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The Counselor

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Floor Plan Financier Can't Reclaim Collateral Due to Lack of UCC Filing

BY MICHAEL WEISSMAN

A floor plan financier argued that its trust agreement with a bankrupt debtor excused its failure to make an Article 9 UCC filing to perfect its security interest. The court rejected that argument in *In re Hawaii Motorsports, LLC*, 2020 Bankr. Lexis 3428 (Bankr. D. Mont. 2020).

Hawaii Motorsports, LCC, the debtor, was in bankruptcy, and American Honda Finance Corporation, the financing source for the debtor, was trying to reclaim the debtor's inventory and proceeds from the sale of inventory. In order to do so, it had to convince the court to lift the automatic stay of all remedies that arises when a bankruptcy case is filed. American Honda was opposed by another creditor, Hawaii State Federal Credit Union, the debtor, and the Chapter 7 bankruptcy trustee.

On November 7, 2016 the debtor and American Honda executed a Wholesale

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Proposed Changes to the TODI Act

BY GARY R. GEHLBACH

The Illinois Residential Real Property Transfer on Death Instrument Act became effective January 1, 2012 (P.A. 97-555), and modest changes were made three years later (P.A. 98-821). Now that the TODI Act is seasoned and in fairly wide use, a committee of ISBA, ably chaired by Charles Brown of DeKalb (the principal draftsperson of the Act), has recommended significant changes that would clarify many of the provisions of the Act, conform provisions to Illinois law, and render it a more effective estate planning tool.

The proposed revisions are incorporated in SB3150, introduced in February 2020 and, except for COVID-19's impact on the legislative process, would likely have passed

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Finance Agreement and a Wholesale Finance Security Agreement. Subsequently, vehicles were delivered to the debtor and sold by the debtor but business wasn't healthy enough to keep it out of bankruptcy. When the bankruptcy case was filed, there were unsold vehicles and sales proceeds in the possession of the debtor.

American Honda argued it was entitled to reclaim the vehicles and proceeds based on Section 24 of the Wholesale Finance Agreement that stated, "[Debtor] shall hold and keep all property and the proceeds thereof (collectively, the 'Trust Property") in trust for the benefit of American Honda." According to American Honda that was sufficient to support the conclusion that Article 9 wasn't applicable.

But the trust language was an outlier. The balance of the two American Honda documents spoke the language of Article 9 of the UCC. The Wholesale Finance Security Agreement's recitals stated that in consideration of the loans American Honda was making to the debtor, the "[Debtor] has agreed to grant [Honda] a security interest in the Property" and "It is the intention of [Debtor] to grant [Honda] a security interest in the Collateral." It goes on to expressly grant American Honda a security interest in all Collateral "whether now owned or hereafter acquired " as well as all proceeds from the sale of the Collateral, and authorizes American Honda to file appropriate financing statements with respect to the Collateral and American Honda's interest therein.

In the face of such unequivocal language, the court said:

Even a cursory review of the WFA and the WFSA indicates the parties entered into a lender borrower, not a trustor trustee relationship. Both documents expressly provide for the creation of a security interest in favor of Honda. Accordingly, it falls within the scope of Article 9.

That provided clarity as to just what sort of arrangement existed between the debtor and American Honda, but it did not permit American Honda to get the collateral back. To do so American Honda had to show it had a perfected security interest that took precedence over the bankruptcy trustee's status as the holder of a perfected security interest as of the date of bankruptcy. That meant American Honda had to have filed a UCC-1 financing statement prior to the date the bankruptcy case was filed.

But American Honda had failed to file a UCC-1 financing statement to perfect its security interest. Addressing that issue, the court said that the essence of perfection is to furnish public notice of the secured party's interest in the collateral, thereby protecting third persons against secret liens, and that the "trust" arrangement urged by Honda appeared to be precisely the sort of secret lien, or interest, perfection is intended to protect against.

The court's ultimate conclusion was that "Honda has failed to establish that the Debtor's inventory and sale proceeds are subject to an express trust outside the scope of Article 9," and since Article 9 applies, "Honda has failed to show it has a perfected security interest in Debtor's inventory and sale proceeds."

What's the point? This case is a classic example of attempting to deny your own words. One cannot state that a security interest is intended to be created, and later, upon finding that no UCC filing has been made to perfect it, suddenly disavow the plain language of the operative documents. In case of any doubt as whether Article 9 is involved, always file a UCC-1. If the arrangement isn't under Article 9, a court will simply ignore it. But if it is under Article 9, failure to file will be a very expensive error.■

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Proposed Changes to the TODI Act

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earlier this year. The changes are summarized as follows:

The definition of "Owner" in section 5 would exclude anyone acting as an agent for the owner or in any other fiduciary capacity on behalf of the owner, the rationale being that the TODI is similar in many respects to a will.

The definition of "Person," also in section 5, would clarify that a permissible beneficiary of a TODI could be a trustee of a trust, even a trust created under the TODI.

One of the most significant changes is in the definition of "Real Property" (in section 5), which would remove the reference to "Residential Real Property." Illinois being the only state with a TODI statute limited to residential real property, this change would make a TODI applicable to any interest in Illinois realty.

Revised section 20 would provide that a TODI would be able to be used to transfer the interest in real property to a beneficiary in any form of ownership allowed under Illinois law.

A new section 20 would state that a beneficiary of a TODI could be a trustee of a trust in existence when the TODI is executed and, unless the TODI provides otherwise, the interest in real property transferred by the TODI will be subject to the trust, including amendments to the trust later made, even after the owner's death.

Even though a TODI is only effective at the owner's death, it is not, under section 30, a "testamentary instrument" and cannot be admitted to probate.

Some TODIs having been found not to be in compliance by some title companies for omitting the beneficiaries' addresses. Section 40, while still providing that a TODI "must contain the essential elements of deed," would no longer require the addresses of the beneficiaries (their addresses are likely to change before the owner dies).

The execution requirements under section 45 include two credible witnesses and a notary (who must notarize the owner's and witnesses' signatures). The proposed change would specify that if a witness or the notary is a beneficiary or a spouse of a beneficiary, that person's interest and all persons claiming under him or her would be void.

Considering that the TODI is revocable and only effective on the owner's death, section 60 would clarify that a transfer of the property revokes the TODI under the doctrine of ademption. ("Extinction or withdrawal of legacy by testator's act equivalent to revocation or indicating intention to revoke." Black's Law Dictionary Fifth Ed. 1979.)

If a TODI identifies more than one beneficiary to receive concurrent interests, the interests are taken in equal undivided shares with no right of survivorship, under section 65. Moreover, if one of the beneficiaries predeceases the owner, that beneficiary's interest lapses (unless that beneficiary is a descendant of the owner, in which case that beneficiary's interest passes to his or her descendants per stirpes) and is transferred to the other beneficiaries in proportion to the other beneficiaries' interests. If the TODI only identifies one beneficiary who predeceases the owner, the real property interest passes to the owner's estate, unless that beneficiary is a descendant of the owner's, in which case the interest passes to the beneficiary's descendants per stirpes).

New section 66 addresses a surviving spouse's right of renunciation. Unless the right of a surviving spouse is waived (which can be in the TODI), the TODI may be renounced by the surviving spouse, in which event the surviving spouse is entitled to a one-third interest in the real property if the owner was survived by any descendant, or one-half if not. To renounce the TODI, the surviving spouse must, within six months after the owner's death (contrasted with section 2-8 of the Probate Act that allows seven months), file an instrument with the Recorder's office. However, by filing a renunciation, the surviving spouse will waive any other right under the TODI.

Consistent with Illinois case law, by which a decedent's assets are subject to the claims of his or her creditors, regardless of how the assets are transferred at the owner's death, new section 85 would clarify that if the decedent's probate estate is insufficient to satisfy all claims, the TODI property is liable.

Finally, new section 90 would specify that an action contesting a TODI or asserting a claim against the TODI property must be commenced within the time prescribed in section 13-220 of the Code of Civil Procedure (within two years of the owner's death, unless within that two years, letters of office are issued, in which case, the time for claims to be filed is pursuant to the Probate Act).

Our hope is that COVID-19 is under sufficient control fairly soon, enabling us to resume what had been life's normalcy, and allowing the Illinois General Assembly to address meaningful legislation, including SB3150.■

Pandemic/COVID-19 Workplace Claims – A Plaintiff's Perspective

BY DAVID FISH

As we transition out of the blindsiding-shock phase of the COVID-19 pandemic (where, for example, restaurant workers were terminated because local authorities shut them down on a few days' notice) and we enter the "new normal", at least for the foreseeable future, we are starting to see employers make illegal decisions such as cutting those employees who are exercising their legal rights, using COVID-19 as a pretext for an illegal termination, and failing to properly navigate the new legislation being passed on the federal, state, and local levels.

Here are the types of employment cases that we see, and will continue to result, because of the COVID-19/Coronavirus pandemic:

Health & Safety Retaliation Claims

We have already seen, and we predict we will continue to see, many retaliation claims filed where workers raise COVID-19 related health and/or safety complaints. A typical situation involves an employee raising some type of concern about the safety of the workplace. These concerns can be things relating to the lack of personal protective equipment, an employer's failure to follow social distancing guidelines, or an employee being forced to work next to someone who has a bad cough (and potentially COVID-19).

Employees at this time are scared because they're worried about catching COVID-19. Imagine if you had to sit in a cubicle next to the guy who kept coughing and you had a newborn at home and a spouse with health conditions that make her more susceptible to dying from COVID-19. Employees are, understandably, worried about getting sick. They are also scared about bringing an infection home and infecting their family members.

As a result of this fear, the new water-cooler chat inevitably turns to health and safety concerns. In every crowd, there is usually an employee who speaks up and starts asking about things like working from home, having the company buy more PPE, or allowing other accommodations. Unfortunately, making a workplace safe costs money and, in this economy, some employers are more keen on saving than spending. This creates tension between worker rights and employer rights.

Management often does not like it when people complain. What can unfortunately happen is that the employee who raises the concerns gets fired. Terminating employees for complaining about health and safety issues is often illegal and, understandably, there are a number of different laws that protect workers in this arena.

These claims are typically pursued under the common law of retaliatory discharge. "An employee can state a cause of action if he alleges that he was terminated for protesting unsafe working conditions." *Fragassi v. Neiburger*, 269 Ill. App. 3d 633, 638, 646 N.E.2d 315, 318 (2d Dist. 1995). Alternatively, because there are so many COVID-related rules and regulations, such complaints can be protected under the Illinois Whistleblower Act. 740 ILCS 174/15.

Given that many courts are closed for trials right now, and justice delayed is justice denied, we have turned to federal agencies that have remained open to advance our clients' interests. When our clients have engaged in concerted activities with other workers concerning safety concerns (i.e., speaking up at a safety meeting), we suggest pursuing claims with the National Labor Relations Board (NLRB).

While I have several criticisms about the NLRB, one thing I cannot complain about is how quickly it responds. In the last two NLRB retaliation claims that we have filed since the pandemic, our clients have had their NLRB retaliation interviews scheduled in less than three business days from the day we filed the complaint and the interviews were conducted telephonically. Remember, contrary to popular belief, the National Labor Relations Act protects many non-union employees and can allow employees to get reinstated to their prior positions and receive back wages. As such, I anticipate a substantial increase in NLRB claims.

The OSHA Act of 1970 requires that "Each employer shall furnish to his employees employment and a place of employment which are free from recognized hazards that are causing or are likely to cause death or serious physical harm to his employees" and that "Each employee shall comply with occupational safety and health standards and all the rules, regulations, and orders issued by this Act which are applicable to his own conduct." I also foresee that OSHA whistleblower litigation will substantially increase. Although not as quick as the lightning fast-NLRB process, OSHA provides another forum for resolving health and safety-related complaints. OSHA has a very easy online whistleblower complaint form. As it is so easy to file, and workers are scared right now about health and safety, we anticipate a number of OSHA claims.

Over the next few years, many retaliatory discharge claims arising out of COVID-19 issues will work their way through the courts. In some jurisdictions, the best way to maximize damages for a retaliation claim based upon health and safety issues is by filing a retaliatory discharge claim in court. The downside of this method is that the process takes a long time; the upside is juries do not like to see employees being fired for complaining about health and safety issues. Also, in some jurisdictions (like those where I practice), punitive damages are allowed. Multi-million jury awards are not uncommon for retaliation claims.

Finally, one nice thing about retaliation claims based on health and safety issues is that you can file in multiple forums. For example, you can file with the NLRB and also proceed in court. This allows you to have the benefit of a governmental investigation of your claims which may provide you with a head-start in court.

False Claims/Qui Tam Claims

There will be an explosion in False Claims and Qui Tam cases. The federal government quickly spent over $2 trillion dollars and likely will spend more. State and local governments are also putting out money. Billions are being spent on the care of those who have contracted COVID-19. The Department of Justice has prioritized the investigation of COVID-19 related fraud and directed local offices to appoint a Coronavirus Coordinator.

Employees often know the dirt on what their employers are doing and are eager to share it when they are fired. This makes them prime candidates to be a whistleblower to expose fraud on the government. For example, is an employer taking paycheck protection money and doing something with it other than paying employees defrauding the government? Are physicians and health care providers improperly billing for medical care? Are the companies that are being contracted to provide essential equipment during the pandemic lying to boost up their profits?

Workers' Compensation Claims

There will be a significant number of workers' compensation claims filed as a result of employees becoming sick or dying from COVID-19. An example of such a claim is a health care aide at a nursing home who dies or becomes sick from COVID-19 exposure in the workplace.

Typically, in a workers' compensation claim, a successful claim requires an injury in the line of duty. Usually, this is simple: if a worker has a finger taken off while operating a press at work, that is the type of claim that is clearly in the line of duty. However, showing this is not an easy task in the case of COVID-19; for example, how would an employee be able to prove that she was infected at work as opposed to while shopping at the grocery store?

The interesting question will be how to value these claims. I think it will be somewhat hard to value non-death claims. For example, if someone is sick but recovers in two weeks without any permanent injuries or serious hospitalizations, what is the value of their claim? I anticipate that the most common claim will be death claims, i.e., people who died from their COVID-19 exposure. And, unfortunately, there will be many such fallen heroes.

CARES Act Claims/Disability Related Claims

There will be a significant number of cases brought under the Coronavirus Aid, Relief, and Economic Security (CARES) Act and related emergency legislation. In addition, given the panic in the workplace by those with symptoms that make them more susceptible to dying from COVID, there will be an uptick in disability-related claims under the Americans with Disabilities Act and related legislation. With this said, we think that the majority of these claims are likely to be brought on an individual/non-class basis.

The Family and Medical Leave Act (FMLA) now allows an eligible employee to take FMLA leave on an expanded basis, *i.e.*, to care for a child whose school is closed or unavailable due to the COVID-19 pandemic. Like the FMLA, the Emergency Paid Sick Leave Act (EPSLA), includes anti-retaliation and anti-discrimination provisions. It incorporates the Fair Labor Standards Act (FLSA) by allowing for liquidated damages and attorneys' fees.

Many employers are very reasonable when it comes to COVID-19 related accommodations. Where we tend to find the highest level of claims is for those employees who are "below-average" employees. While the employer may have been willing to put up with these employees under normal circumstances, now that the employee has the "audacity" to ask for an accommodation (that the law allows), that employee may be looking at termination. We anticipate the future issue in many of these cases will be whether the employee would have ended up being terminated anyway, or whether they were fired because he/she requested some type of leave or accommodation. In many respects, I believe that the next few years of employment litigation will be similar to what it was like after the tragic 9-11 attacks: some employers will claim that these employees would have ultimately been fired (anyway) because the economy was crashing.

Wage Claims

Last, but certainly not least, there will be some wage and hour litigation. One area we are seeing frequent violations is with respect to the computation of the "regular rate" for overtime purposes. Consider this example: employer is paying $10 per hour. Employer is adding on hazard pay of $4 per hour extra. When computing the overtime rate, many employers are still paying overtime on the base rate (i.e., an overtime rate of $15 per hour) whereas the appropriate rate is 1.5 times the total compensation ($14) which would make the overtime rate $21 per hour.

As direct employers go out of business and cannot pay wages, one interesting area will be testing the scope of what constitutes an "employer" or "joint employer" under the wage laws. For example, if a temporary agency fails to pay its workers, the end client (i.e., where the employee is placed) may be a viable target for collection purposes. Likewise, because employment laws have expansive liability for certain individuals who own/operate a business, those individuals may be brought in as defendants in wage cases.

There will be claims in the future under the WARN Act. I don't believe that these claims will necessarily arise from the sudden government shutdown, although there have been some cases filed already. (See *e.g.*, *Siers v. Velodyne Lidar*, No. 5:20-cv-02290 (N.D. Cal. Apr. 3, 2020) (claim under WARN Act alleging Pandemic as a pretext for the improper layoffs). We will see some WARN Act claims down the road for those businesses that are dying a slow death (a restaurant, of course, does not need to WARN when it is given no notice that it must shut down); however, a business that is slowly seeing its sales decline and is predicting internally the need to layoff may have a WARN obligation.

Executives with contracts that are prematurely terminated due to the economy will have significant claims. There may also be ERISA claims due to employee benefit violations and diminishing employee retirement account balances.

I anticipate that there may be some claims associated with worker expenses that arise from working at home in those states that require employee expense reimbursement. I don't think these claims are particularly exciting (nor valuable), but having an employee work from home does result in the employee potentially incurring some costs. And, in some instances, the "free and clear" take-home pay could dip below minimum wage and trigger FLSA liability.

There will be some overtime claims from people who are claiming to be working more at home, but I think that these are going to be small, insignificant, and individualized claims (although, from what I have read, the defense bar seems to think otherwise).

With all of these new laws, some with no precedent, the next few years should be an exciting time for employment lawyers. There will be bumpy roads ahead and we, as lawyers, will help keep everyone on the straight and narrow.■

Executive Orders and Their Challenges During COVID-19

BY LESLEY GOOL

Governors across the United States have issued executive orders as the country responds to the unending coronavirus pandemic (COVID-19) in hopes of slowing the virus's spread and thus helping to safeguard the health and well-being of our communities. Here in Illinois, Governor Pritzker has used his executive authority to require residents to maintain social distancing, stay in their homes or residences, prohibit particular outdoor activities, restrict the operation of non-essential businesses, and limit the number of people gathered together outside a single household, to name a few.

For a number of constituents, this was the first time an Executive Order noticeably affected their normal ways of life, and after the first 30-day stay-at-home Order was issued, civilians began to wonder what the function of an executive order is and where did Governor Pritzker's authority to make these seemingly unilateral decisions originate. It is the purpose of this article to provide a brief historical background of a proclamation or executive order and to examine the governor's authority to issue such orders, with an emphasis on recent lawsuits challenging Governor Pritzker's COVID-19 Orders.

Executive orders and proclamations originated with the English king. The monarch enjoyed specific entitlements and rights which belonged only to him by virtue of his preeminent position. Certain direct prerogatives, including the power to make war and the right to send ambassadors to other countries, were considered a part of the king's sovereignty. Other incidental entitlements were attached to the Crown, including that no costs could be recovered against the king and his debt was preferred to the debt of anyone else. These exceptions were established from the general rules applicable to the entire kingdom.

Unlike the king, whose authority to issue a proclamation or an executive order is rooted in his position, the office of governor was created by state constitutions to head the executive department of the state. Reacting to the arbitrary and powerful colonial governors preceding the American Revolution, the legislatures of the newly established states expressed their fear of the governor's office by constitutionally limiting the authority of the executive branch. In contrast to the king, a governor possessed only those powers delegated to him by the state constitution or by state statute, and such powers were limited in that they could be exercised only in the manner provided. Most state constitutions place the supreme executive power, the chief executive power, or the executive power in the office of the governor, and frequently cloak their chief executive with the responsibility to "take care that the laws be carefully executed."

Particularly in Illinois, the governor's implied power to promulgate an executive order or proclamation in response to the coronavirus pandemic is centered within Article V, Section 8 of the Illinois Constitution and explicitly stated in the Illinois Emergency Management Agency Act. See 20 ILCS 3305 *et seq*. which is hereinafter referred to as the "IEMAA."

Article V, Section 8 of the Illinois Constitution states: "The Governor shall have the supreme executive power and shall be responsible for the faithful execution of the laws."

The IEMMA states: "In the event of a disaster, as defined in Section 4, the governor may by proclamation declare that a disaster exists. Upon such proclamation, the governor shall have and may exercise for a period not to exceed 30 days the following emergency powers." See 20 ILCS 3305/7.

Section 4 of the IEMMA defines a disaster as the following: "Disaster" means an occurrence or threat of widespread or severe damage, injury or loss of life or property resulting from any natural or technological cause, including but not limited to fire, flood, earthquake, wind, storm, hazardous materials spill or other

water contamination requiring emergency action to avert danger or damage, epidemic, air contamination, blight, extended periods of severe and inclement weather, drought, infestation, critical shortages of essential fuels and energy, explosion, riot, hostile military or paramilitary action, public health emergencies, or acts of domestic terrorism. See 20 ILCS 3305/4.

Pursuant to his authority, explicit and implicit, Governor Pritzker proclaimed that a disaster existed within the State of Illinois after determining that the circumstances surrounding COVID-19 constituted a public health emergency, and he declared all counties in the State as a disaster area on March 9, 2020 (Gubernatorial Disaster Proclamation). Thereafter, Governor Pritzker issued a number of executive orders, the first being Executive Order 2020-10 on March 20, 2020, which required Illinois residents to maintain social distancing and stay in their homes, except to engage in "Essential Activities, Essential Government Functions, or to operate Essential Businesses and Operations." The Executive Order became effective on March 21, 2020 at 5:00 p.m. and continued until April 7, 2020. On April 1, 2020, Governor Pritzker issued a second proclamation declaring the COVID-19 pandemic to be a continuing public health emergency and extended the duration of the March 20 Executive Order twice with the last extension until May 30, 2020.

While residents and leaders from both parties had given Governor Pritzker high marks for his handling of the crisis, especially after his early stay-at-home order was widely credited for helping control the spread of infection in Illinois, there were a handful of lawsuits filed challenging the constitutional and statutory authority of those executive orders.

Lawsuits Challenging the Governor's Exercise of Executive Power

The first lawsuit was filed in Clay County by Darren Bailey on April 23, 2020, alleging the governor overstepped his power by declaring more than one state of emergency and shutting down non-essential businesses to address the COVID-19 pandemic. The Clay County Circuit Court judge presiding over the matter ruled that the 30-days of emergency powers provided under the IEMAA lapsed on April 8, 2020 and any executive orders in effect after that date relating to COVID-19 were void. Particularly, this ruling did not apply statewide and only applied to the individual Bailey. The Illinois Attorney General's Office, which represents the governor, appealed the ruling to the Illinois Supreme Court.

Governor Pritzker then had to defend against other lawsuits, including six that were filed in July 2020 in six downstate counties, that also alleged the governor overstepped his legal authority in issuing executive orders in response to the COVID-19 pandemic, and that the Pandemic did not fit the criteria under state law as a public health emergency in their respective counties. While the plaintiffs concede the COVID-19 pandemic satisfied section (a) of the definition, because COVID-19 is "an illness or health condition that (a) is believed to be caused by the appearance of a novel or previously controlled or eradicated infectious agent or biological toxin", the plaintiffs insist the COVID-19 pandemic is not a public health emergency because it does not satisfy any of the three disjunctive requirements set forth in section (b). Specifically, the lawsuits plead only three factual allegations in support of their theory: 1) the total number of people who have been tested for, 2) contracted, and 3) died from COVID-19 in each of their counties, which did not demonstrate that COVID-19 was a public health emergency within the meaning of the IEMAA.

Governor Pritzker, through representation by the Illinois Attorney General, filed to dismiss the six lawsuits, collectively, before a Sangamon County Circuit Court judge, who granted the governor's motion to dismiss. The court stated in its ruling that the complaints fell short on facts needed to support their claims. The judge explained that "Illinois is a fact pleading state, which means that plaintiffs must allege facts, not conclusions to establish a viable cause of action."

Additionally, the initial lawsuit filed by Bailey was redirected by the Illinois Supreme Court to the same above-mentioned Sangamon County Circuit Court judge, and the court also dismissed Bailey's complaint on the grounds that his amended complaint failed to state a cause of action and therefore any amendment would be futile.

Similarly, on October 30, 2020, McHenry County Circuit Court Judge Michael Chmiel ruled against a group of restaurant owners who had filed suit against the governor arguing he exceeded his authority in restricting indoor dining at restaurants and drinking at bars, which would permanently imperil their businesses. Judge Chmiel found that the governor has authority to impose restrictions on businesses because the IEMAA gives the governor the authority to continue to issue new disaster declarations and reassert emergency powers every 30 days. Notably, Judge Chmiel factored in the role of the legislative branch by drawing attention to the fact that lawmakers could have taken the time to insert language in the IEMAA explicitly granting the governor such extended emergency powers.

As recent as November 6, 2020, the Illinois second district appellate court struck down an order from a Kane County Circuit Court judge that had allowed a restaurant in Geneva, IL to continue operating legally despite the executive orders issued by Governor Pritzker that had otherwise shut down indoor restaurant dining this fall in order to reduce the spread of COVID-19. The court explicitly declared Governor Pritzker has the authority under state law to claim emergency powers by executive order for as long as he believes the disaster that caused the emergency continues.

While only the Clay County judge has declared Governor Pritzker's orders unconstitutional, these rolling controversies spotlight the need to explicitly clarify the governor's authority and boundaries involving the use of executive orders in relation to the COVID-19 Pandemic. Without any federal mandates, an executive order or proclamation is the only tool available to Governor Pritzker to implement various restrictions and guidelines in order to protect Illinois residents and prevent the spread of COVID-19. And given recent data regarding the increased spread of the virus in Illinois, it is possible we will see new and different, or renewed executive orders issued by the governor—and thus more challenges to those orders. ■

Is Illinois's New Retailers Occupation Tax Scheme Unconstitutional?

BY STANLEY R. KAMINSKI

A hallmark of the commerce clause of the U.S. Constitution is the requirement that state or local taxes cannot discriminate against interstate commerce. Stated more succinctly, a state or local tax cannot discriminate between out-of-state businesses and in-state businesses so as to put the out-of-state businesses at a tax disadvantage.[1] The Supreme Court recently explained this basic constitutional principle in *Comptroller of the Treasury of Maryland v. Wynne*:

Under our precedents, the dormant Commerce Clause precludes States from "discriminat[ing] between transactions on the basis of some interstate element." This means, among other things, that a State "may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." "Nor may a State impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business, or by subjecting interstate commerce to the burden of 'multiple taxation.'"[2]

Notwithstanding this fundamental prohibition on discriminatory taxation, effective January 1, 2021, Illinois will institute a major structural change in its state and local retailers occupation tax (ROT) — the Illinois sales tax — which will openly discriminate against non-Illinois retailers and interstate sales.[3] This discrimination is accomplished by expanding the state and local ROT to any non-Illinois retailer that lacks physical presence in Illinois but that meets economic presence thresholds in Illinois (a "remote retailer" under the new law), while also providing that a retailer that has a physical presence in Illinois either will not be subject to the ROT (only a 6.25 percent Illinois use tax will be due)[4] or, in many cases, will pay substantially less ROT on its sales than a remote retailer.[5] In other words, these non-Illinois remote retailers (that have no physical presence in Illinois) will now be required to pay state and local ROT on their sales based on the delivery location of the item sold, thus imposing a combined state and local ROT rate of up to 11 percent on these interstate sales. However, retailers with physical presence in Illinois, but that also make similar sales outside Illinois, will only have to pay use tax of 6.25 percent and will not be subject to state or local ROT, giving them a distinct competitive advantage over remote retailers.

The discrimination gets is exacerbated when compared with solely intrastate sales. Under this new ROT taxing scheme, Illinois retailers that make sales from inside the state will only pay local ROT based on the origin location of the sale (which could be as low as 6.25 percent), and not the delivery location that a remote retailer will have to use. So, in many cases, these intrastate sales will be taxed at a substantially lower ROT rate than a remote retailer must pay on its interstate sales. This provides these Illinois retailers a clear competitive advantage over non-Illinois retailers and thus punishes the non-Illinois retailers for making interstate sales. Therefore, on its face, the ROT taxing scheme is expressly designed to discriminate against out-of-state businesses and interstate sales in favor of local businesses and intrastate sales, based on an "interstate element" (that is, whether the sale occurred outside Illinois and whether the retailer has no local business presence in Illinois).

To further illustrate this discriminatory competitive advantage, below are some examples.

Example 1. An appliance retailer solely located in Indianapolis sells appliances online, including to customers in Chicago and Peoria, Illinois. It has no physical presence in Illinois but meets the economic threshold of $100,000 in sales a year to Illinois, so it is considered a remote retailer under the state and local ROT.[6]

On January 1, 2021, the retailer sells over the internet, for delivery, a refrigerator with a sales price of $2,000 to Customer A in Chicago and another refrigerator with a sales price of $2,000 to Customer B in Peoria. Under the new ROT taxing scheme, this Indiana retailer must pay combined state and local ROT rates of 10.25 percent (or $205 in tax) for the delivery to the Chicago customer and a combined ROT rate of 9 percent (or $180 in tax) for the Peoria customer delivery.

Example 2. If the above Indiana appliance retailer also has a small sales office in Naperville, Illinois (and even if that office is uninvolved in the Example 1 sales), its sales are now taxed quite differently. Under the new ROT taxing scheme, the Indiana retailer is no longer considered a remote retailer because of this physical presence in Illinois. Therefore, the state and local ROT do not apply unless the sales occur in Illinois. Here, as in Example 1, all aspects of the sales from the acceptance, invoicing, and shipment occur in Indiana, so under the ROT taxing scheme no state and local ROT must be paid; rather only the 6.25 percent use tax applies.[7] So, for the delivery of the refrigerators to both the Chicago and Peoria customers, only a 6.25 percent use tax (or $125 in tax) is due on each sale.[8] This means that by having an Illinois physical presence, the retailer pays 64 percent less in tax for its Chicago delivery and 44 percent less in tax for its Peoria delivery, an undeniably significant tax savings.

Example 3. If, in this example, the Indiana appliance dealer's Naperville office makes the sales of the appliances in Naperville — by soliciting, negotiating, and approving the sales; invoicing the customers; and collecting the sales price there — then the state and local ROT due changes again. Under the new ROT taxing scheme the sales now occur in Naperville, and the state and

local ROT due on both the Chicago sale and the Peoria sale is only 7.75 percent, which is the Naperville ROT rate or $155 in tax per customer. Again, by having a local physical presence in Illinois and converting the sale from an interstate sale to an intrastate sale, a substantial tax savings occurs.

As this shows, under Examples 2 and 3, when the retailer has a local Illinois presence or makes sales from an Illinois location, that retailer's sales are taxed considerably less than when it is a non-Illinois retailer as in Example 1. This is classic tax discrimination against interstate commerce.

There are many more examples of the discrimination built into the new ROT taxing scheme, but the three examples are sufficient to plainly illuminate its discriminatory design. What is quite unusual about the Illinois General Assembly imposing this new ROT taxing scheme is that it surely must have been made aware that an almost identical taxing scheme was tried by Missouri 25 years ago and was unanimously found unconstitutional by the U.S. Supreme Court.[9] Yet the legislature passed the discriminatory taxing scheme anyway.

In *Associated Industries*, Missouri, like Illinois, enacted a discriminatory local sales and use tax scheme that allowed Missouri retailers to pay local sales tax on their sales based on the sale location rather than the delivery location. So, if a Missouri retailer in one Missouri municipality sold goods to a customer in another Missouri municipality, the sales tax rate for the municipality where the sale took place was applied (origin location) rather than the tax rate for the municipality of delivery.

In contrast, under the Missouri sales and use tax scheme, if a sale took place from a non-Missouri retailer for delivery to a Missouri customer, then an additional 1.5 percent use tax was applied to the sale. As a result, for some sales the overall sales and use tax rate for the non-Missouri sale exceeded the sales and use tax rate on the Missouri retail sale. The Supreme Court had no problem unanimously holding that "Missouri's use tax scheme impermissibly discriminates against interstate commerce."[10]

What is even more surprising about the new Illinois ROT taxing scheme is not that the legislature simply disregarded long-established Supreme Court precedent in enacting it, but that this new ROT taxing scheme goes even further in its discrimination against interstate commerce than the unconstitutional Missouri law. Not only does the new Illinois ROT taxing scheme favor sales ~~in Illinois to the~~ disadvantage of non-Illinois sales, but it also discriminates against interstate sales based on whether the retailer has local physical presence in Illinois. It is expressly designed to punish non-Illinois retail sales when the retailer fails to establish some local physical presence in Illinois. Consequently, an Illinois consumer will pay a higher sales and use tax if it buys from a retailer that is exclusively located outside Illinois than if it buys from a retailer with an Illinois office. This discrimination against interstate businesses is the type the commerce clause was plainly designed to prevent.[11]

Nevertheless, some have oddly suggested that the Supreme Court's decision in *South Dakota v. Wayfair Inc.*[12] could somehow be interpreted as authorizing discriminatory taxes against interstate sales. But *Wayfair* was not concerned with a taxing scheme that discriminated against interstate sales, and its holding in no way supports a discriminatory taxing scheme like Illinois's new ROT taxing scheme. First, *Wayfair* plainly did not overrule *Associated Industries*'s unanimous holding that tax rates that discriminate against interstate sales are unconstitutional. Second, and even more important, the *Wayfair* Court expressly acknowledged that discrimination against out-of-state sales and retailers was prohibited. In reviewing the South Dakota tax law at issue, the Court noted that "South Dakota's tax system includes several features that appear designed to prevent discrimination against . . . interstate commerce."[13] And the *Wayfair* Court knew that in South Dakota the sales tax rate was the same for both intrastate and interstate sales, so no discrimination in tax rates was occurring. Therefore, *Wayfair* offers no support for Illinois's new ROT discriminatory taxing scheme.

The only remaining question is when will a remote retailer or Illinois consumer file an action challenging the new ROT taxing scheme as being in violation of the Commerce Clause? I am sure we will not have to wait long.[14] ■

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1. See *Associated Industries of Missouri v. Lohman*, 511 U.S. 641 (1994).
2. 135 S. Ct. 1787, 1794 (2015) (internal citations omitted).
3. Public Act 101-0031 (puzzlingly called the "Leveling the Playing Field for Illinois Retail Act"); 35 Ill. Comp. Stat. 120/1 et seq. There are other U.S. and Illinois constitutional issues with the new ROT taxing scheme, but those are for another article.
4. There is a 1 percent Chicago use tax that could apply to consumers who use retail purchases in Chicago.
5. See 35 Ill. Comp. Stat. 120/1 (definition of remote retailer); 35 Ill. Comp. Stat. 120/2(b) (economic presence test); 35 Ill. Comp. Stat. 105/2 (economic presence test); and Ill. Admin. Code tit. 86, section 270.115 (sourcing of sales).
6. 35 Ill. Comp. Stat. 120/1).
7. See, *e.g.*, Ill. Admin. Code tit. 86, section 270.115.
8. The Chicago customer may have to pay an additional 1 percent Chicago use tax if the price exceeds the customer's annual Chicago use tax credit.
9. *Associated Industries*, 511 U.S. 641.
10. *Id*. at 654.
11. See, *e.g.*, *Tennessee Wine and Spirits Retailers Association v. Thomas*, 588 U.S. ___; 139 S. Ct. 2449 (2019).
12. 138 S. Ct. 2080 (2018).
13. *Id*. at 2099.
14. Interestingly, the Illinois legislature also made sure to amend the Illinois use tax to likewise tax remote retailers at 6.25 percent. *See* P.A. 101-0604. No doubt this was done as an insurance policy to limit the loss of the state ROT, if (or when) the new ROT taxing scheme is found unconstitutional. But this does not help the discriminatory imposition of the local ROT of up to 4.75 percent, since there is no backup local use tax, which means when (or if) it is found unconstitutional, the law goes back to what it was before January 1, 2021.