

ARE YOUR INDEPENDENT CONTRACTORS REALLY “INDEPENDENT”? Illinois Legislature Poised to Tighten Definition of Independent Contractor

Contractors, subcontractors and other companies engaged in construction work and related transportation activities in Illinois should prepare themselves for the impact that House Bill 1795 (Osterman, D-Chicago) may have on their operations. Now pending before the Illinois General Assembly, HB 1795 proposes a new state law, the Employee Classification Act. As of this writing, the bill is expected to pass and be signed by the governor, with an effective date of January 1, 2008. If enacted, the bill will dramatically change how many companies utilize independent contractors in Illinois.

Overview: Your Payroll May Grow

The bill tightens the definition of “independent contractor” (and of “sole proprietor” and “partnership”) and will apply that definition to a broad segment of businesses engaged in construction-related activities. As a result, individuals now being treated as independent contractors may not be independent contractors as defined in the bill. Covered employers, regardless of size, will have to start treating those individuals *as employees*. This means making payroll deductions for taxes, providing coverage for workers’ compensation and unemployment compensation insurance, and contributing to applicable health and welfare and retirement benefit plans. Depending upon the job duties of misclassified individuals, it may also mean paying overtime for hours worked over forty in the workweek.

The bill imposes obligations on state agencies to ensure that affected individuals are properly classified so that they may receive all appropriate wages and benefits. Substantial civil and criminal penalties are established. The bill calls for government-initiated audits and enforcement actions and allows concurrent private actions brought by interested parties on their own behalf and on behalf of others in an affected class. Retaliatory conduct is prohibited. Employers will have to post multilingual notices summarizing the requirements of the new law.

Scope of the Bill’s Coverage

Because HB 1795 will broadly cover all forms of construction-related activity, including construction, alteration, reconstruction, repair, rehabilitation, renovation, improvement, maintenance, landscaping, wrecking and other changes to real property, roads, bridges, sewers and related structures, it may reach businesses whose primary focus is not construction. Because the bill will also extend the definition of “construction” to include the movement of equipment and material to and from the job site, it will jettison the standard presumption that

independent owner-operators hauling equipment and material to a job site are not employees. The only positive aspect of the bill, from the standpoint of affected employers, is that a contractor will not be responsible for a subcontractor's treatment of its employees.

Definition of Independent Contractor

The bill will confer "employee" status upon any individual performing services for a contractor or subcontractor unless the following multipart test is satisfied:

- (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* [emphasis added].

Definition of Sole Proprietor/Partnership

To be deemed a *sole proprietor or partnership* and not an employee, all elements of the following 12-part test must be satisfied. A business entity must:

- (1) perform services free from direction or control over the means and manner of providing the services, subject only to the right of the contractor for whom the services are provided to specify the desired result;
- (2) not be subject to cancellation or destruction upon severance of the relationship with the contractor;
- (3) have a substantial investment of capital in its business beyond ordinary tools and equipment and a personal vehicle;
- (4) own the capital goods, gain the profits and bear the losses of its business;
- (5) make services available to the general public or the business community on a continuing basis;
- (6) include services rendered on a federal income tax schedule as an independent business or profession;
- (7) perform services for the contractor under its own name;
- (8) obtain and pay for required licenses or permits in its own name;
- (9) furnish the tools and equipment necessary to provide the services;
- (10) if necessary, hire its own employees without contractor approval, pay the employees without reimbursement from the contractor and report the employees' income to the Internal Revenue Service;

(11) not be represented by the contractor as an employee of the contractor; and

(12) have the right to perform similar services for others on whatever basis and whenever it chooses.

Enforcement and Penalties

The Illinois Department of Labor will enforce the new law and may inspect employer records, subpoena witnesses and documents, issue cease-and-desist orders, and seek other remedies, including civil penalties. If there is a violation, the offending employer will have to provide successful claimants with the same benefits and compensation required by law that it provides to all its other employees. The bill does not say how far back such a remedy may go. Repeat violators will face debarment from participation in state contracts for four years. There will be penalties of up to \$1,500 for the first violation and up to \$2,500 for each subsequent violation. Each day that a person remains misclassified will constitute a separate violation. Willful violations or “obstructionist” conduct will result in double damages *plus* an equivalent amount in punitive damages and possible criminal prosecution.

Any interested party will be permitted to file a private suit, including a class action. Available civil court relief will include the penalties mentioned above, all employment-related compensation and benefits, liquidated damages in an equal amount, and compensatory damages of up to \$500 per person per day of violation, *plus* attorneys’ fees and costs. Waiver of rights set forth in the bill will be prohibited.

Practical Considerations—Undertake an Audit Now

As we have mentioned, HB 1795 is expected to pass and become effective January 1, 2008. The back pay, penalties and administrative costs associated with a violation or continuing violation of this bill are potentially enormous. Consequently, if you are an Illinois contractor or other business engaged in work covered by this bill, you may wish to audit how you use independent contractors so you can make any needed changes and avoid potentially hefty monetary liability. Some of these changes may require only the documentation of certain aspects of your existing independent contractor relationships; others may be far-reaching.

A key requirement for avoiding employee status will be that the employer *does not control or direct the performance of work or how the work should be done*. Thus, you should analyze closely your working relationship with each individual currently classified as an independent contractor, sole proprietor or partnership. State compliance audits likely will use a fact-based analysis that looks behind any written documentation to confirm what and how duties are actually performed. Anecdotal testimony, written contracts, work orders and daily work logs will be among the key pieces of evidence reviewed.

We Can Help

Vedder Price represents a broad cross section of employers in the construction industry on a variety of matters, including contract negotiations, mechanics’ liens, picketing disputes, and compliance with applicable state and federal laws and regulations. As experienced legal counsel, we can assist you in navigating the new and potentially difficult waters surrounding HB 1795. If you have any questions about the status of this bill, or how to come into compliance with its requirements, please contact Ted Tierney (312-609-7530), Karen Layng (312-609-7891), Jim Spizzo (312-609-7705) or any other Vedder Price attorney with whom you have worked.

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