

STATE OF CALIFORNIA
DEPARTMENT OF INDUSTRIAL RELATIONS

In the Matter of the Request for Review of:

**Adventist Health System/West,
TEG/LVI Environmental Services, Inc., and
HBE Corporation, a Delaware corporation**

Case Nos. 16-0222-PWH
16-0225-PWH
16-0227-PWH

From a Civil Wage and Penalty Assessment issued by:

Division of Labor Standards Enforcement

**DECISION OF THE DIRECTOR
OF INDUSTRIAL RELATIONS**

Affected prime contractor HBE Corporation, a Delaware corporation (HBE) and its subcontractor TEG/LVI Environmental Services, Inc. dba Structural Protection Service Systems (TEG), each submitted a timely request for review of the Civil Wage and Penalty Assessment (Assessment) issued by Division of Labor Standards Enforcement (DLSE) with respect to the construction of a new Frank R. Howard Memorial Hospital (Project) in the City of Willits, Mendocino County. The Assessment, as amended, determined that \$132,387.05 in unpaid prevailing wages and statutory penalties were due. Adventist Health System/West (Adventist), a non-profit religious corporation, sought permissive intervention as an Interested Person.¹

HBE, TEG, and Adventist all assert that the workers on the Project were not entitled to the payment of prevailing wages because the Project is not covered by the California prevailing wage law. In compliance with the Hearing Officer's Preliminary

¹ Adventist Health System/West is a California non-profit religious corporation doing business as Adventist Health. Adventist initially filed a formal request with the Department for a coverage determination. That request was deferred for the coverage issue to be addressed in the context of this proceeding. Before the first Prehearing Conference scheduled by the Hearing Officer, Adventist filed a request to intervene as an Interested Person pursuant to Rule 8(d) (Cal. Code Regs., tit. 8, § 17208, subd. (d).) The Department opened file no. 16-0222-PWH in response to Adventist's intervention/coverage request. There has been no objection to Adventist's requested intervention, and Adventist has been treated as an Interested Person in this proceeding. Case no. 16-0222-PWH has been coordinated with the other two files that were opened in response to the Requests for Review filed on behalf of HBE and TEG.

Order no. 7, HBE, TEG, and Adventist each provided legal argument and supporting documentary evidence on the coverage issue before the first scheduled Prehearing Conference. DLSE also filed and served a letter with points and authorities, along with supporting documentation, explaining why it considered the Project a public work. HBE, TEG, and Adventist jointly asked that the Prehearing Conference be continued to a later date and that they be given time to reply to the issues raised in DLSE's letter. This request was granted and additional argument and documents were filed on behalf of HBE, TEG, and Adventist. DLSE subsequently declined to further respond. HBE, TEG, and Adventist all requested a hearing on the coverage issue. The Hearing Officer, John J. Korbol, denied the request for a hearing on the ground that the facts bearing on the coverage issue were not in dispute. The bifurcated issue of coverage was submitted for decision as of May 4, 2017.

The issue for decision is:

- Whether work performed by TEG as a subcontractor to HBE was subject to the prevailing wage requirements of Labor Code section 1720 et seq.²

The Director finds that the work in question is not subject to the prevailing wage requirements of section 1720 et seq. Accordingly, HBE Corporation and TEG/LVI Environmental Services Inc. have no liability for the wages and penalties assessed and the Assessment is dismissed.

FACTS

The Project entailed the construction of the Frank R. Howard Memorial Hospital in the City of Willits as a replacement structure for the original, but obsolete, hospital with the same name. The original hospital opened in 1928. From 1966 to 1986, it was operated by the Frank R. Howard Foundation (Foundation), a private non-profit corporation. In 1986, Adventist³ established Willits Hospital, Inc., doing business as Frank R. Howard Memorial Hospital (HMH), a California non-profit religious corporation, to take over operation of the hospital under a lease from the Foundation. In

² All further statutory references are to the California Labor Code, unless otherwise indicated.

³ Adventist is the sole corporate member of HMH.

2003, the Foundation received 33 acres of industrial land from a private donor to serve as the site for a new hospital structure. In 2010, the Foundation entered into a 50-year ground lease with HMH, whereby HMH agreed to finance and construct the building of a new hospital on the land that had been donated to the Foundation. HMH also agreed to operate the new hospital for 50 years. In 2012, HMH entered into a design-build contract with HBE to construct the Project, consisting of a two-story medical campus of approximately 74,000 square feet. HBE subcontracted with TEG to apply spray-on fireproofing material.

The design-build contract included a Miscellaneous Equipment Schedule listing the medical equipment HBE was required to furnish before the new hospital could open for business. All of this equipment was installed on the premises before patients could be admitted.

A ribbon-cutting was conducted on September 3, 2015, and admissions began in October 2015, when the hospital became equipped and operational. On December 17, 2015, the Project was listed as 100 percent complete by Facilities Development Division of the California Office of Statewide Health Planning and Development.

The total construction costs amounted to approximately \$64 million. To finance the construction of the Project, HMH used funds raised by Adventist through the sale of revenue bonds issued by the California Health Facilities Financing Authority (CHFFA) in 2013. Adventist raised \$290,365,000 from the sale of these bonds.⁴

For a time, public funding for the Project had been made available. Such funding originated from the Willits Environmental Remediation Trust, a fund established as a result of the settlement of a federal lawsuit by the City of Willits against Remco Hydraulics for environmental damage in and around Willits. Nicknamed the “Pepsi Fund” after Pepsi America, a successor-in-interest to the defendants in the litigation, the Pepsi Fund was subject to the terms of a consent decree issued by the federal court. In 2006, the federal court approved the disbursement of \$2.5 million from the Pepsi Fund to the Foundation in 2007, with an additional \$1.5 million in 2008 for the purpose of constructing a new hospital. However, Adventist produced evidence that the \$4 million

⁴ The bond issuance was not project-specific. Therefore, it must be inferred that most of the revenue was allocated to other Adventist projects in addition to the Project that is the subject of this Decision.

in public funds were never used to defray the costs of construction of the Project. In 2012, the City of Willits obtained a federal court order that the \$4 million already disbursed from the Pepsi Fund could be used instead for “the purchase of equipment necessary to provide essential health care services at the New Hospital.” As of March 10, 2016, the City of Willits demanded that the Foundation return the Pepsi Fund monies, since none of it had been used for either of the two uses approved by court order: construction of the hospital (which was already open and operating) or the purchase of medical equipment. In mid-2016, the City of Willits, the Foundation, and Adventist engaged in discussions as to how the Pepsi Fund monies should be spent to benefit the health and welfare of the community. It was eventually agreed that the \$4 million should be used to buy additional medical equipment for the hospital. Denominated “Willits Healthcare Enhancing Equipment,” a list of items was developed, separate and distinct from the medical equipment installed by HBE under the design-build contract for the hospital’s construction. A federal court order was obtained to permit the Foundation to keep the \$4 million in Pepsi Fund monies, which were then used by the Foundation to purchase the additional medical equipment for the new hospital in August and September of 2016.

DISCUSSION

Sections 1720 and following set forth a scheme for determining and requiring the payment of prevailing wages to workers employed on public works construction projects. Specifically:

The overall purpose of the prevailing wage law . . . is to benefit and protect employees on public works projects. This general objective subsumes within it a number of specific goals: to protect employees from substandard wages that might be paid if contractors could recruit labor from distant cheap-labor areas; to permit union contractors to compete with nonunion contractors; to benefit the public through the superior efficiency of well-paid employees; and to compensate nonpublic employees with higher wages for the absence of job security and employment benefits enjoyed by public employees.

(*Lusardi Construction Co. v. Aubry* (1992) 1 Cal.4th 976, 987, citations omitted (*Lusardi*)). DLSE enforces prevailing wage requirements not only for the benefit of workers but also “to protect employers who comply with the law from those who attempt

to gain competitive advantage at the expense of their workers by failing to comply with minimum labor standards.” (§ 90.5, subd. (a), and *Lusardi, supra*, at p. 985.)

Section 1775, subdivision (a) requires, among other provisions, that contractors and subcontractors pay the difference to workers who were paid less than the prevailing wage rate, and prescribes penalties for failing to pay the prevailing wage rate. Section 1742.1, subdivision (a) provides for the imposition of liquidated damages, essentially a doubling of the unpaid wages, if those wages are not paid within sixty days following service of a civil wage and penalty assessment under section 1741.

When DLSE determines that a violation of the prevailing wage laws has occurred, a written civil wage and penalty assessment is issued pursuant to section 1741. An affected contractor or subcontractor may appeal the assessment by filing a request for review under section 1742. Subdivision (b) of section 1742 provides in part that “[t]he contractor or subcontractor shall have the burden of proving that the basis for the civil wage and penalty assessment is incorrect.”

The critical issue for decision is whether the work performed on the Project by TEG as an environmental services subcontractor to HBE requires the payment of prevailing wages. For the following reasons, the Project was not a public work subject to prevailing wage requirements because the work was not paid for in whole or in part out of public funds.

Section 1771 generally requires the payment of prevailing wages to workers employed on public works. Section 1720, subdivision (a)(1) defines “public works” as “[c]onstruction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds” There is no dispute that the Project involved construction and repair work and that the work was carried out pursuant to a contract between HBE and HMH. Section 1720(b)(1) defines the term “paid for in whole or in part out of public funds” to include “[t]he payment of money or the equivalent of money by the state or political subdivision directly to or on behalf of the public works contractor, subcontractor, or developer.” The key inquiry is whether public funds were used to pay, in part, for the work that was done. HBE, TEG, and Adventist all contend that no public funds were used to finance construction of the Project.

Bond Financing. HBE, TEG, and Adventist state that construction of the Project

was financed through revenue raised from the sale of bonds issued by CHFFA in 2013. The documentation submitted by these parties justifies the characterization of the bonds as conduit revenue bonds. In this case, CHFFA issued the bonds and simultaneously sold them to investment bankers. The bond proceeds were assigned to a trustee (acting on behalf of the bond holders), who then advanced the proceeds to Adventist for construction of the Project and other enterprises. Adventist was then bound to repay the trustee from its revenues, including revenues from the operation of the finished hospital, on terms that match the terms of the repayment of the bonds. Neither the conduit bond revenues nor the repayments ever enter the coffers of CHFFA or any other public agency, nor are they collected for CHFFA. Since none of the money flows into or out of public coffers, the revenue derived from the sale of the conduit bonds does not constitute public funding within the meaning of section 1720, subdivision (b)(1). (See, e.g., PW 2004-016, *Rancho Santa Fe Village Senior Affordable Housing Project* (February 25, 2005).⁵

Pepsi Fund. As described above, the \$4 million in public funds had once been set aside in the Pepsi Fund for construction of the Project. However, once it was decided to use conduit revenue bond financing for the Project, the Pepsi Fund monies were no longer needed and were not used to subsidize, offset, or otherwise defray the costs of constructing the Project. Further, although HBE was responsible for furnishing and/or installing certain equipment in the newly built hospital under HBE's design-build contract with HMH, none of the equipment purchased by the Foundation and donated to the hospital in 2016 was included in the design-build contract.⁶ Because the medical equipment needed to make the new hospital operational had been purchased and installed

⁵ In 2015, the Legislature passed, and the Governor signed, Assembly Bill No. 852, which added Section 1720.7 to the Labor Code. That section provides that certain types of projects on "acute care" hospitals financed with conduit revenue bonds are to be considered "public works" for purposes of the prevailing wage law. Because this Project was constructed pursuant to a contract executed in 2012 and was completed by the end of 2015, section 1720.7, which did not become effective until January 1, 2016, does not apply to the Project. (Stats, 2015, ch. 698, § 1 (Assem. Bill 852).)

⁶ HBE's project manager, Amy Ford, submitted a declaration confirming the list of the medical equipment furnished and installed by HBE in 2015 as part of the construction contract, as well as the list of additional and different medical equipment obtained for the hospital by the Foundation with Pepsi Fund monies in 2016. The documents attached to Amy Ford's declaration also confirm that the design-build contract between HMS and HBE did not anticipate or reference the Pepsi Fund monies ultimately used to purchase additional medical equipment following the completion of the Project.

when the hospital opened in 2015, the 2016 equipment purchase should not be considered an indirect subsidy for the Project, nor can it be deemed to be a component part of the Project itself.

City Funds for Seismic Testing. DLSE asserts that public funding for the Project consisted of \$200,000 from the City of Willits to pay for seismic testing at the site of the Project. DLSE relies on a letter from Willits City Council member Ron Orenstein that was attached to the agenda for the November 14, 2012, Willits City Council meeting, where Orenstein made that assertion. According to documents jointly submitted by TEG, HBE, and Adventist, Orenstein was mistaken. Instead, Orenstein appears to have been misremembering a contribution of \$200,000 by the City of Willits to the Foundation in 2003, whereby the funds were used in connection with remodeling work done at the old hospital and a neighboring clinic. The City of Willits possesses no documents to support Orenstein's notion that public funds were used for seismic testing at the Project site.⁷

Hence, TEG, HBE, and Adventist have jointly carried their burden under section 1742, subdivision (b) to prove that the basis for the Assessments is incorrect. The documentation establishes that the Project at issue is not a public work because it was not paid for in whole or in part out of public funds.⁸

FINDINGS

1. HBE Corporation and TEG/LVI Environmental Services, Inc. each filed a timely Request for Review from a Civil Wage and Penalty Assessment issued by the Division of Labor Standards Enforcement. Adventist Health System West timely sought intervention as an Interested Person.

2. The work performed by the employees of affected subcontractor TEG/LVI Environmental Services, Inc. was not subject to the prevailing wage requirements of Labor Code section 1720 et seq., and therefore neither TEG/LVI Environmental Services, Inc. nor

⁷ A response by the City of Willits' to a California Public Records Act request confirms that it has no such documents.

⁸ With this finding, it is unnecessary to address the alternative argument advanced by TEG, HBE, and Adventist: that even if the \$4 million purchase of medical equipment for the hospital in 2016 is deemed to be public financing for the Project, such expenditure does not trigger prevailing wage requirements because it is *de minimis* in the context of the Project under section 1720, subdivision (c)(3).

the prime contractor, HBE Corporation, are liable for the wages and penalties set forth in the Assessment.

ORDER

Based on these findings, it is ordered that the Assessment is dismissed in its entirety. The Hearing Officer shall issue a Notice of Findings which shall be served with this Decision on the Parties.

Dated: July 16 2018



André Schoorl
Acting Director of Industrial Relations