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CALIFORNIA EMPLOYMENT LAW LETTER

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WAGE AND HOUR LAW

General contractor forced to answer for subs' wage violations

by Michael Futterman and Jaime Touchstone

Construction workers sued their subcontractor employers and the general contractor for wage and hour violations. The workers argued that the general contractor should be held liable because it didn't pay the subcontractors enough money on the projects so they could afford to pay the workers legally adequate wages. The California Court of Appeal held that a general contractor must pay enough money to allow a subcontractor to pay the minimum wage but not a "prevailing wage."

Workers sue for Labor Code violations

Toll Brothers develops large-scale residential projects. Subcontractors submit competitive bids to work on the projects. In the fall of 2006, two groups of construction workers filed separate class-action lawsuits against two framing subcontractors and against Toll Brothers as the general contractor. They alleged a series of wage and hour violations by the subcontractors, including:

(1) failure to pay overtime;
(2) failure to provide adequate meal breaks and rest periods;
(3) failure to provide accurate wage statements and keep accurate payroll records;
(4) failure to pay wages in a timely manner and on a biweekly schedule; and
(5) outright refusal to pay wages.

The workers sought to impose liability on Toll Brothers on the grounds that it knew or should have known the sums it was paying the subcontractors were far too low to allow them to pay the "prevailing wage" in the construction industry. Toll Brothers denied liability, arguing that it was required only to pay the subcontractors enough to pay their workers the minimum wage rather than a "prevailing wage" and that it had met that standard.

The trial court ruled in Toll Brothers' favor and found that the minimum wage, not the prevailing wage, was the appropriate measure of the legality of the subcontracts. The workers appealed, and the two class actions were consolidated. The California Court of Appeal agreed with the trial court's interpretation but determined the workers had presented sufficient evidence that Toll Brothers knew or should have known that the subcontract price on one of the projects was so low the subcontractor might be unable to pay its workers the minimum wage.

Legislature acts to improve working conditions

Fierce competition among construction contractors in California has resulted in subcontractors performing

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work for general contractors at prices so low they're unable to make contributions to mandatory social programs such as social security, workers' compensation, and unemployment. As a result, subcontractors often pay wages below the legal minimum and/or provide substandard working conditions.

In an effort to remedy that problem, the California Legislature enacted Labor Code Section 2810, which prohibits people and businesses from entering into labor or service contracts with construction, farm labor, garment, janitorial, or security guard subcontractors if the general contractor knows or should know that the subcontract "does not include funds sufficient to allow the [sub]contractor to comply with all applicable local, state, and federal laws or regulations governing labor or services to be provided."

In this case, the workers argued that Section 2810 required Toll Brothers to evaluate its subcontracts based on the subcontractors' ability to pay the locally "prevailing wage" for similar work rather than the legal minimum. In response, Toll Brothers asserted that the legislature intended only to eliminate contracts that are so inadequate that "the bare minimum labor law requirements cannot be met"; thus, any subcontract allowing for the payment of the minimum wage is sufficient. The court of appeal agreed. It stated that Section 2810 doesn't require an employer to pay its employees the average local wage for a particular skill or trade if the average wage is higher than the legal minimum. Thus, Toll Brothers, as the general contractor, couldn't be found liable on that basis.

Subcontractors often pay wages below the legal minimum.

Liability under minimum wage test

The workers also argued that the subcontracts between Toll Brothers and the subcontractors not only were insufficient to pay the prevailing wage but also allocated so few dollars to labor costs that Toll Brothers had to have known the workers wouldn't be paid even the minimum wage. Under Section 2810, a laborer who has been injured by a subcontractor's labor violations can sue the general contractor if:

(1) it knew or should have known the subcontract price was reasonably likely to be insufficient at the time the contract was executed; and

(2) the contract price was ultimately too low to comply with labor laws.

In this case, evidence from the workers' expert suggested that the likely cost of materials and overhead for one of the projects would actually exceed the contract price, leaving no money to pay wages. For the other project, the contract arguably allocated insufficient funds to pay a minimum wage.

The court found that Toll Brothers should have known of those problems because they were based on specific information in the contract and on cost-estimating techniques generally available to and accepted in the construction industry. Accordingly, the court held that Toll Brothers could face potential liability under Section 2810 for those particular claims.

No liability outside Section 2810

In addition to the Section 2810 claim, the workers sued Toll Brothers for unjust enrichment, negligence, and unfair competition. The court of appeal affirmed the trial court's ruling that the duties created by the wage and hour laws run solely from employer to employee. Toll Brothers wasn't the workers' employer and thus had no duty to safeguard against subcontractors'

continued on pg. 4

continued from pg. 2

Labor Code violations or any statutory liability to the workers outside Section 2810. *Castillo/Hernandez v. Toll Bros., Inc.* (California Court of Appeal, First Appellate District, 7/28/11).

Bottom line

A general contractor can't insulate itself against potential wage and hour violations by its subcontractors if it knows or should know that the agreed-on contract prices are insufficient to allow the subcontractors to pay the minimum wage and otherwise comply with wage and hour laws. That doesn't mean workers employed by subcontractors can invariably hold the general contractor liable for Labor Code violations, but it does effectively limit a general contractor's ability to simply award a contract to the lowest bidder.

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