

INITIAL STATEMENT OF REASONS
for
PROPOSALS TO AMEND SECTIONS 16423, 16450 THROUGH 16453,
AND 16455 OF TITLE 8, CALIFORNIA CODE OF REGULATIONS

The Acting Director of the Department of Industrial Relations (“Acting Director”) proposes to amend one regulation governing Labor Compliance Programs and five regulations governing fee-based monitoring and enforcement by the Department of Industrial Relations on state bond-funded and other specified public works projects.

GENERAL INFORMATION

The laws regulating public works projects require among other things that contractors and subcontractors pay their workers not less than the general prevailing wage rates as determined under the Labor Code. State prevailing wage requirements customarily are enforced by the State Labor Commissioner (also known as the Chief of the Division of Labor Standards Enforcement) through the investigation of complaints and the issuance of civil wage and penalty assessments to compel the payment of sums found due. Historically, public agencies that award public works contracts (known as “awarding bodies”) have also shared responsibility for monitoring compliance with prevailing wage requirements, taking cognizance of violations, and pursuing appropriate enforcement action.

Through the adoption of Labor Code section 1771.5¹ in 1989, the legislature formally recognized and encouraged awarding bodies to initiate and enforce labor compliance programs (“LCPs”) to monitor and enforce prevailing wage requirements on their projects. LCPs must be approved by the Director and are subject to specified statutory and regulatory requirements under the oversight of the Labor Commissioner and the Director. Initially, Labor Code section 1771.5 provided for higher prevailing wage exemptions for awarding bodies that used an approved LCP for all of their public works projects. Subsequently legislation began to require awarding bodies to use LCPs on specific projects as a condition for using certain bond funds or alternative procurement methods such as design-build for those projects.²

The required use of LCPs, especially under Labor Code section 1771.7, which applied to projects funded by the Kindergarten-University Public Education Facilities Bond Acts of 2002 and 2004, led to a proliferation in the number of approved LCPs. However, after a Legislative Analyst’s Office study of the cost-effectiveness of LCPs, the legislature and governor concluded that the mandated use of LCPs was a flawed enforcement model and that the Department could monitor and enforce compliance more effectively for less cost. This led in turn to the adoption in early 2009 of SBX2-9,³ which replaced the required use of LCPs for specified projects with a requirement to pay a fee to the Department for compliance monitoring and enforcement on those

¹ Stats. 1989, ch. 1224, §2.

² A list of these laws is available at <http://www.dir.ca.gov/lcp/StatutesRequiringLCPs.pdf>.

³ Stats. 2009-2010, 2d Ex. Sess., ch. 7.

projects. SBX2-9 also extended this requirement to projects funded by *any* state-issued public works construction bond (rather than just specified bonds).

SBX2-9 further specified that its requirements would go into effect upon the determination and adoption of the fees to be charged for these services and the adoption of regulations setting forth the manner in which the Department would ensure compliance with and enforce prevailing wage compliance on subject projects. The former Director commenced a rulemaking in November of 2009 to establish fees, with related notice and fee waiver requirements, and to set forth the specific monitoring and enforcement activities to be undertaken by a new Compliance Monitoring Unit (“CMU”) within the Division of Labor Standards Enforcement. Final regulations were approved by the Office of Administrative Law and filed with the Secretary of State on June 29, 2010, and were set to become effective on August 1, 2010.⁴

Just prior to the effective date of the new regulations, other state agencies and their bond counsel within the Attorney General’s Office raised concerns regarding the consistency of SBX2-9’s fee requirements with other legal requirements governing the expenditure of bond funds. In light of these concerns, bond counsel was unwilling to write an unqualified opinion letter for an upcoming bond sale, thereby jeopardizing the state’s ability to sell bonds to fund public works projects. The former Director then conducted an emergency rulemaking to delete the new subchapter 4.5 regulations, thereby delaying the applicability of SBX2-9’s fee requirements and removing the impediment to issuing unqualified bond opinions and selling bonds while the concerns raised by bond counsel were addressed.

Because emergency regulations can only remain in effect up to a maximum of 360 days (per Government Code section 11346.1), the emergency rulemaking had the effect of suspending but not fully repealing the new subchapter 4.5 regulations.⁵ By law, the suspended regulations will become effective unless replaced by permanent regulations or an order of repeal adopted through a regular rulemaking within that same time period. At the present time, the emergency action has been extended once and is set to expire on August 1, 2011, but is potentially eligible for one more 90 day extension through October 31, 2011.

The Acting Director is now conducting this regular rulemaking for the purpose of modifying certain requirements in the subchapter 4.5 regulations in order to accommodate concerns raised by bond counsel. These proposed modifications are principally related to fees and to the effective date of the new requirements. The Acting Director is not proposing to modify the standards governing the operation of the Compliance Monitoring Unit in sections 16460 through 16464 or other regulatory requirements that were not implicated in the concerns raised by bond counsel. Instead, the provisions will be restored once the emergency rulemaking expires and the requirements of SBX2-9, as modified by this regular rulemaking and any new legislation, be-

⁴ This rulemaking added a new subchapter 4.5, consisting of sections 16450 – 16455 and 16460 – 16464, to Chapter 8, Division 1, of Title 8 of the California Code of Regulations. The same rulemaking also made several revisions to the LCP regulations in Subchapter 4 that were mostly unrelated to the new Subchapter 4.5 requirements.

⁵ The emergency rulemaking also made revisions to section 16423 of the LCP regulations to delete references to the new subchapter 4.5 regulations. With this one exception, the amendments to the LCP regulations that became effective on August 1, 2010, were *not* affected by the emergency rulemaking.

come effective.

Through research and continuing consultations the legal concerns raised by bond counsel have been substantially narrowed and are focused on not construing SBX2-9 fee provisions as authorizing expenditures that would go beyond the authority provided by any specific bond measure to which the fee provisions apply. The parties to these discussions believe that some legislative changes are needed to fully resolve these concerns. Unfortunately, because the emergency suspension of the subchapter 4.5 regulations can only remain in effect until October 31, 2011, at the latest, it is necessary to commence this regular rulemaking (to supersede the emergency action) without knowing what will be adopted in any corrective legislation. Consequently, the language of these proposals has been drafted with a focus on avoiding continuing concerns under bond law but without the same level of public input and precision that went into the original language and that may be desired by the regulated public. At the same time, the Acting Director is attempting, insofar as possible, to leave intact the original regulatory language that was produced through a full and robust public rulemaking and was not implicated by the issues raised by bond counsel.

PROPOSED AMENDMENTS

The Acting Director proposes to amend section 16423 within Subchapter 4 of Chapter 8, Division, Title 8 of the California Code of Regulations (Labor Compliance Programs) and sections 16450, 16451, 16452, 16453, and 16455, within Subchapter 4.5 (Compliance Monitoring by Department of Industrial Relations). Some of these changes are substantive and others are clarifying or technical, including some revisions to Reference notes.

In drafting these proposals, the Acting Director relied upon the rulemaking records from the original rulemaking which led to the adoption of Subchapter 4.5 in 2010 (OAL File No. 2010-0517-04 S), the Emergency Rulemaking Action which suspended those regulations on November 4, 2010 (OAL File No. 2010-1028-01 E), and the extension of the Emergency Rulemaking Action on May 2, 2011 (OAL File No. 2011-0422 EE). The complete rulemaking records are available through the Department's contact person listed in the Notice of Proposed Rulemaking for this rulemaking, and the principal rulemaking documents are available on the Department's website at <http://www.dir.ca.gov/LaborComplianceRegulations/LCP-SBX2-9.htm> and http://www.dir.ca.gov/dlse/cmu/EmergencyRulemaking/EmergencyRulemaking_SBX2-9.htm.

The Acting Director also relied on research by legal staff and consultations with bond counsel in the Attorney General's Office and representatives of the Department of Finance and State Treasurer's Office as noted above. Department staff have consulted informally with representatives of construction trades contractors and labor organizations, labor compliance programs, school districts, and other governmental agencies regarding the subject matter of these proposals. However, due to time constraints there has been no structured public discussion of the proposals with interested and affected parties, as contemplated by Government Code section 11346.45.

These proposals amend the permanent regulatory text (*i.e.* the regulations that were ap-

proved on June 29, 2010, and set to become effective on August 1, 2010), rather than emergency regulatory amendments and repeals that were approved later but will expire automatically at the end of the emergency period.

These proposals will impose no new or discrete impacts on individuals, employees, small businesses, businesses, competitiveness, local government including school districts, or state government, except as follows:

- The revised effective date of the Subchapter 4.5 regulations will further delay the projected cost savings of paying a fee for compliance monitoring and enforcement by the Department in lieu of using LCPs for prevailing wage compliance monitoring and enforcement, as required under several existing statutes.
- The revised effective date of the Subchapter 4.5 regulations will further delay the projected benefits associated with compliance monitoring and enforcement on the Department on state bond-funded projects that currently are not subject to an LCP requirement. Although statutory requirements to use an LCP or the CMU impose a small increase in the upfront costs for public works construction, this enforcement model significantly improves the chances of identifying and correcting prevailing wage violations early before they evolve into large liabilities and litigation. Increased monitoring and enforcement also promotes the underlying public purposes of prevailing wage laws, as expressed by the state Supreme Court in *Lusardi Construction Co. v. Aubry* (1992) 1 Cal.4th 976 at 987.

“... 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.” (Citations omitted.)

- The revised fee requirements may result in increased administrative costs to both local and state government for invoicing, billing, payment, and collection of fees for compliance monitoring and enforcement by the Department. The insurance model flat fee calculation and payment method that had been designed to eliminate these costs is being removed from the existing regulatory text due to the legal concerns raised by bond counsel. Although these revisions are designed to remove the potential for comingling or misapplication of bond funds from different sources and may also result in lower fees on some projects where the Department’s compliance monitoring and enforcement activities are limited, they may also result in increased overall costs due to associated administrative and accounting costs.

- The proposed revisions to how “total project costs” are calculated may result in the reduction of some fees, although the costs associated with calculating fees and then ensuring that the correct fees are paid will increase.
- The impacts of fee-based monitoring and compliance by the Department as implemented through the Subchapter 4.5 regulations, including these proposed amendments to those regulations, are necessarily contingent upon two other factors that are beyond the Department’s control: (1) any legislation which may amend the requirements of SBX2-9; and (2) any limitations or other requirements that the Department of Finance may impose on the collection of fees for compliance monitoring and enforcement on state bond-funded projects.
- The Acting Director believes that the existing regulatory language constitutes the most reasonable and cost-effective alternative for carrying out the purposes of SBX2-9.⁶ The current proposals are likely to be more costly and burdensome for awarding bodies and the Department, but are designed to address legal concerns with respect to the use of bond funds, as noted above. The Acting Director is not aware of other alternatives to implement the requirements of SBX2-9.
- These proposals will impose no new obligations in terms of the use of technologies or equipment. The web-based notice and reporting systems that were contemplated in the original rulemaking were designed and in the process of being implemented when the regulations were suspended.
- These proposals directly impact only those state and local agencies and contractors that choose to engage in public works construction projects that are subject to the fee and monitoring requirements prescribed by SBX2-9. The proposals make no changes in the legal obligations of contractors on public works construction projects. For awarding bodies, they are likely to create additional administrative burdens as discussed above.
- The Acting Director believes that these proposals impose no mandates or costs that are different or distinct from what the Legislature has required by statute and what may also be required by the State Constitution or other laws governing the expenditure of bond funds.

Amendment to section 16423: This revision is unrelated to the other amendments to the Subchapter 4.5 regulations, but is proposed for the reason and purpose of adding clarity to the language of subpart (e) of *section 16423*. The purpose of subsection (e) is to clarify the need for an awarding body to use its LCP for *all* of its public works projects in order to be entitled to higher prevailing wage exemptions under Labor Code section 1771.5(a). The existing language uses the phrase “all public works projects in which the Awarding Body participates,” which can

⁶ See the Notice of Proposed Rulemaking and Initial Statement of Reasons for the original Subchapter 4.5 regulations (at pages 13 and 4 respectively) for the former Director’s basis for reaching this conclusion.

construed as going beyond the statutory intent to embrace any project in which the awarding body may play a role as a funding conduit or provider of administrative support, without being the agency that awards and oversees the public works contract. The Acting Director proposes to replace this text with “every public works project under the authority of the Awarding Body,” which is drawn directly from the statute and avoids the possibility of inferring a different regulatory meaning or intent. The necessity for the revision is to avoid such misinterpretation.

The former Director intended to make this change as part of the 2007-8 amendments to the LCP regulations, and the revised text can be found in the rulemaking documents for those amendments. However, because those revisions were not properly delineated through the striking out of deleted text and underlining of new text, the revisions were not incorporated into the final published rules. This rulemaking is now being used as an opportunity to make this long-intended correction.

Amendments to section 16450: The purpose of these revisions is to replace obsolete “effective date” language in subpart (a), which pertains to bond-funded projects, and to add “effective date” language to subpart (b), which pertains to other projects that are subject to a statutory requirement to pay a fee for compliance monitoring and enforcement by the Department. The reason and necessity for “effective date” language and for replacing the existing language in subpart (a) is twofold. First, under Labor Code section 1771.55(b) and several other statutes that refer back to that section, the adoption of regulations setting forth how the Department would monitor and enforce compliance was one of the prerequisites for making the requirements of SBX2-9 operational. This originally was supposed to occur on August 1, 2010, the effective date for the original Subchapter 4.5 regulations, but the regulations ended up being repealed (temporarily) through emergency action to avoid having SBX2-9 go into effect. Thus, the August 1, 2010 date has been rendered obsolete and will be a source of continuing confusing unless removed and replaced by new language. Second, a specific ascertainable “effective date” is also critical for purposes of determining which public works projects are subject to the old pre-SBX2-9 requirements, and which come under the new requirements. The statutory language used throughout SBX2-9 creates a clear dividing line between public works contracts awarded before the effective date of the regulations, which are subject to the old rules *for the life of the project*, and contracts awarded on or after the effective date, which come under the new rules and fee requirements. These proposed revisions attempt to create certainty by expressing the effective date with the greatest clarity possible, while also recognizing that the regulations cannot become effective until approved and that corrective legislation may change when or how the requirements of SBX2-9 go into effect.

The “effective date” language is being placed in subparts (a) and (b) because those subparts cover the project for which fee-based monitoring and compliance by the Department (or waiver of fees based on use of an approved LCP) will be required under SBX2-9. Since subparts (c) and (d) cover situations in which fee-based monitoring and compliance by the Department is a voluntary choice for the awarding body, there is no corresponding need for an expressly-stated effective date.

The Acting Director is also proposing to correct the Reference note by adding two more statutory sections that will require fee-based monitoring and enforcement by the Department. These sections were omitted inadvertently during the original rulemaking in 2010.

Amendments to section 16451: The Acting Director is proposing to revise the title of this section from “Notice of Projects Subject to Fees” to “Notice of Projects Subject to Requirements of Subchapter.” The purpose, reason, and necessity for this revision is for the sake of accuracy and clarity, since some awarding bodies may be subject to notice requirements but not to the payment of fees if entitled to a waiver under section 16455(b) of the Subchapter 4.5 regulations.

The Acting Director is also proposing to revise the meaning of “estimated total project costs” in subpart (a)(3)(G). The reason and purpose of this revision is to confine the definition to the gross amount of contracts that are subject to public works requirements and exclude other awarding body costs that are indirectly related to but not a “public works” cost as that term is defined in Labor Code sections 1720 and following. This statutory definition is being used because it provides an ascertainable meaning that is consistent with what the legislature intended in capping fees based on “total *project* costs.” This restated meaning allows awarding bodies to exclude items that may be related to a project but are not “public works” under the Labor Code, such as land acquisition or internal administrative costs. However, it does not enable individual cost items to be parsed out or excluded if they are within the public works contract. The definition also refers to “*every* public works contract” in recognition that some public works projects are built through multiple prime contracts between the awarding body and different general or specialty contractors, rather than a single prime contract with a single prime contractor (who subcontracts work to specialty contractors).

The necessity for this revision is to address concerns raised by bond counsel about the potential calculation and payment of fees that may exceed and be unrelated to the reasonable and necessary costs of compliance monitoring and enforcement by the Department. Although fee requirements are set forth in the following regulatory section 16452, this particular provision refers to a project contract dollar amount that is reported to the Department and can be used for estimating the fee for compliance monitoring and enforcement on the project. The revised language proposed for this subpart is the same as the language used in the proposed revision of section 16453(c), discussed below.

The Acting Director is also proposing to correct the Reference note by adding two more statutory sections that will require fee-based monitoring and enforcement by the Department. These sections were omitted inadvertently during the original rulemaking in 2010.

Amendments to section 16452: The overall purpose and reason for the revisions to this section is to change the principles governing how fees for compliance monitoring and enforcement by the Department will be determined. The flat-rate insurance model with advance calculation and payment specified in existing subparts (a) through (c) has been one of the primary sources of concern for bond counsel. Consequently, it is necessary to delete those requirements and replace them with other provisions that do not raise the same concern.

The purpose and reasons for the proposed new subpart (a) is to confirm the general principle that fees are to be paid for the Department's reasonable and necessary expenses that are directly related to compliance monitoring and enforcement for the project in question. The necessity for this provision is to avoid construing SBX2-9 as authorizing fees for activities that are unrelated to compliance monitoring and enforcement on covered projects or unrelated to purposes of the bond from which the fee for a particular project is derived.

The purpose and reason for the proposed new subpart (b) is tie the fee requirements for bond-funded projects to standards approved by the Department of Finance (consistent with the Director of Finance's authority to approve this fee under Labor Code section 1771.3(a)(2)), and to any other applicable constitutional, statutory, and bond purpose limitations. The necessity for this provision is to avoid construing SBX2-9 as authorizing fee charges or payments under any circumstance that would violate state law. The purpose and reason for the second sentence is to incorporate a 2010 amendment to Labor Code section 1771.3(a)(2) which provides for direct payment of the Department's fee by agencies that award bond-funding for public works projects.⁷ The Acting Director has decided not to propose more specific bond fee requirements because of continuing uncertainty over standards that may be incorporated into corrective legislation or required by the Department of Finance. The Acting Director also notes that the statute does not require the fee to be set by regulation, and that it is not feasible to adopt specific regulations governing the calculation of fees if the method of calculation necessarily must vary according to the bond, project, stage at which monitoring and enforcement commences, personnel used, and nature and extent of required enforcement.

The purpose and reason for the proposed new subpart (c) is restate the cap on fees for compliance monitoring and enforcement by the Department on any project and to limit the meaning of "total project costs" for purposes of calculating that maximum fee. As with section 16451(a)(3)(G) above, the term "total project costs" has been revised here so that it includes the gross amount of contracts that are subject to public works requirements, but excludes other awarding body costs that are indirectly related to a project but not part of a contract for "public works," as that term is defined in Labor Code sections 1720 and following. The necessity for this revision is to address concerns raised by bond counsel about the potential calculation and payment of fees that may exceed and be unrelated to the reasonable and necessary costs of compliance monitoring and enforcement by the Department.

The reason, purpose, and necessity for deleting subpart (e) of this section is that it was superseded by the 2010 amendment to Labor Code section 1771.3(a)(2), providing for direct payment of the Department's fee by agencies that award bond-funding for public works projects.⁸ This statutory revision has also been incorporated into the revised language for subpart (b), as discussed above.

The Acting Director is also proposing to correct the Reference note by adding two more statutory sections that will require fee-based monitoring and enforcement by the Department.

⁷ Stats. 2010, ch. 719, §47 (SB 856).

⁸ Stats. 2010, ch. 719, §47 (SB 856).

These sections were omitted inadvertently during the original rulemaking in 2010.

Amendments to section 16453: The purpose and reason for the proposed revisions to subparts (b) and (d) of this section are to bring the language into conformity with the proposed revisions to section 16452 discussed above. Since the language of section 16452(a) has been rewritten and specific fee calculation language eliminated, it is necessary to eliminate specific references in subpart (b) to how the fee is determined and negotiated reductions. For the same reason, it is also necessary to remove language from subpart (d) that limited fees to the same percentage amount that would have been due under the language proposed for elimination.

The Acting Director is also proposing to correct the Reference note by adding two more statutory sections that will require fee-based monitoring and enforcement by the Department. These sections were omitted inadvertently during the original rulemaking in 2010.

Amendments to section 16455: The Acting Director is proposing to correct the Reference note by adding two more statutory sections that will require fee-based monitoring and enforcement by the Department. These sections were omitted inadvertently during the original rulemaking in 2010. No substantive revisions to this section are proposed, and the Acting Director is not proposing to amend any other Subchapter 4.5 regulations.