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Contractor Liable under the Home Repair and Remodeling Act

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Contractor liability under the Home Repair and Remodeling Act, 815 ILCS 513 (the "Act") was recently addressed by the Illinois Appellate Court in *Smith v. Bogard*, 2007 Ill. App. LEXIS 1393 (4th Dist. 2007). In this case, a contractor unsuccessfully appealed the trial court's finding that his numerous violations of the Act preclude him from recovering any unpaid balance for work he performed under both equitable and contract theories.

The Act, which went into effect on January 1, 2000, was drafted to improve communications between consumers and persons engaged in the business of home repairs or remodeling in order to "increase consumer confidence, reduce the likelihood of disputes, and promote fair and honest practices in that business in this State." Specifically at issue was Section 15, which states that "a person engaged in the business of home repair or remodeling" shall provide a written contract or work order to the consumer prior to initiating any work over $1,000. The contract or work order must set forth the total cost of the project.

The Act also provides that it is unlawful for any person engaged in the business of home repairs and remodeling to begin a project without first obtaining a signed contract or work order. Moreover, the person performing the construction services must provide the customer with a copy of the pamphlet "Home Repair: Know Your Consumer Rights" prior to the execution of any contract.

In this case, upon completion of Smith's construction work in conjunction with a remodeling project on a couple's house, the owners refused to pay the remaining balance citing numerous violations of the Act as precluding his ability to collect the remaining balance. The owners alleged that Smith provided them with an oral estimate of "$20,000 or less" as a cost for labor and materials for completion of the job. Once work was completed, the total cost of the project was $25,515.85, and a balance of $10, 515.85 remained to be paid to Smith.

In response to the owner's refusal to pay, the contractor filed suit seeking an amount consisting of the remaining balance plus interest under the theories of breach of contract and unjust enrichment. The owners sought to dismiss on the grounds that recovery is precluded by the contractor's violation of the Act and more specifically his failure to secure a written contract prior to initiating construction and by failing to provide them with the consumer-rights pamphlet.

The trial court granted the owner's motion to dismiss the suit, finding that, because the contractor had failed to comply with the Act, he was precluded from recovery on the breach of contract claim. In addition, the court found that the contractor was precluded from recovery under any equitable theory as well because such a recovery would "defeat the entire purpose" of the Home Repair Act "and the public policy behind it."

The appellate court held that the Act applied to the contractor and that he could not recover the sums owed him in his action for breach of contract because he had failed to comply with the provisions of the Act.

Furthermore, it stated that allowing a contractor to recover for the reasonable value of his services under the doctrine of unjust enrichment would run afoul of the legislature's intent of protecting consumers, reward deceptive practices, and violate public policy.

Independent Contractors May Not Be Independent Contractors

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The Illinois Employee Classification Act effective January 1, 2008, imposes rigid limitations on the term "independent contractor" within the construction industry. Under this new law, the "employee" designation would be applied to all construction workers unless it is shown:

1. The individual performing services is free from control or direction;

2. The individual's services are outside the usual scope of services provided for by the contractor; and

3. The individual is engaged in an independently established trade, occupation or profession; and/or the individual is deemed a legitimate sole proprietor or partnership.

Subcontractors and lower tiered contractors are subject to all provisions of this Act. It is a violation of this Act for an employer or entity not to designate an individual as an employee unless the employer or entity satisfies the above exception to the rule.

A violation of the Act can be alleged by any interested party by filing a complaint against an entity or employer with the Department of Labor. For instance, a complaint could be filed by a worker but more likely would be filed by a construction contractor that believes it is being under bid by those violating this Act. If there is a reasonable belief that the entity or employer is in violation of this Act, the Department of Labor then conducts an investigation which can entail inspections of work site, attendance of worker by subpoena, production of books, payrolls, records, papers and other evidence in any investigation.

If a violation is determined by the Department of Labor, the Department may:

1. Issue and cause to be served on any party an order to cease and desist from further violation of the Act;

2. Take action to eliminate the effect of the violation;

3. Collect the amount of wages, salary, employment benefits or other compensation denied or lost to the individual; and

4. Assess any civil penalty discussed below.

An employer or entity that violates this Act is subject to a civil penalty of not more than $1,500 for each violation during the first audit. After the first audit, a violator will be subject to a penalty not to exceed $2,500 for each repeat violation within a 5-year period. Importantly, each violation and each day the violation continues shall constitute a separate and distinct violation.

Of further importance, for any second or subsequent violation which is within five years of an earlier violation, the employer's name will be added to a list posted on Department of Labor's website and no state contract shall be awarded to an employer or entity appearing on the list until four years have elapsed from the date of the last violation.

Court Dismisses Homeowners' Breach of Warranty Claim

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The Illinois Appellate Court affirmed a trial court decision dismissing a homeowners' complaint alleging breach of warranty and requesting declaratory judgment. *Weiss v. MI Home Products, Inc.*, 376 Ill. App. 3d 1001 (1st Dist. 2007). In doing so, the court adjudicated a significant issue of first impression in Illinois.

The homeowners had purchased a townhome in 1994 as original owners. They alleged that windows manufactured and installed in their townhome by a subcontractor "failed and fogged." The subcontractor had issued two warranties to the homeowners. Under the warranty, the subcontractor replaced, free of charge, some of the windows that the homeowners claimed were defective. Nevertheless, the subcontractor refused to pay for the costs of shipping and installation of those replacement windows. In addition, other allegedly defective windows were not replaced at all, as the subcontractor claimed the warranty on certain windows had expired.

The homeowners sought to have the warranty terms enforced under the Magnuson-Moss Warranty Federal Trade Improvement Act, 15 U.S.C. § 2301, *et seq*. (2000), and under the Uniform Commercial Code, 810 ILCS 5/2-105 (1) (West 2006). The homeowners believed that under the express warranty terms the subcontractor was required to pay for shipping and labor costs, as well as provide a lifetime warranty for the windows.

The homeowners claimed, first, that the windows constituted "consumer products" covered under the Magnuson-Moss Act. In addition, they claimed that the windows were also "goods" under the UCC. The homeowners contended that since the windows were both "consumer products" and "goods" the warranties would have to be enforced in their favor.

Unfortunately for the homeowners, the appellate court disagreed. First, the court addressed whether the windows were "consumer products" within the Magnuson-Moss Act. In analyzing the definition of a "consumer product", the court looked to the Magnuson-Moss Act statutory language as well as U.S. Federal Trade Commission regulations and interpretations regarding the Act. The court explained that "if at the time of sale the products are integrated into the structure of the dwelling, they are not consumer products." Here, the issue was whether the windows were being added to "an already existing structure" or "being utilized to create the structure." Ultimately, the court decided that the windows were installed to "create the structure," thus, the windows were not a "consumer product." Therefore, the Magnuson-Moss Act did not apply.

Next, the court determined whether the windows should be considered a "good" under the UCC. The court's analysis as to this issue was brief; windows are a "good" when movable, but once the windows became part of the townhome the windows were no longer a "good." The breach of warranty claim failed once again, as the UCC did not apply to enforce the warranty provisions against the subcontractor. Therefore, dismissal of the homeowners' suit was affirmed.

Changes to AIA Documents

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In late 2007, the American Institute of Architects issued revised additions of certain of its documents. The important changes include those to the A201, General Conditions of the Contract for Construction, and the architect's agreements. The 1997 additions of the B141 and B151 were dropped and replaced with a new 207B101 Owner/Architect Agreement.

The major change in the AIA documents has been elimination of the mandatory arbitration provision. Users now can select one of several alternatives for dispute resolution. Litigation is the default alternative.

The A201 now states that claims must be commenced within the applicable statute of limitations. However, no claim may be commenced more than ten years after substantial completion.

The insurance provision of A201 was changed requiring that both the owner and architect be named as additional insureds on the contractor's liability policies. In addition, the contractor must procure completed operations coverage, also naming the owner as an additional insured. The project management liability insurance provision was deleted.

The financial requirements provision of the A201 also has changed. Under the 1997 addition, the contractor could request financial information from the owner at any time during the project. Now, the contractor only may request such information before work commences or if the owner fails to make payment.

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The A201 now also addresses prompt payment to subcontractors. The contractor must issue payment to its subcontractors within seven days of receiving payment from the owner. Further, if the contractor does not provide satisfactory evidence that it has paid its subcontractors, the owner may issue joint checks.

The B101 requires the architect to procure insurance, naming specific types of policies and the limits of each. Under the instruments of service provision, the owner now has greater access to the design documents for the owner's construction, use, maintenance, alteration and addition to the project.

Deadlines of Mechanics Lien Act Require Strict Compliance

The obligation to strictly comply with the Illinois Mechanics Lien Act's notice requirement deadlines was recently addressed in two Illinois Appellate Court decisions. In the case of *Cyclonaire Corp. v. ISG Riverdale, Inc*., 2007 Ill. App. LEXIS 1388 (1st Dist. 2007), the court addressed the 90-day written notice requirement of Section 24 of the Mechanics Lien Act (the "Act"). In that case, a vendor had contracted to deliver five units of equipment to the defendant's steel mill. The equipment was delivered on December 16, 2003 and, based on some deficiencies in the equipment, the vendor had to perform work on the equipment at the site until February 6, 2004. Cyclonaire did not file its notice of mechanics lien until May 4, 2004.

The trial court heard testimony from various witnesses establishing that although the equipment was delivered in December, 2003, it was not working properly until February, 2004. The vendor argued that the last day of work on the jobsite was February 6, 2004, the day the equipment was up and running. The vendor, therefore, argued that the May 4, 2004 lien filing was within the 90 days required by a subcontractor under the Act.

The defendant argued that the lien was defeated because the equipment was delivered on December 16, 2003 and the lien was not filed until May 4, 2004. The defendant contended that the vendor's work between December 16, 2003, and February 6, 2004 was merely warranty work and did not arise out of the initial contract; it was only performed after the contract and delivery of the materials was complete. The trial court agreed with the defendant and found that the work was performed as a repair of the equipment and that any repair was merely warranty work that would not extend the time for filing the subcontractor's notice under the Act. The appellate court found that the trial court's finding that the 90-day notice was late was not against the manifest weight of the evidence. The appellate court also reviewed previous case law in Illinois and held that the notice requirement must be strictly complied with and that subsequent repair work cannot extend the Act's strict notice filing deadlines with respect to the original lienable work or material.

In the case of *Stafford-Smith Inc. v. Intercontinental River East LLC*, 2007 Ill. App. LEXIS 1300 (1st Dist. 2007), the court addressed the notice requirements of an equipment supplier under Section 7 of the Act and the validity of a lien. The main issue in determining the validity of the lien was whether the defendant was an owner or purchaser.

There, the supplier entered into a contract with a tenant to supply and install commercial kitchen equipment at the property. Pursuant to the contract, the supplier began work on the premises on November 5, 2005, and completed its work on February 10, 2006. The supplier recorded its lien on the premises on May 1, 2006 and filed an amended lien on October 3, 2006 to correct the legal description, property index number for the property, and also to list additional owners of the property. The October 3, 2006 lien listed, for the first time, the defendant, IRE and/or Intercontinental Real Estate Corporation, as the owner.

Between the start of work in November 2005 and the end of work on February 10, 2006, IRE became an owner of the property when it purchased the property on January 9, 2006, from the tenant. As a result of the change in ownership, IRE argued that the vendor's lien was time barred under Section 7 of the Act because IRE was a purchaser in good faith and the lien claim had not been filed with the recorder of deeds within four months of completion of the supplier's work.

The appellate court found that in this case IRE was not the owner of the property when the contract was formed. Furthermore, for the purposes of the Act, IRE became the owner of the property when actual title was

conveyed on January 9, 2006; thus, as a good faith purchaser, IRE was entitled to proper notice within four months of completion of the work. Finally, the supplier did not offer any proof that IRE was a beneficial owner of the property or that IRE had a contract to purchase the property before January 9, 2006.

These cases highlight the importance of knowing the different time limits under the Act and the importance of knowing who has an ownership interest in the property when work commences and when it is completed.

Credit Information Sheets Trip up Contractor

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The recent decision in *Midwest Building, Inc. v. Lord and Essex, Inc.*, 2007 Ill. App. LEXIS 1176 (1st Dist. 2007), addresses some common issues in construction projects. There, a company providing cabinets and appliances for homebuilders brought a breach of contract claim against a homebuilder for failure to pay for delivered goods. The trial court found for the supplier and the decision was affirmed on appeal.

The homebuilder had filled out a credit information sheet provided by the supplier prior to delivery of cabinets and appliances. The credit information sheet contained blanks for general company information, specific credit-related information, and provisions concerning attorney fees, court costs, and interest on overdue payments. The court found that, although the credit information sheet did not contain due dates for payments or credit limits, it could be used to obligate the purchaser to pay the supplier's litigation costs to collect any overdue sums.

The homebuilder also argued that the integration clause included in multiple subcontractor agreements between the parties made any previous agreements null and void. The integration clause purported to supersede "all previous understandings, representations and agreements between the parties relating to the subject matter of this Agreement."

Although the court upheld the validity of the integration clause, it found that the collection terms of the credit information sheet were not superseded, because it was "so far a separate and distinct matter as to be capable of existence as an independent legal act." The terms of the credit information sheet survived because the subject of late payment and collections was completely ignored in the subcontractor agreements.

Recent Construction Insurance Cases

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In *State Automobile Mut. Ins. Co. v. Habitat Construction Co*., 377 Ill. App. 3d 281 (1st Dist. 2007), the Illinois Appellate Court discussed whether a general contractor was an additional insured under a subcontractor's general liability policy. There, an employee of a subcontractor was injured in the course of his work and brought a bodily injury claim against the general contractor. A written contract required the subcontractor to add the general contractor as an additional insured on the subcontractor's general liability policy. The policy had a "Blanket Additional Insured Endorsement – Primary and Non-Contributory" which added any person the subcontractor was required to name as an additional insured, but only with respect to liability arising out of the insured's "work." There was a professional services exclusion applicable to the blanket endorsement. The general contractor had its own general liability policy issued by another insurer.

The general contractor tendered the defense of the injury claim to subcontractor's insurer. The claim was denied because the underlying complaint did not allege that the claimant's injury arose out of the insured subcontractor's work. The insurer filed a declaratory judgment action.

On appeal, the court initially addressed whether the underlying complaint triggered the additional insured coverage based on liability "arising out of" the subcontractor's work at the project. The court stated that it would first determine whether there was an exclusionary provision in the policy applicable to the facts to preclude a duty to defend. Absent any controlling exclusionary clause, the court would then apply a "but for" analysis to determine whether there

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was a causal connection between the accident and the subcontractor's work that triggered a duty to defend.

The court distinguished cases finding no duty to defend by noting that the insurer failed to expressly exclude coverage for the general contractor's own negligence. The court held that the underlying allegations sufficiently alleged that the claimant's injuries potentially arose out of the subcontractor's work, giving rise to a duty to defend under the language of the policy. The court further found that the professional services exclusion was not applicable and remanded the issue of whether the general contractor could target-tender to the subcontractor's insurer.

Coverage also hinged on whether the underlying claim arose out of the named insured's work in *Essex Insurance Co. v. City of Chicago*, 2007 U.S. Dist. LEXIS 74602 (N.D. Ill. 2007). The claimant was injured while working for a subcontractor at a City construction project and sued the City, the general contractor and two subcontractors for his injuries, asserting separate acts of negligence against each defendant.

The City sought coverage under the general contractor's general liability policy pursuant to an "Additional Insured – State or Political Subdivision Endorsement." That provision included as an insured any state or political subdivision listed in a Schedule but stated that it applied "only with respect to *operations performed by you [the named insured] or on your behalf* for which the state or political subdivision has issued a permit." The City conceded that the underlying complaint alleged negligence directly attributed to it and did not allege derivative liability, but argued that it was entitled to coverage because it had issued a permit for the named insured's operations. The court rejected that argument and found that the facts alleged in the underlying complaint did not bring the City within the Additional Insured – State or Political Subdivision Endorsement.

The federal court in *State Automobile Property & Casualty Insurance Co. v. Rockbranch Ironworks, Inc.*, 2007 U.S. Dist. LEXIS 89400 (S.D. Ill. 2007) examined whether a commercial general liability policy covered a breach of contract claim based on the insured subcontractor's failure to complete a project. Specifically, when the structural steel subcontractor on the project failed to procure qualified welders for the work, it abandoned the project. The general contractor subsequently sued the subcontractor for breach of contract and for "negligently" violating the subcontract. The subcontractor tendered the claim to its general liability insurer, which denied coverage based on no "occurrence" or "property damage" and filed a declaratory judgment action. On cross motions for summary judgment, the court held that there was not even a remote possibility of coverage and thus, there was no duty to defend, stating "[t]o suggest that a CGL policy should cover a party who intentionally abandons a project and breaches its contract is absurd."

Federal Court Construes Section 414

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Section 414 of the Restatement (Second) of Torts, adopted by Illinois courts, provides the basis under which liability can be found in construction negligence cases.

> One who entrusts work to an independent contractor, but who retains the control of any part of the work, is subject to liability for physical harm to others for whose safety the employer owes a duty to exercise reasonable care, which is caused by his failure to exercise his control with reasonable care.

The "retained control" theory of negligence liability described in Section 414 was adopted by the Illinois Supreme Court in *Larson v. Commonwealth Edison Co.*, 33 Ill.2d 316 (Ill. 1965). However, there is a difference of opinion among Illinois intermediate appellate courts regarding whether Section 414 states a theory of vicarious liability or direct liability. The Illinois Supreme Court has not heard a case regarding this issue. Nevertheless, a recent case heard in the Seventh Circuit Court of Appeals has addressed the issues presented under Section 414 in *Aguirre v. Turner*, 2007 U.S. App. LEXIS 21461 (7th Cir. 2007). The court has the authority to determine how the highest court of a state would rule when an unsettled

question of state law while sitting in diversity is presented to the court. *Hinc v. Lime-O-Sol Co.*, 382 F.3d 716, 720 (7th Cir. 2004).

The court found that the bulk of the disagreements among circuit courts stems from Section 414 comment a, which states:

> If the employer of an independent contractor retains control over the operative detail of doing any part of the work, he is subject to liability for the negligence of the employees of the contractor engaged therein, under the rules of that part of the law of agency which deals with the relation of master and servant. The employer may, however, retain a control less than that which is necessary to subject him to liability as master. He may retain only the power to direct the order in which the work shall be done, or to forbid its being done in a manner likely to be dangerous to himself or others. Such a supervisory control may not subject him to liability under the principles of Agency, but he may be liable under the rule stated in this Section unless he exercises his supervisory control with reasonable care so as to prevent the work which he has ordered to be done from causing injury to others.

The Seventh Circuit held that courts have mistakenly read this comment as first laying out when Section 414 applies then examining the control and finding that no liability exists when the general contractor retains control only to direct the order in which the work shall be done, or to forbid its being done in a manner likely to be dangerous to himself or others. Rather, the court found that comment does just the opposite.

The first sentence does not explain the scope of Section 414, but rather merely refers to the principles of vicarious liability within the Restatement of Agency. Where the level of retained control gives rise to a master-servant relationship, the master will be liable for the torts of his servant; this is no-fault vicarious liability and it is based on the principles of agency law, not negligence law. The court goes on to say that when comment a continues with "[t]he employer may, however, retain a control less than that which is necessary to subject him to liability as master" and "may retain only the power to direct the order in which the work shall be done, or to forbid its being done in a manner likely to be dangerous to himself or others," the commentators are demarcating the boundary between agency law (which if applicable imposes vicarious liability) and the negligence principles encompassed in Section 414.

Therefore, Section 414 takes over where agency law ends by providing a theory of direct liability based on the existence of a duty of reasonable care. That duty is triggered when the employer – usually the general contractor – has retained supervisory control over the independent contractor without retaining control over all operative details of a project. As comment b explains, the rule stated in Section 414 "is usually, though not exclusively, applicable when a principal contractor entrusts a part of the work to subcontractors, but himself or through a foreman superintends the entire job."

It should be noted that this case is a Seventh Circuit's interpretation of what the Illinois Supreme Court would have held. Furthermore, this case sets forth only that this is no-fault vicarious liability and it is based on the principles of agency law, not negligence law. However, the "retained control" is still the standard to be applied when determining any liability.

In this case, the court held that "control" is a question of law; this is contrary to several Illinois cases where the question of "control" is a question of fact. *Weber v. Northern Illinois Gas Company*, 10 Ill. App d 625, (1st Dist. 1973); *Pasko v. Commonwealth Edison Company*, 14 Ill. App d 481, (1st Dist. 1973).

Construction Notes

On November 29, 2007, the Illinois Supreme Court affirmed the Appellate Court's ruling in *Kajima Construction Services, Inc. v. St. Paul Fire & Marine Insurance Co*., 227 Ill.2d 102 (Ill. 2007). The appellate court held that when targeted tenders are made because the loss is covered by multiple insurance policies the primary policies must be exhausted before any umbrella or excess insurance policy is invoked. See Querrey & Harrow's Construction Law Quarterly, Winter, 2007.

* * *

In a recent federal appellate court case, the Seventh Circuit Court of Appeals, sitting in Chicago, held that two persons experienced in construction could testify about workmanship and labor rates, even though neither had any licenses or specialized academic training. *Trustees of Chicago Painters & Decorators Pension v. Royal International Drywall & Decorating*, 493 F 3d 782 (7th Cir. 2007).

* * *

The jury in a Cook County case found the defendant residential home developer not guilty where the plaintiff alleged that he had been stung by a hoard of hornets or wasps when he walked onto a wooden deck of a model home. The plaintiff had contended that the model home had been improperly maintained. *Naseeruddin v. Pasquinelli, Inc*., 03 L 15665 – Sept. 11, 2007.

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