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The Pitfalls of Blurring Traditional Contractor/Subcontractor Relationship with a Caveat for Most Contracts within New York State, by Michael Ganz, Esq. & Aaron Solomon, Esq., The Long Island Sounder, April 2033

The Pitfalls Of Blurring The Traditional Contractor/Subcontractor Relationship
With A Caveat For Most Contracts Performed Within New York State

Traditionally, a general contractor (GC) will enter in to a subcontract with a subcontractor and the two entities will operate as separate companies, each paying their own employees, each with the power to only terminate their own employees and essentially each controlling their own employees. However, there are often situations, particularly when a subcontractor is having cash flow problems in which a contractor may decide to pay the subcontractor's employees directly. This is done to ensure that the subcontractor will continue to perform work and the subcontractor will not use payments from the contractor for other purposes or to fund other projects. A GC should not do this and therefore must continue to maintain the legal distinction between companies. As discussed below, a GC might find itself liable for their subcontractors' violations of the law, even if the GC had nothing to do with the violation.

In a recent federal case, the Fourth Circuit Court of Appeals (Even though New York State is within the Second Circuit, this matter is a federal case and may influence a New York court.) found that employees of a framing and drywall subcontractor were also the employees of a GC for purposes of federal employment laws.

In the federal case, several employees of the Subcontractor filed a lawsuit against the Subcontractor and the GC for Subcontractor's failure to pay the employees proper overtime wages. The issue before the Court was whether GC was a "joint employer" of Subcontractor's employees. Since the Subcontractor was defunct with no money to pay a judgment, the GC was their only means of recovery.

The lower court dismissed the case against the GC because the GC and Subcontractor entered into a "traditionally … recognized," legitimate contractor-subcontractor relationship that did not attempt to avoid the law. This rationale is consistent with industry expectations that when a GC hires a subcontractor to do work, although there is some supervision required of the subcontractor, the GC does not take on legal responsibility for the subcontractor's workers.

However, on appeal, the Fourth Circuit found that the GC was a joint employer and stated that the "legitimacy of the business relationship was not the most important factor." Instead, a GC is a joint employer when (1) it shares responsibility for the terms and conditions of a worker's employment, and (2) the two entities' combined influence renders the worker an employee rather than an independent contractor.

The factual allegations supporting the Court's decision were as follows:

- ***The GC threatened to fire a Subcontractor employee on at least one occasion;***
- ***On some jobs, the Subcontractor's employees worked directly for GC;***
- ***The GC had control over the schedules of the Subcontractor's employees; and***
- ***The Subcontractor's employees wore GC's clothing/hard hats with the GC logo on site.***

Therefore, the Court determined a joint employer status for the GC and Subcontractor. The significance of joint employer status is that all joint employers are liable, jointly and severally, for any FLSA wage and hour violations. In the past, Courts have held that the joint employer test is whether the employee is "economically dependent" on the alleged joint employers. The Fourth Circuit rejected that test. Instead, it explained, the fundamental question is "whether two or more persons or entities are 'not completely disassociated' with respect to a worker such that the persons or entities share, agree to allocate

responsibility for, or otherwise codetermine—formally or informally, directly or indirectly—the essential terms and conditions of the worker's employment."

There is a six factor test as to the Joint Employer relationship.

1. Whether, formally or in practice, the joint employers jointly determine, share the power to direct, control or supervise the worker;
2. Whether, formally or in practice, the joint employers jointly determine, share the power to hire or fire the worker or modify the terms or conditions of the worker's employment;
3. The degree of permanency and duration of the relationship between the joint employers;
4. Whether, through shared management or a direct or indirect ownership interest, one joint employer controls, is controlled by or is under common control with the other joint employer;
5. Whether the work is performed in an office owned or controlled by one or more of the joint employers, and
6. Whether, formally or in practice, the employers jointly determine, share or allocate responsibility over functions ordinarily carried out by an employer, such as handling payroll; providing workers' compensation insurance; paying payroll taxes; or providing the facilities, alleged equipment, tools or materials necessary to complete the work.

Importantly, the claimant does not have to satisfy all six factors. The Fourth Circuit explained that "one factor alone can serve as the basis for finding that two or more persons or entities are 'not completely disassociated'" and are therefore joint employers. The contractor-subcontractor relationship is a vertical employment relationship. In the past, joint employer status was typically found in a horizontal employment relationship. In horizontal relationships, an employee is admittedly employed by two separate entities and the question is whether those entities are sufficiently related such that they should be considered one employer for FLSA purposes. An example is a laborer that works for two separate contractors operated by the same entity. The facts of the Fourth Circuit case were atypical and unfavorable to the GC. There, the subcontractor worked almost exclusively for the GC and took other work only when GC had nothing available. GC provided the subcontractor's employees nearly all tools, material and equipment. It required the plaintiffs to sign in on GC time sheets each day, wear GC branded hard hats and vests, and tell anyone who asked that they worked for GC. The employees were directed by the GC, not the Subcontractor, how and where to perform the day's work. Also, in some instances the employees' paychecks came directly from the GC. Here, it is clear that the GC was essentially the real employer of the Subcontractors' employees.

New York State Caveat – The Statutory Erosion of a General Contractor's protection for wage violations committed by sub-contractors.

In January 2022, New York changed the game with respect to a New York General Contractor's lability for a sub contractor's wage violations. Specifically, a new wage protection statute was added to New York Labor Law, Section 198(e) which holds construction contractors liable for all sorts of claims under the New York Labor Law committed by their subcontractors and all down-stream sub-subcontractors, at any tier, in connection with work performed on "construction contracts." The terms construction contracts, contractors, subcontractors, and owners are broadly defined. However, the New York Legislature mercifully agreed to exclude home improvement contracts with the owner of an occupied dwelling and construction contracts for one- or two-family dwelling units (except where such contract or contracts involve the construction of more than 10 units at one project site) from the statute's coverage.

The law imposed strict liability on General Contractors for the wage violations of their subcontractors. This is significant because the employees of a General Contractor's subcontractors, at any tier, can sue the General Contractor for relief for New York Labor Law violations committed by their employer. This includes recovery of unpaid minimum wages, unpaid overtime wages, benefits that might be wages (i.e. reimbursement for expenses, vacation, holiday, and separation pay), civil penalties, and attorneys' fees. Further, the limitation period for claims against the general contractor under NYLL 198(e) is three years.

As discussed above, prior to this law, a general contractor would not be responsible for its subcontractor's wage practices or liability to their employees unless it was found to be a "joint" employer, which, is discussed above. Now, as mentioned, contractors face strict liability for claims associated with the subcontractor's and down-stream sub-subcontractor's payroll practices.

Also, the New York Legislature added section 756(f) to the New York General Business Law (GBL). This section authorizes contractors to withhold payments owed to subcontractors who fail to pay their construction workers or who fail to comply with

the law or requests by contractors for payroll information and records required by the law (i.e., certified payroll records, records of names of employees, payments of wages and benefits and dates of work).

This necessary provision allows general contractors to impose significant contract, audit, payment and indemnity provisions on subcontractors in an attempt to manage and limit their liability for subcontractor's wage claims.

Therefore, if you employ subcontractors, make certain your contracts contain the correct language on the independent contractor relationship, contain strong indemnification provisions and insurance requirements that establish the subcontractor as a distinct entity. Moreover, even if your contractors are proper, your interactions with subcontractors and their employees are even more important. General Contractors in New York must take appropriate additional care. Given the stringent and arguably onerous scope of liability, contractors must address these requirements in their subcontracts and explicitly advise their subcontractors of their responsibilities and record keeping requirements. An evaluation of a subcontractor's wage practices must be evaluated in advance of retention. For example, General Contractors may wish to avoid engaging subcontractors who pay in cash as well as those who pay a "daily" or "weekly" rate to their workers. General Contractors must be especially wary of subcontractors who fail to pay employees on a weekly basis.

General Contractors must ensure that a contract contains strong auditing provisions and payment to a subcontractor must be contingent upon the successful outcome of an audit. Additional license must be given to a General Contractor to terminate a contract. For example, a General Contractor may wish to include language in a contract providing for termination in the event the subcontractor demonstrates that it is engaging in an improper wage practice. This includes the failure to pass a wage compliance audit, the failure to remit payment of wages to its employees, or the failure to keep and maintain appropriate records. Failure to take appropriate care can lead to peril.

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