
Direct Contractors Potentially Liable for Subcontractors' Failure to Pay Wages

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Commencing on January 1, 2018, California has enforced and made effective AB 1701 (Labor Code § 218.7). In accordance with this new law, "direct contractors" on private works of improvements will now be directly liable for "any debt owed to a wage claimant or third party on the wage claimant's behalf, incurred by a subcontractor or any sub tier acting under or for the direct contractor." (Labor Code § 218.7(a)(1)). Thus if a subcontractor fails to pay its employees or union trust fund contributions, the general contractor will be required to make the payment directly, even if it has already paid the subcontractor in full. The law was drafted to protect employees in the construction industry from subcontractors who attempt to avoid their obligations to their employees even though they have been fully paid under their subcontracts.

Enforcement of this law can occur in three ways:

- 1) Enforcement of unpaid wages, and interest, against the direct contractor may be made by the Labor Commissioner through an administrative action, a civil action, or citation;
- 2) A third party owed fringe or other benefit payments/contributions may bring a civil action against the general contractor to enforce the subcontractor's obligation to the employee; and
- 3) A joint labor-management cooperation committee may bring a civil action against a direct contractor for unpaid wages upon 30 days' written notice by the committee. The notice need only describe the general nature of the claim and cannot limit the liability by the direct contractor due to the statements made in the letter.

The law authorizes a direct contractor to request and receive payroll records for a subcontractor's employees working on a project. If the subcontractor does not comply, this does not relieve the direct contractor of liability for unpaid wages and benefits. The direct contractor may withhold all sums owed if the subcontractor does not timely provide the information requested.

Direct contractors can protect themselves from this additional liability by:

- 1) Including in all private works construction contracts the requirement that subcontractors (including subcontractors of subcontractors) provide copies of all time cards, paystubs and proof of payment of benefits for employees on the project before any payments are issued to the subcontractor. Failure to produce this information shall result in a withholding of payments to the subcontractor. The production date should include sufficient time for review of the documentation and still comply with payment obligations set forth within the contract.
- 2) Including an indemnity clause within the contract that specifically requires the subcontractor to defend and indemnify the direct contractor for any claim made by the subcontractor's (or subcontractor's subcontractor) employees for any claim for unpaid wages and or benefits made under Labor Code § 218.7.
- 3) Requiring the subcontractor provide a payment bond to satisfy the claims that could be made against the direct contractor under this section.

If you have any questions regarding Labor Code § 218.7, contact Tammara Bokmuller at tbokmuller@clarkhill.com or Creighton Sebra at csebra@clarkhill.com.