No. 00-152

In The

Supreme Court of the United States

ARTHUR S. LUJAN, an individual, in his official capacity as Labor Commissioner of the State of California; LLOYD W. AUBRY, JR., an individual, in his official capacity as Director of the Department of Industrial Relations of the State of California; DANIEL DELLAROCCA, an individual, in his official capacity as Deputy Labor Commissioner of the State of California; ROGER MILLER, an individual in his official capacity as Deputy Labor Commissioner of the State of California; ROSA FRAZIER, an individual in her official capacity as Deputy Labor Commissioner of the State of California; DIVISION OF LABOR STANDARDS ENFORCEMENT, an agency of the State of California; DEPARTMENT OF INDUSTRIAL RELATIONS, an agency of the State of California,

Petitioners,

v.

G&G FIRE SPRINKLERS, INC.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

PETITIONERS' BRIEF

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QUESTIONS PRESENTED

1. Whether the discretionary withholding of funds by a prime contractor from his subcontractor, where authorized by statute, constitutes state action.

2. Whether a subcontractor who has not alleged that he has an entitlement to public funds can state a claim for denial of due process based on the state's withholding of said funds from his prime contractor.

3. Whether nonpayment to a private contractor by a state agency under the terms of a commercial contract constitutes a deprivation of due process.

4. Whether a post-deprivation hearing pursuant to common law or statutory remedies satisfies the requirements of due process.

5. Whether a subcontractor not targeted by a withholding statute suffers a denial of due process where his loss is at most indirect.

LIST OF PARTIES

Arthur S. Lujan[1], Lloyd W. Aubry, Jr.[2], Daniel Dellarocca, Roger Miller, Rosa Frazier, the Division of Labor Standards Enforcement, and the Department of Industrial Relations of the State of California are the petitioners herein. G&G Fire Sprinklers, Inc., a subcontractor on construction projects, is the respondent.

[1] Arthur S. Lujan is the Labor Commissioner of the State of California, a position Victoria Bradshaw held when this litigation commenced.

[2] Lloyd W. Aubry, Jr., was sued in his official capacity as Director of the Department of Industrial Relations of the State of California, a position he held when this litigation commenced. Stephen Smith is the current Director.

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

OPINIONS AND ORDERS

The judgment of the District Court, entered on November 9, 1995, is not officially reported but is reprinted in Volume II, p. 372 of the Joint Appendix. The original opinion of the United States Court of Appeals for the Ninth Circuit is officially reported at 136 F.3d 587 (9th Cir. 1998) and is reprinted at A-52 of the Petition. The Ninth Circuit issued a subsequent order and amended opinion on September 10, 1998, officially reported at 156 F.3d 893 (9th Cir. 1998), and reprinted at A-16 of the Petition. Following the October 28, 1998 order denying the petition for rehearing, the State filed a Petition for Writ of Certiorari with this Court, which petition was granted on April 19, 1999 (526 U.S. 1061). This Court summarily vacated the judgment below and remanded the case for further consideration in light of *American Manufacturers Mutual Insurance Co. v. Sullivan*, 526 U.S. 40, 119 S.Ct. 977 (1999). The Ninth Circuit issued yet a third opinion in this case on February 23, 2000, officially reported at 204 F.3d 941 (9th Cir. 2000) and reprinted at A-1 of the Petition.

JURISDICTION

The Ninth Circuit issued its amended opinion and order on February 23, 2000. A timely petition for rehearing and rehearing en banc was denied on May 1, 2000. The petition for writ of certiorari was filed within ninety days of the denial of rehearing. This Court has jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The Fourteenth Amendment of the United States Constitution provides, in relevant part, "No State shall . . . deprive any person of life, liberty, or property, without due process of law. . . . "

42 U.S.C. § 1983 provides, in relevant part, "Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State . . . subjects, or causes to be subjected any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress."

The relevant California statutory provisions are reproduced in the appendix to the Petition at A-77, and include California Labor Code §§ 1720, 1727, 1729, 1730, 1731, 1732, 1733, 1771, 1772, 1773, 1773.2, 1774, 1775, 1776, and 1813, and California Civil Code §§ 3103, 3110, 3181, 3184, 3186, 3210, 3245, 3250.

STATEMENT OF THE CASE

A. Material Facts

Respondent, G&G Fire Sprinklers, Inc. (hereinafter "G&G"), a fire protection company that installs fire sprinkler systems, contracted as a subcontractor with certain

prime contractors on certain "public works"[3] projects with California governmental agencies during 1995. (Jt. App. 18, 20-21, 64, 67.)

California, like many other states, has adopted a prevailing wage law (California Labor Code §§ 1720-1861) applicable to public works projects undertaken within its geographical boundaries. Under this law, enacted in 1931, the State pays a premium for construction work done on public projects and in consideration of such premium requires all contractors working on these projects to pay their employees "prevailing wages" in the construction industry. The prime contractor agrees, in his contract with the governmental entity, that its construction workers, and the workers of the subcontractors whom he later selects to perform the contract, will be paid prevailing wages[4] as required by California Labor Code §§ 1771 and 1774. Section 1775 mandates that the prevailing wage requirement is incorporated into and becomes a part of the contract. The governmental awarding body is required by § 1772 to withhold funds otherwise due to the prime contractors where there are violations of the prevailing wage requirement, so that this money can be held for and eventually paid to the affected workers.

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[3] The term "public work" is defined at Cal. Labor Code § 1720 to include "construction, alteration, demolition, or repair work done under contract and paid in whole or in part out of public funds. . . . "

[4] Prevailing wages are fixed for each construction craft or classification in the locality in which the public work is performed. The procedure for determining prevailing wages is set out at Cal. Labor Code § 1773.

Each of the prime contractors that subcontracted work to G&G on these projects was accordingly required by law to agree to the following contractual provisions in their public works contracts with the respective public awarding bodies: (1) that prevailing wages would be paid to all workers employed on the project, whether by the prime contractor or its subcontractors, (2) that certified payroll records would be kept, and provided to the Division of Labor Standards Enforcement (hereinafter "DLSE") upon request, showing the hours worked and wages paid to all workers employed on the project by the prime contractor and its subcontractors, and (3) that the public agencies that had awarded the contracts could withhold contract payments to these prime contractors to cover unpaid wages and penalties if the agreements were breached.

DLSE, pursuant to California Labor Code § 1727, having discovered after investigation certain prevailing wage law violations by G&G, i.e., the failure to pay prevailing wages, concerning three separate projects undertaken by G&G, issued notices to the awarding bodies to withhold contract payments from the prime contractors on these projects. This investigation also disclosed a failure by G&G to provide DLSE with certified payroll records, an additional violation of law. Following issuance of notices to withhold from DLSE, the awarding bodies for each of the projects withheld money from the prime contractors. The prime contractors, in turn, withheld from G&G payments allegedly otherwise due under their subcontracts, as authorized by California Labor Code § 1729 "on account of G&G's failure to comply"

with the prevailing wage requirements. (Jt. App. 21, et seq., 67, et seq.).

Following the prime contractors withholding from G&G, it appears that G&G did not obtain an assignment of any of its prime contractors' rights to sue to recover the funds withheld by the State under California Labor Code § 1730-1733. G&G did not assert that it was subrogated to the rights of the prime contractor against the State under the doctrine of equitable subrogation. Furthermore, it did not pursue any common law remedy existing under California law, including an action for breach of contract for damages, recission, or restitution. It did not pursue its rights under the stop notice provisions of the California Civil Code, consisting, *inter alia*, of the right to file a stop notice, setting forth the amount owed by the prime contractor to the subcontractor for work performed under the subcontract. Finally, it did not commence an action against the prime contractors' payment bonds pursuant to the applicable provisions of the California Civil Code. In other words, G&G did not avail itself of any existing state law remedy in challenging the withholding of funds.

B. The District Court Proceedings

G&G brought this action for declaratory and injunctive relief under 42 U.S.C. § 1983 and 28 U.S.C. §§ 2201-2202 in the United States District Court for the Central District of California, claiming that the issuance of the notices to withhold by the State without a prior hearing constituted a deprivation of property without

due process of law, in violation of the Fourteenth Amendment. G&G alleged therein that the notices to withhold issued by petitioners were "wrongful, incorrect, excessive" and "arbitrary and unreasonable." (Jt. App. 69) G&G did not, however, allege in the initial Complaint or the First Amended Complaint, either in *haec verba* or in substance, the existence of an agreement between it and any of its prime contractors in connection with the projects which are the subject matter of this action. (Jt. App. 16, et seq., 62, et seq.) It also failed to allege that it had performed all conditions precedent to these contracts if any; and it further failed to allege that it had complied in all respects with the provisions of the prevailing wage law.

The State responded with a motion to dismiss, and G&G shortly thereafter filed a motion for summary judgment (Jt. App. 79, et seq., 143, et seq.). The district court denied the state's motion to dismiss and granted G&G's motion for summary judgment. The district court's judgment declared §§ 1727, 1730-1733, 1775, 1776(g) and 1813 of the California Labor Code unconstitutional, and enjoined the state from enforcing those statutes against G&G. (Jt. App. 372).

Petitioners filed a timely notice of appeal from this judgment. (Jt. App. 392).

C. The Ninth Circuit Proceedings

On February 3, 1998, Judge Hawkins, joined by Judge Reinhardt, issued an opinion, in part affirming and in part reversing the district court, and remanding the case for further proceedings consistent with the opinion.

Judge Kozinski vigorously dissented. The panel majority held that due process requires that the state provide a subcontractor with either a pre- or prompt post-deprivation hearing when withholding payments from a public works contractor for unpaid wages or penalties. This holding is founded upon the majority's view that a subcontractor "has a property interest in being paid in full for the construction work it completed," and that this interest, which "arises from *its*[5] public works contract", is protected by the Due Process Clause. 136 F.3d at 595-597. (Pet. A-63). The panel also concluded, however, that the district court's injunction was overbroad in that the challenged withholding provisions, while unconstitutional as applied, were not facially invalid. (Pet. A-72 to 73).

In his dissent, Judge Kozinski protested the majority's "categorical approach that turns every right to receive payment on a public works contract into a property right protected by due process." 136 F.3d at 602. (Pet. A-80). Instead, Judge Kozinski maintained that any rights arising under commercial contracts, such as service contracts, material supply contracts, and construction contracts, are not protected by the Due Process Clause.

Judge Kozinski warned that the majority decision not only conflicts with the opinions of other circuits, but that it is "very bad policy" because it saddles the state, when

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[5] No party contended at any stage in this litigation that G&G, with respect to the three public works contracts at issue herein, was anything but a subcontractor – i.e., that it (rather than the prime contractors) had entered into any contracts with these public agencies.

it engages in "the purely commercial activity of construction", with "a burden not suffered by private builders", who routinely put provisions for payment withholdings for failure (or suspected failure) of performance into their private construction contracts. 136 F.3d at 602. (Pet. A-81 to 82). Judge Kozinski explained that payment withholdings are consistent with the awarding bodies' activities as market participants, and that any contractor or subcontractor who objects to provisions for withholdings is free not to do business with the state. Consequently, a dispute over withholdings is nothing more than a "run-of-the-mill contract dispute", for which the subcontractor's remedy lies in a state court breach of contract action against the prime contractor, or, as an assignee of the prime contractor, against the awarding body. 136 F.3d at 603. (Pet. A-82 to 83).

Finally, Judge Kozinski cautioned that drastic consequences would result from the majority decision, as due process requirements would inexorably apply to *any* withholding of payments under any commercial contract with the state, be it a withholding for failure to pay prevailing wages, or in more mundane instances, a failure to complete a project on time or a failure to comply with applicable building codes. (Pet. A-83 to 84).

The State petitioned for rehearing. This petition was granted, and on September 10, 1998, the panel issued an amended opinion and order. 156 F.3d 903. Once again, the panel split, with Judge Kozinski in the minority. The only significant change in the majority's opinion is its concession that "the state's interest in ensuring payment of prevailing wages is sufficiently important to justify the withholding of funds pending the outcome of whatever

kind of hearing may be afforded." 156 F.3d at 903 (Internal citation and quotation omitted.) (Pet. A-35 to 36). Thus, the majority concluded that a pre-deprivation hearing is not required, but that a prompt post-deprivation hearing is necessary to satisfy due process requirements.

In his dissent to this amended opinion, Judge Kozinski found that under California law, every subcontractor who wishes to challenge a withholding has an adequate state law remedy. Under California Labor Code § 1733, a subcontractor with an assignment from the contractor can file a breach of contract action against the awarding body to recover sums withheld. Furthermore, Judge Kozinski noted, any subcontractor unable to obtain an assignment but whose payment had been withheld by the prime contractor could bring suit against the awarding body under various state law theories. 156 F.3d at 909. (Pet. A-50).

The panel majority, however, concluded that even if the aggrieved subcontractor could bring an action on the contract, such an action would not be sufficient. While conceding that this Court has held that in certain circumstances, a post-deprivation state court action may fulfill the requirements of due process, the majority held that the right to bring a breach of contract action to recover withheld payments, when the withholding was carried out by state officials pursuant to state policy, would not provide adequate due process. (Pet. A-20).

On October 28, 1998, the court entered an order denying a petition for rehearing, indicating however that Judge Kozinski had voted to grant the petition for rehearing and to accept the suggestion for rehearing en banc.

D. Certiorari in the Supreme Court

Petitioners petitioned for a Writ of Certiorari. This Court granted the petition on April 10, 1999, summarily vacating the Ninth Circuit's judgment and remanding the case back for further consideration in light of *American Manufacturers Mutual Insurance Co. v. Sullivan, supra.*

E. Additional Proceedings in the Ninth Circuit

Following additional oral argument, the Ninth Circuit issued a third opinion on February 23, 2000. Determining that its prior reasoning "fits comfortably within the analytic framework set forth in *Sullivan*", Judges Hawkins and Reinhardt reinstated the prior judgment and opinion 204 F.3d 941. (Pet. A-7). Judge Kozinski again vigorously dissented, observing that "*Sullivan* fits the majority's rationale about as comfortably as Cinderella's slipper on the wicked step-sister's foot." (Pet. A-7). He pointed out as well that, under the analysis mandated by this Court in *Sullivan*, the withholding by the prime contractor of funds from G&G was purely private conduct. Continuing on, he opined that the claim of G&G did not qualify as a valid property interest without a showing that G&G had met the prevailing wage requirements. (Pet. A-8 to 11).

F. Legislative Changes

The Governor of California signed Assembly Bill 1646 on September 29 of this year. That new law repeals certain provisions of the California Labor Code (as specifically noted therein) and adds new language providing procedures for an appeal and hearing for both subcontractors and prime contractors in the event of a withholding by the State due to an alleged prevailing wage violation.[6]

SUMMARY OF ARGUMENT

The act of the prime contractors in withholding funds from G&G, their subcontractor, even though authorized by state statute, did not constitute state action within the meaning of 42 U.S.C. § 1983 because this action remained within the sole discretion of these prime contractors and the prime contractors were not subject to any penalty imposed by the State if they chose not to withhold. The District Court had no jurisdiction to hear this matter because the prime contractors did not act under color of law in withholding these funds from G&G.

[6] The text of the new law, which is not effective until July, 2001, is attached in an appendix hereto. A number of cases which arose after the decisions of the Ninth Circuit in this case nevertheless remain pending under the existing statutory provisions of the prevailing wage law that are being challenged in this case. The combined prayer for these cases exceeds $1,000,000.00. It is anticipated similar new challenges will be filed in the courts as well prior to the effective date of the new law.

G&G has failed to plead the necessary elements sufficient to show entitlement to the funds withheld, i.e., it has not alleged the existence of any contract between it and the prime contractors; or that it complied with the prevailing wage law; or even that it performed all conditions entitling it to payment under said contract.

A subcontractor contracting with the prime contractor on a public works project has no property right to payment from the state within the meaning of the Due Process Clause of the Fourteenth Amendment. In acknowledging such a right for the first time the Ninth Circuit found contrary to all other courts that have entertained the question.

G&G failed to avail itself of other valid, existing remedies under California law for recovery of the sums allegedly wrongfully withheld, including a common law breach of contract action against the prime contractor, a suit on the theory of equitable subrogation, and actions under alternative statutory remedies designed to afford the relief sought here.

Being only indirectly impacted by the State's withholding of payments, an action taken by the State solely against the prime contractors, G&G has not stated a claim for relief for deprivation of due process.

ARGUMENT

I

THE DISTRICT COURT WAS WITHOUT JURISDICTION BECAUSE THE DEPRIVATION OF PROPERTY COMPLAINED OF BY G&G WAS NOT PURSUANT TO STATE ACTION

Upon the initial granting of certiorari by this Court on April 10, 1999, and the consequent vacating of the Ninth Circuit's decision, this case was remanded for further consideration in light of this Court's decision in *American Manufacturers Mutual Insurance Co. v. Sullivan supra*, 526 U.S. 40. The instructions of this Court in remanding the case were explicit and unambiguous: G&G's rights in this action, if any, were to be reexamined in light of the express teachings of *Sullivan*.

In *Sullivan*, the respondent claimants attacked on due process grounds a Pennsylvania law authorizing the withholding by private insurers of their medical benefits in workers compensation cases without a hearing where the insurer submitted a form to the State contesting the reasonableness or necessity of the treatment provided. Respondents argued that these benefits could not be withheld by the insurers without a hearing. An issue also arose concerning whether the withholding of medical payments pursuant to the Pennsylvania law by the insurers constituted state action within the meaning of 42 U.S.C. § 1983. This Court rejected all of respondents' arguments, expressly finding, *inter alia*, that the withholding by the insurers was not state action.

When the operative facts in this case are examined with respect to the issue of private versus state action, they prove to be strikingly similar to those in *Sullivan*. G&G was a subcontractor under a public works contract. California law authorizes DLSE to issue a notice to withhold funds from the prime contractor on a public works project if his workers or the workers of his subcontractors have not been paid the prevailing wage. Upon issuance of the notice to withhold, the awarding body withholds an equivalent amount from the funds otherwise due the prime contractor. California Labor Code §§ 1727, 1774, 1775. There is no requirement in the law that the prime contractor must withhold all or any part of that sum from the subcontractor. The awarding body does not itself deduct any funds from the subcontractor. Section 1729, however, allows the prime contractor to deduct a like amount from its payments to the subcontractor "on account of the subcontractor's failure to comply with" the prevailing wage law. But the prime contractor may choose not to do so. Here, funds were withheld from G&G's prime contractors after the issuance of notices to withhold pursuant to these code sections and the prime contractors decided, in their sole discretion, and as a self-help remedy, to deduct a like amount from the money they presumably owed G&G.

Where state action is in issue, the inquiry must begin with the threshold principle that § 1983 "excludes from its reach merely private conduct, no matter how discriminatory or wrongful." *Sullivan*, 526 U.S. 40, 50 (1999). Under this basic tenet of law, the federal courts have no jurisdiction over a 1983 action unless the plaintiff can plead and prove state action.

The issue of state action under § 1983 has often been litigated in the federal courts, with the result that several well-established principles have emerged. Thus, it has long since been concluded that the fact, standing alone, "that a business is subject to state regulation does not convert its action into that of the State for purposes of the Fourteenth Amendment." *Blum v. Yaretsky*, 457 U.S. 991, 1004, 102 S.Ct. 2777, 73 L.Ed. 2d 534 (1981); *Jackson v. Metropolitan Edison Co.*, 419 U.S. 345, 350, 95 S.Ct. 449, 42 L.Ed. 2d 477 (1974). It is also clear that a plaintiff seeking relief under § 1983 must affirmatively show "a sufficiently close nexus" between the State and the challenged action so that "the latter may be fairly treated as that of the State itself." *Blum, supra*, 457 U.S. at 1004. Finally, the State can be held responsible for private action "only when it has exercised coercive power or has provided significant encouragement, either overt or covert, that the choice must in law be deemed that of the State." *Blum, supra*, 457 U.S. at 1004; *Flagg Bros., Inc. v. Brooks*, 436 U.S. 149, 166, 98 S.Ct. 1789, 56 L.Ed. 2d 185 (1978).

In deciding *Sullivan*, this Court expressly confirmed these longstanding principles. Its opinion points out that "action taken by private entities with the mere approval or acquiescence of the State is not state action." Going further, in words that echo resoundingly in this case, this Court stated that it had never declared that "[t]he mere availability of a remedy for wrongful conduct even where that remedy serves important public interests, so significantly encourages the private entity so as to make the State responsible for it." 526 U.S. 40, 53.

Careful analysis of the principles enunciated in *Sullivan* manifestly compels the overturning of the Ninth

Circuit's unwarranted application of the state action doctrine to the facts of this case. In *Sullivan*, as here, the state law authorized a private business to withhold funds under certain conditions. The insurers in *Sullivan were permitted to* withhold payment if they suspected that the treatment provided by the physician or other care giver was not reasonable or necessary and filed a form with the state to that effect. Here, the prime contractors are permitted to withhold payment due a subcontractor if they believe the subcontractor has failed to comply with prevailing wage obligations. In both cases the applicable statute does not mandate withholding by the regulated party, it only permits it. The decision whether or not to withhold is in the ultimate discretion of the private party, not the sovereign. Here, too, "the State's decision to allow the prime contractors to withhold payments . . . can just as easily be seen as state inaction. . . . " 526 U.S. at 53.

There can accordingly be no logical distinction between the effect of the withholding sanctioned by California law in this case and the effect of the withholding which survived judicial scrutiny in *Sullivan*. If anything, there is arguably lesser participation by the State in this case than there was in *Sullivan*, since there the actual withholding required government approval, albeit pro forma approval, while here no official approval is mandated by law prior to withholding. Otherwise, with respect to the operative factors discussed by this Court, this case and *Sullivan* are indistinguishable in law. The result in *Sullivan* with respect to the issue of state action clearly compels a similar result in this case.

As in *Sullivan*, all the State did here was to provide a remedy to the prime contractor, a remedy for relief from

the subcontractor's violations of the prevailing wage law. The State of California did not mandate utilization of this remedy any more than the State of Pennsylvania mandated withholding in *Sullivan*. The teaching of *Sullivan* is unequivocal: "[p]rivate use of state-sanctioned private remedies does not rise to the level of state action." 526 U.S. 40, 53.

The conclusion below was that the "withholding here was specifically directed by State officials in an environment where the withholding party had no discretion at all" 204 F.3d at 944. (Pet. A-6 to 7). This statement, the factual cornerstone of the reasoning of the Ninth Circuit with respect to this issue, represents a confusion of two separate and distinct events. It refers both to the issuance by DLSE of notices to withhold to the awarding body, and the mandatory withholding by that body from the prime contractors, on the one hand, and the discretionary withholding from G&G by the prime contractors, on the other. But the actual withholding by the prime contractor of money purportedly due G&G, which is the act complained of in this case, consists solely of the election of the prime contractors, private parties. The prime contractor under this statutory scheme has the absolute power to withhold or not withhold and is not subject to penalty or forfeiture of any kind from the State regardless of his decision. If the rest of the court below was confused about this distinction, Judge Kozinski was not, as he correctly points out in his dissent:

> "This would be true had the prime contractor been ordered, under penalty of law, to withhold funds from G&G. It was not. The only entity 'specifically directed' to withhold funds was the

awarding body, which withheld funds only from the prime contractor, not from G&G. While the challenged provisions *authorized* – even *encouraged* – the prime to withhold an equivalent amount from G&G, the prime was free to pay G&G the full amount specified by the contract. *Sullivan* clearly holds that mere authorization and encouragement do not render a private entity's decisions 'fairly attributable' to the state. 119 S.Ct. at 986. Under *the reasoning of Sullivan*, then, the prime contractor who chose to deprive G&G of funds was not a state actor". 204 F.3d 934-935. (A-18 to 19).

Here, as in *Sullivan*, there is no evidence before the Court to show that the action of the private entity complained of was the result of either the "coercive power" or "significant encouragement" of the State. The evidence, in fact, is plainly to the contrary. The prime contractor may indeed under the particular circumstances prevailing at the time find it in his business interest to withhold funds from the subcontractor, but he clearly need not do so, and, again, he need fear no adverse response from the State if he chooses not to withhold, the State being satisfied in the first instance to receive the money it claims is owed to the workers.

In both this case and in *Sullivan*, the last link in the chain of action was a private one, requiring the exercise of private discretion before the determination was made whether there was or was not to be withholding from the subcontractor. The fact that the prime contractors in fact chose to withhold from G&G does not alter our analysis. The common and controlling fact in both this case and *Sullivan* is that the final act was entrusted to a private

party who either could have withheld or not withheld in its sole discretion.

The reasoning in the decision below, as pointed out, *supra*, is grounded on a misconceived assumption, i.e., that the prime contractor had no choice but to continue the chain of conduct initiated by the State and withhold from the subcontractor. This perception has no support in the record and is plainly at variance with the true circumstances. The undisputed truth is that a prime contractor in this situation has the absolute discretion to either withdraw or not withdraw funds from the subcontractor. It is not compelled to do the former and can freely choose to do the latter without fear of reprisal.

G&G's claim here accordingly lacks a fundamental jurisdictional element under § 1983, the key factor of state action. It is evident from the record that G&G will never be able to cure this inherent defect in its case. The decision below must be overturned on this ground at least, since it goes to the power of the District Court to hear the matter.

II

G&G FAILED TO SUSTAIN ITS BURDEN OF SHOWING THE EXISTENCE OF A LEGALLY COGNIZABLE ENTITLEMENT TO THE FUNDS IN QUESTION

This Court further held in *Sullivan* that the workers compensation claimants in that case had not established a property right to a hearing because they had not made a showing of the basic elements of entitlement to the money withheld, i.e., they had not established that the

medical treatment in question was reasonable and necessary. Having failed to make this mandatory threshold showing, they were not entitled to any relief thereafter.

> "Respondents obviously have not cleared both of these hurdles. While they indeed have established their initial *eligibility* for medical treatment, they have yet to make good on their claim that the particular medical treatment they received was reasonable and necessary. Consequently, they do not have a property interest." 526 U.S. 40, 61.

It is apparent upon the most cursory analysis of G&G's claim in this case that it is subject to the same infirmity as the claims asserted in *Sullivan*.

Assuming, *arguendo*, that a subcontractor that lacks privity of contract with an awarding body can nonetheless assert a claim based on the awarding body's contract with the prime contractor, the question that must be carefully addressed is whether, under either the public works contract or applicable state law, there is an entitlement to payment in full once the job is purportedly completed. Under the California prevailing wage law the right to payment in full is contingent not only on the existence of a contract between the parties, and the satisfactory completion of the ordinary specifications of the job, but also on compliance with the prevailing wage and certified payroll record keeping requirements.

G&G, as has been previously noted, never alleged the existence of any agreements between itself and the prime contractors, making it impossible to determine what, if any, property rights it possesses. Moreover, it has never made any kind of a showing at any level that it was in

compliance with the prevailing wage law. Finally, it has not alleged that it was due the funds withheld by the prime contractors because it had fully performed its part of the contract. It has never, in fact, even alleged any entitlement to these funds (Jt. App. 15, et seq., 62, et seq.). Clearly, under *Sullivan*, G&G has fallen far short of meeting its affirmative burden as the moving party in its own lawsuit. Its failure to "clear" these essential "hurdles" in its pleadings strongly suggests that in actuality G&G can establish no valid claim on the merits.

The action G&G filed in the District Court sought only declaratory and injunctive relief on constitutional grounds for the failure of DLSE to grant a hearing prior to the issuance of the notices to withhold. Significantly, G&G did not seek recovery of the funds withheld. While G&G alleged in that action that the notices to withhold were "wrongful" and "arbitrary and unreasonable" (Jt. App. 69),[7] *it has never alleged, and could never allege, either in the District Court or thereafter, that it was in compliance with the prevailing wage law requirements and had therefore met all of the conditions entitling it to payment in full.*[8] There is not even an allegation in the First Amended Complaint

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[7] It is well-settled that such conclusionary allegations are insufficient to defeat a motion to dismiss for failure to state a claim. *Epstein v. Washington Energy Co.*, 83 F.3d 1136, 1140 (9th Cir. 1996); *Anderson v. Clow*, 89 F.3d 1399, 1403 (9th Cir. 1996).

[8] As is argued more fully *infra*, § 1729 of the California Labor Code conditions the prime contractor's withholding from the subcontractor on "the subcontractor's failure to comply with the terms of this chapter," i.e., the prevailing wage law. Where the subcontractor pleads and proves compliance with this law, the state court must necessarily find in its favor.

that all contractual conditions precedent to receipt of the funds (i.e., full performance of the terms of the contract) were satisfied. (Jt. App. 69) Instead, G&G took the position that all it needed to do to state a claim for relief was to allege the withholding took place without an administrative hearing, and that this allegation would, in and of itself, establish a deprivation of due process, regardless of the validity of G&G's claims on the merits.

G&G's naked contention that it possesses a property interest and an entitlement to these withheld funds is clearly insufficient and cannot substitute for factual allegations to that effect. As this Court stated years ago in *Board of Regents v. Roth*, 408 U.S. 564, 577, 92 S.Ct. 2701, 33 L.Ed. 2d 548 (1972) in considering the nature of property interests for purposes of due process:

> "To have a property interest in a benefit, a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have *a legitimate claim of entitlement to it.*" (Emphasis added.)

What is clearly missing in G&G's pleadings and proof is a showing that it has a property right to the funds in question based on the existence of a valid contract, in other words, "a legitimate claim of entitlement" to these funds. Without such threshold allegations and averments, G&G cannot be heard to argue that it is entitled to relief in either this Court, the Ninth Circuit, or the District Court.

Judges Hawkins and Reinhardt elected not to address this fundamental failing on G&G's part. They appear to have simply overlooked the fact that G&G, having failed

to set forth its entitlement to the funds by omitting allegations establishing the existence of a contract or contracts and allegations that it had performed all the terms of such contracts, had not stated a claim upon which any relief could be granted.

Judge Kozinki's learned dissent, on the other hand, points out that "G&G can have no property interest in being paid for work that has not been shown to satisfy the contractual conditions that it be completed in accordance with the prevailing wage requirements." 204 F.3d 946-947. (Pet. A-71).

G&G must be made, like any other litigant, to stand or fall on the sufficiency of its pleadings, pleadings in this instance that omitted essential allegations necessary to maintain its due process claims. As the Ninth Circuit has observed in comparable circumstances, "[a] complaint is not a puzzle, however, and we are loathe to allow plaintiffs to tax defendants, against whom they have leveled very serious charges, with the burden of solving puzzles in addition to the burden of formulating an answer to their complaint." *In re Glenfed, Inc. Securities Litigation*, 42 F.3d 1541, 1554 (9th Cir. 1994).

Having failed to sufficiently address, let alone prove at any stage of the administrative or judicial proceedings, its entitlement to the funds withheld by its prime contractor, G&G cannot be heard to argue at this juncture that it had a property right for due process purposes to a hearing in this case.

III

G&G'S CLAIM AGAINST THE STATE PURSUANT TO A CONSTRUCTION CONTRACT DOES NOT CONSTITUTE A PROPERTY RIGHT FOR DUE PROCESS PURPOSES

The Court below expressly determined that G&G's interest in being paid in full under its public works contract constituted a cognizable due process property right under the Fourteenth Amendment (136 F.3d 595-597). (Pet. A-63). As the carefully considered dissent of Judge Kozinski makes clear, the reductio ad absurdum of this novel reasoning is that every failure by the state to pay its bills on time will necessarily equate to a constitutional violation actionable in the federal courts.[9]

While this Court has not had occasion to make a conclusive determination with respect to the property rights of contractors performing public works for purposes of due process, virtually all the federal courts that have dealt with the question have reached a single conclusion. These courts have held unequivocally that the scope of due process rights does not extend to these kinds of cases. The overwhelming weight of these decisions lends support to Judge Kozinki's assessment of the

[9] The expansion of property rights in due process cases has principally involved the interests of individuals and is relatively contemporary in origin. Thus a scholar writing twenty-five years ago observed that "due process protections have only comparatively recently been extended to protect advantageous relations with the government." Stewart, *The Reformation of American Administrative Law*, 88 Harvard Law Review 1667, 1717 (1975).

contrary decision by the majority in G&G as "very bad policy". 136 F.3d at 602. (Pet. A-81 to 82).

Thus the Second Circuit in *S & D Maintenance Co. v. Goldin*, 844 F.2d 962 (2nd Cir. 1988), *Martz v. Village of Valley Stream*, 22 F.3d 26 (2nd Cir. 1994), and *Christ Gatzonis Electrical Contractor, Inc. v. New York City School Construction Authority*, 23 F.3d 636 (2nd Cir. 1994) has consistently held that purported rights existing under ordinary construction and supply contracts do not equate to significant property interests protected by the Fourteenth Amendment.

In each of these Second Circuit cases, contractors filed actions under 42 U.S.C. § 1983 against public agencies that had withheld contract payments, asserting that the withholdings without hearings constituted a violation of due process. The Second Circuit held that the contractual relationship between a contractor and a public agency does not create a constitutionally protected interest in the payment of sums allegedly due pursuant to the contract. In a careful analysis that distinguishes between ordinary contract rights and property rights protected under the Due Process Clause, the Second Circuit reasoned:

> "An interest in enforcement of an ordinary commercial contract with a state is qualitatively different from the interests the Supreme Court has thus far viewed as "property" entitled to procedural due process protection. . . . [T]he Due Process Clause is invoked to protect something more than an ordinary contractual right. Rather, procedural protection is sought in connection with a state's revocation of a status, an estate

> within the public sphere characterized by a quality of either extreme dependence in the case of welfare benefits, or permanence in the case of tenure, or sometimes both, as frequently occurs in the case of social security benefits. . . . But we hesitate to extend the doctrine further to constitutionalize contractual interests that are not associated with any cognizable status of the claimant beyond its temporary role as a government contractor." *S & D Maintenance Co., supra,* 844 F.2d 966-67.

This pragmatic analysis, distinguishing ordinary contract rights from the sort of property right that is protected by due process, resonates in the decisions of other circuits as well. Justice Breyer, then on the First Circuit, wrote: "A mere breach of a contractual right is not a deprivation of property without constitutional due process of law. . . . Otherwise virtually every controversy involving an alleged breach of contract with a governmental institution or agency or instrumentality would be a constitutional case." *Bleeker v. Dukakis,* 665 F.2d 401, 403 (1st Cir. 1981). The Seventh Circuit, in affirming the dismissal of a § 1983 action brought by county employees asserting that the county violated their due process rights by its refusal to abide by a contract to permit time off in compensation for overtime hours worked, cautioned that "[t]here is reason to doubt whether the Fourteenth Amendment was intended to allow every person with a breach of contract claim against a state to bring that claim in federal Court", and that the Amendment was "not intended to shift the whole of the public law of the states into the federal courts." *Brown v. Brienen,* 722 F.2d 360, 364 (7th Cir. 1983).

The Third Circuit has likewise observed that "if every breach of contract by someone acting under color of state law constituted a deprivation of property for procedural due process purposes, the federal courts would be called upon to pass judgment on the procedural fairness of the processing of a myriad of contract claims against public entities," and that "the wholesale federalization of state public contract law seems far afield from the great purposes of the Due Process Clause." *Reich v. Beharry,* 883 F.2d 239, 242 (3rd Cir. 1989). Following this analysis, the Third Circuit upheld summary judgment against a building contractor asserting a property interest in its contract with a city housing authority, while at the same time permitting the contractor's claim for unpaid compensation for work allegedly performed under the contract to proceed under the state public contract law. *Linan-Faye Construction Co., Inc. v. Housing Authority of the City of Camden,* 49 F.3d 915 (3rd Cir. 1995). The court further held that whatever severe consequential damages the contractor may have suffered as a result of the housing authority's allegedly wrongful retention of the contractor's performance bond, that fact "cannot convert a contract claim into a deprivation of liberty." *Ibid.,* at 932.[10]

With its decision in *G&G,* the Ninth Circuit became the only circuit to find an enforceable property right under the Fourteenth Amendment in a garden variety

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[10] So pervasive has been this line of cases that the court in *Chavez v. Arte Publico Press,* 157 F.3d 282, 289 (5th Cir. 1998) was emboldened to state that its research "discloses no ordinary breach of contract case that has been allowed to proceed in federal courts against a state."

public works contract dispute between a public agency and a private contractor. Prior to *G&G*, the Ninth Circuit stood in the mainstream of federal law on this issue. In *San Bernardino Physicians' Services Medical Group, Inc. v. County of San Bernardino*, 825 F.2d 1404, 1408 (9th Cir. 1987), the court explained that "[e]ven though every contract may confer some legal rights under state law, that fact alone need not place all contracts within federal due process protection." In drawing the line between those government contracts that may create rights that are protected by the Fourteenth Amendment and those that do not, the court focused on the distinction between employment contracts and ordinary commercial contracts, such as contracts to perform a construction project or to supply the state with services or materials. "The right of an individual not to be deprived of employment that he or she has been guaranteed is more easily characterized as a civil right, meant to be protected by § 1983, than are many other contractual rights." *Ibid.*, at 1409. Consequently, "the farther the purely contractual claim is from an interest as central to the individual as employment, the more difficult it is to extend it constitutional protection without subsuming the entire state law of public contracts." Based on this analysis, the court held that a corporation's contract to supply medical services to a county hospital did not implicate any constitutionally protected interest, and that such a "contract to supply services to the state cannot sensibly be distinguished from construction contracts or even purely material supply contracts." *Ibid.*, at 410.

The *G&G* panel majority abandoned this reasoned and historic approach in favor of an unwarranted and

sweeping expansion of property rights and due process protections far beyond any contemplated in prior decisions of the federal courts. G&G's constitutional claim, according to the panel majority, "arises from its public works contract; it has a property interest in being paid in full for the construction work it has completed." (136 F.3d 595-597). (Pet. A-63).

The federal courts have uniformly held that there can be " 'no legitimate claim of entitlement' to funds allegedly due" pursuant to "a contract [that] vested" a public agency "with discretion to withhold interim payments." *(Christ Gatzonis Electrical Contractor, Inc., supra,* 23 F.3d at 640). In so ruling, these courts have relied on *Board of Regents v. Roth, supra,* 408 U.S. 564, 576-78, 92 S.Ct. 2701, 2708-09, 33 L.Ed. 2d 548 (1972). As this Court stated in that case, "Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law. . . . " 408 U.S. at 577.

Other decisions of this Court have followed the same reasoning. *See, e.g., Bishop v. Wood,* 426 U.S. 341, 344, 96 S.Ct. 2074, 48 L.Ed. 2d 684 (1976); *Memphis Light, Gas, and Water Division v. Craft,* 436 U.S. 1, 11-12, 98 S.Ct. 1554, 56 L.Ed. 2d 52 (1978) ["The hallmark of property, the Court has emphasized, is an individual entitlement grounded in state law, which cannot be removed except 'for cause' "].

The California courts have also directly addressed the question of the property rights of contractors under the prevailing wage law in *O.G. Sansone Co. v. Department of Transportation,* 55 Cal. App. 3d 444, 127 Cal. Rptr. 799

(1976). The *Sansone* Court, relying in part on this Court's earlier determination in *Atkin v. Kansas*, 191 U.S. 207, 24 S.Ct. 124, 48 L.Ed. 148 (1903) stated:

> "Under the statutory scheme presently before us, in acting pursuant to Labor Code § 1727 the state did not take property belonging to plaintiffs; rather, it withheld sums pursuant to the terms of its contract with plaintiffs."
>
> 55 Cal. App. 3d at 456.

In *Lloyd v. Stewart & Nuss*, 327 F.2d 642, 645-646 (9th Cir. 1964), a bankruptcy case, the Ninth Circuit likewise held that a subcontractor under the California prevailing wage law has no property right in any sums withheld by the state.

It therefore appears that not only have the purported property rights asserted by G&G failed to attain "constitutional status by virtue of the fact that they have been initially recognized and protected by state law" (*Paul v. Davis*, 424 U.S. 693, 710, 96 S.Ct. 1155, 47 L.Ed. 2d 405), these so called "rights" have been specifically denied such status by all the California courts that have considered the question.

The Ninth Circuit *G&G* panel majority, however, looked beyond state law, and beyond the state's contracts, to the Constitution as an independent source of property rights. Ultimately unable to find any basis for G&G's asserted claim to a property interest in the provisions of the public works contracts or in state law in general, the panel majority relies on *Sniadach v. Family Finance Corp.*, 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed. 2d 349 (1969) to conclude that although G&G has no right to

prompt payment (and no right to a deprivation hearing) under the state's statutory scheme (156 F.3d 901), any withholding under this scheme is constitutionally infirm. *Sniadach*, however, is inapposite. In a garnishment case, such as *Sniadach*, a creditor seeks to seize funds that are indisputably owed by a third party to the debtor. The funds being seized are the debtor's property. In contrast, in a public works contract case such as this, there is inevitably a substantive dispute between the immediate parties to the contract as to whether the contract requires payment of the amounts withheld. The awarding body promises to make the payment; but the contractor promises, *inter alia*, that prevailing wages will be paid and that certified payroll records will be kept and made available as conditions precedent to receiving payment. To say that the contractor is entitled to the withheld funds, and therefore that the state's failure to make payment has deprived the contractor of its "property" without due process of law, is to decide the merits of the *substantive* dispute – a dispute founded upon a breach of contract claim – between the contracting parties.[11]

If the Ninth Circuit's reasoning on this point is to stand as legal precedent, then, as previously mentioned, every failure by a state, county or municipality to pay its bills on time will arguably constitute an actual deprivation of due process. Under this misconceived theory an

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[11] G&G also finds itself in the dubious position of being one who has availed itself of the benefits of the very statute it attacks. *Arnett v. Kennedy*, 416 U.S. 134, 153, 94 S.Ct. 1663, 40 L.Ed. 2d 15 (1974); *Fahey v. Mallonee*, 332 U.S. 245, 255, 67 S.Ct. 1552, 91 L.Ed. 2030 (1947).

alarming number of contractual sows' ears are to be converted to constitutional silk purses. As has been discussed, *supra*, the result, which a more circumspect Ninth Circuit earlier warned against in *San Bernardino Physician Services, supra*, and the Seventh Circuit warned against in *Brown v. Brienen, supra*, will be the inevitable shifting "of the whole of the public law of the state into the federal courts", courts which are already known to be overburdened with a demanding caseload. If the Ninth Circuit's approach is to be upheld, for the first time in their history, federal district judges will be required to routinely adjudicate local construction disputes, including but not limited to claims concerning the adequacy of plumbing, heating and air conditioning improvements and compliance or noncompliance with state and municipal building codes.

This Ninth Circuit's approach to property rights and due process goes well beyond any intent expressed by the framers of the Constitution, finds no support in logic, and is contrary to established precedent. Unless it is overturned, it threatens to upset the carefully preserved balance between the state and federal courts.

IV

A WIDE ARRAY OF STATE LAWS EXISTS TO REMEDY THE DAMAGE G&G CLAIMS TO HAVE SUSTAINED

The G&G panel majority held that a state court breach of contract action to recover the withheld funds does not provide adequate due process to a subcontractor in the position of G&G in this case; that the subcontractor

is in effect left with an "empty bag." (Pet. A-28). Other federal courts have reached the opposite conclusion, finding that state lawsuits provide a satisfactory vehicle for the vindication of the subcontractor's rights in these types of cases.

In *Brown v. Brienen, supra*, 722 F.2d 360, the Seventh Circuit held that even if a county's denial of time off for overtime worked by county employees could be said to implicate any property rights (a proposition the court found extremely doubtful), the availability of a post-deprivation state court action for breach of contract which could make the employees whole for any losses provided an adequate remedy that satisfied the requirements of due process. Likewise, in *Reich v. Beharry, supra*, 883 F.2d 239, 242-243, the Third Circuit, after expressing "considerable doubt" that a private attorney had an enforceable property interest in the payment of amounts allegedly due as a result of work he had performed under a contract with a county, held that the availability of a breach of contract remedy in state court through which he could be made whole for the unpaid fees provides "all the process that was constitutionally due."

A subcontractor involved in a public works project in California who has had funds withheld under the prevailing wage law may request an assignment of the prime contractor's rights to bring a lawsuit against the state under Labor Code §§ 1730-1733. The prime contractor in most cases is understandably motivated to agree to such an assignment because it will tend to eliminate a suit by

the subcontractor against the prime,[12] thereby sparing the latter the cost and travail of litigation. The assignment of the claim serves the interests of both prime contractor and subcontractor.

In the unlikely event there is no assignment, however, the subcontractor is still not foreclosed from asserting his right to the withheld funds. A well-developed body of case law in California invests the subcontractor with comprehensive remedies for breach of contract. This body of decisional law provides, *inter alia*, for suits for damages (*Coughlin v. Blair*, 41 Cal. 2d 587, 597, 262 P.2d 305 (1953)), recission (*Integrated, Inc. v. Fergusson Electrical Contractor*, 250 Cal. App. 2d 287, 297, 58 Cal. Rptr. 503 (1967) [Subcontractor on state public works project could rescind contract for nonpayment amounting to a material breach of contract and sue for reasonable value of services]), restitution on a theory of unjust enrichment (*Crofoot Lumber v. Thompson*, 163 Cal. App. 2d 324, 331, 329 P.2d 302 (1958)), specific performance, declaratory relief and injunctive relief (*Smith v. Mendonsa*, 108 Cal. App. 2d 540, 544, 238 P.2d 1039 (1952)).[13]

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[12] Indeed, a subcontractor operating under the California prevailing wage law could bargain for a provision in the subcontract automatically entitling him to an assignment in the event of a withholding from the prime contractor by an awarding body.

[13] The California Supreme Court long ago recognized that equitable remedies, such as those sought by G&G here, are as readily available under a public contract as under private contracts. "The cases recognize no distinction between public and private contracts with respect to the right of equitable relief. . . . The California cases refuse to apply special rules of law simply because a government body is a party to a contract."

The Ninth Circuit had grave doubts about the efficacy of a state claim by a subcontractor against a prime contractor for breach of contract, erroneously concluding that the provisions of § 1729 of the Labor Code could constitute a complete defense to any breach of contract action under state law. (156 F.3d at 602).

This interpretation of § 1729, for which the court cited no authority or precedent, is based on a misconstruction of the language of that section. While that section does provide that it shall be "lawful for any contractor to withhold from any subcontractor under him sufficient sums to cover any penalties withheld from him by the awarding body," the right of withholding by the prime contractor is qualified and can only be justified "on account of the subcontractor's failure to comply" with the prevailing wage law. If the withholding is not "on account of a violation" of the prevailing wage law, this section by definition does not provide a defense. The trier of fact, finding no violation of the law, would surely further find that the subcontractor is entitled to recover the withheld funds. A fair reading of § 1729 can only lead to the conclusion that its exculpatory effect is limited to the situation where there is a demonstrable violation by the subcontractor.

The dissent by Judge Kozinski, noted a remedy in addition to the remedy of a common law suit for breach of contract, i.e., a subcontractor may sue for equitable subrogation and get a full hearing of its claims why the

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M.F. Kemper Construction v. City of Los Angeles (1951) 37 Cal. 2d 696, 704, 235 P.2d 1.

funds should not be withheld. (Pet. A-50). There is nothing in either the record or the law to suggest that the relief thus granted would in any way be inferior to the relief mandated by the court. The DLSE has continued to take the position in this litigation that equitable subrogation permits the subcontractor to stand in the shoes of the prime contractor and obtain a full and fair hearing under §§ 1730-1733 of the California Labor Code. As the agency empowered to administer the prevailing wage law in California, its determinations in this respect have been accorded great weight in the California courts. *Henning v. Industrial Welfare Commission*, 46 Cal. 3d 1262, 1269, 252 Cal. Rptr. 278 (1988).

While it has not been widely applied in the public works area, the doctrine of equitable subrogation is "broad enough to include every instance in which one person, not acting as a mere volunteer or intruder, pays a debt for which another is primarily liable, and which in equity and good conscience should have been discharged by the latter." *Caito v. United California Bank*, 20 Cal. 3d 694 704, 144 Cal. Rptr. 751 (1978).

In addition, over the years the California Legislature has created two distinct statutory vehicles for subcontractors on public works projects to use to prosecute their rights to withheld funds. Thus, the subcontractor is empowered to proceed to recover the withheld funds under both the stop notice procedures and the payment bond provisions of the California Civil Code.

The right of a subcontractor on a public works project to invoke the stop notice provisions of California Civil Code §§ 3110 and 3181 is clear, subcontractors having

been expressly included among those persons entitled to "serve a stop notice upon the public entity responsible for the public work. . . . " (Cal. Civ. Code § 3181). Upon receipt of a stop notice, Civil Code § 3186 requires the public entity to withhold from the original contractor "an amount sufficient to answer the [subcontractor's] claim." In effect, the filing imposes "a trust obligation on the public agency." The subcontractor may then file a lawsuit pursuant to § 3210 of the Civil Code and require the awarding body to pay it the money claimed.

In *United States Fidelity & Guaranty Co. v. Oak Grove Union School District*, 205 Cal. App. 2d 226, 230-231, 22 Cal. Rptr. 907, 910 (1962), the California Court of Appeal explained that the stop notice procedure exists "to provide protection to subcontractors against defaulting contractors." Thus, a subcontractor, such as G&G, has a defined statutory remedy under Civil Code § 3210, in addition to the aforementioned breach of contract theories of action against the prime contractor, to secure payment of amounts purportedly due under its subcontract by use of the stop notice procedure. G&G has never argued that this statutory remedy is insufficient to protect its rights.

The provisions of California Civil Code § 3248, which require prime contractors on public works projects to purchase a payment bond, arm subcontractors in California with an additional remedy should the prime contractor default on payment. (*Department of Industrial Relations v. Seaboard Surety Co.*, 50 Cal. App. 4th 1501, 1508, 58 Cal. Rptr. 2d 532 (1996).) Moreover, a subcontractor's action against the payment bond "may be maintained separately from" an action upon a stop notice claim. (Cal.

Civ. Code § 3250). *Contractors Labor Pool v. Westway Construction*, 53 Cal. App. 4th 152, 158-160, 61 Cal. Rptr. 2d 715 (1997). Thus in *Consolidated Electric Distributor, Inc. v. Kirkham, et al.*, 18 Cal. App. 3d 54, 61, 95 Cal. Rptr. 673, 677 (1971), the Court of Appeal recognized that the two forms of action are independent.

The adequacy of post-deprivation state court remedies is an issue that has come frequently before this Court over the years. This case presents this Court with an opportunity to revisit this issue in the context of an alleged deprivation of property founded upon a commercial contract with a state entity.[14]

In *Parratt v. Taylor*, 451 U.S. 527, 101 S.Ct. 1908, 68 L.Ed. 2d 420, *overruled in part on other grounds by Daniels v. Williams*, 474 U.S. 327, 106 S.Ct. 662, 88 L.Ed. 2d 662 (1981), the Court recognized that "post-deprivation remedies made available by the State can satisfy the Due Process Clause." 451 U.S. at 538, 101 S.Ct. at 1914. The Court reasoned:

> "[E]ither the necessity of quick action by the State or the impracticality of providing any meaningful pre-deprivation process, when coupled with the availability of some meaningful means by which to assess the propriety of the

[14] An academic commentator's detailed examination of this issue concluded that "[c]ontractual interests, though protected by the Constitution, receive adequate protection in state court post-deprivation proceedings." Kreynin, *Breach of Contract as Due Process Violation: Can the Constitution Be a Font of Contract Law?*, 90 Columbia Law Rev. 1098, 1122 (1990).

> State's action at some time after the initial taking, can satisfy the requirements of procedural due process." 451 U.S. at 539, 101 S.Ct. at 1915.

The Court held that although an action under § 1983 might provide more relief than a state tort action, the available state remedies "could have fully compensated the respondent for the property loss he suffered, and we hold that they are sufficient to satisfy the requirements of due process." 451 U.S. at 544, 101 S.Ct. at 1917.

In *Hudson v. Palmer*, 468 U.S. 517, 104 S.Ct. 3194, 82 L.Ed. 2d 393 (1984), like *Parratt*, the Court found the availability of a post-deprivation state tort action that could provide compensation for the loss constitutes sufficient due process with respect to prisoners' claims of wrongful destruction of property by prison officers. To be sure, part of the rationale behind these cases was that the alleged destruction of the property did not stem from the proper implementation of an established state procedure, but rather, from the unauthorized and unanticipated acts of state employees.

Even the fact that the challenged action is authorized by state law and is implemented in an anticipated way by state employees consistent with established methods does not necessarily mean that a state court post-deprivation remedy is inadequate. For example, in *Ingraham v. Wright*, 430 U.S. 651, 97 S.Ct. 1401, 51 L.Ed. 2d 711 (1977), this Court held that state tort remedies provided adequate process for students subjected to corporal punishment in school. Having concluded that a pre-disciplinary administrative hearing was not required, the Court could have insisted on a post-disciplinary hearing. It did not, as a

post-disciplinary tort action could adequately compensate the student for the wrongful imposition of discipline.

In cases where this Court has sought to limit *Parratt* and *Hudson*, the available state court remedy plainly could not provide adequate compensation for the deprivation. Thus, in *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 435-37, 101 S.Ct. 1148, 1157-58, 71 L.Ed. 2d 265 (1982), this Court, after observing that a post-deprivation tort remedy was not capable of making the plaintiff whole, held that the availability of such a remedy did not satisfy the requirements of due process. The deprivation consisted of a state administrative agency's wrongful failure to proceed on a claim that was filed, within the agency's jurisdiction, against an employer for having discharged the claimant in violation of the state's anti-discrimination laws. The Court noted that reinstatement was not an available remedy under a tort claim, and thus, even a successful lawsuit could not provide him with the relief that would have been available but for the state's deprivation of his right to proceed on his anti-discrimination claim.

Likewise, in *Zinermon v. Burch*, 494 U.S. 113, 110 S.Ct. 975, 108 L.Ed. 2d 100 (1990), a sharply divided Court held that allegations in a mental patient's complaint that employees of a state mental treatment facility admitted him to the facility as a voluntary patient without taking any steps to ascertain whether he was mentally competent to sign admission forms were sufficient to state a § 1983 claim, notwithstanding the availability of post-deprivation tort remedies. In ascertaining the adequacy of the state's post-deprivation tort remedies, the Court applied the familiar tripartite test set forth in *Mathews v.*

Eldridge, 424 U.S. 319, 335, 96 S.Ct. 893, 903 (1976), weighing the following factors:

> "First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Zinermon v. Burch, supra*, 494 U.S. at 127, 110 S.Ct. at 984.

Not surprisingly, applying this test to a situation where the deprivation consisted of an extremely lengthy stay in a mental institution, the Court concluded that the state's post-deprivation tort remedy was inadequate.

In contrast to the injuries in *Logan* and *Zinermon*, the routine nature of the deprivation allegedly suffered by G&G renders it wholly compensable through the aforementioned state post-deprivation remedies. These remedies provide all the process that is due to a contractor challenging the state's failure to make payments allegedly owed under a commercial contract. The view of the court below would result in an enormous burden to states, counties, cities, and all other public agencies that award contracts.

V

THE DEPRIVATION COMPLAINED OF WAS INDIRECT AND DID NOT CONSTITUTE A DENIAL OF DUE PROCESS

A companion issue to the issue of state versus private action is the question of whether G&G was foreclosed

from proceeding against petitioners because the action of the State in withholding funds from the prime contractor only impacted G&G indirectly.

The sole action taken by petitioners, i.e., the issuance of notices to withhold to the contracting public bodies based on G&G's noncompliance with the prevailing wage law, was taken solely against the prime contractors, who thereafter unilaterally chose to withhold monies due G&G for work performed under its subcontracts. While the law allows the prime contractor to deduct wages and penalties from the subcontractor, the decision is that of the prime contractor, not the state.

> "Over a century ago this Court recognized the principle that the due process provision . . . does not apply to the *indirect adverse effects* of governmental action. Thus, in the *Legal Tender Cases*, 12 Wall. 457, 551, the Court stated:
>
> > 'That provision has always been understood as referring only to a *direct* appropriation, and not to consequential injuries resulting from the exercise of legal power. It has never been supposed to have any bearing upon, or to inhibit laws that *indirectly* work harm and loss to individuals.' "

O'Bannon v. Town Court Nursing Center, 447 U.S. 773, 788-789, 100 S.Ct. 2467, 65 L.Ed. 2d 506 (1980) (Emphasis added).

The Ninth Circuit refused to apply the principle of *O'Bannon* and its progeny in this case, seizing on the idea that G&G, as a subcontractor, was the "target of the state's action here" (Pet. A-67) and that, therefore, this case falls within an express exception noted in *O'Bannon*,

i.e., where action is taken by one party for the purpose of "punishing" another. It is submitted, however, that this is yet another misreading of the record on the part of the Ninth Circuit, there being absolutely no evidence to support the conclusion that it was ever the intent or the policy of the State in enforcing the prevailing wage law to target or punish G&G, or other subcontractors.

The ascribing of such a motive to petitioners is fanciful, unwarranted and unfounded, particularly in view of the fact that the California courts have uniformly found that the purpose of the prevailing wage law, far from being a punitive one, is to foster the public welfare.

> "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 absences of job security and employment benefits enjoyed by public employees."

Lusardi Construction Co. v. Aubry, 1 Cal. 4th 976, 987, 4 Cal. Rptr. 2d 847 (1992).

None of the three opinions of the Ninth Circuit in this case refer to any evidence that suggests that in enforcing its contract the state was acting for any purpose other than that set forth in *Lusardi*, because, as noted, no such evidence exists. Not even G&G has argued that the

state acted with the motive assigned by the court in issuing the notices to withhold. Since there was nothing from which the court below could have inferred that the state acted with a specific intent to impact G&G, it therefore had no factual basis upon which to draw such an inference.

The mere knowledge that an adverse impact on third parties is likely to follow from the enforcement of the law is clearly not enough to vitiate the reasoning in *O'Bannon*. Thus, the fact that the state had reason to know that the withholding from the prime contractor might impact G&G is no more significant than the fact that in *O'Bannon* the government had reason to know that the cessation of reimbursements to a medical facility would impact its patients; that the Department of Agriculture had reason to know that the closing of a store would impact the employees of the store [*Castaneda v. U.S. Department of Agriculture*, 807 F.2d 1478 (9th Cir. 1987)]; that the U.S. Department of Education had reason to know that revoking student aid to a college would impact the students [*Grove City College v. Bell*, 687 F.2d 684, 704 (3rd Cir. 1982)]; or that the U.S. Department of Energy had reason to know that its offering of free storage facilities for nuclear waste would impact those in the business of providing such facilities. [*Nuclear Transport & Storage v. United States*, 890 F.2d 1348 (6th Cir. 1989)]. Yet the injured third parties suing in these cases, all of whom had as strong a claim as G&G has here, were held to be only indirectly affected by the government's action and, therefore, could state no due process claim.

The State of California, like most other states, has decided to conduct its business in the same fashion as

every builder in the private sector by electing to contract and deal exclusively with the prime contractor. The decision of the Panel clearly flies in the face of the long judicially acknowledged right of a state to dictate the terms and conditions upon which public works will be performed by private contractors.

In *Atkin v. Kansas, supra*, 191 U.S. 207, the Supreme Court upheld challenged Kansas legislation providing for maximum hours of work and requiring minimum rates of pay on public works projects. The Court stated:

> "It cannot be deemed a part of the liberty of any contractor that *he* be allowed to do public work in any mode he may choose to adopt, without regard to the wishes of the state. *On the contrary, it belongs to the state, as the guardian and trustee for its people, and having control of its affairs, to prescribe the conditions upon which it will permit public work to be done on its behalf, or on behalf of its municipalities.* No court has authority to review its actions in that respect. Regulations on this subject suggest only considerations of public policy. And with such considerations the courts have no concern." 191 U.S. at 222-223 (emphasis added).

In *Perkins v. Luekens Steel Co.*, 310 U.S. 113, 60 S.Ct. 869, 84 L.Ed. 1108 (1940), a steel producer attacked the Public Contracts Act, a statute setting forth standards for those who deal with the federal government. This Court upheld the law, pointing out that '[l]ike private individuals and businesses, the government enjoys the unrestricted power to produce its own supplies, *to determine*

those with whom it will deal, and to fix the terms and conditions upon which it will make needed purchases." 310 U.S. at 127 (emphasis added).

Correctly viewed, the terms and conditions of the state's public works contracts merely empower it and its political subdivisions to do what every private proprietor in the marketplace does, deal on building projects with a single prime contractor who, in turn, has the direct responsibility for the companies and individuals it chooses to select as subcontractors on the project. This is a practice that has existed as long as there has been a building industry in this country. See, e.g., discussion in Haggerty, *Real Estate Construction Current Problems* (Practicing Law Institute, 1973), p. 47, et seq. Business efficiency dictates that the owner (in this case the State) be permitted to look to and deal exclusively with the prime contractor, the only party with which it is in privity of contract, and to say that it holds the prime contractor accountable for all failures or defects in performance, whether they in fact be due to the fault of the prime contractor or one of its subcontractors.

Here, the State is merely exercising its right as a proprietor. Consequently, far from punishing or targeting those with whom it does not contract, the State here is engaging in a legitimate business practice, sanctioned by custom and practice, of refusing to deal with anyone other than the prime contractor and insisting that the prime contractor be responsible for the performance under the contract of all other parties. The Ninth Circuit had no justification for supposing any other motive on the part of petitioners.

Being only indirectly impacted by the alleged deprivation of the State, G&G cannot be heard to complain that it was denied due process.

CONCLUSION

For the reasons stated above, the decision of the court below should be vacated with instructions to enter judgment in favor of petitioners.

Respectfully submitted,

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APPENDIX

BILL NUMBER: AB 1646 CHAPTERED
BILL TEXT

CHAPTER 954
FILED WITH SECRETARY OF STATE SEPTEMBER 30, 2000
APPROVED BY GOVERNOR SEPTEMBER 29, 2000
PASSED THE ASSEMBLY SEPTEMBER 1, 2000
PASSED THE SENATE AUGUST 30, 2000
AMENDED IN SENATE AUGUST 29, 2000
AMENDED IN SENATE AUGUST 25, 2000
AMENDED IN SENATE AUGUST 7, 2000
AMENDED IN SENATE AUGUST 30, 1999
AMENDED IN SENATE AUGUST 16, 1999
AMENDED IN SENATE JULY 1, 1999
AMENDED IN SENATE JUNE 24, 1999

INTRODUCED BY Assembly Member Steinberg

MARCH 4, 1999

An act to amend Sections 1723, 1726, 1727, and 1773.1 of, to add Sections 1741 and 1743 to, to add and repeal Sections 1742 and 1742.1 of, to repeal Sections 1730, 1731, 1732, 1733, and 1771.7 of, to repeal and amend Section 1775 of, and to repeal and add Section 1771.6 of, the Labor Code, relating to public works.

LEGISLATIVE COUNSEL'S DIGEST

AB 1646, Steinberg. Public works: payments.

(1) Existing law regulating public works contracts requires the awarding body of a public works contract to withhold and retain from payments to the contractor all wages and penalties that have been forfeited pursuant to

the contract or existing law. The awarding body is required to transfer all wages and penalties retained, to the Labor Commissioner for disbursement pursuant to specified provisions whenever a contractor fails to bring a suit against the awarding body for recovery of wages and penalties withheld within 90 days after the completion of the contract and formal acceptance of the job.

This bill would require the awarding body to report promptly any suspected violations of the laws regulating public works contracts to the Labor Commission and to retain all amounts required to satisfy any civil wage and penalty assessment issued by the Labor Commissioner.

(2) Existing law authorizes the contractor to bring suit for the limited purpose of recovery of the penalties or forfeitures withheld.

Existing law permits the Division of Labor Standards Enforcement to intervene in a contractor's suit for recovery of amounts withheld, provides for the deposit of wages for workers who cannot be located into the Industrial Relations Unpaid Wages Fund, and provides for the deposit of penalties into the General Fund. Existing law, until January 1, 2003, requires a contractor to withhold moneys due a subcontractor in an amount sufficient to pay the wages that are the subject of a claim filed with the Division of Labor Standards Enforcement, as directed by the division, if the body awarding the public works contract has not withheld sufficient moneys to pay the wage claims. Existing law requires the contractor to pay those moneys to the subcontractor after receipt of notification that the claim has been resolved, or to pay those

moneys to the awarding body, under specified circumstances.

This bill would repeal these provisions and instead would require the Labor Commissioner to issue a civil wage and penalty assessment to the contractor or subcontractor or both if the Labor Commissioner determines after investigation that there has been a violation of the laws regulating public works contracts. The bill would permit an affected contractor or subcontractor to obtain review of a civil wage and penalty assessment by transmitting a written request for a hearing to the office of the Labor Commissioner that appears on the assessment within 60 days after service of the assessment and would require an impartial hearing officer, until January 1, 2005, and then an administrative law judge appointed by the Director of Industrial Relations to commence a hearing within 90 days of receipt of the request. The bill would permit an affected contractor or subcontractor to obtain review of the decision of the director, until January 1, 2005, and then an administrative law judge by filing a petition for a writ of mandate to the superior court within 45 days after service of the decision. The bill would provide for liquidated damages in an amount equal to the amount of unpaid wages, as specified. The bill would also authorize informal settlement meetings.

The bill would provide that the contractor and subcontractor are jointly and severally liable for all amounts due pursuant to a final order or a judgment on that final order, but would require the Labor Commissioner to collect amounts due from the subcontractor before pursuing the claim against the contractor. The bill would require

that the wage claim be satisfied from the amounts collected prior to those amounts being applied to penalties and that the money be prorated among all workers if an insufficient amount is recovered to pay each worker in full. The bill would require wages for workers who cannot be located to be placed in the Industrial Relations Unpaid Wage Fund, a continuously appropriated fund, and penalties to be paid into the General Fund.

(3) Existing law requires any political subdivision that enforces the laws regulating public works contracts and any court collecting fines or penalties that result from enforcement actions by political subdivisions to deposit penalties or forfeitures withheld from any contract payment in the General Fund of the political subdivision. Existing law authorizes a contractor to appeal an enforcement action by a political subdivision to the Director of Industrial Relations.

The bill would repeal and recast this provision to apply to any awarding body that enforces the laws regulating public works contracts in accordance with specified provisions of existing law.

The bill would require such an awarding body to provide written notice of the withholding of contract payments to the contractor and subcontractor, as specified. The withholding of contract payments would be reviewable in the same manner as a civil penalty order of the Labor Commissioner.

(4) Existing law provides that per diem wages shall be deemed to include employer payments for health and welfare, pension, vacation, travel, and subsistence pay, apprenticeship or other training programs, and similar

purposes. Existing law requires the representative of any craft, classification, or type of worker needed to execute a public works contract entered into with the state to file with the Department of Industrial Relations, fully executed copies of the collective bargaining agreements for the particular craft, classification, or type of work involved for the purposes of determining the per diem wages.

This bill would specify the employer contributions, costs, and payments that employer payments may include and would provide that employer payments not required to be provided by state or federal law are a credit against the obligation to pay the general prevailing rate of wages. However, credits for employer payments would not reduce the obligation to pay the hourly straight time or overtime wages found to be prevailing. This bill would expand the requirement that copies of collective bargaining agreements be filed with the Department of Industrial Relations to apply to representatives of any craft, classification, or type of worker needed to execute a public works contract entered into with a public entity other than the state. The bill would revise the filing requirements to permit, if the collective bargaining agreement has not been formalized, the temporary filing of a typescript of the final draft accompanied by a statement under penalty of perjury as to its effective date. Because this bill would impose additional duties on local agency employers, expand the scope of the existing crime of perjury, and provide that a violation of these provisions is a misdemeanor, this bill would impose a state-mandated local program.

(5) This bill provides that it would become operative on July 1, 2001.

(6) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement, including the creation of a State Mandates Claims Fund to pay the costs of mandates that do not exceed $1,000,000 statewide and other procedures for claims whose statewide costs exceed $1,000,000.

This bill would provide that with regard to certain mandates no reimbursement is required by this act for a specified reason.

With regard to any other mandates, this bill would provide that, if the Commission on State Mandates determines that the bill contains costs so mandated by the state, reimbursement for those costs shall be made pursuant to the statutory provisions noted above.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. The Legislature declares that its intent in adopting this act is to provide contractors and subcontractors with a prompt administrative hearing in the event that the contractor or subcontractor is alleged by the Labor Commissioner or an awarding body to have violated Labor Code provisions governing the obligations of contractors and subcontractors on public works projects, and to provide that the exclusive method for review of the decision after the administrative hearing is by petition for writ of mandate under Section 1094.5 of the

Code of Civil Procedure. It is not the intent of this act to preclude remedies otherwise authorized by law to remedy violations of this chapter.

SEC. 2. Section 1723 of the Labor Code is amended to read:

1723. "Worker" includes laborer, worker, or mechanic.

SEC. 3. Section 1726 of the Labor Code is amended to read:

1726. The body awarding the contract for public work shall take cognizance of violations of the provisions of this chapter committed in the course of the execution of the contract, and shall promptly report any suspected violations to the Labor Commissioner.

If the awarding body determines as a result of its own investigation that there has been a violation of this chapter and withholds contract payments, the procedures in Section 1771.6 shall be followed.

SEC. 4. Section 1727 of the Labor Code is amended to read:

1727. (a) Before making payments to the contractor of money due under a contract for public work, the awarding body shall withhold and retain therefrom all amounts required to satisfy any civil wage and penalty assessment issued by the Labor Commissioner under this chapter. The amounts required to satisfy a civil wage and penalty assessment shall not be disbursed by the awarding body until receipt of a final order that is no longer subject to judicial review.

(b) If the awarding body has not retained sufficient money under the contract to satisfy a civil wage and penalty assessment based on a subcontractor's violations, the contractor shall, upon the request of the Labor Commissioner, withhold sufficient money due the subcontractor under the contract to satisfy the assessment and transfer the money to the awarding body. These amounts shall not be disbursed by the awarding body until receipt of a final order that is no longer subject to judicial review.

SEC. 5. Section 1730 of the Labor Code is repealed.

SEC. 6. Section 1731 of the Labor Code is repealed.

SEC. 7. Section 1732 of the Labor Code is repealed.

SEC. 8. Section 1733 of the Labor Code is repealed.

SEC. 9. Section 1741 is added to the Labor Code, to read:

1741. If the Labor Commissioner or his or her designee determines after an investigation that there has been a violation of this chapter, the Labor Commissioner shall with reasonable promptness issue a civil wage and penalty assessment to the contractor or subcontractor or both. The assessment shall be in writing and shall describe the nature of the violation and the amount of wages, penalties, and forfeitures due and shall include the basis for the assessment. The assessment shall be served not later than 180 days after the filing of a valid notice of completion in the office of the county recorder in each county in which the public work or some part thereof was performed, or not later than 180 days after acceptance of the public work, whichever occurs last. However, if the assessment is served after the expiration

of this 180-day period, but before the expiration of an additional 180 days, and the awarding body has not yet made full payment to the contractor, the assessment is valid up to the amount of the funds retained. Service of the assessment shall be completed pursuant to Section 1013 of the Code of Civil Procedure by first-class and certified mail to the contractor, subcontractor, and awarding body. The assessment shall advise the contractor and subcontractor of the procedure for obtaining review of the assessment. The Labor Commissioner shall, to the extent practicable, ascertain the identity of any bonding company issuing a bond that secures the payment of wages covered by the assessment and any surety on a bond, and shall serve a copy of the assessment by certified mail to the bonding company or surety at the same time service is made to the contractor, subcontractor, and awarding body. However, no bonding company or surety shall be relieved of its responsibilities because it failed to receive notice from the Labor Commissioner.

SEC. 10. Section 1742 is added to the Labor Code, to read:

1742. (a) An affected contractor or subcontractor may obtain review of a civil wage and penalty assessment under this chapter by transmitting a written request to the office of the Labor Commissioner that appears on the assessment within 60 days after service of the assessment. If no hearing is requested within 60 days after service of the assessment, the assessment shall become final.

(b) Upon receipt of a timely request, a hearing shall be commenced within 90 days before the director, who shall appoint an impartial hearing officer possessing the

qualifications of an administrative law judge pursuant to subdivision (b) of Section 11502 of the Government Code. The appointed hearing officer shall be an employee of the department, but shall not be an employee of the Division of Labor Standards Enforcement. The contractor or subcontractor shall be provided an opportunity to review evidence to be utilized by the Labor Commissioner at the hearing within 20 days of the receipt of the written request for a hearing. Any evidence obtained by the Labor Commissioner subsequent to the 20-day cutoff shall be promptly disclosed to the contractor or subcontractor.

The contractor or subcontractor shall have the burden of proving that the basis for the civil wage and penalty assessment is incorrect. The assessment shall be sufficiently detailed to provide fair notice to the contractor or subcontractor of the issues at the hearing.

Within 45 days of the conclusion of the hearing, the director shall issue a written decision affirming, modifying, or dismissing the assessment. The decision of the director shall consist of a notice of findings, findings, and an order. This decision shall be served on all parties and the awarding body pursuant to Section 1013 of the Code of Civil Procedure by first-class mail at the last known address of the party on file with the Labor Commissioner. Within 15 days of the issuance of the decision, the director may reconsider or modify the decision to correct an error, except that a clerical error may be corrected at any time.

The director shall adopt regulations setting forth procedures for hearings under this subdivision.

(c) An affected contractor or subcontractor may obtain review of the decision of the director by filing a petition for a writ of mandate to the appropriate superior court pursuant to Section 1094.5 of the Code of Civil Procedure within 45 days after service of the decision. If no petition for writ of mandate is filed within 45 days after service of the decision, the order shall become final. If it is claimed in a petition for writ of mandate that the findings are not supported by the evidence, abuse of discretion is established if the court determines that the findings are not supported by substantial evidence in the light of the whole record.

(d) A certified copy of a final order may be filed by the Labor Commissioner in the office of the clerk of the superior court in any county in which the affected contractor or subcontractor has property or has or had a place of business. The clerk, immediately upon the filing, shall enter judgment for the state against the person assessed in the amount shown on the certified order.

(e) A judgment entered pursuant to this section shall bear the same rate of interest and shall have the same effect as other judgments and shall be given the same preference allowed by law on other judgments rendered for claims for taxes. The clerk shall not charge for the service performed by him or her pursuant to this section.

(f) An awarding body that has withheld funds in response to a civil wage and penalty assessment under this chapter shall, upon receipt of a certified copy of a final order that is no longer subject to judicial review,

promptly transmit the withheld funds, up to the amount of the certified order, to the Labor Commissioner.

(g) This section shall provide the exclusive method for review of a civil wage and penalty assessment by the Labor Commissioner under this chapter or the decision of an awarding body to withhold contract payments pursuant to Section 1771.5.

(h) This section shall remain in effect only until January 1, 2005, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2005, deletes or extends that date.

SEC. 11. Section 1742 is added to the Labor Code, to read:

1742. (a) An affected contractor or subcontractor may obtain review of a civil wage and penalty assessment under this chapter by transmitting a written request to the office of the Labor Commissioner that appears on the assessment within 60 days after service of the assessment. If no hearing is requested within 60 days after service of the assessment, the assessment shall become final.

(b)(1) Upon receipt of a timely request, a hearing shall be commenced within 90 days before an administrative law judge appointed by the Director of Industrial Relations. The appointed hearing judge shall be an employee of the department, but shall not be an employee of the Division of Labor Standards Enforcement. The contractor or subcontractor shall be provided an opportunity to review evidence to be utilized by the Labor Commissioner at the hearing within 20 days of the receipt of the written request for a hearing. Any evidence

obtained by the Labor Commissioner subsequent to the 20-day cutoff shall be promptly disclosed to the contractor or subcontractor.

(2) The contractor or subcontractor shall have the burden of proving that the basis for the civil wage and penalty assessment is incorrect. The assessment shall be sufficiently detailed to provide fair notice to the contractor or subcontractor of the issues at the hearing.

(3) Within 45 days of the conclusion of the hearing, the administrative law judge shall issue a written decision affirming, modifying, or dismissing the assessment. The decision of the administrative law judge shall consist of a notice of findings, findings, and an order. This decision shall be served on all parties and the awarding body pursuant to Section 1013 of the Code of Civil Procedure by first-class mail at the last known address of the party on file with the Labor Commissioner. Within 15 days of the issuance of the decision, the administrative law judge may reconsider or modify the decision to correct an error, except that a clerical error may be corrected at any time.

(4) The Director of Industrial Relations shall adopt regulations setting forth procedures for hearings under this subdivision.

(c) An affected contractor or subcontractor may obtain review of the decision of the administrative law judge by filing a petition for a writ of mandate to the appropriate superior court pursuant to Section 1094.5 of the Code of Civil Procedure within 45 days after service of the decision. If no petition for writ of mandate is filed within 45 days after service of the decision, the order shall become final. If it is claimed in a petition for writ of

mandate that the findings are not supported by the evidence, abuse of discretion is established if the court determines that the findings are not supported by substantial evidence in the light of the whole record.

(d) A certified copy of a final order may be filed by the Labor Commissioner in the office of the clerk of the superior court in any county in which the affected contractor or subcontractor has property or has or had a place of business. The clerk, immediately upon the filing, shall enter judgment for the state against the person assessed in the amount shown on the certified order.

(e) A judgment entered pursuant to this section shall bear the same rate of interest and shall have the same effect as other judgments and shall be given the same preference allowed by law on other judgments rendered for claims for taxes. The clerk shall not charge for the service performed by him or her pursuant to this section.

(f) An awarding body that has withheld funds in response to a civil wage and penalty assessment under this chapter shall, upon receipt of a certified copy of a final order that is no longer subject to judicial review, promptly transmit the withheld funds, up to the amount of the certified order, to the Labor Commissioner.

(g) This section shall provide the exclusive method for review of a civil wage and penalty assessment by the Labor Commissioner under this chapter or the decision of an awarding body to withhold contract payments pursuant to Section 1771.5.

(h) This section shall become operative on January 1, 2005.

SEC. 12. Section 1742.1 is added to the Labor Code, to read:

1742.1. (a) After 60 days following the service of a civil wage and penalty assessment under Section 1741 or a notice of withholding under subdivision (a) of Section 1771.6, the affected contractor, subcontractor, and surety on a bond or bonds issued to secure the payment of wages covered by the assessment or notice shall be liable for liquidated damages in an amount equal to the wages, or portion thereof, that still remain unpaid. If the assessment or notice subsequently is overturned or modified after administrative or judicial review, liquidated damages shall be payable only on the wages found to be due and unpaid. If the contractor or subcontractor demonstrates to the satisfaction of the director that he or she had substantial grounds for believing the assessment or notice to be in error, the director shall waive payment of the liquidated damages. Any liquidated damages collected shall be distributed to the employee along with the unpaid wages. Section 203.5 shall not apply to claims for prevailing wages under this chapter.

(b) The Labor Commissioner shall, upon receipt of a request from the affected contractor or subcontractor within 30 days following the service of a civil wage and penalty assessment under Section 1741, afford the contractor or subcontractor the opportunity to meet with the Labor Commissioner or his or her designee to attempt to settle a dispute regarding the assessment without the need for formal proceedings. The awarding body shall,

upon receipt of a request from the affected contractor or subcontractor within 30 days following the service of a notice of withholding under subdivision (a) of Section 1771.6, afford the contractor or subcontractor the opportunity to meet with the designee of the awarding body to attempt to settle a dispute regarding the notice without the need for formal proceedings. The settlement meeting may be held in person or by telephone and shall take place before the expiration of the 60-day period for seeking administrative review. No evidence of anything said or any admission made for the purpose of, in the course of, or pursuant to, the settlement meeting is admissible or subject to discovery in any administrative or civil proceeding. No writing prepared for the purpose of, in the course of, or pursuant to, the settlement meeting, other than a final settlement agreement, is admissible or subject to discovery in any administrative or civil proceeding. The assessment or notice shall advise the contractor or subcontractor of the opportunity to request a settlement meeting.

This section shall remain in effect only until January 1, 2005, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2005, deletes or extends that date.

SEC. 13. Section 1742.1 is added to the Labor Code, to read:

1742.1. (a) After 60 days following the service of a civil wage and penalty assessment under Section 1741 or a notice of withholding under subdivision (a) of Section 1771.6, the affected contractor, subcontractor, and surety on a bond or bonds issued to secure the payment of

wages covered by the assessment or notice shall be liable for liquidated damages in an amount equal to the wages, or portion thereof, that still remain unpaid. If the assessment or notice subsequently is overturned or modified after administrative or judicial review, liquidated damages shall be payable only on the wages found to be due and unpaid. If the contractor or subcontractor demonstrates to the satisfaction of the administrative law judge that he or she had substantial grounds for believing the assessment or notice to be in error, the administrative law judge shall waive payment of the liquidated damages. Any liquidated damages collected shall be distributed to the employee along with the unpaid wages. Section 203.5 shall not apply to claims for prevailing wages under this chapter.

(b) The Labor Commissioner shall, upon receipt of a request from the affected contractor or subcontractor within 30 days following the service of a civil wage and penalty assessment under Section 1741, afford the contractor or subcontractor the opportunity to meet with the Labor Commissioner or his or her designee to attempt to settle a dispute regarding the assessment without the need for formal proceedings. The awarding body shall, upon receipt of a request from the affected contractor or subcontractor within 30 days following the service of a notice of withholding under subdivision (a) of Section 1771.6, afford the contractor or subcontractor the opportunity to meet with the designee of the awarding body to attempt to settle a dispute regarding the notice without the need for formal proceedings. The settlement meeting may be held in person or by telephone and shall take

place before the expiration of the 60-day period for seeking administrative review. No evidence of anything said or any admission made for the purpose of, in the course of, or pursuant to, the settlement meeting is admissible or subject to discovery in any administrative or civil proceeding. No writing prepared for the purpose of, in the course of, or pursuant to, the settlement meeting, other than a final settlement agreement, is admissible or subject to discovery in any administrative or civil proceeding. The assessment or notice shall advise the contractor or subcontractor of the opportunity to request a settlement meeting.

This section shall become operative on January 1, 2005.

SEC. 14. Section 1743 is added to the Labor Code, to read:

1743. (a) The contractor and subcontractor shall be jointly and severally liable for all amounts due pursuant to a final order under this chapter or a judgment thereon. The Labor Commissioner shall first exhaust all reasonable remedies to collect the amount due from the subcontractor before pursuing the claim against the contractor.

(b) From the amount collected, the wage claim shall be satisfied prior to the amount being applied to penalties. If insufficient money is recovered to pay each worker in full, the money shall be prorated among all workers.

(c) Wages for workers who cannot be located shall be placed in the Industrial Relations Unpaid Wage Fund and held in trust for the workers pursuant to Section 96.7. Penalties shall be paid into the General Fund.

(d) A final order under this chapter or a judgment thereon shall be binding, with respect to the amount found to be due, on a bonding company issuing a bond that secures the payment of wages and a surety on a bond. The limitations period of any action on a payment bond shall be tolled pending a final order that is no longer subject to judicial review.

SEC. 15. Section 1771.6 of the Labor Code is repealed.

SEC. 16. Section 1771.6 is added to the Labor Code, to read:

1771.6. (a) Any awarding body that enforces this chapter in accordance with Section 1726 or 1771.5 shall provide notice of the withholding of contract payments to the contractor and subcontractor, if applicable. The notice shall be in writing and shall describe the nature of the violation and the amount of wages, penalties, and forfeitures withheld. Service of the notice shall be completed pursuant to Section 1013 of the Code of Civil Procedure by first-class and certified mail to the contractor and subcontractor, if applicable. The notice shall advise the contractor and subcontractor, if applicable, of the procedure for obtaining review of the withholding of contract payments.

The awarding body shall also serve a copy of the notice by certified mail to any bonding company issuing a bond that secures the payment of wages covered by the notice and to any surety on a bond, if their identities are known to the awarding body.

(b) The withholding of contract payments in accordance with Section 1726 or 1771.5 shall be reviewable

under Section 1742 in the same manner as if the notice of the withholding was a civil penalty order of the Labor Commissioner under this chapter. If review is requested, the Labor Commissioner may intervene to represent the awarding body.

(c) Pending a final order, or the expiration of the time period for seeking review of the notice of the withholding, the awarding body shall not disburse any contract payments withheld.

(d) From the amount recovered, the wage claim shall be satisfied prior to the amount being applied to penalties. If insufficient money is recovered to pay each worker in full, the money shall be prorated among all workers.

(e) Wages for workers who cannot be located shall be placed in the Industrial Relations Unpaid Wage Fund and held in trust for the workers pursuant to Section 96.7. Penalties shall be paid into the General Fund of the awarding body that has enforced this chapter pursuant to Section 1771.5.

SEC. 17. Section 1771.7 of the Labor Code is repealed.

SEC. 18. Section 1773.1 of the Labor Code is amended to read:

1773.1. (a) Per diem wages shall be deemed to include employer payments for health and welfare, pension, vacation, travel, subsistence, and apprenticeship or other training programs authorized by Section 3093, so long as the cost of training is reasonably related to the amount of the contributions, and similar purposes, when

the term "per diem wages" is used in this chapter or in any other statute applicable to public works.

(b) Employer payments include all of the following:

(1) The rate of contribution irrevocably made by the employer to a trustee or third person pursuant to a plan, fund, or program.

(2) The rate of actual costs to the employer reasonably anticipated in providing benefits to workers pursuant to an enforceable commitment to carry out a financially responsible plan or program communicated in writing to the workers affected.

(3) Payments to the California Apprenticeship Council pursuant to Section 1777.5.

(c) Employer payments are a credit against the obligation to pay the general prevailing rate of per diem wages. However, no credit shall be granted for benefits required to be provided by other state or federal law. Credits for employer payments also shall not reduce the obligation to pay the hourly straight time or overtime wages found to be prevailing.

(d) The credit for employer payments shall be computed on an annualized basis where the employer seeks credit for employer payments that are higher for public works projects than for private construction performed by the same employer, except where one or more of the following occur:

(1) The employer has an enforceable obligation to make the higher rate of payments on future private construction performed by the employer.

(2) The higher rate of payments is required by a project labor agreement.

(3) The payments are made to the California Apprenticeship Council pursuant to Section 1777.5.

(4) The director determines that annualization would not serve the purposes of this chapter.

(e) For the purpose of determining those per diem wages for contracts, the representative of any craft, classification, or type of worker needed to execute contracts shall file with the Department of Industrial Relations fully executed copies of the collective bargaining agreements for the particular craft, classification, or type of work involved. The collective bargaining agreements shall be filed after their execution and thereafter may be taken into consideration pursuant to Section 1773 whenever filed 30 days prior to the call for bids. If the collective bargaining agreement has not been formalized, a typescript of the final draft may be filed temporarily, accompanied by a statement under penalty of perjury as to its effective date.

Where a copy of the collective bargaining agreement has previously been filed, fully executed copies of all modifications and extensions of the agreement that affect per diem wages or holidays shall be filed.

The failure to comply with filing requirements of this subdivision shall not be grounds for setting aside a prevailing wage determination if the information taken into consideration is correct.

SEC. 19. Section 1775 of the Labor Code, as amended by Section 1 of Chapter 757 of the Statutes of 1997, is repealed.

SEC. 20. Section 1775 of the Labor Code, as added by Section 2 of Chapter 757 of the Statutes of 1997, is amended to read:

1775. (a) The contractor and any subcontractor under him or her shall, as a penalty to the state or political subdivision on whose behalf the contract is made or awarded, forfeit not more than fifty dollars ($50) for each calendar day, or portion thereof, for each worker paid less than the prevailing wage rates as determined by the director for the work or craft in which the worker is employed for any public work done under the contract by him or her or, except as provided in subdivision (b), by any subcontractor under him or her.

The amount of this penalty shall be determined by the Labor Commissioner based on consideration of both of the following:

(1) Whether the failure of the contractor or subcontractor to pay the correct rate of per diem wages was a good faith mistake and, if so, the error was promptly and voluntarily corrected upon being brought to the attention of the contractor or subcontractor.

(2) Whether the contractor or subcontractor has a prior record of failing to meet its prevailing wage obligations.

The determination of the Labor Commissioner as to the amount of the penalty shall be reviewable only for abuse of discretion. The difference between the prevailing

wage rates and the amount paid to each worker for each calendar day or portion thereof for which each worker was paid less than the prevailing wage rate shall be paid to each worker by the contractor or subcontractor, and the body awarding the contract shall cause to be inserted in the contract a stipulation that this section will be complied with.

(b) If a worker employed by a subcontractor on a public works project is not paid the general prevailing per diem wages by the subcontractor, the prime contractor of the project is not liable for any penalties under subdivision (a) unless the prime contractor had knowledge of that failure of the subcontractor to pay the specified prevailing rate of wages to those workers or unless the prime contractor fails to comply with all of the following requirements:

(1) The contract executed between the contractor and the subcontractor for the performance of work on the public works project shall include a copy of the provisions of Sections 1771, 1775, 1776, 1777.5, 1813, and 1815.

(2) The contractor shall monitor the payment of the specified general prevailing rate of per diem wages by the subcontractor to the employees, by periodic review of the certified payroll records of the subcontractor.

(3) Upon becoming aware of the failure of the subcontractor to pay his or her workers the specified prevailing rate of wages, the contractor shall diligently take corrective action to halt or rectify the failure, including, but not limited to, retaining sufficient funds due the subcontractor for work performed on the public works project.

(4) Prior to making final payment to the subcontractor for work performed on the public works project, the contractor shall obtain an affidavit signed under penalty of perjury from the subcontractor that the subcontractor has paid the specified general prevailing rate of per diem wages to his or her employees on the public works project and any amounts due pursuant to Section 1813.

(c) The Division of Labor Standards Enforcement shall notify the contractor on a public works project within 15 days of the receipt by the Division of Labor Standards Enforcement of a complaint of the failure of a subcontractor on that public works project to pay workers the general prevailing rate of per diem wages.

SEC. 21. This act shall become operative on July 1, 2001.

SEC. 22. No reimbursement is required by this act pursuant to Section 6 of Article XIIIB of the California Constitution for certain costs that may be incurred by a local agency or school district because in that regard this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIIIB of the California Constitution.

However, notwithstanding Section 17610 of the Government Code, if the Commission on State Mandates determines that this act contains other costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made pursuant to Part 7 (commencing with Section 17500) of Division 4 of Title 2

of the Government Code. If the statewide cost of the claim for reimbursement does not exceed one million dollars ($1,000,000), reimbursement shall be made from the State Mandates Claims Fund.