

BY SCOTT WOLFE, JR.

HOW GCs CAN NAVIGATE HR & *the Payment Chain Around Recent Legislation*



With recent legislation changes in California and other states, there have been decidedly more HR duties added to GCs' responsibilities.¹ Per these changes, GCs now assume new HR-related responsibilities within contracting chains.²

In fact, in certain states, GCs are now potentially exposed to such complications as payroll and benefits processing by all subcontractors on their projects.³

This article will outline and analyze new responsibilities and associated risks affecting GCs due to recent legislative changes and provide insight into potential best practices.

LEGISLATIVE CHANGES: WHAT'S GOING ON?

Currently in effect, California's *Assembly Bill No. 1701* makes GCs jointly liable for the unpaid wages, fringe benefits, or other benefit payments or contributions of subcontractors (at any tier).⁴ The idea behind the requirement is theoretically similar to that of mechanics liens or other construction payment protections: parties atop the chain can better control the flow of money throughout. This ability and the idea that GCs can use inherent leverage to direct subcontractors' actions can make GCs vulnerable to perceived payment issues or abuses.

The purported benefit to *Assembly Bill No. 1701* is that additional GC liability for sub-tier wages, and the associated control, will provide a stronger mandate with respect to payment of all workers on a construction project.

Requiring a GC to be responsible for wages all the way down the contracting chain, beyond just ensuring payment to its own employees and subcontractors, will presumably provide greater down-the-chain protection and help prevent the misclassification of employees as independent contractors.⁵ If a GC pays its subcontractor, that subcontractor pays its subcontractor, but that sub-subcontractor does not pay wages, then the GC will still be liable.⁶ And, as the



& the Payment Chain Around Recent Legislation

ultimately responsible for all employee workers on the project, the GC can be incentivized to carefully select subcontractors in order to minimize the risk of paying twice. But it is questionable how much merely being selective can help.

According to *Assembly Bill No. 1701* author Tony Thurmond, “[t]his measure incentivizes the use of responsible subcontractors and helps to ensure the economic vitality of the construction industry and its role in the creation of good paying middle class jobs.”⁷ However, it can be argued that a fairly tenuous thread exists between increased GC liability for unrelated parties’ wages and the construction industry’s employment rate.

California is not alone in believing the GC should ultimately bear responsibility for every worker’s wages on a project. In legislation effective October 2018, Maryland mandated that a GC performing work on a construction services project is liable to a worker to the same extent as the employee’s direct employer.⁸ Similar to California, this responsibility is not limited to first-tier subcontractors and applies “regardless of whether the subcontractor is in a direct contractual relationship with the GC.”⁹ In excess of the obligation imposed in California, which is limited to unpaid wages and interest, the obligation in Maryland extends to penalties the unpaid worker could recover from his or her direct employer – three times the owed wages, plus attorneys’ fees and costs.¹⁰

While ensuring the payment of individual workers is a noble goal, there may already be solutions in place. With respect to these obligations, what practices should a GC’s HR department implement and what tools are HR professionals given to ensure compliance?

GCs can monitor payments made by subcontractors and have access to subcontractors’ payroll, employee records, and contracts. If a subcontractor fails to provide information upon its GC’s request, the GC can withhold disputed sums. But is requesting and examining subcontractor payroll records sufficient?

YOU’VE GOT EXPOSURE FOR OTHER PARTIES’ WAGES & BENEFITS: WHAT DOES THIS MEAN?

Pursuant to the legislation previously outlined, GCs are responsible for ensuring that all employees working on a project (no matter whose employees, or how far down they are on the payment chain) are paid the wages and benefits they are owed. As such, changes may need to be made to HR processes to better ensure compliance and limit potential exposure. But should this project-wide responsibility of ensuring appropriate management of other parties’ payroll ultimately be handled by a GC’s HR department?

Having these responsibilities reside in the same place that has control of the payroll function seems like an easy answer. After all, what is the responsibility other than additional duties related to payroll processing and benefits administration down the payment chain? These functions can be handled solely by HR, or in collaboration with the accounting department, depending on company preference. But stopping the inquiry there may not address the complexity of these obligations. Running internal payroll and benefits administration is an entirely different set of functions than the information-gathering and examination of other parties’ payroll processes.

To further complicate matters, internal payroll has no relation to the A/P of outside parties. In order to limit potential exposure and the responsibility of overseeing the payment of workers employed by a subcontractor or sub-subcontractor, this examination must be intertwined with the process of payment being made down the chain, along with the associated complexity of the pay-app and lien waiver process.

For example, if a GC is ultimately directly responsible for the wages of sub-tier parties, should progress payments to subcontractors not only be dependent on a potential examination of payroll down the chain, but also the receipt of lien waivers or payment affidavits from each individual laborer? In order to fully limit exposure, perhaps. From a practical standpoint, the administration and management of that amount of paper would be a nightmare. Which department has the bandwidth and skills to ensure compliance by contracting parties?

While HR generally has the most hands-on knowledge of payroll and benefits processing, as well as the most familiarity with the examination of employee status, a sufficient process to limit company exposure with respect to rules like those in California and Maryland requires interdepartmental collaboration. The best processes should involve both HR and the accounting A/P departments, with some oversight by legal/risk management. Just as HR must work with legal to maintain compliance in internal labor management, the same must be true to manage compliance externally.

DO THESE REQUIREMENTS REQUIRE THE LIMITING OR CONSOLIDATION OF SUBCONTRACTORS? DOES THIS LIMIT LIABILITY?

A specifically stated outcome is that it “incentivizes the use of responsible subcontractors.”¹¹ While there can be some debate about the efficacy of mandatory responsibility for wages driving the selection of responsible subcontractors, it does seem reasonable for GCs to attempt to decrease the administrative burden by contracting with fewer subcontractors. By doing so, GCs can more closely manage subcontractors and gain confidence in their processes and representations.

While it makes sense to attempt to limit exposure in this manner, artificially limiting a subcontractor pool could be detrimental in other ways. With less competition, it is not difficult to imagine paying subcontractors more or being involved in workmanship disputes if the cost of changing subcontractors becomes too prohibitive.

Additionally, since these payment responsibilities extend throughout the payment chain no matter the tier, limiting the available subcontractor pool may not have the desired effect of limiting exposure – unless control can also be exerted over the chosen subcontractors' subcontracts.

BEST PRACTICES & HELPFUL HINTS

What are some best practices to avoid the consequences of someone else's HR department's missteps?

Modify the Subcontract-Subcontractor Agreement

Stricter contracts, or contracts that impose potential additional penalties, should likely never be the go-to answer for solving any construction payment problem. More onerous contracts can create more problems than they solve, and they may not foster the open and transparent payment ecosystem that can allow all parties to work toward good outcomes

rather than pulling back into a protectionist mindset. That being said, GCs should consider specific clauses requiring the subcontractor's acknowledgment of an obligation to defend and indemnify the GC from any wage claims by employees of its sub-subcontracting parties.

However, there can be an opportunity to reexamine subcontracts or other subcontractor agreements in a way that benefits all parties. Requesting employee lists or payment practices, or publishing a desire to receive informational notices from all participants on a project are contractual policies that could help immensely.

To avoid liability for unpaid employees throughout the payment chain, GCs should consider implementing contractual requirements that enable this beneficial oversight.

Promote a Culture of Visibility & Good Outcomes

While the additional oversight requirements, potential liability, and potential for more paperwork are all frustrating, ensuring everyone on a project is paid what they earned is easy to get behind. It can be tempting to look at legislation only through the lens of what it means for one's own processes, timelines, workflows, and exposure. Taking a step back and looking at a project (or even the industry) as a whole provides a different, and often more accurate, picture.

While one may argue as to whether a particular solution is the fairest fix to a problem, most would agree that everyone who performs the work should be paid fairly. The entire project benefits to the extent that parties can work together for good outcomes, rather than layering protection upon protection and leverage upon leverage to merely move risk to another party.

One way to work for good outcomes is to adopt the SET framework¹² for jobs:

See everyone on the job

Easy paperwork

Talk it out

While all aspects of the SET framework are implicated with respect to the GC's ultimate liability for wage payments to subcontractors' employees, "seeing everyone" on the project should be prioritized first. Visibility on many projects can be broken at the level of second-tier subcontractors.





Create Opportunities

Achieve more than you believed possible.

WEALTH ADVISORY
OUTSOURCING
AUDIT, TAX, AND CONSULTING

CLAAconnect.com/construction

Investment advisory services are offered through CliftonLarsonAllen Wealth Advisors, LLC, an SEC-registered investment advisor. ©2018 CliftonLarsonAllen LLP | 27-0939



& the Payment Chain Around Recent Legislation

It's easy to know parties with which you contract directly; but absent privity of contract, it can be difficult to know who else is doing work. In the context of subcontractor payroll liability, how can a GC oversee and mitigate potential exposure if sub-subcontractors' identities are not even known?

In many respects, this situation mirrors lien liability. Contractual provisions aside, GCs remain at risk of liens from parties on the project that they might not even know. The best way to mitigate the risk of "hidden liens" is also the best way to mitigate the risk of subcontractor payroll liability – gain project visibility in order to decrease the "unknowns" on a project. And the best way to gain project visibility is to encourage the use of informational visibility documents, such as preliminary notices (whether required to protect lien rights, or not) or the exchange of other informational documents.

Connect HR With Subcontractors' Processes & Provide Oversight

Once everyone on the project can be seen, some control or oversight can be exerted to make sure all goes smoothly. These rules allow GCs to gather insight into the records and processes of the subcontractors to whose employees they may be liable in order to make sure everyone gets paid appropriately.

Get HR involved at the start, and relationships can be built so that payment doesn't have to be unnecessarily delayed while reviewing the payroll and employee designations of multiple third parties. Establishing common sense check-ins throughout the project and linking your HR department with those of your subcontractors can help catch issues before they become problems.

Certified Payroll: Enact Mandatory Reporting & Records Review by HR Prior to Payment?

One check-in or requirement that could prove helpful can be taken from the realm of public works projects and prevailing wage determinations. Many subcontractors are familiar with providing a certified payroll for prevailing wage projects. A similar requirement could be implemented without an enormous amount of overhead for all projects in which a GC may incur liability for subcontractors' payroll.

By requiring a certified payroll that lists every employee's wages, eligible benefits, work, hours, gross wages, and withholdings along with a statement of compliance from the subcontractor, then problems can also be avoided prior to payment to the subcontractor (and when rolled out throughout the payment chain pursuant to the visibility gained above) presumably from the sub-subcontractors.

CONCLUSION

The responsibility of GCs to ensure the proper payment of every employee working on the job, regardless of actual employer or tier, is a significant obligation.

However, through promoting visibility and implementing some collaborative HR procedures throughout the payment chain, GCs can feel comfortable working toward good outcomes on their projects – and proactively avoid payroll issues down the chain. ■

Endnotes

1. www.leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB1701.
2. Ibid.
3. Ibid.
4. Ibid.
5. Ibid.
6. www.leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201720180AB1701.
7. <https://a15.asmdc.org/press-releases/thurmonds-labor-bills-pass-senate-labor-committee>.
8. www.lerchearty.com/news/new-maryland-law-makes-construction-general-contractors-liable-for-wage-and-hour-violations-by-subcontractors.
9. govt.westlaw.com/mdc/Document/N1E24AC50831211E88795828A65D8C1A1.
10. www.bakerdonelson.com/new-maryland-law-makes-construction-gcs-liable-for-subcontractors-wage-and-hour-violations.
11. <https://a15.asmdc.org/press-releases/thurmonds-labor-bills-pass-senate-labor-committee>.
12. "Managing the Payment Chain: Collaboration, Not Control," January/February 2019, *CFMA Building Profits*.

SCOTT WOLFE, JR., CEO of Levelset in New Orleans, LA, is on a mission to help contractors and suppliers across the globe get payment under control and sees a world where no one loses a night's sleep over payment. Levelset connects more than 500,000 contractors and suppliers nationwide to make payments easier, faster, and less stressful.

A CFMA member and previous author for *CFMA Building Profits*, Scott's numerous publications have appeared in outlets such as *Construction Executive*, *Construction Business Owner*, *Construction Dive*, *tED Magazine*, and *LinkedIn*.

Phone: 866-720-5436, ext. 700
E-Mail: scott@levelset.com
Twitter Handle: @scottwolfejr