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Does a General Contractor Get More Than it Bargained For?

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March 28, 2008

Whether building a single house, a resort or a high-rise building, general contractors use subcontractors to perform most aspects of the job. And while a project manager (or several managers) supervises the activities of subcontractors, ultimately, subcontractors perform most of the actual work. The work will include demolition, framing, plumbing, electrical, painting and more. In addition to being the industry norm, the benefits to a general contractor of such an arrangement are significant.

General contractors focus on doing what they do best: project management, coordination of work and dealing with the owner. In return, the general contractor can rely on subcontractors to obtain specialized licenses, process payroll, handle human resources and locate manpower. But questions remain over whether a general contractor is liable for the misconduct of its subcontractors.

Outline of the Problem
No one would suggest that a subcontractor's quality of work is supervised and ensured by the general contractor. If standards are not met, the owner (or architect) will look to the general contractor and expect the problems remedied. In turn, the general contractor will direct the subcontractor to fix the problem or coordinate repair by another. But, what if the subcontractor's misconduct is not in the quality of work and instead in its own internal business practices? The answer to that question is less clear. Throughout the country, the ability to find laborers for construction projects has grown increasingly difficult. A workforce eligible to work in the United States has always been a challenge in the industry, and recent developments in the immigration front may not solve the problem. As a bit of irony, particularly following a large natural disaster, it is incredibly difficult for manpower to be located, marshaled and assigned to the areas that need it most. And, when it does happen, the reliability of the workforce can be called into question.

In addition to problems with unskilled labor, the availability of skilled labor to handle aspects of a job is also difficult. Particularly in an area of a large disaster, skilled labor is at a premium and general contractors (particularly smaller ones) can have difficultly obtaining skilled labor. In such an environment, some subcontractors surface to fill the need, yet they may not be fully compliant with the law.

Unscrupulous subcontractors often cut corners in many ways – such as licensing and performance – but a recent phenomenon has been the violation of labor laws.

The Fair Labor Standards Act[1]
The FLSA provides several protections to workers, the most notable being the establishment of a minimum wage and the requirement that overtime be paid for all hours worked in excess of forty in a week.[2] Current wage scales mean that minimum wage concerns rarely arise on a jobsite,[3] but payment of overtime can often be a thorny issue.

Non-exempt workers (generally, professionals or non-managerial, salaried employees) are required to be paid "time and a half" for every hour worked over forty in a week. However, unscrupulous subcontractors may pay workers straight time for hours worked, while withholding all overtime that is otherwise payable. Not only does this misconduct violate the FLSA, but state wage laws are also implicated.

Notably, the artificial classification of a worker as an independent contractor does not obviate the need to pay overtime. Courts will look directly past such labels and focus on the true nature of the relationship with the worker. And, the FLSA (contrary to common practice) does not permit overtime requirements to be circumvented by paying workers on a day or piecemeal rate. With rare exception, an employee working more than forty hours in a week is entitled to "time and a half" for such hours – regardless of the labels and wage agreements manufactured by the employer. Traditionally, general contractors have been insulated from subcontractor payroll practices, but some recent developments warrant attention.

The Essence of the Problem

Under the FLSA, an "employer" is "any person acting directly or indirectly in the interest of an employee in relation to an employer."[4] Thus, the term "employer" is not traditionally defined to include one's direct employer alone. Instead, any entity for whom the employee works is a potential employer under the Act.

In light of the above, courts review several factors in determining whether or not an individual is considered the employer of a worker: (1) who provided the equipment the employee used; (2) whether the employee was economically beholden to the protective employer; (3) the level of skill employed by the workers; (4) whether the putative employer had an ownership interest in the subcontractor; (5) the degree to which the employee's efforts were supervised; (6) whether the employee worked predominantly for the putative employer; (7) who set the terms and conditions of the employment; and (8) who maintained the employment records regarding the employee.5 In addition, courts consider the historical practice in the industry – obviously a significant factor in the construction industry.[6]

Traditionally, general construction contractors have not been considered the "employer" of a subcontractor's workforce for purposes of the FLSA. This decision is based on historical use of subcontractors in the construction industry, as well as an analysis of all the factors outlined above. However, there have been some attempts to attack that distinction.

Recent Developments

Recently, the United States Department of Labor (the administrative entity charged with enforcing the FLSA) has opened investigations in the New Orleans area and other parts of the country regarding payroll practices of construction companies.7 Generally, the DOL focuses on direct employers (i.e., subcontractors), to ensure that workers are being paid all amounts owed under the Act. However, there are instances where investigations expand to include workers of general contractors.[8]

In addition, lawsuits have been filed alleging that general construction contractors are the employers of their subcontractors' workers on jobsites. In fact, the authors of this article are defending one such action in New Orleans, and several other actions have been filed around the country. The essence of the argument by the plaintiffs is that subcontractors are beholden to general contractors such that it is the general, not the subcontractor, that is the true employer on a jobsite. The argument continues that general contractors supervise, govern and otherwise monitor the subcontractors' work, hiring practices and termination of employees when necessary. As a result, the plaintiffs assert the general should be liable for FLSA violations of the subcontractors.[9] These arguments are generally unsupported in the jurisprudence,[10] but general contractors should nonetheless be aware of their significance.

Appropriate Preventive Measures

In response to the above, and as a generally well-advised business practice, general contractors need to preserve the line of demarcation between its own operations and the operations of the subcontractor. Doing so will help ensure that an "employment" relationship is not created. That said, general contractors are advised to make reasonable efforts to ensure that subcontractors are obeying the law in this regard.

The first step in this process is to include and enforce audit rights in contracts with subcontractors. General contractors typically have the right of audit of subcontractor records and should not hesitate to use it if there are suspicions of illegal payroll practices on a jobsite. Nipping such a problem in the bud is the best way to avoid a later lawsuit and keep the job moving smoothly. In addition, being aware of the problem and correcting it before retainage is released is often the best method for ensuring that a general contractor will not be left holding the bag or defending a lawsuit if a subcontractor disappears.

In addition, project managers should be cognizant of their duties on this topic. A general contractor is not charged with a duty to ensure that every subcontractor's worker is paid all amounts owed under the FLSA. However, it is in the general contractor's best interests to respond and remedy such a concern if it is brought to a project manager's attention. Turning a blind eye to this type of practice can not only cause a lawsuit to be filed where one otherwise would not exist, but it could be a "bad fact" in any such litigation as it appears that a general contractor is using the subcontractor as a subterfuge to avoid FLSA obligations. Despite the above, there will be instances where the subcontractor's misconduct cannot be prevented, and it is important that a general contractor respond immediately.

Appropriate Response

When notified of a payroll violation (whether by the DOL, a lawsuit or an individual worker), it is important that the general contractor immediately document the allegation and provide the subcontractor notice of it. In addition, that notice should invoke the rights of indemnification and offset for any amounts owed and further instruct the subcontractor to provide all records related to the allegation at once. Upon review of the records, if a problem is noted, general contractors should instruct subcontractors to immediately make payments to cure the issues. If the subcontractor is reluctant to do so, the general contractor should make the payment directly and offset it against invoices still outstanding from the subcontractor.

Conclusion

With the constantly evolving workforce available in all markets, and particularly in disaster areas, the problems incident to payroll practices are increasing constantly. It is important for general contractors to be aware of this issue and takes steps to avoid it. But more importantly, the issue is likely to arise and the general contractor must be in a position to respond effectively and immediately to the allegations as presented.

1. 29 U.S.C. §§ 201-19.

2. For federal contracts, the Davis Bacon or Service Contract Acts require that prevailing wages be paid to workers on jobsites. In addition to the concerns regarding payment of overtime outlined above, there are additional concerns regarding the payment of benefits. This article will not address those areas specifically, but the principles explained herein are absolutely applicable.

3. In 2007, the President signed into law raises to the current minimum wage. Although current wage scales on construction jobs are likely still higher than the increases, one must be cognizant of this issue as well.

4. 29 U.S.C. § 203(d).

5. *Zheng v. Liberty Apparel Company, Inc.*, 355 F.3d 61, 74 (2nd Cir. 2003); *Morcon v. Air France*, 343 F.3d 1179, 1188 (9th Cir. 2003); *Watson v. Graves*, 909 F.2d 1549, 1553 (5th Cir. 1990).

6. *Zheng*, 355 F.3d at 73.

7. It is beyond the scope of this article to describe the scope of authority of the DOL to open and pursue administrative investigations of employers. It suffices to say, however, that you should be advised to cooperate with the DOL should such an investigation be initiated.

8. This is particularly true in the area of enforcement of the David Bacon and Service Contract Acts.

9. Of course, the plaintiffs' necessity to raise this argument arises when a subcontractor is insolvent or disappears – a likely result if unscrupulous subcontractors are involved.

10. *See, e.g., Quintanilla v. A&R Demolition, Inc.*, 2005 WL 2095104 (S.D. Tex. August 30, 2005).