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DEPARTMENT OF INDUSTRIAL RELATIONS

OFFICE OF THE DIRECTOR

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San Francisco, CA 94102

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**To All Interested Parties:**

**Re: PW Case 2005-016, Oxnard Marketplace Shopping Center - Fry's Electronics - City of Oxnard**

The December 1, 2006 determination in Public Works Case No. 2005-016 by then Acting Director John Rea was rescinded and vacated on or about March 4, 2009 pursuant to the order of the State Superior Court in Ventura, California in the action entitled Fry's Electronics, Inc. v. Department of Industrial Relations, et al., bearing Case No. 56-2007-00309431-CU-PT-VTA.

## DEPARTMENT OF INDUSTRIAL RELATIONS

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December 1, 2006

Donald C. Carroll, Esq.  
CARROLL & SCULLY, INC.  
300 Montgomery Street, Suite 735  
San Francisco, CA 94104

Re: Public Works Case No. 2005-016  
Oxnard Marketplace Shopping Center – Fry's Electronics  
City of Oxnard

Dear Mr. Carroll:

This constitutes the determination of the Director of Industrial Relations regarding coverage of the above-referenced project under California's prevailing wage laws and is made pursuant to California Code of Regulations, title 8, section 16001(a). Based on my review of the facts and an analysis of the applicable state law, it is my determination that the rehabilitation of a vacant retail store in the Oxnard Marketplace Shopping Center with the construction of a Fry's Electronics store ("Project") is a public work subject to prevailing wage requirements.

### Summary of Project

Sometime prior to November 1, 2003, the Oxnard Community Development Commission ("OCDC"), the City of Oxnard ("City"), Quality Real Estate Management, LLC ("QREM"), and Fry's Electronics, Inc. ("Fry's") began negotiating an economic assistance package for the rehabilitation of a parcel of land owned by Clearlake Investment Co. within the Oxnard Marketplace Shopping Center ("Shopping Center") on which was located an approximately 103,904 square foot vacant building formerly used as a HomeBase retail store ("Site"). The parties agreed to rehabilitate the Site by building a new Fry's retail store. The deal was finalized in September 2004. Over the course of the negotiations, the form of the economic assistance package changed but the nature of the Project, to acquire and rehabilitate the Site, remained the same.

### The Owner Participation and Parking Lease-Sublease Agreements

Initially, the economic assistance package was structured as an Owner Participation Agreement ("OPA") and Parking Lease-Sublease Agreement ("Sublease"). The purpose was "to provide for the rehabilitation of the Site with a Fry's retail store ..."<sup>1</sup> The OPA, Sublease and related documents were prepared by City's Special Counsel, Susan Apy.

Under the OPA, OCDC agreed to provide an annual rehabilitation grant to QREM. QREM and Fry's agreed "to rehabilitate the Site to construct, maintain and operate a Fry's retail store

<sup>1</sup> OPA, Recital G, p. 2; OPA, Article 2.3, p. 13.

consisting of a minimum of 135, 000 gross leasable square feet of retail space”<sup>2</sup> in accordance with plans and drawings approved by OCDC and City.<sup>3</sup> Under the Sublease, City agreed to make annual lease payments to QREM. The grant and lease payments were not to exceed \$3 million based on formulae tied to sales taxes generated by Fry’s and were to commence after completion of the Project, i.e., “after Fry’s has completed construction of the Project on the Site.”<sup>4</sup> The Project was defined to include “that certain discount electronic retail store to be developed on the Site ... which is opened as a Fry’s retail store ... of approximately 135,000 gross leasable square feet of retail space ....”<sup>5</sup>

#### The Purchase Agreement

On or about November 13, 2003, QREM entered into a purchase and sale agreement with Clearlake Investment Co. for the purchase of the Site (the “Purchase Agreement”). A condition precedent to closing escrow on the Site was that QREM obtain “an agreement for economic assistance (and all permits necessary for the development and operation of the [Site] as a [Fry’s] retail store of not less than 103,904 square feet of ground floor area) from [City] for the development and operation of the [Site], including acceptable conditions of approval which may be imposed by [City].”<sup>6</sup>

In January 2004, Apy e-mailed the OPA, Sublease and related documents to Fry’s counsel, William Foley.

In March 2004, Foley e-mailed Apy that the parties were “uncomfortable with the present structure of the economic assistance program.” One concern raised was that the lease arrangement would trigger “possible ‘prevailing wage’ obligations.” Foley suggested that the economic assistance program be structured in the form of a payment to QREM/Fry’s “of compensation in return for a covenant to operate the [Site] for no purpose other than a defined Fry’s Electronics Retail Store for a fixed period (e.g., until the \$3 million cap amount has been received or, if later, 10 years); with the economic assistance payments continuing during that period provided the covenant is being complied with.”

In April 2004, OCDC agreed “to remove all construction obligations” from the OPA and Sublease.<sup>7</sup>

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<sup>2</sup> OPA, Recital B, p. 1. This constitutes an approximately 30 percent increase in the size of the vacant HomeBase store.

<sup>3</sup> OPA, Article 3, pp. 17-19.

<sup>4</sup> OPA, Article 1, Definitions, “Completion,” p. 4.

<sup>5</sup> OPA, Article 1, Definitions, “Project,” p. 9.

<sup>6</sup> Purchase Agreement, Paras. 7(a)(E)(iv) and 26.

<sup>7</sup> E-mail from Apy to Foley dated April 21, 2004.

### The Draft Loan Agreement

On June 14, 2004, Foley sent Apy an e-mail stating that the new "economic assistance concept ... would involve a loan by the City to the acquisition entity; would not involve Redevelopment Agency; would be based upon forgiveness of loan pursuant to a formula based upon project-generated sales tax revenue."<sup>8</sup>

That same date, Apy e-mailed Foley a "Proposed Alternative Deal Structure" outlining the terms of the "revised deal structure" premised on the following: (1) QREM has entered into a Purchase Agreement for the Site and will assign its interests in the Purchase Agreement to a newly formed acquisition entity, which will enter into a lease with Fry's for development and operation of a Fry's retail store; (2) Fry's will rehabilitate an existing building on the Site to develop the Fry's retail store; and (3) Fry's will be reimbursed by the acquisition entity for a portion of the costs of the rehabilitation.<sup>9</sup>

The alternative deal was to be structured as follows: City would loan the acquisition entity \$2.8 million toward the purchase price of the Site; the loan would be made for "economic development purposes (to retain businesses and jobs at the shopping center, to create jobs at the shopping center and to create sales tax for the City);" City would record covenants against the Site including that the Fry's retail store must be continuously operated for 10 years, achieve minimum annual sales of \$50 million and provide a certain agreed number of jobs; the loan would be repaid in equal installments over 10 years, with 1/10 of the loan plus one year's interest to be forgiven for each year in which City received at least \$500,000 in sales tax from Fry's and Fry's provided the agreed number of jobs; and repayment of the loan would be guaranteed by Fry's.

On July 2, 2004, Apy sent Foley a draft Loan Agreement ("draft Loan Agreement") and related documents.<sup>10</sup> The parties to the draft Loan Agreement were City, QREM, and Fry's. City agreed to loan \$2.8 million to QREM "for the purpose of funding a portion of the acquisition costs of the Site ..."<sup>11</sup> As was true under the OPA/Sublease, the draft Loan Agreement was premised on the understanding that "Fry's will rehabilitate the Site in order to construct, maintain and operate a Fry's retail store consisting of a minimum of 135,000 gross leasable feet

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<sup>8</sup> E-mail from Foley to Apy dated June 14, 2004. See also "Oxnard - Fry's Retail Store (2) Proposed Alternative Deal Structure," June 14, 2004.

<sup>9</sup> In November 2004, QREM assigned the Purchase Agreement to the acquisition entity, Zacharee, L.P. ("Zacharee"). In the Assignment and Assumption Agreement, Zacharee is identified as "a single purpose entity created to acquire the Site and to lease the same to Fry's Electronics . . . for the operation thereon of a Fry's Electronics retail store." QREM is the general partner of Zacharee.

<sup>10</sup> Although the loan was to be to QREM, it appears from documents provided by QREM and Apy that the terms of the draft Loan Agreement and related documents were negotiated by Apy and Fry's through its counsel, Foley.

<sup>11</sup> Draft Loan Agreement, Definitions, "City Loan," p. 2.

of retail space ...”<sup>12</sup> It was noted that, “A portion of the costs of the rehabilitation will be reimbursed to Fry’s by [QREM].”<sup>13</sup>

The draft loan documents included a Promissory Note in the amount of \$2.8 million (“Installment Loan”) to be secured by a Deed of Trust and an Irrevocable Guaranty from Fry’s guaranteeing payment by QREM. The Installment Loan was to be paid in 10 annual installments, the first installment due and payable after Fry’s completed construction of its retail store on the Site.<sup>14</sup> Repayment of each annual installment was to be forgiven for every year in which Fry’s met the above-referenced conditions concerning sales tax and jobs, with the number of jobs to be provided subject to an employment proposal from Fry’s.<sup>15</sup>

The conditions for funding the Installment Loan included approval by City of Fry’s “financial capability to construct the Project,” a “duly executed construction contract between Fry’s and a California licensed general contractor,” and “a duly executed copy of Fry’s Lease” with QREM.<sup>16</sup>

The Municipal Purpose for the Installment Loan was stated in part as follows:

*[QREM] and Fry’s represent and agree that their undertakings pursuant to this Agreement are for the purpose of redevelopment of the Site. [QREM] and Fry’s further recognize that the qualifications and identity of [QREM] and Fry’s are of particular concern to City, in light of the following: (a) the importance of the redevelopment of the Site to the general welfare of the community; and (b) the public assistance that has been made available by law and by the government for the purpose of making such redevelopment possible.*<sup>17</sup>

On August 10, 2004, Foley sent an e-mail to Apy discussing several DIR precedential decisions concerning whether “construction” is “paid for in whole or in part out of public funds” and thus subject to the prevailing wage law. He suggested that the economic assistance package be restructured again so that the consideration for the loan and contingent repayment obligation “is in exchange for the sales tax revenue to be derived by City through the operation of the Fry’s retail store and for the operating covenant that tends to assure that such revenues will be generated, without providing a nexus by either requiring construction or exerting any control over such construction ... .” Foley further suggested that City could justify the loan “by the

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<sup>12</sup> Draft Loan Agreement, Recital C, p. 1. “Project” is defined also to include “all required on and off site public improvements, facilities and utilities on or for the benefit of the Site.” Draft Loan Agreement, Definitions, “Project,” p. 6.

<sup>13</sup> Draft Loan Agreement dated July 2, 2004, Recital C, p. 1.

<sup>14</sup> Draft Promissory Note, Para. 3(a), p. 1; draft Loan Agreement, Article 1, Definitions, “Completion,” p. 2, “Project,” p. 6.

<sup>15</sup> Draft Promissory Note, Para. 3(b).

<sup>16</sup> Draft Loan Agreement, section 4.2(a), (b) and (c), pp. 22-23.

<sup>17</sup> Draft Loan Agreement, section 3.7, p. 13 (emphasis added).

potential for sales tax revenues it will enjoy and new jobs that will be created if the Fry's retail store becomes a reality."

On August 20, 2004, Apy sent Foley an e-mail noting that, "If ... the City Loan will come after Fry's is open for business, many of the provisions of the Loan documents will need to be revised."

On August 27, 2004, Apy e-mailed Foley clean and redlined versions of the draft Loan Agreement and related documents. The redlined version incorporated changes requested by Fry's and City. Apy stated that City was amenable "to removing construction obligations from the Loan Agreement if the City Loan is disbursed once the store opens," which "achieves the current request of Fry's that the City Loan be disbursed in a lump sum ... and well within the time frame originally requested by Fry's" but because Fry's had not confirmed that the "new disbursement date" was acceptable, she had not made such changes to the draft Loan Agreement.<sup>18</sup>

#### The Loan Agreement

On or about September 2, 2004, the draft loan documents were revised by Apy and Foley. References to "redevelopment" or "rehabilitation" of the Site, to "development costs," and the provisions by which City reserved the right to approve the construction documents, were deleted. The provision in Recital B stating that Fry's would "construct" a retail store was revised to state only that Fry's would "maintain and operate" a retail store of approximately 135,000 gross leasable square feet. Instead of providing in Recital E for "the rehabilitation" and "redevelopment" of the Site with a Fry's retail store, the revised Loan Agreement (the "Loan Agreement") provides for the "operation on" the Site of a Fry's retail store. Fry's is not a party to the Loan Agreement nor obligated to guaranty repayment.

In the Loan Agreement, City agrees to lend QREM \$2.8 million in one lump sum with 5.5 percent annual interest (the "Loan") premised on the following: (1) QREM has entered into the Purchase Agreement for the Site; (2) the Site currently is improved with a 103,904 square foot vacant building; (3) Fry's intends to enter into a ground lease with QREM and *will rehabilitate the Site* in order to maintain and operate a retail store of approximately 135,000 gross leasable square feet of retail space; (4) QREM will borrow from City a portion of the acquisition price for the Site; and (5) the Fry's retail store will provide a major anchor tenant to the Shopping Center.<sup>19</sup>

Loan closing is conditioned on completion of the "Project," defined, as it was under the OPA, to mean "that certain electronic retail store to be operated on the Site pursuant to this Agreement which is opened as a Fry's retail store ... of approximately 135,000 gross leasable square feet of retail space ... ." <sup>20</sup> It is also conditioned on approval by City of a duly executed

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<sup>18</sup> E-mail from Apy to Foley dated August 27, 2004.

<sup>19</sup> Loan Agreement, Recitals A - E, p. 1.

<sup>20</sup> Loan Agreement, section 1.2, Definitions, "Project," pp. 7-8; section 4.2(a), p. 21.

copy of Fry's lease, which has to include a provision that QREM and Fry's will observe and perform all obligations imposed on QREM and Fry's in the Fry's lease and the Loan Documents<sup>21</sup> and an acknowledgment from Fry's that its lease is subject and subordinate to the Loan Documents.<sup>22</sup> One of Fry's obligations under the lease is to construct improvements to the Site, including a building, as set forth in a Construction Agreement attached to the lease.<sup>23</sup>

Another condition of the Loan closing is that QREM and Fry's enter into an Agreement Containing Covenants with City ("Covenant Agreement") to be recorded against the Site in second priority position behind the Deed of Trust.<sup>24</sup> The purpose of the Covenant Agreement is "to ensure that the Site is used for the purposes intended by the parties," namely, "for the operation of the Project as provided in the Loan Agreement."<sup>25</sup> As in the Loan Agreement, QREM and Fry's agree that they and their respective successors and assignees will only use the Site "for the operation of the Project" (i.e., a Fry's retail store as defined in the Loan Agreement) for 10 years following the date on which the first of 10 annual installments for repayment of the Loan is due.<sup>26</sup>

The terms and conditions of the Loan are set forth in a Promissory Note. The Loan is to be repaid in 10 successive annual payments. Each annual payment will be forgiven by City if certain conditions are met on the date the payment is due. These conditions include: (1) that City has received for the preceding year a minimum of \$500,000 in annual sales tax revenues from the operation of the Fry's store; and (2) that the Fry's retail store has during that year provided at least 250 full or part-time jobs.

City approved the Loan Agreement on September 21, 2004. The Minutes of the City Council for that date reflect that purchase of the Site by QREM for lease to Fry's is contingent on Loan approval and that funds for the Loan would come from City's General Fund Operating Reserve. In its report to the City Council recommending approval of the Loan Agreement, City's Community Development Department estimates the "[t]otal investment in the [Site] by QREM and Fry's, including the [Loan]" to be approximately \$14 million, which includes expansion of the existing building area to approximately 135,000 square feet.<sup>27</sup>

On or about December 30, 2004, Zacharee and Fry's entered into a ground lease with an initial term of 15 years with options to extend the lease for 7 consecutive 5-year periods. Upon the termination of the lease, the improvements to the Site will be owned by Zacharee. The

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<sup>21</sup> The Loan Documents include, collectively, the Loan Agreement, the Promissory Note, the Deed of Trust, and the Agreement Containing Covenants.

<sup>22</sup> Loan Agreement, Article 4.2(c), p. 22. In addition, the Loan is to be secured by a Deed of Trust on the Site.

<sup>23</sup> See Commercial Real Property Lease between Zacharee and Fry's effective December 30, 2004, Exhibit "C".

<sup>24</sup> Loan Agreement, section 4.2(h).

<sup>25</sup> Covenant Agreement, Recital C, p. 1; Para. 1(a), p. 2.

<sup>26</sup> Covenant Agreement, Para. 1(a), p.2.; Loan Agreement, section 5.1, p. 24.

<sup>27</sup> Report to City Council dated September 13, 2004, p. 2.

Department has been advised by counsel for QREM that when the Loan is funded, the Loan proceeds will be paid to Zacharee, which will assume any repayment obligation.

### Analysis

Labor Code section 1771<sup>28</sup> generally requires the payment of prevailing wages to workers employed on public works. Section 1720(a)(1) defines "public works" to mean "construction, alteration, demolition, installation or repair work done under contract and paid for in whole or in part out of public funds . . . ." Section 1720(b) provides that "paid for in whole or in part out of public funds" means all of the following:

- (1) The 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.
- (2) Performance of construction work by the state or political subdivision in execution of the project.
- (3) Transfer by the state or political subdivision of an asset for less than fair market price.
- (4) Fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations that would normally be required in the execution of the contract, that are paid, reduced, charged at less than fair market value waived, or forgiven by the state or political subdivision.
- (5) Money loaned by the state or political subdivision that is to be repaid on a contingent basis.
- (6) Credits that are applied by the state or political subdivision against repayment obligations to the state or political subdivision.

The Project involves construction done under contract. The issue is whether it is paid for in whole or in part out of public funds. A determination whether the Project is "paid for in whole or in part out of public funds" requires an analysis of section 1720 as amended in 2001 by Senate Bill 975 ("SB 975"), which is the law applicable to the Project.<sup>29</sup>

SB 975 went into effect on January 1, 2002. Prior to 2002, section 1720 provided only that construction was a "public works" if "paid for in whole or in part out of public funds." In SB 975, the Legislature added subsection (b), which defines "paid for in whole or in part out of public funds," and subsection (c), which exempts certain development projects from the coverage of the prevailing wage laws even though there may be public subsidies involved that would otherwise render such projects public works.

Section 1720(a) still provides in relevant part that "construction . . . paid for in whole or in part out of public funds" is "public works." By defining "paid for in whole or in part out of public funds" to mean the public subsidies listed in 1720(b) subparts (1) – (6), the Legislature has

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<sup>28</sup> All further statutory references are to the Labor Code unless otherwise indicated.

<sup>29</sup> This is the law in effect on the benchmark event, which is the date on which the parties entered into the operative agreement, the Loan Agreement dated September 21, 2004.

determined that construction is paid for out of public funds where a public entity contributes one or more such subsidies to a development project.

Moreover, the public subsidy need not pay for the actual construction costs in order for the construction to be a public work. Among the enumerated forms of public subsidies to a development project in section 1720(b) are subsidies which cannot be used to pay for the cost of construction, and yet the Legislature nevertheless has determined these subsidies to be payment for construction. These subsidies include: a public entity's performance of construction work - 1720(b)(2); a public entity's transfer of an asset, such as real property, for below fair market price - 1720(b)(3); a public entity's waiver or payment of fees, costs, rents, insurance or bond premiums - 1720(b)(4); and a public entity's allowance of credits against repayment obligations - 1720(b)(6). Thus, under the current provisions of section 1720, construction is a public work subject to prevailing wage requirements where there is a public subsidy to a development project even though the public subsidy does not pay for actual construction. Thus, QREM's reliance on *City of Long Beach v. Department of Industrial Relations* (2004) 34 Cal.4th 942 and *Greystone Homes, Inc. v. Chuck Cake* (2005) 135 Cal.App.4th 1, both of which arose under the pre-SB 975 version of section 1720, is misplaced.

In *City of Long Beach, supra*, the project was a private animal shelter. The City contributed funds to the project that were earmarked for project development, design and related *preconstruction* costs, including architectural design costs and surveying fees. When the City entered into the contract in 1998 to contribute money to assist in the development and *preconstruction* phases of the shelter, "construction" was not defined in the statute. The Court held that payment of public funds for *pre-construction activities* did not constitute payment for "construction."<sup>30</sup>

In *Greystone Homes, Inc., supra*, the project was a housing development. The court characterized the "dispositive question" after *City of Long Beach* to be "whether *actual construction* ... was paid for in whole or in part out of public funds." *Greystone Homes, Inc. supra*, 135 Cal.App.4th at p. 10 (emphasis in original). The court held that public funds used to pay for land acquisition costs of the project did not constitute payment for construction. Accordingly, the project was not a public work. *Id.* at p. 13.

To the extent that these cases held that the pre-SB 975 version of section 1720 required that public funds be traced to payment for the costs of the actual construction (or for design and *preconstruction* activities after 2000), they have been rendered inapposite by SB 975. As shown above, the text of the current statute demonstrates that such tracing is not possible and therefore cannot be required. By defining "paid for in whole or in part out of public funds" to include public subsidies for project costs other than actual construction, the legislative intent is clear – a development project may be a public work even though no public funds pay for actual construction.

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<sup>30</sup> After the benchmark event in *City of Long Beach*, the Legislature passed Senate Bill 1999 in 2000, effective January 1, 2001, amending section 1720(a) to specifically include design and *preconstruction* phases of construction, including inspection and surveying, in the definition of construction. The Court determined that this amendment changed existing law and operated prospectively only. *City of Long Beach, supra*, 34 Cal.App.4th at p. 951.

SB 975 was in part a response to *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576. In that case, the issue was whether the construction of a residential shelter care facility for emotionally disturbed minors had been paid for in whole or in part out of public funds. Riverside County had subleased a tract of undeveloped land to Helicon, Inc. for the purpose of constructing, operating and maintaining the facility at no cost to the County. The County agreed to place children in the facility and to use AFDC funds to pay for treatment programs provided by Helicon. The County also agreed to forbear rent for the first 20 years of operation of the facility, to absorb certain inspection costs, and to pay bond premiums on the project.

The court held that the AFDC funds paid for public services, which did not make “incidental construction work done by a private provider of those services ‘public works’ under section 1720, subdivision (a).” *Id.* at p. 1586. The court concluded that “paid for in whole or in part out of public funds” meant “the delivery of money or its equivalent . . . [out of] available pecuniary resources . . . including cash and negotiable paper, and . . . property of value which may be converted into cash.” *Id.* at p. 1588 (internal quotes and citations omitted.) Based thereon, the court found that neither rent forbearance nor cost waivers was payment of public funds for construction, as neither involved “payment of funds out of county coffers.” *Id.* at pp. 1589, 1590.<sup>31</sup> The court added, however, the following:

Legislators could easily express an intent to bring waived costs (or rent) within the concept of payment with “public funds” but have not done so. A holding that waived inspection costs are partial payment from public funds could make public works of any project where a county has used cost waivers as incentives to development, even though the project may serve purely private needs. The statute gives no warning that this result was intended. *Id.* at p. 1590.

The Legislature provided such warning in SB 975 by overturning the holding in *McIntosh* that “paid for in whole or in part out of public funds” was limited to “the delivery of money or its equivalent” and therefore did not include rent forbearance, cost waivers, or below-market interest rates. Section 1720(b) defines “paid for in whole or in part out of public funds” to mean all of these forms of public subsidies.

Moreover, when SB 975 is read as a whole, it is clear that where there is a public subsidy to a development project, which, as shown, need not pay for actual construction, public works status attaches to the overall project. For example, section 1720(c)(2) exempts from coverage “an otherwise private development project” where, among other conditions, a public entity does not contribute more money or the equivalent of money to the “overall project” than is required to pay for “public improvement work” required as a condition of regulatory approval. Similarly, under section 1720(c)(3), a “private development project” is not a public work if the public subsidy to the project is “de minimis.” Thus, if a private development project that receives a public subsidy does not meet the requirements for exemption (e.g., if the public entity has contributed either more money than required for public improvement work or a

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<sup>31</sup> The court held that County’s payment of bond premiums did constitute payment out of public funds. Helicon, however, had agreed to repay the County. Therefore, the court concluded that County’s assistance was in essence a loan, and even though interest-free, it did not constitute payment for construction. *Id.* at p. 1590.

public subsidy that is more than de minimis), *the project* is a public work thereby rendering the related construction activities subject to the prevailing wage laws.<sup>32</sup>

Finally, to the extent there is any ambiguity concerning the relationship between sections 1720(a) and 1720(b), the legislative history of SB 975 shows that the Legislature intended "public works" to include construction in which public funds do not pay for the physical act of building a structure or work. As stated in an Assembly Bill Analysis of SB 975:

This bill establishes a definition of "public funds" that conforms to several precedential coverage decisions made by the Department of Industrial Relations. These coverage decisions define payment by land, reimbursement plans, installation, grants, waiver of fees, and other types of public subsidy as public funds. The definition of public funds in this bill seeks to remove ambiguity regarding the definition of public subsidy of development projects.<sup>33</sup>

One of the precedential coverage decisions codified by SB 975 is PW 99-039, *Riverview Business Center Office Building D* (November 17, 1999). That case involved a complex land swap. A private party constructed an office building on privately-owned property with private funds. The improved parcel was then transferred to the public entity in exchange for a parcel of publicly-owned property. The Director held that the transfer of publicly-owned real property for the improved parcel constituted the payment of public funds *for construction* triggering prevailing wage requirements. Other precedential coverage decisions described in the Bill Analysis in which the Director found that public subsidies to development projects constituted payment for construction even though the subsidy in question did not pay for the costs of actual construction are PW 2000-015, *Downtown Redevelopment Projects, City of Vacaville* (March 22, 2001) (payment of fees on behalf of developer); PW 2000-11, *Town Square Project, City of King* (December 11, 2000) (credits applied against repayment obligations; payment of site assembly costs); and PW 2000-043, *13<sup>th</sup> and F Street Townhouse Project, City of Sacramento* (January 23, 2001) (forgiven loans for both land acquisition and construction).<sup>34</sup>

In short, SB 975 changed the pre-existing law to provide that where there is a public subsidy to a development project in which there is a construction obligation, the project is a public work regardless of whether the public subsidy pays for the cost of the actual construction.

Turning to the facts of this case, rehabilitation of the Site with the construction of the Fry's retail store, as mentioned above, qualifies as construction done under contract. The question presented here is whether the construction is "paid for in whole or in part out of public funds." The answer turns on whether there is a public subsidy to the Project and the Project requires construction. If both are present, then the Project is a public work and the construction is subject to prevailing wage requirements.

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<sup>32</sup> See 2A Singer, *Statutes and Statutory Construction* (6<sup>th</sup> ed. 2000) § 47:11, p. 252 ("true statutory exceptions exist only to exempt something which would otherwise be covered").

<sup>33</sup> California Bill Analysis, Assembly Floor, 2001-2002 Regular Session, Senate Bill 975, August 30, 2001.

<sup>34</sup> See Department of Industrial Relations, Enrolled Bill Report on SB 975, 2001-2002 Reg. Sess.

Here, the Loan will be forgiven by City in whole or in part if the sales tax revenue and employment goals are met. Thus, the Loan constitutes a public subsidy to the Project under section 1720(b)(4). Repayment is contingent on Fry's *not* meeting the minimum levels of sales, sales tax revenues, and employment set forth in the Loan Documents. Accordingly, the Loan also constitutes "money loaned ... that is to be repaid on a contingent basis" within the meaning of section 1720(b)(5).

Moreover, from the outset, City's economic assistance package has been tied to the rehabilitation of the vacant HomeBase store with the construction of a Fry's retail store.<sup>35</sup> The parties themselves have defined the Project to mean "*that certain electronic retail store to be operated on the Site pursuant to [the Loan Agreement] which is opened as a Fry's retail store . . . of approximately 135,000 gross leaseable square feet of retail space . . .*"<sup>36</sup> The Project would not have gone forward and the store would not have been built without the Loan from City. The acquisition of the Site and the lease to Fry's, the rehabilitation of the Site with the construction of a Fry's store, and the operation of the Fry's store are all pre-conditions for the Loan closing. Thus, the Loan would not be funded if either QREM or Fry's did not undertake the expansion and rehabilitation of the exiting vacant store with the construction of a 135,000 square foot retail store on the Site, increasing the total square footage by 30 percent. ~~\*\*\*\*~~

In material respects, the Loan Documents do not distinguish between QREM and Fry's. For example, in the Covenant Agreement, City, QREM and Fry's acknowledge that the purpose of the Agreement is "to ensure that the Site is used for the purposes intended by the parties . . .,"<sup>37</sup> which is for QREM and Fry's to "use the Site for the operation of the Project (i.e., the 135,000 square foot Fry's retail store) as provided in the Loan Agreement . . ."<sup>38</sup> Similarly, in the Loan Agreement, QREM and Fry's agree that the Site shall be only used for the operation of the Fry's store for 10 years after the first installment is due for repayment of the Loan.<sup>39</sup> QREM acknowledges and agrees that its undertakings pursuant to the Loan Agreement are "for the purpose of providing the operation of the [Fry's store] at the Site" and that the Loan has been made available by City "for the purpose of making such operation possible."<sup>40</sup>

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<sup>35</sup> In *McIntosh v. Aubry, supra*, the court held that payment of public funds for public services did not constitute payment for construction. This aspect of the holding, though not disturbed by SB 975, is not applicable. The public subsidy here is not paying for public services. The Loan is tied to the purchase and rehabilitation of the Site and construction of the Fry's store. Only *repayment* of the Loan is contingent on tax revenues generated by the store and employment levels achieved by Fry's. Thus, we need not reach the question of when the payment of public funds as an incentive for business development unconnected to an obligation to construct may be considered payment for public services.

<sup>36</sup> Loan Agreement, Article 1.2, pp. 7-8 (emphasis added).

<sup>37</sup> Covenant Agreement, Recital C, p.1.

<sup>38</sup> Covenant Agreement, Section 1 and 1(a).

<sup>39</sup> Loan Agreement, section 5.1(a), p. 24.

<sup>40</sup> Loan Agreement, section 3.7, p. 14.

Thus, it is not true, as QREM argues, that there is no relationship between the Loan Agreement and the construction. It does not matter that the Loan is to QREM or that Fry's is not a signatory to the Loan Agreement and has no repayment obligation. Once it has been determined that the Project is a public work, public works status attaches regardless of the fact that Site acquisition and construction were undertaken by more than one party.

Likewise, QREM's reliance on the Decision on Appeal in *PW 2003-028, Baldwin Park Marketplace Project* (June 28, 2005) for the proposition that the construction of the Fry's store is an independent undertaking is misplaced. *Baldwin Park Marketplace Project* was decided under pre-SB 975 law and involved an analysis under PW 2000-016, *Vineyard Creek Hotel and Conference Center/Redevelopment Agency, City of Santa Rosa* (October 16, 2000) of construction that was independent of separate construction that was a public work. The Project here is a single development project consisting of the acquisition and rehabilitation of the Site. Thus, *Baldwin Place Marketplace Project* is not applicable.

Based on the facts of this case, I find the Project to be a public work subject to prevailing wage requirements.<sup>41</sup>

#### Conclusion

In sum, public works status attaches to the public subsidies listed in section 1720(b) when the subsidies support an economic development project that requires construction (or any other enumerated covered work under section 1720(a)(1)). This would be true even if the provision of the public subsidies for the project as a whole is conditioned on meeting payroll and sales tax goals, so long as the definite construction obligation is also present.

Here, the public subsidy supports the Project, which requires construction to rehabilitate the existing vacant store with 30,000 additional square feet of retail space. Thus, the Project is a public work subject to the prevailing wage laws.

I hope this determination satisfactorily answers your inquiry.

Sincerely,



John M. Rea  
Acting Director

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<sup>41</sup> In the event QREM decides not to accept the Loan, and if there is no other public subsidy to the Project, the rehabilitation of the Site and construction of the Fry's store would not be subject to the prevailing wage requirements.