

THE GRAND JURY OF THE SUPREME COURT  
OF THE STATE OF NEW YORK  
COUNTY OF NEW YORK

REPORT OF THE GRAND JURY  
OF THE SUPREME COURT  
STATE OF NEW YORK  
FIRST JUDICIAL DISTRICT  
ISSUED PURSUANT TO  
CRIMINAL PROCEDURE LAW  
SECTION 190.85 SUBDIVISION (1)(c)

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DISTRICT ATTORNEY  
NEW YORK COUNTY

## INTRODUCTION

On March 25, 1911, a fire raged through the Triangle Shirtwaist Factory building on Washington Place, causing the deaths of 146 garment workers, most of whom were immigrants, some as young as 12 years old. This disaster was the catalyst for the passage of New York's workers' compensation law,<sup>1</sup> a no-fault social insurance program that protects both employees and employers from financial loss when job-related accidents result in disability, injury, or death. Without this system, employees would have no financial recourse except through personal injury lawsuits, with their attendant legal costs and delay. Instead, through the mandate that every employer maintain insurance coverage for his or her employees, the Workers' Compensation Law ensures that employees can recover for lost wages and medical expenses and that employers are protected from economic ruin.

During the course of its work, however, this Grand Jury saw how vulnerable the system is to fraud by employers scheming to reduce their workers' compensation insurance premiums.<sup>2</sup> The incidents of premium fraud

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<sup>1</sup> New York Workers' Compensation Law Articles 1 through 11.

<sup>2</sup> This Grand Jury was impaneled by the Honorable Robert M. Stolz, upon application of New York County District Attorney Cyrus R. Vance, Jr. on September 12, 2013, and extended on October 3, 2013, to a term ending on February 27, 2014. In the limited time available, the Grand Jury has found legally sufficient evidence to return two indictments charging two persons with multiple felony charges relating to workers' compensation insurance premium fraud as well as other tax-related charges, and has heard evidence about the misconduct of other subjects, who were employers or officers of employers, who have agreed to enter guilty pleas in connection with

misconduct we examined gave the wrongdoers an improper competitive advantage over all law-abiding businesses, divested vulnerable workers of important protections and benefits, and deprived New York State and New York City of substantial revenue.

In our effort to find systemic remedies for the problem created by this type of fraud, we heard testimony from a broad range of witnesses: law enforcement personnel, representatives of government agencies, money service businesses, the insurance industry, and individuals employed in the construction industry. We also heard perspectives from those representing labor and those representing employers, including some who had committed workers' compensation premium fraud. We have learned that premium fraud by employers is the costliest form of fraud afflicting New York's \$6 billion-a-year workers' compensation insurance industry. In a single year, for example, the financial loss from premium fraud in the construction industry in New York City alone approached half a billion dollars. And every lost dollar must be made up by a dollar increase somewhere else, a cost-shifting phenomenon that affects us all. Every law-abiding employer is a victim of this criminal conduct, as is every hard-working employee, every consumer, and every honest taxpayer. We believe that legislative, executive, and administrative reforms can

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similar fraudulent schemes. All of these cases involved employers in the construction industry.

assist in early detection of this type of fraud, improve compliance and enforcement efforts, deter cheating, and ensure fair and equitable treatment of all policyholders.

Our recommendations fall into four general categories:

- increased penalties to ensure that sentences are proportionate to the magnitude of the fraud;
- increased transparency by reforming the application and audit process, thereby making it more effective and less susceptible to fraud;
- increased dissemination of information into the hands of those charged with investigating and prosecuting fraud; and
- increased education for employees and the community at large about the workers' compensation system and its value to the public, so that everyone is better able to protect the system from fraud.

### NEW YORK'S WORKERS' COMPENSATION SYSTEM

New York law requires every employer to obtain workers' compensation insurance. Employers can form a self-insurance program, turn to private commercial carriers, or seek government insurance from the State Insurance Fund, which is a part of the Department of Labor. The New York State Insurance Fund, which recently celebrated its 100<sup>th</sup> anniversary, handles about

40 percent of New York's workers' compensation market as the insurer of last resort.<sup>3</sup>

The New York's Workers' Compensation Board administers the Workers' Compensation Law. One of the board's functions is to levy assessments or penalties on employers. Additionally, the Department of Financial Services regulates the State Insurance Fund and all private workers' compensation insurance carriers.

At the same time, the New York Compensation Rating Board, an independent body, collects and analyzes data to develop the workers' compensation rate structure for 571 job classifications, ranging from accountants to landscapers to roofers, and also sets the premium rates each year. The rate for each classification is based on actuarial analyses, which are updated annually and translated into a dollar amount. The rate for a relatively safe job may be as low as 2 cents for each \$100 of payroll. More dangerous jobs may be rated as high as \$35 for each \$100 of payroll.

An individual employer's premium is set by a formula that considers the amount of the employer's gross payroll, the amount of the employer's gross receipts, the employer's prior history, and the rates assigned to the type of work each employee performs. As we heard in the evidence before us, this system

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<sup>3</sup> The New York State Insurance Fund was created in part to guarantee the availability of workers' compensation protection to any employer seeking coverage.

creates an incentive for unscrupulous employers to falsify one or more of these figures in an attempt to lower their premiums.

## HOW EMPLOYERS CIRCUMVENT THE SYSTEM

### A. Types of Fraud

We heard evidence that employers cheat the system in several ways, some of which are quite sophisticated. The simplest method is to avoid securing insurance altogether, a practice prevalent even in some of the most hazardous construction fields. Other employers understate the number of employees or the amount of their payroll. Often, these employers also pay the hidden employees “off-the-books,” in whole or in part, as part of the scheme. These illicit payments are sometimes made in cash, usually generated at a commercial check casher, and sometimes made from a bank account that appears on its face to be unrelated to the employer.

Another fraudulent practice about which we heard evidence involves phantom subcontractors or employers, who exist only to disguise the true number of the employer’s own work force. In this variation, the dishonest employer pays his workers with funds funneled through one or more entities. These entities may produce a certificate of insurance that insulates the true employer from liability, but will rarely provide adequate coverage for all the actual employer’s employees. Moreover, these phantom entities simply dissolve

when questions arise — often re-establishing themselves under new names to start the fraudulent process anew.

Other forms of fraud involve misclassifying employees in one of two ways. In the first, the employer lies about what work the employee performs, using a code classification that corresponds to cheaper insurance than the correct code would.<sup>4</sup> In the second, the employer misrepresents an employee, required to be insured, as an independent contractor, who is not. The true nature of the business relationship is disguised by such tactics as giving the employee a Form 1099 instead of a W2.<sup>5</sup> In either circumstance, the deceitful employer improperly lowers his or her insurance premium. According to expert evidence presented to the Grand Jury, such purposeful misclassifications are very common.

In yet another form of fraud, the employer lies about his past history, a factor also known as the “experience modifier,” in order to conceal prior workplace accidents or falsify how long the business has been operating. A simple technique dishonest employers use is to change the name of their business or hide the true owner’s identity.

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<sup>4</sup> For example, an employer might list a “roofer” as a “clerical employee,” substituting a false low-risk classification for the high-risk trade the worker is actually performing.

## B. Estimated Magnitude of the Problem

The number of employers who pursue these schemes continues to explode. In June 2013, the Fiscal Policy Institute published a study of New York City's construction industry circa 2011. The report estimated that New York State and New York City lost over \$420 million that year solely from the way 70,000 construction laborers were being paid off-the-books or misclassified as independent contractors.<sup>6</sup> The biggest single component of that loss was unpaid workers' compensation premium, which was well over \$230 million.<sup>7</sup> Another \$100 million represented health-care costs borne by the taxpayer or financed by surcharges on employer-paid health insurance.<sup>8</sup>

## C. Effect of Premium Fraud

Premium fraud that costs the city and state also harms law-abiding employers in multiple ways. Dishonest employers illegally lower their labor costs and can afford to pay higher salaries, thus luring the more experienced workers from honest competitors. Defrauding employers can also sell products at a lower price and underbid their law-abiding competitors.

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<sup>5</sup> In cases like this, the employer also cheats on withholding tax and unemployment insurance tax.

<sup>6</sup> The city and state also lose money through underpayment of business tax and the MTA surcharge tax, amounts that could push the total loss toward the half billion dollar mark.

<sup>7</sup> Notably, this amount, huge as it is, does not include losses attributable to improper classification of the occupational code of employees.

<sup>8</sup> Other portions of the loss come from unpaid unemployment insurance tax, unpaid city and state withholding tax, and unpaid city and state personal income tax.

Additionally, the deficits created by dishonest employers result in higher premiums, which are ultimately shouldered by law-abiding employers.

Premium fraud harms employees as well. As perhaps unwitting participants in an underground economy, employees are deprived of the protections and benefits the social insurance program provides in the event of death, injury, disability, or unemployment. And, because the employers do not pay the proper amount of withholding tax, the employee's social security benefits may be reduced. Hidden workers are often paid less than the prevailing wage standard, lose overtime pay, and receive little or no health, vacation, and retirement benefits.

Overall, premium fraud generates an unfair business environment in which honest business owners cannot compete with rogue employers and are either forced out of the market or dissuaded from entering it in the first place. Either way, there is a loss of jobs and entrepreneurial ventures.

### RECOMMENDATIONS

Following careful consideration of the evidence and our legal instructions, we have invoked our authority pursuant to Criminal Procedure Law Section 190.85(1)(c) to submit a report to the impaneling Court, “[p]roposing recommendations for legislative, executive or administrative action in the public interest based upon stated findings.”

## Recommendation One

The Grand Jury urges the legislature to revise the criminal provisions contained in the Workers' Compensation Law to make them reflect the gravity of premium fraud. For example, the law should be amended to:

- create graduated degrees of felony offenses for all acts of premium fraud and increase criminal fines to provide a more proportionate financial deterrent;
- amend corresponding provisions of the Penal Law to increase possibilities for prosecution; and
- require the publication of all criminal dispositions.

The current Workers' Compensation Law is the result of a patchwork development, with crimes scattered throughout.<sup>9</sup> None of the offenses contain any degree enhancement for the magnitude of the fraud. For instance, the indictments we have returned include charges under Section 96 of the Workers' Compensation Law, a charge that remains a class E felony whether the amount of the premium fraud is \$1,000, or \$100,000.<sup>10</sup> We recommend that the relevant statutes be amended to include a graduated series of crimes, distinguished by monetary thresholds, so that the charge can reflect the magnitude of the wrongdoing. In addition, both the Penal Law and the

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<sup>9</sup> For example, some provisions are in Article 4, others in Article 6, and still others in Article 7.

<sup>10</sup> In contrast, we have voted to charge Tax Law offenses of varying degrees, distinguished by the amount of evasion proven.

Workers' Compensation Law should be changed to make it clear that the laws are intended to cover all forms of premium fraud, whether committed by lying about a fact relevant to the premium calculation, by refusing to submit to an audit, or by refusing to provide required documents during an audit.

The legislature should also amend the money-laundering statutes, Penal Law section 470.00 *et seq.*, and the enterprise-corruption statute, Penal Law section 460.00 *et seq.*, to include Workers' Compensation Law felonies as possible predicate offenses. This amendment would not only provide prosecutors with additional tools to fight premium fraud, but would also emphasize the seriousness of this form of wrongdoing.

We also believe that the criminal fines currently available do not constitute a sufficient financial penalty or an effective deterrent. In fact, the potential criminal fine could in many cases be far smaller than the amount of unpaid insurance resulting from the fraud. The law should be amended to increase the criminal fines as a general matter and to give judges the option of imposing a fine that is double or triple the amount of the fraud.<sup>11</sup>

We also recommend that the Workers' Compensation Board be required to publish information on its website about all criminal dispositions.

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<sup>11</sup> The Legislature should also consider the possibility of enhancing enforcement efforts by setting aside a portion of the criminal fines collected to be used for investigative purposes.

Publication of this information will, over time, inform the public about the nature of this type of fraud and the penalties that can result.

### Recommendation Two

This Grand Jury also recommends overhauling the application process by employers and the audit procedure of the employer/policyholder. Some recommendations can be implemented through the regulatory authority of the Workers' Compensation Board or other appropriate governmental agencies; others will require enactment by the New York legislature. The following recommendations are vital in curbing the high incidence of premium fraud:

- design a uniform workers' compensation insurance application;
- require vigorous and thorough annual audits by all insurance carriers;
- issue every employee a Workers' Compensation Insurance card;
- revise the certificate of insurance to include more detail; and
- require issuers of 1099 Forms to file an annual report with the Workers' Compensation Board.

The Grand Jury urges the design of a standard application, patterned after the comprehensive State Insurance Fund's form, to be used by every insurer and to be electronically transmitted to the Workers' Compensation

Board. Several witnesses' testimony highlighted a three-fold advantage for auditors: (1) a standard application would make it easier to catch discrepancies or irregularities; (2) a standard electronic application would be readily searchable; and (3) standard electronically-stored applications would create a powerful database of background information about the employer.

Moreover, the employer should be required to swear to the truth of the information submitted, and the application should contain warnings that all statements are made under the penalties of perjury. Ironically, an employee who submits an injury-related claim must certify that he or she is entitled to the payment, but the law does not impose a similar obligation upon the employers purchasing coverage.

The Grand Jury heard evidence that the insurance premium quoted at the beginning of the policy year is an estimate, and that the insurance carrier will pay the difference between the estimate and the actual amount of premium, known as "truing-up" the premium, after the close of the policy year during an annual audit. Unfortunately, some unscrupulous employers, like those investigated by the Grand Jury, view the existence of the audit process as a license to lie during the application process. Others treat the audit as an invitation to engage in a cat-and-mouse game of deception.

The timing of the typical audit, which usually occurs 15 to 18 months after the policy is issued, creates difficulties for the auditor. By the time of an

audit in the construction industry, for example, the construction project may have been completed, the jobsite vacated, and the laborers sent on to other locations, facts that make it difficult to verify the identity, number, and trade of the employees. Moreover, devious employers often surf from one insurer to another, or reorganize under a new name controlled by a supposedly new owner, rendering the audit moot or its determination difficult to enforce. Furthermore, some unprincipled employers refuse to provide the necessary documents to avoid paying the correct premium. Furthermore, records produced by the employer during an audit are usually not retained, nor is the employer required to sign any summary or exit report at the end of the audit. Instead, a representative of the business may sign, a practice that allows cheating employers, if questions arise, to distance themselves from any misrepresentations.

Since a vigorous audit is a potent tool for ferreting out fraud, the law should require that all carriers conduct thorough audits. In this way, no carrier will suffer a competitive disadvantage from being assertive in its auditing practices. Auditors should be required to make on-site physical inspections, particularly in the construction industry. There should be a thorough document review—not just a cursory telephone inquiry. Documents produced during the audit should be electronically transmitted to the insurance carrier, so that they will be available for examination if there is a later allegation of fraud.

Employers should be required to certify the accuracy of the information provided, under the penalty of perjury, and to acknowledge or dispute the auditor's findings at the conclusion of the audit.

One witness described an existing practice in the construction industry that could be used as a model to deter premium fraud, based on the relationship between the subcontractor and general contractor. Specifically, general contractors require their subcontractors to provide a release of all mechanics liens before they will pay the subcontractor. We believe subcontractors should also be required to provide general contractors with proof from the insurance carrier verifying that all employees at a jobsite are covered by the subcontractor's workers' compensation insurance policy before payment is made to the subcontractor.

As things stand now, it is difficult to tell which employees are actually covered by an employer's insurance policy and which are not. One witness suggested, and the Grand Jury agrees, that a Workers' Compensation Identification Card should be issued to each employee. This card should contain the name of the employee, the employer, and the insurance carrier. It could be presented when the employee seeks medical services or prescription drugs in connection with a job-related injury or illness. It could also be shown to general contractors, owners, law enforcement, first responders, and auditors.

The Grand Jury also believes that certificates of insurance currently in use do not contain enough information. At the moment, the certificates merely verify that there is an existing workers' compensation insurance policy. They do not give any information about which laborers are covered or what work they are supposed to be doing. A more detailed certificate should be required and should, at the least, list the workers insured and their code classifications. In addition, at construction sites, the certificate should be publicly posted, just as the relevant permits are.

To address instances in which employers intentionally misclassify employees as "independent contractors" to lower the amount of the workers' compensation insurance premium, we recommend that any business required to provide a federal Form 1099 for services performed should also be required to report independent contractors to the Workers' Compensation Board. These reports will provide a valuable database that can be used to verify information provided during the workers' compensation audit.

### Recommendation Three

The Grand Jury recommends broader data collection, wider collaboration among state and local agencies and between public and private sectors, and the implementation of analytical methods to detect patterns of fraud. To effectuate this, it is necessary to:

- create an integrated database to combat workers' compensation insurance fraud;
- include in that database all applications, audit exit reports, and certificates of insurance; and
- create a real-time database of information from commercial check cashers available to the Workers' Compensation Board.

As underscored through witness testimony, advanced technology could help combat workers' compensation premium fraud. At the moment, applications and audit exit reports are not digitally maintained by the Workers' Compensation Board. Other databases, such as City Health Department records containing data on food handlers, for example, cannot easily be cross-checked with the records of restaurant employees. Other similar governmental "data sets" could be used to cross-check employer representations, such as those maintained by the New York State Department of Education licensing divisions. In the private sector, the National Insurance Crime Bureau maintains an industry-wide database of fraud complaints reported to all state insurance or financial services departments. All the states participate—except New York. Another private-sector resource that could be tapped is the "real time" data maintained by commercial check cashers, whose services are often used by cheating employers.<sup>12</sup> Additional information could be gleaned from reports filed by any business issuing federal 1099 Forms. Databases that do

exist, such as those containing information about policyholder and fraud complaints filed with the Workers' Compensation Board, are not accessible to law enforcement.

The Grand Jury recommends building a database that assembles all of this data for use in the fight against premium fraud. Fortunately, there is a ready model: the City, through its Office of Data Analytics, has launched DataBridge, a database of digital information from many city agencies, a few state agencies, and some private sector sources. Formerly maintained in isolated and disconnected databases, this information trove can now be accessed from single platform. This system could readily be expanded to integrate data maintained by other state agencies like the Workers' Compensation Board and other branches the Department of Labor, with their consent, thus capturing essential information that can help uncover premium fraud. The database can also incorporate predictive analytics that can detect anomalies that will help focus scarce investigative resources. In fact, the Office of Data Analytics provided the Grand Jury an impressive example of how it assisted one City agency to double its productivity without increasing its personnel.

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<sup>12</sup> Commercial check cashers are required to maintain a daily register of the checks cashed and images of any check cashed that is greater than \$1,500.

A database of this kind would yield many benefits to those tasked with the investigation or prosecution of premium fraud, including more effective use of resources and more efficient selection of subjects. It would enable cross-agency compliance checks and foster cooperation among state and local agencies, as well as between the government and the private sectors. At the same time, all confidential information could be protected with built-in firewalls and data encryption, limiting the number of users with access.

#### Recommendation Four

The Grand Jury recommends broader education directed to a wider audience. Outreach should:

- provide employers with knowledge of their obligations under the system;
- teach law enforcement how to fight premium fraud;
- increase community awareness about the negative effects of premium fraud; and
- tell employees about their rights under the system and how to protect them.

Traditional training – whether at the workplace, through handouts, in mailings, or on website postings – is insufficient to reach everyone who needs to be informed about the harm produced by premium fraud. The testimony

underscores at least four missed opportunities, which, if corrected, would help reduce premium fraud.

First, “startup” employers need counseling on their obligation to provide appropriate coverage for all employees. Second, first responders at a workplace accident or to a traffic incident involving a commercial vehicle should be collecting information about workers’ compensation coverage. Police officers, emergency medical technicians, and firefighters, if made aware of the importance of this information, can become a front line in the fight against premium fraud.

Third, the public needs more information about the need for coverage, the significance of certificates of insurance, and the reasons for proper classification of employees. With this knowledge, they can become the eyes and ears of law enforcement in detecting premium fraud.

Fourth, there needs to be more outreach to employees. They need to be informed about the benefits they forfeit by being driven underground and enlightened about the dangers of being treated improperly as independent contractors, or, at least, about the fact that, in assuming that role, they will also need to be responsible for covering the costs of work-place injuries, for themselves and all laborers working for them.

Other educational projects can be launched through trades associations or chambers of commerce or by local bar associations in partnership with state and local government agencies and prosecutorial offices.

### CONCLUSION

Workers' compensation insurance is designed to be affordable so employers can stay in business and employees can be made whole. It is an important part of the economic structure of New York. A well-functioning workers' compensation system not only generates significant revenues for the City and the State, but also fosters equality in the marketplace and allows small businesses to flourish, creating the sorely-needed jobs. It benefits every employer, every employee, every consumer, and every taxpayer. The changes we recommend will help deter premium fraud and help detect it when it is committed, making the system more effective for everyone.

WE THE GRAND JURY OF THE SUPREME COURT, STATE OF  
NEW YORK, FIRST JUDICIAL DISTRICT, PURSUANT TO THE  
PROVISIONS OF CRIMINAL PROCEDURE LAW SECTION 190.85(1)(c),  
BASED UPON OUR STATED FINDINGS, SUBMIT THIS REPORT  
RECOMMENDING LEGISLATIVE, EXECUTIVE AND  
ADMINISTRATIVE ACTION IN THE PUBLIC INTEREST.