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DUE PROCESS

Are the States’ “Prevailing Wage Laws” Constitutional?

by Ralph C. Anzivino

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ISSUE

Do “prevailing wage laws” that authorize state officials, without any notice or hearing, to order the withholding of monies due a contractor violate the due process clause of the Fourteenth Amendment?

FACTS

During 1995, 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” projects with California governmental agencies. 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. California law mandates that the prevailing wage requirement be incorporated into and become a part of the contract. The governmental awarding body is required to withhold funds otherwise due to the prime contractor where there are violations of the prevailing wage requirement so that this money can be held for, and eventually paid to, the affected workers.

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. The California Labor Code provides various enforcement mechanisms for violations of the prevailing wage laws. A violation may give rise to criminal penalties, administrative debarment, civil penalties, and liability for wage underpayments. The Labor Code provides for the payment of the civil penalties and wage claims from the money that becomes due under the public works contract.

The Notice to Withhold is a procedure used by DLSE to enforce the prevailing wage provisions of the Labor Code. The Notice to Withhold is a statutory seizure order issued by DLSE to an awarding body. The seizure is made without any notice or hearing. The Notice to Withhold seizes payments as they become due under the contract. The Notice to Withhold sets forth the civil penalties assessed by DLSE and the alleged wage claims asserted by DLSE. The Notice to Withhold identifies the subcontractor, if any, alleged to have violated the Labor Code. The awarding body is ordered to remit the money seized to DLSE, unless the contractor files a lawsuit pursuant to the Labor Code. If a lawsuit is filed, the money is held by the awarding body, as a stakeholder, pending completion of the lawsuit, including exhaustion of all appellate rights. The lawsuit is the exclusive remedy, and no other issue may be included in the action. The awarding body has a mandatory duty under the Labor Code to comply with the Notice to Withhold. A refusal to comply with the Notice to Withhold can be a crime.

After allegedly discovering certain prevailing wage law violations by G&G, i.e., the failure to pay prevailing wages concerning three separate projects undertaken by G&G, DLSE issued notices to the awarding bodies to withhold contract payments from the prime contractors on these projects. Following receipt of the 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 subcontractors "on account of G&G's failure to comply" with the prevailing wage requirements.

After the prime contractors withheld from G&G, 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. G&G claimed 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.

The state responded with a motion to dismiss, and G&G filed a motion for summary judgment. 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 various sections of the California Labor Code unconstitutional and enjoined the state from enforcing those statutes against G&G. Petitioners filed a timely notice of appeal from this judgment.

The Ninth Circuit affirmed the District Court's judgment, with a modification. G & G Fire Sprinklers, Inc. v. Bradshaw, 156 F.3d 893 (9th Cir. 1998). The Ninth Circuit agreed that the Notice to Withhold procedure was unconstitutional but concluded that the statutes need not be declared unconstitutional on their face. The Ninth Circuit held that the statutes were unconstitutional as applied. The Ninth Circuit opined that the constitutional defect could be remedied by the adoption of regulations that provided for a pre-deprivation or prompt post-deprivation hearing. The Ninth Circuit concluded that the contractor's right to file a lawsuit under California's Labor Code did not satisfy the requirements of due process.

Upon a Petition for Rehearing by DLSE, the Ninth Circuit modified its opinion to state that a post-deprivation hearing would be sufficient (as opposed to requiring a pre-deprivation hearing). G & G Fire Sprinklers, Inc. v. Bradshaw, 156 F.3d 903 (9th Cir. 1998).


**Case Analysis**

Where state action is an issue, the inquiry must begin with the threshold principle that § 1983 "excludes from its reach merely private con-
duet, 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. The result is that several well-established principles have emerged. For example, the fact 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 (1981). 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, 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.” Flagg Bros., Inc. v. Brooks, 436 U.S. 149 (1978).

Petitioner DLSE asserts that the district court was without jurisdiction because the deprivation of property complained of was not pursuant to state action as recently defined by the Supreme Court in Sullivan. In Sullivan, the respondents attacked on due process grounds a Pennsylvania statute that authorized private insurers, without a hearing, to withhold medical benefits in workers' compensation cases where the insurer submitted a form to the state contesting the reasonableness or necessity of the treatment provided. It was argued that the insurers could not withhold those benefits without a hearing. It was also argued that the withholding of the medical payments pursuant to the Pennsylvania statute constituted state action within the meaning of 42 U.S.C. § 1983. The Supreme Court rejected all of respondents' arguments and expressly held that the withholding by the insurers was not state action.

Petitioner believes that when the operative facts in this case are compared with those in Sullivan, they are strikingly similar. 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 they 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. Therefore, as in Sullivan, the state's decision to allow the prime contractors to withhold payment can just as easily be seen as state action. Petitioner asserts that all the statute does here is to provide a remedy to the prime contractor for violations of the prevailing wage law. The state of California does not mandate utilization of this remedy any more than the state of Pennsylvania mandated withholding in Sullivan. The teaching of Sullivan is unequivocal—the private use of state-sanctioned private remedies does not rise to the level of state action.

Moreover, petitioner contends that 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. Further, petitioner states that the prime contractor will receive no adverse response from the state if he chooses not to withhold.

In both this case and in Sullivan, the last link in the chain of action is a private one, requiring the exercise of private discretion before the determination is made whether to withhold from the subcontractor or not. The common and controlling fact in both this case and Sullivan is that the final act is entrusted to a private party who can decide in its sole discretion. The reasoning of the Ninth Circuit 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 withhold or not. Therefore, G&G's claim under section 1983 lacks the fundamental jurisdictional element of state action.

Petitioner next argues that G&G's pleadings have omitted essential allegations necessary to maintain its due process claim. G&G 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. Clearly, under Sullivan, G&G has fallen far short of meeting its affirmative burden as the moving party in its own lawsuit. G&G has failed to plead necessary elements sufficient to show entitlement to the funds withheld. Therefore, G&G has no basis to assert a due process violation.

Petitioner also contends that G&G’s claim against the state pursuant to its construction contract does not constitute a “property right” for due process purposes. While acknowledging that the Supreme 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. The federal courts have unequivocally held that the scope of due process rights does not extend to these kinds of cases. The Second Circuit in Marts v. Village of Valley Stream, 22 F.3d 26 (2nd Cir. 1994), held that purported rights existing under ordinary construction and supply contracts do not equate to significant property interests protected by the Fourteenth Amendment. Likewise, the First Circuit has held that a mere breach of a contractual right is not a deprivation of property implicating 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. Bleecker v. Dukakis, 665 F.2d 401 (1st Cir. 1981).

Also, the Seventh Circuit, in affirming the dismissal of a § 1983 action brought by county employees for breach of contract, cautioned that there 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. Brown v. Brienen, 722 F.2d 360 (7th Cir. 1983). Finally, 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 a myriad of contract claims against public entities. Reich v. Beharry, 883 F.2d 239 (3rd Cir. 1989). The Ninth Circuit’s decision in this case is the only circuit court decision to find an enforceable property right under the Fourteenth Amendment in a garden-variety public works contract dispute between a public agency and a private contractor.

Petitioner notes that the Ninth Circuit’s decision finding a “property right” is premised in large part on Sniadach v. Family Finance Corp., 395 U.S. 337 (1969). Petitioner, however, asserts that Sniadach is not a controlling authority. Petitioner distinguishes Sniadach on the basis that in Sniadach it was the debtor’s indisputable property (his wages) that were seized. In this case, G&G did not have an absolute right to the funds because of a dispute over compliance with a condition precedent to entitlement to the funds—compliance with the prevailing wage laws. Therefore, Sniadach is not applicable in this case.

Petitioner further argues that state law provides sufficient remedies to satisfy the requirements of due process. In Parratt v. Taylor, 451 U.S. 527, overruled in part on other grounds by Daniels v. Williams, 474 U.S. 327 (1981), the Supreme Court recognized that post-deprivation remedies made available by the state can satisfy the due process clause. Petitioner argues that there are a number of state remedies available to G&G. First, 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 the Labor Code.

Second, a well-developed body of case law in California invests the subcontractor with comprehensive remedies for breach of contract. Third, a subcontractor may sue for equitable subrogation and get a full hearing on its claim to the withheld funds. Equitable subrogation permits the subcontractor to stand in the shoes of the prime contractor and obtain a full and fair hearing under the California Labor Code.

In addition, the California Legislature has created two distinct statutory vehicles for subcontractors on public works projects to use for prosecuting their claims to withheld funds. 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. In summary, 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 withholding process.

Finally, petitioner posits that the deprivation complained of by G&G is “indirect” and therefore not protected by the due process clause. For over a century, the Supreme
Court has recognized the principle that the due process clause does not apply to indirect adverse effects of governmental action. Legal Tender Cases, 12 Wall 457, 20 L.Ed. 287 (1870). 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. 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 constitute direct action against the subcontractor. Thus, the impact on G&G is indirect and not protected by the due process clause.

On the other hand, G&G asserts that the pass-through of the seizure from the prime contractor to a subcontractor is state action. In Sullivan, the Court explained that a private party’s resort to the machinery of the state to effect an ex parte seizure of property is state action. In this case, state action is thrust upon a private party to effect an ex parte seizure to advance the regulatory purpose of the state. DLSE speaks of the prime contractor’s discretion to pay the subcontractor. DLSE grants the prime contractor discretion to absorb the loss from DLSE’s targeting of the subcontractor as an alleged violator of the Labor Code, or alternately, the prime contractor may accept the role of DLSE’s enforcement. Significantly, the Labor Code grants a safe harbor to the compliant prime contractor. The net effect is that the subcontractor bears the burden of the civil penalties and alleged wage claims by becoming the subject of the seizure. The prime contractor is enlisted by DLSE in the transfer as a mere conduit—or at most, a joint participant—by the hammer of economic compulsion. The prime contractor is drafted into the fray only after DLSE interjects itself into the contractual relations of the project participants, by seizing money due to the prime contractor. DLSE identifies the subcontractor as the alleged violator of the Labor Code, thereby rendering the prime contractor’s pass-through inevitable. The subcontractor’s predicament is not the result of judgments made by private parties, but rather the subcontractor is directly in the crosshairs of a proactive state enforcement agency. State action is clearly manifest.

The respondents argue that, contrary to petitioner’s assertion, G&G suffered a direct injury from the seizure of the prime contractor’s money due and, therefore, has standing to challenge the constitutionality of that seizure. The injury to G&G, as a subcontractor, from the seizure of the prime contractor’s money due was a direct injury caused by the DLSE. No other result makes sense. The prime contractor suffers no injury to the extent the seizure is passed through to the subcontractor. Obviously, the seizure causes an injury. If the prime contractor is not injured, the injury must be suffered by the subcontractor.

The subcontractor’s right to receive monies due under its contract is a “property interest” protected by the due process clause. The Supreme Court has held that a deprivation of property occurs when an entitlement grounded in state law is removed. Logan v. Zimmerman, 455 U.S. 422 (1982). The subcontractor’s entitlement to money due actually includes two property interests—a statutory right to receive payment from the prime contractor’s payment, and the old-fashioned money due for work performed. The Notice to Withhold terminates these statutory entitlements. The targeted subcontractor who is owed money would be paid “but for” the seizure of the prime contractor’s payment due. Clearly, significant property rights of the subcontractor are being affected by the state statute.

According to the respondent, setting aside the subcontractor’s property interest in monies due, the seizure of the prime contractor’s money due is a sufficient basis to declare the statutory scheme violative of the due process clause. The Notice to Withhold seizes the prime contractor’s right to receive money due under the contract. The money is paid, instead, into a fund to be used for the payment of civil penalties and wage claims. The seizure of the prime contractor’s right to receive money due under the contract is a deprivation of property. Vindicating the prime contractor’s right to a hearing establishes that the procedure is unconstitutional.

Respondent asserts that the Ninth Circuit’s decision striking down the California statutory scheme is consistent with the Sullivan decision. Sullivan involved the denial of a claim by a public insurance company. The Court held that the mere submission of a payment request did not establish an entitlement to payment. This case addresses the situation where the payment request has been approved, and the obligation to pay has arisen. The question here is whether a seizure of the right to receive the payment is a deprivation of property. In Sullivan, the enforcement officials did not seize money due under the insurance policy for payment of civil penalties.
and third-party claims arising from an alleged violation of law. *Sullivan* did not involve money due, civil penalties, third-party claims, or regulatory enforcement action. *Sullivan* did not involve termination of an entitlement. Instead, *Sullivan* involved classic proprietary conduct by a public entity. An employer could purchase insurance from the private insurer or the public insurer. This case is the flip side of the *Sullivan* coin. *Sullivan* involved the denial of a claim by an insurance company. A due process violation did not arise merely because the insurer was a public company. In this case, DLSE’s enforcement action would require due process if a private project were involved. The mere fact that the project owner may be a public company does not eliminate the need for due process.

Respondent refutes petitioner’s assertion that adequate state law remedies exist to address a state’s improper withholding of monies due. The right of a contractor to sue does not address the deprivation. The deprivation here is the seizure of money pending the final determination of such a lawsuit. The “temporary” seizure can be devastating in its effect. The release of the money seized, years later, does not remedy the injury suffered by cutting off a contractor’s cash flow. The Supreme Court requires notice and a hearing for such a “temporary seizure.”

In a lawsuit to recover monies seized by a Notice to Withhold, the contractor has the burden of proof. DLSE is not required, at any time, to establish that adequate grounds existed for the issuance of the Notice to Withhold. A contractor’s money may be held for years, even if it is ultimately determined that DLSE did not have legitimate grounds to issue the Notice to Withhold. The procedure provides tremendous leverage for enforcement officials that could be misused. Excessive and improper seizures can be used to compel a contractor to accept demands not justified by the facts or law. The power of the enforcement officials must be constrained by due process.

Generally, the Court balances several factors when considering what process is due: (1) the private interest involved, (2) the governmental interest, (3) any administrative burden, and (4) the risk of an erroneous decision. Consideration of these factors in this case establishes that the right to the state remedies is not adequate process for the seizure. The private interest in this case is substantial. First, the failure to provide a prompt hearing causes substantial harm to an important private interest. Cutting off the cash flow to a contractor causes substantial injury and can even force the contractor out of business. Second, the government’s interest is not affected by a hearing. The government’s interest is in enforcing the Labor Code. A hearing to determine probable validity does not conflict with that governmental interest. Certainly, the state has no legitimate interest in the baseless seizure of money. Third, a right to a hearing would impose no administrative burden. The hearing would only serve to weed out claims that lack merit. Finally, the risk of error is substantial with a Notice to Withhold. The risk of erroneous deprivation is high where the underlying determination involves factual disputes. The determination to resolve reported prevailing wage violations generally involves hotly contested factual disputes. Therefore, there is great risk of an erroneous deprivation.

Finally, respondent notes that petitioner’s brief for the first time reveals legislative changes scheduled to take effect in July 2001. Respondent believes that these legislative changes should not affect the judgment in this case. The judgment in this case remains as vital as ever, even if the legislative changes take effect. This case is not moot. It is well settled that a defendant’s voluntary cessation of a challenged practice does not deprive a federal court of its power to determine the legality of the practice. *City of Mesquite v. Aladdin’s Castle*, 455 U.S. 283 (1982). Also, a case and controversy exist as to G&G’s award of attorney fees under the current statute, and as to pending proceedings under the current law. Finally, the statutes provide that DLSE shall adopt regulations to implement the statutes. It is important that DLSE do so in the context of a judgment declaring that due process concerns must be honored.

**Significance**

There are two predicates to an action under the due process clause of the Fourteenth Amendment—state action and a sufficient property interest warranting protection. Both issues are in play in this case. State action cases generally involve some direct action against the person claiming a constitutional violation. The California “prevailing wage” statute is directed at the prime contractors, but the ultimate impact is visited upon the subcontractors, whose monies are withheld. Will the Supreme Court extend the state action doctrine to cover the derivative impact upon a third party?

In addition to state action, a due process violation further requires a showing that one has been deprived of his or her property without due process of law. In this case, the property question has two distinct

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facets. First, the circuits are split on whether a contractor who performs work under a contract, and thereby becomes entitled to payment, has a cognizable property interest protected by the Fourteenth Amendment. And second, can a property interest (the contractual right to payment) exist before all conditions precedent to that right to payment have been fulfilled? In this case, compliance with the “prevailing wage laws” is argued to be a condition precedent to any monies due under the construction contract. These are important questions for which we will soon have answers.

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