



CORPORATION, SECURITIES & BUSINESS LAW FORUM

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A look at the Illinois Employee Classification Act

By Markus May; Eckhart Kolak LLC, Chicago, Illinois

The Illinois Employee Classification Act (“Act”) became effective on January 1, 2008. 820 ILCS 185/1 et.seq. In order to get your attention, let’s look at the draconian and overly harsh penalties for violation of the Act. First, there is a civil penalty of up to \$1,500 for each violation of the Act which is found in an audit by the Department of Labor. Id. at 185/40. This steps up to \$2,500 for subsequent audits. Id. Each day a violation continues constitute a separate and distinct violation. Id. Further, in any civil action brought by an interested party under Section 40, the court is required to award the interested party 10% of the amount recovered – essentially a bounty for pursuing violators. Id. Second, if there is more than one violation, no state contract is allowed to be awarded to the violator for five years. Id. at 185/42. Third, anyone who “willfully” violates the Act is liable for (a) penalties up to double the statutory amount; (b) punitive damage equal to the penalties in (a); and (c) commits a Class C misdemeanor and on a second violation a Class 4 penalty. Id. at 185/45. Fourth, an “interested party” or person aggrieved by a violation of the Act may file suit in circuit court and “is entitled to collect” (1) the amount of wages and salary and other benefits lost by reason of the violation plus an equal amount in liquidated damages; (2) compensatory damages and an amount of \$500 for each violation of the Act (remember each day is a separate violation); and (3) attorney fees and costs. Id. at 185/60.

Therefore, if one of your clients hires a worker for \$10 an hour to help renovate a kitchen for 10 days, but does not hire him as an employee, the following penalties apply to your client:

1. a fine of \$15,000
2. If he knew of the Act and “willfully” violated it, penalties of an additional \$15,000,

plus punitive damages of another \$15,000

3. a Class C misdemeanor
4. a smaller amount of money for not providing social security benefits and perhaps vacation pay
5. liquidated damages in the amount awarded under number 4 above
6. \$5,000 as compensatory damages
7. payment of all attorneys' fees and costs

This equates to over \$50,000 in damages and penalties and a criminal record for hiring someone to help renovate a kitchen!

So now that I have your attention, let's see who the Act affects. The Act significantly affects anyone in the construction industry. The very expansive definition of "Construction" includes "any constructing, altering, reconstructing, repairing, rehabilitating, refinishing, refurbishing, remodeling, remediating, renovating, custom fabricating, maintenance, landscaping, improving, wrecking, painting, decorating, demolishing, and adding to or subtracting from any building, structure, highway, roadway, street, bridge, alley, sewer, ditch, sewage disposal plant, water works, parking facility, railroad, excavation or other structure, project, development, real property or improvement, or to do any part thereof, whether or not the performance of the work herein described involves the addition to, or fabrication into, any structure, project, development, real property or improvement herein described of any material or article of merchandise. Construction shall also include moving construction related materials on the job site to or from the job site." This means that all truckers moving construction related materials to a job site will be covered under the Act as well as all contractors and subcontractors in the construction industry. Id. at 185/5.

The Act provides that any individual performing services for a contractor (which is defined as any entity which engages in construction) is deemed to be an employee, and not an independent contractor, of the contractor absent very limited circumstances. Id. at 185/5 and 10. It is a violation of the Act for an employee or entity not to designate an individual as an employee unless the following limited circumstances are met.

(b) An individual performing services for a contractor is deemed to be an employee of the contractor unless it is shown that:

- (1) the individual has been and will continue to be free from control or direction over the performance of the service for the contractor, both under the individual's contract of service and in fact;
- (2) the service performed by the individual is outside the usual course of services performed by the contractor; and
- (3) the individual is engaged in an independently established trade, occupation, profession or business; or
- (4) the individual is deemed a legitimate sole proprietor or partnership under subsection (c) of this Section.

Id. at 185/10 and 20.

In order to be deemed a legitimate sole proprietor or partnership, the following twelve factors must all be met under subsection (c):

The sole proprietor or partnership performing services for a contractor as a subcontractor is deemed legitimate if the sole proprietor or partnership:

- (1) performing the service free from the direction or control over the means and manner of providing the service, subject only to the right of the contractor for whom the service is provided to specify the desired result;
- (2) is not subject to cancellation or destruction upon severance of the relationship with the contractor;
- (3) has a substantial investment of capital in the sole proprietorship or partnership beyond ordinary tools and equipment and a personal vehicle;
- (4) owns the capital goods and gains the profits and bears the losses of the sole proprietorship or partnership;
- (5) makes its services available to the general public or the business community on a continuing basis;
- (6) includes services rendered on a Federal Income Tax Schedule as an independent business or profession;
- (7) performs services for the contractor under the sole proprietorship's or partnership's name;
- (8) obtains and pays for the license or permit in the sole proprietorship's or partnership's name when the services being provided require a license or permit,;
- (9) furnishes the tools and equipment necessary to provide the service;
- (10) if applicable, hires its own employees without contractor approval, pays the employees without reimbursement from the contractor and reports the employees' income to the Internal Revenue Service;
- (11) is not represented as an employee by the contractor to its customers; and
- (12) has the right to perform similar services for others on whatever basis and whenever it chooses.

Id. at 185/10.

These factors are very difficult to meet and more stringent than the normal independent contractor/employee classification law. Finally, if an entity hires someone who is not classified as an employee, a notice in English, Spanish, and Polish which summarizes the requirements of the Act must be posted on each job site and in each office. Merely not posting the notice is a violation that could subject a contractor to the above damages.

So who would bring an action under the Act? As they pushed for the legislation, it is anticipated labor unions will argue they are an "interested party" under the Act. Therefore unions will likely bring actions against the larger non-union contractors and urge the Department of Labor to pursue regulatory action. The Department of Labor has a great incentive to pursue these actions as it will be able to retain the penalties in a separate

fund. Further, every “independent contractor” that should be deemed an employee under the Act now has a private cause of action. This private cause of action can not be waived as there is no waiver of any provision of the Act. Id. at 185/70. In fact, it is a Class C misdemeanor for an employer to attempt to induce an individual to waive any provision of the Act. Id.

If a contractor hires an individual as an independent contractor to work on a home for nine months, and the individual does not meet the statutory definition of a “legitimate sole proprietor” the potential damages are staggering. Assuming the person worked for 200 days, the person would be entitled to receive \$100,000 in a private cause of action plus all attorneys fees and two times any actual damages. This is a big incentive for anyone to sue.

So what is a “construction” contractor to do? If a contractor wishes to hire an individual “independent contractor” who will be subject to the contractor’s control, the contractor would need to ensure the individual meets the above 12 factor test. The amount of due diligence to ensure these factors are all met is too burdensome to be performed in the normal course of business. Basically the safest and most prudent thing a contractor can do is only hire “employees” or enter into contracts with entities other than individuals.

As the Act begins to be enforced, there will be a large outcry as the actual economic impact of the Act is felt throughout the Illinois construction industry. However, it will take either a change in the law or court action invalidating the law before anything changes. Therefore it is anticipated the number of corporation and limited liability company filings will greatly increase as contractors require individuals who were previously hired as independent contractors to create a separate legal entity. The contractors will then sign contracts with the individual companies to perform services on behalf of the contractor. The Act is definitely one law to keep your eye on and to notify your clients about.