



## Construction Law

Lindsay Drecoll Brown and John J. Vitanovec  
Cassiday Schade LLP, Chicago

# Counting Contractors: Why Construction Companies Shouldn't Gamble when it Comes to Classifying Employees in Compliance with the ECA

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A great number of construction industry employers have faced allegations of employee misclassification; that is, misidentifying workers as independent contractors as opposed to employees in order to avoid taxes and employment regulations. Although many construction companies legitimately utilize the services of independent contractors in a legal manner to supplement their workforce, the practice of intentionally misidentifying workers has historically plagued the construction industry in Illinois, where the problem of employee misclassification is believed to be more prevalent than in almost any other state or industry. Michael Kelsay, James Sturgeon, Kelly Pinkham, “The Economic Costs of Employee Misclassification in the State of Illinois” (Dept of Economics: University of Missouri-Kansas City: December 2006) at p. 5, 10. This convention has harmed Illinois construction companies in a number of ways, including creating an uneven playing field for contractors who classify workers appropriately and find themselves underbid by less scrupulous competitors. Misclassification has also damaged the state economy by creating a tremendous tax deficit. In fact, misclassification resulted in an estimated loss of \$17.3 million in state income taxes from the construction sector in the year 2005 alone. *Id.* at p. 7.

In an effort to remedy, or at least curtail this conduct, the Illinois General Assembly enacted the Employee Classification Act (ECA). The ECA prohibits construction industry employers from misclassifying workers as independent contractors to avoid payroll taxes, unemployment insurance contributions, workers’ compensation premiums and minimum wage and overtime payments. Ill. Admin. Code tit. 56, pt. 240.100(a). Recently, the ECA’s impact upon construction contractors and workers has been amplified by the publication of the Illinois Supreme Court’s decision of *Bartlow v. Costigan*, the enactment of a Cook County ordinance that augments the Act’s sanctions, and the Federal Government’s increased efforts to coordinate with state agencies to prosecute misclassification. This article provides practitioners with a brief reminder of the Act’s provisions and an overview of the aforementioned new developments.

## Construction Workers Presumed to be Employees under the ECA

Under the ECA, any individual performing services for an entity engaged in the performance of construction work is generally assumed to be an employee of that entity. 820 ILCS 185/5 (2015); 820 ILCS 185/10 (2015); *See, e.g., World Painting Co. v. Costigan*, 2012 IL App (4th) 110869. The definition of what may be construed as “construction work” is expansive, including not only construction itself, but also any work involving “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” or structure of any kind. What is more, the provisions of the Act also apply to



any worker moving construction related materials around, to or from a project. 820 ICCS 185/5. Whether Courts will broadly interpret the language of the Act to apply its provisions to companies engaged in additional activities that could be construed as construction related, such as installing satellites on buildings, remains to be seen. *See, e.g., People ex rel. Dep't of Labor v. Ketterman Communs., Inc.*, 2014 IL App (4th) 120460-U, ¶¶ 20, 36 (noting that the issue of whether satellite installation work fell under the auspices of the Act was an issue not ripe for adjudication).

When a company is engaged in the type of work described above, a strict set of requirements must be met in order to demonstrate that any given worker is not its employee, such that his or her work may be considered services by an independent contractor. 820 ILCS 185/5 and 10 (2015). First, the individual must 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. 820 ILCS 185/10 (2015). Second, the service performed by the individual must fall outside the usual course of services performed by the contractor. *Id.* Finally, the individual must either be engaged in an independently established trade, occupation, profession or business, or the individual must be deemed a legitimate sole proprietor or to be engaged in a partnership. *Id.*

The individual's work will be deemed for a sole proprietor or a partnership only if it meets all twelve of the following requirements:

- (1) the sole proprietor or partnership 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) the sole proprietor or partnership is not subject to cancellation or destruction upon severance of the relationship with the contractor;
- (3) the sole proprietor or partnership has a substantial investment of capital in the sole proprietorship or partnership beyond ordinary tools and equipment and a personal vehicle;
- (4) the sole proprietor or partnership owns the capital goods and gains the profits and bears the losses of the sole proprietorship or partnership;
- (5) the sole proprietor or partnership makes its services available to the general public or the business community on a continuing basis;
- (6) the sole proprietor or partnership includes services rendered on a Federal Income Tax Schedule as an independent business or profession;
- (7) the sole proprietor or partnership performs services for the contractor under the sole proprietorship's or partnership's name;
- (8) when the services being provided require a license or permit, the sole proprietor or partnership obtains and pays for the license or permit in the sole proprietorship's or partnership's name;



- (9) the sole proprietor or partnership furnishes the tools and equipment necessary to provide the service;
- (10) if necessary, the sole proprietor or partnership 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) the contractor does not represent the sole proprietorship or partnership as an employee of the contractor to its customers; and
- (12) the sole proprietor or partnership has the right to perform similar services for others on whatever basis and whenever it chooses.

820 ILCS 185/10(c) (2015).

Of importance, a presumption of employment will be applied to “[a]ny contractor for which an individual is performing services” if the above requirements for independent contractor status are not satisfied. 820 ILCS 185/10. That is, as long as the “individual” performing services is not a *bona fide* corporation. 56 Ill. Adm.Code 240.110 (2008); *Michael v. Pella Products, Inc.*, 2014 IL App (1st) 132695, ¶16. Notably, the ECA does not include any provisions that directly address whether an entity may violate the Act while acting in the capacity of a joint employer, nor has the issue of joint employment been addressed by any Illinois Appellate Court in the context of the ECA. See 820 ILCS 185 *et seq.*; *Zampos v. W&E Communs.*, 970 F. Supp. 2d 794 (N.D. Ill. 2013). Thus, prudent contractors not only need to carefully adhere to ECA guidelines with respect to their own practices, but may also need to be vigilant of the practices of entities sharing their jobsite responsibilities lest they be found in violation of the Act with respect to a worker brought to the project as an “independent contractor” by a less scrupulous contractor.

### Consequences of Violations Set Forth in the Act

When the ECA was initially enacted, there was no mechanism for employers to challenge a determination that their company had committed an infraction. However, effective January 1, 2014, an Amendment to the enforcement proceeding provision, located in Section 25 of the Act, added language to remedy that flaw. Pursuant to the 2014 amendment, the Department of Labor must notify an employer of that a complaint has been filed within 120 days. 820 ILCS 185/25(a). That written notification must inform the employer of the nature of the allegations being investigated, as well as the location of the work at issue and the contractors affected. *Id.* Additionally, an approximation as to the date of the implicated project(s) must be provided. *Id.* If a violation is found as a result of that complaint, then a written finding with any proposed relief due and/or penalties assessed must be given to the employer and the matter proceeds to a formal hearing before an Administrative Law Judge. 820 ILCS 185/25(c).

The result of such a hearing can be quite costly for a construction industry employer. The Assembly did not hold back on violation penalties, which have been characterized as “draconian” and “overly harsh.” “A look at the Illinois Employee Classification Act” Markus May, Eckhart Kolak LLC, available at [illinois-business-lawyer.com/Documents /A%20Look%20at%20the%20Illinois%20Employee%20Classification%20Act.PDF](http://illinois-business-lawyer.com/Documents/A%20Look%20at%20the%20Illinois%20Employee%20Classification%20Act.PDF).



For each individual employee that is found to be misclassified the contractor faces a civil penalty of up to \$1,000. 820 ILCS 185/40 (2015). Any subsequent violations cost \$2,000—and each individual day that passes where the worker continues to perform services under the inappropriate heading is deemed a separate and distinct violation under the Act. *Id.* Moreover, if the contractor is found to have committed a second violation, the contractor will be prohibited from working on any state projects five years. 820 ILCS 185/42 (2015).

The ECA also provides for criminal prosecution of anyone found to be in willful violation of the Act's provisions. An adjudication of a willful violation can result in penalties up to double the statutory amount, punitive damages, and conviction of a Class C misdemeanor. 820 ILCS 185/45 (2015). If a contractor willfully violates the ECA a second time, they face a Class 4 felony. *Id.*

In addition to sanctions imposed for violations investigated by the Department of Labor, the ECA enables any person allegedly aggrieved by a violation of the Act to file a civil action against the employing contractor 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; and (3) attorney fees and costs. 820 ILCS 185/60 (2015).

### **The ECA Withstood Constitutional Challenge in *Bartlow v. Costigan***

In *Bartlow v. Costigan*, our state's supreme court examined the parameters for independent contractor status included in the Act in the face of a constitutional challenge of vagueness. 2014 IL 115152 *denied* October 14, 2014, 135 S. Ct. 377 (2014)). The plaintiffs, partners in a company specializing in the installation of siding, windows, gutters, and roofs, filed an action against the Department of Labor seeking injunctive relief and a declaratory judgment. *Id.* ¶ 4. Prior to the filing of the plaintiffs' complaint, the Department collected over 750 documents during an investigation and determined that the plaintiffs' company had misclassified 10 individuals as independent contractors for periods of time between 8 and 160 days. *Id.* ¶¶ 6-7. The Department warned of a potential fine of approximately \$1.7 million before sending the plaintiffs notice of a second investigation. *Id.* ¶¶ 7-10. The plaintiffs sought to enjoin the Department from proceeding with its lawsuit, requesting that the court enjoin the Department from enforcing the provisions of the ECA and interfering with their business. ¶ 10. The Court considered the plaintiffs' argument that the ECA was unconstitutional because it was impermissibly vague under the due process clauses of the United States and Illinois Constitutions. *Id.*

The plaintiffs' vagueness challenge specifically focused on section 10 of the ECA, which sets forth the exception of when an individual is an independent contractor. *Id.* ¶ 38. Primarily, the plaintiffs argued that this section was unconstitutionally vague because a person of ordinary intelligence could not determine from the language of the Act whether an individual qualifies for exemption under Section 10. *Id.* ¶ 39.

The supreme court disagreed, first finding that a careful review of section 10 demonstrates that (1) its provisions do provide a person of ordinary intelligence a reasonable opportunity to understand how to qualify for the independent contractor exception, and (2) the provisions are sufficiently detailed and specific to preclude arbitrary enforcement. *Id.* ¶ 45. Alternatively, the plaintiffs argued that forcing of contractors to obtain financial and scheduling information within the exclusive control of their subcontractors makes complying with the ECA's exemptions impossible. *Id.* ¶ 49. The supreme court similarly rejected this second argument, finding that contractors have the opportunity to demand that subcontractors furnish the relevant information before entering into a subcontract in order to ensure that he or she is properly classified. *Id.* ¶ 49.



## Sanctions Imposed on ECA Violators Under the 2015 Cook County Wage Theft Ordinance

A finding of a violation of the ECA could burn construction industry employers well beyond the penalties explicitly authorized under the provisions of the ECA, tarnishing the entity's professional reputation, impacting its relationship with labor union representatives, and subjecting the company to add-on penalties imposed by local ordinances. One such ordinance is the Cook County Wage Theft Ordinance, which became effective on May 1, 2015. Under the provisions of that ordinance, any Cook County entity found guilty of violating the ECA within the past five years may be (1) ineligible to receive property tax incentives, (2) disqualified from receiving or renewing a Cook County business license, and (3) barred from entering into a contract with Cook County. Chicago, Ill., Art. II, Div. 2, §74-74; Art. IV, Div. 4, §34-179(a); Art. X, §54-384(a)(8) and §54-391(b). In addition, the contractor may be found in default of any existing County contracts. Chicago, Ill., Art. IV, Div. 4, §34-179(c).

## Federal Prosecution of Misclassification Amplifies the Impact of ECA Violations

Pursuant to a Memorandum of Understanding, the Illinois Department of Labor shares information pertaining to its ECA investigations with the United States Department of Labor's Wage and Hour Division so that those agencies—as well as the IRS—can jointly prosecute worker misclassification. <http://www.dol.gov/whd/workers/MOU/il.pdf>. Thus, even after resolving a state ECA claim, contractors may face federal prosecution for illegal misclassification under the federal Fair Labor Standards Act or for tax evasion. This coordination is part of a federal "Misclassification Initiative" aimed to target this problem which, according to Thomas Perez, Secretary of Labor, is quite serious in the construction arena. <https://blog.dol.gov/2015/04/23/battling-a-damaging-workplace-trend/>. Secretary Perez notes that "[m]isclassification cheats every taxpayer, and it undermines employers who play by the rules. ... We are taking a vigorous approach to enforcement[.]" *Id.*

## Conclusion

The cases, amendments and legislative changes addressed in this column call for a re-assessment of independent contractor relationships, contracts, and day-to-day practices followed by businesses in the construction industry. Practitioners are forewarned that ongoing enforcement of the ECA indicates that the language of the Act will be applied broadly and that penalties for violations extend well beyond those set forth in the Act. Construction entities should therefore be made aware of all new developments in the arena of employee classification regulations, particularly when the company relies upon the services of independent contractors.

## About the Authors

**Lindsay Drecoll Brown** is a senior associate in the Chicago office of *Cassiday Schade LLP*. She concentrates her practice in civil litigation defense, with an emphasis on construction law, professional liability and product liability. Ms. Brown received her J.D., *cum laude*, from Loyola University Chicago School of Law, and her undergraduate degree



from Michigan State University, with high honors. She is a member of the Illinois Association of Defense Trial Counsel's Construction Law Committee.

**John J. Vitanovec** is an associate at *Cassiday Schade LLP*'s Chicago office. He concentrates his practice in the defense of civil litigation matters concerning construction, medical malpractice, and insurance coverage. He received his undergraduate degree from Loyola University Maryland and his J.D. from DePaul University College of Law. He is a member of the IDC, serving its Construction Law Committee.

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