

## Stuart Kane LLP

## Contract With Care: New Law Increases Direct Risk for General Contractors (and Indirect Risk for Owners) Regarding Subcontractor Wages

While not uncommon for owners and general contractors to haggle over payment of unforeseen cost increases on construction projects, imagine arguing over who pays for a subcontractor's labor costs. For new construction contracts after January 1, 2018, a private direct contractor in California may be held liable for "any debt owed to a wage claimant or third party on the wage claimant's behalf incurred by a subcontractor at any tier" acting under, by or for the direct contractor. Assembly Bill 1701, codified at Section 218.7 of the Labor Code, is squarely aimed at direct (general) contractors, however, owners and tenants hiring those contractors should pay careful attention to the terms of their construction contracts to avoid effectively paying twice for the same work.

### What Is Assembly Bill 1701?

Assembly Bill 1701 is intended to address perceived "wage theft" for employees of California subcontractors. The law authorizes the Labor Commissioner to bring an action against *the direct or general contractor* to enforce any liability of a subcontractor for unpaid wages and interest, although not for statutory or civil penalties or liquidated damages. The law also authorizes private civil actions by a joint-labor management cooperation committee or third parties (think unions) on a wage claimant's behalf.

### How Can an Owner or Tenant Limit Their Exposure?

The first line of defense for any owner or tenant is to ensure that any contract contemplating construction (whether a joint venture agreement or a general construction contract) clearly and unequivocally excludes owner's obligation to pay the cost of any violation of law, including labor laws, by the general contractor **and** subcontractors. Form construction contracts often do not directly address this matter, and those that do attempt to water down a general restriction by limiting it to gross negligence or willful misconduct.

Owners should also ensure their contracts require the general contractor to obtain and review payroll records of subcontractor employees and certify the same to owner as a condition of payment. The new statute expressly gives general contractors the right to request such payroll records from lower tier contractors. If feasible, general contractors should also request certifications and lien releases from union representatives that may be collecting funds for subcontractor employees. Although AB 1701 does not provide a direct cause of action against an owner, a prudent

owner can utilize the payroll information to keep tabs on their general contractor's exposure.

In addition, owners should endeavor to have consent rights over the subcontractors to be hired by the general contractor, especially those representing significant portions of the project budget. If having say over the selection of the subs is not feasible, owners may at least require payment bonds be carried by each significant

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subcontractor. Even if the bonding cost is high, there is comfort in having a deep pocket and diligence from the surety involved in the subcontractor approval process.

It is also worth noting that nothing in the new law prevents a general contractor or owner from requiring subcontractors to provide a contractual indemnity for this potential liability; however, a subcontractor that defaults may not have the funds to pay the general contractor – after all, if it had the funds, it probably would have paid the wages in the first place.

Proactively protecting their interests when entering into their contracts, owners and general contractors would both be wise to make sure this new liability regarding subcontractors is a point of focus before they sign on the dotted line. An owner or general contractor that ignores the impact of AB 1701 does so at its own peril.