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A Watershed Expansion of California's Prevailing Wage Law Places Privately-Funded Developments and Construction at Risk

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The article, "A Watershed Expansion of California's Prevailing Wage Law Places Privately-Funded Developments and Construction at Risk, " listed below, was also published in the September 2011 issue of *Law Journal Newsletters: Commercial Leasing Law & Strategy* (Volume 24, Number 3).

On December 21, 2010, the Second Appellate District of the California Court of Appeal issued a decision in *Azusa Land Partners v. Department of Industrial Relations* (2010) 191 Cal.App.4th 1, that greatly expands the reach of California's Prevailing Wage Law (Labor Code § 1720, *et seq*. ("Prevailing Wage Law")) to cover private works of construction that have never before been deemed "public works" subject to the Prevailing Wage Law. As a consequence, developers and builders will have to consider closely how they structure their developments and agreements so as to avoid unnecessarily and inadvertently imposing Prevailing Wage Law requirements on privately-funded construction.

In *Azusa Land Partners*, the Court employed a "development-wide" approach to the Prevailing Wage Law, adopting completely the expansive interpretation of section 1720 of the Prevailing Wage Law advanced by the Director of the California Department of Industrial Relations ("DIR"). In its simplest terms, the Court's approach states that the payment of public funds to any work of improvement within

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an overall development causes the entire development to become a "public works" subject to the Prevailing Wage Law. The scope of coverage of Prevailing Wage Law obligations may then be limited if exceptions and limitations in the Prevailing Wage Law are applicable to the particular facts.

Specifically, the Court held that (a) the Prevailing Wage Law as it existed before 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.

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.

Generally, 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. [And works of construction built by private parties with private funds and for use by private parties rather than public agencies were simply never considered to be "public works."]

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 entire master-planned development, the "overall scheme of improvement," if any work of 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.

The practical consequences of the Court's new development-wide approach are numerous:

If public funds are contributed toward any work of construction within an overall development and an exception to the Prevailing Wage Law does not apply – perhaps even technically so – the entire development, including all private construction, could become subject to claims that it is a "public works" and that prevailing wages are required for all work performed on the development, including all private works of construction.

On developments where public improvements are required as a condition of regulatory approval and public funds are paid toward any of the required public improvements, the *Azusa Land Partners* decision imposes prevailing wage requirements on all public improvements, those paid for in part with public funds and those constructed entirely with private funds. Failure to comply with prevailing wage requirements can create exposure not only for unpaid prevailing wages but also for substantial statutory penalties and for the imposition of mechanic's liens on private property.

It is important to recognize that the Court's interpretation that Prevailing Wage Law obligations can attach to an entire master development is a much broader interpretation than has been the understanding of developers and public agencies and their respective attorneys. Accordingly, new consideration should be given to whether the

Prevailing Wage Law as now interpreted may apply to development plans previously believed not to trigger Prevailing Wage Law obligations. The consequences of a failure to structure or re-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.

All discrete projects and phases within a master-planned development may now be found interdependent for Prevailing Wage Law purposes. The actions of the master developer or of one merchant builder in one planning area or of one other subsequent purchaser on one phase of construction elsewhere within the overall development could be claimed to trigger Prevailing Wage Law obligations not just on that party but upon all others engaging in any construction within the overall master development. Master developers, merchant builders and other purchasers need to consider the extent to which they address the possible consequences of public funds being received by any other participant in the overall master development.

Finally, the breadth of the Court's decision and the fact that it limits one exception to the Prevailing Wage Law in an unprecedented manner create a risk that the decision may be used by future courts and litigants to limit the application of other exceptions to the Prevailing Wage Law, such as the exclusions provided for residential developments. Consequently, all development plans should be assessed to determine whether the assumptions used about the applicability of other exceptions to the Prevailing Wage Law remain valid.

The Supreme Court declined to review the Court of Appeal decision in *Azusa Land Partners*. Future legislative action or judicial decisions from other appellate districts may place limits on the effects of *Azusa Land Partners*. Until such time, however, provisions should be made in development agreements and other contracts to address the *Azusa Land Partners* decision depending on the circumstances and construction horizon of the project at issue. Failure to do so could expose substantial privately-funded construction to Prevailing Wage Law obligations.