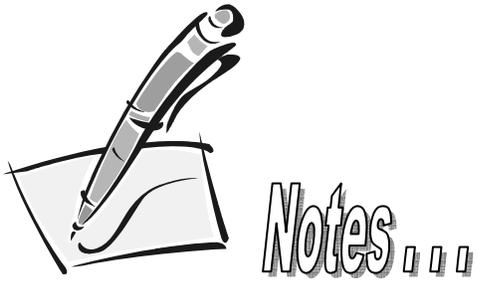




Private Development or “Public Work?” Update on Case Law, Administrative Decisions and Legislation Affecting California Prevailing Wage Laws

Friday, September 23, 2011 General Session; 9:00 – 10:30 a.m.

Ethan Walsh, Best Best & Krieger



Prevailing Wages in California Relevant Law and Case Updates

Ethan Walsh
Best Best & Krieger LLP

I. INTRODUCTION

Over the past decade, cities, redevelopment agencies and other public entities have struggled with a seemingly straightforward question: What is a public work? This is a key question in determining whether or not a construction project is subject to State prevailing wage requirements, which can have a significant impact on labor costs, and in some cases can make the difference in whether or not a project is financially feasible. Prevailing wages, which are wage rates established by the State Department of Industrial Relations (“DIR”), must be paid for any project that is defined as a “public work” under Labor Code Section 1720.¹ In many regions and for many types of work, prevailing wages are much higher than the wages that would be paid on a typical private construction project. The requirement to pay prevailing wages can therefore increase labor costs substantially, and can compromise the financial feasibility of some development projects.

The term “public works” appears to be easily understandable, and in many cases it is. Typical public projects, such as the construction of a city hall or police station, or the expansion of an existing public road, are clearly subject to prevailing wage requirements if paid for and constructed by a general law city or other public entity.² However, many construction projects are more complex and involve an intertwining of public and private sector resources and responsibilities. These

¹ All statutory references in this paper are to the California Labor Code, unless noted otherwise.

² The question of whether State prevailing wage requirements apply to charter cities is the topic of the *State Building and Construction Trades Council of California, AFL-CIO v. City of Vista* case, which is currently pending before the California Supreme Court. The *City of Vista* case is discussed in Section IV of this paper.

projects can blur the lines between public works and private construction, calling into question when and to what extent prevailing wages must be paid.

In 2001, the State Legislature passed Senate Bill 975 (“SB 975”), which made substantial amendments to the definition of “public works” as set forth in Labor Code Section 1720. SB 975 expanded the types of projects that are subject to prevailing wages, but did so in a way that is disjointed and difficult to follow. Many cities and redevelopment agencies were uncertain when prevailing wages would apply to projects in their jurisdiction for many years following the adoption of SB 975. This uncertainty continued for several years due to the lack of published case law interpreting the new definition of public works.³

In the past year, however, three new Court of Appeal opinions have been published that interpret the definition of “public works” set forth in Section 1720, giving cities and redevelopment agencies additional guidance regarding the scope of State prevailing wage requirements. This is not an entirely positive outcome for public agencies, because these opinions take a broad view of prevailing wage requirements and thus limit public agencies’ flexibility in encouraging or facilitating development within their jurisdictions.

This paper provides an outline of State prevailing wage requirements and the definition of “public works” as set forth in Labor Code Section 1720, and discusses the Court of Appeal opinions that have been issued on State prevailing wage requirements over the past year: *Azusa Land Partners v. Department of Industrial*

³ When an interested party wants to determine whether or not a construction project is subject to prevailing wage requirements, that party will typically seek a determination from DIR on whether or not that project is a “public work” under Section 1720. The DIR’s initial determination may be appealed internally to DIR, and after a decision on appeal the party can file a petition for writ of mandate to seek judicial review of DIR’s determination. This is a lengthy process, and as a result it generally takes several years to go from an initial determination to a Court of Appeal decision. In the past, DIR maintained a list of “precedential” administrative determinations to give interested parties guidance in how to interpret Section 1720, but DIR discontinued that practice in 2007. The DIR still lists all determinations on its website at www.dir.ca.gov/dlsr/PWDecision.asp, and they remain helpful to gain insight into how DIR interprets Labor Code section 1720. However, these determinations do not have precedential value, and parties should not rely on them in determining whether or not prevailing wages apply to a given project.

Relations (2010) 191 Cal.App.4th 1; *Oxbow Carbon & Minerals, LLC v. Department of Industrial Relations* (2011) 194 Cal.App.4th 538; and *Hensel Phelps Construction Company v. San Diego Unified Port District* (2011) 197 Cal.App.4th 1020. Lastly, the paper concludes with a brief discussion of the *State Building and Construction Trade Council of California, AFL-CIO v. City of Vista* case that is pending before the California Supreme Court, in which the Court will decide whether charter cities can exempt themselves from State prevailing wage requirements.

II. STATE PREVAILING WAGE REQUIREMENTS FOR “PUBLIC WORKS”

California law has included State prevailing wage requirements since 1931, when the Legislature adopted the Public Wage Rate Act. The current requirements are set forth at Labor Code Section 1720 *et seq.* State law requires that all workers employed on a public works project of more than \$1,000 must be paid the general prevailing rate of per diem wages for the work being performed. (§ 1771.) This requirement does not apply to work done by a public agency’s own forces. (*Id.*) The prevailing wage rates for various job classifications in each locality are set by the DIR, generally based on wage rates paid in the locality and the nearest market area to a majority or the largest number of workers in a given classification. (§ 1773.9.)

The definition of “public works” is set forth in subdivision (a) of Labor Code Section 1720. Subdivision (a) includes six categories of projects that are public works, but the primary category is in paragraph (a)(1), which declares that public works include “[c]onstruction, alteration, demolition, installation or repair work done under contract and *paid for in whole or in part out of public funds,*” except for work done by a public utility by order of the PUC or other public authority. (§ 1720 (a)(1) [emphasis added].)⁴ Paragraph (a)(1) also specifies that “construction”

⁴ The other five categories of “public works” listed in subdivision (a) are the following: (2) Work done for irrigation, utility, reclamation and improvement districts and other districts of this type; (3) street, sewer or other improvement work done under the direction and supervision of a public agency; (4) laying of carpet done under a building lease-maintenance contract and paid for in whole or in part out of public funds; (5) laying of carpet in a public building done under contract and paid for in whole or in part out of public funds; and (6) public transportation

includes work performed during the design and preconstruction phases of a project, including but not limited to inspection and land surveying work. (Id.)

Subdivision (b) of Section 1720 expands on paragraph (a)(1) by providing further defining the phrase “paid for in whole or in part out of public funds.” “Paid for in whole or in part out of public funds,” according to subdivision (b), means all of the following:

1. The payment of money or its equivalent by the state or political subdivision directly to or on behalf of the contractor or developer;
2. Performance of construction work by the public agency in execution of the project;
3. Transfer by the public agency of “an asset of value for less than fair market price;”
4. Fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of the contract that are paid, reduced, charged at less than fair market value, waived or forgiven by the public agency;
5. Money loaned by the public agency that is repaid on a contingent basis; and
6. Credits that are applied by the public agency against repayment obligations to the public agency.

Next, subdivision (c) of Section 1720 *exempts* certain projects or portions of projects from prevailing wage requirements notwithstanding the broad definition of “paid for in whole or in part out of public funds” set forth in subdivision (b).⁵ The projects exempted by subdivision (c) include:

1. Private residential projects built on private property, unless built pursuant to an agreement with a state agency, redevelopment agency or housing authority;

demonstration projects authorized pursuant to Section 143 of the Streets and Highways Code.

⁵ Subdivision (d) of Section 1720 contains additional exemptions from prevailing wage requirements, but those exemptions have sunsetted under the terms of the statute.

2. If the State or a public agency requires a developer to perform construction, alteration, demolition, installation or repair work on a public work of improvement as a condition of regulatory approval on an otherwise private development project, and the state public agency contributes no more money or the equivalent of money to the overall project than is required to perform the public improvement work, and the state or public agency maintains no proprietary interest in the overall project, then only the public improvement work is subject to prevailing wage requirements;
3. Private development projects that receive a direct or indirect public subsidy from the state or a local public agency, if the subsidy is *de minimus* in the context of the project;
4. Construction or rehabilitation of low or moderate income housing that is paid for solely with redevelopment agency low and moderate income housing funds or a combination of low and moderate income housing funds and private funds;
5. Tax credits provided pursuant to Section 23649 of the Revenue and Taxation Code are not considered public funds that trigger prevailing wages; and
6. Private residential projects that meet any of the following five conditions (so long as prevailing wages are not required by another public funding program):
 - a. Construction of a self-help housing project in which the homebuyers performed at least 500 hours of construction work;
 - b. Rehabilitation or expansion of a not-for-profit facility operated as temporary or transitional housing for homeless persons with a project cost of less than \$25,000;
 - c. Construction or rehabilitation of a single family home where the owner receives mortgage assistance, down payment assistance or assistance for rehabilitation of the home;

- d. Construction, expansion or rehabilitation of a private, not-for-profit facility operated to provide emergency or transitional shelter and ancillary services and assistance to homeless adults and children, so long as 50% of the total project costs are from non-public sources; or
- e. Construction of a residential project where occupancy of at least 40% of the units are restricted for at least 20 years by deed or regulatory agreement to individuals or families earning no more than 80% of the area median income.

(§ 1720(c)(1)-(6).)

While this definition of public works is detailed, numerous questions arise when applying specific facts to the definition. Two fundamental questions that come up on a recurring basis in prevailing wage disputes are the following:

1. What is the scope of the construction work that is subject to prevailing wage requirements? Development projects frequently include multiple facets and phases. Private development often includes the construction of public improvements in conjunction with the project. It is often unclear how far the prevailing wage requirement spreads, and as a result this question frequently comes up in prevailing wage disputes. This question is addressed in both the *Azusa Land Partners* and *Oxbow Carbon & Minerals* cases discussed in Section III below.

2. What constitutes a “payment of public funds?” While the definition of “paid for in whole or in part out of public funds” set forth in subdivision (b) of Section 1720 is extensive, the categories of “payments” that trigger prevailing wages are less than clear. Further, even if there is a payment of public funds under subdivision (b), the parties must determine whether the project qualifies for one of the exemptions in subdivision (c). This can require a complex and somewhat subjective analysis. This question is discussed in both *Azusa Land Partners* and *Hensel Phelps Construction*, as discussed below.

Questions regarding prevailing wages typically arise in connection with private development projects that include some amount of public assistance or participation. The private developer is not normally subject to prevailing wage

requirements, but if a public agency makes a payment of public funds as described in subdivision (b) of Section 1720 in connection with the project, prevailing wages can be triggered. The payment of public funds that triggers prevailing wage requirements, could be the conveyance of property for less than fair market price, a fee waiver, a contingent or forgivable loan, or any of the other categories of assistance listed in subdivision (b). Cities and redevelopment agencies have traditionally used many of these mechanisms to encourage economic development and redevelopment in their jurisdictions. If a payment of public funds is made for construction undertaken by a private party, that private party will have to pay prevailing wages on the work, which may significantly increase labor costs and compromise the financial feasibility of the project.

While the potential for triggering prevailing wage requirements certainly creates financial risks for developers that work with cities and redevelopment agencies, it also creates problems for the cities and redevelopment agencies. First, cities and redevelopment agencies typically want these projects to move forward. If labor costs increase due to prevailing wage requirements, the city or agency often has to increase the public assistance to the project if it is to proceed. The city or agency will not be able to assist as many redevelopment or economic development projects. Secondly, the public agency can have exposure to liability for the increased costs that arise as a result of the prevailing wage requirement. Under Labor Code Section 1781, if a contractor incurs increased costs as the result of a determination that prevailing wages apply to a construction project, where the public body did not notify the contractor that the project was a public work in advance of construction, the contractor can bring an action against the public body to recover those increased costs, including any penalties for failure to pay prevailing wages. (§ 1781(a)(1).) The public agency can avoid liability under this section if (1) it does not directly contract with the public agency, (2) the public agency specifically stated in the document by which it undertook the construction project that the construction to be completed is a public work subject to prevailing wage requirements, and (3) the public agency fulfilled all its duties regarding the provision of bonds to secure payment of contractors. (§ 1781(a)(2).) As a result, of

this requirement, cities and redevelopment agencies frequently take a conservative approach and require prevailing wages to protect against liability under Section 1781, or insist that the developer indemnify the city or agency against liability related to prevailing wages. Given the potential exposure faced by public agencies for failure to pay prevailing wages, it is important for public agencies to remain informed on the scope of prevailing wage requirements.

III. RECENT CASE LAW ON “PUBLIC WORKS”

A. Azusa Land Partners v. Department of Industrial Relations

Azusa Land Partners involves the development of a master planned community known as the “Roseland project” on over 500 acres in the City of Azusa that was previously owned by Monrovia Nursery. The Roseland project contemplates the development of over 1,200 homes, approximately 50,000 square feet of commercial development and associated public infrastructure and facilities.

In order to finance a portion of the costs of public facilities and improvements required under the terms of the development agreement, the City and Developer agreed to establish a community facilities district (the “CFD”) that would issue Mello-Roos bonds. The Developer entered into a series of agreements to construct certain “Eligible Facilities,” which would be owned and operated by the City and other public entities. The Eligible Facilities were listed in the CFD formation documents as improvements that *may* be funded with Mello-Roos bond proceeds. A smaller subset of the Eligible Facilities, referred to as the “Publicly Financed Facilities,” were *actually* funded with proceeds of the Mello Roos bonds. Following formation, the CFD issued approximately \$71 million in bonds to fund the construction of the Publicly Financed Facilities. The total cost of the Eligible Facilities was approximately \$146 million. The public improvements that were not financed with Mello-Roos bonds, estimated to cost approximately \$77 million, were to be privately financed by the Developer.

In October 2005, an initial request was filed with DIR for a determination that the entire Roseland project is a public work subject to payments of prevailing

wages. The Developer informed the DIR that it intended to pay prevailing wages on the Publicly Financed Facilities that were funded with bond proceeds, but was not required to pay prevailing wages for the other privately financed public improvement work.

The DIR determined that the use of bond proceeds for the construction of public infrastructure and facilities constitutes a payment of public funds, and as a result, the *entire Roseland project* is a public work under the definition set forth in Section 1720(a)(1). However, the DIR also found that the project qualified for the exemption set forth in Section 1720(c)(2), which states that if the public funds contributed to the overall project are no more than the amount required to construct public improvements that the Developer must complete as a condition of regulatory approval for the overall project, then only the public improvements are subject to state prevailing wage requirements. (§ 1720(c)(2).) As a result, the DIR determined that the developer of the Roseland project did not have to pay prevailing wages on its private development, but it did have to pay prevailing wages for *all* public facilities and improvements constructed in connection with the Roseland project, including the public improvements that were being financed solely by the developer.

The DIR's original determination was upheld on administrative appeal, and was affirmed by the trial court after the developer filed a petition of writ of mandate for review of the DIR determination. The developer appealed the trial court ruling.

On appeal, the developer first argued that the privately financed improvements were not part of a "public work" at all, because the CFD is an "improvement district," and the work conducted by the Developer with Mello-Roos bond funds was separate work "done for an improvement district" and is subject to the prevailing wage requirement based on Labor Code Section 1720(a)(2). Since the CFD funded work was governed by paragraph (a)(2), the remaining work was not paid for with public funds and was not subject to prevailing wage requirements.

The Court disagreed with this argument. Even if paragraph (a)(2) did apply, the Court declared that the *entirety* of the public facilities and improvements were done for the CFD, not just the Publicly Financed Facilities. The Court reasoned that

all the improvements were eligible for funding from the CFD, as they were listed as Eligible Facilities in the CFD documents. The Court reasoned that even if it did not directly fund the additional public improvements, all the improvements were work done for the CFD. Further, the Court asserted that even if subdivision (a)(2) did apply to the work paid for with the CFD bond funds, subdivision (a)(1) could simultaneously apply to the larger development project. The Court reasoned that the six categories of work listed as public works in subdivision (a) were overlapping. The Court could find that the entire project was a public work under paragraph (a)(1), regardless of whether or not other paragraphs under subdivision (a) applied as well.

The Developer next argued that Mello-Roos bonds are simply a financing mechanism that the Developer, a private entity, can utilize to construct the public improvements required to be built in connection with private development. The funds are not public funds, but instead come from the bondholders as a result of the issuance of Mello-Roos bonds, and therefore do not constitute a payment of public funds that triggers prevailing wages.

The Court did not agree with this argument either. The Court acknowledged that in previous administrative determinations, the DIR had determined that proceeds from bonds, where the public agency acted solely as a conduit issuer, did not constitute public funds that trigger prevailing wage requirements. Mello-Roos bonds, however, are distinguishable from those conduit issuances. In the *Rancho Santa Fe Village Senior Affordable Housing Project* determination (Public Works Case No. 2004-016), the DIR found that proceeds from tax exempt low income housing bonds issued by CSCDA did not trigger prevailing wages because CSCDA acted solely as a conduit to facilitate the issuance, but never held or controlled any of the bond proceeds of the project. The Court distinguished the Roseland CFD from that administrative determination. In the Roseland project, the City, acting through the CFD, does not serve solely as a conduit for the issuance of the bonds. It is integrally involved in the approval and funding of the construction work. The City manager or finance director must authorize payment for the construction work, and no payments are made until the improvements are constructed and approved as in

compliance with the approved plans. Therefore, in the Court's view, the bond proceeds were public funds that were used to pay for the public improvements, and work performed on the Roseland project was a public work triggering prevailing wage requirements.

Lastly, the Developer argued that even if the Mello-Roos financing did constitute public funds, the "public work" that was subject to prevailing wage requirements was only the construction work that was actually paid for in whole or in part out of public funds. The other construction projects that were paid for solely with private financing should not be subject to prevailing wage requirements.

The Court refused to find that only those public improvements that are paid for with the Mello-Roos bond proceeds are subject to prevailing wage requirements. The Court asserts that both the definition of "public works" in subdivision (a)(1) and the partial exemption in (c)(2) require that prevailing wages apply to the "overall project," while allowing an exemption for the purely private components of the project. The Court asserts that it is appropriate, given the statute's intended goal of ensuring payment of prevailing wages for all public works, to interpret the scope of the prevailing wage requirements to apply broadly. Failure to look at the overall project would allow developers to funnel any needed public subsidy to a limited number of improvements, solely to minimize the developer's prevailing wage liability. This outcome, in the Court's view, would severely limit the effect of the state prevailing wage laws. Therefore, the "public work" is the entire development project. While the private improvements are exempted from prevailing wages by subdivision (c)(2), the Court refused to accept that only those improvements that receive direct public funding should be subject to prevailing wages.

It is not surprising that the Court found that the Mello-Roos bond proceeds constitute public funds that trigger prevailing wage requirements. The Court's broad interpretation of the "project" that is subject to prevailing wages, however, is troubling and will be difficult to apply in many situations. Many large scale projects move forward in multiple phases over an extended period of time. The Developer will not necessarily know how it intends to finance the public improvements in the later phases at the time it commences with the first phase of a development. If the

Developer of a large scale project were to decide to utilize CFD financing for public improvements in a later phase of development, it is not clear how the Court's broad interpretation would apply to the earlier phases of development.

Regardless of the outstanding questions raised by *Azusa Land Partners*, it is clear that cities and developers should avoid trying to segment larger projects to avoid prevailing wage requirements. The Court took a broad view of the scope of the public work that was subject to prevailing wages, and cities and developers should anticipate that the DIR and future courts will do so as well. Cities should take care to limit their exposure to liability for prevailing wage costs that may be incurred by developers through development agreements, subdivision improvements agreements, or other entitlement approvals that could be interpreted to result in a payment of public funds to the Developer.

B. Oxbow Carbon & Minerals, LLC v. Department of Industrial Relations

Similar to *Azusa Land Partners*, the *Oxbow Carbon & Minerals* case also addresses the scope of the project that is subject to prevailing wages. Until 2003, a company called AIMCOR leased property from the City of Long Beach at the Long Beach Pier, where it stored petroleum coke, a by-product of the oil refining process, in a four walled structure that was open at the top. AIMCOR would dump coke into this structure from overhead, and then convey it out from the floor of the structure to ships in the harbor. However, changes to air quality regulations in 2001 prohibited the storage of coke in open-air facilities, and AIMCOR was prohibited from storing coke in the existing structure.

In 2003, AIMCOR merged with Oxbow Carbon & Minerals, LLC ("Oxbow"), and Oxbow planned to reinstate operations at the Long Beach facility leased from the City. In order to do so, Oxbow had to install a roof on the existing structure in order to comply with air quality regulations. In addition to the roof, Oxbow planned to construct a conveyor system to transport coke to and from the facility. In 2005, the City and Oxbow amended their existing lease to provide that the City would reimburse Oxbow up to \$2,258,000 for the construction of conveyors on the property, and that ownership of the conveyors would be transferred to the City

upon completion of the construction work and reimbursement of Oxbow. The lease amendment explicitly provided that Oxbow must pay prevailing wages for the construction of the conveyor system, but did not address the construction of the roof on the existing structure.

Oxbow entered into a contract for the erection of the new conveyor system, and a separate contract with a different contractor for the design and construction of a roof for the structure. The two construction projects were undertaken simultaneously.

A local union requested a determination from DIR as to whether prevailing wages must be paid for construction of the roof, as well as the conveyors. The DIR issued an initial determination declaring that the roof and conveyor construction work produced a single structure that could be used for the storage and distribution of coke, and therefore both contracts constituted a single integrated public works project that was paid for in part out of public funds, and therefore is subject to prevailing wage requirements. The DIR's determination was upheld on administrative appeal. Oxbow filed a petition for writ of mandate, and the trial court affirmed the DIR's decision. On appeal, Oxbow did not dispute that the contract for the conveyor was subject to prevailing wages, but asserted that the contract for the roof enclosure was a separate project, paid for solely with private funds, and should not be subject to prevailing wage requirements.

The Court disagreed, holding that the conveyor and enclosure work, taken together, converted an unusable structure to a functioning coke receiving and storage facility, and therefore should be treated as a single integrated public work. The two projects were built under separate contracts, but Oxbow did not pursue the contracts for separate, independent purposes. Oxbow proceeded with the two contracts at the same time, and the design of the roof and conveyor system was integrated to allow for the conveyance of coke in the structure. The Court determined that allowing Oxbow to segment the project would encourage private parties to funnel all public assistance into a single component of a larger project, and thereby limit their prevailing wage liability.

As with *Azusa Land Partners*, the holding in *Oxbow Carbon & Minerals* serves as further reminder that there is significant risk in segmenting larger projects and only paying prevailing wages for the portions that are funded with public money. *Azusa Land Partners* and *Oxbow* should both serve as a reminder to carefully review any projects that are partially funded with public funds, and consider the extent to which the prevailing wage requirements will apply to the project.

C. *Hensel Phelps Construction Company v. San Diego Unified Port District*

The *Hensel Phelps* case involves the development of a hotel project on a waterfront parcel near the San Diego Convention Center, and whether a rent credit provided under the terms of a ground lease from the Port District to the developer of the hotel project constitutes a payment of public funds triggering prevailing wage requirements. The Port District owns a parcel on the waterfront near the Convention Center, and in 2002 issued a request for proposals for a hotel to be built on the Property. The RFP called for the development of a four-star quality hotel containing 1,000-1,200 guest rooms and other specified amenities.

The Port District selected Hilton San Diego Convention Center LLC (“Hilton”) to develop the hotel project and entered into an option agreement with Hilton. Hilton had indicated to the Port District that a direct subsidy of \$26.5 million would be required to make the project financially feasible. In lieu of that subsidy, the parties agreed that the Port District would provide a “rent credit” as discussed below. Hilton assigned the option agreement to One Park Boulevard, LLC (“OPB”) at the end of 2005, and OPB entered into the lease agreement with the Port District.

The lease provided that OPB shall pay rent to the Port District based on percentage rents for a variety of income producing activities by the hotel (such as room rentals, food sales and beverage sales), with a guaranteed minimum annual rent during the first two years of \$2,250,000 and \$4,500,000 for the third through 20th years. However, the lease further provides for a credit of 100 percent of the monthly rent for the first 34-36 months of the lease (depending on the length of the construction period), and 60 percent of the monthly rent thereafter, until the earlier of (i) the end of the 11th year of the lease, or (ii) the time that the total rent credited

equals \$46.5 million. Hensel Phelps served as the construction manager on the project.

Following commencement of construction, the Carpenters/Contractors Cooperation Committee (“CCCC”) sought a determination from DIR that the construction of the hotel project was public work subject to state prevailing wage requirements. The DIR determined in its initial ruling and on administrative appeal that the rent credit provided for in the Lease constituted a payment of public funds under subdivision (b)(4) of Section 1720 (“rents . . . that are . . . paid, reduced, charged at less than fair market value, waived or forgiven.”), and therefore prevailing wages must be paid on the hotel construction. Hensel Phelps filed a petition for writ of mandate seeking to overturn the DIR’s determination. The trial court concluded that the terms of the lease did *not* result in a payment of public funds. The trial court reasoned that the rent credit was not a reduction, waiver or forgiveness of rent, because the credit was built into the terms of the lease, and therefore there was no baseline amount of rent that was waived or reduced. Additionally, the Port District had obtained an appraisal declaring that the overall rent for the full term of the lease would provide a fair market return for the District. That appraisal, coupled with the fact that the lease was the product of an arms-length transaction between sophisticated parties, demonstrated that the rent was not charged at less than fair market value. The CCCC, which had intervened in the trial court proceedings, appealed the trial court decision. The Court of Appeal overturned the trial court, and found that the lease terms did constitute a payment of public funds triggering payment of prevailing wages for the hotel construction.

On appeal, OPB argued that the construction of the hotel was not “construction . . . done under contract” within the meaning of the prevailing wage laws, because the Port District did not directly contract for any construction work, but instead had simply entered into a lease with OPB. The Court disagreed, noting that the lease agreement required OPB to construct a hotel on the Property according to the Port District’s specifications and to spend certain minimum amounts on construction, with the ultimate goal of developing a waterfront hotel. The court points out that if the prevailing wage requirements were intended to

apply only to construction done under contract directly with a public agency, the definition of "paid for in whole or in part out of public funds" would largely be rendered meaningless. The types of subsidies contemplated in subdivision (b) (transfer of assets for less than fair market price, fee waivers, rent reductions, etc.) would never be utilized to pay a contractor directly for work. The court therefore held that the construction work on the hotel was construction work done under contract for purposes of Labor Code Section 1720.

Secondly, the Court held that the rent credit granted to OPB did constitute a payment of public funds under Section 1720(b). The court reasoned that the rent credit resulted in a reduction in the guaranteed minimum rent set forth under the terms of the lease. In the Court's view, the minimum rent served as the baseline, and the credit provided over the first 11 years reduced that rent, resulting in a payment of public funds under paragraph (b)(4) of Section 1720.

The Court was also not swayed by the Petitioners' argument that even with the rent credit, the total amount of rent to be paid over the term of the lease would be equal to fair market value. The Court reasoned that determining the fair market value of the rent payments over the life of the lease would be overly complex, especially in light of the clear indication that the rent was reduced through the rent credit.

The Court's refusal to give credence to the argument that OPB was in fact going to pay fair market rent over the course of the lease is troubling. Leases are structured in a wide variety of ways for legitimate business purposes, and courts should give careful consideration to whether the public agency is receiving a fair market return. In complex public-private development transactions where the parties believe that prevailing wages are not merited, the parties often obtain fair market value appraisals to demonstrate that the public entity is not conveying property for less than fair market price. The Court's refusal to consider this information in light of the more straight-forward argument that the rent credit reduced the rent is cause for some concern because it indicates that the courts may not defer to this type of market data. However, the Court's reluctance to give credence to the market data appear to be based in large part on the specific facts of

this case. As noted above, the early reports to the Port District indicated that a subsidy would be needed for the hotel development to be financially viable, and the rent credit was granted in place of a direct \$26.5 million subsidy to the project. Further, under the terms of the lease, OPB was to pay *no rent* for the first three years of the lease. In light of these facts, it is not surprising that the Court of Appeal overturned the trial court and upheld the DIR's determination.

IV. CHARTER CITIES AND *CITY OF VISTA*

One of the most eagerly awaited prevailing wage decisions is currently pending before the California Supreme Court. In the *State Building and Construction Trades Council of America, AFL-CIO v. City of Vista*, the California Supreme Court is expected to issue an opinion on whether or not charter cities can exempt themselves from prevailing wage requirements for local public works projects. This case is fully briefed, but has not yet been set for oral argument.

For many years, some charter cities have exempted themselves from prevailing wage requirements for public works projects constructed solely with local funds based on a 1932 California Supreme Court case holding that the Public Wage Rate Act (the predecessor to today's State prevailing wage law), did not apply to charter city's contract for a fence built around a municipal reservoir. (*City of Pasadena v. Charleville* (1932) 215 Cal. 384.) The Supreme Court held that the construction of the fence was a municipal affair under Article XI, Section 5 of the California Constitution. Article XI, Section 5 declares that with respect to municipal affairs, a city charter shall supersede any inconsistent state laws. Because the construction of the fence was a municipal affair, the City was not subject to state prevailing wage laws for construction of the fence. In addition to *Charleville*, a more recent (but very cursory) Court of Appeal decision in *Vial v. City of San Diego* (1981) 122 Cal.App.3d 346 declared that the City of San Diego, as a charter city, is not subject to state prevailing wage requirements.

The ability of charter cities to exempt themselves from prevailing wage requirements was called into question in 2003 when the Court of Appeal held in *City of Long Beach v. Department of Industrial Relations* (2003) 110 Cal.App.4th 636 that

the payment of prevailing wages should be considered a matter of *statewide* concern, and a charter city could not exempt itself from state prevailing wage requirements. That decision was *overturned* by the California Supreme Court, but the Supreme Court's ruling was based on the fact the purported public assistance at issue in that case was for pre-construction expenses, and did not constitute a payment of public funds for construction work under the pre-SB 975 definition of public works. (*City of Long Beach v. Department of Industrial Relations* (2004) 34 Cal.4th 942.) The Supreme Court did not address the issue of whether payment of prevailing wages constituted a municipal affair. Notwithstanding the fact that the *City of Long Beach* Court of Appeal decision was overturned, the Supreme Court's refusal to address the charter city issue left some uncertainty over whether payment of prevailing wages on local public works remained a municipal affair.

The City of Vista became a charter city in 2007, and shortly after the charter was adopted, the City Council enacted an ordinance declaring that the City is not required to pay prevailing wages on local public works projects. The Petitioners sought a writ of mandate directing the City to comply with state prevailing wage laws, notwithstanding the City's ordinance declaring it was not subject to state requirements. The trial court denied the petition and the Petitioners appealed. The Court of Appeal affirmed the trial court decision in an extensive opinion, declaring that prevailing wages remained a municipal affair under Article XI, Section 5. The Petitioner filed a petition for review with the California Supreme Court, which was granted in August 2009. The case has been fully briefed since February 2010, but has not been set for oral argument yet. In September 2010, the Court issued an order to the parties directing them to limit their argument to the following issue: "Does the Prevailing Wage Law (Lab. Code §1720 et seq.) apply to Charter Cities?" Based on this order, it appears that the Court's opinion will directly address the charter city question. Charter cities eagerly await this decision and the clarity it will bring regarding their ability to govern the payment of wages on local public works.

V. CONCLUSION

These new cases reaffirm that public agencies should be sensitive to the potential application of prevailing wages to development projects that include some level of public participation, and should take steps to protect themselves against exposure in the event that the DIR or a court determines that prevailing wages should be paid. In each of these recent cases, the courts emphasize the State's goal of ensuring prevailing wages be paid on all public works, and choose to interpret Section 1720 broadly as a result. In particular, public agencies should carefully consider any efforts to segment a development into multiple projects, and only pay prevailing wages on some of those "projects." While this approach may be appropriate in some cases, public agencies should consider the broad interpretation of the applicable project in the *Azusa Land Partners* and *Oxbow Carbon & Minerals* cases when deciding the extent to which prevailing wages are likely to apply to a given project. Additionally, the *Hensel Phelps Construction* case should serve as a reminder that public agencies and developers should consider prevailing wage implications in structuring any public-private transaction, and should be aware that any agreement that offers credits, waivers, or payments by the public agency for the benefit of the developer may trigger prevailing wages, even if the public agency and developer provide evidence that the overall transaction provides the public agency a market rate return. While charter cities may obtain some clarity in the coming months on whether or not they must pay prevailing wages for local public works, general law cities still must grapple with many unanswered questions related to prevailing wages, and should exercise caution when evaluating the extent to which prevailing wages apply.