

Use of Contractors Carries Hidden Risk for Businesses

LABOR: Firms can be held liable for labor law violations.

If you hire a contractor to perform construction, farm labor, garment, janitorial, or security services, there is a huge financial risk you need to know about. Under a little known provision in the California Labor Code, your company could be held liable to the contractor's employees in the event the contractor skirts its labor law obligations.

Labor Code Section 2810, which went into effect with little fanfare in 2004, is designed to weed out unscrupulous contractors that provide low ball prices by cheating employees on required wage and other payments.

To combat this practice, the law holds both the contractor and its customer liable for the contractor's labor law violations where it can be proven that the customer knew (or should have known) that there wasn't enough money in the contract for the contractor to meet its legal obligations. Businesses which take advantage of such "deals" could find themselves on the receiving end of a class action lawsuit seeking to collect the back wages and other penalties for the wages and taxes that the contractor did not pay.

How do the authorities establish the requisite knowledge to bind the customer? The term "know" is defined broadly as the "knowledge arising from a familiarity with the normal facts and circumstances of the business activity engaged in" that the contract does not have sufficient funds. The phrase "should know" is broadly defined as the "knowledge of any additional facts or information that would make a reasonably prudent person undertake to inquire whether, taken together, the contract or agreement contains sufficient funds to allow the contractor to comply with applicable laws".

'Knowledge' is key

Maybe at this point you're thinking that you are simply better off not knowing. But, there's a big gotcha in the law there as well. Importantly, the law goes on to state that a failure by a person or entity to even ask the contractor for this information constitutes "knowledge" of that information. In other words, a don't ask don't tell policy will be worse in the long run because the law will impute knowledge of the deficiency to the customer if the customer doesn't ask.

There is a ray of hope for the intrepid customer. The law creates a "rebuttable presumption" that the customer is NOT in violation of



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the statute where the customer goes to the trouble of obtaining a written contract for the contractor's services which contains all of the following information:

- (1) The name of the persons through which the services are actually provided;
- (2) A description of the labor or services to be provided and a statement of when the services are to commence and be completed;
- (3) The employer identification number for state tax purposes of the contractor;
- (4) The workers' compensation insurance policy number and the contact information of the contractor's insurance carrier;
- (5) The vehicle identification number and insurance information of any vehicle that is owned by the contractor and will be used in connection with any service provided pursuant to the contract;
- (6) The address of any real property used to house the contractor's workers;
- (7) The total number of workers to be employed, the total amount of all wages paid, and the date these wages are paid;
- (8) The amount of commission paid to the contractor;
- (9) The total amount of independent contractors who will be utilized and their contractor license identification number; and
- (10) The signatures of all parties, and the date the agreement was signed.

Where the information in items (7) and (8) is unknown to the customer at the time the contract is executed, the law allows you to use a best estimate. However, in that case, you have a continuing duty to update the information and reduce it to writing once the information is known. Further, if there is a material change to the terms of the contract, this too must be in writing.

Keeping files

A copy of the contract and all supplemental data must be kept for at least four years following the termination of the agreement.

To take advantage of the law's compliance presumption, you must go on the offensive and ask pointed questions of the contractor after receiving the bid. Inquire into what's going on. For example, ask the contractor for estimates of payroll and the number of workers on the project. Be sure there is enough money in the contract to cover at least the minimum wage (currently \$8.00 per hour in CA) and any expected overtime pay.

If the contractor is on the up and up, then on top of that will be the same payroll costs that your company experiences for taxes, workers' compensation insurance and other benefits. If the contract appears to be too skinny financially to pay all of that – and allow some profit to the contractor as well – then something is likely amiss.

Once you have this information, it's a good idea to follow up with the contractor periodically to check on whether it is meeting its payroll obligations. The contractor should be willing to furnish copies of this information.

Something else you might want to consider is checking to be sure the contractor is timely making its quarterly employment tax remittances and that its workers compensation policy is in force.

Properly crafted contract documents can be a big help to securing your right to this information. Among other things, you will want the contractor to commit in writing that it will comply with all laws and furnish the information you need.

Also consider asking the contractor to indemnify and defend you in the event a suit is filed against you on behalf of the contractor's employees. If the contractor balks at this, it's a sign of trouble.

If you are still not sure, consider asking the contractor to post a bond for an amount approximating the possible loss. Also consider asking the contractor to name your company as an additional insured on any employment practices liability or other business insurance policy it has. If they don't carry these policies, you may want to choose another contractor.

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