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RISK MANAGEMENT ALERT: CALIFORNIA BUILDING OWNERS AND CONTRACTORS EXPOSURE INCREASES FOR NON-PAYING SUBCONTRACTORS

10.30.17

On October 14, 2017, California Governor Jerry Brown signed Assembly Bill 1701 into law. This law makes direct contractors liable for a subcontractor's non-payment of its employees. This law is only applicable to private, non-public work. Under AB 1701, if a direct contractor hires and pays a subcontractor to perform electrical work, and the subcontractor does not pay its employees, the direct contractor is liable for the unpaid wages and fringe benefits, plus interest, regardless of the fact that the direct contractor already paid the subcontractor. The direct contractor, however, will not be liable for any penalties resulting from the subcontractor's failure to pay.

Proponents of the bill see it as a boon for employees of sketchy subcontractors and sub-subcontractors, while opponents see it as unnecessary legislation that will raise costs for direct contractors and, by extension, raise the costs of construction. Either way, direct contractors will be exposed to increased liability.

Beginning January 1, 2018, direct contractors will be liable for any non-payment of wages or fringe benefits to employees of subcontractors. Listed below are a few vital pieces of information necessary to understanding and dealing with the AB 1701:

- Direct contractors should attempt to enter into any covered contracts before the beginning of 2018.
- Though the law is designed to ensure payment of subcontractor employees, the law does not confer standing on the unpaid employees themselves to bring suit to recover their personal unpaid wages against the direct contractor. Instead, the law gives the Labor Commissioner, Labor-Management Cooperation Committees and unions standing to bring an action against the direct contractor.

PROFESSIONALS

Stephen J. Henning

Keith E. Smith

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- If a Labor Management Cooperation Committee or labor union bring suit against a direct contractor and prevails, the court "shall award" reasonable attorney's fees and costs, including expert witness fees. The law also authorizes courts to attach the direct contractor's property to pay for any judgment entered pursuant to this law.
- Direct contractors will have to wait at least one year until after the completion of a project for the statute of limitations to run. Any action brought pursuant to this law must be filed within one year of the earliest: (1) recordation of a notice of completion of the direct contract; (2) recordation of a notice of cessation of the work covered by direct contract; or (3) actual completion of work covered by direct contractor.
- Upon a direct contractor's request, subcontractors and lower tier subcontractors must provide payroll records and project award information. A direct contractor may withhold as "disputed" all sums owed if a subcontractor does not timely provide the requested records and information. However, a subcontractor's failure to comply with such a request does not excuse a direct contractor from liability.
- Actions under this section can be brought in conjunction with any other obligations and remedies provided by law.
- Governor Brown issued a memo alongside his signing of the bill into law stating that clarifications of the scope of the law will be forthcoming in 2018. Thus, direct contractors should not only familiarize themselves with the current law, but also be on the lookout for upcoming revisions.

What You Can Do To Protect Your Organization:

- Execute as many pending agreements as possible in 2017 to avoid the effects of the law.
- Vet your subcontractors – check references, check their project history, make sure they are trustworthy.
- Include broad audit provisions in the subcontracts.
- Include defense and indemnity provisions.
- Require subcontractors to provide a payment bond and a letter of credit.
- Require personal guarantees.
- Include withholding and back-charge provisions.
- Implement a system to confirm evidence of payments to subcontractor employees.
- Implement site security to confirm identification of all employees on the job site so no previously unidentified subcontractors can later appear seemingly out of nowhere and claim their employer did not pay them.

If you are concerned that this new piece of legislation could affect you or your business, please contact WSHB and we will advise you of the best course of action to protect yourself and your business.