



Construction Law Update

AB 1701: The New Law that Expands Prime Contractor Liability for Subcontractor Wage Payment Issues

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Assembly Bill 1701 is a new law that affects direct contractors (aka, prime or general contractors) on contracts for private works of construction entered into on or after January 1, 2018. In short, AB 1701 makes direct contractors liable for unpaid wages and benefits owed to employees of subcontractors, including lower-tiered subcontractors.

New Requirements

The nightmare scenario for direct contractors under AB 1701 is as follows: The direct contractor faithfully pays its subcontractor, but the subcontractor, or any lower-tiered subcontractor, goes bankrupt or otherwise runs off with the money without paying the wages or benefits owed to its employees. Under AB 1701, the general contractor can be held liable for these unpaid wages or benefits **even if** the direct contractor otherwise fully paid the subcontractor for its labor costs and did not have knowledge of the subcontractor's actions.

This new law also prohibits a direct contractor from making any attempt to “evade” or “negate” its liability under AB 1701, and also requires a direct contractor to pay prevailing party attorney fees to any labor union or third-party fringe/benefit plan that successfully sues a direct contractor under AB 1701. With the availability of prevailing party attorney fees, there will be no shortage of plaintiff attorneys looking to capitalize on opportunities to initiate suits on even minuscule amounts of unpaid wages or benefits.

Following is information aimed at helping direct contractors and subcontractors understand the key provisions of AB 1701 and what direct contractors can do to help mitigate their exposure to wage & benefit claims originating from the employees of subcontractors, including any lower-tiered subcontractors.

Where is AB 1701 codified?

AB 1701 is codified under California's Labor Code § 218.7.

Does AB 1701 apply to my business?

AB 1701 applies to direct contractors (contractors with a contract with the owner) on private works of construction for contracts entered into on or after January 1, 2018.

Who can enforce AB 1701?

AB 1701 lists three different entities that have standing to pursue a claim or enforcement action: (1) California's Labor Commissioner; (2) a third party owed fringe or benefit that is owed contributions on behalf of wage claimants; or (3) a joint labor-management cooperation committee (i.e., a labor union). Aside from these three entities, AB 1701 expressly states that “[n]o other party may bring an action against a direct contractor to enforce [AB 1701].”

Is there a deadline for when a claim under AB 1701 can be asserted?

Yes. There is a one-year time limit for an action under AB 1701 to be commenced. The one-year time limit begins to run when any one of these events occur: (1) recordation of a notice of completion of the direct contract under California Civil Code § 8182; (2) recordation of a notice of cessation of the work under the direct contract under California Civil Code § 8188; or; (3) actual completion of the work covered by the direct contract.

Is there a potential for penalties or liquidated damages under AB 1701?

No. Unlike other wage and benefit claims permitted under the California Labor Code, a direct contractor's liability under AB 1701 only extends to any unpaid wage, fringe, or other benefits, including interest. Additional penalties or liquidated damages are expressly excluded under AB 1701.

Although penalties and liquidated damages are excluded, a direct contractor is subject to payment of prevailing party attorneys' fees and costs, including expert fees, in the event a labor union or third-party fringe/benefit plan successfully sues under AB 1701.

Can prime contractors contract around AB 1701?

No. The statute expressly provides that direct contractors cannot "evade" or commit any act that would "negate" the rights that employees are afforded under AB 1701.

If prime contractors cannot "evade" or "negate" AB 1701, how can they protect their business?

Although AB 1701 cannot be evaded or negated, it expressly provides that parties are free to contract for "lawful remedies" to protect against any liability that a direct contractor is exposed to under the proposed law. Although specific examples of "lawful remedies" are not provided under the new statute, such remedies would include contractual indemnity provisions that require subcontractors to indemnify, hold harmless, and defend the direct contractor from and against any AB 1701-related claims asserted by the subcontractor's (or lower tiered subcontractor's) employees.

Careful consideration must be taken when including such provisions to ensure they are enforceable and do not violate the limitations placed on indemnity provisions under California law.

Are prime contractors entitled to inspect their subcontractor's payroll records?

Yes. Under AB 1701, direct contractors have a right to demand that their subcontractors (including lower tiered subs) provide payroll records that contain sufficient information to apprise the direct contractor of the status of payment of employee wages and fringe/benefit payments.

In addition to payroll records, AB 1701 also permits a direct contractor to demand that its subcontractors (including

lower tiered subs) provide contract award information that includes (1) the project name; (2) the name and address of the subcontractor and whom they have contracted with; (3) their anticipated start date, duration, and estimated journeymen and apprentice hours; and (4) contact information.

Although subcontractors are required to provide such information, their failure or refusal to do so does not excuse a direct contractor from liability under AB 1701.

Does AB 1701 affect Prompt Payment Statutes?

No. AB 1701 expressly provides that owners and contractors are still required to abide by the prompt payment statutes (e.g., Civ. Code, §§ 8800, 8814, 8814 and Bus. & Prof. Code, §§ 7108.5). However, the failure or refusal of a subcontractor to produce payroll and subcontractor information does permit the direct contractor to "withhold as 'disputed' all sums owed if a subcontractor does not timely provide the information requested [,]" meaning, a subcontractor's ability to sue for prompt payment penalties depends on their compliance with AB 1701's requirement that they provide the direct contractor with payroll and sub-subcontractor related documents.

What are some ways that prime contractors can mitigate the risks associated with AB 1701?

As always, careful subcontractor vetting and selection is the number one line of defense in avoiding claims under AB 1701. Besides that, below are some potential options to consider (though not all may be practical for your business):

(1) Add an indemnity provision to all private works subcontracts that requires subcontractors to indemnify, hold-harmless, and defend the direct contractor from and against any AB 1701-related claims brought on behalf of any of the subcontractor's or lower-tiered subcontractor's employees for unpaid wages or benefits.

(2) Include a provision in all private works subcontracts that expressly puts the subcontractor on notice of its obligation to produce payroll documents and lower-tiered subcontractor information, and condition receipt of progress, final, and retention payments on subcontractor's timely compliance with this obligation.

(3) Include a provision in all private works subcontracts requiring subcontractors to hold all payments received “in trust” for the benefit of the direct contractor and the benefit of the subcontractor’s employees, lower-tiered subcontractor employees, and any related third-party fringe/benefit plans, for the purpose of meeting the wage and benefit obligations owed not only to the subcontractor’s employees, but the employees of any lower-tiered subcontractors.

(4) Require that subcontractors include in their own subcontracts with lower-tiered subcontractors similar indemnity, payroll documentation, and trust provisions that expressly identify the direct contractor as the party to whom the obligation is owed.

(5) Require subcontractors of all tiers to provide payment bonds/letters of credit.

(6) Require personal guarantees from the principals of subcontractors of all tiers.

(7) Require each employee of subcontractors of all tiers and third parties who may be owed fringe or other benefit payments or contributions to sign documentation agreeing they have received payment for their services (or consider some other way to verify such payments).

If any subcontract revisions are made, it is crucial that you consult with an attorney experienced in construction contracts to ensure that the revisions comply with California law such that they are enforceable and to ensure that the revisions are compatible with the existing terms and conditions.

Lisa Nicolls’ practice focuses on all aspects of general civil litigation with an emphasis on construction and business law, which includes the representation of contractors, subcontractors, developers, owners and design professionals. Lisa has been involved in numerous complex construction disputes and assisted in substantial trial preparation in defense of a contractor’s \$20+ million claim on a large wastewater treatment plant project.

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