PEOs AND LABOR BROKERS IN THE CONSTRUCTION INDUSTRY

Charles R. Schrader
Jordan Schrader, PC
PO Box 230669
Portland OR 97281
503.598.7070
chuck.schrader@jordanschrader.com

These materials are intended to inform the reader of general legal principles applicable to the subject area. They are not intended to provide legal advice regarding specific problems or circumstances. Readers should consult with competent counsel with regard to specific situations.

INTRODUCTION

In recent years, the construction industry has seen rapidly increasing utilization of companies whose business is simply to provide employees. Entrepreneurs have recognized the opportunity to provide contractors and subcontractors[1] employees and/or services that reduce their responsibility for hiring, firing, and maintaining benefits for their workers. Services range from pure labor subcontracts, to providing "employees" under a variety of arrangements including leasing or assigning its own "permanent" workers to the contractor for the duration of the project, to a co-employment relationship. Such companies are known by a variety of terms, including professional employee organizations (PEOs), labor brokers, labor contractors, labor leasing organizations, service providers, employee leasing companies, and others[2].

To avoid misunderstandings, it is worthwhile to differentiate between professional employee organizations and other types of separate organizations that provide only labor to contractors. For purposes of these materials, PEOs are

Linda Waugh, an associate in the offices of Jordan Schrader PC, provided valuable assistance in the preparation of these materials.

[1] For ease of reading, unless otherwise specified, the term "contractor" should be understood to mean both contractor and subcontractor.
[2] Throughout these materials, unless the context is clearly otherwise, such labor-providing companies will be called either "PEOs" or "labor brokers" reflecting, generally their status as co-employers or independent contractors, respectively.

© 2004, Jordan Schrader PC

separate entities that agree to take over certain employer rights and responsibilities. PEOs are true co-employers. The contractor retains the rights and responsibilities for the day-to-day production of its workers. The PEO, as the employer of record, pays the wages and taxes of the workers, and maintains many employer records. The PEO may also provide workers compensation coverage and offer employee benefits. In some situations, the PEO establishes and maintains a more direct employer relationship with the workers, and may address worker complaints, and retain the right to hire, reassign, and fire workers.

The reasons contractors turn to PEOs or labor brokers varies. Some see it as a way to provide "big company benefits" to their workers[3] through the buying power of a larger employee base. Some do it because of a lack of working capital. Some are unable to procure labor elsewhere. Some simply prefer to allow a third party to manage their HR paperwork. Regardless of the reasons for the choice, few contractors appear to understand the myriad complications under state and federal law that flow from use of labor brokers in the construction process.

The increasing use of PEOs and labor brokers by contractors has resulted in litigation in a number of areas. These materials focus on the following issues:

- "Who is the employer?" under state and federal law
- Prevailing wage laws and collective bargaining agreements (including subcontractor clauses, duties to bargain, and allied issues)
- Issues to consider in entering into an employee leasing agreement
- State by state analysis of the subcontractor labor broker's right to collect under the contractor's performance and payment bond or to maintain a mechanics or construction lien
- Contractor licensing of a labor broker

[3] Because the designation of an individual as an "employee" has specific legal implications that differ under various state and federal laws, for purposes of these materials, unless otherwise designated, the term "worker" is used. The term "worker" is intended to indicate that the status of the individual as an "employee" of the contractor or of the company is a determination that must be made on a case-by-case basis.

© 2004, Jordan Schrader PC

STATUS AS AN EMPLOYER

Before an analysis of recent court decisions can be meaningful, it is important to understand that the law recognizes only two relationships between a business and its workers. Either the worker is an employee or an independent contractor. There is no other option. There may be complexities involving whether two or more companies are "joint employers" of the worker, but the worker must be designated, ultimately, either an employee or an independent contractor. If the worker is an independent contractor, by definition, the worker is not an employee.

Independent contractors are, generally, those individuals who have their own businesses, set their own hours, control the means and manner of completion of their work, and work for more than one company. Independent contractors also have the right to hire and fire other employees to complete the project. However, the law is neither clear nor uniform on the rules applied to determine independent contractor status. Not only do the laws vary from state to state, but the laws also vary from agency to agency. For example, the test utilized by the Department of Labor under the Fair Labor Standards Act is a pure "economic realities" test. If the worker is controlled by management, has little individual opportunity for profit or loss, has little ability to utilize initiative, skill, or judgment, and has a relatively permanent position, the worker is likely to be classified as an employee. On the other hand, the test utilized by the EEOC to determine to whom to apply the federal Civil Rights laws is a combination "economic realities" and "right of control" test. The additional factors include how the worker is paid, what the worker "could" delegate, etc. Under the NLRA to determine whether workers are employees or independent contractors, the test is one of "right of control". The IRS uses a common law test based on who has the right to control and direct the worker, not only as to the result to be accomplished by the work, but also the details and means by which that result is accomplished. A worker may be an independent contractor for federal employment tax purposes, but an employee for benefits purposes. The details of these distinctions are beyond the scope of these materials.

For businesses, a primary advantage of hiring independent contractors rather than employees is that independent contractors are not subject to minimum wage or overtime requirements. However, an agreement between the business and the worker to designate the worker as an independent contractor will not be

© 2004, Jordan Schrader PC

dispositive. Courts will carefully examine the facts and the true nature of the working relationship. If it is determined that the worker was wrongly classified as an independent contractor when the worker was actually an employer, the business may be liable for unpaid wages and overtime, and other benefits awarded "employees."[4]

Because a worker may be designated as an independent contractor for some purposes, but not for others, contractors are urged to seek competent legal counsel regarding the determination of independent contractor status in the states in which they operate.

Employees, in contrast to independent contractors, work at the direction and control of their employer. Employees generally do not have the right to hire others to complete the tasks, do not need business licenses (as opposed to professional licenses), and have far less discretion in determining the means and manner of completing the task.

Although a worker is, under the law, either an employee or an independent contractor, a business may engage a worker in any of the following ways:

- Directly as its own employee;
- Directly as an independent contractor;
- Through a third party as its employee; or
- Through a third party as an independent contractor.

PREVAILING WAGE LAWS

Under the Davis-Bacon Act[5] all workers on federal or federally funded construction projects over a size threshold must be paid not less than the prevailing wage rate. State prevailing wage laws are similar in scope.

The prevailing wage is that rate, including fringe benefits, determined by the appropriate agency to be the rate paid to a majority of the workers in a geographic area for the same type of work on similar projects. The U.S. Department of Labor

[4] *See, e.g. Vizcaino v. United States Dist. Ct. for the W. Dist. Of Wash.*, 173 F.3d 713 (9th Cir. 1999).
[5] 40 U.S.C. §276a ff. *See also* FAR 22.403-1.

© 2004, Jordan Schrader PC

establishes the prevailing wage rates for Davis-Bacon Act purposes. The method of determination by the individual states vary.

Independent contractors (*e.g.* true owner-operators of a dump truck) are not subject to the prevailing wage act. Employees of independent contractors, on the other hand, are subject workers. It makes no difference if an employee is employed by the prime contractor or a subcontractor or a co-employer. Where a prevailing wage law applies to a project, all employees must be paid the applicable prevailing wage.

COLLECTIVE BARGAINING

An independent contractor provider of labor is subject to the National Labor Relations Act. If general contractor has entered into a collective bargaining agreement that contains a "subcontractor clause", and subsequently signs a subcontract with a labor broker that falls under the coverage of that CBA, the general contractor will be bound by that clause according to its terms. The more difficult situations arise with PEOs and temporary staffing agencies.

The definitive cases are *Sturgis* and *Jeffboat*[6]. Prior to these cases the rule was that temporary employees could be included in the same bargaining unit as the hiring employer's employees only if both the contractor and temporary help firm agreed. The facts in *Sturgis* involved a union organizing campaign in which a temporary worker agency supplied employees that worked alongside its client's regular employees, doing the same work, supervised by the client's managers. *Jeffboat* involved a unit clarification petition in an already organized company designed to include the temporary workers in the client's bargaining unit. In these companion cases, the NLRB reversed its old rule and held that unions can include in one bargaining unit both temporary employees and the contractor's direct employees without the consent of both employers.

In the *Sturgis* and *Jeffboat* cases, as with all PEOs and most temporary help agency situations, the contractor and the employee-providing entity were co-employers. Both co-employers had an employment relationship with the employees. In that situation, both co-employers have a duty to bargain with the applicable union, but the subjects of bargaining differ. Each co-employer is only required to bargain over the things it controls. For example, the primary employer

[6] *M.B. Sturgis, Inc*. and *Jeffboat Division, American Commercial Marine Service Division*, 331 NLRB 1298 (2000)

© 2004, Jordan Schrader PC

may be required to bargain over the normal terms and conditions of employment (wages, working conditions, discipline and discharge, etc.), while the temporary employer or PEO may be required to bargain over the benefits it provides.

The converse is also true. A union could organize all employees of a PEO or temporary staffing firm without having to include employees of their clients. This will not necessarily result in all employees of the client companies becoming organized if they do not share a community of interest sufficient to constitute an appropriate bargaining unit. However, unions have a choice on how to organize a contractor that has a co-employer relationship – directly or through its staffing company.

This creates a number of potential problems for both the contractor and the PEO or temporary help agency. Under the joint employer doctrine, each joint employer may be liable for the unfair labor practices of the other. This may give rise to joint liability for charges arising out of the bargaining process, failure to pay wages, failure to pay for or maintain benefits, unilateral changes in the terms and conditions of employment, etc. For example, if a PEO changes benefits it provides to an organized customer without first bargaining with the applicable union(s) over the issue, both the contractor and the PEO may be subject to liability. A PEO could conceivably be at risk if it terminated its agreement with the contractor without first bargaining[7] over the termination. Similarly, if a dispute arises that centers on a matter over which the PEO has sole control, the PEO might be subject to lawful picketing by the complaining union at any worksite where the PEOs employees work – even if the co-employers at those other worksites have no connection to the industry or disagreement giving rise to the original dispute.

CONSIDERATIONS BEFORE ENTERING INTO A LEASING AGREEMENT

A contractor contemplating entering into an agreement with a company to provide workers should carefully consider the legal ramifications. Many state and federal laws determine the responsibilities of employers, and if the agreement does

[7] *See G. Heileman Brewing Company*, 879 F2d 1526 (7th Cir 1989) [Heileman subcontracted with Lowry to provide maintenance electricians to Heileman's brewery. Electricians who had formerly worked for Heileman became Lowry employees, and were re-assigned to work at Heileman's brewery. Local 309 represented the "Lowry" workers. Heileman desired to reduce the pay for the electricians, and asked Lowry to check with Local 309. When Lowry informed Heileman that the reduction was not acceptable to the union, Heileman terminated the subcontract and contracted with Bienco, who did not have a CBA with Local 309, to supply maintenance electricians to work at the brewery. The Board determined, and the court agreed, that Heileman and Lowry were joint employers of the maintenance electricians, and thus Heileman had a duty to bargain with Local 309.]

© 2004, Jordan Schrader PC

JORDAN SCHRADER

not fully address the numerous issues that can arise, a contractor may incur substantial unplanned liability. This is particularly true in situations where most or all of the workers formerly employed by the contractor are "terminated" by the contractor and "hired" by the company who, in turn, "leases back" the workers to fill the same job they previously held with the contractor.

The following is a partial list of issues of concerns. In all cases, the contractor should obtain competent legal advice to determine how the particular facts of each situation will impact rights and responsibilities under various state and federal laws, and company provided employee benefit plans.

1. "Severed" workers may have claims under the contractor's severance plan, even where the workers experience no loss of employment. *See, e.g. Blau v. Del Monte Corp.*, 748 F.2d 1348 (9th Cir. 1984), *cert. denied*, 474 U.S. 865 (1985). (Workers were granted severance pay under the terms of the severance plan, despite no loss of employment, because the workers were no longer "employed" by the former employer).

2. "Terminated" employees may have post-employment rights, such as continuation of health benefits under COBRA, or rights under ERISA to distributions from individual retirement accounts, profit sharing, stock purchase, or other benefit plans.[8] "Laying off" a sizeable portion of the workforce might also trigger notice requirements under the WARN Act.

3. Contractors contemplating a shift in employer status must consider "final paycheck" rules. These rules vary from state to state, and have ramifications under federal law as well. A contractor in this situation must comply with all local, state, and federal laws regarding commissions, vacation pay, sick pay, and other benefits.

[8] Perhaps the most well known case of misclassification of employees is *Vizcaino v. United States Dist. Ct. for the W. Dist. Of Wash.*, 173 F.3d 713 (9th Cir. 1999) and *Vizcaino v. Microsoft Corp.*, 290 F.3d 1043 (9th Cir. 2002). Microsoft Corporation settled the class-action lawsuit for $96.9 million, with the settlement going into a fund to compensate workers who provided services as "independent contractors" or through temporary staffing agencies. In addition, the court awarded the settlement fund costs and attorneys' fees of $27 million. The case demonstrates the potential liability employers face when the incorrectly classify workers as "independent contractors" or "temporary" workers rather than as employees. Businesses should carefully draft benefit plans to specifically exclude workers who they do not intend to cover under the plan. In doing so, the company should first consult with legal counsel to ensure that it is permissible to exclude certain groups of employees from any selected benefit plan.

© 2004, Jordan Schrader PC

JORDAN SCHRADER

4. If the contractor has workers in several states, the laws will likely vary and, accordingly, the contractor's obligations to its employees will vary as well. Additionally, a "carryover" of benefits from the "old" or previous employer to the "new" employer may undermine the separate-employer status, which could be the very reason the contractor enters into the employee "leasing" arrangement in the first place.

5. Consider collective bargaining issues, such as the impact of a transfer of "employer" status on seniority. Allowing transferred employees to carry over seniority may undermine separate-employer status.

6. A leasing company might agree to assume all of the obligations under the contractor's collective bargaining agreement, but the contractor will not be relieved of joint liability if the labor broker or PEO violates the CBA. In addition, the decision to "lay off" the workforce and contract with a company to "lease back" the workers will likely trigger an obligation to bargain with the union.

7. The contractor should ensure that any agreement with a labor broker or PEO clearly allocates responsibilities between the parties. The agreement should specify how the parties will cover potential liability to the contractor for acts or omissions of the leasing company or PEO (such as failure to pay wages). The agreement should also specify how the parties will designate potential liability to the leasing company or PEO for problems in the workplace, such as harassment or safety concerns.

8. The agreement should also specify which party will be responsible for compliance with the numerous local, state and federal laws governing the workplace. Be aware that, regardless of the agreement between the parties, various laws will designate the party responsible. Liability may exist under OHSA, ERISA, EEOC, workers' compensation laws, state and federal wage and hour laws, tax laws, and a variety of other laws not withstanding contractual provisions to the contrary.

9. Contractors should carefully consider rights and liabilities under differing state workers' compensation or industrial insurance obligations. While, on the one hand, it might seem advantageous to the contractor to avoid liability for workers' compensation premiums by using leased employees, on the other hand, the contractor must consider that by avoiding workers'

© 2004, Jordan Schrader PC

compensation liability, there is a risk of losing the benefits of the "exclusive" remedy of workers' compensation laws.

10. The rights of the parties to manage and supervise the workforce must be clearly established. Determine whether the leasing company or PEO will have a right to maintain a presence on the construction site. Determine which party has the right to hire, fire and discipline.

11. If the contractor desires to avoid joint employer status, the contract and the facts should demonstrate that the contractor has little or no control over the leased employees. Carefully document the business reasons for implementing a leasing transaction. Additionally, the leasing agreement should include indemnification provisions that allocate liability in accordance with the parties' expectations.[9]

12. To avoid a finding of joint employer status, the agreement should be structured so the contractor has little or no control over the leased workers.

13. If a contractor utilizes some "permanent" workers (*i.e.*, its own staff) and also some "leased" workers, and wants to include the permanent workers on benefit plans, but not the leased workers, be advised that poorly drafted benefit plan documents might create potential liability, or result in the contractor being required to extend benefits to the leased workers.

LABOR BROKER'S AND PEO'S RIGHT TO COLLECT UNDER A LIEN OR BOND

When analyzing labor broker and PEO legal rights and obligations in the lien and bond situation, courts examine not only the contractual agreement between the parties, but also the actual working relationship. While the contractual allocation of responsibilities is important, the facts or realities of the affiliation are often determinative.

Generally speaking, the more the arrangement between the labor provider and the contractor looks like the provider, not the contractor, was the actual employer, the greater the likelihood that the provider will be allowed to collect under the lien or bond. The more the arrangement looks like a "payroll services",

[9] When entering into any indemnification provision, consider the financial strength of the indemnifying party.

© 2004, Jordan Schrader PC

the less likely the labor broker or PEO will be able to collect under the bond or lien.

Following is a sampling of recent case law development on this issue.

New York

Tri-State Employment Services, Inc. v. The Mountbatten Surety Company, Inc., 99 NY2d 476, 788 NE 2d 1023, 758 NYS2d 595 (2003): The Court of Appeals for the Second Circuit certified the following issue to the state court: "In the circumstances presented, is a PEO, under New York law, a proper claimant under a labor and materials surety bond?" The Court of Appeals of New York answered in the negative.

In this case, plaintiff PEO "hired" the current employees of the contractor, and then "leased back" the same workers. Plaintiff paid the wages, taxes, worker's compensation insurance, disability insurance and union benefits. Plaintiff did not maintain a worksite presence or supervisory role, nor was it involved in hiring decisions, setting wages, or deciding which workers went to the job site. Plaintiff PEO did not conduct performance evaluations, or regularly discipline or terminate the workers, although it could terminate workers who engaged in sexual harassment or injured another worker or member of the public.

When the contractor failed to make payment, the PEO sought payment under two labor and material payment bonds. The bonds defined a claimant as "one having a direct contract with the Principal or with a Subcontractor of the Principal for labor, material, or both, used or reasonably required for use in the performance of the Contract."

The court reasoned that the claimant status of a "professional employer organization" should not be determined by whether the PEO is categorized as an employer or joint employer, because the bond protected those having a direct contract with the principal or a subcontractor. Moreover, determining whether a PEO is an "employer" unnecessarily complicates the question because the status as employer may vary with the tax, state or federal statute, or common-law standard under consideration.

The court concluded that a PEO's sole or primary role as a provider of administrative and human resources services, and as a payroll financier, gives rise to a presumption that the PEO does *not* provide labor to a contractor for purposes of a payment bond claim. However, the court recognized that the inquiry is essentially factual and that a PEO may exercise sufficient direction and control

© 2004, Jordan Schrader PC

over the employees at the worksite to overcome the presumption and qualify as a provider of labor within the language of the bond.

The Court identified the following factors to consider in determining whether a PEO is a provider of labor:

- The PEO's involvement in selecting and screening the workers, and whether it uses its own criteria in doing so;
- The PEO's affirmative representations to the workers that it is their employer;
- The nature of the documentation exchanged between the workers and the PEO at the start of the working relationship (such as handbooks, manuals and employment forms);
- The PEO's involvement in training, supervising and disciplining the workers and in otherwise retaining control over the workers or directing their behavior;
- Whether the PEO, rather than the contractor, determines which workers to terminate; and
- Whether the PEO withholds workers, rather than services, upon nonpayment by the contractor.

Applying these factors to the case, the Court determined that the plaintiff was not a provider of labor to the project and, accordingly, not a proper claimant under the bond.

California

Sweet v. Fresno Hotel Co., 174 Cal 789, 164 P2d 788 (1917): In a very early case, the Supreme Court found that a furnisher of laborers was entitled to claim under a lien in one situation, but not in another. Under the first contract, the claimant assumed responsibility for payment of all wages due laborers employed in the construction of a hotel. The contractor had the right to hire and discharge the workers, and also kept weekly payroll information for the claimant. The claimant's only function was to act as superintendent and pay the wages due from the contractor to the workers. The court held that the agreement between the claimant and the contractor amounted to a loan enabling the contractor to carry out the construction contract. Accordingly, the court held that the claimant could not recover under the lien.

© 2004, Jordan Schrader PC

JORDAN SCHRADER

Under the second contract, however, the claimant was allowed to recover. The contract provided that the claimant would "furnish all common labor and carpenter labor" necessary to the construction of a building. The claimant hired the workers and "superintended" them in their work. Although the contractor retained the right to discharge workers not satisfactory to it, and replace them by other persons selected by the contractor, the court held that this fact did not make the contractor the employer of the workers. Rather, the court held that the claimant's relation to the contractor "was that of a subcontractor to furnish labor of certain kinds for the erection of the building." *Id*. at 787.

***Primo Team, Inc. v. Blake Construction Co*.,** 3 Cal App 4th 801, 4 Cal Rptr 2d 701, (Cal Ct App 1992): The court rejected a public works payment bond claim made by a worker leasing company that entered into a series of "Labor Services Agreements" with a contractor (in this case, a subcontractor). Under the agreements, the claimant retained the sole authority to recruit, hire, employ, discipline and terminate the workers, but the court found that the reality of the relationship was very different. In fact, the claimant's role was limited to recruiting, interviewing and screening job applicants, verifying eligibility to work, and preparing various reports about the workers. The claimant did not hire, discipline or fire employees, nor did it provide tools or supervise laborers on the job. Instead, these functions were performed by the contractor.

The court found that the claimant's role was limited to advancing funds to cover various payroll obligations, providing introductory orientation materials, maintaining personnel files, providing time clocks and time cards, calculating wages and withholdings, conducting safety meetings, administering the workers' compensation program and filing state and federal tax reports.

The applicable state law allowed recovery for "all persons and laborers of every class performing labor upon or bestowing skill or other necessary services on…a work of improvement." Because the "primary aspect" of the claimant's role was to advance funds for, and administer the collateral functions of, payroll, the court held the entity was not a permissible claimant.

The court specifically rejected the claimant's argument that its services were provided to "a work of improvement." Rather, the court reasoned that although the services were beneficial and necessary to the contractor's operation, they were not bestowed on the work of improvement within the purpose contemplated under state law.

© 2004, Jordan Schrader PC

JORDAN SCHRADER

Contractors Labor Pool, Inc. v. Westway Contractors, Inc. 53 CalApp 4th 152, 61 Cal Rptr 2d 715 (Cal Ct App 1997): The Court of Appeals upheld a trial court's determination that an entity that provided temporary workers to a contractor was a proper claimant under a public improvement bond. The court reasoned that "*the legal status of an employer* of laborers furnished to a work of improvement is the crucial factor which distinguishes a person who 'furnishes' such laborers to the project, and is then entitled to lien rights, from a person who merely organizes the work force, performs administrative functions, advances wages, or does all three *in behalf of* another, and is consequently not entitled to lien rights." (Emphasis in original)

In this case, the service interviewed, screened, and hired workers according to its own procedures and applying its own employment criteria. The workers signed applications for employment with the service and signed written conditions of employment identifying them as the service's employees. The service provided them with its standard employee handbook. The contractor could reject a worker for the project but had no right to fire a worker. Time cards and other personnel documents identified the workers as employees of the service, and the service covered the employees with its own workers' compensation insurance policy. Finally, when the contractor fell into default, the labor company threatened to withdraw workers from the project, not to stop processing or paying payroll.

Under these circumstances, the court held that the labor provider was a "furnisher" of labor and entitled to recover against the bond.

Onceblue Enterprises, Inc. v. Kiewit Pacific Co., 2003 WL 22971070 (2003). In an unpublished opinion, the Court of Appeals affirmed a grant of summary judgment dismissing claims of an employee leasing company against a payment bond. The contract in question provided that the leasing company would provide "basic payroll services" and "workers."

The leasing company did not recruit workers, but simply added a subcontractor's existing employees to its payroll without obtaining employment applications, interviewing them, requiring them to sign any conditions of employment, or providing them with any employment information such as a handbook. The leasing company did not pay workers' compensation insurance premiums. Rather, the subcontractor determined the hours of work, the type of work performed and the project worked on. The subcontractor also had the unilateral right to fire the workers.

© 2004, Jordan Schrader PC

The court concluded that under these facts, the primary function of the leasing company was to advance funds to the subcontractor and, as such, the company was not a proper claimant.

Georgia

Gulf Ins. Co. v. GFA Group, Inc., 251 GaApp 539, 554 SE2d 746 (2001). The Court of Appeals of Georgia held that a payroll services company was not a proper claimant under a payment bond. An eligible claimant was defined as "one having a direct contract with the [Contractor] or with a Subcontractor of the [Contractor] for labor, material, or both, used or reasonably required for use in the performance of the Contract". Under Georgia's Little Miller Act, OCGA § 13-10-1, a claimant under the bond included "all persons supplying labor, materials, machinery, and equipment in the prosecution of the work provided for in the contract."

The question for purposes of determining status as a claimant under the bond was whether the company provided labor to the project. In this case, the agreement expressly provided that the company "will not retain control over the employees nor direct their behavior in any way." The contractor was responsible for hiring, setting rates of pay, supervising, disciplining and terminating employees. The company's role was limited to issuing checks and paying workers' compensation insurance premiums. Accordingly, the court held that the company was not a proper claimant under the bond.

Louisiana

Jean Simpson Personnel Services v. G & G Concrete, LLC, 803 S2d 992 (2002). Under the Public Works Act, the Court of Appeals determined that a company that provided payroll services to a subcontractor was not a proper claimant under a payment bond. The statute, La.R.S. 38:2242(A)(1), allowed recovery to "any person to whom money is due pursuant to a contract with the owner or a contractor or subcontractor for doing work, performing labor, or furnishing materials or supplies …."

The court determined the payroll services company was not entitled to recovery "for doing work" on the project because it "did not supply the laborers." Rather, the company was a "personnel service" which provided only payroll services. Although the company paid state and federal employment taxes, workers' compensations premiums, and required all workers to submit to drug testing, the facts demonstrated that the workers "did not simply belong to some

© 2004, Jordan Schrader PC

pool of temporary laborers" maintained and leased out to various contractors. They had all been previously employed by the subcontractor, and the payroll services company provided "purely administrative" tasks but had no supervision or control over the work done or labor performed.

The court also determined the company could not be considered a subcontractor entitled to lien rights. In reaching its decision, the court reiterated the "test" was not whether there had been time and labor expended in producing the material, but whether the person furnishing the material thereafter performed any labor in attaching to or incorporating the materials into the building or improvements.

New Mexico

Eastland Financial Services v. Mendoza, 132 NM 24, 43 P3d 375 (2002). The court held that the employee leasing company was entitled to recover under the bond, specifically rejecting arguments of the surety that recovery was barred because (1) the company was not licensed under the state's Employee Leasing Act and, thus, its contract was illegal; (2) the company did not provide labor but only financed the labor for the project; and (3) if the company did supply labor, it did so as a contractor and was barred from recovery because it was not licensed.

The court held that although, as a general rule, a contract made in violation of a statute prescribing penalties is void, the rule was not inflexible. In this case, the licensing statute did not contain a provision prohibiting enforcement of contracts entered into in violation of the statute. The court also considered that the purpose of the statute was the protection of leased employees, not the protection of contractors that hire leased employees. Accordingly, the court determined that allowing the leasing company to recover the reasonable value of its services under the contract did not defeat the statutory purpose. Finally, the court reasoned that the contractor would be unjustly enriched if allowed to retain the value of the services rendered without compensation.

The court determined that under the state's Little Miller Act, 13-4-18 NSMA 1978, the company had provided labor and could recover under the bond. The Act provides recovery for "every person, firm or corporation who has furnished labor or material in the prosecution of the work."

Under the facts in the case, the labor provider assumed all payroll responsibilities, maintained all payroll and employee files, provided workers' compensation coverage, and general liability and state disability insurance. Additionally, the contract between company and the contractor specifically stated

© 2004, Jordan Schrader PC

that the company was, "for all purposes" the employer of the workers. Workers were notified that they were employees of the company and any problems should be discussed with its management. The workers were also told that in case of an on-the-job injury, the employee was to inform the health care provider that the labor provider employed the employee. Finally, the contractor had no right to hire or fire the subject workers. If the contractor was dissatisfied with a worker, its sole right was to return the employee to the labor provider.

The court rejected the contractor's argument that the sole reason it entered into the employee leasing contract was because it needed the labor provider to advance its payroll. The court specifically stated that the contractor's motivation for entering into the contract did not affect the labor provider's status as the employer of the laborers.

Finally, the court determined that the labor provider was not a "contractor" and was, therefore, not required to be licensed by the state's Construction Industries Division. The court reasoned that the purpose of the act was to protect the public from incompetence and dishonesty in those providing building and construction services, and that to effect this purpose, "the law need only apply to those who actually perform or supervise the performance of construction services." Because on-site supervision and control of the workers was the responsibility of the contractor, the labor provider did not act in the capacity of contractor for purposes of the Act and was not, therefore, required to be licensed.

<u>Texas</u>

AMS Construction Co., Inc. d/b/a/ AMS v. Warm Springs Rehabilitation Foundation, Inc., 94 SW3d 152 (2002). The Court of Appeals of Texas held that summary judgment was precluded on the issue of whether the claimant furnished a service or furnished labor in actual construction.

Pursuant to a "Professional Employer Organization Services Agreement" entered into between claimant and a subcontractor, the claimant assumed the right to direct and control the employees "assigned to a client's worksites for administrative purposes", the right to hire, fire, discipline and reassign the workers, and the right of direction and control over the adoption of employment and safety policies, and management of workers' compensation claims. The Texas Property Code section 53.021 provided that a person has a lien if the person labors or furnishes labor for construction or repair, and the person labors or furnishes the labor or materials under or by virtue of a contract.

© 2004, Jordan Schrader PC

Under the facts presented, the court concluded there was a genuine issue of fact as to whether the labor broker had a mechanic's lien under the statute.

Washington

Better Financial Solutions, Inc. v. Transtech Electric, Inc. 112 Wash App 697, 51 P3d 108 (2002). The Court of Appeals, Division 1, concluded that a supplier of labor was not a proper claimant under state contractor's bond or a public works retainage statute, nor was the supplier a proper claimant under the subcontractor's common law bond.

The subcontractor contracted with BFS to provide temporary labors. The agreement between the parties expressly provided that the workers were under the subcontractor's supervision and control. BFS paid the wages, taxes, and insurance.

The court rejected BFS claim that it was a "protected class" under the bond statutes, finding that "suppliers of labor are not, and cannot logically be, laborers as well. Laborers are the individuals who actually perform the work at the job site."

The court further held that the statutes protect persons who do actual labor on the project, rather than persons who provide laborers to perform the work.

Better Financial Solutions, Inc. v. Caicos Corp., 117 Wash App 899, 73 P3d 424 (2003). The Court of Appeals, Division 2, agreed with the reasoning of Division 1 in the case above, and held that a supplier of laborers could not claim under lien statutes on theories of either furnishing labor, or of being a subcontractor.

The employee services company contracted individually with union cement masons to perform the work, but did not supervise the workers on the site. However, the company paid industrial insurance premiums and unemployment insurance, filed returns with the Department of Labor and Industries and the state Employment Security Division, and withheld amounts required for federal tax, Medicare, and FICA purposes. The contractor retained "full control over the means and methods of work and procedures to be used," and supervised the laborers' work.

The bond statute, RCW 39.08.010, requires that the contractor "pay all laborers, mechanics, and subcontractors and materialmen, and all persons who supply such person or persons, or subcontractors…."

The court held that BFS was not a proper claimant under the public works bond statutes as a provider of labor. The court also rejected BFS's argument that it could claim under the bond as a subcontractor. A subcontractor under Washington

© 2004, Jordan Schrader PC

law is one who (1) performs or takes from the prime contractor a specific part of the labor or material requirements of the original contract, and (2) has a substantial and important relationship with the prime contractor.

The company neither provided supplies or materials, nor constructed any portion of the project. The court further held that the company "intentionally divorced itself" of the indicia of control and involvement which "a subcontractor commonly bears." The court concluded that BFS performed administrative work but did not undertake a specific portion of the labor on the site. The "reason for its business existence was merely to provide laborers." Accordingly, the court concluded that the company's connection with the project was qualitatively different than that required for subcontractor status.

CONTRACTOR LICENSING, PEOS, AND LABOR BROKERS

Most states, and a number of local governmental jurisdictions, require contractors to be licensed. The licensing schemes vary widely, as do the statutes, ordinances, and regulations that enable and implement them. It is beyond the scope of these materials to do a jurisdiction-by- jurisdiction analysis of contractor licensing.

A common pitfall facing an entity that is required to be licensed but fails to do so is an inability to maintain a lawsuit to recover the value of the work or services it has provided. It in not surprising, therefore, that licensing laws are often used as a sword to avoid payment. Consider, for example, the situation faced by Better Financial Solutions in a series of cases in Oregon. As in the Washington cases cited above, BFS was a labor subcontractor. It provided "labor only" to contractors on public and private works project. In a typical situation, BFS would hire a contractor's employees, thereby taking responsibility for hiring and firing, payroll, tax reporting, processing union dues, and the like. BFS would then subcontract with the contractor to provide it with labor (in many cases, the very same labor previously employed by the contractor) to perform a project. If the contractor then failed or refused to pay BFS, BFS would exercise its lien or bond claim rights to be paid.

When it first came to Oregon, BFS contracted with a number of capital-impaired subcontractors to provide them labor on public works projects. In some cases, BFS required joint check agreements from the prime contractors. In other cases, it simply relied on its bond claim rights. When the subcontractors were

© 2004, Jordan Schrader PC

unable to pay, BFS instituted collection efforts against the prime contractors and/or their surety bonds.

In at least two of these cases, the prime contractors argued that BFS could not bring its collection action because it was not licensed as a contractor in Oregon[10]. In one of those cases,[11] a summary judgment motion was granted on the licensing issue. The trial court determined that failure of a labor-only subcontractor to register with the Oregon Construction Contractors Board prohibited it from collecting under the bond. It is doubtful that if BFS had been a PEO as opposed to a labor broker that the court would have found that it needed to be licensed. However, the facts in each case are important[12], as is the contractor licensing law of the particular state. For example, the New Mexico *Eastland Financial Services*[13] case, cited earlier in the materials, appears to have come to a different conclusion on similar facts.

---

[10] Or. Rev. Stat. 701.002 *et seq.* and Or. Admin. Rules 812-003-0000 *et seq*.
[11] *Hillsboro School District v. Safeco Ins. Co. of America*, Washington County (OR) Case No. C000725CV, *aff'd without opinion*, 185 Or App 162, 58 P.3d 853 (2002).
[12] There is a "substantial injustice" safe harbor in the Oregon act. In determining that enforcing the provisions of the statute would not result in a substantial injustice to BFS, the court relied on the lack of evidence that BFS was defrauded or deceived by anyone connected with the project, that the burden of becoming licensed was light (thus making it easy for BFS to protect itself), and that the general contractor had incurred substantial damages on the project as a result of the insolvency of the subcontractor. The court specifically noted that if the general contractor had taken unfair advantage of BFS's failure to become licensed, or if it would reap an unfair financial windfall from the application of the statute, the court would not have enforced the statute.
[13] *Eastland Financial Services v. Mendoza,* 132 NM 24, 43 P.3d 375 (2002).

© 2004, Jordan Schrader PC