Construction Contracts Law Report

West, a Thomson Reuters business

News & Views

July 22, 2011 Volume 35, Number 15

FEATURE COMMENT: Third Circuit Rules That Delaware's Apprentice Regulations Violate The Commerce Clause: Similar Rules In Numerous Other States Could Be Affected

This Feature Comment was authored by **Kevin J. Cosgrove**, Esq., a partner with the firm of Hunton & Williams LLP. The article was originally published in the firm's publication, "Construction Corner." Reprinted with permission.

The Third Circuit Court of Appeals' recent decision in *Tri-M Group, LLC v. Sharp*, 638 F.3d 406, 190 L.R.R.M. (BNA) 2518, 17 Wage & Hour Cas. 2d (BNA) 712 (3d Cir. 2011) provides an excellent analysis of the Commerce Clause and its effect on state procurement law. Although the case involved Delaware's regulatory scheme for the payment of apprentices on construction projects, its analysis also applies to procurement regulations in the other 49 states as well. For anybody who does business with a state--especially construction and related types of business--this case is a "must read."

Delaware's Apprentice Regulations

In the late 1990s, Delaware enacted an apprentice regulatory scheme. The purpose of the regulations was to provide for the establishment and furtherance of standards for apprenticeships and training to safeguard the welfare of apprentices and trainees. Del. Code Ann. tit. 19, § 201. Delaware also has a minimum wage law which provides that, on public works projects funded in whole or in part by the state, mechanics and laborers--including apprentices--had to be paid a wage set by the Delaware Department of Labor. Del. Code Ann. tit. 29, § 6960. Apprentices covered by these regulations were paid some fraction of the pay received by mechanics. The key point in the regulations, however, was that only contractors that had registered their apprentice programs in Delaware were authorized to pay this lower wage to registered apprentices. To qualify as a Delaware contractor so as to take advantage of these regulations, a contractor was required to maintain a permanent place of business in Delaware. Site trailers or other facilities serving only one contract or related sets of contracts were insufficient to meet this standard. Thus, out-of-state contractors were required to pay their apprentices a wage equal to the wages paid to mechanics.

Under the Delaware regulations, out-of-state contractors were therefore required to pay their apprentices a higher wage than in-state contractors had to pay their Delaware-registered apprentices. These regulations applied to all construction contracts--not just public contracts. Finally, the regulations provided financial penalties and possible suspension or debarment of companies that failed to comply with them.

The Case at Bar

Tri-M Group ("Tri-M") is a Pennsylvania-based electrical contractor. It did not have a permanent office in Delaware. Tri-M received a subcontract to perform electrical and building automation work at the Delaware State Veteran's Home. The project was funded in part by Delaware state funds. Therefore, the Delaware apprentice regulations applied.

Tri-M staffed the work with mechanics and apprentices who were registered in Pennsylvania. The apprentices were paid the fractional amount of the mechanic's wages permitted by Delaware regulations. During the performance of the contract, Tri-M was audited by the Delaware Department of Labor ("DDoL"). DDoL determined

that Tri-M had paid its apprentices at the Delaware-registered apprentice rate rather than the mechanics' rate applicable to non-Delaware-registered apprentices. Tri-M was required to pay the wage "deficiency" to its apprentices who were not recognized as apprentices under Delaware law.

Tri-M made the required payments and completed the project. It then sued DDoL, alleging that Delaware's apprentice regulations discriminated against out-of-state contractors by refusing to recognize their out-of-state registered apprentices. Tri-M's main argument was that Delaware's regulations interfered with interstate commerce in violation of the Commerce Clause. See U.S. Const., art. I, § 8, cl. 3. The trial court found in favor of Tri-M. DDoL appealed to the Third Circuit Court of Appeals, which affirmed the trial court's decision.

Market Participation or Regulation Under the Commerce Clause?

The Commerce Clause grants Congress authority to regulate commerce among the several states. In addition, the Commerce Clause "has long been understood to have a 'negative' aspect that denies states the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Oregon Waste Systems, Inc. v. Department of Environmental Quality of State of Or.*, 511 U.S. 93, 98, 114 S. Ct. 1345, 128 L. Ed. 2d 13, 38 Env't. Rep. Cas. (BNA) 1249, 24 Envtl. L. Rep. 20674, 73 A.F.T.R.2d 94-1603 (1994). This "negative aspect" is known as the dormant commerce clause. When a state regulation provides "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter," that regulation is almost always invalid under dormant commerce clause jurisprudence. *Granholm v. Heald*, 544 U.S. 460, 472, 125 S. Ct. 1885, 161 L. Ed. 2d 796 (2005).

There is, however, a well recognized exception to this rule. A state is free to participate in a market and can favor its own citizens over citizens from other states by virtue of that participation. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 810, 96 S. Ct. 2488, 49 L. Ed. 2d 220 (1976). The line of demarcation for dormant commerce clause jurisprudence is whether a state is acting as a participant in a particular market or as a regulator of that market. Cases have usually found that a state merely participates in the market when "the government was participating directly in some aspect of the market as a purchaser, seller or producer, and the alleged discriminatory effects on the interstate market flowed from these market actions." *Atlantic Coast Demolition & Recycling, Inc. v. Board of Chosen Freeholders of Atlantic County*, 48 F.3d 701, 716, 40 Env't. Rep. Cas. (BNA) 1417, 25 Envtl. L. Rep. 20620 (3d Cir. 1995). Conversely, where the state's purpose "is not the efficient procurement of goods and services, but the furtherance of a labor policy," a state is behaving "in its capacity as a regulator rather than a market participant." *Wisconsin Dept. of Industry, Labor and Human Relations v. Gould Inc.*, 475 U.S. 282, 291, 106 S. Ct. 1057, 89 L. Ed. 2d 223, 121 L.R.R.M. (BNA) 2737, 103 Lab. Cas. (CCH) P 11704 (1986).

Before a court can undertake any analysis under the dormant commerce clause, it must first determine whether the challenged program constitutes participation or regulation of the market. Here, the Third Circuit had no difficulty in determining that Delaware's apprentice regulations constituted market regulation, not mere participation.

> [T]he disputed prevailing wage conditions here are part of an expansive regulatory scheme that controls the market activities of private participants; this involvement clearly reflects a governmental interest in setting labor policy, rather than merely impacting the state's own participation in the market.
>
> As an initial matter, the apprenticeship regulations sweep broadly. They are not limited in scope only to contracts in which the state directly participates in a funding or procurement capacity. As DDOL conceded in its briefing and at oral argument, the [regulations] do not refer exclusively to public contracts.
>
> Another factor distinguishes the instant statutory regime from those that reflect mere market participation by private actors: the potential civil penalty threatened by the State for failure to comply with the prevailing wage conditions.
>
> A governmental entity acts as a market regulator when it employs tools in pursuit of compliance that no private actor could wield, such as the threat of civil fines.
>
> *Tri-M Group*, 2011 WL 941602, at *12.

Because Delaware acted as a market regulator rather than a market participant, the Third Circuit determined that

its regulations were “subject to review for potentially imposing an undue burden on interstate commerce in contravention of the dormant Commerce Clause.” 2011 WL 941602. at *13. The court then began its analysis of the merits of this matter.

Delaware's Apprentice Regulations Deemed Unconstitutional

The Third Circuit took little time in holding that Delaware's apprentice regulatory scheme violated the dormant commerce clause. Commerce Clause jurisprudence teaches that “state laws that discriminate against out-of-state business by forcing them to surrender whatever competition advantages they might possess are especially suspect.” *Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 580, 106 S. Ct. 2080, 90 L. Ed. 2d 552 (1986). The Delaware requirement that an out-of-state contractor must set up and maintain a permanent office in Delaware to take advantage of the Delaware registered apprentice program violated this precept.

> This statutory scheme forces out-of-state contractors such as Tri-M to ‘surrender whatever competition advantage they might possess by burdening them with expenditures for a new local operation, or with the payment of increased wages on their contracts, thereby increasing their costs and decreasing their ability to submit competitive bids for projects.
> *Tri-M Group*, 2011 WL 941602, at *14.

DDoL argued that it had a legitimate interest in safeguarding the welfare of all apprentices, which justified the requirement for a Delaware permanent place of business. DDoL also pointed out that it lacked the resources to monitor out-of-state contractors to ensure compliance with Delaware standards. The court was not impressed.

> [T]he demonstrated existence of non-discriminatory alternatives for ensuring the safety and training of apprentices did not overcome the per se invalidity presumption applicable to discriminatory regulations. Tri-M's lack of a permanent place of business in Delaware did not prevent DDoL from conducting a thorough investigation to ensure Tri-M's compliance with the [regulations].
> [W]e find the record devoid of evidence to substantiate DDoL's assertion that it could not verify out-of-state work standards through postal or electronic transmission of certified payrolls, tax records, or other documentation as compared to a personal inspection of the apprentice's out-of-state work job site.
> *Tri-M Group*, 2011 WL 941602, at *15.

DDoL also argued that Congress had expressly authorized this regulatory scheme when it passed the National Apprenticeship Act of 1937, 29 U.S.C.A. § 50, commonly known as the Fitzgerald Act. The Fitzgerald Act was passed to protect apprentices through the establishment of minimum labor standards. Based on the Fitzgerald Act, DDoL argued its regulations could not be invalidated under the dormant commerce clause. But the court found that DDoL had not met its burden of proof to show “a clear and unambiguous intent on behalf of Congress to permit the discrimination against interstate commerce.” *Tri-M Group*, 2011 WL 941602, at *16. In a stinging observation, the Third Circuit expressly adapted the district court's finding that this argument “is, at a minimum, not compelling.” *Tri-M Group*, 2011 WL 941602, at *16. The decision of the district court that the regulations imposed impermissible discrimination on interstate commerce was affirmed.

Conclusion

This case presents a cautionary tale. Most states have statutes and regulations that favor their own residents when conducting business with in the state. Some of these requirements arise out of a state's participation in a particular market and therefore would pass muster under the Commerce Clause. Others, however, go farther and seek to regulate a market. State legislators and their legal advisors need to consider such enactments in the context of the dormant commerce clause. The *Tri-M Group* decision “calls into doubt the constitutionality of ... the public works procurement laws of approximately 37 other states.” *Id.* at *4. Consider whether the regulations impacting your business are impacted by this decision.

This case is also a ray of hope for contractors and other participants in the construction industry that work in multiple states. Do not assume that state regulations favoring in-state contractors cannot be challenged successfully.

The dormant commerce clause is a powerful tool if a business needs to fight city hall or a state legislature.