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# AB 1701 Has Passed – Developers and General Contractors Are Now Required to Double Pay for Labor Due to Their Subcontractors' Failure to Pay

*By Clayton T. Tanaka*



Clayton T. Tanaka

## Contact

949.271.7222  
Clay.Tanaka@ndlf.com

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On September 13, 2017, the California State Legislators passed a bill that would make developers and general contractors responsible for subcontractors who fail to pay their employees even though they already paid the subcontractors for the work. Assembly Bill 1701 (AB 1701), sponsored by unions who represent carpenters and other building trades, would require general contractors to “assume, and [be] liable for . . . unpaid wage, fringe or other benefit payment or contribution, including interest owed,” which subcontractors owe their employees. Despite vehement opposition from the California Building Industry Association and the Associated General Contractors of California, this bill has been submitted to the Governor and is expected to be signed into law.

## NEW REQUIREMENTS

*Once signed, this bill would impose the following requirements under Labor Code section 218.7:*

### • Applies to All Private Works Contracts That Are Entered Starting January 1, 2018.

For private works contracts entered on or after January 1, 2018, a “direct contractor” (i.e., prime contractor or contractor who has direct contractual relationship with an owner) must assume and be liable for any debt which its subcontractor or a lower tier subcontractor incurs “for [a] wage claimant’s performance of labor included in the subject of the contract between the direct contractor and the owner.” (Lab. Code, § 218.7, subds. (a)(1) and (e).)

### • The Labor Commissioner and Joint Labor-Management Cooperation Committees May Bring Action to Recover Unpaid Wages on Behalf of Wage Claimants.

The California Labor Commissioner and joint Labor-Management Cooperation Committees established under the federal Labor Management Cooperation Act of 1978 (29 U.S.C. § 175a) (typically comprised of labor unions and management) may bring a civil action against the direct contractor for unpaid wages owed to a wage claimant. (Lab. Code, § 218.7, subds. (b)(1) and (3).) The Labor Commissioner may also bring its claims through administrative hearings (Labor Code section 98) or by citations (Labor Code section 1197.1). (Lab. Code, § 218.7, subd. (b)(1).)



- **Third Parties That Are Owed Fringe or Other Benefit Payments or Contribution on Behalf of Wage Claimants (Labor Unions) May Bring Action.**

Third parties who are owed fringe or other benefit payments or contributions on a wage claimant's behalf (e.g., labor unions) may bring a civil action against the direct contractor for such unpaid benefit payments or contributions. (Lab. Code, § 218.7, subd. (b)(2).)

- **It Does Not Confer Wage Claimants With Any Right to Sue Direct Contractors.**

AB 1701 gives the Labor Commissioner, Labor-Management Cooperation Committees and the unions standing to bring an action against the direct contractor, but it does not confer any private right of action by the wage claimants against the direct contractor.

- **Labor-Management Cooperation Committees and Labor Unions Shall Recover as Prevailing Plaintiffs Their Attorneys' Fees and Costs, Including Expert Fees.**

For actions brought by Labor-Management Cooperation Committees or labor unions, "[t]he court shall award a prevailing plaintiff in such an action its reasonable attorney's fees and costs, including expert witness fees." (Lab. Code, § 218.7, subds. (b)(2)-(3).)

- **Direct Contractor's Property May Be Attached to Pay for Judgment.**

AB 1701 authorizes the attachment of direct contractor's property to pay for any judgment that is entered pursuant to this section. (Lab. Code, § 218.7, subd. (c).)

- **One-Year Statute of Limitation to Bring Action under This Section.**

Actions brought pursuant to this section must be filed within one year of the earliest of: (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 contract. (Lab. Code, § 218.7, subd. (d).)

- **Rights to Receive Payroll Records and Project Award Information from Subcontractors and to Withdraw All Payments Owed for Their Failure to Comply.**

Upon the direct contractor's request, subcontractors and lower tier subcontractors must provide payroll records and project award information. (Lab. Code, § 218.7, subds. (f)(1)-(2).) Direct contractor may withhold as "disputed" all sums owed if a subcontractor does not timely provide the requested records and information without specifying what is untimely and such failure to comply does not excuse direct contractor from any liability under this section. (Lab. Code, § 218.7, subds. (f)(3) and (i).)

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- **Further Legislative Efforts on Subdivision (h) Are Expected in 2018.**

Subdivision (h), which states that “[t]he obligations and remedies provided in this section shall be in addition to any obligations and remedies otherwise provided by law . . .” (emphasis added) is potentially misleading since the author and sponsor of the bill have indicated that the bill is not intended to punish direct contractors with liquidated damages or penalties. As such, further legislative efforts on subdivision (h) are expected in 2018.

## **ADDITIONAL CONSIDERATIONS**

While workers should be paid for the work they perform, AB 1701 would place undue burden on general contractors to monitor their subcontractors’ payroll, confirm that all wages and benefits are paid timely and withhold disputed payments from non-compliant subcontractors. General contractors would also need to caution against the chain reaction that could result from such withholding, including work stoppage, increased change order requests, and an overall increase in construction costs. Finally, general contractors would need to brace themselves for at least a year after project completion against any union or a Labor-Management Cooperation Committee actions armed with a prevailing party’s right to recover attorneys’ fees and expert fees, for previously unidentified subcontractor or sub-subcontractor workers.

## **STRATEGIES DEVELOPERS AND GENERAL CONTRACTORS SHOULD LOOK FOR**

In anticipation of AB 1701 being signed into law and its potentially harsh effects, developers and general contractors are advised to consult their attorneys for a review and revision of their existing contracts, to develop plans for accessing and monitoring subcontractor payroll records, and to consider strategies for mitigating claims that may be brought against them, as follows:

- ***Execute all pending agreements*** before January 1, 2018 to avoid the effects of AB 1701;
- ***Include an audit provision*** requiring subcontractors and sub-subcontractors to provide payroll records (at minimum, information set forth in Labor Code section 226) and project award information, regularly and/or upon request, with specific deadlines for such production, as subdivision (f) does not specify what is untimely;
- ***Include defense and indemnity provisions*** that would require subcontractors to defend and indemnify the general contractor for claims that are brought pursuant to this section arising from labor performed by employees for subcontractors and sub-subcontractors, and require subcontractors to include a similar provision in their own contracts with sub-subcontractors that would require lower tier subcontractors to also defend and indemnify the general contractor for claims arising from their respective employees’ work;
- ***Require subcontractors to provide a payment bond and/or a letter of credit*** to satisfy claims that are made against the general contractor under this section;
- ***Require personal guarantees*** from owners, partners or key subcontractor personnel;



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- ***Include withholding and back-charge provisions*** that would allow general contractors to withhold or charge back the subcontractors for disputed amounts, for claims brought against them, and for failure to comply with the audit, bond, and guarantee requirements.
- ***Consider implementing a system to confirm evidence of payments***, such as signed acknowledgment of payment by each subcontractor and sub-subcontractor employees and by third parties entitled to recover fringe and other benefit payments or contribution, possibly working with electronic billing software providers to implement such system.

Clay Tanaka is a partner in the Newport Beach office of Newmeyer & Dillion, focusing on construction, real estate, business and insurance disputes in both California and Nevada. As a licensed civil engineer, Clay has significant experience in design and construction of all types of construction projects, which he has effectively utilized in his litigation, trial and arbitration practice to obtain great results for his clients. For questions related to AB1701, please contact Clay Tanaka ([clay.tanaka@ndlf.com](mailto:clay.tanaka@ndlf.com)) or Newport Beach Partner Mark Himmelstein ([mark.himmelstein@ndlf.com](mailto:mark.himmelstein@ndlf.com)).

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