

# Beware the Illinois Employee Classification Act

by Markus May

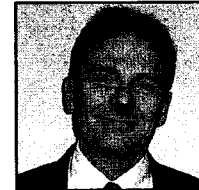
The Illinois Employee Classification Act ("Act") became effective on January 1, 2008.<sup>1</sup> In order to get your attention, let's look at the draconian and overly harsh penalties for violation of the Act. First, there is a civil penalty of up to \$1,500 for each violation of the Act which is found in an audit by the Department of Labor.<sup>2</sup> This increases to \$2,500 in subsequent audits.<sup>3</sup> Each day a violation continues constitute a separate and distinct violation.<sup>4</sup> Second, if there is more than one violation, the violator cannot be awarded a state contract for the next five years.<sup>5</sup> Third, anyone who "willfully" violates the Act is liable for (a) penalties up to double the statutory amount; (b) punitive damages equal to the penalties in (a); and (c) commits a Class C misdemeanor and on a second violation a Class 4 penalty.<sup>6</sup> 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 up to \$500 for each violation of the Act (there is a question whether each day is a separate violation for purposes of this section – see discussion below); and (3) attorneys fees and costs.<sup>7</sup> Finally, if a covered 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. Therefore, merely not posting the notice is a violation that could subject a contractor to the above damages.

The following example is a useful illustration showing the far ranging effect of the Act. Assume one of your clients hires a worker for \$10 an hour to help renovate a kitchen for 10 days, but does not hire the worker as an employee. The following penalties may apply to your client if the worker is misclassified as an independent contractor:

- a fine of \$15,000
- If the client knew of the Act and "willfully" violated it, penalties of an additional \$15,000, plus punitive damages of another \$15,000
- a Class C misdemeanor
- a smaller amount of money for not providing social security benefits and perhaps vacation pay
- liquidated damages in the amount awarded above
- \$500 or \$5,000 as compensatory damages
- payment of all attorneys fees and costs

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



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**Coverage of the Act.** So now that your attention has hopefully been piqued, the remainder of the article looks in more detail at the Act and potential ways to advise client's on how to avoid potential liability. 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.<sup>9</sup> Though probably not the intent of the drafters, the definition of "construction" is so broad that it really applies to any work performed on any building or real property. For example, "decorating" is included and therefore technically the Act could be construed to cover the actions of interior decorators, wedding and party planners, etc.

**Independent Contractor or Employee?** 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.<sup>9</sup> The statute provides it is a violation of the Act for an employee or entity not to designate an individual as an employee unless certain 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.<sup>10</sup>

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) is 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

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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.<sup>11</sup>

These factors may be very difficult to meet and more stringent than the normal independent contractor/employee classification law. It will also be difficult for the Contractor to determine if the individual actually meets the above requirements. For example, how will it be determined whether an individual has a "substantial investment of capital" in the individual's business. Will the Contractor now need to request the individual's tax return in order to determine whether the individual's services are listed as a separate business? Will the individual doing electrical work for an electrical contractor really need to obtain a separate permit to do the electrical

work? All in all, it will be very difficult for a Contractor to feel comfortable that the individual being hired meets the above twelve part test.

**Potential Plaintiffs.** So who can and who would bring an action under the Act? Under Section 40 of the Act, the Director of the Department of Labor is authorized to bring an action to recover the \$1,500 or \$2,500 per violation. Further, a "person aggrieved by a violation" of the Act can bring an independent action to recover the amount of the penalty assessed by the Director of the Department of Labor under Section 40. The Act then provides that in a civil action brought by an "interested party", the court is required to award the interested party 10% of the amount recovered – essentially a bounty for pursuing violators. An "interested party" is person "with an interest in compliance with this Act."<sup>12</sup> 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.<sup>13</sup> 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.<sup>14</sup> In fact, it is a Class C misdemeanor for an employer to attempt to induce an individual to waive any provision of the Act.

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. If the person worked for 200 days, the person may be entitled to receive up to \$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. There is a potential limitation in the amount of damages under the private cause of action. Section 185/60 does not include the specific language note in Section 40 which provides: "*For purposes of this Section, each violation of this Act for each person and for each day the violation continues*" is a separate violation. Because this language is missing from Section 185/60, there is a question whether each day is counted as a separate violation under a private cause of action that is not enforcing a Department of Labor audit. Some attorneys may argue the italicized language shows an intent to limit the daily violations only to Section 40. Other attorneys may argue that a violation which continues for a year should certainly be worth more than one that continues for one day and that the language in Section 40 should not prevent Section 60 from being construed in a similar manner. In any event, given the dollars at stake, litigation is almost a certainty.

**Potential Options.** 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 should ensure the individual meets the above twelve factor test. The amount of due diligence required to ensure these factors are all met is often too burdensome to be performed in the normal course of business. Also, just because an

individual has complied with the twelve step test in the past, there is no guarantee the test will be met in the future.

Realistically, contractors now have two options. The first is to only hire employees. Of course this then leads to subsequent unemployment claims as well as potential employee/employer liability related claims. The second option is to enter into contracts with entities rather than individuals. The Act applies only to individuals (and possibly partnerships pursuant to Section 10(b)(4) and 10(c)). Therefore, if the contractor enters into a contract with a bona fide corporation or limited liability company, the Act should not apply. If an individual creates a company and then performs work for the newly created company, and not the contractor, then the individual should not be an improperly classified employee. Of course this presumes that the individual has created a company and the company has in turn entered into a contract with the contractor. An alternative entity to contract with would be a temporary job service which provides day labor or contractual labor where the individual is an employee of the service. It is likely that these service companies which provide temporary laborers will benefit from the Act in those situations where the individual is not willing to create a separate company.

**Summary.** As the Act begins to be enforced, there will likely 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. It is anticipated contractors will begin to refuse to enter into contracts with

individuals because of the potential liability under the Act. As a result, the number of corporation and limited liability company filings should greatly increase as individuals set up companies which can enter into contracts with contractors. The complexity and cost of doing business will go up for contractors as well as the individuals and their new businesses. Whether there will be any impact on the Illinois business climate in general remains to be seen. The ultimate winners will be the unions, the Department of Labor, the Secretary of State's office with the increased filings, the service companies providing temporary labor, and the attorneys who get to litigate the Act and perform the transactional work required to avoid the Act. ■

<sup>1</sup>820 ILCS 185/1 et.seq.

<sup>2</sup>*Id.*

. at 185/40.

<sup>3</sup>*Id.*

<sup>4</sup> *Id.*

<sup>5</sup>*Id.* at 185/42.

<sup>6</sup>*Id.* at 185/45.

<sup>7</sup>*Id.* at 185/60.

<sup>8</sup> *Id.* at 185/5.

<sup>9</sup>*Id.* at 185/5 and 10.

<sup>10</sup> *Id.* at 185/10 and 20.

<sup>11</sup>*Id.* at 185/10.

<sup>12</sup> *Id.* at 185/5.

<sup>13</sup> *Id.* at 185/50.

<sup>14</sup> *Id.* at 185/70.