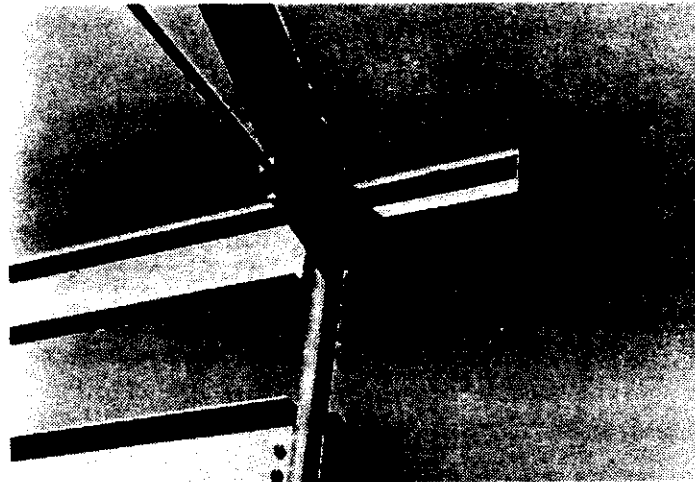


TECHNICAL PUBLICATION NO. 72

**APPLICABILITY OF A MECHANIC'S LIEN LAW
RECOVERY FUND FOR THE FLORIDA
RESIDENTIAL CONSTRUCTION INDUSTRY**

**SPONSORED BY A GRANT FROM THE BUILDING
CONSTRUCTION INDUSTRY ADVISORY COMMITTEE**



G. Arlan Toy

1991



APPLICABILITY OF A
MECHANIC'S LIEN LAW RECOVERY FUND
FOR THE
FLORIDA RESIDENTIAL CONSTRUCTION INDUSTRY

FOR PRESENTATION TO THE
BUILDING CONSTRUCTION INDUSTRY ADVISORY COMMITTEE

BY

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December 1990

EXECUTIVE SUMMARY

1. The Complaints Study Committee and the Building Construction Industry Advisory Committee have suggested a mechanic's lien law recovery fund be considered for the Florida residential construction industry because of the apparent problem with harm to the public in this sector of the industry.
2. The residential construction industry has more less-sophisticated clients and more less-sophisticated contractors than other industry segments.
3. Residential recovery funds exist in Arizona, Connecticut, Hawaii, Maryland, Michigan, New Jersey, Tennessee, and Virginia. They cover residential construction and/or home improvements. Indiana has a plumber's recovery fund.
4. The Michigan recovery fund specifically involves the mechanic's lien law. The client/owner is released from liens and the state legal staff directly defends the fund from the lien (now fund) claims of subcontractors, suppliers, and workers.
5. As means of restitution for residential contractor harm, contract bonds are not often used in residential work and license bonds are seldom sufficient.
6. Judgement through the civil courts is arrived at through tort or breach of contract proceedings. Recovery funds do not replace the need for court actions. They simply provide a source of funds for recovery of "actual" damages (and sometimes court costs and attorneys' fees) if the contractor is insolvent.
7. Final judgement through arbitration is a sufficient prerequisite for payment from most recovery funds.
8. Recovery Funds are financed by mandatory contributions from contractors whose acts are covered by the fund. In Michigan the subcontractors, suppliers, and workers must be contributory members of the fund.
9. Revoking a contractor's license is little deterrent to owner/client harm if that contractor is insolvent. Reducing unlicensed activity increasing the amount of the license bond are the two things most likely to reduce the level of harm to homeowners.
10. A Mechanic's Lien Law Recovery Fund for the Residential Construction Industry in Florida is **NOT** recommended. Florida is in the middle third of all-states and recovery fund states in harm-to-clients level and has shown good performance in reducing this level from 1980-86.

A copy of this technical publication can be obtained by contacting:

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ACKNOWLEDGEMENTS

My deepest appreciation is extended to Dr. Weilin Chang for his patience and support for me in this study. I thank Simon Shen, graduate assistant at the University of Florida, for his work on the state data from the recovery fund survey and on alternative restitution methods.

My appreciation to the Department of Education, Dr. Brisbane Brown, Jr., Kinney Harley, and the Committee for the time extension on the contract and for their patience with me in completion of the final report. I have enjoyed working with the Building Construction Industry Advisory Committee in the past and with my move to Georgia will miss doing research studies for them.

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CHAPTER I - INTRODUCTION

Statement of the Problem

Three different groups can suffer financial loss as a result of dealing with construction contractors: workers/employees, subcontractors/suppliers, and owners/clients. Worker compensation statutes and lien laws respectively are specifically aimed at reducing harm and providing recovery for loss for the first two of these groups. Owners and clients, however, often are obligated for payments to suppliers and to subcontractors they thought had been covered in their payments to the general contractor. Frequently, their only avenue of recourse for restitution lies in suing the general contractor in the civil courts. Such legal action is often fruitless since the cause of the financial harm was the insolvency of the prime contractor's business organization.

Owners/clients sometimes suffer financial loss due to the actions of prime contractors. The civil courts are not effective in bringing about restitution for financial loss when the source of funds is bankrupt. Contract bonds are not universally required and license bonds are often insufficient in amount. Repeatedly these problems occur where the owners/clients are the least sophisticated and the prime contractors the least stable, in the residential and/or home improvement sector of the construction industry.

Purpose of the Study

The purpose of this study is to determine the applicability of a mechanic's lien law recovery fund for the Florida residential construction industry.

Background and Justification

Recognizing that the problem of substantial financial harm to the public exists The Construction Complaints Study Committee in A Report to the Florida Legislature, dated March 1, 1989, recommended "That a study be funded to determine the applicability of a Recovery Fund in Florida." This research is the response to the Committee's recommendation #16 and the subsequent request for proposal from the Building Construction Industry Advisory Committee.

Provisions in contractor licensing statutes and lien laws for restitution to the contractor's owner/client public for harm done are scarce. Construction industry regulation results from the need to protect the public from harm. The proactive preventive aspect of regulation is action designed to prevent harm in the first place. The prevention of harm to the public has been the purpose of admission qualifications and requirement features in contractor licensing processes. Disciplinary processes are often a reaction to harm already done to the public. The intent of most disciplinary actions is to prevent future harm to the

public, but there is a restorative aspect of regulation as well. Most avenues for restitution for harm done to the public by contractors are left within the civil courts. Only contract and license bond requirements and the few recovery fund statutes have directly addressed the issue of restitution within construction industry regulation.

Limitations and Delimitations

The researcher is not an attorney, nor has he had legal training, therefore, the analysis of cases and the legal implications of recovery fund statutes are interpreted from a layman's point of view.

Data are not available delineating the exclusive costs of administering the separate recovery funds, costs of court cases, awards, and attorneys' costs, etc., therefore the author is not attempting to do a definitive cost benefit analysis of different methods of restitution.

Definitions

Contract bond: is a "guarantee of the faithful performance of construction contract and the payment of all labor and material bills incident thereto." (Davids, p. 64, 1977)

Contractor: is the party who contracts with an owner to construct a project or make improvements to real property.

Laborer: is an individual who provides an improvement

to real property through personal labor under a contract with a contractor or subcontractor.

Loss ratio is the "percentage of losses to premiums."

(Davids, p. 157, 1977)

Revoke is the involuntary termination of the professional's license.

Subcontractor: is the party who provides an improvement to real property through a contract with a contractor.

Supplier: is the party who provides materials or equipment used in an improvement to real property through an agreement with a contractor or subcontractor.

Organization of the Study

In Chapter One, the researcher has presented the problem of contractor harm to the public which this study addresses, that of the perceived ineffective restitution for harm done. He has stated the purpose of this study and given the background and justification for it. The scope of the study has been delineated, terms defined, and limitations stated. At the beginning of Chapter Two, the ways in which contractors can harm the public are presented. Following this listing is a section on what the trend is in civil court actions against contractors. In Chapter Two there is a section on recovery funds which includes a synopsis of what sunset review reports on state contractor licensing laws have said about recovery funds and a detailed

presentation of the Michigan Lien Law Recovery Fund. Alternative methods of judgement and restitution have been identified from the current literature and stated in the final section of Chapter Two. A recovery fund survey of the 50 states is presented in Chapter Three. Common and related features of all recovery funds have been identified, grouped, and listed. In Chapter Four, performance of recovery fund states in reducing harm, state licensing features in recovery fund states, and the funds mechanisms themselves have been presented and analyzed. Chapter Four ends with a narrative analysis of harm, licensing, and recovery fund protection. In Chapter Five is a summary of the analysis and researcher's conclusions. Recommendations are given in Chapter Six.

CHAPTER II - LITERATURE SEARCH

Contractor Harm to the Public

Figure 2.1 shows the different harm situations involving prime contractors. For each situation avenues for restitution appear on the left and comments to the right. With the harm situations listed in Figure 2.1 it is easier to understand the areas for which recovery funds have been established. Restitution for physical injury to employees has largely been provided for by the Worker Compensation Laws which nearly all states have instituted. Many states, particularly those licensing contractors also have required minimum levels of contractor liability insurance for further protection of the injured employee. Referring to the last item in Figure 2.1, financial harm to the general public is covered by the general liability insurance which is nearly always required of the contractor.

The remaining items in Figure 2.1 may be related to a recovery fund. Financial harm to employees, subcontractors, and suppliers often result in lien law actions by those parties against the client/owner. If the contract is covered by a contract bond (performance and payment) the client/owner is protected and sufficient restitution comes from the surety. Contract bonds are not usually required on small residential contracts and often are not required on

<u>Figure 2.1 Restitution for Contractor Harm</u>	
<u>PHYSICAL INJURY TO EMPLOYEES</u>	
WORKER COMPENSATION	Statutory limitations
CIVIL COURT - TORT	Court & Attorney costs Bankruptcy limitations Liability insurance
<u>FINANCIAL HARM TO EMPLOYEES, wages</u>	
LIEN LAWS IN CIVIL COURTS	Typically harm shifts to client/owner
<u>FINANCIAL HARM TO SUBCONTRACTORS OR SUPPLIERS</u>	
CIVIL COURT - BREACH OF CONTRACT	Bankruptcy limitations Contract limitations
LIEN LAWS IN CIVIL COURTS	Typically harm shifts to client/owner
<u>FINANCIAL HARM TO CLIENTS, liens, abandonment</u>	
CIVIL COURT - BREACH OF CONTRACT	Bankruptcy limitations Contract limitations
CIVIL COURT - TORT	Bankruptcy limitations
CONTRACT BOND	Seldom used in small projects (residential)
LICENSE BOND	Usually insufficient
CRIMINAL COURT - FRAUD	Bankruptcy limitations
<u>FINANCIAL HARM TO CLIENTS, completed operations</u>	
CIVIL COURTS - TORT or IMPLIED WARRANTEE	Completed Operations Insurance, Court costs, Bankruptcy limitations
THIRD PARTY WARRANTIES	Premium costs, Limited coverage
<u>PHYSICAL OR FINANCIAL HARM TO GENERAL PUBLIC</u>	
CIVIL COURTS - TORT	Gen. Liability Ins.

private commercial contracts. A license bond is usually required for contractors, but the coverage amount is, more often than not, insufficient to cover a significant claim. If there is no contract bond and only a small license bond, the owner has recourse to the civil (and occasionally the criminal) courts. If the contractor has defaulted or abandoned the project, he is likely in bankruptcy; and restitution will not be forthcoming even if a judgement goes to the client/owner. It is in just such cases that most recovery funds address restitution. In addition they may address restitution for financial harm to clients/owners for economic losses after project is completed.

Restitution and The Civil Courts

Over the past 20 years there have been consistent efforts "to turn every breach of contract into a tort" (Wright and Nicholas, p. 457, 1987) Lawyers have tried to convert ordinary economic loss claims "into negligence actions against parties with whom their clients have no contractual relationship." (Wright and Nicholas, p. 457, 1987) The purpose of this part of the literature review is to point out how this trend and the historical intent of tort and contract law relate to restitution for harm done by contractors. The researcher believes it is essential that the reader have a basic understanding of these causes for action and the remedies in law prior to consideration of

alternative or supplementary forms of restitution for harm done.

Breach of contract occurs when a party to a contract fails to perform. When a contract is breached, the terms and conditions of the contract control or should control the outcome of the case.

The aim of contract law is simply to give the parties to a contract the benefit of their bargain, and in event of breach, to put the injured party in as good a position as if performance had been rendered as promised. (Wright and Nicholas, p. 461, 1987)

A tort is a wrongful act, damage, or injury done willfully, negligently, or in circumstances involving strict liability. Tort law has been established to handle these acts, damages, and injuries. Negligence, as a cause of action within tort law, evolved to shift the cost of accidents to the responsible party. It has developed to compensate personal injury victims (Wright and Nicholas, 1987).

Attorneys pursuing their clients' interests are attracted to the tort realm for several reasons. The first of these is that consequential damages are recovered more easily in negligence than in contract claims. In fact, the general rule of contract damages is that consequential damages are not recoverable unless the parties to the contract were pondering them at the time of contracting and they were a basis for the pact. A second reason for preferring tort action is that it is possible to have

numerous defendants rather than just the contract partner. And finally, recovery is not limited to contract provisions limiting recoveries from the partner in privity (Wright and Nicholas, 1987).

Over recent years the privity defense has been eliminated in personal injury and property damage cases. Courts have reasoned that if it is eliminated in some cases it should be eliminated for all cases including the privity of contracts (Wright and Nicholas, 1987). "Many courts now allow recovery on construction claims for negligent conduct on a construction project, even where no privity of contract exists." (Cohen and Bain, p. 3, 1988). The traditional rule of not allowing claims if the parties were not in privity has been attacked in three contexts:

1. the architect-owner relationship where the architect's duty to use ordinary skill, care and diligence in providing professional service led to courts speaking of "negligent breach of contract";
2. where personal injury was involved; and,
3. to ensure a viable remedy for the purchasers of used homes.

In a 1978 Florida case, *Simmons v. Owens*, the court stated:

The purchaser can ill afford to suddenly find a latent defect in his or her home that completely destroys the family's budget and have no remedy or recourse. . . . The careless work of contractors, who in the past have been insulated from liability, must cease or they must accept financial responsibility for their negligence. (Cohen and Bain, p. 4, 1988)

The elimination of the privity defense and the application of negligence principles for personal injury is consistent with tort principles. (Wright and Nicholas, p. 467)

"Negligence is the omission to do something which a reasonable man, guided by those ordinary considerations which ordinarily regulate human affairs, would do, or the doing of something which a reasonable and prudent man would not do." (Wright and Nicholas, p. 459, 1987). A victim of negligence may recover for both the direct and consequential losses proximately caused by the breach of duty (Wright and Nicholas, 1987).

"Tort law is not designed to provide relief to those who have suffered purely economic losses." (Wright and Nicholas, p. 467, 1987). However, in commercial products liability cases "plaintiffs have attempted to recover purely economic losses from manufacturers with whom they are not in privity." (Wright and Nicholas, p. 475, 1987). A recent trend in the courts is the conclusion that negligence principles are not compatible with economic loss claims (Wright and Nicholas, 1987). The 1982 Illinois Supreme Court decision in *Moorman Manufacturing Co. v. National Tank Co.*, denied recovery for purely economic losses but left open two possible ways to apply tort principles in a case based on economic loss claims: 1) if the loss is caused by intentional misrepresentations; or, 2) if one in the business of supplying information guiding others in business

transactions makes negligent misrepresentations (Wright and Nicholas, 1987).

Wright and Nicholas (1987) report that the boundaries of tort and contract are becoming sharper. In 1987 the Florida Supreme Court in the three cases appeared to narrow sharply the circumstances under which economic damages may be recovered in tort arising out of conduct in the formation or performance of a contract between the parties. In a Florida Power and Light case it was found that a plaintiff may not recover economic losses in tort without a claim for personal injury or property damage to property other than the allegedly defective goods. In an Aetna case, injury to persons or property was determined not to include economic damages. An AFM case conclusion is that without some conduct resulting in personal injury or property damage, there can be no independent tort flowing from a contractual breach which would justify a tort claim for economic losses (Gough, p. 51, 1988).

Proof in negligence cases is based on a societal standard of reasonable care.

To recover in negligence, the plaintiff must establish: 1) a defect in workmanship, supervision, design, etc.; 2) the defendant was responsible for that defect; 3) the defendant's method of carrying out his obligations fell below the standard of care in the industry; and, 4) the defect proximately caused plaintiff's damages. (Cohen and Bain, 1988).

Cohen and Bain (1988) listed the following as a test that several courts have used to determine negligence:

1. the extent to which the transaction was intended to affect the plaintiff;
2. the foreseeability of harm to him;
3. the degree of certainty that the plaintiff suffered injury;
4. the closeness of the connection between defendant's conduct and the injury suffered;
5. the moral blame attached to defendant's conduct; and
6. the policy of preventing future harm.

Cohen and Bain (1988) gave examples of recovery under the test:

1. a contractor recovering against construction manager or architect for delays caused by negligent supervision.
2. a contractor, homeowner, subcontractor against architect for defective plans and specifications.
3. tenants against contractor or subcontractor for delays in completing the premises.
4. a lender against inspector for providing inadequate information.
5. an owner against contractor for negligence.
6. a limited partner in failed development against architect for negligence in certifying contractor work performed.

There still exists a bias towards allowing claims in negligence. Courts have lessened the impact of contract

limitations by requiring the specific inclusion of the word "negligence" in the limitation of liability clauses (Cohen and Bain, 1988). Recovery of economic damages in tort in the absence of personal injury or property damage is still permitted when there is negligent or fraudulent misrepresentation or general fraud in the formation or performance of a contract for the sale of goods. Action is also allowed when a tort independent of the breach exists

Figure 2.2 Construction Liability		
	BREACH	TORT
WITH CONTRACT	<u>ECONOMIC LOSS</u> Privity partners	<u>PERSONAL INJURY</u> <u>PROPERTY DAMAGE</u> Architect - Owner
WITHOUT CONTRACT	***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** ***** *****	<u>PERSONAL INJURY</u> <u>PROPERTY DAMAGE</u> Contractor - AE/CM Contr/Owner/Sub - AE Tenant - Contr/Sub Lender - Inspector <u>ECONOMIC LOSS</u> Used Home (Florida) Misrepresentation

(Gough, 1988). Even though courts have tended toward non-recovery for economic loss under negligence claims, they have "devised other means of allowing recovery" (Cohen and

Bain, p. 32, 1988). In Redarowicz v. Ohlendorf, in 1984, an implied warranty claim was held by the court. A Minnesota court found the contractor was a third party beneficiary of an owner-architect contract (Cohen and Bain, 1988).

Figure 2.2 on the previous page outlines the types of legal action and recoveries described in the preceding paragraphs.

Recovery Funds

Regulatory Review Recommendations

In the study of sunset reviews only one recovery fund recommendation was found. The sunset review committee for California suggested to California policy makers "that they look very closely at the recovery fund, especially one that was used in Hawaii" (CLCBP, p. 79, 1981).

Michigan Lien Law Recovery Fund

Introduction. One of the specific objectives of this study was the review of the Michigan Lien Law Recovery Fund. The Michigan law was felt to be the one most likely to function as a model for a recovery fund linked to a Mechanic's Lien Law.

In 1982, Michigan established the Construction Lien Recovery Fund under the reformed Construction Lien Act (PA 497 of 1980). The objective of the fund is, in the case that all debts owed on a home are not paid by a contractor, to provide protection for homeowners who have contracted

with the contractor for home construction or improvement as well as to provide protection for subcontractors, suppliers, and laborers who have furnished materials or labor on the job.

On a residential construction project the parties usually involved are a contractor, subcontractors, suppliers, and laborers. If the contractor does not pay for the work or materials needed, the subcontractor, supplier and subcontractor are entitled to impose a construction lien on the owner's property by the Construction Lien Act. The unpaid parties may foreclose the lien through the court and force the owner to sell the property to pay the debts if he/she could not pay otherwise. Before 1982, it was not unusual that the owner had to pay twice in order to release the lien on his/her property.

With the Construction Lien Recovery Fund, the homeowner and lien claimants may be protected by the payment from the fund if they follow the right procedures.

Fund administration. The Construction Lien Recovery Fund is created within the Department of Licensing and Regulation. The sources of the fund include the fees from almost all the parties involved in a home project and annual assessment from those parties if necessary. Any lien claimants who have not contributed to the fund may become eligible for recovering from the fund by paying a timely fee to the fund. The fees contributed into the fund are

assessed in the following manners:

- (1) When applying for an initial license or renewing a license, the residential builder, the maintenance and alteration contractor, the electrical contractor, the master plumber, and the mechanical contractor have to deposit a fee of \$50.00 in the fund, in addition to the license fee.
- (2) A laborer who seeks to recover from the fund does not need to pay the fee in advance. When the payment to him is released, a fee of \$15.00 will be withheld by the fund. The withhold shall not exceed \$50.00 annually for one laborer.
- (3) All other lien claimants may become eligible for recoveries from the fund by paying a fee of \$50.00 prior to the date of the lien claimant's contract to the improvement to the residential structure. A claimant shall not pay more than \$50.00 per year.
- (4) On December 1 of each year, if the balance of the fund falls below \$1,000,000, the director of licensing and regulation may require an additional assessment not exceeding \$50.00, from each of the persons described in (1) and (3).
- (5) A party is not eligible to recover from the fund unless it has paid into the fund as required.

The administrator of the affairs of the fund is the director of licensing and regulation. An annual financial statement shall be published. The fund is subject to an audit by the auditor general. The state treasurer has the responsibility to deposit or invest money from the fund.

Necessary professionals, office staff, private attorneys may be employed or hired temporarily to deal with investigation, defenses and any other affairs of the fund. The wages, professional fees and administrative expenditures incurred for the operation of the fund shall be derived from the fund. The total such expenses shall not exceed 20% of funds collected in the previous fiscal year.

Limitations of the fund. The maximum payment from the

fund to subcontractors, suppliers, and laborers is \$75,000 per residential structure. In the event of the total amount claimed exceeds \$75,000, the subcontractors, suppliers, and laborers shall be paid their proportional shares of that amount. The fund pays the lien claimant only if the court finds he or she is entitled to payment from the fund. The fund will pay the amount of the judgement of the court but subject to the maximum limitation of \$75,000 per residential structure.

Recourse on licensee by the fund. Once a payment is made from the fund to a claimant, the department of licensing and regulation shall be subrogated to the rights of the claimant. The department may maintain an action in its own name against the licensee who did not pay the claimant. Any amount recovered by the department shall be deposited into the fund. If the department of licensing and regulation makes a payment from the fund due to a licensee's failure to pay a lien claimant, the department shall enter a complaint against the licensee with the appropriate licensing agency.

Homeowner protection. If a contractor which the owner has paid fails to pay his or her subcontractor, suppliers, or laborers, the Construction Lien Recovery Fund will protect the owner by paying those unpaid debts. Therefore, the owner does not pay twice for the same labor or materials to release the lien on the owner's property placed by lien

claimants. However, the homeowner has to meet the following conditions in order to be entitled to be protected by the fund:

- (1) The contractor who has worked on the owner's property has to be licensed. It is critical that the owner always needs to make sure that he is dealing with a licensed contractor.
- (2) The contract must be in writing and include the contractor's license number. All changes and additions must be in writing.
- (3) The owner must complete and return a Notice of Commencement form to the contractor with 10 days of a request.
- (4) Keep records of all the Notice of Furnishing from subcontractors, suppliers or laborers.
- (5) Always request a Sworn Statement from the contractor, subcontractors, suppliers and laborers.
- (6) Request a Waiver of Lien as your records when making each payment on a contract.

If an owner follows the procedures described above, he or she will be protected by the Construction Lien Recovery Fund.

Protection for lien claimants. The Construction Lien Recovery Fund also protects subcontractors, suppliers and laborers to get paid when they furnish materials or labor on a home construction or remodeling. In order to collect from the fund through filing a lien on the owner's property, claimants have to meet the following requirements:

- (1) The claimant has to be a member of the Construction Lien Recovery Fund to be eligible for the claim against the fund.
- (2) The contractor the lien claimant has dealt with has to be licensed.
- (3) Request a copy of the Notice of Commencement for the contractor or subcontractor.
- (4) Furnish the Notice of Furnishing to the homeowner and contractor within twenty (20) days of your first delivery of materials or labor either in

- person or by certified mail.
- (5) Provide the Sworn Statement to the contractor.
 - (6) Upon full payment under the contract, sign the right Waiver of Lien.
 - (7) The Claim of Lien has to be filed within ninety (90) days after the date the claimant last worked on the project or delivered materials.
 - (8) The Claim of Lien and Proof of Service of the Notice of Furnishing must be delivered to the homeowner either in person or by certified mail within fifteen (15) days of recording the lien.
 - (9) The lawsuit on the Claim of Lien has to be filed within one (1) year after the date of recording.

If a lien claimant has done the above, the homeowner has fully paid the contractor according to a Sworn Statement, and the lien is found valid in court, he or she can collect from the Construction Lien Recovery Fund.

Other Means of Judgement and Restitution

Arbitration

Arbitration of construction disputes is not a new concept in the United States. As early as the 1800s, arbitration provisions appeared in construction contracts. By 1966, arbitration had become the preferred mode of settlement of construction disputes. Major segments of construction industry started to provide for arbitration between owners, architects, engineers, general contractors, and subcontractors (Gibbons and Miller, 1981). In 1964, an AIA-AGC liaison committee conducted a survey to assess the effectiveness of arbitration procedures. As a result of the survey, a recommendation was made to designate the AAA (American Arbitration Association) as the sole administrator

of an arbitration procedure to be custom tailored for the construction industry (Stokes and Finuf, 1986). The standard form contracts of the AIA , the AGC, and the national Society of Professional Engineers now contain an arbitration clause, which is similar to the following clause:

All claims, disputes and other matters in question between the contractor and the owner arising out of, or relating to, the contract documents or the breach thereof ... shall be decided by arbitration in accordance with the Construction industry Arbitration Rules of the American Arbitration Association then obtaining unless the parties mutually agree otherwise. [AIA,A201/CM (1980), para. 7.9].

Arbitration is a voluntary method of resolving disputes by submitting disputes to a third party and agreeing to be bound by that party's decision. The decision to arbitrate is generally reached by two different methods. The contract between the parties may contain a clause to arbitrate future disputes, such as the clause cited above. It is also common that an agreement may be reached to arbitrate after the dispute arises. The parties involved in a contract can authorize a third party to decide any dispute that might arise between them in the performance of the contract. Arbitration is not completely independent of the judicial system. The court sometimes is the place to determine whether a dispute should be arbitrated or not. Court assistance is frequently sought to enforce the carry out of the awards of an arbitration if the parties do not comply

voluntarily.

The procedure for arbitrating varies significantly based upon what is specified in the arbitration agreement. The most commonly adopted procedure is the one used by the AAA. The rules of the association are incorporated in AIA general conditions and Standard Subcontract Form A401.

Frequently, the agreement to arbitrate specifies the method of selecting arbitrator(s) and number of arbitrators. One arbitrator may be used for a simple dispute while a panel of three arbitrators are necessary for a large and complicated case.

While the arbitrators are being selected, dates on which both parties are available may be determined. Final dates of arbitration are normally selected from the dates commonly preferred by both parties. If the parties agree to discovery or if the arbitrators allow discovery, the date for hearing is usually postponed by the selected arbitrators until the discovery is completed.

Any contractual designation of where the arbitration is to take place will be given effect as long as the selection is reasonable. However, if the place is designated by the stronger party to take the advantages of the location to weaken the other party's right, the clause will not be given effect (Sweet, 1985). In the case that the parties do not agree on the location of hearing, the AAA shall have the authority to determine the place of hearing and the decision

shall be final and binding (Sweet, 1985).

Discovery is a very expensive and time-consuming process in litigating a case. Arbitration is supposed to be a time saving method. For this reason, discovery had not been allowed in arbitration until recently. However, there is a trend toward allowing more expansive discovery in the arbitration process. Discovery in arbitration proceedings is a highly complex area. The limits and reaches of discovery may be set by agreement between the parties. In the case of no such an agreement, state and federal statutes govern the scope of the discovery.

Generally, arbitration clauses do not specify the method of hearing. Certain statutes give general directives, while most do not. In the absence of rules, the arbitrator determines how the hearing is to be conducted. However, the hearing in arbitration is usually similar to a court proceeding. The arbitrators act as judges and witnesses may be present at the hearing. The rules of evidence applied in courts are relaxed or not applied at all. Any testimony which is believed to be relevant or of probative value may be allowed at hearing. Usually the moving party presents its case and relevant records first and then the opposing party does the same. At the end of the proceeding, each party may have a closing statement, which resembles the closing argument in a court of law.

After reviewing any documents submitted and listening

to any records related to the hearing, the arbitrators enter their decision. The decision need not be unanimous unless the arbitration clause or the arbitration rules require it to be so. The rules of the AAA require the decision must be rendered within thirty days. The award can be simple and gives no explanations. The award may grant any remedy or relief "that is just and equitable and that is within the terms of the agreement between the parties." (Stokes and Finuf, 1986, p. 195) A party may request an award to be modified under the AAA rules by writing a letter to the AAA with a copy to the opposing party. The other party is given an opportunity to respond. The arbitrators may then either modify or affirm the award.

Compliance with an arbitration award will end the proceedings between the parties. However, failure to comply with an arbitration may bring an award for judicial involvement and review by either party. It should be noted that this kind of review is necessarily very limited due to the quasi-judicial nature of arbitration (Stokes and Finuf, 1986). Most state arbitration statutes specify grounds for reviewing an arbitrators' award. Section 12 of the Uniform Arbitration Act permits an award to be vacated where any of the following exists (Sweet, 1985, p. 795):

- (1) The award was procured by corruption, fraud or other undue means;
- (2) There was evident partiality by an arbitrator appointed as neutral or corruption in any of the arbitrators or misconduct prejudicing the rights of any party;

- (3) The arbitrators exceed their powers;
- (4) The arbitrators refused to postpone the hearing upon sufficient cause being shown therefor or refused to hear evidence material to the controversy or otherwise so conducted the hearing, contrary to the provisions of Section 5, as to prejudice substantially the rights of a party; or
- (5) There was no arbitration agreement ... and the party did not participate in the arbitration hearing without raising the objection.

The award may be modified or corrected if (Section 13 of Uniform Arbitration Act):

- (1) There was an evident miscalculation of figures or an evident mistake in the description of any person, thing or property referred to in the award;
- (2) The arbitrators have awarded upon a matter not submitted to them and the award may be corrected without affecting the merits of the decision upon the issues submitted; or
- (3) The award is imperfect in a matter of form, not affecting the merits of the controversy.

Other than these grounds described above, most courts will not review an arbitration award.

The popularity of arbitration in resolving construction disputes comes from the following advantages of arbitration compared to litigation: (1) Construction Arbitrators usually have technical expertise in the area at issue. Construction disputes often involve technical questions that can best be understood and decided by construction experts; (2) Arbitration is generally quicker than litigation in resolving claims. An arbitration may be concluded in six to nine months while litigation seldom is completed in less than twelve months. This is of particular importance to contractors who seeking money recovery; (3) Arbitration is

less expensive. The costs of arbitration are normally reasonable and moderate. This is partially due to less time involved in arbitration. In addition, lawyers are not required; and (4) Arbitration is simpler and more flexible. The hearing may be scheduled at both parties' convenience. The place of hearing and choice of decision makers may be negotiable and determined by the involved parties.

Mediation

Despite the success of arbitration in resolving construction disputes, it has been recognized that a supplementary procedure needed for resolving disputes in their early stages. This alternative is called mediation, which seeks to avoid the kind of preparations necessary for an arbitration or court proceedings. Mediation consists of the effort of a third party to assist the parties in reaching the settlement of a controversy or claim by direct negotiation between and among themselves. If the parties do not settle a dispute, the third party can use normal arbitration power to decide it. Therefore, this system is also called mediation-arbitration. Mediation-arbitration is not commonly used in construction disputes (Sweet, 1985,). The opposition comes from the difficulty of finding a third party in whom the parties involved in a contract have confidence and who have both skill and time to play an ongoing role during construction.

Bonds

Surety bonds play a critical role in the construction process and are an important avenue of restitution in the industry. A surety is a party that assumes legal liability for the debt, default, or failure in duty of another. A surety bond represents the surety's guarantee that the contractor it is dealing with is financially backed up by the surety. Bonds provide a relatively immediate and easy method to protect the interests of the owner, subcontractor, and suppliers engaged in a construction project. Three parties are usually involved in a bond. The party which issues the bond guaranteeing the contractor to complete a project in accordance with the contract documents and specifications is the surety company. The party entitled to recover damages from the surety bond in case of contractor default is called obligee. The contractor is the principal.

A variety of bonds exist in the construction industry. They include bid bond, performance bond, payment bond, subcontract bond, maintenance bond, license bond, etc.. Not every project requires the contractor to be bonded. Nor is every bond needed on a project. For example, a large portion of private construction is not bonded while by law all public jobs have to be. A few types of bonds frequently used are explained in the following sections.

Performance Bond. The purpose of performance bond is to protect the owner from damages or losses if the

contractor breaches the contract or default. It guarantees the contract will be completed in accordance with the terms specified in the contract. The provisions or terms of a bond depend entirely on how the bond form is written. Normally a performance bond has a face value, which states the upper limit of expense that surety will pay for. Under the AIA bond form, if the contractor defaults, the surety may take the following resolutions (Stokes and Finuf, 1986, p. 211):

- (1) Pay the amount of the bond;
- (2) Bring the contractor back onto the job and finance the job until the project is completed;
- (3) Propose a new contractor to the owner for the completion of the work under a new contract, which will be directly between the new contractor and the owner;
- (4) Complete the work with a new contractor under a contract between the new contractor and the bonding company;
- (5) Allow the owner to obtain a new contractor and pay the cost of construction exceeding the amount of the contract funds remaining.

Payment Bond. A payment bond provides a guarantee to pay the contractor's bill for labor and materials incurred in the performance of construction. The owner is thereby protected against liens that may be filed on his property by unpaid parties such as material subcontractors and suppliers. A typical payment bond may provide (Clough, 1975, p. 149):

- (1) The claimant must have had a direct contract with the general contractor or a subcontractor.
- (2) Labor and material include water, gas, power, light, heat, oil, gasoline, telephone, and rental of equipment directly applicable to the contract.
- (3) Written notice must be given by claimant, other

than one having a direct contract with general contractor, to any two of these: general contractor, owner, or surety, within 90 days after claimant performed his last work or furnished the last of the materials.

- (4) The owner is exempted from any liabilities in connection with such claims.
- (5) Claims must be filed in the appropriate court.
- (6) No claims shall be commenced after the expiration of one year following the date on which the general contractor stopped work, barring a statute to the contrary.

License Bond. A license bond, also known as a permit bond, is a bond required by state law or municipal ordinance as a prerequisite to a contractor's license or permit. It protects the general public against the damages or losses resulting from the licensee violations of his legal or financial obligations. The license bond also guarantees that the licensee will make proper payment for required permits and inspections.

The license bond is not required for all contractors but rather for those whose work intimately involves public health and safety. The following specialty contractors are generally required to post a permanent bond with the designated public agency (Clough, 1975, p. 16):

- Boiler installation
- Demolition
- Electrical
- Elevator installation
- Gas fitting
- House moving
- Plumbing
- Sign erection

Insurance

One suggestion for an alternative to the licensing laws

has been to let the market risk transference vehicle of insurance do the regulating. Insurance companies would take a more active interest in the quality of services provided by those they insure (Kasper, p. 169, 1977). A recent study of licensing laws showed that many licensing states had requirements for contractor's liability insurance, but none were found to require third party or post construction types of coverage (Toy, 1989). A recent complaints study in Florida recommended a Completed Operations Insurance requirement for Florida (CCSC, p. 18, 1989).

Regulatory Protections for Client

There are many parts of a regulatory process that serve to protect the client from harm. Some are preventive, some are restorative (Toy, 1989, p. 134). Figure 2.3 shows some of the options available to regulatory bodies to protect the user of contractor services.

Figure 2.3 Client Protection Options

1. Consumer education program
2. Full disclosure and public information access (#2)
3. Field citation system
4. Disciplinary process. fine, suspend, revoke
5. Completed operations insurance requirement
6. Complaint investigation process
7. Mediation process
8. Recovery fund
9. Third party warranty
10. Financial responsibility requirement
11. Competency examination
12. Minimum experience requirement (#1)
13. License bond requirement
14. Premises and operations liability insurance requirement

Most of these are preventive in nature and do nothing in the way of restitution for harm caused to clients. Only completed operations insurance, mediation, recovery funds, third party warranty, and license bond directly address restitution. The disciplinary process, if it had civil powers to award damages, also would address restitution.

CHAPTER III - RECOVERY FUND SURVEY

Introduction

A survey has been conducted by sending each state a request for information regarding existing recovery fund in the state. Forty five states responded. Not responding were California, Delaware, Kansas, Louisiana and West Virginia. A previous licensing study indicated that these five states did not have recovery funds (Toy, 1989). A sample request letter is in Appendix A. The survey revealed that nine states have construction related recovery funds. Pennsylvania and Montana have real estate recovery funds only and were not counted. The name of the recovery fund varies from state to state. However, the construction sector the fund covers is almost always the same, residential construction. The following section of this chapter summarizes the recovery funds for the nine states having them. The final section of this chapter details the features found in recovery funds. A matrix which gives a quick review of these existing funds has been compiled and is included in the first part of Chapter Four. The following sections detail the features of recovery funds as determined from the materials obtained from the survey request letter.

State Recovery Funds

Arizona

In Arizona the property owner and lessee can be compensated under the recovery fund. The fund affects new residential construction and home improvement. The fund has no direct relationship to mechanics' lien law. Complaints are developed through the courts.

Funds are raised as follows: 1) Each contractor pays an assessment not more than \$300 to the fund when he applies for a license; and 2) When the fund is insufficient, the Registrar may assess additional fees for all residential contractors. The minimum balance of the fund is \$100,000.

The fund can compensate for: 1) actual damages sustained by the act, representation, transaction or conduct; but, 2) exclude attorney's or costs except in contested cases appealed to the Superior Court. The prerequisites to compensation are: 1) An action for a judgement which may result in an order for collection from the fund. Shall not be commenced later than 2 years from the accrual of the cause of action; 2) Notify the registrar at the time of commencement of the action; 3) The claimant shall not be the spouse of the contractor or the personal representative of the spouse; 4) Obtained a final judgement from a court; 5) proceeded against any existing bond; 6) not aware of any personal assets of the debtor which may satisfy the judgement. The triggers for payment are: 1)

final judgement from a court; and 2) exhausting actions against bond and other means to recover the damage. The maximum award to an individual is \$15,000 and to a group of claimants is \$75,000 per contractor. The Registrar of Contractors distributes monies from the Fund.

The state has the following recourse on the contractor:

1) The right of subrogation to the extent of payments made from the fund; 2) Suspend the contractor's license; 3) The contractor is ineligible to receive or renew or reactivate his license until the full amount plus interest at 10%/year has been paid.

Connecticut

The Connecticut Home Improvement Guaranty Fund compensates homeowners. It covers residential home improvement limited to single or multi-family dwellings of six units or less. It has no direct relationship to the mechanic's lien law. Complaints are developed through the courts.

Contributions to the Fund are \$25 per year for each salesman and \$50 per year for each contractor in home improvements. The minimum balance for the Fund is \$750,000. The fund can compensate for the judgement for actual damages and costs taxed by the court and for reasonable attorney's fees. The following items are prerequisites to compensation: 1) the contractor was registered at the time of signing of the contract; 2) the contract must be for

residential property; 3) total contract must exceed \$200; 4) have a court judgement on or after Dec. 31, 1989; and, 5) exhausted all other remedies. The triggers for payment are: 1) court's final judgement; 2) need to apply to the commissioner for the recovery; 3) exhausting all other remedies; and 4) application must be made within one year from the determination of appeal. The maximum award is \$10,000 for any single claim by an owner, but to a group of claimants the maximum is not restricted. The Commissioner, Department of Consumer Protection, distributes monies from the Fund.

Connecticut has the following recourse on the contractor: 1) The contractor is ineligible to receive a new or renewed certificate until he has repaid the amount in full plus interest; and, 2) It may take action for reimbursement of the fund from the contractor involved.

Hawaii

Owners or lessees of private residences can be compensated by the Fund. The fund covers construction of private residences and improvements or alterations to private residences. The fund will pay the amount of a lien, even mechanic's liens and materialman's liens, plus reasonable attorney's fees. Complaints are developed through the Circuit courts and District courts.

A contractor pays \$150 to the fund when he applies for a contractors license. If the fund is below the minimum

balance in December of a year, a \$250 fee will be assessed for the license renewer. The minimum balance for the Fund is \$250,000. The Fund can compensate for court costs and fees, attorney fees, judgement resulting from the enforcement of a mechanic's lien or materialman's lien together with reasonable attorney's fees. As prerequisites to compensation: 1) No action for a judgement shall be commenced against the fund later than 6 yrs from the cause of action; 2) A claimant shall notify the board of the commencement of his action for the judgement; 3) All action against bonds has been exhausted; and 4) The claimant is not a spouse of debtor, or the personal representative of such spouse. The triggers for payment are final judgement of the court and having exhausted all remedies available to recover the judgement of the court. The maximum award is \$12,500 per contract. The contractors license board distributes monies from the funds.

Hawaii has the typical recourse on the offending contractor. The contractor's license will be terminated. The contractor is not eligible to receive a new license until he has paid the amount paid from the fund on the contractor's account plus the interest at 6%/year.

Indiana

Any aggrieved person who obtains a final judgement in any court against any plumbing contractor to recover damages for a violation of Regulation of Plumbers or the plumbing

codes of the state that results in an actual cash loss to him can be compensated by the Fund. Only plumbing is covered by this Fund. No relationship to a mechanics' lien law was mentioned. Complaints are developed through the courts.

Plumbing contractors and journeyman plumbers pay fees into the fund at the time of application. When the fund is insufficient, an additional fee is assessed for initial or renewal license. Balance of the Fund is maintained at a level of \$400,000. If at the end of a year the balance is less than \$250,000, an additional fee would be assessed for next year. The fund can compensate for actual damages and court costs, but excluding attorney's fees or punitive damages. The prerequisites to compensation from the fund are: 1) No collusion between the judgement creditor and debtor; 2) The judgement made application not more that one year after the termination of all proceedings for collection purposes; 3) The debtor's violation occurred when he was licensed and acted in a capacity for which a license is required, and the violation occurred after 12/31/1987; and, 4) An order for payment from the fund only may be issued within 2 years after the termination of all proceedings against the plumbing contractor. The final order of the court directing that payment be made out of the plumbers recovery fund triggers that payment. The maximum awards are \$20,000 per judgement and \$50,000 per licensee. The

Plumbing Commission distributes monies from the Fund.

Indiana has the recourse to suspend the judgement debtor's license. The licensee is not eligible to be licensed again until he's repaid the full amount plus interest at 12% annually. The Commission is subrogated to the rights of the judgement creditor.

Maryland

The Maryland Home-Improvement Guaranty Fund can compensate homeowners for harm caused by contractors. Both residential construction and home improvement are covered by the Fund. Relationship to mechanics' lien not mentioned. Complaints are developed through the Commission's investigation, the courts, and arbitration.

Funding comes from: 1) \$50.00 per license when a contractor applies for or renews his license; and 2) the commission assessing a fee if the balance is insufficient. The minimum balance for the Fund is \$250,000. The Fund can compensate for actual losses incurred as a result of conduct by licensed contractors who have performed work under a home-improvement contract in a poor manner, or, a violation of Code of Maryland regulations. Prerequisites to Compensation are: 1) Any remedies available under the bond exhausted; 2) Written agreements to submit any dispute to arbitration have been complied with; and, 3) A claimant may not be a spouse or other immediate relative of an individual licensee involved in the claim, a partner, officer, or

employee of a licensee or an immediate relative of them. Payment from the fund will be triggered after: 1) Court's final judgement; 2) Final award in an arbitration; 3) The commission's final decision or order; and 4) All other remedies or appeal have been exhausted. The maximum awards are \$10,000 per claim up to \$50,000 per licensed contractor. The Home Improvement Commission distributes the monies from the Fund.

Maryland has the following recourse on the contractor: 1) The commission is subrogated to all of the rights of the claimant up to the amount paid from the fund; 2) Sue the contractor in a court for the unpaid amount which was paid to the claimant on his account; and, 3) May take disciplinary action against the contractor.

Michigan

The Homeowner Construction Lien Recovery Fund protects homeowners, suppliers, subcontractors, and building trade workers. Home construction and home improvement are covered by the Fund. The Fund is directly tied into the mechanics' lien law with the fund actually being one of the defendants in the court proceedings. If all conditions are met, it protects the homeowner from paying twice resulting from a lien. Complaints are developed through the courts.

The Fund is maintained by: 1) Fees paid by the residential builder, residential maintenance and alteration contractor, the electrical contractor, the master plumber,

and mechanical contractor; 2) A fee of \$15.00 will be withheld by the fund from the laborer's recovery; 3) All other lien claimants may pay \$50.00 to be a member of the fund prior to the date of the lien claimant's contract for the improvement to the residential structure. The statutory minimum balance for the Fund is \$1,000,000. The Fund can compensate for the amount payable to the claimant in a court judgement. Prerequisites to Compensation are: 1) Being entitled to a construction lien on a residential structure; 2) The payment was made by the owner to the contractor or subcontractor; 3) The lien claimant has not been paid by the contractor or subcontractor; 4) The claimant has a membership in the fund or has paid a fee to the fund; 5) The claimant has no collusion with another person to obtain a payment from the fund; 6) The claimant has complied with any applicable licensing acts; 7) He has made a reasonable effort to obtain a payment from the contractor or subcontractor; and, 8) The contractor or subcontractor was licensed when the contract involved was performed. Final judgement of the court triggers payment from the Fund. The maximum award is \$75,000 per residential structure. The Department of Licensing and Regulation administers monies from the Fund.

The Department has the following recourse against the contractor: 1) The department shall be subrogated to the rights of the person to whom the payment was made; 2) The

department may maintain an action against the contractor or subcontractor.

New Jersey

The New Home Warranty Security Fund is designed to compensate the new home owner, excluding dwelling units constructed solely for lease, for harm caused by contractors. Residential construction, particularly new home construction, is covered by the statute. There is no direct relationship to the mechanics' lien law. Complaints are developed through the Commissioner's investigation.

Home builders pay fees sufficient to cover anticipated claims plus a reasonable reserve and to cover the costs of administering the fund. The Fund can compensate for reasonable costs necessary to correct any defect or defects covered under the warranty. The prerequisites to compensation from the Fund are: 1) One year from the warranty date, the home shall be free from defects caused by faulty workmanship and defective materials; 2) Two years limitation for defects caused by faulty installation of plumbing, electrical, heating and cooling delivery system; 3) Ten years limitation on major construction defects, defined as " any actual damage to the load bearing portion of the home including damage due to subsidence, expansion or lateral movement of the soil which affects its load bearing function and which vitally affect use of the home for residential purposes; 4) The owner has notified the builder

of the defects and has allowed a reasonable time for repairing them, but the builder failed to do the repair. Payment is warranted when award is made by the Department of Community Affairs; and, the builder is unable to or refuses to correct the defects. The maximum award is the purchase price (fair market value) of the new home when it is completed. The Commissioner of the Department of Community Affairs distributes monies from the Fund which is maintained by the State Treasurer.

The state has the following recourse against the contractor: 1) discontinue the participation in the fund of the builder responsible for a significant number of claims; 2) surcharges against the builder; and 3) suspend or revoke the builder's certificate of registration.

Tennessee

The Tennessee Home Improvement Guaranty Fund can compensate homeowners. It covers residential construction home improvement. It does not have a direct relationship to the mechanics' lien law. Complaints are developed through the courts or through the arbitration process.

Each contractor pays a fee when applying or renewing a license and will be assessed a fee (\$50/year) when the fund is insufficient. The minimum balance for the fund is \$250,000. The fund can compensate for: 1) loss due to inadequate or incomplete work; 2) loss due to violation by a licensed contractor of any provision of this chapter; 3)

attorney's fees, court costs; and 4) judgement resulting from the enforcement of a sub's mechanic's and materialman's lien. The prerequisites to compensation are that: 1) the losses have to be those caused by inadequate or incomplete work, violation of provision of this chapter; 2) a claimant may not be a spouse, immediate relatives of a licensee; 3) a claimant may not be a partner, officer, employee of a licensee or immediate relatives of them; and, 4) all other remedies are exhausted to recover the loss. Payment is warranted upon: 1) certified copy of a final judgement of a court; or, 2) a final award in arbitration, with all rights of appeal exhausted; 3) the passage of 60 days after the court's judgement or arbitration's award. The maximum award to an individual is \$10,000 and to a group of claimants is \$50,000 (against one contractor). The Home Improvement Commission, Board for Licensing Contractors, distributes funds from the recovery fund.

The state has the right to require the contractor who is responsible for the claim to repay the amount paid to the claimant from the fund plus 10% simple interest; and, to sue the contractor for the unpaid amount if the contractor fails to pay the amount in full within 30 days after noticed.

Virginia

A person who has been awarded a judgement against a contractor licensed in Virginia in a court can be compensated from the recovery fund. The claimant cannot be:

1) an employee, vendor, spouse or child of the contractor; 2) another licensed contractor; 3) a financial or lending institution; or, 4) anyone whose business involves the construction or development of real property. The statute covers residential construction. There is no direct relationship with the mechanic's lien law. Complaints are developed through the courts.

Contractors licensed by the Commonwealth of Virginia pay a fee into the fund. The statutory minimum balance of the Fund is \$400,000. The fund can compensate in the amount remaining unpaid on the court judgement, subject to maximum limitations. It can compensate for court costs and attorneys' fees. For a claimant to receive funds from the recovery fund, the court's judgement must be based on the improper or dishonest conduct of the contractor; the contractor must have been licensed during the period in which the improper or dishonest conduct occurred; and the contractor must have been contracting within its license or the contract must be for the consumer's residence. Payment is warranted upon the Board's review and determination of the claim which must be filed within six months after the final court judgement. The maximum award to an individual is \$10,000 for each claim. To group of claimants involving one contractor the maximum award is limited to \$20,000. The Board for Contractors distributes monies from the Fund.

The Board may revoke the involved contractor's license.

The Board for Contractors also may take further disciplinary actions against the contractor.

Fund Mechanism Features

Title of the Recovery Fund

The title of the recovery funds differ from state to state. The title of the recovery fund frequently indicates the scope or nature of the fund. For example, the recovery fund in Michigan is called Construction Lien Recovery Fund, which obviously indicates its relationship with the mechanic's lien law. The funds in Tennessee, Maryland and Connecticut are titled Home Improvement Guaranty Fund, which indicates the fund only applies to the home improvement. New Jersey's recovery fund is a New Home Warranty Security Fund, which covers the new home construction only. Indiana's Plumbers Recovery Fund solely deals with claims against licensed plumbers. Virginia's recovery fund has title of Virginia Contractor Transaction Recovery Fund.

Who Can Be Protected

The recovery fund act, when created, normally specifies who can be protected. The parties which can be protected by the fund vary from state to state depending upon the scope of the fund. To the Home Improvement Guaranty Fund, the home owner is the only party protected by the fund. The New Jersey's New Home Guaranty Fund is designed for the protection of new home owners. Indiana's Plumbers Recovery

Fund states that " Any aggrieved person who obtains a final judgement in any court against any plumbing contractor to recover damages for a violation of Regulation of Plumbers or the plumbing codes of the state that results in an actual cash loss to him" may be compensated for by the fund. Michigan's Construction Lien Recover Fund virtually protects all parties which might be involved in a lien, including homeowners, suppliers, subcontractors, and even building trade workers.

Prerequisites to Compensation

In order to recover losses or damages from a recovery fund, the party has to meet certain conditions to be eligible. Slight differences do exist among the funds of different states, mainly due to a variance in scope of the particular fund. The next section of this chapter includes a listing of the prerequisites to compensation for each recovery fund. The prerequisites that the funds commonly have are summarized in the following:

- (1) The contractor was registered or licensed at the time of signing of the contract.
- (2) The claimant has no collusion with another person to obtain a payment from the fund.
- (3) The claimant has a final judgement from a court or arbitration or fund administration department.
- (4) The losses or damages have to those defined in the recovery fund act.

(5) The claim has to be made within the time limit specified in the recovery act.

(6) The claimant has reasonably exhausted other remedies to recover his damages or losses.

In addition to those described above, other specific conditions may have to be met under the fund statute for each state.

Fund Administrative Body

The recovery fund act always specifies who administrates the fund and any affairs related to the fund. Each state has a designated authority to administer the fund. Depending upon the nature of the fund, the authority is named differently. In most states, the contractors licensing authority is in charge of the fund. However, in some states a commission may be created to administer the fund. For example, the fund in the State of New Jersey is run by the Commissioner of the Department of Community Affairs while the State of Connecticut's fund is run by the Commissioner of Consumer Protection.

Monetary Sources of the Fund

Contractors who are specified in the recovery fund act contribute the funds. Usually, a single fee is assessed at the time of a license is granted. Each existing fund sets a minimum balance of the fund. When the fund balance becomes insufficient, an additional annual fee or a fee upon license renewal may be assessed by the fund administration. The

amount of the fee ranges from \$25 to \$150 in different states.

Balance of the Fund

The minimum balance of the fund is determined by studying the amount of claims filed annually so that a sufficient fund for possible recoveries is maintained. The figure is from \$100,000 for Arizona to \$1,000,000 for Michigan. The minimum balance for Connecticut is \$750,000 and \$400,000 for Virginia. The remaining five states' minimum balance figure is \$250,000.

Maximum Awards

All the recovery funds surveyed in this study specify the maximum amount of awards for which a claimant may be compensated. The maximum amount may be specified in a variety of ways, including by each claim, each court judgement, each contract, each licensee, or each home. The maximum award to each claimant is approximately \$10,000 to \$15,000 while to each licensee the figure varies from \$20,000 in Virginia to \$75,000 in Arizona. Michigan's limit is \$75,000 per residential structure while the limit in New Jersey is defined as " the purchase price (at the fair market value) of the new home when it is completed."

Coverage of the Fund

The fund usually pays the actual losses or damages defined in the recovery fund but subject to the maximum limitations. Some funds cover court costs and reasonable

attorney's fees while others do not. Among the nine states discussed in this study, four of them pay neither court costs or attorney's fees; Indiana's fund compensates for courts costs but excludes attorney's fees or punitive damages. The other four states pay both the court costs and attorney's fees.

Relationship to Mechanics' Lien

Three of nine states' recovery fund are related to mechanics' lien laws. They are Hawaii, Michigan, and Tennessee. All the three funds provide protection for the homeowner from the mechanics' lien imposed by unpaid subcontractors or material suppliers. The funds provide for payment of the judgement resulting from the enforcement of mechanic's and materialman's lien and thereby release the lien on the owner's property.

Development of Complaints

Complaints are almost always developed in court. Eight of nine states award the recovery based upon the final judgement of the court while the New Home Warranty Security Fund in New Jersey awards on the basis of the Commissioner's investigation. Arbitration is another avenue for developing the complaint. The Maryland and Tennessee recovery funds acknowledge the final award of an arbitration and pay the amount of the award. The Commission's investigation may also result in an award in Maryland.

Recourse on the Licensee

After the payment is made to the claimant from the recovery fund, the fund administration normally take the following recourse on the licensee who resulted in this payment:

(1) The licensee's license or registration may be revoked or suspended. In most cases, the contractor's registration will not be reinstated, renewed or reissued until he has repaid the full amount paid to the claimant on his account plus the interest specified.

(2) The fund administration may take legal action against the contractor to recover the amount paid to the claimant from the fund.

(3) The fund administration has the right of subrogation to the extent of payments made from the fund and may seek other means to recover the payment.

CHAPTER IV - ANALYSIS

Harm Reduction Performance

The following sections present partial results of an analysis of harm levels existing in states and the performance of state licensing processes in reducing them (Toy, 1989).

Worker Harm

All recovery fund states except New Jersey, because it was without injury incidence rate data, were categorized by level of harm and performance for injury incidence rate and the results shown in Figure 4.1. Florida was included in this table also. States that have been licensing contractors with a competency examination process since 1980 were marked with an asterisk. Tables showing the ranking of

Figure 4.1 Harm to Workers - Recovery Fund States			
LEVEL OF HARM	PERFORMANCE		
	poor	average	good
H	Connecticut	* Arizona	* Florida * Hawaii
M	Maryland	Virginia	Tennessee
L	* Michigan	Indiana	

* States licensing with competency exam since 1980.

all states by injury incidence rate, performance of the

injury incidence rate, contract bond loss ratio, performance of the contract bond loss ratio, and average liability insurance premium index can be found in Appendix B. The derivations of the variables II, CB, PI, and PC (indicated in Appendix B) are explained in Appendix C.

Client Harm

All the recovery fund states and Florida were categorized by level of harm and performance for contract bond loss ratio and the results shown in Figure 4.2. The groupings in the extreme categories from upper left to lower right indicated a divergence of states in contract bond loss ratio. The high level of harm states had poor performance and the low level of harm states had good performance. Having a recovery fund does not seem to matter.

Figure 4.2 Harm to Clients - Recovery Fund States			
LEVEL OF HARM	PERFORMANCE		
	poor	average	good
H	* Arizona Tennessee * Hawaii	* Michigan	
M			Indiana * Florida
L			Connecticut Maryland New Jersey Virginia

* States licensing with competency exam since 1980.

Public Harm

All recovery fund states and Florida were categorized by level of harm for average liability insurance premium index and the results shown in Figure 4.3. New Jersey was without liability insurance data and was omitted. This table was not like the previous two in that there was no performance variable in the referenced research with which to categorize. States that have been licensing contractors with a competency examination process since 1980 were marked with an asterisk.

Figure 4.3 Harm to Public - Recovery Fund States				
LEVEL OF HARM	no performance levels available			
	H	* Michigan	Indiana	Maryland
M	* Florida	* Arizona		
L	Tennessee	* Hawaii	Virginia	
* States licensing with competency exam since 1980.				

Of the Figures 4.1, 4.2, and 4.3 the most relevant to the discussion of recovery funds is Figure 4.2 showing levels of harm to clients/owners and performance in reducing this level of harm as measured by the contract bond loss ratio. In Figure 4.2 it should be noted that Florida has a middle level of harm and its level of harm dropped in the period

1980-1986. Also note that Arizona, Tennessee, Hawaii, and Michigan have the highest levels of harm. Note also that these same states are doing the most in the way of contractor licensing to resolve the problem (Figure 4.4) but have the poorest performance (Figure 4.2).

Related State Contractor Licensing Features

The information listed in Figure 4.4 below came from a survey of the state contractor licensing practices for all 50 states conducted in 1988-89 (Toy, 1989). The categories

Figure 4.4 Licensing Features - Recovery Fund States										
	FL	AZ	HI	MI	TN	VA	MD	NJ	CT	IN
LICENSE	68	31	57	66	31	85	27	77	N	N
EXAM	68	31	57	66	86	85	N	N	N	N
RESIDENTIAL	Y	Y	Y	Y	Y	Y	Y	Y	N	N
BUILDING	Y	Y	Y	N	Y	Y	Y	N	N	N
GENERAL	Y	Y	Y	N	Y	Y	Y	N	N	N
AGENT-RME	Y	N	Y	Y	N	Y	N	N	N	N
BUSINESS	N	Y	Y	Y	Y	Y	Y	Y	N	N
INDIVIDUAL	Y	Y	Y	Y	Y	Y	Y	Y	N	N
EXCEPT<\$	N	Y	Y	Y	N	Y	N	N	N	N
LIC. BOND	N	Y	Y	N	N	N	N	N	N	N
REVOKE	Y	Y	Y	Y	Y	Y	N	Y	N	N
AWARD \$	N	Y	N	Y	Y	N	N	N	N	N
										(Y)ES (N)O

listed down the left in Figure 4.4 are LICENSE for the year in which state licensing law took effect; EXAM for the year in which competency examination requirement took effect; RESIDENTIAL for whether or not they license residential contractors; BUILDING for licensing building contractors; GENERAL for licensing general contractors; AGENT-RME for whether the state licenses a single agent or responsible

management employee; BUSINESS for whether the business is licensed; INDIVIDUAL for whether or not individuals are licensed; EXCEPT<\$ for whether or not there are minimum dollar amount exceptions for requirement to be licensed; LIC.BOND for whether a license bond is required for contractors; REVOKE for whether the licensing body has the power to revoke a license; and, AWARD \$ for whether or not the licensing body has the power to award damages to a complainant.

If a comparison is made between Figure 4.2 and Figure 4.4 the following things stand out: 1) The high harm - low to average performance states, Arizona, Hawaii, Michigan, and Tennessee, all have state licensing competency examination processes; 2) The high harm - low to average performance states have minimum dollar contract amount exceptions to their regulation; 3) All recovery fund states that license contractors include residential contractors; 4) All recovery fund states that license contractors license both the business and the individual; 5) Of the high harm - low to average performance states only Maryland does not allow their licensing agency to award damages; and, 6) Only two recovery fund states requires a license bond.

Construction Recovery Funds

Matrix Comparisons

Figure 4.5 has been summarized from the information provided by each recovery fund state. With the exception of Indiana which focuses only on plumbing contracts, the parties protected by the recovery fund are connected residential property as homeowners or lessees.

Because of the way the Michigan law works suppliers, subcontractors, and workers may be directly involved with the recovery fund after lien claims against the owner have been discharged. In Michigan and Connecticut parties other than the prime (or in Indiana, the plumbing) contractor contribute to the recovery fund. Three of the four high harm - low to moderate performance states from Figure 4.2 have recovery funds that have a stated relationship to the lien law of the state.

In New Jersey the Commission is more important in the operation of the fund as only upon their investigation and subsequent order can funds be paid out. Other states rely on court or arbitration procedures to develop and make a final judgement prerequisite to payment from the fund.

Figure 4.5 Features Matrix	AZ	CT	HI	IN	MD	MI	NJ	TN	VA
PARTIES PROTECTED									
Homeowner	x	x	x		x	x		x	
New Homeowner							x		
Lessee	x		x						
Supplier						x			
Subcontractor						x			
Worker						x			
Person awarded court judgement against licensed contractor				x					x

ADMINISTRATION BODY									
Board for Contractors									x
Home Improvement Commission					x			x	
Commissioner of the Dept. of Community Affairs							x		
Dept. of Licensing & Reg. Plumbing Commission				x		x			
Commissioner of Dept. of Consumer Protection		x							
Registrar of Contractors	x								
Contractors License Board			x						

MINIMUM FUND BALANCE									
No specific figure							x		
\$100,000	x								
\$250,000			x	x	x			x	
\$400,000									x
\$750,000		x							
\$1,000,000						x			

SOURCES OF THE FUND									
Contractor		x	x		x			x	x
Residential Contractor	x					x	x		
Electrical Contractor						x			
Plumber				x		x			
Mechanical Contractor						x			
Laborer						x			
Lien Claimants						x			
Salesman		x							

CONSTRUCTION SECTORS AFFECTED									
New home construction	x					x	x		
Home improvement	x	x			x	x		x	
Residential			x						x
Plumbing				x					

Figure 4.5 Features Matrix	AZ	CT	HI	IN	MD	MI	NJ	TN	VA
RELATION TO MECHANIC'S LIEN			x			x		x	
COVERAGE OF THE FUND									
Actual Losses & Damages	x		x	x	x			x	
Court Costs & Fees			x	x				x	x
Attorney's Fees		x	x					x	x
Punitive Costs									
Judgement resulting from the enforcement of lien			x					x	
Court Judgement		x				x			x
Costs to correct defects							x		

MAXIMUM AWARD LIMITATIONS									
Per Claim									
\$10,000		x			x			x	x
\$15,000	x								
Per Contract									
\$12,500			x						
Per Judgement									
\$20,000				x					
Per Home									
\$75,000						x			
Market Price of new home upon its completion							x		
Per Licensee									
\$20,000									x
\$50,000				x	x			x	
\$75,000	x								

DEVELOPMENT OF COMPLAINTS									
Courts	x	x	x	x	x	x		x	x
Arbitration					x			x	
Commission's Investigation					x		x		

RECOURSE ON THE LICENSEE									
Revoke/Suspend License	x		x	x			x		x
Require the amount paid to claimant be repaid+Interest	x	x	x	x			x	x	
Sue the licensee for unpaid amount					x			x	
Take actions against licensee		x			x	x			x

TRIGGERS FOR PAYMENT FROM FUND									
Final judgement from courts	x	x	x	x	x	x		x	x
Final award from arbitrations					x			x	
Commission's decision/order					x		x		x
Exhausted other remedies	x	x	x		x			x	

Court Cases on Recovery Funds

Several court cases specifically relating to recovery funds are presented in this section. They are summarized and presented in state alphabetical order in the following paragraphs.

In *Wilson vs Arizona Registrar of Contractors* the Court of Appeals said awarding attorney fees and costs was disallowed. The right to recover is a substantive right vesting at the time it is assertable as a legal cause of action which is after an injured person recovers a 'valid judgement'. The Arizona law was amended disallowing recovery of attorney fees before this injured person got his valid judgement. This case speaks to the issue of when rights to recover from the fund are established. It points out, however, that recovery of attorney fees is currently disallowed in Arizona.

In *Graham Construction Supply, Inc vs Schrader Construction, Inc* a supplier was allowed to recover from the recovery fund under wording which was later amended. The old wording was "any person aggrieved by an act, representation, transaction or conduct of a duly licensed contractor" and within that definition the supplier qualified. The licensing law was amended restricting the class of persons entitled to payment to owners or lessees of private premises. This case brings up the issue of who is entitled to collect from a recovery fund.

In the first of two cases in Michigan, *Kitchen Suppliers, Inc vs ERB Lumber Company*, the issue of who is entitled to collect from the fund again arises. ERB's claim against Michigan Homeowner Construction Lien Recovery Fund was reinstated by the Court of Appeals. Johannes' had an executory contract with the builder, Shelby Woods Properties who hired ERB and Kitchen Suppliers. The court defined ERB as a supplier and Johannes' as lessees, therefore liens were dismissed and ERB's claim reinstated. In Michigan, payment from the fund may be made only to a subcontractor, supplier, or laborer. Owners are protected by the dismissal of liens against their property. This shows how the Michigan law protects the owner from making double payments and provides for payment to subcontractors, suppliers and laborers.

In the other Michigan case, *Titanus Cement Wall Company, Inc. vs Watson*, the Michigan Homeowner Construction Lien Recovery Fund was released by the lower court and the decision affirmed by the Court of Appeals because: 1) plaintiffs were prime contractors for owner/builder/developer and not subcontractors, suppliers or laborers; and, 2) structures were not 'residential structures' as defined by the law requiring living in by the owner. This again addresses the issue of who is entitled to recovery and what is covered by the law.

In *State Board for Contractors vs H. B. Sedwick, Jr. Building Supply Company, Inc.* the Virginia Supreme Court

disallowed the building supplies company recovery from the fund because of specific language excluding vendors of a judgement debtor. This again addresses the issue of who is entitled to recovery and is dramatically different from the Michigan solution.

Harm, Licensing, Recovery Fund, and Alternatives

It is obvious from the research findings that consumer complaints and harm done by prime contractors are most prevalent in the residential and home improvements sector of the construction industry. With the exception of the plumbing recovery fund in Indiana, all recovery funds address this segment of the industry.

Only housing, home improvements, and repairs should be regulated. It should be noted that the great majority of commercial, industrial, and institutional contractors, seldom are the subject of complaints and disciplinary action. (HLA, p. 50, 1983)

It is also apparent that the weakest protection for the public lies in the area of harm to the client/owner. This harm is nearly always due to failure of the prime contractor to perform. It can take the form of liens from laborers, suppliers, and subcontractors or may result from having to contract with someone else to complete the project.

Taken together, the most apparent need for protection from harm is the client/owner in new residential construction or home improvements. It is in this area that contract amounts are relatively small as construction

contracts go, but are much more important to the client/owner as often it is the largest single lifetime monetary commitment made by that client/owner. In this area there are more less-sophisticated builders than in other areas of the industry and there are more less-sophisticated consumers, the homeowner/clients.

Sometimes state licensing regulations work against protecting the residential homeowner/client. In North Carolina, for instance, the licensing statute contained an exclusion of contracts under \$30,000 from the licensing requirement. The sunset committee stated that this "has the potential of subjecting many people, particularly homeowners, to irreparable harm and serious financial loss." (NCGEC, p. 13, 1979) and went on to say that the exemptions "were so restrictive (less than \$30,000 and own property) that the Board lacks jurisdiction in some 80% of all complaints received." (NCGEC, p. 14, 1979)

A second serious problem in this area is unlicensed activity. To combat the unlicensed activity a 1987 change in Florida law "provided for triple damages to an injured consumer in an action for damages against an unlicensed contractor and removed unlicensed contractors from the protection of the mechanics' lien law." (SECCAC, p. 14, 1987) Also in 1984 the Department of Professional Regulation was given "administrative enforcement authority, in the form of cease and desist orders, over unlicensed

individuals and established standing in both civil court and the administrative law area." (SECCAC, p. 69, 1987)

When a contractor fails to perform it is often because he is bankrupt. Business failures in the construction industry are among the highest among all industries. When the contractor's business fails, he is not concerned with maintaining his contractor license. The licensing agency loses its leverage over the contractor. It is in these cases that contract bonds and recovery funds have their most important use. Since contract bonds are not typically used in small private contract work, particularly residential, recovery funds and license bonds may be the only source of restitution for harm done by the contractor. License bonds are often insufficient in amount leaving only the recovery fund (if any) to keep a client/owner from serious harm.

The is one preventive measure that could protect a homeowner/client from serious financial harm in the case of a contractor's failure to perform. Direct disbursement is a method of payment to the contractor and his subcontractors and suppliers directly by a private agency. The homeowner hires the agency to review progress of the job and pay appropriate amounts directly to the contractor, material suppliers and subcontractors monitoring releases of lien as the project progresses. If the contractor fails to perform, at least the owner has paid for only the work done to that point and he is assured that there will be no major liens.

CHAPTER V - SUMMARY AND CONCLUSIONS

The purpose of this study is to determine the applicability of a mechanic's lien law recovery fund to the residential construction industry in Florida. The problem, the background leading up to this study, the statement of purpose, the limitations of this study, the definitions used in the study and its organization are presented in Chapter One. In Chapter Two, the larger framework of harm done to the public by contractors is introduced so that the reader can get a reasonable perspective on the focus of this study. For a similar reason, the major mechanisms for judgement and restitution in matters of contractor harm to the public also are presented in Chapter Two. States which have recovery funds connected to the construction industry were determined by direct inquiry. Fund information abstracted from literature provided by these states is presented in Chapter Three to help the reader understand what other states have done to address similar problems in their jurisdictions. An analysis of the performance of states in reducing harm to the public is found at the beginning of Chapter Four. A comparison of harm reduction performance and regulatory features is shown for the recovery fund states and Florida. This analysis is followed by a matrix summary of recovery fund features and the thrust of the existing court cases concerning recovery funds. At the end of Chapter is a short section refocusing on client harm in the residential

construction and home improvements segment of the industry, on the shortcomings of state regulations and other forms of restitution in this area, and on non-regulatory alternatives.

Owner/clients can be harmed directly by contractors. In the civil courts there has been a tendency toward allowing recovery beyond that allowed for just breach of contract. These instances of tort developed judgement will result in restitution only if the contractor is solvent, a contract bond exists and applies, and/or general liability insurance is in force and covers the injury. However, restitution for other than economic damages (and attorney's fees) is universally exempted by recovery fund statutes.

Owners/clients can be harmed indirectly by contractors. From the contractor harm categories in Figure 2.1 it is apparent that recovery funds could apply to financial harm done to employees, subcontractors, and suppliers when there is no contract bond to protect them sufficiently. Injured parties typically will pursue judgement and restitution in the civil courts using the lien statutes. The primary defendant is not the contractor, who often is insolvent, but the owner/client. Harm thus can shift to the owner/client.

The Michigan Construction Lien Recovery Fund is unique in that it actually becomes the defendant, essentially replacing the owner in lien actions brought by employees, subcontractors, and suppliers. If the owner has followed

certain procedures, the liens are released against him and the action goes against the recovery fund. This unfortunately puts state legal staff in an adversarial relationship with the employees, subcontractors, and suppliers who are the plaintiffs. State funds are spent trying to prevent the distribution of recovery fund assets to those who contributed to the fund.

Mediation as well as arbitration are alternative methods for developing judgements for cases where the contractor and owner/client have a conflict and the contractor has not defaulted. Arbitration is usually the only alternative to civil courts in cases of insolvency with no contract bond. If it is not required by the contract, the owner/client and contractor would have to agree on it. Where arbitration results in a judgement against the contractor which cannot be paid, most recovery funds use the final judgement as a basis for restitution subject to statutory limitations.

Bonds offer restitution with less legal action, typically. Performance and payment bonds offer protection to the owner/client for completion of the project and payment of claims against the owner in relation to the project. Performance and payment bonds are not often used in the single family residential and home improvement sector of the construction industry. The jobs are too small and the contractors are less stable. License bonds offer

protection to the owner and general public for a contractor's harmful actions up to the amount of the bond. License bond requirements are typically from \$1,000 to \$5000. Though contract and license bonds offer restitution, in the residential sector of the industry they are either seldom used or insufficient in amount.

Premises and operations insurance and contractor's general liability insurance provide a vehicle for restitution for property damage and injury done by the contractor to others. Recovery funds offer restitution to parties to a contract with a contractor for economic loss.

Completed operations insurance offers restitution to the public for injury arising out of actions of the contractor after the project is complete and turned over to the owner/client. This offers some protection to the owner/client for actions of the general contractor that injure the general public on the owner's property. To the extent that the loss is economic and arising out of the contract there conceivably may be some overlap with a recovery fund coverage, but this researcher could find none.

Many different regulatory protections for the public exist in the different states. In a recent study on contractor licensing (Toy, 1989) two preventive measures were found to have a significant relationship to reduction of harm to owner/clients. These two were a minimum experience requirement and a system of full disclosure on

contractors with public information access. Other mechanisms aimed at protecting the public that would be particularly apropos to residential construction are a field citation system, a consumer education program, and a third party warranty. Two of these are preventive in nature and do not deal directly with restitution for harm done, but with the prevention of harm. The third party warranty offers some protection to the owner/client for quality of the product.

Nine states have recovery funds involving the construction industry. All but Indiana's fund cover either new residential construction or home improvements or both. Three states specifically identify subcontractors, laborers, and suppliers as parties who are harmed by contractors and are allowed access to the recovery fund through the lien statutes. Of these three states, Michigan is unusual in that after the owner is released from lien action by subcontractors, suppliers, and laborers, the recovery fund legal staff defends the fund from the lien action.

Recovery funds vary in what is covered but nearly always limit payment to economic loss, not injury. The contractor involved must be licensed or certified. All of the states involved except Connecticut and Indiana have state licensing of contractors. Sometimes attorneys' fees and court costs are covered. Recovery is allowed only after all other means of obtaining restitution are exhausted and

final judgement has been made. Sometimes the final judgement can be in arbitration, but most of the time it is through the courts.

The Funds are typically financed by contributions from the licensed or certified contractors who are regulated. Michigan requires the plaintiff subcontractors, suppliers, and/or workers to be contribute to the fund as well. Statutory minimum balances range from \$100,000 to \$1,000,000. Maximum awards range from \$10,000 for an individual claimant to "fair market value of home when completed". Maximum awards are also expressed as by licensee. Recourse by Funds against the contractor is revocation of license or certificate and the normal court action available to the owner harmed by the contractor.

Whether or not a state has a recovery fund does not seem to be related to whether it has been experiencing high levels of contractor harm to clients as measured by the contract bond loss ratio or whether it has been doing better over time at lowering the high harm level. Florida is in the middle third of states with regard to level of harm to clients, and has a good performance record at reducing this harm.

Recovery fund states do not as a group show any significant deviation from non-recovery fund states in levels of harm or performance in reducing levels of harm to workers, clients, or the general public. Compared to

recovery fund states, Florida shows no tendency toward the extremes in either worker harm, client harm, or public harm.

If Indiana is excluded from the list because it limits coverage to plumbing contractors, seven of the remaining residential recovery fund states have state contractor licensing and regulation. Only Connecticut does not. Of those seven state licensing residential recovery fund states all license the business as well as individuals and all but Maryland have the regulatory power to revoke the license.

Because of the nature of contractors and clients harm is most prevalent in the residential sector of the construction industry, particularly home improvements. Homeowner/clients and residential contractors alike are relatively unsophisticated as far as the construction industry as a whole is concerned. Harm in this area is mostly a result of failure to perform on the part of the contractor. Failure to perform as a result of financial failure of the contractor will also mean recovery from the contractor is unlikely. A contractor who has failed financially is not concerned with maintaining the contractor's license.

CHAPTER VI - RECOMMENDATIONS

Recommendation No. 1: Do not institute a mechanic's lien law recovery fund for the residential construction industry at this time. Compared with all other states as well as with the recovery fund states, Florida is in the middle in overall harm statistics. In fact, Florida's licensing law with competency examination has apparently reduced harm-to-client levels as measured by the contract bond loss ratio.

Recommendation No. 2: Continue attempts to reduce unlicensed contracting activity. Many of the complaints in the residential construction industry are the result of the actions of unlicensed contractors.

Recommendation No. 3: Require a contractor license on any new residential construction. There should be no exempt amount. Unlicensed activity is a problem and eliminating this grey area should help clarify the requirement for this sector of the industry.

Recommendation No. 4: Publicize legal impotence of unlicensed residential contractors and specialty (sub)contractors. It has been shown that availability of consumer information on licensing and contracting helps reduce harm. This should have the effect of reducing unlicensed activity.

Recommendation No. 5: Do not require contract bonds on

residential or home improvement work. The cost of administrative overhead does not allow sureties to provide cost effective coverage in the small policy amounts that would be required.

Recommendation No. 6: Require larger license bond. A \$5,000 license bond would cover many home improvement contract amounts and would provide regulation through the operation of the free-enterprise system. Forfeiture of the bond would result in its cancellation or at least non-renewal.

Recommendation No. 7: If a recovery fund is instituted in the future:

A. Do not link it to lien law. For lien claimants, let the claimant perfect the lien and obtain judgement against owner. For other claims including warrantee and workmanship, let courts determine judgement; then if contractor does not pay within specified time and owner makes application to fund, revoke contractor's license, and pay owner to maximum value established.

B. Require a contract bond or direct disbursement on work over the established maximum fund payment amount. Establish a maximum value for payment from the recovery fund and require a contract bond or direct disbursement in the licensing law for projects above the statutory maximum amount.

APPENDIX A

June 29, 1990

Mr. R. P. Burns, Director
Division of Occupational Licensing
P. O. Box D-LIC
Juneau, Alaska 99811-0800

Dear Sir:

The School of Building Construction, University of Florida, is conducting research entitled "Applicability of a Recovery Fund for the Florida Construction Industry." In order to evaluate the recovery fund concept in construction industry regulation, I am trying to collect and study existing "recovery funds" within state construction industry regulatory statutes in the United States.

Please send me information on any "Recovery Fund" mechanism in your state. My special interest would be in a recovery fund applicable to construction industry, possibly in connection of mechanics' lien law.

The information that you provide is vital to this research. Please send your information to:

Dr. G. Arlan Toy
The School of Building Construction
FAC 101, University of Florida
Gainesville, Florida 32611

Thank you for your help. Your assistance in this research is appreciated.

Sincerely,

G. Arlan Toy, Ph.D

APPENDIX B

STATES IN INJURY INCIDENCE RATE ORDER

	<u>ST</u>	<u>HWL</u>	<u>II</u>
1	HI	-1	25.3
2	ME	-1	21.5
3	WA	-1	19.0
4	UT	-1	18.1
5	CA	-1	18.0
6	VT	-1	17.8
7	AZ	-1	17.6
8	NV	-1	17.5
9	AK	-1	16.8
10	FL	-1	16.7
11	CT	-1	16.6
12	MT	-1	16.0
13	OR	-1	16.0
14	AL	0	15.7
15	MN	0	15.5
16	VA	0	15.3
17	IA	0	15.1
18	PA	0	15.1
19	MD	0	15.0
20	MO	0	14.8
21	TN	0	14.7
22	NM	0	14.7
23	NE	0	14.5
24	LA	0	14.0
25	WY	0	13.6
26	OK	1	13.3
27	KY	1	13.1
28	NC	1	12.9
29	AR	1	12.9
30	WV	1	12.8
31	KS	1	12.7
32	IN	1	12.4
33	SC	1	12.4
34	DE	1	12.4
35	MS	1	12.2
36	MA	1	12.0
37	MI	1	11.5
38	RI	1	11.5

OHIO, ILLINOIS, TEXAS, COLORADO, IDAHO, SOUTH DAKOTA,
 GEORGIA, WISCONSIN, NEW HAMPSHIRE, NORTH DAKOTA, NEW YORK,
 AND NEW JERSEY HAD MISSING VALUES.

APPENDIX B cont.

STATES IN INJURY INCIDENCE RATE PERFORMANCE ORDER

	<u>ST</u>	<u>HWP</u>	<u>PI</u>
1	VT	-1	0.33
2	KS	-1	0.13
3	AL	-1	0.12
4	WA	-1	0.12
5	MI	-1	0.11
6	ME	-1	0.08
7	MD	-1	0.08
8	NC	-1	0.07
9	MO	-1	0.06
10	WY	-1	0.05
11	CT	-1	0.05
12	MT	0	0.04
13	UT	0	0.02
14	VA	0	0.01
15	OR	0	-0.01
16	AZ	0	-0.02
17	RI	0	-0.02
18	AK	0	-0.02
19	KY	0	-0.03
20	IA	0	-0.03
21	CA	0	-0.04
22	IN	0	-0.05
23	NE	1	-0.07
24	SC	1	-0.07
25	DE	1	-0.08
26	AR	1	-0.08
27	WV	1	-0.08
28	TN	1	-0.09
29	NM	1	-0.09
30	FL	1	-0.16
31	MN	1	-0.17
32	LA	1	-0.17
33	NV	1	-0.26
34	HI	1	-0.30

OHIO, MISSISSIPPI, MASSACHUSETTS, ILLINOIS, TEXAS, COLORADO, OKLAHOMA, IDAHO, SOUTH DAKOTA, GEORGIA, PENNSYLVANIA, WISCONSIN, NEW HAMPSHIRE, NORTH DAKOTA, NEW YORK, AND NEW JERSEY HAD MISSING VALUES.

APPENDIX B cont.

STATES IN CONTRACT BOND LOSS RATIO ORDER

	<u>ST</u>	<u>HCL</u>	<u>CB</u>
1	OH	-1	3.21
2	MS	-1	2.57
3	TN	-1	2.27
4	MA	-1	1.82
5	AZ	-1	1.77
6	NE	-1	1.61
7	NC	-1	1.52
8	HI	-1	1.35
9	RI	-1	1.34
10	MI	-1	1.24
11	TX	-1	1.24
12	KS	-1	1.10
13	IL	-1	1.07
14	NM	-1	1.00
15	AL	-1	0.97
16	CO	-1	0.92
17	LA	-1	0.88
18	CA	0	0.78
19	OK	0	0.75
20	ID	0	0.73
21	NV	0	0.70
22	AR	0	0.70
23	SC	0	0.70
24	GA	0	0.64
25	UT	0	0.63
26	FL	0	0.63
27	IN	0	0.59
28	DE	0	0.51
29	SD	0	0.49
30	WY	0	0.44
31	OR	0	0.41
32	MO	0	0.41
33	PA	0	0.40
34	KY	0	0.36

APPENDIX B cont.

STATES IN CONTRACT BOND LOSS RATIO ORDER

	ST	HCL	CB
35	WA	1	0.21
36	MT	1	0.19
37	NY	1	0.16
38	WI	1	0.11
39	IA	1	0.10
40	AK	1	0.03
41	VT	1	-0.01
42	MD	1	-0.03
43	WV	1	-0.05
44	MN	1	-0.06
45	NH	1	-0.08
46	CT	1	-0.09
47	VA	1	-0.15
48	NJ	1	-0.20
49	ND	1	-0.37
50	ME	1	-0.40

APPENDIX B cont.

STATES IN CONTRACT BOND LOSS RATIO PERFORMANCE ORDER

	<u>ST</u>	<u>HPC</u>	<u>PC</u>
1	OH	-1	3.01
2	MS	-1	2.18
3	HI	-1	1.98
4	TN	-1	1.97
5	AZ	-1	1.86
6	NE	-1	1.60
7	MA	-1	1.30
8	IL	-1	1.15
9	NM	-1	1.01
10	TX	-1	0.93
11	KS	-1	0.83
12	RI	-1	0.81
13	UT	-1	0.80
14	CO	-1	0.73
15	OK	-1	0.65
16	NC	-1	0.62
17	AK	-1	0.61
18	ID	0	0.60
19	MI	0	0.55
20	SD	0	0.51
21	DE	0	0.50
22	AR	0	0.49
23	OR	0	0.48
24	GA	0	0.42
25	WY	0	0.34
26	MT	0	0.28
27	PA	0	0.24
28	WI	0	0.14
29	MO	0	0.12
30	KY	0	0.12
31	SC	0	0.11
32	IA	0	0.04
33	NH	0	-0.10

APPENDIX B cont.

STATES IN CONTRACT BOND LOSS RATIO PERFORMANCE ORDER

	ST	HPC	PC
34	VT	1	-0.21
35	CA	1	-0.26
36	MN	1	-0.35
37	ND	1	-0.36
38	NY	1	-0.46
39	CT	1	-0.60
40	IN	1	-0.78
41	VA	1	-0.94
42	WV	1	-0.94
43	AL	1	-0.97
44	LA	1	-0.98
45	WA	1	-0.99
46	FL	1	-1.16
47	ME	1	-1.27
48	MD	1	-2.44
49	NJ	1	-5.17
50	NV	1	-7.97

APPENDIX B cont.

STATES IN AVERAGE LIABILITY INSURANCE PREMIUM INDEX ORDER

	<u>ST</u>	<u>HPL</u>	<u>AP</u>
1	NY	-1	3.025
2	AL	-1	2.540
3	PA	-1	1.765
4	CT	-1	1.065
5	MI	-1	1.000
6	NV	-1	0.800
7	ID	-1	0.590
8	WA	-1	0.515
9	MD	-1	0.445
10	MO	-1	0.300
11	MT	-1	0.300
12	CO	-1	0.215
13	IN	-1	0.210
14	OH	-1	0.175
15	MN	-1	0.150
16	LA	0	0.100
17	IA	0	0.095
18	FL	0	0.080
19	AR	0	0.015
20	NH	0	0.010
21	SD	0	-0.010
22	AZ	0	-0.025
23	WI	0	-0.070
24	UT	0	-0.185
25	OR	0	-0.225
26	DE	0	-0.250
27	VT	0	-0.300
28	GA	0	-0.310
29	ME	0	-0.320

APPENDIX B cont.

STATES IN AVERAGE LIABILITY INSURANCE PREMIUM INDEX ORDER

	<u>ST</u>	<u>HPL</u>	<u>AP</u>
30	RI	1	-0.335
31	TN	1	-0.365
32	ND	1	-0.500
33	TX	1	-0.515
34	NM	1	-0.530
35	KS	1	-0.595
36	MS	1	-0.625
37	VA	1	-0.680
38	WV	1	-0.705
39	AK	1	-0.715
40	OK	1	-0.725
41	NC	1	-0.960
42	NE	1	-1.115
43	HI	1	-1.380
44	SC	1	-1.965

CALIFORNIA, ILLINOIS, KENTUCKY, MASSACHUSETTS, NEW JERSEY
AND WYOMING HAD MISSING VALUES.

APPENDIX C

II, injury incidence rate. This rate was from data received from the U. S. Department of Labor on electromagnetic media. This rate was the injury incidence rate for each participating state in the prime contractor Standard Industrial Classification, SIC, codes 15 and 16 for the year 1986. OSHA occupational injury and death incidence rates were obtained for states that have worked with the Bureau of Labor Statistics in a joint effort to develop statistics were comparable between states. These data were from the National Technical Information Service Supplementary Data System files. Data for 1980, 1983 and 1986 were obtained directly from the Bureau of Labor Statistics.

CB, contract bond composite loss ratio. This dependent variable was a composite of information for 1984, 1985, and 1986 for the 17 public and private prime contractor categories of work listed below:

<u>Code</u>	<u>Description</u>
302	Highways and paving - federal
333	Airport buildings - federal
334	Educational buildings - federal
335	Hospitals/clinics - federal
336	Industrial, missile - federal
337	Office buildings - federal
340	Sewer and water treatment - federal

APPENDIX C cont.

352	Highways
363	Street paving
381	Apartment buildings
382	Commercial buildings
383	Airport buildings
384	Educational buildings
385	Hospitals/clinics
386	Industrial
387	Office
390	Sewer and water treatment

PI. performance of injury incidence rate. This dependent variable was the per cent change in injury incidence rate from 1980 to 1986 for each state supplying data to the Bureau of Labor Statistics Supplementary Data System.

PC. performance of contract bond loss ratio. This dependent variable was the per cent change in contract bond loss ratio from the composite years 1978-79-80 to the composite years 1984-85-86. The raw data was obtained from The Surety Association of America, Inc. data sheets for the years indicated.

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BIOGRAPHICAL SKETCH

Gene Arlan Toy was born in Orlando, Florida. He graduated from the University of Florida with a Bachelor of Science in Business Administration degree in 1968. He taught mathematics in the secondary schools in Orlando and pursued a Master of Arts in Teaching degree at Rollins College at the same time graduating in 1971. He returned to the University of Florida where he completed a Master of Building Construction degree in 1975. He completed a Doctor of Philosophy degree at the University of Florida in 1989.

He is currently a Professor and Department Head of the Construction Department at Southern College of Technology in Marietta, Georgia. He is a member of the American Institute of Constructors, National Association of Parliamentarians, Alpha Tau Omega, Phi Kappa Phi, Sigma Lambda Chi (construction honor), and Kappa Delta Pi.

As an Assistant Professor in the University of Florida School of Building Construction from 1981-1990, Arlan Toy conducted research into the purpose, trends in and effect of state regulation of the construction industry through licensing and competency testing; updated a previously published economic impact report on the construction industry in Florida (\$12,411 D.O.E. grant, 1987, BCIAC); did the original research on the economic impact of the construction industry in Florida (\$27,562 D.O.E. grant + \$7,500 matching funds, 1984, BCIAC); and, researched force

account construction (\$14,371 D.O.E. grant, 1983, BCIAC). He wrote "The Contractor's Role in Competitive Bid Construction" for the CEFP Journal, Council of Educational Facilities Planners, November-December 1986. Two of his articles, "'Management Course Enrichment: Video, Films, Articles, Abstracts, and Computers" and "Contractor Licensing Performance" were published in 1987 and 1988 Associated Schools of Construction Proceedings respectively. Professor Toy has been the principal investigator or author for the publications: Force Account Pilot Project, 1983; A Study of the Total Impact of the Construction Industry on Florida's Economy, 1984; "The Contractor's Role in Competitive Bid Construction", CEFP Journal, November-December 1986; The Impact of the Florida Construction Industry on the State Economy, 1987; and "Contractor Licensing Performance", Proceedings of the 1988 Regional Meeting of the Associated Schools of Construction, 1988; A Model for Protecting the Public Through Contractor Licensing, 1989; "Tort vs Breach: Contractor Liability", Proceedings of the 1990 Regional Meeting of the Associated Schools of Construction, 1990; and co-author of Outcome Assessment, a white paper for the American Council for Construction Education, 1990.

Professor Toy has an excellent background in the field operations of general contracting having been a project manager with Great Southwest Corporation, Tampa 1978-9 and

an assistant project manager with Frank J. Rooney, Inc., Ft. Lauderdale 1976-8. He holds a Class A Florida Certified General Contractor's License and was a residential operative builder. His consulting work has included advising condominium owners' association and savings and loan development corporation on construction deficiencies, deviations from building code and plans, and poor construction practice; advising attorneys on personal injury and accidental death cases; and being expert witness on contracts, field operations, and construction definitions.