

DEPARTMENT OF INDUSTRIAL RELATIONS

OFFICE OF THE DIRECTOR

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April 14, 2008

Chad T. Wishchuk
MARKS, GOLIA & FINCH, LLP
3900 Harney Street – First Floor
San Diego, CA 92110-2825Re: Public Works Case No. 2007-011
Rebuilding of the Agricultural Commissioner Office Building
County of Imperial

Dear Mr. Wishchuk:

This letter 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 of this case and an analysis of the applicable law, it is my determination that the rebuilding of the Agricultural Commissioner office building ("Project") is a public work subject to prevailing wage requirements.

Facts

On March 29, 2005, the County of Imperial ("County") entered into an agreement ("Original Contract") with RSM2 Contractors, Inc. ("Contractor") for the construction of a new 12,000 square foot building at 852 Broadway, El Centro, California, to house the offices of County Agricultural Commissioner at a cost to County of \$1.6 million. The Original Contract required payment of prevailing wages. The Original Contract also required Contractor to provide both a general commercial liability policy in the amount of \$1 million and all risk property coverage or builders risk insurance equal to or greater than the Original Contract amount to cover the full replacement cost of the building and improvements in the event of loss, damage, or destruction by fire or other perils. Contractor did not obtain the all risk property coverage or builders risk insurance. Contractor did, however, have a pre-existing general commercial liability policy.

Independent of the requirements under the Original Contract, County maintained its own all risk property insurance policy with Lexington Insurance Company ("Insurer"). That policy contained a \$5,000 deductible.¹ The policy between County and Insurer states: "It is further understood and agreed that reported losses over the described Deductibles shall be adjusted with and payable to the 'Member Agency' to whom the Property belongs, any Mortgagees and/or Additional Interests."²

¹County's policy with Insurer is entitled Company Reinsurance Policy. The insured is listed as the CSAC Excess Insurance Authority and California Public Entity Insurance Authority ("CSAC") and County as a member entity of CSAC. CSAC is a risk sharing pool of California public entities and agencies, formed as a joint powers authority and dedicated to controlling losses and providing effective risk management solutions. County purchased its policy with Insurer through CSAC.

²Company Reinsurance Policy, section 1, page 27.

On or about February 6, 2006, when construction was near completion, a fire burned down most of the building. County submitted a claim for the damage to Insurer. A liability dispute ensued and was mediated, producing a settlement agreement effective August 8, 2007. Under the settlement agreement, Contractor's general commercial liability carrier agreed to pay \$400,000 to Insurer; Contractor's two subcontractors for alarm and carpet work agreed to pay \$25,000 each to Insurer; and Contractor's insurance broker agreed to pay \$10,000 to Insurer. In addition, Contractor assigned to Insurer its collection rights for recovery of Contractor's out-of-pocket costs.

On or about January 3, 2008, County and Contractor entered into a Rebuilding Agreement ("Rebuilding Agreement"). The Rebuilding Agreement provides that Contractor will rebuild the office building for approximately \$1.55 million, funded entirely by Insurer "on the County's behalf and pursuant to" County's policy with Insurer. The Rebuilding Agreement further provides that construction will proceed according to the Original Contract and associated change orders. The Rebuilding Agreement deviated from the Original Contract only in the following provisions: Contractor is to certify the concrete slab and underground improvements that survived the fire meet the requirements of the Original Contract; County is to reimburse Contractor for the cost of new city permits over \$7,500; County is to provide "course of construction/builders risk insurance for the Project in lieu of Contractor providing such insurance"³; Contractor is to install a fire sprinkler system at no additional cost to County as long as the sprinkler system can be installed without structural changes; and Contractor is not obligated to pay prevailing wages or use the subcontractors listed in the original bid unless otherwise required by law.

The Rebuilding Agreement also provides that the \$1.55 million in Insurer funds shall be deposited into an escrow account at Torrey Pines Bank ("Bank") in La Mesa. Under the escrow agreement, "County will deposit" the funds into the account. Thereafter, Contractor, designated by the escrow agreement as the beneficial owner of that account, is to submit to County monthly pay applications to be approved by County based on the progress of construction. After approval, the escrow agent is to make progress payments to Contractor. Only interest earned on the account may be withdrawn by Contractor without notice. Neither the escrow agreement nor the Rebuilding Agreement mention whether County paid the \$5,000 deductible in connection with the rebuilding work.⁴ To date, Insurer has delivered a partial payment to County in the amount of \$389,718. County deposited that check in a County Treasurer's trust account⁵ and, within 24 hours of deposit, transferred the exact same amount to the escrow account at Bank. Contractor represents that the balance of the \$1.55 million will be deposited by Insurer into the escrow account at Bank.

³County's existing policy with Insurer satisfied County's obligation under the Rebuilding Agreement to obtain construction/builders risk insurance.

⁴Contractor represents that payment of the deductible is not required. If Insurer later so requires, the deductible will be paid by Contractor, not County.

⁵Contractor represents that the Treasurer's trust account contains no County general funds and earns no interest.

Discussion

Under Labor Code section 1771,⁶ prevailing wages must be paid to workers employed on public works projects. Section 1720(a)(1) defines “public works” as “Construction, alteration, demolition, installation, or repair work done under contract and paid for in whole or in part out of public funds” Under section 1720(b)(1), the phrase “paid for in whole or in part out of public funds” means “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.”

The Project entails construction that is performed under contract. The only question is whether the Project is paid for in whole or in part out of public funds. The answer turns on whether the funding of the Project with proceeds from County’s property insurance policy constitutes “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” within the meaning section 1720(b)(1).⁷

According to the terms of the County’s insurance policy, “reported losses over the Described deductibles shall be adjusted with and payable to the ‘Member Agency’ to whom the property belongs ...” Under the Rebuilding Agreement, County agreed to deposit the insurance proceeds to which it was entitled on account of its reported loss into the escrow account. No party argues that any entity besides County owned the County Agricultural Commissioner building that was destroyed by the fire or that any entity besides County is entitled to the insurance proceeds.⁸ Insurer issued a check made payable to County in the amount of \$389,718. County deposited the check into a County Treasurer’s trust account. As required under the Rebuilding Agreement, County set up an escrow account to administer the construction funds and deposited into the escrow account an initial check for \$389,718. County will control disbursements to Contractor from the escrow account as County approves Contractor’s pay applications based on the progress of construction. Regardless of whether the insurance proceeds were deposited into the escrow account by County, or by Insurer on behalf of County, the fact remains that County had the legal right to the proceeds and will control how they are spent. And, regardless of which County account the County used for Insurer’s initial check, whether County earned interest on that account, and whether the account contained other County funds, the fact is that County actually received and deposited the insurance proceeds and disbursed them to the escrow account. As such, the funding mechanism meets the definition of “paid for in whole or in part out of public funds” under section 1720(b)(1) in that the payment by County of \$389,718 out of the County Treasurer’s

⁶All statutory references are to the California Labor Code, unless otherwise indicated.

⁷Another potential source of public funds payments is the payment of property insurance policy premiums by County. Section 1720(b)(4) includes within the definition of “paid for in whole or in part out of public funds” the following: “Fees ... insurance or bond premiums ... that are paid ... by the state or political subdivision.” Given the conclusion reached herein that funding of the Project with proceeds from County’s property insurance policy constitutes a payment out of public funds under section 1720(b)(1), the section 1720(b)(4) issue need not be addressed.

⁸See, Insurance Code section 281 (“Every interest in property, or any relation thereto, or liability in respect thereof, of such a nature that a contemplated peril might directly damnify the insured, is an insurable interest”); and *Burns v. California Fair Plan* (2007) 152 Cal.App.4th 646, 651 (“In common parlance, we speak of a house as being insured, but, strictly speaking, it is not the house but the interest of the owner therein that is insured”(Citation omitted)).

trust account into the escrow account at Bank to fund construction of the Project constitutes "the payment of money ... by the state or political subdivision ... on behalf of the public works contractor." That payment alone is sufficient to satisfy section 1720(a)(1)'s requirement that construction be paid for at least "in part" out of public funds. In addition, County's unquestioned legal entitlement to the balance of the proceeds as the holder of the insured interest constitutes the "equivalent of money" within the meaning of that same section. (See, *McIntosh v. Aubry* (1993) 14 Cal.App.4th 1576, 1588 ["funds" includes "property of value which may be converted into cash [citations]"] quoting *Keene v. Keene* (1962) 57 Cal.2d 657, 663.)

Contractor cites *McIntosh* to argue that because the insurance proceeds will never reach County coffers and will be paid to Contractor from the Bank escrow account, no public funds are involved. However, the facts show that at least \$389,718 of the proceeds did reach County coffers. Moreover, the relevance of the specific passage in *McIntosh* relied on by Contractor is questionable. It states: "Like the forbearance of rent, these [inspection] cost waivers involve no payment of funds out of county coffers." (*McIntosh*, supra, 14 Cal.App.4th at p. 1590.) After *McIntosh*, the Legislature passed Senate Bill 975 ("SB 975") effective January 1, 2002. SB 975 adopted a definition of "paid for in whole or in part out of public funds," a phrase that was previously undefined by statute. The expanded definition specifically includes the public subsidies the *McIntosh* court found not to be payments out of public funds, like rent forbearance and cost waivers.

Even under the previous law as interpreted by *McIntosh*, the interpretation urged by Contractor would not apply here. In *McIntosh*, the question was whether construction of a residential shelter care facility had been paid for in whole or in part out of county funds. The county had subleased the undeveloped land to a private corporation for the purpose of constructing, operating and maintaining the facility at no cost to the county. In connection with the construction project, the county agreed to forebear rent for the first 20 years of operation of the facility, absorb inspection costs, and pay bond premiums on the project. The court held that the forbearance of rent and inspection cost waiver did not qualify as payment of public funds for construction under the former section 1720(a). When evaluating the forbearance of rent issue, the court stated 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." (*McIntosh*, 14 Cal.App.4th at p. 1588 [internal quotes and citations omitted].) The court stated: "The county's right to charge rent is not an available pecuniary resource like cash or some readily cash-convertible asset. To take rent collected from one source and use it to pay obligations would plainly be a payment of public funds, but the County here will not collect the rent." (*Ibid.*)

Unlike the forbearance of rent or absorption of inspection costs involved in *McIntosh*, County's insurance proceeds does constitute "an available pecuniary resource like cash or some readily cash-convertible asset." County did not have a mere right to pursue a claim for damages. As acknowledged by the Rebuilding Agreement, County had a legal entitlement to cash proceeds under its insurance policy, for which it presumably paid premiums. As such, the funding of the Project with County's insurance proceeds constitutes "the delivery of money or its equivalent ... out of available pecuniary resources" such as "cash or some readily cash-convertible asset." This

definition from *McIntosh* of “paid for in whole or in part out of public funds” closely resembles section 1720(b)(1) upon which coverage in this case is based.⁹

Contractor also relies on a handful of previous public works coverage determinations by the Director.¹⁰ However, those determinations are factually distinguishable and, in any event, their significance is limited given the subsequent passage of SB 975. In PW 26-PW-20473, *Insurance Company Replacement of Esperanza High School Burned Out Wing* (June 11, 1985), the work to repair fire damage was undertaken by the insurance company, not the public entity. Similarly, in PW 90-006, *Insurance Company Proceeds Used to Pay for Water Damage Repair for a School District, S.C. Anderson Inc.* (January 14, 1991), insurance proceeds were used to pay for water damage repair to school buildings, yet the insurance company and not the school district was the party undertaking the repairs. Here, County, not Insurer, is undertaking the rebuilding work under the Rebuilding Agreement. Contractor also cites PW 93-062, *City of Malibu Fire Debris Clearance and Erosion* (December 1, 1993), in which the city paid for emergency fire debris removal and erosion control work on private property subject to reimbursement under private homeowner insurance policies. Here, County, not a third party, is the insured.

The facts in this matter are more analogous to the situation in PW 92-03, *Calexico Airport Hangar* (January 25, 1993), which found a public work where insurance proceeds stemming from a fire were deposited in city accounts from which city made progress payments for construction of replacement facilities. (See also PW 2003-009, *Energy Efficiency and Generation Work, San Diego Police Headquarters* (January 28, 2005) [work paid by renewable energy incentive payments made to a contractor from private sources was public work where those incentive payments were due a city]; and PW 93-054, *Tustin Fire Station, Tustin Ranch* (June 28, 1994) [money collected for, or in the coffers of, a public entity is “public funds” within the meaning of section 1720].)

In summary, the Project is construction performed under contract, and it is paid for in whole or in part out of public funds in the form of County’s insurance proceeds within the meaning of section 1720(b)(1).

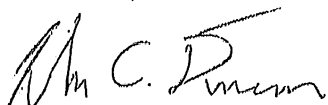
⁹Also, in the event that Contractor’s installation of the fire sprinkler system necessitates structural changes for which County will pay additional costs from County revenues, such payment would constitute an additional payment out of public funds within the meaning of section 1720(b)(1). Similarly, if County reimburses Contractor for new city permits over \$7,500, that too would be an additional payment out of public funds within the meaning of sections 1720(b)(1) and 1720(b)(4).

¹⁰The Department decided it would no longer designate public works coverage determinations as “precedential” under Government Code section 11425.60. Consequently, past determinations no longer have precedential effect. Public notice of the Department’s decision to discontinue the use of precedent decisions can be found at [www.dir.ca.gov/DLSR/09-06-2007\(pwcd\).pdf](http://www.dir.ca.gov/DLSR/09-06-2007(pwcd).pdf).

Letter to Chad T. Wishchuk, Esq.
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I hope this determination satisfactorily answers your inquiry.

Sincerely,

A handwritten signature in black ink, appearing to read "John C. Duncan". The signature is written in a cursive style with a large initial "J" and "D".

John C. Duncan
Director