently debated subjects in Liability insurance is the status of subcontractors – those engaged by a policyholder to perform work on its behalf.

Policyholders use subcontractors for several reasons:

1

It may be more cost effective to “employ” people on this basis because it means the policyholder can adapt the size of its workforce to meet the demands of its workload – rather than directly employ full time staff and incur the associated costs of doing so.

2

In particularly busy periods it gives the policyholder the flexibility to quickly expand to handle any increased workload.

3

It may be that some tasks are outside the policyholders’ core expertise, and the services of a specialist are required to enable the policyholder to offer a more complete service.

Why is the Status of Subcontractors so important?

Subcontractors are engaged under a contract of service or under a contract for services. There has been much legal discussion about the characteristics of each, however, we will try and summarise these below:

- **A labour only subcontractor (LOSC)** will be treated as if they are working under a contract of service in a similar way to a directly employed person. There will be a master-servant relationship that is recognised in law
- **An independent contractor – or bona fide subcontractor (BFSC)** – will work under a contract for services where they will control the whole activity themselves, rather than work under the direct supervision of their employer

There are no standard definitions of the different types of subcontractor, however, there is extensive legal case history, and it is of vital importance that the policyholder has a proper understanding of the basis on which the subcontractor is being engaged, and what their status is:

The nature of this relationship will determine to what extent the policyholder is liable for injury to the subcontractor, and the extent to which the policyholder is liable for the actions of the subcontractor. Insurers will take this into account in their acceptance and pricing of Employers' and Public/Products Liability exposures, which means the policyholder must understand the differences between BFSC and LOSC's to ensure that the correct insurance cover is in place.

As well as the implications for the policyholder's Liability insurance, the failure to correctly classify a subcontractor as an employee working under a contract of service, could result in a failure to comply with Employers Liability compulsory insurance regulations, meaning the policyholder could incur fines/penalties.

How can subcontractors be correctly classified?

It is the nature of the contract between the policyholder and the subcontractor (which may be in writing but can also include implied terms and verbal agreements) that will determine the nature of the policyholder's relationship with the subcontractor.

However, in the event of legal disputes, the courts will look at the facts of each case and, importantly, consider how the relationship worked in practice, and may even ignore the contractual intention of both parties. For this reason, it is important to look beyond any contractual agreement and consider how the subcontractors are controlled and supervised in practice.

What is a LOSC?

A LOSC generally works under the direct supervision and control of the policyholder. They work under a **contract of service** and do not usually provide their own materials or tools. They may have their own insurances; however, they are almost inseparable from the policyholder's own employees and are treated as one and the same for the purposes of Liability insurance.

Their wage roll should be included in any estimates that are provided for the purposes of rating Employers' Liability cover. If they are injured in the course of their employment there is likely to be an EL claim against the policyholder, and the policyholder is likely to have a vicarious liability for any injury or damage caused by the LOSC.

Example: A policyholder who is a building contractor is working on a construction project, the contract is too large for full time employees to handle in a timely manner, ultimately, the policyholder does not feel they will complete the construction project on time. The policyholder requires an extra pair of hands on a short-term basis to complete the job, they therefore, engage labour only subcontractors to assist.

What is a BFSC?

BFSC are usually a separate company (but can be individuals) engaged by the policyholder for the purpose of providing a specialist service or simply to provide additional resource. They work under a **contract for services**. BFSC are deemed to be independent contractors who work without any direct supervision and control from the policyholder. They hold their own insurance and usually provide their own materials and tools (although they can provide labour in isolation as well).

BFSC don't need to be included under the policyholders' Employers' Liability cover. The policyholder will not usually have a vicarious liability for their actions, but insurers usually provide 'contingency' cover under Public/Products Liability insurance and claims are often initially made against the policyholder, as principal.

If a BFSC suffers injury whilst working on behalf of the policyholder, this will be dealt with under the Public/Products Liability insurance, **provided the nature of their engagement is such that the court would not deem them to be an employee.**

Example: A policyholder is undertaking a building construction project; the contract includes complex plumbing work which is beyond the experience of the policyholder's full-time employees. The policyholder engages a specialist independent plumbing contractor to carry out the specific plumbing activities on the build project, as the policyholder does not have the expertise to undertake these works directly themselves.

Why is this important to Liability insurers?

Liability insurers usually adopt the following approach:

- Payments to LOSC are included in wage roll estimates for the purpose of rating.
- Payments to BFSC are excluded from wage roll estimates.
- The PL cover is rated on T/O excluding payments to BFSC, but a lower rate is applied to the payments to BFSC to reflect the contingent nature of the PL risk.
- Some insurers may NOT discount the PL rate for BFSC due the increased risk of PL claims arising as result of injury to BFSC.

In order to justify the lower level of premium being charged to reflect work undertaken by BFSC, it is common for insurers to add a Bona Fide Subcontractors Condition to the policy. This will require the policyholder to ensure that the BFSC have in full force and effect, throughout the duration of their contract, both EL and PL insurance (with a specified Limit of Indemnity).

The Condition usually requires the BFSC insurance policies to contain an **Indemnity to Principal** clause which will benefit the policyholder in the event that a loss caused by the BFSC results in a claim against the policyholder. It is usually a requirement that written evidence of BFSC insurances is obtained and retained.

If the policyholder incorrectly classifies BFSC as LOSC and vice versa, there is a risk that the insurer will charge the wrong premium and/or apply inappropriate terms, which could lead to claims being unpaid, the cover being avoided and/or additional premium becoming payable in order to retrospectively rectify any mistakes.

A breach of the BFSC Condition may also result in insurers rejecting a claim.

What cover is provided for BFSC?

Most insurers will automatically provide contingent cover for the actions of BFSC. The need for contingent cover arises where a loss is caused by a BFSC and:

- It is decided that the policyholder is vicariously liability for the actions of the BFSC or,
- The BFSC insurance fails for some reason but the BFSC Condition has been complied with

Even where work is undertaken by a BFSC, the policyholder may still be liable for losses caused by the BFSC if, for example, there has been a failure to manage the overall safety of the site.

LOSC v BFSC – A quick reference guide

Although there is no standard definition, there is much case law that helps us determine what factors are important in the determining the classification of LOSC or BFSC:

LOSC – the subcontractor	BFSC – the subcontractor
is usually an individual (but be aware of labour gangs and individuals working under an umbrella company)	is usually a firm (but could be an individual) that employs others and has the freedom to move employees onto other jobs
works under the direct control/supervision of the policyholder and is told what to do and where and when to do it	works to a job specification provided by the policyholder but decides exactly how, where and when the work is done, and by whom
works under the policyholder's method statements and risk assessments	creates own method statements and risk assessments which employees must follow
works mainly for one principal	decides who to accept work from and/or regularly works for multiple parties
paid daily/hourly/weekly	paid a fixed fee for the job and takes the financial risk if costs increase
provides labour only	provides labour for every job and usually provides materials (some BFSC can provide labour only)
uses tools, safety equipment and materials provided by policyholder	provides own tools and safety equipment
can't subcontract the work given	is free to subcontract work to others
could carry their own Liability insurance	always has their own Liability insurance
have no say in how the business is run and no financial risk in the contract	always has the final say in how the business is run
is referred to as an employee or as under a contract of service with the insured in any documentation	is referred to as working under a contract for services in any documentation
entitled to sick/holiday pay if absent from work	is not entitled to sick pay or holiday pay by the policyholder

This is not an exhaustive list and it is recommended that policyholders seek legal advice



Conclusion

As this article highlights, it is of crucial importance that the policyholder has a clear understanding of the status of any subcontractors they engage.

The most important consideration is the degree of supervision, direction and control the policyholder has over their subcontractors. Contracts can include terms that are implied and spoken, therefore, intentions always need to be made clear. However, it is ultimately the specific circumstances of each relationship and the facts of each case that will influence the courts to determine the subcontractor's status.

The policyholder needs to ensure that they always make adequate checks when utilising any subcontractor and should seek the appropriate legal advice in the event of any uncertainty.





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