HAS COMMON SENSE FINALLY PREVAILED? THE COURT OF APPEALS CREATES A NEW THREE-PRONG TEST TO DETERMINE APPLICABILITY OF PREVAILING RATE ON PUBLIC PROJECTS

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With little fanfare, the New York State Court of Appeals has unanimously decreed that a newly refined, three-prong test must be applied to determine whether a particular project is subject to prevailing wage requirements in New York State. In *De La Cruz v. Caddell Dry Dock & Repair Co., Inc.*[1], the Court established the new test as follows:

> First, a public agency must be a party to a contract involving the employment of laborers, workmen, or mechanics. Second, the contract must concern a project that primarily involves construction-like labor and is paid for by public funds. Third, the primary objective or function of the work product must be the use or other benefit of the general public.

For almost 30 years the Court had applied a two-prong test requiring only that a public agency must be a party to a contract involving the employment of laborers, workmen, or mechanics, and that the contract must concern a public works project.[2] The new test keeps the first prong unchanged, but has refined the definition of "public works" by adopting the new prongs two and three.

The Court has recently focused on the first prong of the old test, twice holding that efforts by the New York State Department of Labor ("NYSDOL") to impose prevailing wage requirements on charter schools and certain volunteer fire departments did not satisfy the mandate that a public agency be a party to the applicable contract.[3] In both instances, the actual construction contracts at issue were entered into by private, not-for-profit entities, not by any public agency. The NYSDOL argued, however, that secondary agreements entered into between a not-for-profit entity and a public agency were sufficient to bridge that gap, and should qualify as the requisite contract involving the employment of laborers, workmen or mechanics. In the *M.G.M. Insulation* case, the NYSDOL went so far (and the Appellate Division, Third Department initially agreed) that courts should adopt a "functional equivalent" test under which certain entities (there a volunteer fire department) should be considered a municipal corporation within the meaning of the Labor Law, even though established as not-for-profit private entities. The Court of Appeals rejected both efforts by the NYSDOL to expand the first prong of the

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[1] __NY3d__, 2013 WL 3213308 (2013), 2013 NY Slip Op. 04842. All Judges participating concurred, notably including Chief Judge Lippman. He issued dissenting opinions in both the *MGM Insulation* and *Charter School* decisions (*infra.).* His concurrence in *De La Cruz* should help signal that the Court is firmly united with this outcome.

[2] *Matter of New York Charter School Assn v. Smith*, 15 NY3d 403, 413 (2010), quoting *Erie County Industrial Development Agency*, 94 AD2d 532 (4th Dept 1983), *aff'd* 63 NY2d 810 (1984).

[3] *See New York Charter School Assn v. Smith*, 15 NY3d 403 (2010), *Matter of M.G.M. Insulation, Inc. v. Gardner*, 20 NY3d 469 (2013).

established test, but in neither case was the Court required to examine the second prong requirement that "public work" be involved.

De La Cruz provided the Court with the opportunity to thoroughly examine what constitutes public work under the meaning of the Labor Law and the State Constitution. One reason *De La Cruz* has somewhat flown under the radar is because neither the NYSDOL or a contractor were parties. Rather it concerned a direct action by employees of a dry dock and repair company who had performed work on city-owned vessels. The employees maintained that the vessels qualified as "public works" and sued individually and on behalf of a class of approximately 750 fellow employees who repaired and maintained the city-owned vessels. The Court ultimately agreed with the employees, holding that the work on the city-owned vessels qualified as a public work subject to prevailing rate requirements. But, in doing so, the Court engaged in an exhaustive examination of what can qualify as a public work.

As a result, the Court created the second and third prongs of the new test, holding that the work must be "construction-like labor" in order to qualify, and that the project's primary objective must be to benefit the public.[4] But, the Court critically added within the new second prong the specific mandate that the project "is paid for by public funds". The Court reached that conclusion in large part through simple reliance upon definitions of "public works" within various dictionaries.[5] The Court observed that the two central aspects of the meaning of "public works" to be discerned from the dictionaries are that public works are works paid for by public funds and made for public use or other benefit.

The importance of the express requirement that public funds be involved cannot be overstated. This seemingly common sense observation is entirely new, with prior case law having held that the source of funding may be irrelevant. Most notably, in *Sarkisian Brothers, Inc. v. Hartnett*, the Appellate Division, Third Department ruled that an entirely privately financed hotel project, undeniably undertaken as a private venture for profit, could be wedged into the prevailing wage requirement if the NYSDOL was able to allege and demonstrate some public use, access and public enjoyment.[6] The Court has now definitively ruled that the absence of public funding for a project must be fatal to any effort to characterize a project as a public work subject to the prevailing rate requirements.

In recent years, the NYSDOL has targeted privately funded apartments adjacent to community colleges and even a privately owned and funded barbecue restaurant, because of arguable connections to public entities, either via a not-for-profit corporation's relationships or underlying public land ownership. One very gray area had been situations in which a public entity leased land to private developers that sought to privately fund, construct, and operate

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[4] *Citing Matthew of Twin State CCS Corp. v. Roberts*, 72 NY2d 897 (1988) and *Matter of 60 Market Street Assoc. v. Hartnett*, 153 AD2d 205 (3rd Dept 1990) *aff'd* 76 NY2d 993 (1990).

[5] __ NY3d __, 2013 WL 3213308 at p.6; *citing Black's Law Dictionary*, 1746 (9th Ed. 2009), *Websters New Twentieth Century Dictionary of the English Language Unabridged* 1368 (1st Ed. 1950), *Merriam-Webster's Collegiate Dictionary* 1006 (11Ed. 2003) and *The Oxford English Dictionary Third Edition*, http://www.oed.com.

[6] 172 AD2d 895 (3rd Dept 1991), *mot for leave to app denied,* 78 NY2d 859 (1991).

various types of projects. The newly minted test mandate that public funds be involved creates a bright line test, removing much of the doubt previously inherent in such a project structure.

The scope of the 2007 so-called "Third Party Bill," that expanded the applicability of prevailing rate to projects carried out by private parties in the place of, on behalf of and for the benefit of defined public entities, should also now be more easily defined.[7] The fact that a lease, permit or other agreement exists between such a third party and a public entity may help satisfy prong one to the test, but public funding now must also be involved to satisfy the newly crafted second prong.

The new *De La Cruz* three prong test should permit greater certainty concerning whether or not the prevailing rate applies to given projects that are primarily of a private nature. In fact, this new, common sense test may allow for greater use in New York of public-private initiatives, because the mere involvement of a public entity should not necessarily eliminate the favorable lower cost structure that allows privately funded projects to succeed. It will be interesting to see how the NYSDOL responds.

[7] §220 (2) New York Labor Law, 2007 amendments.