

## Proposal #3: Recovery Fund

### September 19, 2006

#### Background

The Construction Contractors Board (CCB) provides dispute resolution services to homeowners and contractors in breach of contract disputes. If the CCB orders a contractor to pay money to a homeowner and the contractor fails to pay, the contractor's CCB bond may be available to pay the unpaid portion of the order. However, the bond may not be sufficient to cover the amount of the claim. Amounts left unpaid after the CCB bond has been depleted are currently paid from a contractor's surety bond, which a contractor must buy in order to get licensed with the CCB. Bond amounts range from \$5,000 to \$15,000. As noted above, not all losses are covered by payments from contractor's bonds. Oregon had 41,284 licensed contractors as of December 2005, with an estimated 28,000 contractors undertaking residential-only work. For the fiscal year 2005, CCB records show that 69 contractors had damages awarded on residential structures above their bond limits, leaving a shortfall of \$917,850.

In the May 24, 2006 meeting, the Task Force directed staff to develop recovery fund options, including but not limited to funding for residential structures.<sup>1</sup>

#### Summary of Recommendations

After distilling testimony and conducting comparative research on the structure of recovery funds, it appears that the important characteristics of a recovery fund turn on (1) who has access to the recovery fund, (2) the source of the money for the recovery fund, and (3) limitations on payout from the recovery fund. Out of the Task Force guidance, testimony, and staff research, staff recommendations are:

- Establish a recovery fund for residential construction only.
- Extend the applicability of a residential recovery fund to owners of detached single-family homes, duplexes, townhouses, rowhouses, and residential structures three stories or less in height.
- Allow current CCB dispute resolution services to directly pay out of the recovery fund at the conclusion of dispute resolution proceedings, or payouts based on civil litigation.
- Confer administrative authority for the recovery fund in the Construction Contractors Board.
- Assess residential-only contractors a reasonable fee between \$20 and \$40, offset with civil penalty funds and other funding sources.
- Provide additional assessment authority (\$20 to \$40) to mitigate unforeseen contingencies and to maintain the solvency of the fund.
- Retain investment income made off recovery fund money for additional resources.
- Restrict recovery fund uses to paying claims and administering the fund.
- Set aside 15 to 19 percent of the recovery fund's gross revenues for administrative expenses.
- Require periodic third-party actuarial support to project future claims and reserves.
- Allow the Construction Contractors Board to pursue subrogation claims to replenish the recovery fund.
- Allow the Construction Contractors Board to condition, suspend or revoke a license to secure payment from the recovery fund.
- Cap payouts to \$10,000 per transaction.
- Cap aggregate liabilities against a *person* to \$200,000.
- Limit damage reimbursement to actual damages.

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<sup>1</sup> Minutes, Construction Claims Task Force 10 (May 24, 2006).

- Create mechanisms for prorated and proportional share payments from recovery fund.
- Confer limited discretion on the CCB to schedule the time and amount of payouts if necessary to preserve the integrity of the recovery fund.

## **Access to Recovery Fund**

### Summary of Recommendations

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- Extend the applicability of a residential recovery fund to owners of detached single-family homes, duplexes, townhouses, rowhouses, and residential structures three stories or less in height.
- Allow current CCB dispute resolution services to directly pay out of the recovery fund at the conclusion of dispute resolution proceedings, or payouts based on civil litigation.

The most basic question in the establishment of a recovery fund is who will be the intended beneficiaries. Testimony taken by the Task Force indicated a preference for recovery funds that covers residential construction rather than commercial ventures.

Access to recovery funds entails examining (1) which class of owner – e.g, residential homeowners – can apply for funds and (2) what steps the homeowner must take to be eligible to apply for those funds. The first group of recovery funds generally provide access directly to injured homeowners. Some states limit a fund’s applicability to single-family residences, while other states include multi-unit construction.

### Types of Construction Defects Eligible for Recovery Fund Money

#### *1. Recovery Fund Claims Against Residential Structures*

In Connecticut, consumers may obtain payments from the state’s guaranty fund against a new home construction contractor.<sup>2</sup> New home construction contractors, in turn, are certified by the state to build single-family dwellings, duplexes, or condominium units and common areas.<sup>3</sup>

In Florida, the Homeowners’ Construction Recovery Fund is available to homeowners of an owner-occupied residence, which includes individual condominium units or “a residential building containing not more than two residential units.”<sup>4</sup>

In Hawaii, an “injured person” may recover amounts from the state’s recovery fund. “Injured persons” are limited to owners or lessees of private residences, condominiums and cooperative units.<sup>5</sup>

In Minnesota, the state’s recovery fund compensates an “aggrieved owner or lessee” for a contractor’s bad conduct – fraudulent, deceptive or dishonest business practices, conversion of funds, or failure to perform contracted work.<sup>6</sup> The fund covers an owner’s residential property or new construction that was not occupied by the owner, or was occupied by the contractor for less than one year before sale to the owner.<sup>7</sup> Minnesota law or regulation does not specifically state whether residential property excludes multi-unit dwellings.

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<sup>2</sup> CONN. GEN. STAT. § 20-417i.

<sup>3</sup> CONN. GEN. STAT. § 20-417a(6).

<sup>4</sup> FLA. STAT. 489.1402. After January 1, 2005, claimants are defined as natural persons, rather than homeowners.

<sup>5</sup> HAW. REV. STAT. § 444-26.

<sup>6</sup> MINN. STAT. § 326.975(2)(i).

<sup>7</sup> Id.

Similar to Hawaii, Nevada law allows “injured persons” to recover damages from the state’s recovery fund by the “failure of a residential contractor to perform qualified services adequately”, but defines an injured person to be a natural person who owns a single-family residence.<sup>8</sup>

New Jersey’s fund is not a recovery fund *per se*, but a warranty security fund. The state’s warranty security fund is available to owners who made agreements for the construction of a new home or purchased a new home from another owner.<sup>9</sup> For purposes of the warranty, a new home is a dwelling unit not previously occupied and not dwelling units constructed for lease.<sup>10</sup>

North Carolina law provides access to recovery fund money to owners or former owners of a “single-family residential dwelling unit” that suffered a “reimbursable loss”.<sup>11</sup> Further, a “reimbursable loss” is an unpaid loss that results from dishonest or incompetent conduct by a general contractor and is not covered by bonds, sureties or insurance.<sup>12</sup> A residential dwelling unit is further defined as a “separately owned residence...whether or not attached to other such residences.”<sup>13</sup>

Virginia’s recovery fund is slightly different, in that it focuses on egregious conduct perpetuated by a contractor. Virginia law allows a “person with an unsatisfied judgment involving residential construction” against a contractor access to recovery fund monies.<sup>14</sup> In addition to the connection with residential construction, Virginia law requires that the behavior of the contractor amounted to “improper and dishonest conduct”.<sup>15</sup> “Improper and dishonest conduct” is a narrow term of art that encompasses “the wrongful taking or conversion of money, property or other things of value which involves fraud, material misrepresentation, or conduct constituting gross negligence, continued incompetence, or intentional violation of [the state building code].”<sup>16</sup> Virginia law clearly precludes breach of contract actions from the definition of “improper and dishonest conduct.”<sup>17</sup>

## 2. Staff Analysis and Recommendations

Looking at the approaches taken by other states, all the recovery funds surveyed apply to residential construction. Owners of commercial buildings did not have access to the states’ recovery funds. The vast majority of states make recovery funds available to residential owners. The states that do not authorize payment to residential owners indirectly protect homeowners by insulating them from liens. In terms of the type of residential construction, recovery funds generally cover single-family dwellings, duplexes and individual condominium units. If the experience of other jurisdictions is any guide, recovery funds are established to clearly benefit homeowners. Even in the two states that established lien recovery fund, the clear intent of the legislation is the protection of homeowners.

Staff recommends that any recovery fund focus exclusively on residential construction. Given the practices of other states in this area, “residential construction” should entail more than single-family residential structures. However, the line between residential and commercial construction blurs when the context is high-rise residential towers. In order to benefit the most homeowners possible, staff recommends that a proposed recovery fund cover only structures meeting the requirements of the residential specialty code. For purposes of this discussion, this definition would include detached single-family homes, duplexes, townhouses, rowhouses, and residential structures three stories or less in height.

<sup>8</sup> NEV. REV. STAT. 624.420 to 624.430.

<sup>9</sup> N.J. STAT. § 46:3B-2(2)(e).

<sup>10</sup> N.J. STAT. § 46:3B-2(2)(d).

<sup>11</sup> N.C. GEN. STAT. § 87-15.5(1).

<sup>12</sup> N.C. GEN. STAT. § 87-15.5(6).

<sup>13</sup> N.C. GEN. STAT. § 87-15.5(7).

<sup>14</sup> VA. CODE ANN. § 54.1-1118.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

Staff thus recommends that a recovery fund proposal extend coverage to owners of detached single-family homes, duplexes, townhouses, rowhouses, and residential structures three stories or less in height.

### Obtaining Access to Recovery Funds

#### *1. Last-Resort Recovery from Judicial Proceedings*

Most states grant money to homeowners that prevailed in a judicial proceeding, but cannot recover money from the defendant.

In Arizona, an injured person generally files an action with the courts and pursues the bond before applying for recovery from the fund.<sup>18</sup> However, Arizona law does allow access to the fund if a contractor cannot or will not follow an order issued by the Arizona Registrar of Contractors.<sup>19</sup> This characteristic was noted by a 2001 California Contractors State Licensing Board study on recovery funds. The California study stated that “as a *first-resort*, under certain conditions, the homeowner may go directly to the [Arizona Registrar of Contractors] for recovery if the contractor’s license has been revoked or has been suspended as a result of an order to remedy a violation.”<sup>20</sup>

In Connecticut, there are two ways a consumer can be eligible to apply for payment from the recovery fund. First, Connecticut law requires a consumer to obtain a court judgment and make a good faith effort to recover money or property from the contractor before going to the recovery fund.<sup>21</sup> Alternatively, the Commissioner of the Department of Consumer Protection or the Attorney General can bring a proceeding against a contractor; any restitution awarded to a homeowner as a result of that proceeding can then be paid out of the state’s recovery fund if the consumer has not been paid.<sup>22</sup>

In Florida, a homeowner also needs to obtain a judgment from court or an arbitration award and then exhaust “any available bond, cash bond, surety, guarantee, warranty, letter of credit, or policy of insurance” before applying for relief from the recovery fund.<sup>23</sup> The homeowner must attempt to satisfy the judgment by making “reasonable searches and inquiries” for the contractor’s property that could satisfy the judgment or award.<sup>24</sup> However, if a contractor moves assets into bankruptcy, the homeowner has the option of going directly to the recovery fund.<sup>25</sup>

In Hawaii, the Contractor Licensing Board disburses recovery fund money to injured persons upon a court order.<sup>26</sup> After attempting to recover from the contractor’s bond, the homeowner gives the Board ten days’ notice before applying to the court for a payment from the recovery fund.<sup>27</sup> The court receiving the application requires the homeowner to show whether they “made all reasonable searches or inquiries” into the contractor’s assets and property that could be applied to the judgment, but could find assets or did not find enough assets to fully pay off the judgment.<sup>28</sup>

Minnesota’s recovery fund also requires the owner of the defective property to obtain a final judgment from a court before applying to the recovery fund; however, Minnesota’s statutes are silent as to whether the applicant has to prove they were diligent in trying to satisfy their judgments.<sup>29</sup>

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<sup>18</sup> ARIZ. REV. STAT. § 32-1136(D).

<sup>19</sup> See ARIZ. REV. STAT. § 32-1154(F).

<sup>20</sup> CALIFORNIA CONTRACTORS STATE LICENSING BOARD, ANALYSIS OF STATE RECOVERY FUNDS 15 (2001).

<sup>21</sup> CONN. GEN. STAT. § 20-417i(d).

<sup>22</sup> CONN. GEN. STAT. § 20-417i(f).

<sup>23</sup> FLA. STAT. 489.141(1) (2005).

<sup>24</sup> FLA. STAT. 489.141(1)(e)(1)-(2).

<sup>25</sup> FLA. STAT. 489.141(1)(a)(2).

<sup>26</sup> HAW. REV. STAT. § 444-26(a).

<sup>27</sup> HAW. REV. STAT. § 444-28(b).

<sup>28</sup> HAW. REV. STAT. § 444-28(c)(4)-(5).

<sup>29</sup> MINN. STAT. 326.975(2)(i).

New Jersey's warranty security fund differs from the recovery funds in other states in that all homeowners are "enrolled" by the contractor. All homes must be covered by either the default state-mandated warranty or an alternate warranty security program.<sup>30</sup> The homeowner's ability to obtain relief from the warranty security fund, then, depends on whether a construction defect is covered by the warranty. The minimum standards for warranties in the state cover performance standard defects, mechanical and electrical systems and major structural defects for one year.<sup>31</sup> The warranty covers appliance, fixture and equipment defects (subject to the manufacturer's warranty), mechanical and electrical systems, and major structural defects for two years.<sup>32</sup> Finally, warranties cover major structural defects for ten years.<sup>33</sup> In practice, however, the warranty coverage after three years is a very narrow window of eligibility for the homeowner. On the subject of warranty coverage, the New Jersey State Commission of Investigation concluded that "under the rules as currently written, a home would have to sustain actual damage or be near total collapse before warranty coverage would become effective."<sup>34</sup>

As noted above, North Carolina law requires a homeowner to suffer a "reimbursable loss" in order to qualify for recovery fund monies. North Carolina will not pay out from the recovery fund if a person "directly or indirectly...obtain[s] the building permit in the person's own name." As with many of the surveyed states, North Carolina requires a person to "exhaust all civil remedies against the contractor" and possess a judgment from a court that remains unfulfilled.<sup>35</sup> If the contractor that allegedly caused the defect files for bankruptcy, the homeowner is excused from showing that they followed through with all their remedial options and can go directly to the recovery fund, so long as the applicant will not be paid from the bankruptcy proceeding.<sup>36</sup>

In Virginia, homeowners first obtain a court judgment against the contractor, and then file a claim against the recovery fund.<sup>37</sup> In order to make a valid claim, the homeowner must show that they requested in writing information from the contractor to determine whether there was sufficient funds or property that could be taken to satisfy the judgment and if assets were taken and sold, the remaining balance owed to the homeowner.<sup>38</sup>

## *2. Lien Recovery Procedures to Divert Litigation from Homeowners*

Unlike the majority of residential recovery funds, the lien recovery funds in Michigan and Utah directly benefit contractors, subcontractors and laborers. Thus, these states address eligibility differently.

For example, in Michigan liens only attach to a residential structure when there is a written agreement for the work, and the residential builder, plumber and electrician on the project hold licenses.<sup>39</sup> If a party attempts to get money owed from the contract by enforcing a lien, the owner of a structure can remove themselves from court proceedings by filing an affidavit with the court.<sup>40</sup> The affidavit states that the owner paid the contractor for improvements, did not collude with others to get access to the fund and will cooperate with the state in the defense of the fund.<sup>41</sup> Once the owner establishes he or she met the statutory requirements, then the subcontractors, laborers or other parties

<sup>30</sup> N.J. STAT. ANN. § 46:3B-3; N.J. ADMIN. CODE § 5:25-5.3.

<sup>31</sup> N.J. ADMIN. CODE. § 5:25-3.2(1).

<sup>32</sup> N.J. ADMIN. CODE. § 5:25-3.2(2).

<sup>33</sup> N.J. ADMIN. CODE. § 5:25-3.2(3).

<sup>34</sup> NEW JERSEY STATE COMMISSION OF INVESTIGATION, THE GOOD, THE BAD AND THE UGLY: NEW-HOME CONSTRUCTION IN NEW JERSEY 21 (March 2005).

<sup>35</sup> N.C. GEN. STAT. § 87-15.8(a)(3); 21 N.C. ADMIN. CODE 12.0903(a).

<sup>36</sup> Id.

<sup>37</sup> VA. CODE ANN. § 54.1-1120(A).

<sup>38</sup> VA. CODE ANN. § 54.1-1120(A)(6).

<sup>39</sup> MICH. COMP. LAWS § 570.1114(a)

<sup>40</sup> MICH. COMP. LAWS § 570.1203(1).

<sup>41</sup> Id.

can attempt to collect from the recovery fund.<sup>42</sup> As long as the homeowner actively files the right papers with the state, they can avoid having their property brought into a construction dispute.

Utah's approach is very similar to the Michigan lien fund. As long as the owner of an owner-occupied residence makes a written agreement with the contractor and pays the owed amount in full, parties are barred from placing a lien on the structure.<sup>43</sup> If this is the case, then the party that could have placed a lien on the structure can make a claim with the Division of Occupational and Professional Licensing for payment from the recovery fund.<sup>44</sup>

**Figure 1: Beneficiaries and Contributors to Recovery Funds, by State**

	Claim Types	Beneficiaries	Contributors
Ariz.	Residential	Homeowner	Residential Contractors
Conn.	Residential	Homeowner	Residential Contractors
Fla.	Residential	Homeowner	All Contractors
Hawaii	Residential	Homeowner	Residential Contractors
Mich.	Residential	Lienholders	Residential Contractors; Lienholders
Minn.	Residential <sup>1</sup>	Homeowner	Residential Contractors
Nev.	Residential	Homeowner	Residential Contractors
N.J.	Residential	Homeowner	Residential Contractors
N.C.	Residential	Homeowner	All Contractors
Utah	Residential	Lienholders	Residential Contractors; Lienholders
Va.	Residential	Homeowner	Residential Contractors

### 3. Staff Analysis and Recommendations

A trend that appears after comparative analysis is that generally a homeowner has to have a court judgment in their possession and pursue assets and property before applying to a public body for possible recovery. A “judgment” implies that a judge determines who is responsible for repairing a structure, who should pay for repairs, and other determinations that form the core of a dispute. Settlements and other resolutions that do not require the pronouncement of a decree are not “judgments” in the sense of the word, and may preclude recovery from these funds.<sup>45</sup>

Testimony from the homeowner panel paints a picture of what a homeowner may need to accomplish in order to collect from a last-resort recovery fund. John Stuart, for example, explained to the task force that after paying \$75,000 in attorney fees and related costs, he was awarded a judgment of \$375,000.<sup>46</sup> Dean Aldritch, an attorney who handles construction defect cases, also testified on the high cost of litigation to resolve a construction defect case, and their attendant effect on homeowners.<sup>47</sup> The result is that very diligent effort on the part of the homeowner may be required in order to collect from a recovery fund.

<sup>42</sup> MICH. COMP. LAWS § 570.1203(3).

<sup>43</sup> UTAH CODE ANN. § 38-11-107(1). *See also* UTAH CODE ANN. § 38-11-204(a)-(b).

<sup>44</sup> UTAH CODE ANN. § 38-11-203.

<sup>45</sup> Compare BLACK'S LAW DICTIONARY 846 (7<sup>th</sup> ed. 1999) (defining “judgment” as a “court’s final determination of the rights and obligations of the parties in a case) with BLACK'S LAW DICTIONARY 1377 (7<sup>th</sup> ed. 1999) (defining “settlement” as “an agreement ending a dispute or lawsuit.”)

<sup>46</sup> Minutes, Construction Claims Task Force 6 (January 25, 2006).

<sup>47</sup> *Id.*

A vast majority of the states surveyed require extensive efforts through the judicial system in order to access their respective recovery funds. Alternative dispute resolution processes already exist to mitigate the pressures of the judicial system. The Construction Contractors Board, for instance, already arbitrates disputes between contractors and consumers. Indeed, as the beginning of this paper makes clear, much of the unpaid orders result from administrative action taken by the CCB.

Staff thus recommends creating two paths to accessing a proposed recovery fund. The first path, one of first-resort, would require a consumer to submit a claim with the CCB and proceed with arbitration. At the close of the arbitration, the consumer may recovery amounts directly from the recovery fund, subject to limitations (see *Limitations on Payout*, below). The other path is similar to the approaches to other states. If a person obtains a civil judgment and proves that they made good faith attempts to secure their judgment with the contractor's assets, property, sureties, and insurance, then the person can recover an amount from the recovery fund. Payouts based on civil litigation would be subject to the same limitations on payout as from orders of the Construction Contractors Board.

## Recovery Fund Sources and Uses

### Summary of Staff Recommendations

- Assess residential-only contractors a reasonable fee (\$20 to \$40), offset with civil penalty funds and other funding sources.
- Provide additional assessment authority (\$20 to \$40) to mitigate unforeseen contingencies and to maintain the solvency of the fund.
- Retain investment income made off recovery fund money for additional resources.
- Restrict the use of the recovery fund to pay construction defect claims.
- Set aside 15 to 19 percent of the recovery fund's gross revenues for administrative expenses.
- Require periodic third-party actuarial support to project future claims and reserves.
- Allow the Construction Contractors Board to pursue subrogation claims to replenish the recovery fund.
- Allow the Construction Contractors Board to condition, suspend or revoke a license to secure payment from the recovery fund.
- Confer administrative authority for the recovery fund in the Construction Contractors Board.

#### *1. Background*

One of the fundamental questions in the establishment of a recovery fund is simply, "who pays?" This section addresses who must pay into a recovery fund, how much should a party pay, and the size of a recovery fund.

When staff submitted concept papers for the April 11, 2006 Task Force meeting, the paper used a hypothetical assessment of \$20 per contractor to raise \$560,000.<sup>48</sup> Together with an estimated \$250,000 in civil penalties rerouted from the general fund, interest and other funding sources, the hypothetical amount would cover a good portion – though not all – of the damages homeowners sustained by offending contractors.<sup>49</sup>

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<sup>48</sup> CONSTRUCTION CLAIMS TASK FORCE, CONSTRUCTION CLAIMS TASK FORCE LIST OF CONCEPTS 8 (April 11, 2006), available at [http://www.oregon.gov/DCBS/CCTF/docs/CCTF\\_Concept\\_Papers\\_Master\\_Document\\_v2.pdf](http://www.oregon.gov/DCBS/CCTF/docs/CCTF_Concept_Papers_Master_Document_v2.pdf).

<sup>49</sup> Id.

## 2. *Recovery Funds Capitalized by Initial and Additional Residential Contractor Assessments in Other States*

In terms of creating funding mechanisms, other states that established recovery funds almost always assess residential contractors a set fee. Many of the states surveyed also provide for the reinvestment of fund balances, use of interest, and other financial mechanisms meant to build up balances. Several states also divert certain civil penalties into the recovery funds.

The Arizona recovery fund, for example, is financed through assessments made to each residential contractor.<sup>50</sup> When applying or renewing a residential contractor license, licensees pay a maximum of \$600 for a two-year licensing cycle.<sup>51</sup> If the fund's balance drops below \$2 million, the Registrar of Contractors may collect additional money.<sup>52</sup> The State Treasurer may invest money sitting in the recovery fund, with any resulting interest deposited into the recovery fund.<sup>53</sup> Arizona law places a 10 percent cap on expenses accrued to administer the recovery fund; the 10 percent is derived from the recovery fund itself.<sup>54</sup>

A 2003 study by the Arizona Office of the Auditor General found that the Registrar of Contractors has been able to pay "all valid claims" by paying claims as money was available, even though the fund had projected long term deficits.<sup>55</sup> A primary cause of the deficits, according to the audit, was the Registrar's decision to assess fees "to pay claims as they are due rather than assessing fees to cover all the liabilities of the Fund."<sup>56</sup> The audit noted that the statute required a fund balance at a level sufficient to pay operating costs and anticipated claims.<sup>57</sup> The report noted that assessments of \$220 per contractor would initially solve the ongoing deficit. The Arizona audit recommended that fees be set according to actuarial projections – a legal requirement at the time the audit was submitted, but no longer part of the controlling law.<sup>58</sup> After the 2003 Arizona legislative session, the recover fund also accounts for its assessments, operating costs and claims through the "cash-basis" method of accounting. In other words, it accounts for money actually received as 'income' and for expenditures actually being paid as an 'expense'.<sup>59</sup> Projected income and revenue do not form the basis of the fund's daily accounting practices. Instead, an independent certified public accountant reviews the fund every three years.<sup>60</sup>

In Connecticut, new home construction contractor pay a \$480 fee every two years into the state's recovery fund, payable during application or renewal.<sup>61</sup> Currently, fees collected from new home construction contractors are credited to the recovery fund until a balance of \$750,000 is reached.<sup>62</sup> Excess fee money is then allocated to the General Fund.<sup>63</sup> However, existing fund balances may be

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<sup>50</sup> ARIZ. REV. STAT. § 32-1132(B).

<sup>51</sup> *Id.*

<sup>52</sup> ARIZ. REV. STAT. § 32-1134.01.

<sup>53</sup> ARIZ. REV. STAT. § 32-1135.

<sup>54</sup> ARIZ. REV. STAT. § 32-1134(A)(7).

<sup>55</sup> STATE OF ARIZONA, OFFICE OF THE AUDITOR GENERAL, REPORT NO. 03-02, PERFORMANCE AUDIT: REGISTRAR OF CONTRACTORS 16 (April 2003).

<sup>56</sup> *Id.*

<sup>57</sup> *Id.*

<sup>58</sup> Compare STATE OF ARIZONA, OFFICE OF THE AUDITOR GENERAL, REPORT NO. 03-02, PERFORMANCE AUDIT: REGISTRAR OF CONTRACTORS 16 (April 2003) with Ariz. Rev. Stat. § 32-1134(A)(2) ("cause an examination of the fund to be made every three years by an independent certified public accountant.")

<sup>59</sup> See BLACK'S LAW DICTIONARY 20 (7th ed. 1999).

<sup>60</sup> ARIZ. REV. STAT. § 32-1134(A)(2).

<sup>61</sup> CONN. GEN. STAT. § 20-417i(b).

<sup>62</sup> CONN. GEN. STAT. § 20-417i(c)(3).

<sup>63</sup> CONN. GEN. STAT. § 20-417i(c)(3).

invested and reinvested, with any interest staying with the recovery fund.<sup>64</sup> Connecticut law does not address actuarial mechanisms to account for projected claims and reserves.

Hawaii law requires contractors to pay a fee of \$150 toward the contractors recovery fund on application.<sup>65</sup> If the fund balance slips below \$250,000, the Contractor Licensing Board can assess, at most, an additional assessment of \$500 per year.<sup>66</sup> Again, as with other states' recovery funds, amounts may be invested and interest credited to the fund.<sup>67</sup> Hawaii law does not address actuarial mechanisms to account for projected claims and reserves. In terms of administrative costs, recovery fund money can be used to hire legal counsel to pursue collection efforts.<sup>68</sup>

Michigan's lien recovery fund derives its funding from \$50 fees paid by residential builders and residential maintenance and alteration contractors.<sup>69</sup> Laborers can access the fund without paying a fee, but \$15 of the amount awarded to the laborer on a claim is retained by the state.<sup>70</sup> Other parties that could attach a lien on a structure, like material suppliers, can pay \$50 to the recovery fund before the contract for improvement on the property commences.<sup>71</sup> In the event that the state's fund balance is less than \$1 million, the Director of Licensing and Regulation can assess an additional \$50 for that year.<sup>72</sup> Again, money in the fund may be invested and unexpended balances remain in the recovery fund.<sup>73</sup> Michigan law does not address actuarial mechanisms to account for projected claims and reserves. Michigan does place a cap of 20 percent on the fund for administrative expenses – wages, professional fees, legal counsel, and other fees “necessary for operation and defense of the fund.”<sup>74</sup> The California recovery fund study reported that Michigan's fund balance was “depleted”, with \$13,000 left in reserve.<sup>75</sup> A special assessment in November 2004 of \$50.00 has brought the fund back to \$3.98 million as of April 2006.<sup>76</sup>

In Minnesota, residential building contractors and residential remodelers pay an additional fee into the recovery fund when applying for a new license or renewing an existing license.<sup>77</sup> The assessment the contractors pay varies based on the “gross annual receipts”<sup>78</sup> of the contractor.<sup>79</sup> Contractors with gross annual receipts under \$1 million pay \$100, contractors with gross annual receipts between \$1 million and \$5 million pay \$150, and contractors with gross annual receipts over \$5 million pay \$200.<sup>80</sup> The state does not appear to specifically be able to invest the fund. Minnesota law does not address actuarial mechanisms to account for projected claims and reserves. An unspecified amount of recovery fund

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<sup>64</sup> CONN. GEN. STAT. § 20-417i(c)(4).

<sup>65</sup> HAW. REV. STAT. § 444-26.

<sup>66</sup> HAW. REV. STAT. § 444-27.

<sup>67</sup> HAW. REV. STAT. § 444-29.

<sup>68</sup> Id.

<sup>69</sup> MICH. COMP. LAWS § 570.1201(1)(a)(i).

<sup>70</sup> MICH. COMP. LAWS § 570.1201(1)(b).

<sup>71</sup> MICH. COMP. LAWS § 570.1201(1)(c).

<sup>72</sup> MICH. COMP. LAWS § 570.1201(2).

<sup>73</sup> MICH. COMP. LAWS § 570.1202(1).

<sup>74</sup> MICH. COMP. LAWS § 570.1201(2).

<sup>75</sup> CALIFORNIA CONTRACTORS STATE LICENSING BOARD, ANALYSIS OF STATE RECOVERY FUNDS 17 (October 2001).

<sup>76</sup> Press Release, Michigan Department of Labor and Economic Growth, 2004 Special Assessment Update (updated May 30, 2006), available at [http://www.michigan.gov/cis/0,1607,7-154-35299\\_35395-132105--,00.html](http://www.michigan.gov/cis/0,1607,7-154-35299_35395-132105--,00.html).

<sup>77</sup> MINN. STAT. §§ 326.83(7); 326.975. Roofers, however, are specifically excluded from participating in the recovery fund. See MINN. STAT. 326.842.

<sup>78</sup> Gross annual receipts are defined as “the total amount derived from residential contracting or remodeling activities, regardless of where the activities are performed, and must not be reduced by cost of goods sold, expenses, losses or any other amount.” MINN. STAT. 326.83(5).

<sup>79</sup> MINN. STAT. 326.975(a)(1).

<sup>80</sup> Id.

money can be used to recoup the legal and administrative expenses.<sup>81</sup> Minnesota's fund is subject to transfers and allocations, as documentation from the state's 2005 special legislative session shows. A House Fiscal Office appropriations tracking sheet showed an expenditure increase of \$100,000 for fiscal years 2006 and 2007.<sup>82</sup>

Nevada law requires residential contractors to pay a yearly fee based on the contractor's authorized monetary limit, which is the maximum value of a project on which a contractor can legally bid.<sup>83</sup> Contractors with an authorized monetary limit of less than \$1 million pay \$100 into the recovery fund.<sup>84</sup> Contractors with a monetary limit of more than \$1 million but capped at some defined limit (by the Nevada State Contractors Board) pay \$250, and contractor with an "unlimited" monetary limit pay \$500.<sup>85</sup> The statutory minimum balance of the fund is \$200,000; the State Contractors Board is obliged to maintain the minimum balance.<sup>86</sup> Nevada law does require the employment of accountants as part of a legislative financial report,<sup>87</sup> but does not address actuarial mechanisms to account for projected claims and reserves. Other administrative expenses reimbursable from the state's recovery fund are equipment, supplies and personnel for processing claims, and public awareness of the fund.<sup>88</sup> Since the beginning of 2006, the Nevada State Contractors Board awarded 47 claimants \$391,423.59 from the recovery fund.<sup>89</sup>

New Jersey law delegates authority to the state's Department of Community Affairs to establish and change from time to time the fee amounts every builder pays into the warranty security fund; currently, the Department charges \$200 to each residential builder.<sup>90</sup> On top of the set registration fee, residential builders that elect to enroll homes into New Jersey's warranty security plan pay a set percentage of the purchase price of each home built for sale.<sup>91</sup> The percentage rate varies based on the number of claims paid as a result of a builder's work; percentages run from 0.17% to a high of 0.595%<sup>92</sup> On a \$250,000 home, then, a contractor may be obligated to pay into the state warranty fund a minimum of \$425 to a maximum of \$1487.50. However, the state's warranty plan only covers about one-quarter of the homes constructed in the state – a majority of New Jersey residential builders use the services of private warranty providers.<sup>93</sup>

Utah's lien recovery fund is financed through multiple sources, but the most common is the initial and special assessments.<sup>94</sup> Initial assessments are set by the legislature through appropriations bills; in the last session the legislature left the initial assessment at \$195.<sup>95</sup> If the fund balance is less than \$1.5 million, special assessments can be made in order to bring the fund up to between \$2 and \$2.5 million.<sup>96</sup>

<sup>81</sup> MINN. STAT. 326.975(a)(2)(ii).

<sup>82</sup> MINNESOTA HOUSE OF REPRESENTATIVES, HOUSE FISCAL ANALYSIS, 2005 SPECIAL SESSION – SPECIAL SESSION CHAPTER 1 APPROPRIATIONS TRACKING (July 6, 2005), available at <http://www.house.state.mn.us/fiscal/files/ed05.pdf>.

<sup>83</sup> See NEV. REV. STAT. 624.220.

<sup>84</sup> NEV. REV. STAT. 624.470.

<sup>85</sup> Id.

<sup>86</sup> NEV. REV. STAT. 624.550.

<sup>87</sup> NEV. REV. STAT. 624.540(1)(b).

<sup>88</sup> NEV. REV. STAT. 624.540(1)(c); NEV. REV. STAT. 624.540(2).

<sup>89</sup> Press Release, Nevada State Contractors Board, 22 Claimants Receive Awards from Residential Recovery Fund (January 19, 2006); Press Release, Nevada State Contractors Board, 14 Claimants Receive Awards from Residential Recovery Fund (March 22, 2006); Press Release, Nevada State Contractors Board, 11 Claimants Receive Awards from Residential Recovery Fund (May 17, 2006).

<sup>90</sup> N.J. STAT. ANN. § 46:3B-7(a); N.J. ADMIN. CODE § 5:25-2.2(a)(1).

<sup>91</sup> N.J. ADMIN. CODE § 5:25-5.4.

<sup>92</sup> N.J. ADMIN. CODE § 5:25-5.4(b).

<sup>93</sup> NEW JERSEY STATE COMMISSION OF INVESTIGATION, THE GOOD, THE BAD AND THE UGLY: NEW-HOME CONSTRUCTION IN NEW JERSEY 23 (March 2005).

<sup>94</sup> See UTAH ADMIN. CODE R156-38a-202a.

<sup>95</sup> S.B. 4, 2006 Gen. Sess. (Ut. 2006).

<sup>96</sup> UTAH CODE ANN. § 38-11-206.

The current special assessment authorized by the Utah legislature is \$125.<sup>97</sup> Other sources of funding for the lien recovery fund are fees withheld from laborers that apply for payment from the fund (laborers need not be licensed to access the fund), civil fines collected for failure to reimburse the fund, reinstatement fees and interest collected on the fund.<sup>98</sup> Because the fund is labeled as a “restricted special revenue fund”, fund balances are legally restricted “to expenditures for [the] specific purpose” of lien recovery.<sup>99</sup> Utah law does not address actuarial mechanisms to account for projected claims and reserves. Administrative costs, including transfers of funds to the attorney general for enforcement proceedings, are paid from the recovery fund.<sup>100</sup>

Virginia’s Contractor Transaction Recovery Fund is funded by assessments of \$25 from each licensed person or entity.<sup>101</sup> The minimum balance on the fund is \$400,000; if the fund falls below or is anticipated to fall below \$400,000, additional payments can be authorized.<sup>102</sup> However, a contractor can only be required to pay \$50 in a two-year period.<sup>103</sup> Accrued interest on the fund money may go directly into the fund, or can be used for providing educational programs on the state’s building code or other subjects beneficial to contractors.<sup>104</sup> As with other recovery funds, contractors that cause payments to be made from the fund face license revocation; eligibility for a new license requires the contractor to pay back the amount paid out of the fund in full, plus interest.<sup>105</sup> Virginia law does not address actuarial mechanisms to account for projected claims and reserves. Administrative costs are borne solely by any interest accrued from fund money investments.<sup>106</sup>

**Figure 2: Assessments and Statutory Fund Balances, by State**

	Base Assessments	Additional Assessments	Minimum Fund Balance
Ariz.	\$600 fee (2 years)	Available	\$2 million
Conn.	\$480 fee (2 years)	–	\$750,000
Fla.	\$.05 / ft <sup>2</sup> . surcharge per project	–	–
Hawaii	\$150 fee (1 year)	Up to \$500 annually	\$250,000
Mich.	\$50 fee (1 year)	Up to \$50	\$1 million
Minn.	\$100-200 fee (1 year)	–	–
Nev.	\$100-500 fee (1 year)	–	\$200,000
N.J.	\$200 fee (1 year)	% of home price	–
N.C.	\$10 surcharge per project	–	\$250,000
Utah	\$195 fee (1 year)	\$125	\$2-2.5 million
Va.	\$25 fee (1 year)	\$50 (2 years)	\$400,000

<sup>97</sup> S.B. 4, 2006 Gen. Sess. (Ut. 2006).

<sup>98</sup> UTAH CODE ANN. § 38-11-202. The state is authorized to withhold \$15 from a laborer’s claim. *See* S.B. 4, 2006 Gen. Sess. (Ut. 2006).

<sup>99</sup> UTAH CODE ANN. § 38-11-201(1); *See also* UTAH CODE ANN. § 51-5-4(5) (definition of restricted special revenue fund).

<sup>100</sup> UTAH CODE ANN. § 38-11-201(3)-(4).

<sup>101</sup> VA. CODE ANN. § 54.1-1119(A).

<sup>102</sup> VA. CODE ANN. § 54.1-1119(B).

<sup>103</sup> *Id.*

<sup>104</sup> VA. CODE ANN. § 54.1-1119(C).

<sup>105</sup> VA. CODE ANN. § 54.1-1126.

<sup>106</sup> VA. CODE ANN. § 54.1-1120(C).

### 3. Staff Analysis and Recommendations

Looking back on the research, a vast majority of the states surveyed directly assess residential contractors to replenish their respective recovery funds. Indeed, the core sources of income were remarkably similar. No state relied completely on civil penalties to provide recovery fund money. Several states did provide specific civil penalties related to the dissemination of recovery fund information or reimbursing the fund, which went back into the recovery fund, but the states did not rely on penalties to fully fund a program. Most states provided for investment and reinvestment of the funds, with interest being applied toward claims. Investment income could provide some, but not all, of the funding needed to reimburse homeowners for loss.

Staff recommends that a recovery fund proposal should be funding through a hybridized system of reasonable assessments, civil penalties, and investment income. If the experience of the other states is any guide, a recovery fund needs to be financed through the use of assessments. Staff recommends an set assessment of \$20 to \$40, in order to raise between \$560,000 and \$1.12 million. A number between \$20 to \$40 should provide enough money to supplement existing sureties or insurance, but not cause undue hardship on contractors.

The ability to raise modest funds in an interim time period also seems prudent, due to events outside the control of the recovery fund administration. An annual report released by the Nevada State Contractors Board described the effect of a single contractor on the state's recovery fund.<sup>107</sup> As stated in the report, the Nevada State Contractors Board experienced "a dramatic increase" in claims "primarily due to one contractor who illegally sold his business to a revoked contractor and scammed over sixty-eight (68) homeowners. The claims filed were in excess of \$691,737."<sup>108</sup> The ability to respond to situations like the one experienced by Nevada builds stability into the fund. Staff also recommends that any recovery fund proposal address specific uses and locations within the treasury of recovery funds. Staff recommends a maximum annual or biennial assessment of \$20 to \$40, if needed to replenish the recovery fund.

While some states did commingle collected funds with the general treasury, others specifically excluded their use as general funds. Both methods of handling the source and use of funds exist in recovery fund legal landscape. In the Oregon experience, the government generally assesses fees for a particular purpose – licensing fees are used for administering a licensing program, for instance. It is not unreasonable to expect that if a contractor is required to pay a set fee into a fund, the money will be available for the particular purpose of reimbursing consumers. Therefore, staff recommends that recovery funds are restricted to paying claims and administering the fund.

In terms of administrative expenses, some states required specific uses and definite amounts of payments from the funds for administrative expenses, whereas other states generally require administrative expenses to be paid from the funds. The Arizona performance audit suggested that administrative expenses are tied to gross revenues, rather than a percentage of the fund balance. Because the fund balance at a given may be lower than incoming revenue, administrative expenses could potentially be lower than needed to properly run the fund. Staff thus recommends the administrative funds of a recovery fund range from 15 to 19 percent of the gross revenues of the recovery fund.

Actuarial support appears to be a rare requirement for recovery funds. Arizona's requirement for actuarial support is no longer part of law, and other surveyed states do not specifically require the services of an actuary to project claims and needed reserves. However, despite the dearth of actuarial

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<sup>107</sup> See NEVADA STATE CONTRACTORS BOARD, ANNUAL ENFORCEMENT REPORT (December 30, 2004), available at [http://www.nvcontractorsboard.com/Executive\\_Officer's\\_Report/0304\\_Annual\\_Report.htm](http://www.nvcontractorsboard.com/Executive_Officer's_Report/0304_Annual_Report.htm).

<sup>108</sup> Id., at 9.

support in the states, staff sees value in requiring an independent actuary to periodically review the recovery fund to accurately project expected revenue, claims and expenditures. An annual review phase may be needed to ensure the most accurate projections, but an actuary should be able to estimate for a biennial cycle.

### Recouping Recovery Fund Liabilities from Contractors

#### *1. Background*

In the first recovery fund concept paper, staff presented an idea that would direct the Construction Contractors Board to use its authority to recover unpaid judgments from contractors.<sup>109</sup>

#### *2. Recovery Fund's Right of Subrogation in Other States*

A trend that appears in the states is the right of subrogation. Subrogation is a legal doctrine that allows (for the purposes of this discussion) the substitution of the state for the homeowner when the state pays money owed by the contractor.<sup>110</sup> The state essentially steps into the shoes of the homeowner and can put its legal resources toward collecting from the contractor.

In Michigan, if a payment is made out of the fund, the department that administers the fund can sue in its own name to recover the money it paid.<sup>111</sup> Nevada law allows the State Contractors Board to collect from bonds after it pays a homeowner from the recovery fund, and shall also “promptly enforce all subrogation claims.”<sup>112</sup> North Carolina also enforces subrogation claims on amounts paid from its recovery fund by going after a general contractor’s assets or estate.<sup>113</sup> In Utah, the Attorney General is directed to enforce subrogation claims based on lien recovery fund payments.<sup>114</sup> The Attorney General can contract with private attorneys to prosecute enforcement claims, and the state’s right to collect from the contractor is superior to civil penalties or the person that filed for lien recovery.<sup>115</sup>

#### *3. License Action to Compel Reimbursement to Recovery Funds*

In the states that do not provide specifically for subrogation, the contractor generally loses their license and cannot reapply until they pay money back in to the fund. For instance, Minnesota suspends a contractor’s license until the contractor can pay back into the fund double the amount of the claim award plus 12 percent interest.<sup>116</sup> In Hawaii, if a contractor has a claim brought against them, then the license is automatically terminated – the contractor can only be reinstated by paying back the amount of the award from the fund plus 10 percent interest.<sup>117</sup> Finally, in Virginia a contractor’s license is revoked on payment from the recovery fund; the contractor can reapply once they pay the full amount of the award back into the fund “at the judgment rate of interest from the date of payment.”<sup>118</sup>

Still other states combine the two processes. In Arizona, when the state pays money from the fund, it has the right of subrogation, and can collect from bonds, cash payments or other forms of security.<sup>119</sup> The state’s Attorney General “shall promptly” pursue subrogation claims.<sup>120</sup> In Connecticut, the Commission simultaneously looks for property to take from a contractor to reimburse the fund and

<sup>109</sup> CONSTRUCTION CLAIMS TASK FORCE, CONSTRUCTION CLAIMS TASK FORCE: LIST OF CONCEPTS 7 (April 11, 2006),

<sup>110</sup> See BLACK’S LAW DICTIONARY 1440 (7th ed. 1999)

<sup>111</sup> MICH. COMP. LAWS § 570.1205(2).

<sup>112</sup> NEV. REV. STAT. 624.510.

<sup>113</sup> N.C. GEN. STAT. § 87-15.9.

<sup>114</sup> UTAH CODE ANN. § 38-11-205(1)(a)(ii).

<sup>115</sup> UTAH CODE ANN. § 38-11-205(1)(b).

<sup>116</sup> MINN. STAT. 326.975(1)(b).

<sup>117</sup> HAW. REV. STAT. § 444-28(e).

<sup>118</sup> VA. CODE ANN. § 54.1-1126.

<sup>119</sup> ARIZ. REV. STAT. § 32-1138.

<sup>120</sup> Id.

suspends the contractor's license until repayment can occur.<sup>121</sup> Connecticut law allows the Commission to make agreements with contractors to make periodic payments back into the fund and not incur more liabilities.<sup>122</sup> In Florida, if a claim is made against the state's recovery fund the offending contractor's license is suspended until the contractor can pay the claim amount back in full, with interest.<sup>123</sup> Regulations promulgated by the Construction Industry Licensing Board create the right of subrogation – in other words, the Board steps into the shoes of the claimant and can pursue legal remedies for reimbursement to the fund.<sup>124</sup>

#### *4. Staff Analysis and Recommendations*

Allowing the state to step into the shoes of a residential homeowner essentially shifts the burden of pursuing litigation from a single person to the state, which has more resources to pursue a contractor's assets and property. Although staff did not explore how much subrogation claims collect, it is reasonable to expect that an entire fund cannot be run from subrogation claims alone. The likelihood of reimbursement is somewhat greater, however, if the entitled party can maintain protracted litigation.

Staff recommends that a recovery fund include mechanisms for taking license actions against a contractor, subrogation, or a mix of the two processes to recover amounts paid out of a proposed recovery fund. In particular, Connecticut's model – suspension of licenses, conditions on licenses that allow a contractor to pay off liabilities in installments, and subrogation – is a good solution. It balances the need for contractors to remain gainfully employed with the need for the state to secure property for payment, to discipline contractors, and replenish its recovery fund; therefore, staff recommends the Connecticut model for inclusion into the final proposal.

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<sup>121</sup> CONN. GEN. STAT. 20-417i(1).

<sup>122</sup> CONN. GEN. STAT. 20-417i

<sup>123</sup> FLA. STAT. 489.143(8).

<sup>124</sup> FLA. ADMIN. CODE § 61G4-21.006

## Public Administration of Funds

### 1. Background

One aspect of a recovery fund's "use" is what entity is authorized to collect and disburse funds. State Rep. Gordon Anderson, House District 3, suggested that a recovery fund should be administered by a "non-government third party overseen by the Portland Arbitration Association."<sup>125</sup> However, staff research did not uncover a single state that delegated responsibility to administer a recovery to a private entity. The chart below details the executive agencies that do administer recovery funds:

**Figure 3: Entities Administering Recovery Funds, by State**

State	Administrator of Recovery Fund
Arizona	Registrar of Contractors
Connecticut	Department of Consumer Protection
Florida	Construction Industry Licensing Board
Hawaii	Contractor Licensing Board
Michigan	Director of Licensing and Regulation
Minnesota	Department of Labor and Industry
Nevada	Nevada State Contractors Board
New Jersey	Department of Community Affairs
North Carolina	State Licensing Board for General Contractors
Utah	Division of Occupational and Professional Licensing
Virginia	Department of Professional and Occupational Licensing

### 2. Staff Analysis and Recommendations

Staff recommends that the recovery fund be administered by the Construction Contractors Board.

## **Limitation on Payout**

### Summary of Staff Recommendations

- Cap payouts to \$10,000 per transaction.
- Cap aggregate liabilities against a *person* to \$200,000.
- Limit damage reimbursement to actual damages.
- Create mechanisms for prorated and proportional share payments from recovery fund.
- Confer limited discretion on the CCB to schedule the time and amount of payouts if necessary to preserve the integrity of the recovery fund.

### 1. Background

The first concept paper submitted to the task force discussed the possibility of limiting the amount of money paid out of the recovery fund per transaction.

### 2. "Transactional" Caps on Recovery Fund Payments

<sup>125</sup> Testimony of State Rep. Gordon Anderson 3 (June 28, 2006) (on file with author).

In the surveyed states, one common approach to control costs against a recovery fund was to limit the amount of an award to a certain dollar amount on a single contract or project. In Arizona, payments from the recovery fund are limited to the amount necessary to complete or repair a residential structure or to reimburse the amount of a deposit for an abandoned project with interest.<sup>126</sup> However, the amount of the award cannot exceed \$30,000.<sup>127</sup> Further, the state's recovery fund only pays for actual damages.<sup>128</sup> In Connecticut, payments from the recovery fund on civil judgments or orders of restitution are capped at \$30,000.<sup>129</sup> As in Arizona, Connecticut law limits payouts to actual damages when payout is based on a court judgment.<sup>130</sup> Florida law limits payment from its recovery fund on a judgment, an award or restitution that specifies actual damages to \$50,000.<sup>131</sup> Florida law specifically discounts postjudgment interest, attorney's fees, court costs, medical damages and punitive damages.<sup>132</sup>

Hawaii law limits recovery from its fund to \$12,500 per contract, "regardless of the number of persons injured under the contract."<sup>133</sup> Hawaii also limits the payouts to compensate actual damages, but does also allow payment of court costs and "reasonable attorney fees."<sup>134</sup> In Minnesota, "nothing may obligate the fund for more than \$50,000 per claimant, nor more than \$75,000 per licensee."<sup>135</sup> However, as mentioned above Minnesota's fund compensates persons for fraudulent and dishonest activities. The nature of the damages may not reflect actual harm. Nevada law restricts payment to "actual damages suffered, but not to exceed \$30,000."<sup>136</sup>

North Carolina law gives the Licensing Board for General Contractors "complete discretion to determine the order, amount and manner of payment of approved applications." Board regulations place two limitations on payments from the fund: first, as previously mentioned, the fund has a minimum fund balance of \$250,000 to maintain; second, payments from the fund are capped at 10 percent of the total amount of the fund at the time the application for payment was approved.<sup>137</sup> Costs that do not reimburse the actual loss – such as consequential damages, court costs, special damages, and the like – are not reimbursed by the fund.<sup>138</sup> Virginia limits payment from a contractor's conduct on a single transaction to \$20,000.<sup>139</sup>

The lien recovery funds operate differently, in terms of payment caps. Because Michigan's fund compensates for residential liens, the statutory limitation on payout is \$75,000 for one structure, regardless of the amount of lienholders.<sup>140</sup> If claims against a residential structure surpass \$75,000, claimants receive a proportional share of the allotted funds.<sup>141</sup> Utah is almost identical: payments from the fund are limited to \$75,000 per construction project, and if the amount of damage alleged is greater than \$75,000 qualified lienholders receive a proportional share of the money.<sup>142</sup> Unlike Michigan,

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<sup>126</sup> ARIZ. REV. STAT. § 32-1132(A).

<sup>127</sup> Id.

<sup>128</sup> Id.

<sup>129</sup> CONN. GEN. STAT. § 20-417i(d).

<sup>130</sup> N.C. GEN. STAT. § 87-15.8(b).

<sup>131</sup> FLA. REV. STAT. 489.141(1)(d); FLA. REV. STAT. 489.143(2).

<sup>132</sup> FLA. REV. STAT. 489.143(2).

<sup>133</sup> HAW. REV. STAT. § 444-26(a).

<sup>134</sup> Id.

<sup>135</sup> MINN. STAT. 326.975(a)(3).

<sup>136</sup> NEV. REV. STAT. § 624.510(3).

<sup>137</sup> 21 N.C. ADMIN. CODE 12.0910(a).

<sup>138</sup> 21 N.C. ADMIN. CODE 12.0910(b).

<sup>139</sup> VA. CODE ANN. § 54.1-1123(A).

<sup>140</sup> MICH. COMP. LAWS. § 570.1204.

<sup>141</sup> Id.

<sup>142</sup> UTAH CODE ANN. § 38-11-203(4).

however, Utah allows the payment of attorney fees from the lien recovery fund, up to 15 percent of qualified services.<sup>143</sup>

### 3. “Aggregate” Caps on Recovery Fund Payments

In addition to limitations on the amount of an individual award, several states utilize aggregate limitations. Arizona law caps the maximum liability of the state’s recovery fund at \$200,000 on a residential contractor’s license.<sup>144</sup> At the point that \$200,000 has been disbursed from the fund and claims are still outstanding on the contractor, the fund will not pick up the remaining balance.<sup>145</sup> Florida institutes two caps: the fund will only pay \$100,000 per year on claims made against any one contractor, and will only pay a total amount of \$500,000 on the liability of a contractor.<sup>146</sup> Hawaii limits its total liability against the recovery fund for contractors to \$25,000.<sup>147</sup> The total liability a contractor can accumulate against Nevada’s recovery fund is \$200,000.<sup>148</sup> Virginia places a two-year maximum cap of \$40,000.<sup>149</sup> If multiple claims against a contractor would go beyond the \$40,000 biennial limit, claimants will get a prorated share of the \$40,000.<sup>150</sup>

New Jersey’s warranty security fund has no set cap for recovery; instead, the fund pays the amount sufficient “to cover the reasonable costs necessary to correct any defect or defects covered under the warranty.”<sup>151</sup> The total amount of an award from the warranty security fund is capped at the purchase price of the home in a good faith sale or the fair market value in a sale where the purchaser knew of the structure’s defects.<sup>152</sup>

**Figure 4: Limitations on Payout, by State**

	Type of Reimbursable Costs	Recovery Limit, per Incident	Total Recovery Caps
Ariz.	Actual	\$30,000	\$200,000 lifetime cap
Conn.	Actual	\$30,000 per contractor	–
Fla.	Actual	\$25,000 per contractor	\$100,000 annual; \$200,000 lifetime
Hawaii.	Actual, Court Costs, Attorney Fees	\$12,500 per structure	\$25,000
Mich.	Construction Lien	\$75,000 per structure	\$75,000 per structure
Minn.	Breach of Contract; Bad Conduct	\$50,000 per claimant	\$75,000 per contractor
Nev.	Actual	\$30,000	\$400,000 lifetime cap
N.J.	Construction Defects	‘Reasonable’ Amount	Purchase Price; Fair Market Value
N.C.	Actual	10% of fund	10% of fund
Utah	Construction Lien, Attorney Fees	\$75,000	\$500,000 lifetime cap
Va.	Improper & Dishonest Conduct	\$20,000	\$40,000 per biennium

<sup>143</sup> UTAH CODE ANN. § 38-11-203(3)(f).

<sup>144</sup> ARIZ. REV. STAT. § 32-1139.

<sup>145</sup> Id.

<sup>146</sup> FLA. REV. STAT. 489.143(5).

<sup>147</sup> HAW. REV. STAT. § 444-34.

<sup>148</sup> Nev. Rev. Stat. 624.510(7).

<sup>149</sup> VA. CODE ANN. § 54.1-1123(A)-(B).

<sup>150</sup> Id.

<sup>151</sup> N.J. STAT. 46:3B-7(c).

<sup>152</sup> Id.

#### 4. *Discretionary Caps on Recovery Fund Payments*

In addition to concrete limits on recovery fund payouts, some states confer discretionary authority on various boards or commissions to limit payouts. For example, Connecticut grants to the Commissioner of the Department of Consumer Protection discretion to lower the amount of an award in order to “preserve the integrity of the [recovery fund].”<sup>153</sup> Although Florida does not specifically require the Construction Industry Licensing Board to consider the fiscal health of the recovery fund, the Board can partially pay a claim or deny it in full.<sup>154</sup> Nevada’s State Contractor Licensing Board, by regulation, considers the financial condition of the recovery fund when making a determination on a complaint.<sup>155</sup> North Carolina will not pay any recovery fund claims if its fund falls below \$250,000, but does give claimants priority over subsequent homeowners when the fund is replenished.<sup>156</sup>

#### 5. *Staff Analysis and Recommendations*

Almost all the states placed a definite cap on individual payouts and instituted a total limit they would pay on a contractor’s claims. Staff recommends that, as with other states, the proposed recovery fund is subject to a transactional cap and an aggregate cap. If a recovery fund is added to the current dispute resolution model within the CCB and the fund becomes a limited first-resort fund, then a lower transactional cap appears needed to ensure the solvency of the fund. Staff believes that a maximum cap of \$10,000 would provide supplemental relief to consumers without placing inordinate pressure on the recovery fund. In addition to a \$10,000 transactional cap, the fund should only be made liable for \$200,000 for a *person*. Tying the aggregate cap to a person means that if a person dissolves a corporate entity or attempts to work under another entity, the recovery fund will not be liable for another \$200,000. A cap of \$200,000 should allow the CCB to respond to claims against a single contractor that constructed multiple homes with construction defects.

In terms of limitations on the type of damage paid from the recovery fund, the research indicates that most funds limit payment to actual damages sustained by a homeowner in the course of construction. A few states allow limited compensation for attorney fees, but the general trend is to only compensate the damage sustained by a licensee.

Staff recommends that the recovery fund compensate consumers for actual damages sustained by a contractor’s conduct. Consequential damages, depending on the circumstances of the case, could lead to ballooning payments. In the interest of administrative efficiency, determining actual damage only means that the agency is not delayed ascertaining the causal chain of events and determining of the contractor caused the damage. If damages are limited to actual harm, then the agency can make a person as whole as it can as expedient as possible. As panelists suggested, the speed of recovery was as important as the amounts.

Finally, no recovery fund is immune from forces outside its control. It is entirely possible that with every possible safeguard an event will occur that threatens the solvency of the fund. Discretion over how much is paid and when payments should occur may be necessary to ensure that consumers are at least paid a certain amount right away, with additional payments on a later date. Therefore, the Construction Contractors Board should have limited discretion to schedule the time and amount of payouts if necessary to preserve the integrity of the recovery fund. Contingencies for prorated and proportional shares is also recommended.

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<sup>153</sup> CONN. GEN. STAT.

<sup>154</sup> FLA. ADMIN. CODE R. 61G4-21.004(7).

<sup>155</sup> NEV. ADMIN. CODE § 624.760(1)(a).

<sup>156</sup> 21 N.C. ADMIN. CODE 12.0902(b).

## Summary

### **Recommendation #3: Staff recommends that a recovery fund concept address the following.**

1. *Establish a recovery fund for residential construction only.*
2. *Limit the applicability of a residential recovery fund to single-family dwellings, two-family dwellings, multi-unit residences and individual condominium units built consistent with the residential specialty code.*
3. *Allow current CCB dispute resolution services to directly pay out of the recovery fund at the conclusion of dispute resolution proceedings, or payouts based on civil litigation.*
4. *Confer administrative authority for the recovery fund in the Construction Contractors Board.*
5. *Assess residential-only contractors a reasonable fee (\$20 to \$40), offset with civil penalty funds and other funding sources.*
6. *Provide additional assessment authority (\$20 to \$40) to mitigate unforeseen contingencies and to maintain the solvency of the fund.*
7. *Retain investment income made off recovery fund money for additional resources.*
8. *Restrict the use of the recovery fund to pay construction defect claims.*
9. *Set aside a flexible percentage of recovery fund money for administrative expenditures.*
10. *Require third-party actuarial support to project future claims and reserves.*
11. *Allow the Construction Contractors Board to pursue subrogation claims to replenish the recovery fund.*
12. *Allow the Construction Contractors Board to condition, suspend or revoke a license to secure payment from the recovery fund.*
13. *Cap payouts to \$10,000 per transaction.*
14. *Cap aggregate liabilities against a person to \$200,000.*
15. *Limit damage reimbursement to actual damages.*
16. *Create mechanisms for prorated and proportional share payments from recovery fund.*
17. *Provide limited ability to Construction Contractors Board to modify orders to protect the integrity of the recovery fund.*