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Bench Press

Employee IOU

What's your personal liability to employees if business falters?

By Brian J. Hunt

THE CORPORATE FORM MAY IMMUNIZE A CORPORATION'S OWNERS AND managers from civil liability, even though they may not always do the right thing from the employee's point of view. Which is why legislatures have enacted statutes designed to protect employees by imposing personal liability on owners and managers in certain limited circumstances. In *Andrews v. Kowa Printing Corporation*, 217 Ill.2d 101 (2005), the Illinois Supreme Court had to decide whether that personal liability was properly enforced.

The case Thomas Kowa owned 100 percent of Kowa Printing Corporation (KPC) and Huston-Patterson Corporation (HPC), both of which focused on commercial printing and were located in neighboring cities. Both firms operated under a common service mark ("The Kowa Group"), and Kowa was the sole officer and director of both firms. The firms were distinct corporate entities formed at different times, with separate employees, management, bank accounts, collective bargaining agreements and retirement plans. However, they regularly marketed each other's services and HPC provided KPC with payroll, purchasing and accounting services.

In 1996, when it was discovered that KPC's accountant had embezzled over $500 thousand, putting the firm in dire financial straits, Kowa agreed to personally guarantee all of KPC's loans in exchange for a forbearance agreement from KPC's only secured creditor, BankIllinois. The stated purpose of this agreement was to prepare the company for sale. Kowa also executed a surrender agreement, which allowed for the peaceful surrender of KPC's assets in the event of foreclosure.

In early 1998, a buyer entered into a written agreement to purchase KPC but, as a condition of that purchase, required certain concessions regarding accrued vacation time from KPC's employees. When the concessions were not forthcoming, the purchase failed. BankIllinois foreclosed shortly thereafter and shuttered KPC. As a result, 35 KPC employees were put out of work and denied their final vacation and severance pay.

Following the foreclosure, the former employees filed a complaint alleging that Kowa, KPC and HPC were each their “employers” as defined by the Illinois Wage and Payment Act (820 ILCS 115/1 et seq.), and, that they had violated Section 5 of the Act. While the trial court ruled in favor of the employees and against all three defendants, the appellate court reversed the judgment with reference to Kowa and HPC.

The Supreme Court’s judgment The Illinois Supreme Court began by noting that Section 5 of the Wage Act provides that, “Every employer shall pay the final compensation of separated employees in full at the time of separation, if possible, but in no case later than the next regularly scheduled payday for such employee.”

As the Court framed the issue, it had to decide whether Kowa and HPC qualified as the plaintiff’s “employer” as defined in the Wage Act. The Court stated that the fundamental rule of statutory construction is to determine and then give effect to the legislature’s intent. The best indicator of legislative intent is the plain and ordinary meeting of the meaning of the statutory language.

The Court further noted that the Wage Act defines the term “employer” in two different places. Pursuant to Section 2, “employer” includes “any individual, partnership, association, corporation, business trust…or any person or group of persons acting directly or indirectly in the interest of any employer in relation to an employee, for which one or more persons is gainfully employed.” Section 13, in turn, states that, “any officers of a corporation or agents of an employer who knowingly permit such employer to violate the provisions of this Act shall be deemed to be the employers of the employees of the corporation.”

The Court then began its analysis with Section 2, and stated that the breadth of that definition was confusing in that it would make an employer of any person who possesses even a modicum of authority over another employee. The Court concluded that the legislature did not set out to make every supervisory employee strictly and personally liable for the payment of subordinates’ wages. Instead, it opted to rely on federal case law that refers to a similar topic, and interpret the language as intending to prevent employers from shielding themselves from responsibility for their agents’ acts.

Turning then to Section 13, which refers to the imposition of liability on officers and agents who commit a knowing violation, the Court concluded that it was clearly Section 13 and not Section 2 that defines who, other than the employer itself, may be treated as an employer. The Court stated that Section 2 and Section 13 form a coherent and sensible policy insofar as Section 2 confirms that the employer itself is liable for both its own violations and violations committed by its agents, while Section 13 imposes personal liability on officers or agents who knowingly permitted the violation.

The final ruling Applying this statutory analysis to the facts at hand, the Court found no evidence that Kowa knowingly permitted the unlawful withholding of plaintiffs’ severance and accrued vacation pay. To that point, the Court noted that the plaintiffs’ separation from KPC occurred after BankIllinois seized KPC and all of its assets, and while BankIllinois was calling the shots. The Court concluded that nothing in the record suggested that either KPC's demise or the loss of plaintiffs' jobs was inevitable but, rather, that Kowa made every effort to ensure that the plaintiffs' livelihoods survived KPC's unexpected financial downturn.

As to HPC, the Court concluded that it could dispense with its purported liability quickly since it was now understood that Section 2 does not make employers of every person "acting directly or indirectly in the interest of any employer," but instead applies only to the employer's agents. As HPC was clearly not an agent of KPC, no liability could be attached.

Furthermore, although joint employment is a recognized legal doctrine under Illinois law and under the Wage Act, the Court rejected the assertion that KPC and HPC jointly employed the plaintiffs. The Court based this conclusion on the separateness of the entities and the complete lack of evidence that HPC exercised any degree of control over KPC employees.

While acknowledging that Kowa—as the sole officer and director of both firms—exercised complete dominion over both KPC and HPC, the Court stated that the control was irrelevant because there was no evidence that HPC controlled the terms and conditions of the plaintiffs' employment. Therefore, it concluded, neither Kowa nor HPC qualified as plaintiffs' "employer" under the Wage Act.

While the Illinois Supreme Court opinion correctly focuses on the statutory language and the facts of the case, it is difficult given the relatively small number of decisions issued by the Court not to see the opinion as an expression of policy. Business owners who find themselves in dire financial straits should not be exposed to personal liability for struggling to keep a sinking ship afloat. As any court's decision is very likely influenced by the pertinent equities, "play fair" is the best possible counsel.

About the author: *Brian J. Hunt is the managing member of The Hunt Law Group, LLC, Chicago, Illinois, and a member of the Defense Research Institute's Professional Liability Committee. His practice focuses on the counseling and representation of CPAs and other business professionals, and on the resolution of business disputes. Brian was selected in 2005, 2006 and 2007 as an Illinois Super Lawyer in Business Litigation. He can be reached at 312.384.2300 or* ***bhunt@hunt-lawgroup.com****.*