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REPORT TO THE COMMITTEE ON RULES, FINANCE AND INTERGOVERNMENTAL RELATIONS

PROPOSED RESPONSIBLE WAGE AND BENEFITS ORDINANCE

INTRODUCTION

On November 5, 2003, the Center for Policy Initiatives [CPI] presented a proposed "Responsible Wage and Benefits Ordinance" to the Committee on Rules, Finance, and Intergovernmental Relations. In general, the proposed ordinance would require those businesses that contract with the City to provide services or that receive financial assistance from the City, to pay their employees a "living wage" that is higher than the minimum wage required under California law. The ordinance also requires these businesses to provide health benefits or, alternately, to pay their employees a higher hourly rate to help these employees purchase their own health insurance.

Although several large cities in California have adopted some form of a living wage ordinance in the last few years, significant legal issues remain. As presently drafted, the proposed ordinance cannot be approved by this Office as to form and legality. This report addresses some of the more significant legal issues and makes recommendations to correct fatal flaws and minimize the City's exposure to legal challenges.

DISCUSSION

The proposed ordinance has three distinct parts. First, the ordinance proposes to implement the living wage and health benefit requirements by adding sections 22.4101–22.4120 to the San Diego Municipal Code [SDMC]. Second, the ordinance proposes expanding the scope of the existing Service Worker Retention provisions (SDMC sections 22.2801–22.2806) from workers at certain City facilities (sports, entertainment, or convention facilities) to all employees of businesses that provide more than $25,000 worth of services to the City in any year. Third, the ordinance would add new SDMC section 22.3224 to specify the qualification factors to consider when selecting service contractors and impose certain reporting requirements on service contractors during the life of the contract.

After the November 5, 2003, Rules Committee meeting, CPI provided a revised version of the proposed ordinance dated February 29, 2004. In general, the revised ordinance raises the monetary threshold for financial assistance to businesses from $50,000 to $500,000. It also reduces the proposed minimum wage from $11.95 per hour, to $9.00 per hour for FY 2005 and $10.00 per hour for FY 2006. It also reduces the health benefit supplement rate from $2.53 per hour to $2.00 per hour for FY 2005. Finally, the revised version removes a requirement that the City pay its employees a living wage.[1] This report discusses the revised version of the proposed ordinance dated February 29, 2004, and addresses some of the more significant legal issues affecting the validity of the ordinance.

I. THE RESPONSIBLE WAGE AND BENEFITS ORDINANCE

A. The Definition of "Financial Assistance" is Vague

The proposed ordinance would impose the living wage and other requirements on businesses that receive more than $500,000 of financial assistance from the City in any one year. "Financial Assistance" is defined as "funds or action of economic value" provided by or through the approval of the City, for the purpose of encouraging economic development or job creation or retention. It would specifically apply to businesses that receive more than $500,000 through the City's Special Promotion Programs for Economic Development and Arts, Culture and Community Festivals.

The definition of "Financial Assistance" includes "environmental remediation, deferred payments, forgivable loans, below-market loans, land write-downs, infrastructure or public improvements or other action of economic value." This definition is very broad and could apply to contracts or projects that are administered by various departments and, therefore, may not easily be identified as an agreement that should be subject to the ordinance. For example, these types of financial assistance are often part of redevelopment incentives to developers. Assuming these developers are covered, it is not clear how or when the living wage ordinance would apply to their businesses and their employees. The ordinance provides that it would apply to employees with regard to any hours worked at the "Financial Assistance Site," which is defined as "the property owned or operated by a Financial Assistance Recipient and that is an intended location of the economic development or job creation that was the purpose of provision of the Financial Assistance . . . ." In many cases of redevelopment, there are no employees at the "site" because the "site" is under construction.

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[1] CPI has indicated they will address the issue of City employees' wages and benefits at a later time. However, an ordinance purporting to bind future city councils in the payment of wages and benefits to City employees who are represented by labor organizations is likely to be preempted by state law and is contrary to the bargaining framework inherent in the Meyers-Milias-Brown Act.

Similarly, it is likely that arts organizations that receive financial assistance have workers who perform their duties at a site that is not owned or operated by the arts organization. Given the variety of financial assistance agreements that might be covered under this broad definition and the practical problem of determining which workers are employed at the site, it may be difficult to consistently apply the ordinance. Accordingly, we recommend that the definition be revised to address these issues.

B. The Definition of Service Contract is Vague

The proposed ordinance would apply to businesses that provide services to the City or other entities for more than $25,000 during any one year. This is probably the largest category of contracts that would be required to comply with the ordinance. The definition of "Service Contracts" includes contracts for services such as janitorial, security, landscaping, childcare, and parking. It does not include the purchase or lease of goods and products, professional service contracts, and construction contracts. Because "professional service" is not defined, there is some concern that the ordinance might apply to banking, financial, and technical services. We recommend that this definition of service contract be clarified to indicate what is meant by the professional services exclusion.

The definition also delegates to the new City Compliance Officer [CCO], the authority to designate as "Service Contracts" other categories of contracts that do not fit the definition: (1) contracts performed on property owned by the City; (2) contracts that could be performed by City employees; and (3) contracts that would further the City's proprietary interest if designated as a Service Contract. This delegation of authority to the CCO is unnecessary because the first two categories are already included within the definition of a Service Contract. The third category, which allows the CCO to designate any other contract as a Service Contract, could lead to arbitrary and discriminatory application of the ordinance. Accordingly, we recommend that this entire portion of the definition authorizing the CCO to add additional contracts be deleted.

C. The Ordinance May Not be Enforceable against Businesses that Operate Outside the City's Territorial Limits

As noted above, the proposed ordinance would apply to service contracts that exceed $25,000 in any year. To the extent that any of these businesses perform the services outside the City's boundaries, the City's ability to enforce the ordinance is uncertain. The City of Hayward presently is defending its living wage ordinance against a laundry business [Cintas] that provides the laundry services outside the city's limits. Cintas contends that, although a city may "exercise proprietary powers with respect to property it owns even if the property lies outside the city's corporate boundaries," the property where it seeks to regulate wages is not owned by the city and is outside the boundaries of Hayward. *S.D. Myers, Inc., v. City and County of San Fransisco,* 253 F.3d 461, 473 (9th Cir. 2001). As such, Cintas argues that the ordinance violates the California Constitution which authorizes cities to make ordinances and regulations only "within its limits."

Cal. Const. art. XI, § 7. A motion for summary judgment was argued in March 2004, and the parties presently are waiting for the court's decision.

A similar argument can be made against the proposed ordinance. It is likely that some of the service contracts will be with businesses that actually perform the services outside the City's limits. Moreover, as written, the proposed ordinance is likely to be considered a regulatory ordinance that must be justified as a proper exercise of the City's police powers. Although the City's contracting and spending powers are cited as authorities in the ordinance, the fact that the ordinance provides a private right of action to employees instead of only contractual remedies to the City, demonstrates a regulatory intent rather than a contractual or proprietary purpose. As a regulatory ordinance, it is unclear whether it can be enforced outside the City's territorial limits.

D. Applying the Ordinance to Existing Contracts at City Facilities is Subject to Legal Challenge

The proposed ordinance would require employers that have existing contracts at Qualcomm Stadium, San Diego Sports Arena, San Diego Convention Center, and the City Concourse, to pay their employees a living wage and provide other employee benefits. In general, legislation regulating or restricting contractual or property rights is within the police power if the operative provisions are reasonably related to the accomplishment of a legitimate governmental purpose. *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129, 158 (1976). In that regard, the Contract Clause doctrine requires the balancing of the competing interests of the Constitutional provision prohibiting the impairment of contracts with those of a government's exercise of its police power. The legislation will be upheld if it does not substantially impair the contract. If it does impair the contract, the legislation will be upheld if the agency can demonstrate that the legislation has a legitimate public purpose, and the means used is appropriate to achieve the objective.

It is likely that the ordinance will increase costs for employers at certain City facilities, but it probably will not substantially impair the contracts. To ensure the validity of the ordinance, the City must articulate the public purpose for requiring those employers to comply with the ordinance, and how the means used to further that purpose is appropriate. The proposed findings state that ensuring that businesses "using City facilities promote the creation of jobs that pay a living wage will increase the ability of San Diego residents to attain self-sufficiency, will decrease economic hardship in the City, and will reduce the need for the taxpayers to fund social services in order to provide supplemental support for the employees of these local businesses" and that requiring the provision of health benefits to their employees, will enhance the health and welfare of workers of the City and their families. These findings, assuming that they are supported by sufficient evidence, appear reasonable. However, additional findings should be made as to why City facilities are being singled out for application under the proposed ordinance.

E. The Requirement to Provide Health Benefits May be Preempted by State Law.

The proposed ordinance requires a covered employer to provide heath benefits, which are described as either: (1) payment of at least the Health Benefits Supplement Rate of $2.00 per hour toward providing health care benefits for each Covered Employee and his or her dependents; or (2) payment of not less than the living wage and the $2.00 Health Benefits Supplement Rate.

These health benefits provisions may be preempted by state law. The recently adopted Health Insurance Act of 2003 requires certain employers to pay a fee for employee health coverage through the State Health Purchasing Program or receive a credit against the fee if the employer provides health care coverage directly for its employees. Certain large employers (more than 200 employees) would need to comply beginning January 1, 2006, followed by medium employers (at least 20 but no more than 199 employees) beginning January 1, 2007. Small employers (at least 2 but not more than 19 employees) are exempt from the law.

Under the preemption doctrine, local regulation of matters of statewide concern "remain[s] subject to and controlled by applicable . . . state laws . . . if it is the intent and purpose of such general laws to occupy the field to the exclusion of municipal regulation." *Bishop v. City of San Jose,* 1 Cal. 3d 56, 61 (1969); Cal. Const. art. XI, § 7. A conflict between local and state regulation may arise where local government attempts to regulate in an area that is fully occupied by general law or where local regulation duplicates or contradicts state law. *Lancaster v. Municipal Court,* 6 Cal. 3d 805, 807–08 (1972). However, where the state's preemption of the field or subject is not complete, local supplemental legislation is not deemed conflicting to the extent that it covers phases of the subject that have not been covered by state law. *Baron v. City of Los Angeles*, 2 Cal. 3d 535, 541 (1970).

It is not clear whether the State intends to fully occupy the area of employee health benefits. The law states that "[e]xisting law does not provide a system of health care coverage for all California residents and does not require employers to provide health care coverage for employees and dependents, other than coverage provided as part of the workers' compensation system for work-related employee injuries." It also imposes a "state-mandated local program" related to enforcement of the law. However, it also provides that the law is not to be construed to diminish any protection already provided pursuant to collective bargaining agreements or employer-sponsored plans that are more favorable to the employees than required by the law. Accordingly, it is not clear whether the health benefit requirements would be completely preempted by the state law. On balance, however, it appears that the City may be able to require employers to provide more favorable coverage and set requirements for smaller employers that are exempt under the state law. We have not analyzed whether the proposed health benefits are more favorable than those required by the state law.

F. The City's Authority to Create Private Remedies is Uncertain

Although some of the living wage ordinances in California provide for a private right of action by the employee for a violation of the ordinance, it is not clear that a city may grant that right. In a pending case involving the City of Hayward's living wage ordinance, the private right of action is being questioned as part of Hayward's attempt to impose the ordinance on service contractors that perform the contract outside the City's territorial boundaries. The California Supreme Court has also questioned whether a city may create a private right of action in connection with its rent control ordinance. *Birkenfeld v. City of Berkeley,* 17 Cal. 3d 129 (1976). The issue was not substantively addressed in the Supreme Court case because the ordinance failed for other reasons. Nonetheless, this is an untested area of the law and subject to challenge. We recommend that the private right of action language be deleted, or significantly scaled back to defer to existing rights and remedies that may be available to employees.

Assuming the private right of action is valid, there are other legal concerns with this section. The civil enforcement procedure allows any natural person, or "any organization designated by such natural person" to file a lawsuit against the business for non-compliance with the ordinance. We are not aware of any legal authority that would allow a designated organization to bring a legal action on someone's behalf. Although it might be appropriate for an employee's union organization to bring an action, the issue of who has standing or is a proper party is best left to existing statewide civil procedure rules.

G. The Proposed Penalties are Unenforceable

More significantly, some of the penalties proposed in the administrative and civil enforcement sections are illegal and unenforceable. In particular, the requirement that an employer pay twice the monetary damages without a finding of willfulness violates due process. SDMC § 22.4115(e)(2). In addition, the revised ordinance provides that when a private action is filed, the court may order, in addition to monetary damages, $100.00 per pay period per violation, plus interest, without a finding that the violation was willful. SDMC § 22.4116(c)(1). It is unconstitutional to provide for a penalty that is mandatory and without limits as to the amount. In a case involving a $100.00 per day penalty, the California Supreme Court held that the penalty was a due process violation because it was "mandatory, mechanical, potentially limitless in its effect regardless of circumstance, and capable of serious abuse." *Hale v. Morgan,* 22 Cal. 3d 388, 403 (1978).

Similarly, the proposed ordinance's $100.00 per pay period per violation is mandatory and potentially limitless, and therefore, an unconstitutional penalty. Further, it is likely that this $100.00 penalty plus treble damages would be viewed by the court as excessive. The ordinance also provides for treble damages, plus interest. It is likely that an award of pre-judgment interest on penalties is unconstitutional. Accordingly, we recommend that these provisions be revised to

provide only for the difference in pay and benefits, rather than twice that amount, and that only the treble damages for a willful violation remain as a penalty.

Finally, the proposed ordinance authorizes attorney's fees only to the employee or their representative organization if they prevail. Although not legally required, we recommend that the ordinance be revised to include a provision that the employer is allowed to recover attorney's fees if the complaint is found by the court to be frivolous. We also note that the proposed ordinance provides for a three year statute of limitations, which is longer than the one year period often found in other living wage ordinances.

H. The City Has No Authority to Enforce Private Remedies Ordered Through the Administrative Enforcement Procedures

The proposed ordinance includes both administrative and civil procedures and remedies. The administrative procedures provide for a complaint process, investigation process, and the initial findings process. If a party disagrees with the findings, there is a hearing procedure and an appeals process. The administrative process authorizes the City to order the employer to pay the employee withheld compensation, treble damages, interest, and order reinstatement if the employee had been terminated. However, we are not aware of any legal authority which would allow the City to enforce these private remedies against a business. Accordingly, we recommend that the administrative procedures process be simplified and that only the contractual remedies, such as termination or suspension of the contract, or debarment, be retained.

The draft ordinance notes at the conclusion of the administrative and civil enforcement sections that the process was modeled after the SDMC's Divisions pertaining to Nondiscrimination in Contracting (SDMC sections 22.3501–22.3517) and Code Enforcement (SDMC sections 12.0101–12.0105). To clarify, the concerns addressed above regarding the private right of action and penalties are not included in the Municipal Code sections referenced in the draft ordinance.

I. Allowing a Waiver of the Ordinance by Collective Bargaining is Subject to Legal Challenge

The proposed ordinance provides that the ordinance may be waived, in whole, or in part, by the written terms of a collective bargaining agreement. This provision is similar to one in the Berkeley living wage ordinance that is presently being challenged in court. One of the issues raised in the *Berkeley* case is that the City improperly delegated authority to employers and collective bargaining units the power to alter the required living wage. Berkeley and the affected union argued that a waiver makes policy sense because organized workers often can negotiate a better overall economic package of benefits than provided in the ordinance. The Federal district court upheld the provision, and the employer appealed. The issue has been argued and a decision

is expected later this year. Accordingly, it is unsettled whether this is an improper delegation of a city's police power.

J. The Council May Not Have the Authority to Require Independent Agencies to Adopt the Ordinance

The proposed ordinance defines "City" to include "all City agencies, and any board, commission, committee, or task force of the City established by action of the City Council . . . including the Housing Authority and Redevelopment Agency." This is very broad, and conceivably would require Centre City Development Corporation, San Diego Data Processing, Southeast Development Corporation, the Retirement Board, and other agencies to include the living wage requirements in its service contracts and financial assistance agreements. However, it is not clear whether the City Council can impose these contracting requirements on agencies that exercise independent control over their expenditures. Accordingly, the ordinance could accomplish its purpose by limiting it to those contracts and financial assistance agreements authorized by the City Council or City Manager.

II. THE SERVICE WORKER RETENTION ORDINANCE

The existing Service Worker Retention ordinance was adopted in 1998 to provide existing employees at certain City facilities (sports, entertainment, or convention buildings structures) a reasonable opportunity to obtain employment with a new contractor who has been awarded the contract through the competitive bidding process.[2] The rationale is that changing contractors does not necessarily include a need to replace workers who already have useful knowledge about the workplace and experience with practices, patrons, or clients that are particular to the City facility. Managerial, supervisory, confidential employees, or persons required to possess an occupational license or certificate, are not protected under the retention ordinance.

The proposed revisions to the Service Worker Retention ordinance would significantly expand its scope to apply to all service contracts in excess of $25,000, and to employees who have worked at least six months, instead of one year. There do not appear to be any significant legal issues with the proposed revisions, except that the "Purpose and Intent" section of the Service Worker Retention ordinance should be revised to explain the purpose for extending the worker retention provisions to this new category of contracts.

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[2] When the City Council considered the adoption of the Service Worker Retention ordinance, it rejected the broader scope proposed by the San Diego-Imperial Counties Labor Council. In particular, the City Council declined to apply the ordinance to service contracts in excess of $25,000 and to workers with at least eight months of employment. The legal and policy issues raised by the broad scope of the ordinance were discussed in two legal memoranda by this office. (*See,* 1997 City Att'y MOL 361 and 1996 City Att'y MOL 429).

III. QUALIFICATION FACTORS FOR SELECTING A SERVICE CONTRACTOR

The proposed ordinance would add a new provision for the selection of contracts for services. The SDMC presently provides that factors such as experience and responsibility, as well as any additional relevant factors, may be considered in evaluating bids. SDMC § 22.3213. The proposed ordinance expands these factors to require the City to consider: (1) financial resources; (2) technical qualifications; (3) experience, (4) organization, material, equipment, facilities and expertise; (5) satisfactory records of performance; (6) satisfactory compliance with applicable statutes and regulations; and (7) satisfactory record of business integrity. The proposed ordinance requires that the bidders submit a response to a questionnaire developed by the Equal Opportunity Contracting Director and that the successful bidder update the answers for the life of the contract, by notifying the City of any change in qualifications within 30 days of such change. Failure to notify the City may be considered a material breach of the contract.

Compliance with these requirements will be burdensome, and the experience and financial requirements could have an adverse effect on small and emerging businesses. In addition, the proposed $25,000 contract threshold is lower than the $50,000 amount the City has set for the competitive bidding process used for service contracts. For example, contracts greater than $10,000 but less than $50,000 may be awarded by the Purchasing Agent without advertising, by soliciting written price quotations for at least five potential sources. SDMC § 22.3211. Presumably, the $50,000 limit is designed to use City resources more efficiently on smaller contracts. Applying the qualification requirements to contracts exceeding $25,000 will require more administration in contract processing. In general, the proposed $25,000 threshold for the living wage, qualification sections, and retention requirements greatly expands the number of service contracts subject to these new requirements.

IV. FORMATTING AND FLEXIBILITY

As presently drafted, the proposed ordinance does not provide any flexibility for the City in its contracting process. A provision should be added to allow the City Council or City Manager to waive the requirements for fiscal emergencies or other circumstances when it is in the best interest of the City not to require compliance with the ordinance. In particular, there may be times when the annual upward adjustment of the wage and health benefits in accordance with the Consumer Price Index is not in the City's best interests. Finally, the proposed ordinance needs revisions to make the formatting, definitions, and other language consistent with the SDMC. Our Office will make these changes after the substantive decisions have been made by the Rules Committee and before it proceeds to City Council.

CONCLUSION

The proposed living wage ordinance is unlike any ordinance the City has adopted. It attempts to expand worker's benefits beyond those established and regulated by federal and state wage and hour laws. It is not merely ensuring that businesses that contract with the City comply with existing laws, such as those dealing with discrimination and equal employment opportunity. It is creating new workers' rights, benefits, and remedies. The authority for a City to impose some of these requirements is legally untested and unresolved.

Because of the legal concerns, we recommend that the ordinance be revised to avoid treading into the areas identified as potential legal challenges. Our Office is willing to work with the City Manager's staff and interested parties in drafting an alternative ordinance which will meet the City's needs and minimize the City's exposure to legal challenges.

Respectfully submitted,

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