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CLIENT ALERT

JANUARY 4, 2011

COURT OF APPEAL EXPANDS REACH OF CALIFORNIA'S PREVAILING WAGE LAW TO COVER PRIVATELY-FINANCED CONSTRUCTION

In one of the most significant California appellate decisions of 2010, the Court of Appeals, Second Appellate District, has adopted completely the expansive interpretation of section 1720 of the California Prevailing Wage Law (Labor Code § 1720, *et seq.* ("Prevailing Wage Law")) advanced by the Director of the California Department of Industrial Relations ("DIR"). In *Azusa Land Partners v. Department of Industrial Relations* (Dec. 21, 2010, No. B218275) 2010 WL 5158551, the Court held for the first time that (a) the Prevailing Wage Law, both before and after the Senate Bill 975 amendments in 2001, renders an entire private master development a "public works" if any "public funds" are paid toward any construction done under contract within the overall development, (b) Mello-Roos funds are "public funds," and (c) the payment of public funds toward construction of one public improvement within a development necessitates the payment of prevailing wages on all other public improvement projects within the development that are privately financed. The Court further suggests that a Mello-Roos community facilities district is an "improvement district" referenced in section 1720(a)(2) of the Prevailing Wage Law and that all construction of all eligible projects within the community facilities district list of eligible projects constitute work "done for the improvement district." Consequently, prevailing wages must be paid on all such projects whether they ever receive Mello-Roos funds or not.

The case arose out of the Rosedale Project master planned community in the City of Azusa. At its inception, the Rosedale Project contemplated development of over 1,200 homes, 50,000 square feet of commercial space, and a number of typical, related public infrastructure and improvement projects (including school, rail, sanitation district, road, bridge and utility construction). The developer agreed to construct each of the public improvements. The Development Agreement provided that construction of these various public projects was a condition of approval of the overall development. A Community Facilities District was established under the Mello-Roos Act (Government Code § 53311, *et seq.*) to issue bonds to cover a portion of the costs of construction of some of the public improvements. All of the public improvement projects were listed as "Public Improvements" eligible for Mello-Roos funds. As is typical, the Mello-Roos bond proceeds did not generate sufficient monies to pay for every one of the public improvement projects, but instead produced approximately $71 million of the $146 million necessary to complete all of the Public Improvements. Once the proceeds of the Mello-Roos bonds were known, the developer and the City amended a Funding and Acquisition Agreement to specify which of the various listed Public Improvements would be eligible for reimbursement. As required by the Mello-Roos Act, those public improvement projects that were to be paid for with proceeds from the Mello-Roos bonds would be constructed in compliance with the Prevailing Wage Law.

The Southern California Labor/Management Operating Engineers Contract Compliance Committee sought an opinion from the Director of the DIR that the entire Rosedale Project – including each of the Public Improvements and all private construction – was a "public works" subject to the Prevailing Wage Law because the Project was "paid for in whole or in part out of public funds," *i.e.*, the Mello-Roos bond proceeds, and fell within the definition of a "public works" in section 1720(a). The Director agreed that the entire Rosedale Project development was a "public works", but determined that section 1720(c)(2) of the Prevailing Wage Law caused only the $146 million of Public Improvement work to be subject to prevailing wage requirements, regardless of whether any particular public improvement was constructed with Mello-Roos funds or private funds.

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The developer challenged the Determination of the Director in the Superior Court by way of a writ of mandate. The Superior Court upheld the Director's Determination, and an appeal was brought to the Court of Appeal. In affirming the trial court's judgment, the Court of Appeal adopted the Director's new, all-encompassing interpretation of the Prevailing Wage Law.

The Prevailing Wage Law imposes prevailing wage and other requirements on "public works" as defined by the statute. Historically, and under the primary definition in section 1720(a), "public works" have been those specific works of construction which are performed under contract and paid for in whole or in part out of public funds. From inception, the Prevailing Wage Law was intended to define a subset of the universe of works of construction commonly known to be "public" works (such as roads, bridges, dams, schools, libraries, etc.) and to impose prevailing wage payment obligations only on the specific public works that fall within this subset of all public works. Public works paid for with public funds are within this subset. Public works built with private funds and later dedicated to the public have never been, except in very limited circumstances, subject to prevailing wage requirements.

This focus on the work of construction to determine what is a "public works" subject to the Prevailing Wage Law has been the accepted analytical approach to application of the Prevailing Wage Law since it was enacted in 1931. However, the Court of Appeal in *Azusa Land Partners* rejected this long-understood focus of the Prevailing Wage Law. Instead, the Court ruled that the Prevailing Wage Law, as it existed before the amendments of SB 975, applies to the "overall scheme of improvement," the entire master-planned development if any construction within that overall development is paid for by public funds. The Court went on to find that the amendments of SB 975 (specifically, section 1720(c)(2)) were intended to "limit" the prevailing wage requirements on a master development deemed a "public works". Section 1720(c)(2) provides that if on an "otherwise private development project… the state or political subdivision contributes no more money, or the equivalent of money… to the overall project than is required to perform this public improvement work, and the state or political subdivision maintains no proprietary interest in the overall project, then only the public improvement work shall thereby become subject to the [Prevailing Wage Law]." The Court determined that under this section, the private development portion of the Rosedale Project is not subject to the Prevailing Wage Law, but all of the various public improvements (whether paid for with Mello-Roos bond funds or private funds) are subject to the Prevailing Wage Law.

This new "development-wide" approach to application of the Prevailing Wage Law may have far reaching implications if it is not reversed by the California Supreme Court. While the DIR has advanced this theory since it dramatically re-interpreted the Prevailing Wage Law in 2000, no appellate court has heretofore ratified it. The Supreme Court in *City of Long Beach v. Department of Industrial Relations* (2004) 34 Cal.4th 942, and the Court of Appeal in *Greystone Homes, Inc. v. Cake* (2005) 135 Cal.App.4th 1, impliedly rejected this interpretation. And the Court of Appeal in *State Building and Construction Trades Council of California v. Duncan* (2008) 162 Cal.App.4th 289, provided an analytical framework for interpretation of the Prevailing Wage Law post-SB 975 that would not likely have resulted in this holding.

Under this decision, if public funds are paid toward any work of construction within any discrete project or phase within a master-planned development, one must assume that the entire development is a "public works". The extent of the prevailing wage obligations imposed as a result of this label attaching depend on whether any of the exceptions to the statute are met and which exceptions those are. The consequences of a failure to structure a transaction properly may be the imposition of prevailing wages on the entire build-out of a development that is overwhelmingly a privately-financed, privately-owned development.

And, contrary to the historic interpretations of the Prevailing Wage Law and of the Mello-Roos Act, all public works of construction privately financed will now be required to be built with prevailing wages if any public work of construction within the overall development receives any public funds. In the case of the Rosedale Project, the result is that the $75 million of public improvement projects which the developer was obligated to build as a condition of approval and at the developer's expense are now subject to the Prevailing Wage Law.

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