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GOVERNOR SIGNS NEW LAW THAT MAKES A GENERAL CONTRACTOR LIABLE IF A SUBCONTRACTOR DOES NOT PAY ITS EMPLOYEES

On October 14, 2017, Governor Brown signed new law that will make a general contractor liable if a subcontractor fails to pay its employees on a private project. The new law, AB 1701, applies to construction contracts entered into after January 1, 2018, for “erection, construction, alteration, or repair of a building, structure, or other private work.” AB Section 218.7 adds Section 218.7 to the Labor Code.

Overview of AB 1701 / Labor Code Section 218.7

Labor Code Section 218.7, as added by AB 1701, provides that the general contractor on a private project “shall assume, and is liable for, any debt owed” by a subcontractor for wages and benefits. The law applies to wages and benefits owed by any subcontractor, regardless of tier.

Section 218.7 only authorizes the recovery of unpaid wages, fringe or other benefit payments or contributions, and interest, but it does not authorize the recovery of penalties or liquidated damages. Three different persons or entities may bring an action to enforce the rights created by Labor Code Section 218.7: (1) the California Labor Commissioner; (2) a third party owed fringe or other benefit payments or contributions (typically, this would be a union trust fund); and (3) joint labor-management cooperation committee established pursuant to the federal Labor Management Cooperation Act of 1978. The Labor Commissioner only may recover for wages and interest, and not for fringe or benefit payments or contributions. A third party owed fringe or benefit payments, and a labor

management cooperation committee, may recover its attorney's fees if they are the prevailing party.

AB 1701 also allows a general contractor to require subcontractors (of all tiers) to provide payroll reports that contain the information required by Section 226 of the Labor Code, including: (1) gross wages earned, (2) total hours worked; (3) all deductions; (4) net wages earned, (5) the inclusive dates of the period for which the employee is paid, (6) the name of the employee and the last four digits of his or her social security number, and (7) all applicable hourly rates.

Effect of the New Law

General contractors on public projects are already liable for amounts owed by a subcontractor or lower tier subcontractor who fails to pay wages, benefits, and contributions. Similarly, under many union agreements, a general contractor will be responsible for wages and benefits that a subcontractor fails to pay if the general contractor and subcontractor are both parties to the same union agreements or to union agreements of affiliated unions.

One effect of AB 1701 may be to force general contractors on private projects to subcontract more work to larger, better capitalized subcontractors that are less likely to fail to pay their workers.

There can be significant legal consequences if you advance or loan funds so that a subcontractor can meet payroll or if you issue checks to a subcontractor's workers. Internal Revenue Code section 3505 considers anyone who pays or advances funds so a company can pay its workers to be responsible for remitting withholding to the IRS. Before advancing funds or providing other assistance to a subcontractor struggling to pay its workers, consult with an attorney to make sure that your rights are protected.

Recommendations

The following are some steps you can take to protect yourself against liability under AB 1701. Many of these are the same recommendations that would apply on a public project where a general contractor is liable if a subcontractor fails to pay its workers.

- Choose subcontractors carefully. Prequalify your subcontractors if possible. This may not always be possible in competitive bid situations.
- In some cases, obtain financial information or tax returns from subcontractors to evaluate their ability to pay their bills.
- Monitor payments by subcontractors to their workers. Obtain payroll reports from subcontractors at every tier and use them to confirm the payment of workers.
 - Consider using spot checks or audits where there is a particular concern. (Note that monitoring is already required on prevailing wage jobs).
 - Compare records of head counts and subcontractor crew hours from inspection and/or superintendent reports with subcontractor payroll reports,

to see if they match.

- Obtain letters and/or releases (if possible) from trust funds and unions to ensure that a subcontractor is up to date on contributions and other payments.
- Consider requiring either subcontractor payment and performance bonds or personal guarantees from owners of subcontractors.
- Where appropriate, recommend that the owner utilize and pay for Subguard or other subcontractor performance insurance.

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