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## Public Agency News

### Recent Legislative Development

## Amendment To Prevailing Wage Law

Effective January 1, 2004,<sup>1</sup> California public agencies that fail to affirmatively state in their contracts that a project is a “public work” subject to prevailing wages may be liable to a contractor for increased costs incurred by the contractor if the project is later determined to be a public work.

### Public Work Defined

State law requires that contractors pay their workers “prevailing wages” when a project is a “public work”.<sup>2</sup> A project is a public work when it is done “under contract and paid for in whole or in part out of public funds.”<sup>3</sup> Beginning in 2001, with the passage of SB 975<sup>4</sup>, the Legislature substantially expanded the scope of what qualifies as a “public work” by, for the first time, defining what it meant to be “paid for in whole or in part out of public funds.” As a result, the prevailing wage laws may now extend to many privately built and owned projects that receive public assistance such as reduced rents, below market interest rates, or impact fee assistance.<sup>5</sup>

Newly adopted SB 966 does not further change the definition of a public work within the meaning of prevailing wage law. However, SB 966 has significant financial implications for public agencies that provide financial assistance for private projects.

### SB 966's implications for public agencies

Prior to the enactment of SB 966, relying on the California Supreme Court's opinion in *Lusardi Construction Co. v. Aubry* (1992) 1 Cal.4<sup>th</sup> 976, it was generally accepted that so long as a public agency did not affirmatively represent that a project was *not* a public works project, the agency would not be liable for the payment of additional wages even if a court or the California Department of Industrial Relations (the “Department”) later determined that the project actually was a public works project requiring the payment of prevailing wages.

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One portion of SB 966 appears to simply codify *Lusardi*. As added, Section 1726(c)(1) provides a contractor with a cause of action against a public agency if the agency affirmatively represents that a project is not a public work and it is later determined that prevailing wages should have been paid. In such a case, the contractor may be able to recover increased wage costs, penalties, and costs and attorney fees incurred as a result of having to pay prevailing wages. (Section 1726(c)(1).)

However, two other portions of SB 966 go significantly beyond *Lusardi* by requiring public agencies, under certain circumstances, to affirmatively state that a project *is* a public work:

- Under new Section 1726(c)(2), a public agency may be liable to a contractor if the public agency receives “actual written notice” from the Department that a project is a public work and fails to disclose that information prior to bid opening or award of a contract. As in the case of an incorrect express representation that a project is not a public work, if the agency fails to disclose Department’s determination the contractor may be entitled to recover increased wage costs, penalties, and costs and attorney fees incurred as a result of having to pay prevailing wages.
- Under new Section 1781, a public agency may also be liable to a contractor if after a contract is awarded it is determined that the work performed under the contract was a public work and the agency failed to identify it as a public work in the relevant bid documents. Where the public agency is not contracting directly with the contractor, the work must be identified as a public work in the written agreement or other writing by which the work is undertaken.

## Applicability of SB 966

New Section 1781 will apply to all local public agencies and many state agencies, and will apply both when the agency is awarding a contract directly and when the agency is “otherwise undertaking any public work”. It appears from the legislative history of SB 966 that the phrase “agency otherwise undertaking any public work” includes public agencies that cooperate with private developers on private development and agencies that provide funding or incentives for private development. Thus a public agency could be required to pay penalties even where the agency does not have a contract directly with the contractor.

### Historical Background: *Lusardi Construction Co. v. Aubry*

During contract negotiations with Lusardi Construction concerning the construction of new facilities, a Hospital District expressly represented that the expansion project was a private work, not a public work, and was thus not subject to the prevailing wage law. Consistent with this representation, the contract did not refer to prevailing wages and Lusardi did not comply with the prevailing wage law. Over two years after construction began, the Department of Industrial Relations determined that the project was a public work subject to the prevailing wage law. Because of its failure to comply with the law, Lusardi was subjected to numerous penalties and liability for underpayment of prevailing wages.

Lusardi sued the Department, arguing that the prevailing wage law could not be applied to it because the contract did not contain a provision requiring compliance with the law. The California Supreme Court disagreed and found that Section 1771 requires the payment of prevailing wages to “*all* workers employed on public works,” not just to workers whose employers have contractually agreed to pay the prevailing wage.

Although the Court found Lusardi liable for the underpaid wages, the Court concluded that it would be “inequitable” to hold Lusardi liable for penalties for failure to pay the prevailing wage, because “Lusardi acted in good faith in entering into the contract on the basis of the District’s representations . . . that the project was not subject to the prevailing wage law.” Most importantly from the perspective of local agencies, the Court also indicated that Lusardi might have a claim against the District for the money it would be required to pay for failing to comply with prevailing wage law, as well as for other consequential damages, because the District affirmatively represented that the prevailing wage law did not apply.

## Types of Assistance and Documents Covered by SB 966

Section 1781 potentially applies to all contracts, agreements, ordinances or other written arrangements approved by a public agency that either awards a contract or “otherwise undertakes” a public work. The full scope of this statute is not clear at this time, but agencies should consider the application of SB 966 whenever financial assistance is provided to private parties. For example, in addition to “traditional” source of assistance such as redevelopment tax increment contributions and sales or property tax sharing agreements, public agencies should also carefully consider the prevailing wage implications of programs that involve fee waivers, below market-rate loans, and other similar forms of development assistance.

Public agencies should also be aware that, because Section 1781 can apply even when there is no direct contractual relationship between the agency and the construction contractor, the agency may potentially be exposed to liability when it enters into, e.g., subdivision improvement agreements, reimbursement agreements, development agreements, and agreements related to density bonuses and fee deferrals. For questions concerning a specific type of program or agreement please contact our office.

## Penalties Under SB 966

Section 1720. If the agency makes an affirmative representation that a project is not a public work or receives a determination by the Department of Industrial Relations that the project is a public work and fails to disclose this to the contractor, the agency may be liable for (1) the difference between the wage paid and prevailing wages, (2) penalties issued by DIR, (3) costs, and (4) attorneys fees.

Section 1781. If the agency fails to identify a project as a public works project and the project is later determined to be a public works project, the agency may be liable for (1) the difference in wages paid and prevailing wages, (2) penalties issued by DIR, and (3) costs. The agency will not be liable for attorneys fees.

## Exception to Labor Code Section 1781

An agency will not be required to pay Section 1781 penalties where all of the following conditions are met:

- (1) The contractor did not submit a bid to, or directly contract with the agency; and
- (2) The agency states in the contract, agreement, ordinance or other written arrangement by which it undertook the public work that the work is a public work as defined in this chapter; and
- (3) That the agency obligated the party with whom it enters into a written arrangement to cause the work to be performed as a public work; and
- (4) The agency fulfilled its duties, if any, under the City Code or any other provision of law pertaining to providing and maintaining bonds to secure payment of contractors and payment of employees.

Section 1781 can apply even when there is no direct contractual relationship between the agency and the construction contractor.

If you would like assistance drafting language to include in contracts or other written arrangements to comply with this provision, please contact Jeffrey Mitchell or another member from our municipal and public agency practice area.

## Limitation

Where the contractor does not directly contract with an agency and does not submit a bid to that agency, the contractor must first seek relief from the developer or other person or company who solicited the contractor's bid or awarded the contract. The contractor, under this circumstance may only seek relief from the agency where the developer is not able to satisfy the judgement, including an attempt to collect from a surety bond, guarantee or some other form of assurance.

## Effective Date

This new legislation became effective on January 1, 2004. However, it may have an impact on contracts you negotiated prior to January 1, 2004. Please contact Jeffrey Mitchell or another member from our municipal and public agency practice area if you would like assistance with existing contracts.

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<sup>1</sup> 2003 Cal. Stat. Ch. 804 (SB 966 Alarcon.)

<sup>2</sup> California Labor Code § 1771. All statutory references are to the Labor Code unless otherwise noted.

<sup>3</sup> Section 1720(a)(1).

<sup>4</sup> 2001 Cal. Stat. Ch. 938 (SB 975 Alarcon.) Additional changes to Section 1720 were made in 2002 (see 2002 Cal. Stat. Ch. 1048 (SB 972 Costa).)

<sup>5</sup> Section 1720(c) and (d) contain a number of full or partial exemptions to the prevailing wage requirement that must be consulted in determining whether any particular project will in fact be considered a "public work." For questions concerning the applicability of these exemptions, please contact our office.

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