Money, Dirt and Steel: Spring 2017

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When Are Your Subcontractor's Employees Your Employees?

By: Michael D. Lord

In January, the Fourth Circuit Court of Appeals entered its decision in *Salinas v. Commercial Interiors, Inc.,* ruling that a contractor and its subcontractor can be the ?joint employers? of the subcontractor?s worker for Fair Labor Standards Act purposes, Case No. 15-1915, thereby opening the door for potential direct employee type claims against the general contractor by workers downstream in the construction chain and putting independent contractor status in jeopardy (4th Cir, Jan. 25, 2017).

In *Salinas,* the subcontractor had a close relationship with the general contractor, working mostly for this one general contractor. Day to day, the general contractor provided tools, materials and equipment; had its foreman supervise the subcontractor?s employees? work; required those employees to attend its safety meetings; required the subcontractor?s employees to sign in and out with its foreman; and had its foreman direct work to be redone.

Further, work was based on job site needs, and payment was on a time and materials basis or hourly versus a lump sum. Interestingly, the general contractor also provided the subcontractor?s employees with logoed hard hats, vests and sweatshirts and even instructed them to say, if asked, that they worked for the general contractor. On these facts, the court found that a jury could find the general contractor and subcontractor were joint employers, with no single fact being dispositive.

In doing so the Court articulated a new standard, and joint employment exists when: two or more entities share, agree to allocate responsibility for, or otherwise co-determine, formally or informally, directly or indirectly, the essential terms and conditions of a worker?s employment; and the two or more entities combined influence over the essential terms and conditions render the worker an employee as opposed to an independent contractor. Six factors are to be considered:

1. Whether formally or as a matter of practice, the putative joint employers determine, share or

allocate the power to direct, control or supervise the work, whether by direct or indirect means;
2. Whether formally or as a matter of practice, the putative joint employers determine, share or allocate the power, directly or indirectly, to hire or fire the worker or modify the terms and conditions of the worker?s employment;
3. The degree of permanency and duration of the relationship between the putative employers;
4. Whether through shared management or a direct or indirect ownership interest, one putative joint employer controls, is controlled by, or is under common control with the other putative joint employer;
5. Whether the work is performed on premises owned or controlled by one or more of the putative joint employers, independently or in connection with one another;
6. Whether formally or as a matter of practice, the putative joint employers jointly determine, share or allocate responsibility for functions ordinarily carried out by an employee, such as handling payroll, providing workers compensation insurance, paying payroll taxes or providing the facilities, equipment, tolls or material necessary to complete the work.

Applying these tests to the facts, one can readily see where common practices in the construction industry, particularly when combined on one job site, can lead to joint employer liability. Also relevant is the fact that these same practices could be construed to make a subcontractor that is providing primarily labor, particularly an individual laborer, an employee. Care should be taken, especially where the same subcontractors are used with regularity and the work is paid hourly. The more control that is exerted and the more the contracted labors looks like an employee, the greater the risk.

Waiver of Arbitration by Plaintiff

By: Gilbert "Gib" C. Laite, III

Public policy favors arbitration of disputes. Therefore, courts closely scrutinize claims of a waiver of the right. When an arbitration right exists, and a civil action is filed, if the plaintiff wants to compel arbitration it generally files a motion to compel with or on the heels of the civil suit, using the suit as a vehicle to perfect any rights required to be so perfected (for example lien claims), to be assured that statutes of limitations are tolled, and to have a vehicle to control and to confirm the arbitration.

A defendant who wants to enforce the arbitration demand would similarly file a motion to compel promptly, perhaps with or before filing its answer to the lawsuit. In this imperfect world, however, either or both parties often delay the exercise of their arbitration right while they get a ?feel? for where the case is going. The risk for either is that they wait too long, and the arbitration right is lost.

This is what occurred in *Town of Belville v. Urban Smart Growth, LLC,* No. COA16-817 (Feb. 21, 2017). The plaintiff filed suit under a development agreement that included an arbitration clause. At the outset, the lawsuit was filed almost two years after the plaintiff had given the defendant notice of default under the agreement. The defendant filed an answer with counterclaims.

The parties then filed a joint motion to have the case designated as Exceptional so that a special judge

could be assigned. After the case was so designated and a judge assigned, the defendant forwarded a discovery plan, confidentiality agreement and scheduling order to the plaintiff. After all this and some seven months after the lawsuit was filed and 32 months after the initial notice of default, the plaintiff filed a motion to compel arbitration.

At the hearing on the motion, the court considered the affidavits of defendant?s counsel that significant legal fees had been incurred thus far in the litigation. The court denied the motion to compel. The Court of Appeals affirmed finding that the defendant had been prejudiced by the plaintiff?s delay because of the attorney?s fees incurred. The moral of this story is make your decision whether to exercise an arbitration right early on and before the other side incurs significant legal fees in litigation-specific matters.

Lease Provision Requiring Payment of Property Taxes "When Due" Without Modifying Language Construed to Include Implicit Grace Period Through the Time That Interest is Imposed Pursuant to G.S. 105-360

By: Gilbert "Gib" C. Laite, III

RME Management, LLC v. Chapel H.O.M. Associates, LLC, COA16-596 (Jan 17, 2017).Commercial lease provided that the Lessee ?shall pay all ad valorem and personal property taxes which may be assessed against the demised premises and the improvements thereon and personal property located therein, or any part thereof, for each year of the term of this lease...? and that ?Lessee expressly agrees to pay all installment of taxes and assessment [*sic*] required to be paid by it *when due* . . . ? [emphasis added].

In Orange County, N.C., the annual tax bills are issued in July and are due on Sept. 1 of each year. Pursuant to North Carolina General Statutes §105-360, real property taxes are payable without interest through Jan. 5 of the following year. The tax bills were sent to the tenant and, for several years, neither Lessor nor Lessee paid much attention to when the bills were paid. However, in 2015, the Lessor sent a notice of default on Sept. 21 for failure to pay the taxes on Sept. 1. The Lessee responded that taxes were not due until Jan. 5.

In response, the Lessor terminated the lease and demanded possession on Oct. 27, 2015, initiated an ejectment action and paid the taxes. The Lessee?s attempts to reimburse the Lessor were rejected. The magistrate found for the Lessee, and this decision was affirmed by the District Court based on the parties? conduct and the ?implicit grace period? to pay the taxes.

On further appeal to the Court of Appeals, the Lessor argued that taxes are due on the date of the tax notice and that, based on G.S. 105-360, any payment after Sept. 1 was late or past due. The Lessee argued that. because taxes are ?first due? on Sept. 1 and not delinquent until Jan. 6, taxes are due anytime between Sept. 1 and Jan. 5.

The Court of Appeal accepted the Lessee?s argument and affirmed. The court found that, based on the language of the lease and G.S. 105-360, the phrase ?when due? meant anytime between Sept. 1 and Jan. 5 of the following year. The court found overly strict the position that taxes must be paid only on a single day or be late. Further, G.S. 105-360 states that taxes are ?payable? without interest through Jan. 5, and a debt cannot be due unless payable.

District Court Lacked Jurisdiction for Strict Foreclosure

By: Gilbert "Gib" C. Laite, III

Banks v. Hunter, COA16-666 (Jan. 17, 2017). Banks lent Hunter $3,606,36, evidenced by a note which required repayment within 90 days and provided that in the event of default, Banks would become the sole owner of certain real estate owned by Hunter. Four days after executing the note, Hunter also executed a Deed of Trust on the property that named Banks as trustee and beneficiary and was recorded. The deed of trust included a power of sale.

When Hunter failed to pay the note, Banks filed a civil action under the note seeking specific performance in the form of a conveyance of the real property to him. A default judgment was entered for Banks. Hunter subsequently sought to set aside the judgment under Rule 6. The lower court denied the relief, and Hunter appealed. The Court of Appeals found that the lower courts lack subject matter jurisdiction and overturned the judgment.

The Court began its analysis by stating that it is possible to deed property to a lender in exchange for the lender?s promise to deed it back upon payment of the amount lent or payment of an agreed sum of money. However, in this case there was no absolute deed of conveyance, only a note and a deed of trust. As such, the creditor needed to resort to a ?foreclosure.?

Three types of foreclosure have been recognized. Years ago, there was ?strict foreclosure? under which, upon default, a court orders the debtor?s interest in the collateral conveyed to the lender without an intervening sale. However, this no longer exists in North Carolina since it infringes upon the debtor?s equity of redemption.

The only other types of foreclosure authorized in North Carolina are foreclosure under a power of sale of a judicial foreclosure. The court likened Banks?s lawsuit to a strict foreclosure and found it was not an attempted foreclosure under a power of sale or judicial foreclosure because the suit did not seek the sale of the property but, instead, a conveyance to the lender.

Notably, the suit did not seek even to collect the sum due. On this reasoning, the court found that the jurisdiction of the court had not been properly invoked since the foreclosure sought was not recognized in this state.

Substitute Trustee Not Required to Re-Notice Hearing

By: Gilbert "Gib" C. Laite, III

In the *Matter of Foreclosure of A deed of Trust,* COA16-653 (Feb. 21, 2017), a foreclosure action was initiated, and the initial substitute trustee noticed a hearing. The matter was continued several times, but, on the day the matter came on for hearing, a new substitute trustee was appointed. The Clerk entered an order of foreclosure and the debtor appealed.

On appeal, the debtor moved to dismiss the action on the basis that the substitute trustee failed to file and serve an amended notice of hearing upon being appointed. It was not disputed that the debtor had in fact received notice of the hearing from the original substitute trustee, and there was no assertion that the new trustee was appointed improperly. The court found no authority for requiring a new notice to be issued and found no prejudice to the debtor and, therefore, rejected the argument. On these and other issues, the foreclosure was affirmed.

Limited Liability Company Protections Pierced

By: Gilbert "Gib" C. Laite, III

Limited liability companies have been all the rage for the past two decades, taking the place of corporate and limited partnership structures. They are relatively simple and easy to establish. However, as demonstrated in the recent decision from the North Carolina Court of Appeals in Southern Shores Realty Services, Inc., v Miller et al, COA16-557 (Jan. 17, 2017), care must still be taking by the members and managers to avoid personal liability.

In Southern Shores, a family established separate LLCs for each of many summer rental properties, with various family members having interests in the LLCs, and the family members also being managing members of the LLCs. Each of the LLC?s signed a contract with Southern Shores Realty for the rental management of the properties for the 2010 summer season.

Southern Shores took deposits for the rentals and forwarded them to the LLCs. At some point, foreclosure proceedings were instituted against one or more of the properties, as a result of which Southern Shores terminated the contractual relationship with the LLCs. Southern Shores informed the prospective tenants of the proceedings and refunded the tenants? deposits for the season out of its own pocket.

Southern Shores then filed suit against the LLCs and the family head personally to recover the deposits. At the end of the day, a jury found the LLCs liable for breach of contract and also found the family head personally liable. The court refused to set aside the jury?s verdict. The Court of Appeals affirmed.

In upholding the personal liability aspect of the verdict, the court began by outlining those elements historically applied to pierce the corporate veil: (1) control; (2) use of control to commit fraud or wrong; and (3) proximate cause, premised on certain factors including: inadequate capitalization, non-compliance with corporate formalities, complete domination and control, and excessive fragmentation of

an enterprise.

Applying these factors to the case before it, the court began by stating that, since, in the LLC context, the management is vested in the manager, and since all members are deemed managers, a management role alone would not be a ground to find ?control? over the LLC for piercing purposes. Further, the court recognized that there are far fewer formal statutory requirements in the management of LLCs. Then turning to the facts before it, the court found that the foreclosures tended to show the LLCs were inadequately capitalized, that the fact there was a separate LLC for each property might be a basis to find excessive fragmentation, and that the family head had acknowledged he was in charge of the family business by, among other things, making statements such as ?I?m the present managing member? and the ?decision maker? and that he would be in charge if there was a bankruptcy.

Further, a letter from counsel had made similar statements, and the family head had written individually to express his contentions to the parties. On these facts, the court believed there was sufficient evidence for the jury to find that the family head was personally liable.

Based on this decision, business owners must be careful when utilizing the LLC structure and remember that LLC status alone does not totally insulate members from personal liability. The structure and use of the LLC must be employed with a focus on subsequent challenges, such as excessive fragmentation of an enterprise, and the members of the LLC must be circumspect in their representations, statements and actions regarding their position and authority.

Related People

- Gilbert C. "Gib" Laite, III ? 919.981.4046 ? glaite@williamsmullen.com
- Michael C. Lord ? 919.981.4093 ? mlord@williamsmullen.com

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