



JONES DAY
COMMENTARY

CALIFORNIA HOSPITALS AND HEALTH CARE SYSTEMS BEWARE: PROPOSED CALIFORNIA BILL WOULD REQUIRE PAYMENT OF PREVAILING WAGES ON CONSTRUCTION FUNDED BY CONDUIT REVENUE BONDS

A proposed bill in the California Senate defines health care construction projects funded by conduit revenue bonds as “public works” and would require payment of prevailing wages to laborers. Consequently, the cost of hospital and health care construction funded with such bonds could increase substantially. Some opponents of mandating payment of prevailing wages contend that construction costs can be increased by 20 percent or more. Regardless of the wisdom of requiring payment of prevailing wages, those who are planning hospital health care construction in California financed by conduit revenue bonds need to be aware that their construction dollars may not go as far as anticipated should Senate Bill 615 (“SB615”) become law. For this reason, we recommend that hospitals and hospital systems planning to build new facilities or upgrade existing facilities monitor the progress of SB615 to

avoid unpleasant surprises, including potential civil and criminal penalties for noncompliance.

Despite the often robust policy debate over the wisdom of legislation mandating payment of prevailing wages on construction projects, the categories of projects requiring that laborers be paid prevailing wages in California has been and continues to be defined by the California Labor Code. See Cal. Lab. Code § 1720 et seq. In California, prevailing wages must be paid on “public works” projects. Ordinarily, one thinks of “public works” projects as those projects constructed by governmental entities. For example, public works would include construction of a public courthouse, a public school, or a county hospital. But SB615 would expand the definition of “public works” on which prevailing wages must be paid to hospital and health care projects funded, in part or

in whole, by conduit revenue bonds even though the project would otherwise be a private works project on which prevailing wages would not have to be paid.

Conduit revenue bonds are municipal bonds the proceeds of which are utilized by nongovernmental entities (e.g., hospitals and health care facilities). Cal. Gov't Code § 5780. As currently drafted, SB615 would require that any hospitals or health care facilities utilizing conduit revenue bonds to fund construction projects pay prevailing wages for labor on those projects. In other words, hospital or health care construction projects that have traditionally been viewed as "private works" would be transmuted to "public works" simply because conduit revenue bonds were the source of funding. Many private hospitals have turned to conduit revenue bonds to fund new construction and necessary upgrades, meaning that this proposed law could affect many health care construction projects.

The current language of SB615 (the preamble and the proposed statute), which has made it through the California Senate and is currently being reviewed in the Assembly, reads as follows (with certain key language highlighted):

Existing law defines "public works," for purposes of regulating public works contracts, as, among other things, construction, alteration, demolition, installation, or repair work done under contract and paid for, in whole or in part, out of public funds. Existing law further requires that, except as specified, not less than the general prevailing rate of per diem wages be paid to workers employed on public works and imposes misdemeanor penalties for a violation of this requirement. Existing law provides that for the purposes of provisions of law relating to the payment of prevailing wages, "public works" includes specified types of construction, alteration, demolition, installation, and repair work.

This bill would expand the definition of "public works," for the purposes of provisions relating to the prevailing rate of per diem wages, to also include any construction, alteration, demolition, installation, or repair work done under private contract on a hospital or health care facility project when the

project is paid for in whole or in part with the proceeds of conduit revenue bonds, as defined.

Because the violation of prevailing wage requirements when engaged in these public works projects would result in the imposition of misdemeanor penalties, this bill would impose a state-mandated local program.

The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1 . Section 1720.7 is added to the Labor Code, to read:

1720.7. For the limited purposes of Article 2 (commencing with Section 1770) of this chapter, "public work" also means any construction, alteration, demolition, installation, or repair work done under private contract on a hospital or healthcare facility project when the project is paid for *in whole or in part* with the proceeds of conduit revenue bonds, as defined in Section 5870 of the Government Code, issued by a public agency.

SEC. 2. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.

The trigger language being proposed is the categorization of hospital/health care construction work funded by conduit revenue bonds as “public work.” This language, in turn, imposes California Labor Code requirements for payment of prevailing wages. Specifically, the California Labor Code provides that, aside from minor exceptions, all workers on “public works” projects must be paid at least the general prevailing rate of wages.

Except for public works projects of one thousand dollars (\$1,000) or less, not less than the general prevailing rate of per diem wages for work of a similar character in the locality in which the public work is performed, and not less than the general prevailing rate of per diem wages for holiday and overtime work fixed as provided in this chapter, shall be paid to all workers employed on public works.

This section is applicable only to work performed under contract, and is not applicable to work carried out by a public agency with its own forces. This section is applicable to contracts let for maintenance work.

Cal. Labor Code § 1771.

Additionally, the phrase in the proposed legislation, “paid for in whole or in part,” could have far-reaching effects on health care construction projects. As a result of this language, which is common in other Labor Code provisions relating to funding of public works, the use of any conduit revenue bond funds, no matter how limited, could impose an obligation to use prevailing wages for an entire project.

Indeed, in somewhat analogous contexts, developers have attempted to structure projects so as to avoid the obligation to pay prevailing wages on an entire development or project by confining the funds that triggered the “public works” definition to a discrete portion of the larger project. But in two notable decisions, California appellate courts have held that the breadth of the phrase “paid for in whole or in part” did not allow escaping the burden of paying higher prevailing wages on the entire project.

In *Oxbow Carbon & Minerals, LLC v. Department of Industrial Relations*, 194 Cal. App. 4th 879 (2011), the Second Appellate District specifically analyzed an attempt of a contractor to divide a project into separate scopes of work—the facility used to store material (an enclosure) and the equipment used to convey the material out of storage and into transporting vehicles (a conveying system)—one with prevailing wages due to public finding, and one without. The court held that where the project was one “complete integrated object,” the entire project was a public works project and subject to prevailing wages. 194 Cal. App. 4th at 886.

Similarly, in *Azusa Pacific Land Partners v. Department of Industrial Relations*, 191 Cal. App. 4th 1 (2010), the Second Appellate District found that *all* of the public infrastructure improvements (regardless of whether publicly or privately funded) were subject to prevailing wages as a public work under Labor Code § 1720(a)(1) because a portion of the project was publicly funded with proceeds of Mello-Roos Bonds. 191 Cal. App. 4th at 20-21. If SB615 passes as drafted, those engaged in large health care capital improvement programs funded only in part by conduit revenue bonds would need to carefully consider cases like *Oxbow* and *Azusa Pacific* in assessing whether prevailing wages would have to be paid on the entire program simply because one phase or one building was funded by such bonds.

Lastly, there are risks to the owner as well as the contractor when prevailing wages otherwise required to be paid are not in fact paid. The risk to an owner in misapplying California’s prevailing wage rules on projects that are determined to be “public works” can include both civil and criminal penalties, claims by the unpaid workers, and potential disbarment of contractors from bidding on future public works projects. The Labor Commissioner is empowered to issue civil wage and penalty assessments requiring developers to forfeit the amount of the underpaid wages, plus a penalty of up to \$50/day for each underpaid worker and liquidated damages in the amount equal to the wages that remain unpaid. If the violation is deemed willful, a developer may be guilty of a misdemeanor punishable by jail, not to exceed six months, or a fine not exceeding \$1,000, or both. Anyone who takes, receives, or conspires to take or receive portions of the wages of any worker or working subcontractor in connection

with services rendered on a public works project is guilty of a felony. See Cal. Labor Code §§ 23; 1194, 1741; 1742.1(a); 1774, 1775; 1777; 1777.1 (a) & (b); 1778.

By way of cautionary note, several years ago voters in California passed two propositions, Propositions 61 and 3, authorizing issuance of bonds to fund construction of children's hospitals. The California Health Facilities Financing Authority dispenses grants funded by the bonds to qualifying applicants. Although these propositions and their codification did not directly indicate that use of funds made available from those enactments could transform an otherwise private works project into a public works project on which prevailing wages must be paid, this was the position taken by the California Division of Industrial Relations ("DIR"). In one particularly high-profile and widely reported action, the DIR imposed substantial penalties on a San Diego area hospital that failed to require payment of prevailing wages on its expansion project funded at least in part by the proceeds from these bonds. This underscores that those who are funding construction of hospital and other health care facilities with conduit revenue bonds need to stay alert to whether SB615 passes so as to avoid potentially adverse consequences of noncompliance.

While it is still unknown whether SB615 will pass the Assembly and whether Governor Jerry Brown would sign it into law, any party contemplating financing health care or hospital construction projects with conduit revenue bonds must be aware of the potential budget (or bid) ramifications from having to pay prevailing wages should this bill become law.

LAWYER CONTACTS

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Aaron R. Gruber

San Francisco
+1.415.875.5849
agruber@jonesday.com

Daniel D. McMillan

Los Angeles
+1.213.243.2582
ddmcmillan@jonesday.com

James R. Dutro

San Francisco
+1.415.875.5839
jdutro@jonesday.com

David J. Kates

Chicago
+1.312.269.1589
djkates@jonesday.com

Glenn L. Krinsky

Los Angeles
+1.213.243.2540
glkrinsky@jonesday.com