

Keep Watch Of Calif.'s Health Care Construction Bill

Law360, New York (August 08, 2013, 1:09 PM ET) -- A proposed California Senate bill defines health care construction projects funded by conduit revenue bonds as “public works” and would require payment of prevailing wages to laborers. As a result, the cost of health care construction funded with such bonds could increase substantially. Some opponents of mandating payment of prevailing wages contend that this can increase construction costs by 20 percent or more.[1]

Regardless of the wisdom of requiring payment of prevailing wages, health care executives planning to finance construction in California with conduit revenue should carefully monitor the progress of Senate Bill 615. While the California Hospital Association is lobbying against SB 615, if this bill becomes law, construction dollars may not go as far as anticipated, and health care providers may confront unanticipated legal exposure, including potential civil and criminal penalties for noncompliance.

The potential legislatively mandated increase in the cost of hospital construction financed by conduit revenue bonds that would accompany SB 615 comes at a particularly challenging time for California hospitals and health care systems. Many hospitals operating on very narrow margins are still struggling to comply with important but costly seismic retrofits legislatively mandated by the Hospital Seismic Safety Act (SB 1953).

This law was enacted in the wake of the Northridge Earthquake. A number of cash-strapped hospitals have closed in recent years “in part because of the demands of SB 1953.”[2] Total costs associated with compliance with retrofitting costs prescribed by SB 1953 have been estimated at as much as \$110 billion, a number that could double when financing costs are considered.[3]

Fortunately, the last 10 years have seen a dramatic transformation and upgrade in the quality of California’s hospital infrastructure, driven in large part by SB 1953; many of the same financial challenges that precipitated recent hospital closures persist.

Unfortunately, coupled with the uncertain financial ramifications of the Affordable Care Act, colloquially referred to as Obamacare, there is much room for debate about the wisdom of mandating payment of prevailing wages on health care construction projects simply because the funding source is conduit revenue bonds. Yet, that is exactly the intent of SB 615.

Setting aside the policy battle over whether prevailing wages should be mandated, it is important to understand how SB 615 would operate. The California Labor Code largely dictates the categories of projects requiring that laborers be paid prevailing wages. See Cal. Lab. Code § 1720 et seq. In short, 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 public hospital like the new Ronald Reagan University of California, Los Angeles Medical Center.

But SB 615 would expand the definition of “public works” to health care projects funded, “in whole or in part,” by conduit revenue bonds even though the project would otherwise be a private works project and would thereby compel payment of prevailing wages on such projects.

So what is a conduit revenue bond? Conduit revenue bonds are bonds offered by a city, county or other governmental entity to finance a project of a private party like a nonprofit or for-profit hospital. Cal. Gov’t Code § 5780. This is why conduit revenue bonds are sometimes referred to as private activity bonds.

As currently drafted, SB 615 would require hospitals or health care providers utilizing conduit revenue bonds to fund construction to pay prevailing wages for labor on those projects. Stated differently, hospital or health care construction projects that have traditionally been viewed as “private works” would be transmuted by SB 615 into public works 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 this proposed law could impact many health care construction projects.

The California Senate passed SB 615, which is currently being considered by the California Assembly. The preamble to SB 615 spells out its purpose in pertinent part as follows:

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.

Among other things, SB 615 would add a new Section 1720.7 to the Labor Code, which, as drafted, provides the following:

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 health care 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.

Thus, the language of the proposed statutory addition would effectively characterize any hospital or health care construction project funded by conduit revenue bonds as public work. This language, in turn, triggers the 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. Some may argue that this language, which is common in other Labor Code provisions relating to funding of public works, should be construed such that use of any conduit revenue bond funds, no matter how limited, would impose an obligation to pay prevailing wages on an entire project.

In other contexts, developers have attempted to structure projects 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 a larger project. But in two notable California appellate decisions, such efforts have been unavailing.

In *Oxbow Carbon & Minerals LLC v. Department of Industrial Relations*, 194 Cal. App. 4th 879 (2011), the Second Appellate District specifically analyzed an attempt by a developer 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 work and subject to payment of prevailing wages. 194 Cal. App. 4th at 886.

Previously, the Second Appellate District had reached a similar result in a case where public infrastructure improvements were paid in part with the proceeds of Mello-Roos bonds. *Azusa Pacific Land Partners v. Department of Industrial Relations*, 191 Cal. App. 4th 1 (2010). If SB 615 becomes law as drafted, those engaged in large health care-capital improvement programs funded even in small part by conduit revenue bonds would need to carefully consider these cases in assessing whether prevailing wages would have to be paid on the entire program simply because one phase or one building of a much larger project was funded by such bonds.

The importance of tracking SB 615 is underscored by the fact that there are risks to a hospital or health care system as the owner of the project and not just the construction contractor when required prevailing wages are not 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 per 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.

These risks are not merely hypothetical. 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 did not directly indicate that use of funds from those enactments could transform an otherwise private project into a public 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 propositions.

At present, it is still unknown whether SB 615 will pass the Assembly, and it is possible that Gov. Jerry

Brown could veto the bill, should it pass. Nonetheless, a health care executive or the finance committee of a hospital board contemplating financing health care or hospital construction with conduit revenue bonds should consider the potential budget (or bid) impact from having to pay prevailing wages, should SB 615 become law.

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[1] See, e.g., Ben Brubeck, "Winning the First Against Government-Mandated PLAs in Federal Contracting," *Construction Executive* p. 4 (June 2013).

[2] Nikki Cobb, *Hospitals Struggle to Comply with Quake Bill*, *Inland Valley Daily Bulletin* (May 21, 2006) p. 1.

[3] Meade & Kulick, *SB 1953 and the Challenge of Hospital Seismic Safety in California* (RAND 2007) p. 5.

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