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# **SECOND REPORT**

## **CONTRACTORS STATE LICENSE BOARD ENFORCEMENT PROGRAM MONITOR**

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Second Report on the Enforcement Program of the  
Contractors State License Board  
Pursuant to Senate Bill 2029 (Figueroa)  
Including Recommendations on Consumer Remedies

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CSLB Enforcement Program Monitor<sup>\*</sup>

Head Deputy District Attorney, Consumer Protection Division  
Los Angeles District Attorney's Office

<sup>\*</sup>Under Appointment by Kathleen Hamilton  
Director, Department of Consumer Affairs

### **Julianne D'Angelo Fellmeth**

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## ACKNOWLEDGMENTS

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A principal focus of this second report is the subject of remedies for consumers and other parties in cases where contractor fraud, incompetence, or abuse injures the public. A number of CSLB and private industry representatives have been especially generous with their time and insights. Among these are CSLB Registrar Stephen Sands, Chief Deputy Registrar Linda Brooks, Enforcement Chief David Fogt, and managers Mike Brown, Glenn Hair, Tom Lennan, Mary Anne Moore, Bob Porter, and Peter Sugar; construction industry representatives Sam Abdulaziz, Don Burns, Donn Harter, Steve Lehtonen, Cyndi Marshall, and Phil Vermeulen; and surety industry representatives Jerry Desmond, Paul Geissler, Jim Lee, and Les Spahnn. Their participation was vital to the deliberations of the Monitor staff, although it does not constitute an endorsement of any specific idea or ideas in this report.

In our analysis of the complex Gordian knot of consumer remedies, the contributions of two scholars and analysts deserve special acknowledgment. CSLB Staff Counsel Ellen Gallagher has contributed tireless efforts and genuine creativity over a period of years to researching existing mechanisms for public redress and identifying potential improvements. Important parts of the remedial package proposed in this report had their origins in Ms. Gallagher's thoughtful work, as presented in such publications as *Using Surety Bonds & Insurance to Protect Consumers* (issued by CSLB in October 2001).

California Law Revision Commission Assistant Executive Secretary Stan Ulrich has undertaken, in collaboration with the Commission members, an exhaustive and compelling analysis of the California law of mechanic's liens and the multiple liability concerns facing consumers in

home improvement construction work. Mr. Ulrich's report for the Commission, *The Double Liability Problem in Home Improvement Contracts*, 31 Cal. L. Revision Comm'n Reports 281 (2001), is the definitive study of its kind on this complex issue. His insightful and balanced approach to solutions for this problem has been a lodestar for our work. Mr. Ulrich's major contribution here is only the most recent exemplar of the rare blend of scholarship and policy acumen he has brought to thirty years of public service to the Law Revision Commission and to California.

As with all the reports from the Monitor's project, the views in this report are those of the Monitor and his colleagues only, and not necessarily those of any other public or private sector contributor.

Thomas A. Papageorge  
Julianne D'Angelo Fellmeth

# EXECUTIVE SUMMARY

## INTRODUCTION

This Executive Summary provides an overview of the developments and recommendations presented in the Second Report of the Contractors State License Board Enforcement Monitor.

The Contractors State License Board Enforcement Program Monitor (the Monitor) was established by Senate Bill 2029 (Figueroa), legislation resulting from the 1999–2000 sunset review of the Contractors State License Board (CSLB) undertaken by the Joint Legislative Sunset Review Committee.

This Executive Summary presents the essential findings of the Report using the following organizational scheme:

- **Introduction**
- **Contractors State License Board Developments**
- **Recommendations on Consumer Remedies**
- **Conclusion**

## CSLB DEVELOPMENTS

### A. The Initial Report of the CSLB Enforcement Program Monitor

After a five-month study that included 81 interviews, a thorough review of CSLB statistical data and fourteen previous analyses of its enforcement program, and collaboration with fellow consultant Ben Frank of NewPoint Group in analyzing the deleterious impacts of the Board’s calamitous 1999 “reengineering” experiment, the CSLB Enforcement Program Monitor published his Initial Report on October 1, 2001. That 140-page report contains numerous findings and 33 initial recommendations that may be summarized under the following nine headings: CSLB mission and mandate; CSLB resources; CSLB management structure and information systems; contractor screening; complaint handling; investigations; prosecutions; public disclosure and outreach; and consumer remedies.

## **B. CSLB's Response to the Monitor's Initial Recommendations**

At its October 2001 meeting, CSLB agreed to support or support in concept (and to study budget implications of) every one of the Monitor's 33 recommendations, and Board staff initiated action to implement many of them.

## **C. Impacts of the State Hiring Freeze**

The Board's efforts to implement some of the Monitor's recommendations were hampered by the statewide hiring freeze ordered by Governor Davis on October 23, 2001. With the strong support of the Monitor (Appendix A), the Board requested waivers from the freeze for its many enforcement program vacancies; to date, those requests have not been acted upon. As such, the 19% vacancy rate in the Board's line investigator positions remains, and CSLB has been able to make little progress in ameliorating the unsatisfactory delays, long cycle times, and huge backlogs in its complaint handling, investigation, and prosecution processes that were identified in the Monitor's Initial Report.

## **D. CSLB's December 2001 Sunset Hearing**

At a December 2001 hearing of the Joint Legislative Sunset Review Committee, JLSRC Chair Senator Liz Figueroa expressed support for the Board's current direction and indicated her intent to carry a sunset bill containing at least four provisions recommended by the Monitor and supported by the Board: (1) an extension of CSLB's existence with a clear consumer protection mandate; (2) a license fee increase to support CSLB's enforcement program and ensure an adequate reserve fund; (3) a fingerprinting requirement for new CSLB licensure applicants; and (4) a requirement for consistent annual enforcement reporting by CSLB. Senator Figueroa also requested that the Enforcement Monitor focus heavily on the consumer remedies issue for the required April 2002 report, such that the Monitor's recommendations in this area might be included in 2002 legislation.

## **E. Update on Selected Issues Highlighted in Initial Report**

As noted, the state hiring freeze has precluded CSLB from filling its enforcement program vacancies and from making a meaningful dent in its complaint and investigation backlogs and from cutting the excessive caseloads and cycle times that have typified its complaint handling for 30 years. However, the Board has been able to implement some of the Monitor's initial



recommendations, and the Board and the Monitor have collaborated to fashion concepts for several legislative provisions that will be included in CSLB's sunset and other legislation during 2002:

**CSLB mission and mandate.** The Monitor has drafted proposed legislation (Appendix B) amending Business and Professions Code section 7000.5 (CSLB's four-year sunset extension) and adding new section 7000.6, which will clarify CSLB's consumer protection priority.

**CSLB resources.** The Monitor has drafted proposed legislation (Appendix C) increasing the statutory caps on CSLB's various licensing fees by approximately 20%, and authorizing the Board to set actual fees by regulation through the Administrative Procedure Act rulemaking process. Both the Board and industry representatives with whom we have spoken support the proposed fee increase, so long as it is used to improve CSLB's enforcement program. The Monitor has also drafted proposed legislation (Appendix D) increasing the permitted level of CSLB's reserve fund from three months of operating expenses to six months of operating expenses.

**Management structure and information system.** During the past six months, CSLB Registrar Sands promoted longtime enforcement manager David Fogt to Enforcement Chief; rearranged the enforcement program's organizational chart so that all enforcement units report directly to Fogt; named CSLB veteran Paige Roush to direct the Board's Intake/Mediation Centers (IMCs) statewide; restructured the Board's investigations hierarchy; and reassigned several managers to new units. The Monitor has drafted proposed legislation (Appendix E) requiring consistent annual reporting of CSLB enforcement data in a variety of areas.

**Licensing system and requirements.** In the past six months, the Monitor, CSLB staff and Board members, and industry have made progress in addressing changes to two aspects of the Board's processing of license applications — criminal history verification and experience verification. The Monitor has drafted proposed legislation (Appendix F) requiring applicants for new CSLB licenses and registrations to submit fingerprints to enable accurate criminal history verification. A fingerprinting requirement will not change the substantial body of existing law governing CSLB's use of criminal convictions in licensing and enforcement decisionmaking, and it will not affect the vast majority of legitimate applicants who truthfully complete their applications. It will simply and finally enable CSLB to detect those who lie about their criminal histories on their applications. The Monitor has also drafted proposed legislation (Appendix G) authorizing CSLB to access employment information from the Employment Development Department, enabling CSLB to more efficiently and effectively investigate and verify experience claimed on licensure applications.

**Complaint handling.** During 2001, CSLB management instituted a number of “quick fix” changes in complaint processing to eliminate unnecessary work steps and documentation requirements, and to increase staff productivity at the Board’s IMCs. January 2002 statistics indicate that these steps appear to be having their intended effect. Additionally, CSLB’s Enforcement Analytical Support & Training (EAST) unit is formulating a Consumer Services Representative training program as suggested by the Monitor.

**Investigations.** The Monitor’s October 2001 Initial Report revealed a 19.7% vacancy rate in the Board’s line investigator positions, causing excessive investigator caseloads, unsatisfactory cycle times, and massive case backlogs. The state hiring freeze has exacerbated these problems, and the persistent vacancy rate continues (reaching crisis proportions in the Board’s Bay Area offices). CSLB investigators carry an average of over 50 cases each; over 52% of the Board’s cases under investigation are over 180 days old (which is contrary to Business and Professions Code section 7011.7, which requires CSLB to establish a goal of processing routine cases within 180 days).

As suggested by the Monitor, CSLB has begun to develop plans to improve investigator training and promote better case coordination with local and state prosecutors, in part through cooperation with the California District Attorneys Association. Additionally, CSLB has ended required “home-officing” for investigators and has taken steps to ensure that only investigators who are properly trained, performing well, and have a home environment that is conducive to efficient and effective performance are afforded the home-officing privilege.

**Arbitration.** CSLB administers both a Mandatory Arbitration Program (MARB) for disputes worth less than \$5,000 and a Voluntary Arbitration Program (VARB) for disputes over amounts between \$5,000 and \$50,000. CSLB is sponsoring SB 2019 (Figueroa) to increase the limit of its mandatory arbitration program to \$7,500 (and correspondingly change its VARB limits to disputes ranging between \$7,500 and \$50,000). Although the Monitor has not had an adequate opportunity to study the impact of this proposed change, it appears reasonable and may in fact result in the referral and resolution of more cases than would otherwise be possible in light of the existing hiring freeze. The Monitor plans future work on several arbitration-related issues, including: (1) the use of outside contractors and agencies to handle CSLB arbitrations; (2) the connection between arbitration and the contractor’s bond; and (3) possible regulatory clarification to preclude abuse of the arbitration system by repeat or egregious offenders.

**Prosecutions.** In his Initial Report, the Monitor made a series of recommendations aimed at promoting statewide consistency in case referral criteria; improving and standardizing cooperation between CSLB and state and local prosecutors involved in administrative, civil, and criminal prosecutions; and enhancing enforcement of certain “indicator” violations that may portend impending insolvency or large-scale fraud. These recommendations are the subject of ongoing communications between the Board and the Attorney General’s Office, and will be the subject of future Monitor attention.

**Public disclosure and outreach.** CSLB is preparing to implement SB 135 (Figueroa) (Chapter 494, Statutes of 2001), a Board-sponsored bill that — effective July 1, 2002 — permits disclosure of serious complaints that have been referred for investigation after a determination by Board enforcement staff that a probable violation has occurred; the disclosure must be accompanied by a disclaimer indicating that the complaint is still an allegation. Additionally, CSLB has adopted regulations requiring contractors to disclose whether they carry general liability insurance and to provide consumers with a checklist of items that should be considered in evaluating a home improvement contract. Finally, CSLB has revamped its Web site format to conform to the state’s standard template.

**Consumer remedies.** As noted above, JLSRC Chair Figueroa requested in December 2001 that the Monitor devote the bulk of this report to the consumer remedies issue — an area that has long vexed policymakers, consumers, and industry. A detailed analysis of numerous consumer remedies and a package of proposed legislation to address this critical area is outlined below.

**Summary of concerns.** In his Initial Report, the Monitor noted that a review of fourteen previous studies of CSLB, our own independent inquiry, and recent consumer surveys which indicate that only 54% of responding consumers are satisfied with the Board’s performance together yield very serious concerns about CSLB’s overall enforcement performance. Specifically, long cycle times for complaint handling and investigations, excessive backlogs for CSRs and investigators, and internal inconsistencies and non-uniformity in complaint handling, investigations, and prosecutions practices are problems that have plagued this agency for thirty years, and nothing the Board has tried to date has adequately addressed them.

The good news is that CSLB is governed by a conscientious Board which has demonstrated unprecedented support for public protection and implementation of the Monitor’s October 2001 recommendations, and staffed by a new Registrar and Chief Deputy Registrar who have made impressive strides in undoing the harmful effects of the prior administration’s reengineering project,

a new Enforcement Chief and upper enforcement management who have rededicated themselves to improving all aspects of this program, and 450 employees all over the state who are finally enjoying some semblance of stability after years of turmoil.

The bad news is that the state's continued hiring freeze is destroying the momentum that accompanied this agency's reception of the Monitor's October 2001 recommendations and frustrating enforcement staff who continue to devote their talents, skills, and experience to CSLB. In the short term, the Monitor urges that CSLB's enforcement positions be exempted from the hiring freeze to enable this Board to carry out the wishes of the Legislature and the Davis Administration in creating the Enforcement Program Monitor position. In the longer term, the Monitor hopes for constructive consideration of the draft legislation contained in this Second Report, which — we believe — will enhance consumer protection without unduly burdening CSLB licensees.

## **RECOMMENDATIONS ON CONSUMER REMEDIES**

### **A. The Problem of Inadequate Consumer Remedies**

**Scope of the problem and inadequacy of present consumer remedies, generally.** Each year, California consumers file complaints with CSLB involving allegations of enormous aggregate losses from unscrupulous or incompetent contractors. Estimates of annual consumer loss — measured as the value of complaints to CSLB each year — range from \$60 million to \$100 million. This estimated dollar value of harm almost certainly understates the actual consumer loss, as many consumers do not know to file formal complaints with CSLB, or choose not to do so.

The principal Licensing Law vehicles for consumer relief — the \$7,500 contractor's bond (\$10,000 for swimming pool contractors) and the \$2,500 capitalization requirement — are clearly insufficient for truly substantial fraud, abandonment, or incompetence cases. The surety bond of \$7,500 required of most contractors offers no realistic prospect of recovery for many cases of consumer loss, including all the most serious cases of such loss, because of: the limited amount of the bond; the superior knowledge and experience of industry claimants; and a difficult and burdensome payout process. Civil litigation remedies are generally little better for consumer victims, both because of the expense and difficulty of the civil litigation process, and because many of the most serious contractor cases involve judgment-proof defendants.

The overwhelming majority of experts we have consulted from CSLB, the Legislature, law enforcement agencies, consumer groups, and the construction industry believe that the present remedial provisions fail — more often than not — to adequately protect the consumers whose interests are CSLB's prime mandate.

Reform of consumer remedies is an issue of great complexity, and has been the subject of numerous studies over a period of years. Virtually everyone agrees that the time for lengthy debate is past: Consumer remedies today are inadequate and the status quo is unacceptable. Concrete proposals for solutions should be the subject of legislation during the present session.

The two most prominent features of the consumer remedies problem concern are (1) the issue of double payments (implicating issues of mechanic's lien rights and third-party claims on consumers), and (2) the issue of inadequate consumer restitution (insufficient redress or recovery for consumer harm and losses associated with improper contractor conduct).

**The remedies problem: double payments.** Construction consumers face a problem of potential double payments when they have already paid unscrupulous, incompetent, or failing contractors who have not paid subcontractors, material suppliers, and laborers. These third parties to the contract between the homeowner and the prime contractor often make demands from the consumer for duplicative payments, which demands are backed by the payment rights conferred by the mechanic's lien law and the stop notice process.

If the prime contractor fails to pay — for reasons which can include dishonesty, financial problems, or mistake — the subcontractor or supplier generally demands payment from the owner, backed by the threat of a lien claim filed under the mechanic's lien law which will cloud title to the owner's property. Many, and probably most, homeowners opt to pay a second time rather than risk title problems or engage in a lengthy and costly legal dispute.

Extrapolations based on CSLB staff studies suggest an estimated 5,600 cases per year involving double payment or lien issues statewide. The Monitor concludes that the double payment problem occurs frequently each year, and works a substantial hardship on many California consumers.

**The remedies problem: consumer restitution.** Consumers are often frustrated by the limited mechanisms available to compensate them for monetary losses, damages, or needed repairs when a contractor fails to perform properly. Today, consumer restitution is at best modest in amount and disproportionately difficult to obtain; at worst, it is entirely unavailable.

Although the majority of consumer complaints to CSLB involve individual claims of less than \$7,500 in amount, cases involving multiple complaints or large-scale projects must almost immediately exhaust the modest \$7,500 bond amount. Thus for the more serious cases of consumer harm, there is an extremely low ceiling of available consumer restitution. When a large-scale contractor fraud, abandonment, or bankruptcy occurs — such as the Crown Builders case in San Diego involving losses to at least 70 families of between \$50,000 and \$130,000 each — the contractor’s single \$7,500 bond provides very little prospect for restitution.

Based on limited existing data, the Monitor estimates that only a small percentage (likely to be much less than 25%) of the \$60–\$100 million in annual consumer complaints to CSLB is satisfied by existing remedies.

### **Principal consumer remedies mechanisms today:**

**The \$7,500/\$10,000 contractor’s license bond.** Business and Professions Code section 7071.5 *et seq.* requires contractors to post a \$7,500 “contractor’s bond” (\$10,000 for swimming pool contractors) ostensibly to protect consumers and subcontractors, material suppliers, and others who are victimized by the misconduct of a contractor. Unfortunately, the overall impact of the bond process in remedying consumer harm is less than satisfactory. The current license bond amount is generally inadequate to cover many or most consumer claims, and the bond recovery process is complicated and cumbersome for the vast majority of consumer claimants.

Although substantial consumer benefits clearly result from the bonding process today (including both bond payouts and surety company efforts at dispute resolution), many consumer losses go unrecompensed. For the contractor bonding process to be a better mechanism to ensure recovery for any intended beneficiary, changes in the amount, type, and collection criteria concerning contractor’s bonds may be required.

**The capitalization requirement.** The License Law requires CSLB licensure applicants to demonstrate “financial solvency” in the amount of \$2,500. This amount — established in 1979 and unchanged in 23 years — is not meaningful as an indicator of financial capacity or solvency in 2002, when \$2,500 is not likely to cover the smallest litigated claim.

**Commercial general liability insurance.** Although commercial general liability insurance offers important protections against certain types of consumer harm, it does not address the most frequent and pressing forms of consumer harm, including the double payment problem and the inadequacy of restitution for improper conduct.

## **B. Criteria for Evaluating Consumer Remedies Proposals**

The Monitor has evaluated all consumer remedies alternatives using the following four criteria:

- 1. Efficacy** — The impact or effectiveness in resolving the double payment and consumer restitution aspects of the remedies problem.
- 2. Cost** — Costs to consumers, the affected industry groups, CSLB, law enforcement, and the judicial system.
- 3. Workability** — Issues relating to practical implementation of the proposed remedy.
- 4. Acceptability to Stakeholders** — Consideration of the legitimate needs and interests of all parties.

## **C. Monitor Recommendations for Improved Consumer Remedies**

The four Monitor recommendations together address both the double payment and consumer restitution aspects of the remedies problem. These recommendations focus primarily on improving remedies in the home improvement portion of the industry, which is the source of the large majority of CSLB complaints.

**Recommendation #34: Require a home improvement contractor’s bond for the exclusive benefit of consumers, as part of the home improvement contractor certification program (Appendix H).** This proposal would require a \$7,500 surety bond — separate from and in addition to the contractor’s license bond — which would be a condition of home improvement contractor certification, and thus mandatory for all contractors engaged in home improvement contracting. The home improvement contractor’s bond would be exclusively for the benefit of homeowners engaged in home improvements, and would be in addition to (but not duplicative of) any benefits obtained from other bonds required by the License Law.

The home improvement contractor’s bond would guarantee an increase in restitution available to consumers; reduce competition for existing license bond payouts; help professionalize the home improvement industry; and provide CSLB with a vehicle for consumer relief toward which it could direct consumer complainants.

**Recommendation #35: Provide homeowners a good faith payment defense against lien claims in home improvement contracts of \$25,000 or less (Appendix I).** This proposal would amend the existing mechanic's lien provisions of the Civil Code to protect homeowners in smaller home improvement projects from having to pay twice in circumstances where the homeowner has already paid the prime contractor in good faith. This proposal would work by establishing a defense against lien enforcement in home improvement contracts of \$25,000 or less where the homeowner has made the required good faith payments to the original contractor.

**Recommendation #36: Clarify the payment standard applicable to the contractor's license bond (Appendix J).** This proposal would amend the provisions of the License Law governing access to the contractor's license bond to clarify the standard of payment on those bonds. The proposal would ensure that these bonds are to benefit any person damaged as a result of a *willful* act in violation of the License Law, or by fraud, and would define "willful" consistently with the definition which governs most criminal and regulatory statutes, found in California Penal Code section 7. Specifically, Penal Code section 7 defines "willfully" as "a purpose or willingness to commit the act, or make the omission referred to. It does not require any intent to violate law, or to injure another, or to acquire any advantage."

The proposal would eliminate existing confusion and variations in surety company and contractor practices by eliminating the element of "deliberate" violation for all claimants governed by this subsection of section 7071.5. This is intended to assist subcontractors, suppliers, laborers, and others with a simpler and clearer payment standard. It is also intended as an indirect assistance to homeowners contracting for home improvement who, though ostensibly covered by subsection (a) of section 7071.5 (which does not require a "willful and deliberate" violation), still sometimes confront reluctance to pay on bonds in cases of allegedly non-deliberate violations.

**Recommendation #37: Provide a new lien expungement provision to assist consumers with unjustified and void liens (Appendix K).** This proposal would amend Civil Code section 3144, which presently limits the binding effect of liens to 90 days "unless within that time an action to foreclose the lien is commenced in the proper court" (except in cases of credit given), and voids lien claims which are not perfected in a timely fashion. This proposal would provide for automatic expungement of invalid and void liens from county property records. The primary goal of this modest change is to automatically clear title for innocent consumers without their having to suffer the burden and expense of taking legal action to remove invalid liens from public records.



## **D. Other Consumer Remedies Alternatives Considered**

Other consumer remedies alternatives considered by the Monitor and the reasons those remedies have been provisionally rejected or reserved for later consideration are considered in this section. Alternatives analyzed include:

### **■ Alternative Remedies Relating to Double Payment**

**Required payment bonding or performance/payment bonding**

**Required joint signature payments/joint control accounts/direct payment**

**Modifications to notices of lien rights (20-day notice practices)**

### **■ Alternative Remedies Relating to Consumer Restitution**

**Large increase in existing contractor's bond amount**

**Required continuous bonds**

**Step bonding**

**Substantial increase in contractor capitalization requirement**

**Consumer restitution recovery fund**

### **■ Other Remedial Alternatives**

**Mandatory commercial general liability insurance**

**Enhanced enforcement efforts**

## **E. Conclusion on Monitor Remedies Recommendations**

The status quo on consumer remedies is unacceptable and debate over change has been interminable. Leaders in the California Legislature have told us the time to act is now. All industry participants should contribute to an improved remedial process, recognizing that a balanced and moderate approach can distribute the burdens fairly and preserve what is vital for all parties.

This package of proposals meets all reasonable criteria for viable improvements in consumer remedies, including efficacy, cost, workability, and reasonable acceptability to all parties. The proposals focus on home improvement, where the majority of the problems and complaints arise. The proposals would work synergistically, reinforcing one another and together improving both the double payment and the consumer redress concerns.

Given that change is on the horizon, these proposals offer a reasonable prospect for all industry stakeholders, including consumers, prime contractors, subcontractors, suppliers, the surety industry, CSLB, and law enforcement. Viewed as a whole, the aggregate effect of these proposals is a significant improvement in consumer redress and freedom from harms associated with contractor misconduct, which improvement avoids unacceptable new costs or burdens for the construction industry.

## **CONCLUSION**

This report presents the two fundamental conclusions of the Monitor:

**CSLB's enforcement system is now headed in the right direction but cannot truly improve until it receives the necessary resources and statutory tools.** CSLB and its management and staff have succeeded in dramatically altering the direction of the agency's enforcement program. At the direction of CSLB's public-spirited Board, new Registrar Stephen Sands, Deputy Chief Linda Brooks, newly appointed Enforcement Chief David Fogt, and their colleagues have fully embraced all 33 recommendations presented by the Enforcement Monitor in his Initial Report, and have added important new system improvements of their own. The Monitor is entirely satisfied that CSLB is headed into a new era of effective law enforcement and public service.

But this new direction can only meet with success if CSLB receives the resources which are absolutely essential to getting this job done. These resources include immediate approvals for limited but vital law enforcement hiring, and changes to its statutory authority which will permit CSLB to increase fees modestly to improve its enforcement program and to implement critical law enforcement tools such as fingerprinting for accurate criminal history verification of prospective licensees.

**Consumer remedies for contractor misconduct are woefully inadequate, but the legislative proposals in this report can provide substantial improvements which should be**

**acceptable to all industry participants.** Almost no one is satisfied with the remedies available to California homeowners today, who too often face the problems of double payments for home improvements and inadequate consumer restitution in cases of contractor fraud or misconduct. The Monitor has presented a package of four interrelated legislative proposals which, taken together, hold out a genuine prospect for improving the remedies available to consumers in the home improvement context (the source of most contractor complaints). These remedies include a new home improvement contractor's bond exclusively for the benefit of homeowners, a new legal defense to protect homeowners from double payments in home improvement contracts, and related remedies.

All improvements of this kind involve a measure of cost and call for compromise among industry participants. But in the final analysis, *all* Californians are consumers of construction services, and *all* Californians — homeowners and contractors; consumers and businesspersons — are beneficiaries of a healthy, efficient, and ethical construction industry. Improvements to consumer welfare in this industry should be important to everyone, and improved professionalism is beneficial not only to consumer-customers but to every honest participant in the construction industry.

The Monitor urges all those who work with or within the construction industry to set aside differences and work together constructively to identify and support changes which will help move this industry to a higher level of professionalism and public service.



# Chapter I

## INTRODUCTION

This is the second report of the Contractors State License Board Enforcement Program Monitor, as mandated by Senate Bill 2029 (Figueroa). This report, and all the Monitor's efforts, are completed under the direction of Department of Consumer Affairs Director Kathleen Hamilton.

This report responds directly to the requirement of Senate Bill 2029, as further articulated by Senator Figueroa, Assembly Member Correa, and others in hearings of the Joint Legislative Sunset Review Committee, that the Enforcement Monitor make concrete recommendations for legislation to improve the CSLB enforcement program and to provide better remedies for California homeowners who are victims of improper contractor conduct.

This report meets these requirements by presenting:

(1) in Chapter III, a detailed update and analysis of developments at CSLB since the Monitor's initial 33 recommendations for improvement were made in the Monitor's Initial Report of October 1, 2001, with special emphasis on the six recommendations to be undertaken in current CSLB sunset legislation, including those relating to license fees increases to support better enforcement, fingerprinting of new license applicants, and other enforcement program improvements; and

(2) in Chapter IV, an analysis of the current problem of inadequate consumer remedies for contractor misconduct and the presentation of a package of four legislative proposals specifically aimed at improving consumer remedies in this industry, including recommendations for a new home improvement contractor's bond exclusively for the benefit of homeowners, and a new legal defense to protect homeowners from double payments in home improvement contracts.

As a healthy and ethical construction industry is important to all Californians, the Monitor calls upon all participants in this industry to join in a cooperative effort to improve construction industry professionalism and promote better service to the public.



## Chapter II

# STATUTORY MANDATE OF THE CSLB ENFORCEMENT PROGRAM MONITOR

The Contractors State License Board Enforcement Program Monitor (the Monitor) was established by Senate Bill 2029 (Figueroa), legislation resulting from the 1999–2000 sunset review of the Contractors State License Board (CSLB) undertaken by the Joint Legislative Sunset Review Committee.<sup>1</sup>

CSLB licenses contractors in the state of California and is charged with the responsibility of protecting the public by enforcing state laws governing contractor conduct. SB 2029, authored by Senate Business and Professions Committee Chair Liz Figueroa, required the Board to establish as a goal the improvement of its disciplinary system, which has been the subject of extensive legislative debate and substantial critical commentary in recent years.<sup>2</sup>

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<sup>1</sup> Cal. Stats. 2000, ch. 1005, approved by Governor Davis September 29, 2000.

<sup>2</sup> See Arthur Andersen & Co., *Report on Management Review of Operations and Personnel Requirements* (1973); Department of Finance, *A Review of the Investigatory Function and Measurement of Productivity of the Contractors State License Board* (1975); Office of the Auditor General, *Contractors State License Board: Need for Improved Administration of the Complaint Processing Program* (1979); Department of Finance, *Report on the Joint Department of Finance/ Contractors State License Board Field Operations Task Force on Complaint Handling* (1980); Department of Finance, *Zero-Based Budget Study* (1982); Price Waterhouse, *Management Review of the Contractors State License Board* (1984); Price Waterhouse, *Report on Interim Workload and Staffing Standards for the Contractors State License Board* (1985); Arthur Young, *Contractors State License Board: Final Report on Field Office Operations, Workload Standards, and Staffing Requirements* (1989); Assembly Consumer Protection Committee Report (1993) (CSLB “critically deficient in protecting consumers from unscrupulous or unqualified contractors”); Joint Legislative Sunset Review Committee, *Contractors’ State License Board: Board Overview, Issues, Findings and Recommendations* (1997); Price Waterhouse, *Transition Review of the California Contractors State License Board* (1998); Joint Legislative Sunset Review Committee, *Contractors’ State License Board: Joint Legislative Sunset Review Committee 2000 Sunset Review Report* (2000); Bureau of State Audits, *Department of Consumer Affairs: Lengthy Delays and Poor Monitoring Weaken Consumer Protection* (2000); NewPoint Group, *Contractors State License Board: Reengineering Project Assessment* (2001).

Effective January 1, 2001, SB 2029 provided for:

- Extension of CSLB’s sunset date to January 1, 2004;
- Expansion of the Board’s membership from 13 to 15, and a concomitant increase in the Board’s quorum from seven to eight;
- A series of four studies to be conducted by the Board (including studies of home equity lending fraud, the impacts of its recent “reengineering” plan, recovery fund programs, and surety bonds) plus a review of its complaint disclosure policy; and
- The appointment of the CSLB Enforcement Program Monitor for a two-year term ending January 31, 2003.

In Business and Professions Code section 7092, SB 2029 provided for the appointment and authority of the Monitor, and established the Monitor’s duty to “monitor and evaluate the Contractors’ State License Board discipline system and procedures, making as his or her highest priority the reform and reengineering of the board’s enforcement program and operations, and the improvement of the overall efficiency of the board’s disciplinary system.”<sup>3</sup>

The Monitor is specifically instructed to direct his efforts to:

- Improving the quality and consistency of complaint processing and investigation, and reducing the time frames for each;
- Reducing any complaint backlog;
- Assuring consistency in the application of sanctions or discipline imposed on licensees; and
- Further addressing: the accurate implementation of disciplinary standards, staff concerns regarding discipline, utilization of licensed professionals to investigate complaints, and the board’s cooperation with other law enforcement agencies.<sup>4</sup>

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<sup>3</sup> Bus. & Prof. Code § 7092(c)(1).

<sup>4</sup> *Id.* at § 7092(c)(2).



The Monitor is required to submit a series of four reports of his findings and conclusions, including an initial report on October 1, 2001, and three subsequent reports at six-month intervals. The reports are to be submitted to the Board, the Department of Consumer Affairs, and the Legislature, and are to be made available to the public and the media.<sup>5</sup>

Department of Consumer Affairs Director Kathleen Hamilton appointed the Monitor on April 5, 2001. The Monitor selected Julianne D'Angelo Fellmeth as principal consultant, and work began immediately on the Monitor project.

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<sup>5</sup> *Id.* at § 7092(d).



## Chapter III

# CONTRACTORS STATE LICENSE BOARD DEVELOPMENTS

### A. October 1, 2001 Initial Report of the CSLB Enforcement Monitor

After a five-month study that included 81 interviews, a thorough review of CSLB statistical data and fourteen previous analyses of its enforcement program,<sup>6</sup> and collaboration with fellow consultant Ben Frank of NewPoint Group in analyzing the deleterious impacts of the Board's calamitous 1999 "reengineering" experiment, the CSLB Enforcement Program Monitor published his Initial Report on October 1, 2001.<sup>7</sup> That 140-page report contains numerous findings and 33 initial recommendations that may be summarized under the following nine headings:

■ **CSLB mission and mandate:** The Monitor recommended that Business and Professions Code section 7000 be amended to state clearly that consumer protection is the first priority of CSLB, and suggested the Board consider adopting a modernized version of its name (*e.g.*, "Contractors Board of California") to more accurately describe the modern licensing *and* enforcement mission of the agency.

■ **CSLB resources:** The Monitor proposed an increase in CSLB licensing and renewal fees (which have remained unchanged since 1994) by approximately 20% to restore CSLB budget and enforcement resources to 1994 per capita levels and to ensure a sufficient reserve fund.

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<sup>6</sup> See *supra* sources cited in Chapter II, n. 2.

<sup>7</sup> Papageorge and Fellmeth, *Initial Report of the CSLB Enforcement Program Monitor* (Oct. 1, 2001) (hereinafter "*Initial Report*") (available at [www.cpil.org](http://www.cpil.org)).

■ **CSLB management structure and information system:** The Monitor suggested that CSLB fill key vacant enforcement management positions, including the enforcement chief position and other senior enforcement positions; rebuild the enforcement program's organizational structure to correct the problems caused by the reengineering project of 1999–2000 (including rebuilding of the enforcement organization on a functional basis with appropriate spans of control); reallocate field resources to better reflect the pattern of demand for consumer services (including opening offices in areas of high demand such as the San Fernando Valley and south Orange County); and ensure consistent annual statistical reporting by the CSLB enforcement program by sponsoring legislation to establish a new statutory mandate for such reporting.

■ **Contractor screening:** To ensure adequate criminal history verification of licensure applicants, the Monitor recommended legislation requiring fingerprinting, and suggested that the Board expand the use of criminal conviction information in licensing and enforcement decisionmaking. The Monitor also proposed to expand the flow of information on contractor misconduct into CSLB by seeking enactment of mandatory reporting statutes and by requiring license renewal reporting of relevant criminal convictions; and suggested that the Board improve its system of experience verification for licensure applicants.

■ **Complaint handling:** The Monitor suggested that CSLB increase its Consumer Services Representative (CSR) staff to reduce caseloads to manageable levels and enable CSRs to perform more actual case mediation; institute comprehensive CSR training, including clear statewide case handling standards and restored interaction with investigators; improve and fully computerize the internal alert system to ensure a rapid and coordinated response to major and repeat offender cases; greatly expand early resolution/mediation efforts made during the first 30 days of complaint processing; improve the telephone information system for complainants to promote prompt access to staff, and improve the consumer complaint form to promote understanding and ease of use; and eliminate career ladder barriers for CSRs and Program Technicians.

■ **Investigations:** Recognizing an extraordinary 19.7% vacancy rate in CSLB's investigator positions, the Monitor recommended that CSLB fill all vacant Enforcement Representative (ER) positions and further increase its ER staff so as to reduce heavy investigative caseloads and staff two or more "major fraud" strike forces (each with peace officers assigned) for rapid deployment on major cases. The Monitor further suggested that CSLB increase its peace officer staff from three to a minimum of 8–10 to improve criminal and civil investigative capabilities; improve and regularize investigator training, with greatly increased emphasis on criminal and civil enforcement investigation techniques; ensure early investigation coordination with state and local prosecutors in

appropriate cases; restore sufficient office facilities for investigators for interviews, meetings, and cooperation with colleagues, and reevaluate and apply “home-officing” only on an individualized basis; and conduct a new workload standards study to update its workload standards for investigators to reflect the changed nature and increased complexity of current casework.

■ **Prosecutions:** The Monitor suggested that CSLB establish more consistent statewide case referral criteria to improve enforcement uniformity, and monitor referral patterns to ensure improved compliance; improve and standardize cooperation between CSLB enforcement staff and state and local prosecutors involved in administrative, criminal, and civil prosecutions; conduct a study of the present pattern of disciplinary bonds and initiate necessary action to ensure that disciplinary bond amounts are sufficient to promote public safety; work with the Attorney General’s Office to improve prosecution of key aspects of contractor fraud and abuse, especially excessive down payments (Business and Professions Code section 7159), qualifiers on revoked/suspended licenses (Business and Professions Code section 7121.5), and employment of unlicensed executives (Business and Professions Code section 7121); and promote increased use of judicial revocation of contractor licenses by educating judges and prosecutors regarding the authority provided by Business and Professions Code section 7106 and Penal Code section 23.

■ **Public disclosure and public outreach:** The Monitor urged the Governor to sign then-pending SB 135 (Figueroa), which would improve CSLB’s public disclosure of complaints and disciplinary actions against contractors. The Monitor also recommended that CSLB determine the feasibility of disclosure of public information such as criminal convictions, civil judgments, and bankruptcies; simplify and clarify its Web site by explaining technical terminology and providing more user-friendly access to complaint information; add appropriate information to its Web site regarding unlicensed contractors with substantial numbers of complaints or actions; add a Web site link to Better Business Bureau Web sites (with an appropriate disclaimer that CSLB does not approve, endorse, or take responsibility for information at those sites); and promote the fraud alert system by increasing the use and visibility of the system for alerting other law enforcement agencies and the public.

■ **Consumer remedies:** The Monitor recommended that CSLB increase its existing contractor’s bond amount (\$7,500 for most contractors; \$10,000 for swimming pool contractors) to a realistic contemporary level (a minimum of \$15,000); revise bonding and/or payment requirements for home improvement projects to address “double payment” and mechanic’s lien problems (including either required payment bonds for home improvement projects in excess of \$10,000, mandatory joint control or joint signature payments, or a similar alternative); and promote consumer

enforcement of legal limits on excess down payments by requiring a clear and conspicuous consumer disclosure on all home improvement contracts regarding maximum down payments pursuant to Business and Professions Code section 7159(d).

## **B. CSLB's Response to the Monitor's Initial Recommendations**

Consistent with their record of cooperation with this project, CSLB staff began work to implement many of the Monitor's recommendations even before the official release of the Monitor's October 1 report. During the summer of 2001, CSLB staff formulated and submitted budget change proposals (BCPs) to permit the agency to fill key enforcement management positions, rebuild the enforcement program's organizational structure to correct the problems caused by the disastrous reengineering project, and open district offices in areas of high consumer demand.<sup>8</sup>

Additionally, CSLB implemented the Monitor's Recommendation #3 by commencing the hiring process to fill the long-vacant Enforcement Chief position, and part of Recommendation #4 by revamping the organizational structure of its enforcement program so that all enforcement-related areas report to the Chief, who in turn reports to the Chief Deputy Registrar and the Registrar.<sup>9</sup> On October 9, CSLB Registrar Steve Sands announced the appointment of longtime CSLB enforcement manager David Fogt as Enforcement Chief. Fogt's knowledge of and experience with this agency will serve him well in this position.

On October 12, CSLB's Enforcement Committee met to discuss the Monitor's report and recommendations. After extended discussion, the Committee voted to recommend to the Board full support or support in concept (and study of budget implications) for every one of the Monitor's 33 recommendations. At its October 23, 2001 meeting, the full Board approved the Enforcement Committee's recommendation. Among both Board and staff members, the momentum at CSLB had clearly shifted toward securing the tools needed to create an effective, efficient, and decisive enforcement system.

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<sup>8</sup> All of these BCPs were later denied.

<sup>9</sup> CSLB's efforts to implement another component of Recommendation #4 — to supplement its investigative supervisors so as to ensure adequate program supervision and reasonable spans of supervisory control — have been thwarted by the hiring freeze.

## C. The Impact of the State's October 23, 2001 Hiring Freeze

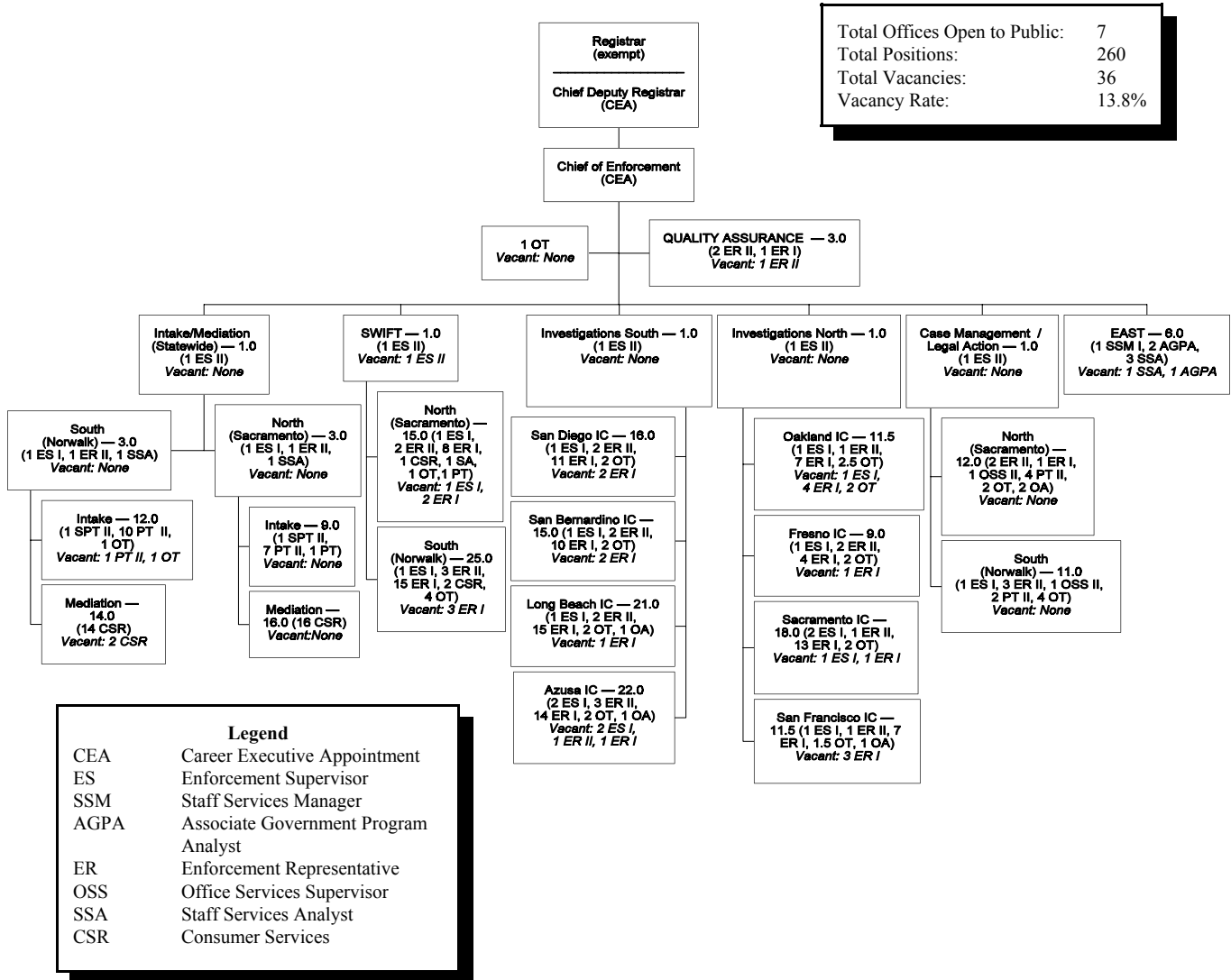
CSLB's momentum was short-lived. The combined effects of unexpected state expenditures for power and the economic slowdown and increased public safety expenses resulting from the tragic events of September 11 wreaked havoc on California's 2001–02 budget. On October 23, 2001, Governor Davis responded to the state's severe general fund budget crisis by issuing Executive Order D-48-01, which ordered an immediate statewide hiring freeze. According to the Order, "when businesses are faced with declining revenues and increasing expenditures, they take actions to reduce spending, and...the State of California must take similar actions without delay to ensure that it lives within its means." Thus, the Governor ordered that "[a]ll State agencies and departments, regardless of funding source, are prohibited from filling vacancies that would constitute a new hire to State Government."

Thus, although CSLB is a special-fund agency whose salary savings due to the freeze would not assist the general fund deficit whatsoever, it was required to cease its efforts to fill its many investigator and other critical enforcement program vacancies. In November 2001, CSLB initiated steps to obtain waivers from the hiring freeze in order to fill its existing ER (investigator) and ES (supervising investigator) positions throughout the state, and two office technicians for its Oakland district office so as to be able to keep that office open to the public.

On December 12, the Monitor submitted a letter in strong support of CSLB's request, noting that CSLB's exemption requests are limited to enforcement positions in the context of an ongoing two-year-long bipartisan legislative and executive branch effort to improve the law enforcement performance of this agency. In the Monitor's judgment, "this is not a routine agency request for hiring freeze relief, but rather an urgent plea for assistance made necessary by chronic enforcement problems at this agency, and by a pressing mandate from the Legislature and the Administration" (see Appendix A).

By February 15, 2002, CSLB's enforcement exemption requests had been approved by both the Department of Consumer Affairs and the State and Consumer Services Agency. However, at this writing, and despite the fact that waivers have been granted to other special-fund agencies, the Department of Finance has not yet acted on CSLB's requests. CSLB's March 2002 organizational chart (Exhibit III-A) indicates a 13.8% vacancy rate in CSLB's enforcement positions overall and a continuing 19.2% vacancy rate in its line investigator (Enforcement Representative I) positions (20 of 104 ER-I positions in Investigations and SWIFT vacant) — a staggering deficit. As a result,

the Oakland office was closed to the public on December 1, 2001,<sup>10</sup> and CSLB has been able to make little progress in ameliorating the unsatisfactory delays, long cycle times, and huge backlogs in its complaint handling, investigation, and prosecution processes that were identified in the Initial Report of the Monitor.



Source: Contractors State License Board, Enforcement Division Organizational Chart (March 28, 2002)

### Ex. III-A. March 2002 Enforcement Program Organization Chart

<sup>10</sup> On March 28, 2002, as this report was going to press, the Department of Finance notified CSLB that it has exempted the Board's two office technician positions in its Oakland Investigative Center from the hiring freeze. This will permit the Board to recruit, hire, and train two OTs to staff a reception counter so the Oakland office may be reopened to the public.



## D. CSLB's December 6, 2001 Sunset Review Hearing

On December 6, 2001, the Joint Legislative Sunset Review Committee (JLSRC), chaired by Senator Liz Figueroa, held a sunset review hearing to receive the five reports completed by the Board as a result of the mandate in SB 2029<sup>11</sup> and to review the Monitor's Initial Report and recommendations.

Following discussion of the Monitor's recommendations, JLSRC Chair Figueroa expressed support for the Board's current direction and indicated her intent to carry a sunset bill containing at least four provisions: (1) an extension of CSLB's existence with a clear consumer protection mandate; (2) a license fee increase to support CSLB's enforcement program and ensure an adequate reserve fund; (3) a fingerprinting requirement for new CSLB licensure applicants; and (4) a requirement for consistent annual enforcement reporting by CSLB. Those proposals (and others) are currently scheduled for inclusion in SB 1953 (Figueroa) and are discussed below.

In addition, Senator Figueroa requested that the Monitor focus heavily on the consumer remedies issue for the required April 1 report, such that the Monitor's recommendations in this area might be included in 2002 legislation. In both of its prior reviews of CSLB (1996–97 and 1999–2000), the JLSRC expressed extreme dissatisfaction about the lack of meaningful remedies for consumers who are victims of contractor fraud, incompetence, unworkmanlike performance, or abandonment.<sup>12</sup> In response to Senator Figueroa's request, Chapter IV of this report is devoted to an analysis of various options and a recommended package of reforms that we believe will significantly enhance consumer remedies without excessively burdening either the construction or surety industries.

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<sup>11</sup> Specifically, the Board complied with Business and Professions Code section 7021 by completing and submitting, respectively: *Home Equity Fraud and the Role of the Contractors State License Board* (section 7021(a)); *Contractors State License Board: Reengineering Project Assessment* (completed by the NewPoint Group in compliance with section 7021(b)); *Analysis of State Recovery Funds* (section 7021(c)); and *Using Surety Bonds and Insurance to Protect Consumers* (section 7021(d)). In compliance with section 7021(e), the Board conducted an analysis of its complaint disclosure policy and sponsored SB 135 (Figueroa) in 2001; that bill was signed by the Governor on October 4, 2001 (Chapter 494) and is discussed in section E.9 of this chapter.

<sup>12</sup> Joint Legislative Sunset Review Committee, *Final Recommendations of the Joint Legislative Sunset Review Committee and the Department of Consumer Affairs: Contractors State License Board* (April 11, 2000) at 6 (Issue #9); Joint Legislative Sunset Review Committee, *JLSRC Findings and Recommendations: Contractors State License Board* (April 1997) at 17. See *infra* Ch. IV ("Recommendations on Consumer Remedies") at subsection A ("The Problem of Inadequate Consumer Remedies").

## **E. Update on Selected Issues Highlighted in Initial Report**

As noted above, the hiring freeze and delayed action on CSLB's waiver requests have precluded CSLB from filling its many enforcement program vacancies. As such, CSLB has been prevented from making a meaningful dent in its complaint and investigation backlogs and from cutting the excessive caseloads and cycle times that have typified its case handling for almost 30 years (in fact, as is demonstrated below, the hiring freeze and continuing 19% vacancy rate in line investigator positions has severely worsened CSLB's investigator caseloads and cycle times). However, the Board has been able to implement some of the Monitor's initial recommendations, and we present an update on that progress below. Additionally, the Board and the Monitor have collaborated to fashion concepts for several legislative provisions that will be included in CSLB's sunset and other legislation during 2002; those provisions are also described below.

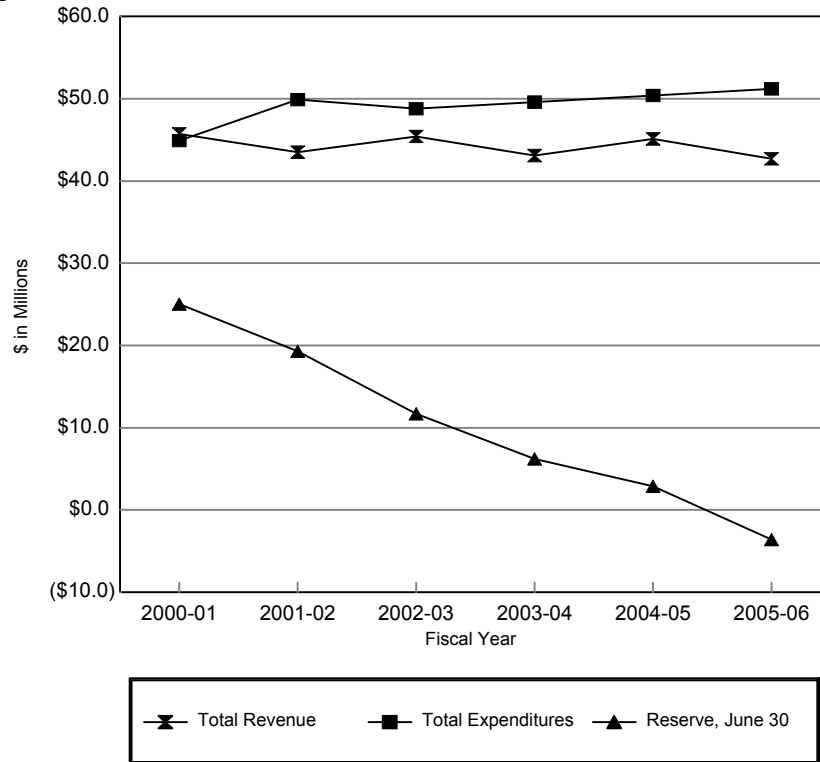
### **1. CSLB Mission and Mandate**

Consistent with the Monitor's Recommendation #1, CSLB has agreed to support legislation to clarify that consumer protection is its highest priority. This clarification of CSLB's mandate would be important both as a visible symbol of the agency's commitment to consumers, and as an aid to courts in interpreting the balance of the Contractors State License Law. Such a provision is included in AB 269 (Correa), an omnibus bill pertaining to all DCA boards. As amended January 18, 2002, AB 269 would add new section 7000.6 to the Business and Professions Code, which would state as follows: "Protection of the public shall be the highest priority for the Contractors' State License Board in exercising its licensing, regulatory, and disciplinary functions. Whenever the protection of the public is inconsistent with other interests sought to be promoted, the protection of the public shall be paramount."

CSLB and the Monitor support AB 269, and — to ensure enactment of that bill's CSLB-related language regardless of the fate of AB 269 — propose inclusion of identical language (in the form of new Business and Professions Code section 7000.6) in SB 1953 (Figueroa), the JLSRC's primary sunset legislation for CSLB. Additionally, the Monitor proposes a four-year extension of the Board's existence, which can be accomplished by amending Business and Professions Code section 7000.5(c) to extend CSLB's inoperative date to July 1, 2007. Draft language of proposed section 7000.6 and amendments to section 7000.5(c) is attached as Appendix B.

**2. CSLB Resources**

CSLB licensing and renewal fees have remained unchanged since 1994, resulting in an approximate 21.2% decrease (as of October 1, 2001) in CSLB resources based on the Consumer Price Index alone. The Monitor’s Recommendation #2 proposed an approximate 20% increase in CSLB license fees to restore CSLB budget and enforcement resources to 1994 per capita levels and to ensure a sufficient reserve fund. Business and Professions Code section 7138.1 requires the Board to maintain a reserve fund of approximately three months’ worth of operating expenses; Exhibit III-B below indicates, under reasonable assumptions, that unless a fee increase is enacted in 2002 (to become effective on January 1, 2003), CSLB’s 2002–03 reserve fund will dip to 2.9 months of operating expenses, and its 2003–04 reserve fund level will decline to only 1.5 months of operating expenses.



	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
<b>Total Revenue</b>	\$45.7	\$43.5	\$45.4	\$43.1	\$45.1	\$42.7
<b>Total Expenditures</b>	\$44.9	\$49.9	\$48.8	\$49.6	\$50.4	\$51.2
<b>Reserve, June 30</b>	\$25.0	\$19.3 (4.6 mos.)	\$11.7 (2.9 mos.)	\$6.2 (1.5 mos.)	\$2.9 (0.7 mos.)	(\$3.6)

Source: CSLB Staff

**Ex. III-B. CSLB Fund Condition Analysis 2002  
(No Fee Increase — Current Budget)**

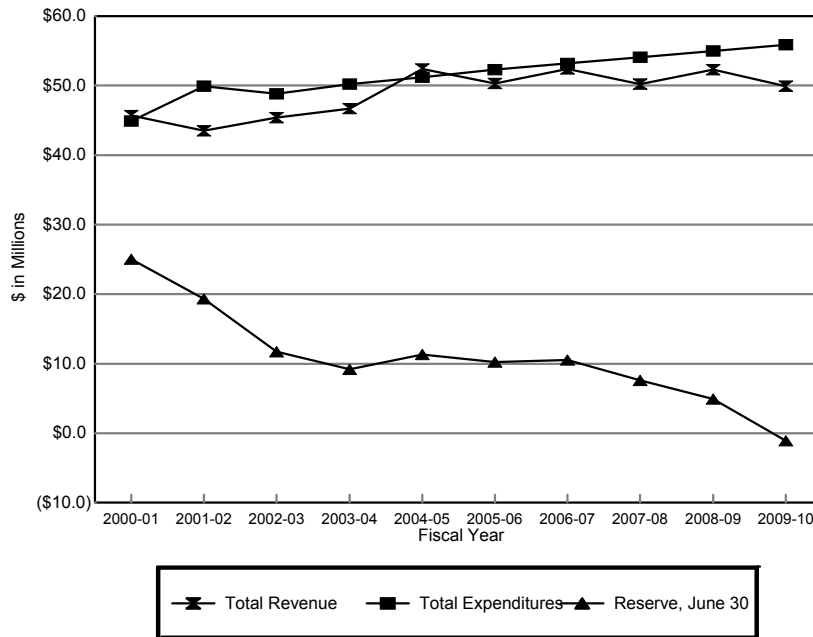
Absent a fee increase, CSLB will be forced to restrict its enforcement program in order to maintain the reserve fund level required by section 7138.1. As amply documented in the Monitor's Initial Report, CSLB's current enforcement program is inadequate from a significant number of perspectives; to minimally protect the public, its resources must be enhanced, not reduced. Further, the Legislature recently imposed a new consumer service mandate on CSLB in the form of Business and Professions Code section 7011.7, which now requires the Board to establish a goal to fully investigate routine case within six months and complex cases within one year. As described below, 52% of the cases pending in Investigations as of February 28, 2002 were over six months old. Even with improvements to its business processes, the Board has no realistic prospect of meeting this new mandate without a fee increase.

Although a proposed fee increase is a somewhat delicate subject considering the state's financial condition, this recommendation has received the important support of the Board and of several industry representatives with whom we have spoken. According to these representatives, industry largely supports a fee increase if it will be used to improve the Board's enforcement efforts against contractors who are tarnishing the reputation of the whole profession, unfairly competing with honest and legitimate businesses, or unlicensed.

Accordingly, SB 1953 (Figueroa) will include a proposed amendment to Business and Professions Code section 7137 to increase the legislative ceiling on most CSLB fees by approximately 20%. However, the legislation would also authorize the Board — for the first time — to establish its actual fees by regulation (which is common practice at many other DCA occupational licensing agencies but has not previously been done by CSLB). This mechanism would permit the Board to adjust its various fees under their statutory caps to meet its costs and enforcement needs through the Administrative Procedure Act rulemaking process<sup>13</sup> — which affords an opportunity for notice to and comment by industry and other interested parties. Exhibit III-C displays the Board's revenue, expenditures, and reserve fund level assuming an approximate 20% increase and implementation of the Monitor's recommendations that are the subject of draft legislative language in the appendices (including fingerprinting). Draft language of proposed amendments to section 7137 is attached as Appendix C.

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<sup>13</sup> Gov't Code § 11340 *et seq.*



	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Total Revenue	\$45.7	\$43.5	\$45.4	\$46.7	\$52.4	\$50.3	\$52.4	\$50.2	\$52.3	\$49.9
Total Expenditures	\$44.9	\$49.9	\$48.8	\$50.2	\$51.2	\$52.3	\$53.2	\$54.1	\$55.0	\$55.9
Reserve, June 30	\$25.0	\$19.3	\$11.7	\$9.2 (2.2 mos.)	\$11.3 (2.6 mos.)	\$10.2 (2.3 mos.)	\$10.5 (2.4 mos.)	\$7.6 (1.7 mos.)	\$4.9 (1.1 mos.)	(\$1.1)

Source: CSLB Staff

**Ex. III-C. CSLB Fund Condition Analysis:  
(Modest Enforcement Monitor Recommendations with 20% Fee Increase)**

Additionally, CSLB believes it needs some flexibility in its reserve fund total. As noted above, the Board is currently required to maintain a reserve fund of no more than three months' worth of operating expenses; a higher reserve fund theoretically triggers a required fee reduction or rebate. CSLB seeks to raise its reserve fund level to approximately six months' worth of operating expenses. This would provide stability in fee levels and prevent the Board from repeatedly having to adjust its fees through the time-consuming rulemaking process due to circumstances beyond its control. For example, the state recently borrowed \$5 million from CSLB's reserve fund to assist it in addressing the general fund deficit. If that \$5 million is repaid in one lump sum, it is likely to bump the reserve fund over the existing three-month level, thus requiring a refund or fee reduction. CSLB's proposal to increase the three-month threshold to six months is identical to a provision in SB 133 (Figueroa) (Chapter 718, Statutes of 2001) which adjusted the Board of Accountancy's

reserve fund from three to six months' worth of operating expenses.<sup>14</sup> We see no reason why CSLB should not be afforded the same treatment, and support the Board's proposal. Draft language of an amendment to section 7138.1 is attached as Appendix D.

### **3. Management Structure and Information System**

In his Initial Report, the Monitor made a series of recommendations related to filling the vacant Enforcement Chief and other senior management positions, to ensure appropriate leadership and accountability in the enforcement program. As noted above, CSLB promoted David Fogt to Enforcement Chief and restructured the enforcement program such that all enforcement units report to him — thus enabling him to provide clear leadership and resolve disagreements between different enforcement program areas. Additionally, CSLB Registrar Sands named Paige Roush to direct the Board's Intake/Mediation Centers statewide; this change will hopefully dissipate the “north vs. south” cultural disparities and inconsistencies that have historically typified CSLB complaint handling.<sup>15</sup> The Registrar also restructured the Board's Investigations hierarchy and reassigned several managers to new units. In November, CSLB lost longtime enforcement manager and SWIFT Chief Cruz Reyna to retirement, and has been unable to fill his position due to the hiring freeze.

As to CSLB's information management system, the Monitor commented that the Board collects an extraordinary amount of data; however, variations in the definitions and categories of enforcement program data collected over the years make it difficult — if not impossible — to conduct meaningful comparisons of CSLB's enforcement performance over time. To stimulate consistent annual enforcement reporting and “apples to apples” comparisons over time, the Monitor's Recommendation #6 suggested that the Board develop permanent definitions for various data categories and to establish in legislation a requirement for consistent annual reporting of these categories, similar to Business and Professions Code section 2313 applicable to the Medical Board of California.

With assistance from Board staff, we have developed draft language for consistent annual reporting which includes required reporting on number and types of complaints received and handled by the Board and its enforcement partners (the Attorney General's Office, the Office of Administrative Hearings, and local prosecutors to whom criminal cases may be referred), automatic license suspensions and revocations that are unique to CSLB, case aging data at all stages of CSLB

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<sup>14</sup> Bus. & Prof. Code § 5134(f).

<sup>15</sup> See *Initial Report*, *supra* note 7, at 47, 83.

complaint processing, information on “backlogged” cases over 180 days old, average caseloads of various categories of Board staff, and staff productivity measures. These reporting data also attempt to capture information on the incidence and Board handling of certain violations identified in the Monitor’s Initial Report as indicators of potential large-scale fraud and/or abusive practices by repeat offenders.<sup>16</sup> This draft legislation is attached as Appendix E.

#### 4. Licensing System and Requirements

In his Initial Report, the Monitor noted that licensing practices (which ostensibly control the screening and exclusion of fraudulent and/or incompetent contractors from the marketplace) greatly impact enforcement burden, and identified a number of concerns about CSLB’s licensing structure and its examination, criminal history verification, experience verification, bonding, and capitalization requirements.<sup>17</sup> In the past six months, the Monitor, CSLB staff and Board members, and industry have made progress in addressing changes to three of these requirements — criminal history verification, experience verification, and bonding. Our proposals regarding criminal history and experience verification are discussed below; bonding is part of the Monitor’s consumer remedies package discussed in Chapter IV.

**Criminal history verification.** For many years, CSLB has been authorized to deny and to discipline a licensee for conviction of a crime that is substantially related to the qualifications, functions, or duties of a contractor.<sup>18</sup> For just as many years, CSLB’s application form has requested information on prior criminal convictions. When applicants report prior convictions, a substantial body of existing law guides CSLB in determining the appropriate course of action. Section 868, Title 16 of the California Code of Regulations (CCR), sets forth an illustrative list of crimes the conviction of which is deemed to be “substantially related” to the qualifications, functions, and

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<sup>16</sup> In the Initial Report, we identified excessive down payments (Business and Professions Code section 7159), qualifiers on revoked/suspended licenses (section 7121.5), and employment of unlicensed executives (section 7121) as allegations indicative of serious problems and worthy of enhanced enforcement. See *Initial Report*, *supra* note 7, at 124–25.

<sup>17</sup> See *id.* at 74–78.

<sup>18</sup> Bus. & Prof. Code §§ 7069 (originally enacted in 1939) and 7123 (originally enacted in 1955); see also Bus. & Prof. Code § 480 *et seq.* (originally enacted in 1974 and applicable to all DCA agencies).

duties of a contractor.<sup>19</sup> Even if a contractor has committed one of the crimes enumerated in section 868, section 869 defines numerous criteria which — if satisfied — may demonstrate that a person with a criminal conviction has rehabilitated him/herself and is presently eligible for a license.<sup>20</sup> And section 870 sets forth the earliest date(s) at which a contractor whose license has been revoked (including revocation for a substantially related criminal conviction) may reapply for licensure.

Over the past many years in which this regulatory scheme has existed to guide CSLB discretion regarding the use of criminal conviction information, many applicants have truthfully reported prior convictions on their application forms. CSLB staff report that very few applications have been denied due to the convictions reported.

Unfortunately, other applicants have lied about their prior criminal history, and CSLB currently has no way of detecting these lies because it lacks the authority to require fingerprints of its license applicants. Some of these applicants have gone on to become licensees who have perpetrated massive frauds against the public. In his Initial Report, the Monitor discussed the Crown Builders matter in San Diego — the latest in what prosecutors say is a long line of cases in which a CSLB licensure applicant lied on his application about his criminal history, was given a

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<sup>19</sup> These acts include, but are not limited to, (a) a criminal conviction based on a violation of the Contractors State License Law; (b) submitting false vouchers to obtain construction loan funds and not using the funds for the purpose for which the claim was submitted; (c) willfully rebating to or on behalf of anyone contracting with a licensee, any part of money tendered the licensee for the provision of services, labor, materials, or equipment; (d) theft of building materials or equipment for use on a construction project; and (e) a criminal conviction based on failure to comply with Board's regulations in Chapter 8, Title 16 of the California Code of Regulations.

<sup>20</sup> When considering the denial of a license or registration, section 869 requires the Board to consider (1) the nature and severity of the act(s) or crime(s) under consideration; (2) evidence of any act(s) committed subsequent to the act(s) or crime(s) under consideration as grounds for denial which also could be considered as grounds for denial under section 480 of the Business and Professions Code; (3) the time that has elapsed since commission of the act(s) or crime(s) referred to in subdivision (1) or (2); (3) the extent to which the applicant has complied with any terms of parole, probation, restitution, or any other sanctions lawfully imposed against the applicant; and (5) evidence, if any, of rehabilitation submitted by the applicant.

When considering disciplinary action against a licensee or registrant based on a criminal conviction, section 869 requires the Board to consider the following criteria: (1) nature and severity of the act(s) or offense(s); (2) total criminal record; (3) the time that has elapsed since commission of the act(s) or offense(s); (4) whether the licensee has complied with any terms of parole, probation, restitution or any other sanctions lawfully imposed against the licensee; (5) if applicable, evidence of expungement proceedings pursuant to Penal Code section 1203.4; and (6) evidence, if any, of rehabilitation submitted by the licensee.



contractor's license by an unsuspecting CSLB, defrauded numerous families of substantial amounts of money, and disappeared.<sup>21</sup>

As a consumer protection agency charged with protecting the public, CSLB must be able to verify the identity of an applicant to whom it is giving a state occupational license, and the accuracy of criminal history information asserted on its application form. Fully 23 other DCA regulatory agencies (and many other non-DCA occupational licensing agencies) already use fingerprinting in connection with their licensing and/or enforcement activities.

A fingerprinting requirement will not change the substantial body of existing law governing CSLB's use of criminal convictions in licensing and enforcement decisionmaking, and it will not affect the vast majority of legitimate applicants who truthfully complete their applications. *It will simply and finally enable CSLB to detect the liars.* And it may deter individuals who would pose a substantial threat to the public from applying for a license. Such a requirement will protect the public without unduly burdening licensure applicants. New "LiveScan" technology permits applicants to be electronically fingerprinted in many locations in every county in California at a cost of only \$56–\$68, and with turnaround notification to CSLB within approximately 72 hours.

In Recommendation #7, the Monitor proposed enactment of a fingerprinting requirement. Importantly, the Board fully supports that recommendation SB 1953 (Figueroa) will contain language requiring applicants for new contractor's licenses and home improvement salesperson registrations to submit fingerprints as part of their applications. Additionally, it will require the Board to obtain accurate criminal history information from the state Department of Justice and the Federal Bureau of Investigation before licensing or registering new applicants, and it will require CSLB to participate in DOJ/FBI's subsequent arrest notification program (such that CSLB will receive information on subsequent arrests of its licensees throughout their tenure as licensees). Draft language of the proposed fingerprinting requirement is attached as Appendix F.

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<sup>21</sup> See *Initial Report*, *supra* note 7, at 75–76 and 108–10. In February 2002, the San Diego District Attorney's Office filed felony charges against Crown's owner, Mark Lee Ross; it is unknown whether the defendant has been served and/or whether he has any assets to repay his victims if he is convicted. In another action, numerous Crown Builders victims have named CSLB in a civil action against Ross for its failure to detect the lies Ross allegedly told on his application and for giving him another contractor's license after his original license was revoked for conviction of a construction-related felony. *Azziz, et al. v. Crown Builders, et al.*, No. GIC778093 (filed Nov. 21, 2001 in San Diego County Superior Court).

**Experience verification.** Under Business and Professions Code section 7068 and section 825, Title 16 of the California Code of Regulations (CCR), a first-time applicant for a contractor's license must demonstrate completion of at least four full years of experience as a journeyman, foreman, supervising employee, contractor, or owner-builder. Although CSLB has no education requirement, completion of certain types of education can substitute for experience in certain circumstances. However, CSLB historically checks only 3–6% of licensure applications to investigate any representation made therein. Further, it lacks an adequate system for verifying the experience claimed. This system is obviously inadequate to ensure that applicants meet statutory requirements for licensure.

In Recommendation #9, the Monitor suggested that CSLB improve its system of experience investigation and verification for license applications. At its January 24, 2002 meeting, the Board approved a proposal to sponsor legislation that will assist its experience verification process. The proposal would amend Unemployment Insurance Code section 1095 to allow CSLB to access the records of the Employment Development Department (EDD) to verify the experience claimed for licensure. Existing section 1095 includes a long list of governmental agencies that may already access EDD's records, including various local, county, state welfare programs, child support enforcement agencies, pension administrators, agencies seeking those who have defaulted on student loans, public employee retirement entities, and law enforcement agencies. A proposed change to section 1095 would add CSLB to the list of agencies authorized to access EDD employment information, enabling it to more efficiently and effectively investigate and verify experience claimed on licensure applications. Draft language of proposed amendments to section 1095 (which will be included in SB 1953) is attached as Appendix G.

**Information regarding civil judgments and settlements.** In Recommendation #8, the Monitor suggested that CSLB sponsor legislation enacting a statutory scheme requiring reporting to the Board of the following information which is relevant to contractor performance and solvency: civil judgments, settlements, and arbitration awards in cases related to contractor performance or honesty; criminal arrests and convictions; bankruptcy filings; and debarments by government agencies.

Although the Board supports a fingerprinting requirement for applicants for new licenses (which will provide accurate criminal history information and — if properly implemented — subsequent arrest information on its licensees), and although it has taken a “support in concept” position on Recommendation #8 and agreed to study both the value of collecting this information and the budget implications associated with this proposal, CSLB has not yet actively studied this

issue. Nor is the Monitor making any recommendation for mandatory reporting legislation in this report, due largely to the precedence of the other issues which have occupied our time during the last six months and which are the subject of recommendations in Chapters III and IV of this report.

However, the Monitor intends to pursue this important issue further in subsequent work with CSLB. Over a dozen other DCA occupational licensing agencies have extensive mandatory reporting statutes which provide them with information (much of which is public information) on licensee misconduct that is directly relevant to their licensees' professional performance of services for which licensure is required. We urge CSLB to initiate a study of these reporting schemes and prepare recommendations on those which would best protect the public.

## 5. Complaint Handling

As described in the Monitor's Initial Report, CSLB's complaint handling function is now centered at two large Intake/Mediation Centers (IMCs) — one in Sacramento and one in Norwalk. Program Technicians (PTs) receive completed complaint forms, assign each case a complaint number, input certain information on CSLB's computer system, and prepare a case file and forward it to a Consumer Services Representative (CSR). CSRs determine whether the Board has jurisdiction and whether the case qualifies for one of two Board arbitration programs (see section E.7 below); further, CSRs contact both parties to the dispute and attempt to discern whether the matter is amenable to mediation. If so, the CSR attempts to smooth out relations between the consumer and the contractor, and facilitate a resolution which may result in the contractor returning to perform corrective or completion work. If the parties reach an agreement and the work is completed, the CSR closes the case. If no agreement is reached, the CSR requests documents relevant to the dispute, compiles a case file, and forwards the matter to the field for investigation.

**Complaint handling backlog.** The Monitor's Initial Report documented a number of problems with CSLB's complaint handling function, some of which resulted from the Board's "reengineering" project instituted by a prior registrar. The reengineering project essentially caused almost all of the Board's experienced CSRs to leave the agency between 1998 and 2000, leaving behind inexperienced and untrained replacements to handle mounting case backlogs. The Sacramento and Norwalk offices handled these massive backlogs differently: Norwalk distributed all incoming cases to CSRs (causing staggering caseloads of 120–140 per CSR), while Sacramento limited CSR caseloads to 60 cases per employee and created a "holding file" where incoming complaints wait in line and grow very old.

During the summer of 2001, CSLB management vowed to clear away the CSR backlog by January 1, 2002. However, the extent of the backlog and the hiring freeze thwarted that goal. Instead, CSLB made some important structural changes that will hopefully reduce the backlog and prevent future problems in complaint handling. First (and as noted above), Registrar Sands filled the long-vacant Enforcement Chief position with David Fogt and rearranged the enforcement program organizational chart such that all enforcement units report directly to Fogt. Second, Sands and Fogt restructured the Board's Intake/Mediation Unit and placed CSLB veteran Paige Roush, an Enforcement Supervisor II, over that unit on a statewide basis.

Finally, management implemented a number of "quick fix" changes in complaint processing intended to eliminate unnecessary work steps and documentation requirements and increase staff productivity in the IMCs. As long as the number of incoming complaints outstrips the number of cases closed and/or moved to the field by the IMCs, the IMCs will always have a backlog, cycle times will suffer, and consumer satisfaction will decline. The following changes have reduced the number of steps at the IMCs and appear to have had a positive impact on the backlog: (1) creation of "express line" handling of cases that meet certain easily identifiable criteria (*e.g.*, cases involving disputes of under \$300) where settlement is likely; (2) elimination of the PTs' and CSRs' use of the "triage checklist," which occasionally required redundant work; (3) replacement of supervisory review of all (100%) PT and CSR case dispositions with random case reviews and training sessions; (4) clarification to CSRs that their case documentation should be less comprehensive in favor of moving cases to the field more quickly; (5) a streamlined process for the handling of cases filed by anonymous complainants; and (6) in Sacramento, staff expended several Saturdays worth of overtime in a comprehensive attack on the holding file. It is unclear whether these "quick fix" changes are permanent or temporary. Additionally, CSRs were returned to geographical assignments wherein they handle complaints coming from a specific area of the state; this focus, which had been removed during reengineering, permits CSRs to interact with and receive feedback from a defined set of CSLB investigators and generally improves their training.

According to a report filed with the Legislature in December 2001, CSLB hoped these steps would enable CSRs to process an average of 60–70 complaints per month (by closing approximately 55% and working up the remaining 45% for transfer to the field for investigation). If staff could accomplish this level of productivity, CSLB estimated that the IMCs could process about 20,000 complaints during 2002 and eliminate the backlog.<sup>22</sup> Exhibit III-D below, the IMCs' statistics for the month of January 2002, indicates that CSLB may be partly achieving its goal. The

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<sup>22</sup> Contractors State License Board, *Report to the Legislature: Item 1230-001-0735* (Dec. 1, 2001) at 6.

Norwalk CSRs moved an average of 65 cases each during January; the Sacramento CSRs moved an average of 55.81 cases each.

OFFICE PRODUCTION							
January 2002							
Sacramento / Norwalk Intake and Mediation Centers							
OFFICE	No. of CSRs	TOTAL Closed by Office	AVERAGE Closed by CSR	TOTAL Transferred by Office to I/C	AVERAGE Transferred by CSR	TOTAL Complaints Moved by Office	AVERAGE Moved by CSR
Norwalk	12	359	29.92	421	35.08	780	65
Sacramento	16	585	36.56	308	19.25	893	55.81

Source: CSLB Staff

**Ex. III-D. January 2002 IMC Output**

However, continuation of this progress depends upon retention of the CSR workforce in the face of the hiring freeze. As of January 31, one CSR had left the Norwalk office and may not be replaced until the position is exempted from the freeze; additionally, one Norwalk CSR is on disability leave.

**CSR training.** In his Initial Report, the Monitor noted that training was essentially nonexistent for many CSRs at CSLB, and suggested (Recommendation #11) that CSLB institute a comprehensive training program for CSRs. We are told that CSLB’s Enforcement Analytical Support & Training (EAST) unit is formulating a CSR training program, and has already administered several components of that program. Additionally, Paige Roush has asked her CSR supervisors for a list of CSR training needs so those can be incorporated into EAST’s CSR training program.

**6. Investigations**

**Investigator vacancies.** In discussing CSLB investigations in his Initial Report, the Monitor found excessive investigator caseloads, unsatisfactory cycle times, and massive case backlogs. At the root of these problems was a 19.7% vacancy rate in CSLB’s Enforcement Representative (ER) positions, which is especially prevalent in the Bay Area because investigator salaries are simply not sufficient to retain qualified and experienced investigators. The Monitor urged the Board to fill those positions as soon as possible and to seek a fee increase to significantly enhance CSLB’s investigative workforce and explore the possibility of a pay differential for investigators in high-cost areas of the state.

As noted above, the state hiring freeze has exacerbated these very serious problems. Exhibit III-E below indicates the excessive vacancies in CSLB's ER-I and ER-II positions (which are nearing crisis levels at the Board's Oakland and San Francisco Investigative Centers), soaring caseloads for CSLB investigators, and unacceptable cycle times — 52% of CSLB's cases under investigation are already over 180 days old, which exceeds the goal set in Business and Professions Code section 7011.7.

Investigation Center	Filled Investigator Positions (ER-I and ER-II)	Vacant Investigator Positions	Total Cases	Average Cases per Investigator	Cases Over 180 Days Old	Percent of Cases Over 180 Days Old
Sacramento	13	1	624	48	409	66%
Oakland	4	4	416	104	281	68%
San Francisco	5	3	421	84.2	250	59%
Fresno	5	1	202	40.4	138	68%
Long Beach	16*	1	431	26.9	139	32%
Azusa	15	2	863	57.5	475	55%
San Bernardino	10	2	674	67.4	263	39%
San Diego	11	2	434	39.5	152	35%
<b>TOTAL</b>	<b>79</b>	<b>16</b>	<b>4,065</b>	<b>51.5</b>	<b>2,107</b>	<b>52%</b>

#### STATEWIDE INVESTIGATIVE FRAUD TEAM

No. SWIFT	8	2	432	54	214	50%
So. SWIFT	15	3	451	30.1	112	25%
<b>TOTAL</b>	<b>23</b>	<b>5</b>	<b>883</b>	<b>38.4</b>	<b>326</b>	<b>37%</b>

Source: CSLB Staff

\* Two Long Beach investigators have been on medical leave for extended periods (both over nine months).

#### Ex. III-E. Total Open Cases by Field Office As of February 28, 2002

On the bright side, the Board's existing investigators are meeting the goals set for them by management. The production goal for Enforcement Representative Is is an average closure of ten (10) cases per month; ER-IIs (who have supervisory and/or other responsibilities in addition to case investigations) are expected to close an average of five (5) cases per month. Recent CSLB enforcement data indicate that during the month of January 2002, the Board's ER-Is closed an average of 10.2 cases each, and its ER-IIs closed an average of 7.7 cases each.

Unfortunately, meeting a monthly goal does nothing to address the massive backlog of cases pending at the Board's Investigative Centers (ICs). According to CSLB's December 2001 report to the legislature, a total of 4,000 cases were then pending at the ICs: 2,340 cases represent a normal work-in-progress caseload for this agency, and the other 1,660 cases are backlogged cases on top of normal work-in-progress. "In other words, if no new complaints were received from consumers and assigned to the ICs for four months, the ICs would still have more than 2,000 complaints in a 'pending' status that would need to be investigated."<sup>23</sup> Put another way, Business and Professions Code section 7011.7 now requires CSLB to establish a goal of fully processing most cases within six months; however, in some areas of the state, complaint investigations may not commence for six months.

This backlog is completely unacceptable and also unnecessary. As we stated in our Initial Report, the Board cannot possibly attack that backlog, reduce its excessive investigator caseloads, or shrink its rising case cycle times unless it fills all existing investigator positions and adds new investigative staff. Fourteen other studies over the past thirty years agree with this conclusion.<sup>24</sup> CSLB must be permitted to fill its existing investigator positions. These are vital law enforcement positions at an important law enforcement agency. Their vacant status is saving no dollars for the general fund. Their vacant status is only hurting enforcement, hurting consumers, and perpetuating the belief among the industry that this agency is a toothless bureaucracy which is generally incapable of aggressive enforcement of the laws of California — certainly not the impression the State of California should want members of a regulated profession to have.

**Investigator training/law enforcement coordination.** The Enforcement Monitor has begun work with Chief of Enforcement David Fogt and his colleagues on the implementation of plans to improve investigator training and promote better case coordination with local and state prosecutors,

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<sup>23</sup> *Id.* at 5.

<sup>24</sup> *See supra* sources cited in n. 2.

in part through cooperation with the California District Attorneys Association (CDAA). These plans include: development of joint training curricula and coordination of training and cross-training, including participation in the CDAA Consumer Protection Prosecution Conference in May 2002; obtaining approval for designated CSLB enforcement personnel to access and use the CDAA Consumer Protection Information Network and Consumer Fraud Index; and joint development of protocols for case referrals, early coordination of investigations, and increased prosecution of “indicator” contracting violations.

**Investigator “home-officing.”** In his Initial Report, the Monitor noted that a featured component of the reengineering project was the elimination of office space for CSLB investigators in favor of home-officing, where investigators equipped with cellular phones and laptop computers work entirely from home. The Monitor found that although clearly beneficial in some work contexts — and perhaps for some employees in the CSLB environment — home-officing in general has created far more problems than it solved for the agency. Investigators no longer have easy access to a CSLB office for official meetings, confidential witness meetings, or suspect interviews (many of which were now conducted in cars or fast-food restaurants). Many investigators with limited typing skills sorely miss the ready availability of clerical assistance. Beneficial contact and teamwork with colleagues has been undermined, and supervisors complain of insufficient contact to permit adequate supervision.

Since the release of the Initial Report, CSLB management has taken steps to ensure that only investigators who are properly trained, performing well, and have a home environment that is conducive to efficient and effective performance are afforded the home-officing privilege. CSLB investigators are no longer required to work from home, and additional office space is being planned for them. In addition, CSLB is conducting a statistical evaluation of employees’ home-officing in lieu of working in state office space. This information will be used by CSLB’s Personnel Office to develop a formal home-officing policy, with minimum qualifying criteria.

## **7. Arbitration**

Pursuant to Business and Professions Code section 7085 *et seq.*, CSLB administers two arbitration programs to encourage the settlement of consumer-contractor and contractor-contractor disputes without disciplinary action. Under section 7085(b), disputes over contracts worth less than \$5,000 (or where the demand for damages is equal to or less than \$5,000 regardless of the contract price) *shall* be referred to CSLB’s Mandatory Arbitration Program (MARB); under section 7085(a), disputes involving damages greater than \$5,000 but less than \$50,000 *may* be referred to CSLB’s



Voluntary Arbitration Program (VARB) with the concurrence of both the complainant and the contractor. The statute specifies that complaints referred to MARB/VARB must meet several criteria, including the following: (1) the complained-of licensee “does not have a history of repeated or similar violations”; (2) the licensee was in good standing at the time of the alleged violation and is in good standing at the time of referral to arbitration; (3) the licensee has no outstanding disciplinary actions filed against him/her; and (4) the parties have not previously agreed to private arbitration in the underlying contract or otherwise. Touted as “fair, fast, and free,” CSLB arbitrations are binding — meaning the parties have only a limited ability to challenge the arbitrator’s decision in court. CSLB’s arbitration decisions are also confidential — meaning they are not disclosed on CSLB’s Web site or elsewhere unless a contractor against whom a monetary judgment is entered fails to pay the judgment (at which time CSLB suspends the contractor’s license and that action is posted on the Board’s Web site).

This arbitration system offers an important alternative dispute resolution mechanism for CSLB complaints, especially during a time of excessive investigative backlog and vacancies. Due to the requested focus of this report on consumer remedies, the Monitor has not yet had a meaningful opportunity to look at a number of issues related to CSLB’s arbitration programs. We set forth a few of those issues below, and intend to explore them in a future report.

**Proposed increase in MARB limit.** CSLB is sponsoring SB 2019 (Figueroa) to increase the limit of its mandatory arbitration program to \$7,500 (and correspondingly change its VARB limits to disputes ranging between \$7,500 and \$50,000). This will result in the automatic referral of more eligible cases to mandatory arbitration. The \$5,000 limit on MARB appears to have been established in 1992, such that ten years have passed since its adjustment from \$2,500. Although the Monitor has not had an adequate opportunity to study the impact of this proposed change, it appears reasonable and may in fact result in the referral and resolution of more cases than would otherwise be possible in light of the existing hiring freeze.

**External arbitrators.** Historically, the Board has utilized one outside contractor (currently Arbitration Works, Inc.) to handle its arbitrations. Effective July 1, 2001, however, parties to CSLB arbitration proceedings have been given a choice of an Arbitration Works arbitrator or an administrative law judge from the Office of Administrative Hearings. The Monitor intends to examine the impact of the use of OAH ALJs in CSLB arbitrations.

**Connection between arbitration and the contractor’s bond.** During our recent focus on consumer remedies, it came to our attention that there is no connection between an arbitration result

and a payout on the required contractor's bond. The reason for this disconnect is twofold: (1) the surety company that writes the contractor's bond is not named as a party to the arbitration proceeding, and (2) in a CSLB arbitration proceeding, the arbitrator does not necessarily make findings regarding whether the contractor violated the License Law — which is a prerequisite to bond payout. The Monitor intends to further evaluate this disconnect to determine whether CSLB arbitrations could be altered to tap into the bond in appropriate cases.

**Exclusion of repeat/egregious offenders from CSLB's arbitration programs.** The value of CSLB's arbitration programs is that they permit contractors with otherwise clean records to resolve a dispute without a disciplinary consequence. This is an appropriate mechanism in that circumstance. However, CSLB has yet to adopt implementing regulations or otherwise define the term "history of repeated or similar violations." It would violate public policy and defeat the purpose of the statute if repeat or egregious offenders could abuse the privilege of arbitration and its confidentiality by "buying off" the few persistent complainants who have the initiative to file a complaint and take it to arbitration. The Monitor intends to take a closer look at the kinds of cases that are being referred to arbitration to determine whether regulatory clarification of the "history" requirement is necessary.

## **8. Prosecutions**

In this area, the Monitor made a series of recommendations aimed at promoting statewide consistency in case referral criteria; improving and standardizing cooperation between CSLB and state and local prosecutors involved in administrative, civil, and criminal prosecutions; and enhancing enforcement of certain "indicator" violations that may be indicative of impending insolvency or large-scale fraud (Recommendations #22–25). These recommendations are the subject of ongoing communications between the Board and the Attorney General's Office, and will be the subject of future Monitor attention. As noted above, the "indicator" violations will be the subject of future CSLB investigator training; additionally, in Appendix E, the Monitor is calling for greater tracking of the receipt and handling of "indicator" violations.

In Recommendation #26, the Monitor suggested that CSLB and the Attorney General's Office undertake an education project to inform judges of their authority to revoke a contractor's license in civil and criminal cases, as appropriate, under Business and Professions Code section 7106 and Penal Code section 23. In January 2002, CSLB enforcement staff met with Attorney General's Office liaison Tony Moreno and developed a protocol to facilitate AG knowledge of and appearance in appropriate civil and criminal actions against contractors to better implement these laws.

## 9. Public Disclosure and Outreach

**CSLB disclosure of complaints against licensees.** On October 4, 2001, Governor Davis signed SB 135 (Figueroa) (Chapter 494, Statutes of 2001), a CSLB-sponsored bill that (among other things) adds section 7124.6 to the Business and Professions Code. Effective July 1, 2002, section 7124.6 requires CSLB to disclose to the public the date, nature, and status of all serious complaints on file against a licensee that have been referred for investigation after a determination by Board enforcement staff that a probable violation has occurred. The bill further requires CSLB to adopt a disclaimer that will inform a consumer to whom complaint information is given that the complaint is still an allegation.

SB 135 permits broader disclosure of complaints than is extant at most DCA agencies, yet is fair to contractors. Under SB 135, not every pending complaint will be disclosed. Complaints that are resolved or referred for arbitration will not be disclosed, thus preserving the ability of legitimate contractors to resolve disputes without disclosure. Only those complaints containing allegations that, if true, “would present a risk of harm” justifying suspension, revocation, or criminal prosecution will be disclosed; minor complaints will remain confidential unless referred for legal action. Further, prior to disclosure, those complaints must be investigated, reviewed by a CSLB supervisor, and referred for further investigation because the supervisor is persuaded that evidence of a “probable violation” exists. Finally, the required disclaimer will inform consumers that the complaint is still in the allegation stage.

As noted, SB 135 does not become effective until July 1, 2002. CSLB staff have developed procedures (and incorporated those procedures into its Complaint Handling Procedures Manual) to identify and disclose complaints subject to SB 135. The Board plans to train its enforcement staff on these new procedures in May 2002. Further, CSLB data programming staff are currently working to ensure that the Board’s Web site reveals the appropriate information by July 1.

Another component of SB 135 requires CSLB to disclose formal disciplinary actions for a minimum of seven years; citations must be disclosed for five years after date of compliance with the citation. This provision becomes effective on January 1, 2003, and CSLB expects timely implementation.

**GLI and “consumer checklist” disclosure regulations.** SB 2029 (Figueroa) added provisions requiring CSLB to adopt regulations governing two additional disclosures to be made by certain contractors in their consumer contracts: (1) a statement whether the contractor carries

commercial general liability insurance (GLI) and, if so, the name and telephone number of the insurer, along with a statement emphasizing the value of GLI and encouraging the homeowner to verify the contractor's GLI coverage and status<sup>25</sup>; and (2) a checklist setting forth the items that a homeowner contracting for home improvement should consider when reviewing a proposed home improvement contract.<sup>26</sup>

Effective February 26, 2002, CSLB adopted new sections 872 and 872.1, Title 16 of the CCR, to implement the GLI and consumer checklist disclosure requirements. In its Winter 2002 newsletter to licensees, CSLB alerted contractors to the new requirements and set forth sample versions of both notices (which are now available for downloading on CSLB's Web site). However, in its newsletter, CSLB notes that "the Board anticipates that evaluations by the CSLB Enforcement Monitor and other reviews will result in changes to the existing home improvement contract requirements by January 1, 2003. Therefore, the Board is not recommending that contractors revise their printed contracts to incorporate the notices at this time." Instead, the Board suggests that licensees attach the required forms to their contracts.

**Web site revisions.** CSLB's Web site contains a vast array of information for consumers, licensees, and licensure/registration applicants. The Web site also provides instant information about licensees (by name and by license number) and an online complaint form that can be completed and returned to CSLB online.

In his Initial Report, the Monitor identified a number of problems with the Web site — primarily with the "licensee look-up" feature. The Monitor noted that the site fails to explain terms of art which may have meaning to CSLB but which have no meaning whatsoever to consumers (*e.g.*, "V/S," "RMO," "P/S/T") — a "glossary of terms" with understandable definitions of these acronyms would cure this problem. The Web site also uses undefined legal jargon and several incorrectly defined legal terms.<sup>27</sup> Further, the Web site fails to provide the dates of any accusation filed and/or legal action taken — an important omission. In Recommendation #28, the Monitor suggested that CSLB undertake a full review — perhaps with the assistance of a consumer focus group — of the

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<sup>25</sup> Bus. & Prof. Code §§ 7159.3(a)(1)–(2), 7164(b)(5)(A)–(B).

<sup>26</sup> *Id.* at § 7159.3(a)(2).

<sup>27</sup> For example, an "accusation" is not a "disciplinary action that has been referred to the Attorney General"; it is a statement of written charges filed by the Attorney General after a completed Board investigation. While the term "legal action" sounds to a consumer like an "action taken," CSLB uses that term to mean a completed investigation that has been "referred for legal action."

information provided on its Web site and revise it accordingly. In Recommendation #30, the Monitor also suggested that CSLB add links to Better Business Bureau (BBB) affiliate organizations in California. BBB has its own consumer-friendly Web sites which convey a great deal of useful information to consumers regarding the reputations of contractors and other businesses in their communities.

In December 2001, CSLB revamped the format of its Web site to conform to the state's standard template. However, the Board has not been able to accomplish much else in the way of Web site overhaul. As its site is a primary vehicle of consumer communication, this is an important issue that merits attention as soon as funds and positions are available. CSLB's Web site already offers a great deal of valuable information, and could be even more helpful to consumers if improved in several critical areas.

## **10. Consumer Remedies**

As noted above, JLSRC Chair Figueroa requested in December 2001 that the Monitor devote the bulk of this report to the consumer remedies issue — an area that has long vexed policymakers, consumers, and industry. Chapter IV contains a detailed analysis of numerous consumer remedies and a package of proposed legislation to address this critical area.

## **11. Summary of Concerns**

In his Initial Report, the Monitor noted that a review of fourteen previous studies of CSLB, our own independent inquiry, and recent consumer surveys which indicate that only 54% of responding consumers are satisfied with the Board's performance together yield very serious concerns about CSLB's overall enforcement performance. Specifically, long cycle times for complaint handling and investigations, excessive backlogs for CSRs and investigators, and internal inconsistencies and non-uniformity in complaint handling, investigations, and prosecutions practices are problems that have plagued this agency for thirty years, and nothing the Board has tried to date has adequately addressed them.

The good news is that CSLB is governed by a conscientious Board which has demonstrated unprecedented support for public protection and implementation of the Monitor's October 2001 recommendations, and staffed by a new Registrar and Chief Deputy Registrar who have made impressive strides in undoing the harmful effects of the prior administration's reengineering project, a new Enforcement Chief and upper enforcement management who have rededicated themselves to

improving all aspects of this program, and 450 employees all over the state who are finally enjoying some semblance of stability after years of turmoil.

The bad news is that the state's continued hiring freeze and inaction on CSLB's requests for exemptions from the freeze for its enforcement positions is destroying the momentum that accompanied this agency's reception of the Monitor's October 2001 recommendations and frustrating enforcement staff who continue to devote their talents, skills, and experience to CSLB. As exemplified by this agency's vacancy rate, many trained and experienced enforcement staff have left for higher salaries, lower caseloads, and less complex cases. Those who stay should be rewarded; however, they are being penalized with higher caseloads, older cases, and understandably irate consumers who must wait months for the Board to address serious complaints about its licensees. In the short term, the Monitor urges that CSLB's enforcement positions be exempted from the hiring freeze to enable this Board to carry out the wishes of the Legislature and the Davis Administration in creating the Enforcement Program Monitor position. In the longer term, the Monitor hopes for constructive consideration of the draft legislation contained in this Second Report, which — we believe — will enhance consumer protection without unduly burdening CSLB licensees.

## Chapter IV

# RECOMMENDATIONS ON CONSUMER REMEDIES

### A. The Problem of Inadequate Consumer Remedies

#### 1. Scope of the Problem and Inadequacy of Present Consumer Remedies, Generally

Each year, California consumers file complaints with CSLB involving allegations of enormous aggregate losses from unscrupulous or incompetent contractors. Estimates of annual consumer loss — measured as the value of complaints to CSLB each year — range from \$60 million to \$100 million. This estimated dollar value of harm almost certainly understates the actual consumer loss, as many consumers do not know to file formal complaints with CSLB, or choose not to do so. (The Better Business Bureau reports that many private attorneys advise clients that complaints to CSLB are worthless in terms of recovering losses, and thus they discourage reporting of losses.)

In light of the scope of annual consumer losses in this industry, it is especially troubling that the present system of potential remedies for consumers is largely inadequate.

The principal Licensing Law vehicles for consumer relief — the \$7,500 contractor's bond (\$10,000 for swimming pool contractors)<sup>28</sup> and the \$2,500 capitalization requirement (viewed as an indicator of solvency for judgment relief) — are clearly insufficient for truly substantial fraud, abandonment, or incompetence cases. The surety bond of \$7,500 required of most contractors offers no realistic prospect of recovery for many cases of consumer loss, including all the most serious cases of such loss. First, the bond amount of \$7,500 is so small as to be exhausted by virtually any

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<sup>28</sup>Bus. & Prof. Code § 7071.6(b). The larger bond of amount of \$10,000 applies to swimming pool contractors, reflecting the Legislature's finding that the risks of public harm in such work are greater than in other categories of contracting. For ease of reference this report will generally refer to the license bond as the "\$7,500 bond," with due acknowledgment of this special category of bond.

claim by a subcontractor or other unpaid claimant in a contemporary home remodeling or similar project. In addition, superior knowledge and experience often mean that claims by subcontractors, material suppliers, and laborers are perfected before those of consumers, leaving consumers at the end of a line of unsatisfied claimants in most cases. Finally, both the payout criteria and the claims process are sufficiently burdensome that few consumer victims have the knowledge and fortitude to perfect a claim.

Unfortunately, civil litigation remedies based on contract theories are generally little better for consumer victims, both because of the expense and difficulty of the civil litigation process, and because many of the most serious contractor cases involve judgment-proof defendants. The insignificant capitalization requirement of \$2,500 for most contractors is entirely inadequate to ensure fiscal solvency or responsibility for contractors who commit to hundreds of thousands of dollars worth of projects, and then renege or fail to perform.

The overwhelming majority of experts we have consulted from CSLB, the Legislature, law enforcement agencies, consumer groups, and the construction industry believe that the present remedial provisions fail — more often than not — to adequately protect the consumers whose interests are CSLB’s prime mandate. The Joint Legislative Sunset Review Committee (the body which helped establish the Monitor’s project) found in 1997: “When a contractor goes out of business, abandons a construction project, fails to perform on the contract, does not follow plans or specifications, or is involved in poor workmanship, the extent of meaningful consumer protections can be woefully lacking.”<sup>29</sup> Three years later, the Committee found once again that “[c]urrent forms of restitution provided for consumers for financial injury suffered as a result of a contractor’s fraud, poor workmanship, malfeasance, abandonment, failure to perform, or other illegal acts, are inadequate.”<sup>30</sup> The \$7,500 license bond requirement and the bonding process as a whole are viewed by the law enforcement community as entirely insufficient. Even a significant number of contractor representatives share this concern, offering the Monitor staff the private view that surety bonds in their present form do not provide adequate protection to California construction consumers.

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<sup>29</sup>Joint Legislative Sunset Review Committee, *JLSRC Findings and Recommendations: Contractors State License Board* (April 1997) at 17.

<sup>30</sup>Joint Legislative Sunset Review Committee, *Final Recommendations of the Joint Legislative Sunset Review Committee and the Department of Consumer Affairs: Contractors State License Board* (April 11, 2000) at 6 (Issue #9) (emphasis original).



This fundamental inadequacy of today's consumer remedies is also readily acknowledged by CSLB members and staff, and this reality erodes morale at the agency. One veteran senior enforcement manager summarized a career's worth of frustration as follows: "The problem is, even when we got the bad guys, we couldn't get people their money back." CSLB staff note that not only is the current system unable to provide consumer recompense in many cases, it is often not even able to prevent further loss, as consumers often must pay twice to complete the needed repairs or improvements.<sup>31</sup>

Reform of consumer remedies in the contracting industry is an issue of great complexity, and it has been the subject of numerous previous and ongoing studies over a period of years.<sup>32</sup> Virtually all who have followed this lengthy debate concur with the members and staff of the Joint Legislative Sunset Review Committee (as articulated at the December 6, 2001, sunset hearing on CSLB) that the time for unlimited philosophical discussion is past: Consumer remedies today are inadequate and the status quo is unacceptable. Concrete proposals for solutions should be the subject of legislation during the present session.

The search for those solutions must begin with a clear understanding of the consumer remedies problem. The two most prominent features of the consumer remedies problem are (1) the issue of double payments (implicating issues of mechanic's lien rights and third-party claims on consumers), and (2) the issue of inadequate consumer restitution (insufficient redress or recovery for consumer harm and losses associated with improper contractor conduct). We begin with a review of these two central aspects of consumer injury in the construction context.

## **2. The Remedies Problem: Double Payments**

Construction consumers face a problem of potential double payments when they have already paid unscrupulous, incompetent, or failing contractors who have not paid subcontractors, material suppliers, and laborers. These third parties to the contract between the homeowner and the prime

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<sup>31</sup> See generally *Initial Report*, *supra* note 7, Ch. VI ("Initial Concerns of the Enforcement Program Monitor") at subsection J ("Consumer Remedies").

<sup>32</sup> See, e.g., California Law Revision Commission, *Mechanic's Liens* (Study H-820), under way since June 28, 1999; Contractors State License Board, *Using Surety Bonds and Insurance to Compensate Homeowners for Losses Caused by Licensed Contractors* (Oct. 1, 2001) (hereinafter "*Using Surety Bonds*"); Contractors State License Board, *Analysis of State Recovery Funds* (Oct. 1, 2001); and sources cited in *Initial Report*, *supra* note 7 at 37, n. 29.

contractor often make demands from the consumer for duplicative payments, which demands are backed by the payment rights conferred by the mechanic's lien law and the stop notice process.<sup>33</sup>

The mechanic's lien right, supplied by a provision of the California constitution and by Civil Code sections 3082 to 3267, entitles subcontractors and material suppliers to enforce claims against the owner's property if they are not paid by the prime contractor for services or products contributed to an owner's property. In many cases, the homeowner only becomes aware of the subcontractor's or supplier's right and claim (if then) when the "preliminary 20-day notice" under Civil Code section 3097 is served on the owner. In many home improvement situations, this notice that a third party has a claim and must be paid comes after the work has been done and thus after the owner can effectively raise the issue with the prime contractor and ensure adequate payment of the third party. And of course, this information often comes after the prime contractor has (improperly) collected much or all of the contract price.

Then if the prime contractor fails to pay — for reasons which can include dishonesty, financial problems, or mistake — the subcontractor or supplier demands payment from the owner, backed by the threat of a lien claim filed under the mechanic's lien law which will cloud title to the owner's property. Many, and probably most, homeowners opt to pay a second time rather than risk title problems or engage in a lengthy and costly legal dispute. And adding insult to injury, a lien claim may be filed as a negotiating ploy and never pursued by the claimant, but with the effect of leaving behind an apparently unresolved lien claim to confuse the status of the owner's title.<sup>34</sup>

Problems of potential or actual double payment clearly occur in home improvement contracts in California. However, there is little comprehensive research on the scope of the problem in California, and there are differing views on the extent of consumer harm here.<sup>35</sup> A fully accurate view of the extent of double payment is difficult in part because the issue involves more than just the incidence of actual lien filings and foreclosures. The most common version of the problem is

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<sup>33</sup> See *The Double Liability Problem in Home Improvement Contracts*, 31 Cal. L. Revision Comm'n Reports 281 (2001), at 285–289 (sometimes cited hereafter as "*The Double Liability Problem*"). Authored under the direction of the Commission by Assistant Executive Secretary Stan Ulrich, this study is an exhaustive description and analysis of the double payment phenomenon, including policy recommendations and a definitive analysis of the constitutional dimensions of this issue. The Monitor staff is indebted to the Commission and Mr. Ulrich for a number of the ideas and proposals contained in the Second Report, and we commend the reader to this CLRC study for further details on mechanic's lien and stop notice issues and possible solutions.

<sup>34</sup> See *id.* at 285–87 for further details on this process.

<sup>35</sup> *Id.* at 287.

likely to leave little or no record of its occurrence: The use by trade contractors and suppliers of the *threat* of a lien as leverage to obtain double payments from homeowners. When pressed by the plumber, roofer, or lumber store, the typical homeowner will reluctantly pay \$500 to \$5,000 a second time rather than hire an attorney at \$150 per hour for months of aggravating and time-consuming litigation to resolve a claim and clear the homeowner's title.

Even absent comprehensive statistics, it is possible to estimate the scope of this problem, and the estimates are unsettling. CSLB staff conducted a review of a sample consisting of 274 complaints closed in 1999, and found 30 of the 274 complaints involved allegations of lien problems or non-payment issues.<sup>36</sup> This incidence rate of 11% of all complaints yields an estimated 2,800 cases per year involving these issues out of the approximately 26,000 complaints CSLB receives annually.

Evaluations of selected complex cases by CSLB staff indicate that only about 50% of consumers who experience lien problems actually complain to CSLB about those problems (the other half mostly chose to pay a second time to end the matter). Applying this conservative 50% figure for the complaint rate to our projected number of existing CSLB complaints raising these issues yields an estimated 5,600 cases per year involving double payment or lien issues statewide.<sup>37</sup> The real number may be far greater.

Whatever the precise rate of incidence statewide, it is clear that this problem occurs with troubling frequency and impact. For example, in the Olympic Roofing Company matter arising in 2000 in the Sacramento area, a roofing contractor allegedly did substandard work and abandoned numerous jobs. A single roofing material supplier filed lien claims against 12 homeowners in the area, with a total value exceeding \$45,000, when most of the homeowners had already paid part or all of the contract price.<sup>38</sup> In 1999 the staff of Assembly Member Honda identified 61 double payment cases as illustrations of this problem in connection with Mr. Honda's legislative proposal addressing this issue.<sup>39</sup> The Monitor concludes that the double payment problem occurs frequently each year, and works a substantial hardship on many California consumers.

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<sup>36</sup> *Using Surety Bonds*, *supra* note 32, at 3.

<sup>37</sup> Estimated 2,800 lien-related complaints per year x 2 (reflecting 50% estimated incidence of actual complaints to CSLB) = 5,600.

<sup>38</sup> *Using Surety Bonds*, *supra* note 32, at 13.

<sup>39</sup> See *California Law Revision Commission Staff Memorandum 2000-9* (Jan. 31, 2000) at 2.

The Monitor believes there are promising potential solutions for the problem of double payments.<sup>40</sup> However, any viable solution must address the legitimate needs of third parties, including innocent subcontractors, material suppliers, and laborers, as well as those of the consumer victims.

### 3. The Remedies Problem: Consumer Restitution

In addition to concerns relating to liens and double payments, construction consumers are often frustrated by the limited mechanisms available to compensate them for monetary losses, damages, or needed repairs when a contractor fails to perform properly. Today, consumer restitution is at best modest in amount and disproportionately difficult to obtain; at worst, it is entirely unavailable.

Although the majority of consumer complaints to CSLB involve individual claims of less than \$7,500 in amount,<sup>41</sup> cases involving multiple complaints or large-scale projects must almost immediately exhaust the modest \$7,500 bond amount. Thus for the more serious cases of consumer harm, there is an extremely low ceiling of available consumer restitution. When a large-scale contractor fraud, abandonment, or bankruptcy occurs — such as the Crown Builders case in San Diego involving losses to at least 70 families of between \$50,000 and \$130,000 each — the contractor’s single \$7,500 bond provides very little prospect for restitution.

There are no reliable global statistics on the full extent of the problem of annual unrecompensed consumer losses due to improper contractor conduct in California. However, the existing indicators again paint a troubling picture. Perhaps the clearest quantifiable indicator of the inadequacy of contemporary remedies is that in recent years California surety companies have paid about \$4.5 million annually in claims against contractor bonds, despite the likely minimum of \$60–\$100 million annual value of consumer losses.<sup>42</sup> Although, as discussed below,<sup>43</sup> surety companies can justifiably claim that significant additional benefits to consumers and others result

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<sup>40</sup> See *infra* Recommendations #35 and #37 (“Monitor Recommendations for Improved Consumer Remedies”).

<sup>41</sup> *Using Surety Bonds*, *supra* note 32, at 31.

<sup>42</sup> CSLB records indicate California sureties paid out a total of \$4,549,042 to consumers from contractor bonds in 2000. *Id.* at 27. Surety Company of the Pacific (SCP) has endorsed an annualized figure of \$4,760,000 for a similar time period (the fiscal year ending in 1999). *Id.*, SCP appendix at 2.

<sup>43</sup> See *infra* Ch.IV, subsection A.2. (“Principal Consumer Remedies Mechanisms Today”).

from the sureties' dispute resolution efforts, it nonetheless appears clear that only a small percentage (likely to be much less than 25%) of all consumer claims for restitution are satisfied by existing remedies.

#### 4. Principal Consumer Remedies Mechanisms Today

**The \$7,500/\$10,000 contractor's license bond.**<sup>44</sup> Business and Professions Code section 7071.5 *et seq.* requires contractors to post a \$7,500 "contractor's bond" (\$10,000 for swimming pool contractors) ostensibly to protect consumers and subcontractors, material suppliers, and others who are victimized by the misconduct of a contractor.

In the construction industry, "[a] surety bond is a promise to be liable for the debt, default or failure of another."<sup>45</sup> A surety bond in the California context is the surety company's financial guarantee that the contractor at issue will perform as required by the licensing laws. In the construction industry as a whole, a variety of bonds are used, including payment bonds, performance and payment bonds, specialized bonds for specific lien rights, and others. Substantial differences exist between bonding practices in commercial construction (where elaborate bond agreements to ensure payment and performance are commonplace) and home improvement contracting, where the typical homeowner is unaware of and makes no use of any bonding mechanism.

In the most common scenario in California home improvement contracting, a contractor undertaking such work need only obtain the basic contractor's bond of \$7,500 to do business with homeowners. A claim against that bond arises out of damages caused by the contractor's failure to comply with the Contractors License Law. When a consumer or other party files a claim against a bonded contractor, the surety company providing the bond typically undertakes its own investigation of the circumstances surrounding the complaint, and determines whether to pay the claim. During this process surety companies attempt to resolve the underlying dispute between the customer and the contractor, and settlements are achieved in a number of cases. Unsettled claims are either paid from the bond's penal amount of \$7,500 (to the extent available) or denied on various possible grounds. However, unlike the case with insurance claims and payments, surety companies seek to recover any payments from the contractors involved, although with mixed success.<sup>46</sup>

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<sup>44</sup> See generally *Using Surety Bonds*, *supra* note 32, at 15–17, and *passim*, for details on the requirements of and procedures regarding California contractor's bonds.

<sup>45</sup> Associated General Contractors of America/National Association of Surety Bond Producers, *The Basic Bond Book* (1993), provides this definition, and is an excellent general description of the surety bond process.

<sup>46</sup> See *Using Surety Bonds*, *supra* note 32, at 25–27.

Unfortunately, the overall impact of the bond process in remedying consumer harm is less than satisfactory. The current license bond amount is generally inadequate to cover many or most consumer claims, and the bond recovery process is complicated and cumbersome for the vast majority of consumer claimants.

The \$7,500/\$10,000 bond requirement — which applies regardless of whether the contractor is undertaking three projects totaling \$30,000 or 100 projects totaling \$5 million — has been characterized by prosecutors experienced in contractor fraud cases as “laughably low” and “exceedingly insufficient.” In light of the obvious limits of a single \$7,500 bond, a 1997 Joint Legislative Sunset Review Committee report flatly concluded that the contractor’s bonds “do not provide protection to consumers.” CSLB staff, consumer victims and advocates, and even many industry representatives with whom the Monitor project staff has consulted agree the current bond amount is too low to offer adequate protection for consumers.

Even assuming the \$7,500 bond sum offered meaningful protection when that sum was set in 1994, it offers materially less protection in 2002, after a 22% increase in the California Consumer Price Index since 1994. A sum of \$9,150 in 2002 dollars would be necessary merely to restore the protective capacity of the 1994 amount. Progress in protecting consumers would require a bond amount in excess of that figure.

However, the bond amount alone is not the only source of consumer benefit that accrues from the contractor’s bonding process. Surety companies rightly assert that a measure of additional benefit accrues to consumers from their efforts at informal settlement and dispute resolution. These attempts to obtain resolutions to complaints about contractors they have bonded are in part enlightened self-interest (the sureties want to avoid unnecessary payments) and in part a response to the sureties’ obligations to inquire into complaints and pay appropriate claims.<sup>47</sup> These informal dispute efforts often result in a needed repair or completion of a project (or other remedy) and thus are an important benefit to the involved consumer.

Although no industrywide data exist to measure the extent of this benefit, Surety Company of the Pacific extrapolates from its own experience and estimates the annual industrywide value of

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<sup>47</sup> See, e.g., 10 CCR § 2695.10(d) (the Department of Insurance’s fair claims settlement practices regulations requiring sureties to diligently pursue claims including seeking “information reasonably required to resolve the claim”). *Using Surety Bonds*, *supra* note 32, at 28–29.

such dispute resolution to be \$10 million.<sup>48</sup> However, even under this assumption (which has some elements of a best-case projection), no more than 25% — and probably a far smaller percentage — of all consumer complaints are remedied by bond payouts or informal surety dispute resolution, suggesting that the vast majority of the \$60–\$100 million in consumer claims goes unremedied, at least through the principal remedial mechanism of the bonding process.<sup>49</sup> In summary, substantial consumer benefits clearly result from the bonding process; just as clearly, many or most consumer losses go uncompensated.

Other problems associated with the bonding process also hamper consumers (and others) seeking restitution from existing contractor's bonds. Most consumers know essentially nothing about the bond claim process. Since both consumers and industry professionals have access to the contractor's bond for redress, the differential in experience and system knowledge generally gives a profound advantage to industry claimants such as subcontractors and material suppliers. Many consumers find themselves last in a long line of claimants on a \$7,500 bond too small to satisfy even the first few in line. In addition, the bond claim process is arcane and legalistic, making consumer access difficult and cumbersome. And, as discussed further below,<sup>50</sup> the legal standard applied to determine access to bond benefits is unclear and applied differently by different surety companies, making the process even more difficult and forbidding for most consumers.<sup>51</sup> Some commentators (including one former Insurance Commissioner) have claimed that some surety companies require all claimants to prove a "willful *and* deliberate" violation of applicable law in order to recover from the bond (even though section 7071.5(a) requires no such standard for homeowner claims). And even when there is apparent agreement on the applicable legal standard, surety companies sometimes require extensive further information and documentation that many consumers are hard pressed to provide.<sup>52</sup>

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<sup>48</sup> See *Memorandum to Contractors State License Board Regarding the Study Mandated by Business and Professions Code section 7021(d)*, August 2001, at 2, included with letter to Registrar Stephen Sands from Surety Company of the Pacific Executive Vice President Paul R. Geissler (January 22, 2002).

<sup>49</sup> If, as SCP asserts, \$10 million accurately represents the consumer value of surety company dispute resolution, and if there is \$4.5 million in annualized surety industry payouts on contractor bonds, California consumers would realize approximately \$15 million in restitutionary benefits from the entire contractor bonding process, which equates to 25% of the minimum estimate of \$60 million in annual consumer complaint value. This figure is 15% if we assume the \$100 million estimate of harms, and must be discounted further to reflect the near-certainty that many injured consumers do not know to or choose to report harms to CSLB.

<sup>50</sup> See *infra* Ch. IV ("Monitor Recommendations for Improved Consumer Remedies"), Recommendation #36.

<sup>51</sup> *Using Surety Bonds*, *supra* note 32, at 28–34.

<sup>52</sup> *Id.* at 28–32.

There is important linkage between the double payment/third-party claimant issue and the consumer restitution issue relating to contractor's bonds. If a solution can be implemented to ease the problem of third-party claims against the license bonds, then even a modest increase in the bond amount accessible to consumers would meaningfully improve the prospect of consumer recovery for losses and damages. Today's \$7,500 contractor's bond does not generally provide a significant remedy in part because third-party claimants often stand in line ahead of consumers. If the claims of third parties, such as subcontractors and suppliers, are no longer in direct competition with consumer claims, then to that extent consumers are more likely to be compensated. Even a comparatively modest bond amount becomes more relevant if consumers are the sole or primary claimants on the bond.

In summary, for the contractor bonding process to be a better mechanism to ensure recovery for any intended beneficiary, changes in the amount, type, and collection criteria concerning contractor's bonds may be required.

**The capitalization requirement.** Business and Professions Code section 7067.5 and section 817, Title 16 of the CCR, require CSLB licensure applicants to demonstrate "financial solvency" in the amount of \$2,500. This amount — established in 1979 and unchanged in 23 years — is not meaningful as an indicator of financial capacity or solvency in 2002, when \$2,500 will not be likely to cover the smallest litigated claim. This minuscule capitalization amount provides no real guarantee of solvency or ability to meet judgment obligations, but the existence of a requirement of "financial solvency" may have the undesired effect of implying to consumers that significant CSLB standards of solvency have been met.

**Commercial general liability insurance.** To the surprise of many consumers, contractors are not required to carry commercial general liability insurance (GLI). GLI does not guarantee competent performance or payment to subcontractors, but instead covers consequential damages caused by a contractor's negligence (which otherwise must be covered by homeowners' insurance or paid out-of-pocket). Although some segments of the construction industry support mandatory GLI as a condition of licensure, the insurance industry has historically opposed such a requirement vigorously.

In 2000, SB 2029 (Figueroa) added a statutory provision requiring CSLB to adopt a regulation containing a statement that "emphasizes the value of commercial general liability insurance and encourages the owner or tenant to verify the contractor's insurance coverage and status." Three months after the Board adopts such a regulation, all home improvement contractors



and contractors building single-family residences must include the Board-adopted statement in their estimates and contracts; those estimates and contracts must also include a check box indicating whether the contractor carries GLI and, if so, the name and telephone number of the insurer. CSLB has now promulgated this regulation, which took effect February 26, 2002.<sup>53</sup> The regulation requires all home improvement contracts to notify consumers about the GLI disclosure requirement and instruct them to call the insurance company to verify that the policy is in effect and will cover the project. The notice will also include the statement: “[CSLB] strongly recommends that all contractors carry [GLI]. The Board cautions you to evaluate the risk to your family and property when contracting with a contractor who is not insured.”<sup>54</sup>

Although GLI offers important protections against certain types of consumer harm, its scope and applicability are often misunderstood, especially by consumers. Most important for our consideration of consumer remedies, GLI does not address the most frequent and pressing forms of consumer harm, including the double payment problem and the inadequacy of restitution for improper conduct.

## **B. Criteria for Evaluating Consumer Remedies Proposals**

The problem of inadequate consumer remedies has been analyzed and debated for much of the past three decades.<sup>55</sup> The challenge has been and remains to identify improvements for consumer remedies which will be: (1) effective in aiding consumers; (2) cost-efficient; (3) workable for all parties; and (4) reasonably acceptable to all stakeholders in the construction process.

The Monitor has applied these four criteria to all the consumer remedies alternatives considered in the following manner:

### **1. Efficacy**

The efficacy or effectiveness of a solution in improving the problem of inadequate consumer remedies is our first criterion. We have looked to determine and/or predict both the impact or effectiveness in resolving the double payment aspect of the problem, and the impact or effectiveness in addressing the consumer restitution problem.

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<sup>53</sup> 16 CCR § 872 (2002).

<sup>54</sup> *Id.*

<sup>55</sup> *See supra* studies, reports and references cited in n. 32.

## 2. Cost

Many solutions could conceivably provide greatly enhanced remedies for consumers, but many of those would do so at a cost which is unacceptable. Sound policy judgment requires a careful application of cost/benefit analysis to ensure that the improved consumer remedies are obtained at an appropriate overall societal cost. We have looked to evaluate potential costs broadly, including in this analysis:

- cost to consumers and/or the public at large (including direct costs and indirect costs passed on through the competitive process in the form of increased construction prices)
- cost to each affected industry group (including prime contractors, subcontractors, trade contractors, material suppliers, laborers, and surety companies)
- cost to government, including CSLB, law enforcement, and the judicial system.

## 3. Workability

In addition to the dimensions of efficacy and cost, each remedy alternative has been considered in light of issues relating to the practical implementation of the remedy. Not every solution which promises relief at a reasonable cost can in fact be implemented effectively; many promising concepts cannot be readily applied to the daily realities of business and government. This broad analytical category includes:

- the ease or difficulty of implementation and operation of the remedy, overall
- the administrative burden for CSLB
- the compliance burden for industry (including contractors, subcontractors, the surety industry, and all other participants)
- any operational burdens for the judicial system and law enforcement
- accessibility for consumers (ease of access, *i.e.*, “user friendliness”)
- any legal/constitutional issues or constraints
- the fairness of the proposal in practice

#### 4. Acceptability to Stakeholders

The California construction industry is not analogous to an old-fashioned melodrama with heroes and villains (although the dialogue in years past has sometimes tended to melodrama and oversimplification). All stakeholders in the construction process play important roles in this \$35 billion industry and in our economic system as a whole. California needs honest and capable contractors, subcontractors, material suppliers, and laborers, and the vast majority of all these groups meet those standards. The surety industry supplies a necessary service that can benefit all industry participants. CSLB and the law enforcement community protect both consumers and honest businesspersons from the small minority of contractors or others who are dishonest or incompetent. And of course customers (consumers) are the lifeblood of this and every industry, and their protection is the first obligation of California government and the Enforcement Monitor's project.

Ultimately all Californians are consumers of construction services, and beneficiaries of a healthy and efficient construction industry. Improvements to consumer welfare in this industry should be of interest to all. Similarly, improved professionalism is beneficial not only to the consumer-customer but to every honest participant in this industry.

Because all stakeholders play important parts in this process, solutions for improved consumer remedies must consider the legitimate needs and interests of all parties, and seek to balance costs and impacts so all groups share equitably in the effort to better protect the public. Thus in evaluating consumer remedies improvements the Monitor project staff has considered the acceptability of various proposals to all relevant stakeholders in this process including:

- consumers
- prime contractors
- subcontractors, trade contractors, material suppliers, and laborers
- the Contractors State License Board and the Department of Consumer Affairs
- the Legislature
- the surety industry
- law enforcement and the judicial system.

## C. Monitor Recommendations for Improved Consumer Remedies

**Introduction to Monitor recommendations for consumer remedies.** As promised in the *Initial Report of the CSLB Enforcement Program Monitor*,<sup>56</sup> the Monitor project staff has undertaken the task of evaluating the problem of consumer remedies and identifying potential improvements to those remedies with the intention of providing concrete recommendations for inclusion in legislation to be acted upon during 2002 by the state Legislature. The following four recommendations together comprise a package of improvements to address both the double payment and consumer restitution aspects of the remedies problem. These recommendations focus primarily on improving remedies in the home improvement portion of the industry, which is the source of the large majority of CSLB complaints.

In developing this package of proposed improvements, the Monitor staff has applied the above four criteria of efficacy, cost, workability, and acceptability to stakeholders. The package is intended as a balanced and moderate approach which calls upon all industry participants to compromise and share equitably both the burdens and the benefits of improved consumer remedies. The Monitor believes it appropriate to make an initial attempt to improve available consumer remedies using a consensus-based program of incremental change, as a generally preferable alternative to more burdensome solutions requiring major structural changes in this industry. To this end, the Monitor staff has consulted extensively with representatives of all relevant stakeholders groups to identify components of what is intended as a balanced and practical approach to change.

While no part of the remedies package is sacred and we stand ready to discuss and improve upon these concepts, the Monitor is operating from the premise — stated clearly by the members and staff of the Joint Legislative Sunset Review Committee on December 6, 2001, and elsewhere — that the only completely unacceptable course of action is to preserve the status quo.

The Monitor recommends the following four related components of a package of improvements to consumer remedies:<sup>57</sup>

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<sup>56</sup> *Initial Report*, *supra* note 7, at 132 and Ch.VIII.

<sup>57</sup> For consistency and to aid clarity of references, the recommendations in this Second Report are numbered to follow consecutively the 33 recommendations of the *Initial Report of CSLB Enforcement Program Monitor*. Thus the these four new proposals as denominated Recommendations #34 to #37.

**Recommendation #34: Require a home improvement contractor's bond for the exclusive benefit of consumers, as part of the home improvement contractor certification program (Appendix H).**<sup>58</sup>

*Description:* This proposal would require a \$7,500 surety bond — separate from and in addition to the existing contractor’s license bond — as a condition of home improvement contractor certification. This “home improvement contractor’s bond” would be mandatory for all contractors engaged in home improvement contracting, under the terms of Business and Professions Code section 7150.2 which requires such certification for contractors undertaking home improvement work as defined in sections 7151 and 7151.2. The home improvement contractor’s bond would be exclusively for the benefit of homeowners engaged in home improvements, and would be in addition to (but not duplicative of) any benefits obtained from other bonds required by the License Law. The proposed language provides:

(c) The home improvement contractor’s bond shall be exclusively for the benefit of any homeowner contracting for home improvement upon the homeowner’s personal family residence damaged as a result of a violation of this chapter by the contractor. Any benefit obtained by a homeowner from a home improvement contractor’s bond shall not bar or limit the homeowner’s recovery of any non-duplicative benefit from any other bond provided by this article.

The new bond would be administered in the same general fashion as the existing contractor’s license bond.<sup>59</sup>

*Discussion: Efficacy* — The broad consensus of industry commentators is that the current contractor’s bond amount and accessibility for consumers are insufficient. However, a large increase in the amount of the contractors’ license bond is widely opposed on several grounds including the following: it would unfairly burden non-home improvement contractors who are not the core of the problem; a large increase would require significant underwriting and substantial increases in premiums; and it would erect substantial barriers to entry for new or smaller contracting individuals and firms.

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<sup>58</sup> Draft statutory language for Recommendation #34 is contained in Appendix H, *infra*.

<sup>59</sup> See Appendix H, proposed § 7150.4 subdivision (e).

In light of estimates that home improvement contracting is as much as 70% of the problem (as measured by complaints received by CSLB),<sup>60</sup> this remedy focuses on the home improvement context, providing a new restitution source reserved exclusively for homeowner cases where the majority of problems occur. This new \$7,500 bond doubles the available funds for direct consumer restitution, and guarantees that at least some bond funds will be available exclusively for consumers.<sup>61</sup> And since a majority of individual consumer complaints to CSLB are for amounts less than \$7,500,<sup>62</sup> this new bond reserved for consumer victims should significantly increase the percentage of cases where consumers actually get recompense.

Limiting access to this bond exclusively to consumers will also improve the flow of benefits to homeowner victims by reducing the existing competition between consumers and more sophisticated claimants (subcontractors, suppliers, and others) for bond payouts. The contractor's bond provides access to both consumer and industry claimants, often fostering what amounts to a "race to the courthouse" which race generally is won by the industry claimants as a function of their greater system knowledge and experience. A separate bond for consumers would be free of this difficulty (and incidentally should also benefit third-party claimants who may face less consumer competition for the license bond).

The proposed home improvement contractor's bond would also provide real consumer protection substance for the existing "Home Improvement Contractor Certification Program," which today has little real content or potential for actual consumer redress.<sup>63</sup> This would be an important step in the process of further professionalizing home improvement contracting, which process was only just begun with the existing certification program.

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<sup>60</sup> CSLB staff estimate that 70% of all complaints to the agency arise from home improvement contracting matters. *See also Using Surety Bonds, supra* note 32, at 31 and *passim*.

<sup>61</sup> This is a more direct and effective way of accomplishing the goal of the current legislative distinction in Business and Professions Code section 7071.5, subdivisions (a) and (b), which were drafted in their present form in part as an attempt to provide a lesser violation standard for homeowners to give them better access to bond funds.

<sup>62</sup> *Using Surety Bonds, supra* note 32, at 31.

<sup>63</sup> In 1997 the Legislature enacted Business and Professions Code section 7150.3, which establishes a certification program for contractors engaging in home improvement work. To achieve this certification (which is now required for all contractors performing home improvement activities), a licensee must take and pass a 20-question, open-book, multiple-choice examination that is available on the Internet. The exam is not trade-specific; it merely tests licensees' knowledge of the requirements of Business and Professions Code section 7159. Exam preparation materials are also available on the Internet; a licensee may take the exam an unlimited number of times until he/she passes. At present this is the only substantive component of the home improvement certification program, raising valid questions about the extent of consumer protection offered by the program in its present form. *See Initial Report, supra* note 7, at 77.

In summary, the home improvement contractor's bond would guarantee an increase in restitution available to consumers; reduce competition for existing license bond payouts; help professionalize the home improvement industry; and provide CSLB with a vehicle for consumer relief toward which it could direct consumer complainants.

Cost — The home improvement bond would mean an additional premium for home improvement contractors. The current range of premiums for the \$7,500 contractor's license bond is roughly \$65 to \$250 per year (minus available discounts),<sup>64</sup> and this is a likely range for the similar new home improvement bond. Such a premium would equate to a new expense of between 25 cents and \$1 per work day for a home improvement contractor. This modest amount would create no significant barrier to entry for most such contractors, many of whom routinely handle five- and six-figure home remodeling projects. And this additional cost is unlikely to add enough to home improvement project costs to become a significant additional expense passed on to consumers.

The bond amount of \$7,500 is also sufficiently small so as to require little if any additional underwriting by surety companies. This should help ensure that surety industry costs in offering this product are manageable. Ultimately this requirement should give rise to a new product with potential for new profits for the surety industry once the equilibrating actuarial process is complete.

Workability — The new home improvement contractor's bond would operate largely through existing bond procedures and practices, so workability problems should be minimal. Contractors, subcontractors, suppliers, sureties, and CSLB all understand the significance of and the process for the existing \$7,500 bond, so little new learning should be necessary. Some new administrative burden for CSLB will be entailed, although this proposal only adds to a remedy process consumers presently have today with the license bond.

Significantly, consumers should have a better chance of understanding and gaining access to this bond reserved exclusively for them. CSLB can assist with consumer education about this new bond. Consideration should also be given to improved consumer disclosures in home improvement contracts regarding the bond.<sup>65</sup> And this remedy has improved workability for consumers in that, at least with regard to the new bond, there is no inherently unequal race to the courthouse or other competition with more sophisticated industry participants.

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<sup>64</sup> *Using Surety Bonds*, *supra* note 32, at 31.

<sup>65</sup> Proposals for revision of home improvement contracts to include consumer disclosure of this new bond will be considered in future Monitor reports.

Acceptability — The proposed new bond is a substantial improvement for homeowners and should be welcomed by those consumers. Of course, a new bond of the comparatively modest amount of \$7,500 cannot offer the prospect of full restitution for cases involving major violations or numerous complaints. It nonetheless offers significantly improved consumer access to restitution.

Home improvement contractors will face small additional costs, but these should be far more acceptable than the much more costly and burdensome alternatives, such as a recovery fund, step bonding, or mandatory payment or payment/performance bonding. Subcontractors and suppliers retain unchanged access to the original license bond, and may even perceive that their access to this relief is improved (by virtue of consumers having an exclusive remedy of their own).

Surety companies should find this solution preferable to the likely alternatives of larger bonds or mandatory payment or payment/performance bonds, all of which would require extensive underwriting and would entail much greater and more unpredictable risks.

**Recommendation #35: Provide homeowners a good faith payment defense against lien claims in home improvement contracts of \$25,000 or less (Appendix I).**<sup>66</sup>

*Description:* This proposal would amend the existing mechanic’s lien provisions of the Civil Code to protect homeowners in smaller home improvement projects from having to pay twice in circumstances where the homeowner has already paid the prime contractor in good faith. This proposal would work by establishing a defense (in the nature of an exception to the “direct lien” under existing law) against lien enforcement in home improvement contracts of \$25,000 or less where the homeowner has made the required good faith payments to the original contractor.

This proposal does not abolish existing mechanic’s lien and stop payment remedies, but makes them enforceable in the specified contracts only to the extent that amounts remain unpaid to the prime contractor, or where payment has been as part of a bad faith evasion of the law. In a case where the original value of the home improvement contract is \$25,000 or less, but contract change orders or extras take the total contract value above this limit, the proposal would protect the homeowner only to the extent of any good faith payments up to the \$25,000 level, retaining mechanic’s lien enforceability for any other sums.

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<sup>66</sup> Draft statutory language for Recommendation #35 is contained in Appendix I, *infra*.



The proposal would modify the Civil Code provisions on lien enforcement, adding a new Civil Code section 3119, which would provide, in relevant part:

(b) Notwithstanding any other provisions in this title, the aggregate amount of mechanic's liens and stop notices that may be enforced in a case of a home improvement contract as provided in subdivision (a) [contract value of \$25,000 or less] against the homeowner's property or construction funds is limited to the amount remaining due and unpaid to the original contractor under the contract. Payments made to the original contractor in good faith discharge the owner's liability to all claimants to the extent of the payments.

*Discussion: Efficacy* — This proposal offers the prospect of real consumer relief from the double payment problem for qualifying home improvement contracts (those under \$25,000). It provides this relief *only* where it is undeniably appropriate, *i.e.*, where the consumer has him/herself acted in good faith by paying the prime contractor all amounts due and payable under the home improvement contract, expecting as a matter of fairness and common sense that subcontractors and suppliers would be paid by the prime contractor. This is a form of equitable defense or set-off available only to the extent that the homeowner has acted equitably.

This proposal would have the effect of spreading the risk of non-payment more rationally within the marketplace. The risk of non-payment in these smaller home improvement contracts — which previously rested entirely on the generally unsophisticated homeowner — would now be shared between experienced industry participants who are, or should be, familiar with the creditworthiness of their business partners and with payment remedies. This solution would remedy the principal defect in the present process: the expectation that the consumer has the knowledge and foresight to anticipate and select the best strategy to ensure third-party payments and avoid liens. This expectation is entirely reasonable and realistic in commercial construction and other situations involving contracts between those with equal industry knowledge and experience; it is entirely unrealistic in the home improvement context. Our proposal addresses the reality of consumer behavior in this situation.

Both actual liens and foreclosures, and the more frequent cases of lien threats as leverage to obtain double payments, should be significantly reduced through this proposal.

Further, under the proposed system, subcontractors, tradespersons, and suppliers on these projects would have an incentive to engage in the sound business practice of checking the credit

history and stability of the prime contractors to whom they are “lending” goods and services. This sound business approach is often not employed today, as some subcontractors and suppliers do not want to alienate prime contractors, and because — put bluntly — subcontractors and suppliers know they can pressure the homeowner into paying twice if the contractor fails to pay. The proposal encourages sound practices every businessperson should employ. In the alternative, these third parties are free to arrange for direct payment from the homeowner if they prefer.

Cost — Administrative implementation of the proposal itself is comparatively costless, as this acts only as a defense to private debt collection efforts and does not rely on regulatory enforcement. The proposal is self-enforcing in that it changes the relative legal rights of the homeowner and third parties, as well as changing the incentive structure facing subcontractors and suppliers, who will be encouraged to inquire about their prime contractors, or arrange for direct payment, or accept a measure of risk of non-payment.

Subcontractors, suppliers, and laborers who could formerly rely on the leverage of the mechanic’s lien may face increased costs of checking creditworthiness, or arranging for direct payment, or taking occasional legal action against non-paying contractors, or absorbing occasional non-payments (of comparatively small amounts in these smaller contracts).

But the actual impact on most subcontractors and suppliers will be minimal because of the modest cap applicable to this defense. Most trade contractors and suppliers do not actually bother to perfect mechanic’s liens as a collection strategy for smaller amounts (typically those under \$5,000 to \$8,000) because of the legal costs involved.<sup>67</sup> In most cases covered by this proposal (projects under \$25,000), few subcontractors or suppliers will have an individual stake larger than \$5,000 to \$8,000, so actual additional costs to subcontractors and others — in the form of debts previously recovered which now go unpaid — should be minimal. The principal significance in those circumstances may be that a trade contractor or supplier might no longer attempt to use the threat of a lien to induce homeowners to pay twice.

Workability — This proposal entails a relatively straightforward change in legal rights and remedies and there is no reason to anticipate unusual problems of implementation for the courts in this adjustment of legal rights.

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<sup>67</sup> *The Double Liability Problem*, *supra* note 33, at 292.

In the nature of a possible workability objection, some in the construction industry may contend that this modest limitation on the enforcement of mechanic's liens is an impermissible infringement on the historical mechanic's lien right conferred by the California Constitution.<sup>68</sup> However, the non-partisan California Law Revision Commission, in its recently published Recommendation in Study H-820, *The Double Liability Problem in Home Improvement Contracts*,<sup>69</sup> has demonstrated conclusively to the contrary: "The Commission's review of the constitutional issues leads to the conclusion that the proposal to protect good-faith payments by owners under home improvement contracts would be constitutional."<sup>70</sup> A review of 120 years of appellate interpretations of this provision reveals that the courts have consistently permitted our state Legislature to exercise its judgment in the precise implementation of the general mechanic's lien right. For example, the courts have upheld the Legislature's discretion to limit the mechanic's lien right in cases of unlicensed contracting and in public projects, when neither limitation is mentioned in the 1879 constitutional language.<sup>71</sup> The modest limitation proposed here is significantly less sweeping than the public projects or unlicensed contracting limitations, and will survive any constitutional scrutiny just as have those provisions.

Acceptability — Consumers, CSLB, and the law enforcement community will welcome this significant new consumer protection for one class of home improvement projects. Contractors uninvolved in home improvement work will be unaffected by this statutory defense.

Home improvement prime contractors may face more instances of scrutiny for creditworthiness or subcontractor requests for direct payment plans, but neither of these results is a serious impediment for the honest and responsible prime contractor. And of course, contractors who do not pay subcontractors may face legal action, but their plight is of their own making.

Subcontractors, suppliers, and laborers may not welcome even a small limitation on their access to the legal tool of the mechanic's lien. However, this proposal is crafted to minimize the

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<sup>68</sup> Cal. Const., art. XIV, § 3.

<sup>69</sup> 31 Cal. L. Revision Comm'n Reports 281 (2001); Appendix: Constitutional Considerations; part of publication #212 [2001–2002 Recommendations].

<sup>70</sup> *Id.* at 330.

<sup>71</sup> *Vallejo Development Co. v. Beck Development Co.* (1994) 24 Cal.App.4th 929,938 (limitation of mechanic's lien right to licensed contracting upheld); *Mayrhofer v. Board of Education* (1891) 89 Cal. 110, 112–113 (California Supreme Court upholds limitation of mechanic's lien right in cases of public property). See *The Double Liability Problem*, *supra* note 33, at 323–27.

day-to-day impact for most subcontractors or suppliers who exercise sound business judgment. Most of these do not in fact file such liens in cases as small as those covered by this proposal. Further, this moderate change ensures that they still retain the mechanic's lien right for larger home improvement projects, and all other forms of contracting, where much more is at stake.

In the longer run, this change should help promote better use of sound business practices — such as credit checks and direct payment (where appropriate) — in these smaller projects. This proposal may actually provide a solid justification for change in these practices, which may help the subcontractors and suppliers adopt better practices without damaging relationships or losing business to those who do not employ sound practices. And in the final analysis, it is hoped the subcontractors and suppliers will appreciate that this is a reasonable solution to a serious problem, and is a means of avoiding more drastic changes in laws or rights.

**Recommendation #36: Clarify the payment standard applicable to the contractor's license bond (Appendix J).**<sup>72</sup>

*Description:* This proposal would amend the provisions of the License Law governing access to the contractor's license bond to clarify the standard of payment on those bonds.<sup>73</sup> The proposal would ensure that these bonds are to benefit any person damaged as a result of a *willful* act in violation of the License Law, or by fraud, and would define the term “willful” consistently with the definition which governs most criminal and regulatory statutes, found in California Penal Code section 7. Specifically, Penal Code section 7 defines “willfully” as “a purpose or willingness to commit the act, or make the omission referred to. It does not require any intent to violate law, or to injure another, or to acquire any advantage.”

The proposed statutory change to accomplish this would read, in relevant part:

7071.5 The contractor's bond required by this article shall be executed by an admitted surety in favor of the State of California, in a form acceptable to the registrar and filed with the registrar by the licensee or applicant. The contractor's bond shall be for the benefit of the following:

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<sup>72</sup> Draft statutory language for Recommendation #36 is contained in Appendix J, *infra*.

<sup>73</sup> Bus. & Prof. Code § 7071.5 (contractor's bond) and § 7071.10(a)(2) (qualifying individual's bond).

(a) Any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the licensee.

(b) Any person damaged as a result of a willful ~~and deliberate~~ act in violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

(c) Any employee of the licensee damaged by the licensee's failure to pay wages.

...

(e) As used in this section, "willful" means simply a purpose or willingness to commit the act, or make the omission referred to, and does not require any intent to violate the law, or to injure another, or to acquire any advantage. For the purposes of this section "willful" shall be interpreted in a manner consistent with the meaning of "willfully" provided by Section 7(1) of the Penal Code.

The proposal seeks to eliminate existing confusion and variations in surety company and contractor practices by eliminating the element of "deliberate" violation for all claimants governed by this subsection of section 7071.5. This is intended to assist subcontractors, suppliers, laborers, and others, with a simpler and clearer payment standard. It is also intended as an indirect assistance to homeowners contracting for home improvement, who, though ostensibly covered by subsection (a) of section 7071.5 (which does not require a "willful and deliberate" violation) still sometimes confront reluctance to pay on bonds in cases of allegedly non-deliberate violations.

*Discussion: Efficacy* — As described above and in *Using Surety Bonds*, there exists today considerable confusion surrounding the differing standards for access to the contractor's bond. Different surety companies require differing standards of violation and differing amounts of documentation or proof before payment is made on contractor bonds.<sup>74</sup> A portion of this confusion arises because of the inclusion of "willful and deliberate" in section 7071.5(b) and elsewhere. Some interpret this conjunctive statement as a requirement of intent to defraud or conscious intent to violate a known License Law standard.

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<sup>74</sup> *Using Surety Bonds*, *supra* note 32, at 28–31.

Many commentators (and previous legislative proposals) have sought clarification of this legal standard. The Monitor staff received suggestions from many sources that the confusion could be eased by the adoption of a single intent element (*i.e.*, “willful”) and by correlating the meaning of this element with the longstanding and well-precedented statutory meaning of “willful” contained in Penal Code section 7. Supported by consistent judicial interpretations, the plain meaning of “willful” under section 7 is that the actor intends to do the act, as opposed to situations involving an accident (where the actor intends to do something else) or a case of duress or coercion.<sup>75</sup>

The “deliberateness” of the current standard may require a level of specific intent that is often impossible to prove adequately. Experts we have consulted contend it is inappropriate to insist on intentional or specific-intent violations in order to provide the relief of a bond payment. They analogize to tort law and the doctrine of negligence *per se*, under which negligence (and thus liability) is presumed where a person acts in violation of a statute, even without the intention to violate the law or knowledge of the law. The law establishes a presumption of the appropriate duty of care, and a person is held responsible to behave in a way that meets the requirements of the law. Shouldn’t licensed contractors be required to adhere to the law in the same way?

Adoption of the Penal Code section 7 willfulness concept clarifies that no form of specific intent, or intent to defraud, or intent to violate law, is required for a violation triggering bond access. A contractor who intends an action which is ultimately determined to be in violation of the License Law can be the subject of a bond payment. Consistent with many misdemeanor and other regulatory offenses, this change would reduce confusion and uncertainty among subcontractors, suppliers, contractors, and surety companies, which in turn should reduce legal uncertainty and legal transaction costs.

Importantly, the use of this definition of “willful” does not render the presence of the term meaningless. There is still significant protection for contractors in that this definition of willfulness screens out genuine accidents (acts which were not intended to be taken), acts under duress or coercion, and arguably acts taken under certain kinds of mistake of fact, among others (none of which should necessarily trigger either bond payment or license action). However, this standard would place an increased emphasis on the importance of contractors understanding the License Law and taking care to comply with it. This should be viewed as a positive step in further professionalizing this industry.

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<sup>75</sup> See *People v. Atkins* (2001) 25 Cal.4th 76 (“willfully” requires only that the illegal act occur intentionally, without regard to motive or ignorance of the act’s prohibited character); *In re Jerry R.* (1994) 29 Cal.App.4th 1432, review denied.

Cost — This proposal would cause at least some increase in payouts to non-consumer bond claimants and perhaps in some consumer cases, as well (in light of the current varying practices and standards on bond payments applied by the differing surety firms). Costs of payment for surety companies will increase to some extent, although these costs can and should ultimately be factored into actuarial analysis and recovered in premiums. To some extent, additional industrywide costs absorbed by surety companies will be offset by reduced costs (reduced losses) to subcontractors and suppliers who are now better able to recover payments due them, which in turn reduces total industry costs. It is likely that the net effect of this proposal would be simply a fairer spreading and sharing of the risks of certain improper conduct.

Workability — The adoption of the well-established Penal Code standard should if anything ease workability for the judicial and administrative processes, as clarity of legal standard reduces legal disputes and legal transaction costs.

Surety companies may find that the easier payout standard for subcontractors and suppliers increases the sureties' need to perform rudimentary underwriting for these bonds. However, use of this legal standard still retains the fundamental requirement of a proven violation of the License Law; this approach will not bring on a form of "open season" for accidental mistakes, as most true accidents are not "willful" within the meaning of Penal Code section 7. And mistakes of judgment would only trigger payment if they violate the License Law — an appropriate public policy result in the view of many experts.

Acceptability — Subcontractors, suppliers, consumers, and many others will appreciate the use of a clearer and simpler standard, and the elimination of confusion which often overwhelms even legitimate claimants. Surety companies logically would not welcome an easier payment standard without other policy motivations and considerations in play. But it is hoped that this solution will be acceptable as part of balanced package of changes which together do not unduly jeopardize the overall position of surety companies. Contractors will likely face a marginally greater incidence of bond payouts and the attendant consequences, but these payouts will only occur where License Law violations have been established (and not violations resulting from true accidents). This comparatively modest impact on most law-abiding and careful contractors should still be preferable to more burdensome remedy systems which are under active consideration today.

**Recommendation #37: Provide new lien expungement provision to assist consumers with unjustified and void liens (Appendix K).<sup>76</sup>**

*Description:* This proposal would amend Civil Code section 3144, which presently limits the binding effect of liens to 90 days “unless within that time an action to foreclose the lien is commenced in the proper court” (except in cases of credit given), and voids lien claims which are not perfected in a timely fashion. This proposal would provide for automatic expungement of invalid and void liens from county property records. The primary goal of this modest change is to automatically clear title for innocent consumers without their having to suffer the burden and expense of taking legal action to remove invalid liens from public records.

The relevant statutory language to accomplish this result would read as follows:

3144. (a) No lien provided for in this chapter binds any property for a longer period of time than 90 days after the recording of the claim of lien, unless within that time an action to foreclose the lien is commenced in a proper court, except that, if credit is given and notice of the fact and terms of such credit is recorded in the office of the county recorder subsequent to the recording of such claim of lien and prior to the expiration of such 90-day period, then such lien continues in force until 90 days after the expiration of such credit, but in no case longer than one year from the time of completion of the work of improvement.

(b) If the claimant fails to commence an action to foreclose the lien within the time limitation provided in this section, the lien automatically shall be null and void and of no further force or effect.

(c) On the expiration of any applicable period specified in subsection (a), if a notice of pendency has not been recorded in accordance with the provisions of Chapter 1 (commencing with Section 405) of Title 4.5 of Part 2 of the Code of Civil Procedure, any lien that has become void under the provisions of this section shall be expunged by operation of law and shall be removed from the record by the county recorder or official responsible for the recording of liens provided for in this chapter.

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<sup>76</sup> Draft statutory language for Recommendation #37 is contained in Appendix K, *infra*.



*Discussion:* Efficacy — This proposal is intended as a modest form of assistance for homeowners in dealing with the challenges presented by mechanic's liens. This simple change is intended to reduce or eliminate the burden on a homeowner of having to hire an attorney to help expunge a lien claim which was recorded but never foreclosed or perfected.

By current operation of law in Civil Code section 3144, such liens become void within a specified time period, typically 90 days (except in special cases where credit is advanced). However, the filed lien claim may still appear on the county property records, which may cause confusion or difficulty when the homeowner goes to borrow on or sell the property. Such filed lien claims are also now picked up by certain of the commercial public records services, which can result in harms to the consumer's credit rating, job prospects, and the like.

Unsophisticated consumers with little knowledge of the lien process should not have to go to the expense and trouble of clearing title in circumstances of void lien claims which subcontractors or suppliers have filed but not perfected. Automatic expungement of void liens would end this unfair result and ensure that non-meritorious parties cannot impose costs on innocent consumers. This remedy may also reduce the perceived burden and the psychological leverage associated with a subcontractor's or supplier's lien threat, which in turn may make the improper uses of this leverage less effective and thus less common.

Cost — This remedy would reduce costs for homeowners and impose no costs on other stakeholders in the construction industry. Some additional clerical costs for recorders' offices may result, but ensuring clear and accurate property records is an important part of the proper mission of these offices.

Workability — This proposal simply adds to the existing Civil Code principles on void lien claims, and we perceive no significant legal workability issues. This remedy would require recorders' offices to develop a process to carry out these routine expungements, and it may be advisable to consult with recorders' offices on means to ease this burden.

Acceptability — Consumers will welcome this small but helpful remedy, and the Monitor staff is unaware of any stakeholder with a legitimate objection to expunging lien claims which are already void by operation of law. The only parties conceivably disadvantaged are those few subcontractors or suppliers who make a practice of obtaining leverage by filing and serving lien papers even without the intention to proceed. But there is no sound public policy reason to support such practices.

## D. Other Consumer Remedies Alternatives Considered

The problem of inadequate consumer remedies in the construction industry has given rise to a wide range of proposals for change. There is an extensive body of literature considering these remedial alternatives and a recapitulation of those studies is beyond the scope of this report.<sup>77</sup>

However, to assist in evaluating the Monitor's recommendations, we offer a summary review of other consumer remedies alternatives considered by the Monitor and the reasons those remedies have been provisionally rejected or reserved for later consideration. Some of these remedial alternatives — including such remedies as a consumer recovery fund, step bonding, or mandatory payment or payment/performance bonding — may yet prove necessary if less sweeping and burdensome alternatives cannot be implemented successfully.

Grouped by the aspects of the consumer remedies problem the Monitor has identified, these other consumer remedies alternatives include the following:

### ■ Alternative Remedies Relating to Double Payment

**Required payment bonding or performance/payment bonding.**<sup>78</sup> This proposal would require all contractors (or all home improvement contractors) to obtain payment bonds (bonds which guarantee that subcontractors, material suppliers and laborers are paid) or performance and payment bonds (which guarantee both satisfactory completion of the contracted work and also the payment of all subcontractors, material suppliers and laborers). This requirement would be an effective tool for avoiding double payments, lien issues, and for ensuring adequate performance, and such bonding is widely used in commercial construction. The California Law Revision Commission strongly considered such a proposal in its H-820 study of these problems<sup>79</sup> and a version of such a

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<sup>77</sup> See, e.g., Joint Legislative Sunset Review Committee, *JLSRC Findings and Recommendations: Contractors State License Board* (April 1997); Joint Legislative Sunset Review Committee, *Final Recommendations of the Joint Legislative Sunset Review Committee and the Department of Consumer Affairs: Contractors State License Board* (April 11, 2000); California Law Revision Commission, *Mechanic's Liens* (Study H-820), under way since June 28, 1999; California Law Revision Commission Study H-820, *Memorandum 2002-8* (January 2002) (hereinafter "*Memorandum 2002-8*"); *The Double Liability Problem*, *supra* note 33; *Using Surety Bonds*, *supra* note 32; Contractors State License Board, *Analysis of State Recovery Funds* (Oct. 1, 2001); and sources cited in *Initial Report*, *supra* note 7, at 37, n. 29.

<sup>78</sup> See *Using Surety Bonds*, *supra* note 32, at 6; *Memorandum 2002-8*, *supra* note 77, at 13–16.

<sup>79</sup> California Law Revision Commission, *Mechanic's Liens* (Study H-820), under way since June 28, 1999; *Memorandum 2002-8*, *supra* note 77, at 13–16.

requirement may yet be necessary to effectively solve double payment and restitution problems. However, disadvantages of this approach include cost (underwriting would be necessary; premiums would be substantial; and these would create major barriers to entry for some contractors); workability (a large administrative burden for industry and for CSLB, if it is expected to monitor projects and enforce this requirement); and acceptability (contractors object to greatly increased premiums and entry barriers; sureties fear underwriting obligations of this kind; and CSLB management is reluctant to take on major new administrative burdens now in an era of limited resources). For these reasons, the Law Revision Commission withdrew its proposal in this regard at least for the present.

**Required joint signature payments/joint control accounts/direct payment.**<sup>80</sup> These related proposals all attempt to resolve the double payment problem by similar means: joint signature requirements on home improvement contract checks (to ensure that contractors and third parties work together and divide payments correctly); joint control accounts (a type of escrow fund used to ensure correct payment disbursement); and direct payment (in which the homeowner must pay subcontractors and suppliers directly as a means of avoiding liens). These approaches also represent potentially effective tools for avoiding double payment and lien problems, and a few sophisticated consumers can and should be expected to use these alternatives as lien avoidance methods, especially on larger projects justifying the expense and effort. Problems include costs (“escrow” charges for smaller projects); workability (considerable set-up efforts may be necessary; these mandate a business relationship and a mode of operation, which mandate may add transactional burdens that are impractical and may reveal more about contract profitability than prime contractors are prepared to share); and acceptability (contractors for the above reasons).

**Modifications to notices of lien rights (20-day notice practices).**<sup>81</sup> Better notice of lien rights could be mandated. Improved notice and education might provide consumers enough understanding in time to act, and some might be able to take steps to protect themselves. But most consumers lack the experience, system knowledge, and willingness to take effective action, so it is unrealistic to expect that improved notice alone would be effective in significantly reducing consumer harms.

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<sup>80</sup> *Using Surety Bonds*, *supra* note 32, at 6–7; *Memorandum 2002-8*, *supra* note 77, at 8–9.

<sup>81</sup> *Id.* at 5–6.

### ■ Alternative Remedies Relating to Consumer Restitution

**Large increase in existing contractor's bond amount.**<sup>82</sup> This concept involves raising the existing contractor's bond amount dramatically, to perhaps \$25,000 or more (more in line with bonds for such others as telemarketers (\$100,000) and immigration consultants (\$50,000)). This proposal largely involves questions of degree which are addressed in Monitor Recommendation #34.

A very substantial increase (to \$25,000 or more) would be at least somewhat effective in making a greater amount available for consumer redress. However, potential problems associated with a large increase, undertaken without other changes, include efficacy (without limitations on access for third-party claimants, consumers will still be "last in line" for bond amounts); cost (a large increase will require substantial underwriting and greatly increased premiums, both of which would create substantial barriers to entry for small businesspersons); workability (the mechanics of underwriting and the uncertainty that surety companies would offer sufficient product); and acceptability (a large bond increase for all contractors burdens even those who are not in problem industry segments; a large increase is likely to meet stiff opposition from smaller contractors and the surety industry).

**Required continuous bonds.**<sup>83</sup> This concept involves mandating a change in the bond applicability period so that bonds are coterminous in time with two-year licensure periods. This would effectively double bond funds available for redress and bond payment exposure for surety companies. This proposal involves many of the same advantages and problems which are associated with a large increase in the bond amount (discussed immediately above).

**Step bonding.**<sup>84</sup> This proposal would require a graduated (or "stepped") system of bond amounts, with larger amounts required for contractors who undertake larger contracts. Nevada presently uses such a system, admittedly for a much smaller construction industry.<sup>85</sup> While offering real promise for improved consumer restitution, a step bonding system would entail major structural change in the California construction industry and the CSLB regulatory process, as it would involve substantial financial accounting and monitoring, extensive underwriting by surety companies, dramatically increased premiums, and significant new enforcement and administrative obligations for CSLB. The Contractors Board has concluded that the dramatic differences in size and

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<sup>82</sup> *Using Surety Bonds*, *supra* note 32, at 25–27; *Memorandum 2002-8*, *supra* note 77, at 6–7.

<sup>83</sup> *Using Surety Bonds*, *supra* note 32, at 32.

<sup>84</sup> *Id.* 21–22; *Memorandum 2002-8*, *supra* note 77, at 7.

<sup>85</sup> Nevada Revised Statutes § 624.270.

complexity between the two industries “make Nevada’s approach impractical in California.”<sup>86</sup> The Monitor believes these challenges make a good argument for attempting other incremental changes before revisiting this issue, but this remains a potential option if less sweeping change cannot be made to work.

**Substantial increase in contractor capitalization requirement.** This concept involves increasing the minimum capitalization requirement to qualify for a California contractor’s license from \$2,500 to a figure which would more clearly indicate substantial financial solvency (such as \$10,000–\$25,000 or more). However, any but a very large increase would add only marginally to judgment relief prospects, and there are serious concerns over cost (a substantial financial requirement would in fact act as a barrier to new entrants and small individual contractors) and acceptability, as many in this industry cherish the tradition of the industry as a bastion of opportunity, and would likely oppose anything but a small increase.

**Consumer restitution recovery fund.**<sup>87</sup> This proposal, adopted in various forms in fifteen other states, would establish a recovery fund, supported by an assessment on contractors or contracts, which would make payments to consumers injured by improper contractor conduct. This would bear some analogy to the existing recovery funds administered today by the California State Bar and the California Department of Real Estate.<sup>88</sup> This proposal has perhaps the best potential for substantial recovery for consumer losses. By virtue of funding and payment processes controlled by legislative mandate and the regulatory agency, problems of inadequate relief and difficulties of consumer access could be addressed unilaterally. With adequate funding and efficient administration, a recovery fund could well achieve high levels of consumer redress. However, a recovery fund would require major structural, operational, and financial changes for the California construction industry. Such changes would certainly entail substantial costs for all participants, including CSLB to which would fall the substantial burden of administering a major new consumer program. And a wide range of workability concerns would require resolution, including fund solvency issues and rules and procedures for efficient and easy consumer access. Because of the major structural changes and substantial costs associated with a recovery fund, many segments of this industry would find the prospect of such a fund daunting. The Monitor believes this concept has

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<sup>86</sup> *Using Surety Bonds*, *supra* note 32, at 22.

<sup>87</sup> See Contractors State License Board, *Analysis of State Recovery Funds* (Oct. 1, 2001); *Memorandum 2002-8*, *supra* note 77, at 12–13.

<sup>88</sup> *Id.*

considerable merit, but he is committed to attempting to find less burdensome solutions as a first alternative.

#### ■ Other Remedial Alternatives

**Mandatory commercial general liability insurance.**<sup>89</sup> This proposal would mandate commercial general liability insurance (GLI) for all licensed California contractors. This proposal would provide significant new protection for consumers from a variety of tort-type liabilities, and the Monitor supports this concept. However, this mandate would not directly address the double payment or consumer redress issues, and thus is not a direct response to the most prominent aspects of consumer remedies problem.

**Enhanced enforcement efforts.** In numerous discussions with industry leaders, we have heard a repeated call for enhanced CSLB enforcement efforts as a means of reducing the need for consumer remedies by aggressively identifying and removing the small minority of truly fraudulent or grossly incompetent contractors, which small minority contributes disproportionately to the problems requiring consumer remedies. The Monitor agrees wholeheartedly with the importance of improved enforcement efforts, as the *Initial Report* addresses at length.<sup>90</sup> And although not a substitute for a direct response to the inadequacy of current consumer remedies, better enforcement is and should be a central part of the overall strategy to better protect the California public.

### E. Conclusion on Monitor Remedies Recommendations

In choosing a course of action to improve consumer remedies, we should begin and end with this important principle: The status quo is unacceptable and debate over change has been interminable. Leaders in the California Legislature have told us the time to act is now. It is incumbent on all stakeholders to contribute to an improved remedial process, understanding that no improved protection of the public will be costless, but recognizing that a balanced and moderate approach can distribute the burdens fairly and preserve what is vital for all parties.

This package of proposals meets all reasonable criteria for viable improvements in consumer remedies, including efficacy, cost, workability, and reasonable acceptability to all parties. The proposals focus on home improvement, where the majority of the problems and complaints arise.

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<sup>89</sup> *Using Surety Bonds*, *supra* note 32, at 35–38.

<sup>90</sup> *See Initial Report*, *supra* note 7.

The proposals would work synergistically, reinforcing one another and together improving both the double payment and the consumer redress concerns. By way of examples, the pressure on the modest contractor's bond today is especially serious because third-party claimants have a substantial advantage in accessing the only available bond. A separate bond reserved for consumers eases that pressure and increases the availability of consumer redress. And a carefully crafted limit on the mechanic's lien addressing the double payment issue will materially assist homeowners without dramatically altering the economic positions of the construction industry members.

Given that change is on the horizon, these proposals offer a reasonable prospect for all the industry stakeholders:

**Consumers** obtain effective protection from double payment in smaller home improvement contracts, but only to the extent that they meet their responsibilities in good faith. Consumers gain a much improved prospect of restitution for harm, automatic expungement of void and invalid liens, and greater clarity on recovery standards in the industry as a whole.

**Prime contractors** in home improvement gain improved professionalism and industry integrity, without the necessity of other more burdensome and costly remedies under current consideration and without the attendant barriers to entry. Contractors not engaged in home improvement contracting for the most part remain completely unburdened by remedies targeting problems in home improvement.

**Subcontractors, suppliers, and laborers** gain a clarified and simplified standard for bond recovery with the new "willful" legal standard. And while few businesspersons readily embrace limits on available legal remedies (such as the proposal for a modest good faith payment defense here), many thoughtful industry commentators have confided to us that subcontractors and suppliers would benefit significantly in the long run from adopting sound business practices here, including insisting on the background information and assurances that most businesses utilize. An unfortunate cultural norm of lax business practices in this regard may be changed to the benefit of *all*. And importantly, this remedy leaves mechanic's lien rights entirely unaffected for most contracts and all larger contracts.

**The surety industry** participates in a new era of consumer remedies without major structural and operational changes to the industry, such as would attend new forms of bonding or greater bond amounts requiring extensive underwriting. And ultimately the surety companies will have a new and profitable product to sell without undue burden or exposure.

**CSLB and the enforcement community** help bring about important new consumer remedies to better serve the public, and achieve this without unmanageable new administrative burdens.

Viewed as a whole, the aggregate effect of these proposals is a significant improvement in consumer redress and freedom from harms associated with contractor misconduct, which improvement avoids unacceptable new costs or burdens for the construction industry.

The Monitor believes these proposals are a balanced and appropriate program constituting real progress for the construction industry. Together these proposals represent good medicine to cure the ailments of the present system without major surgery that few will welcome. This package is a consensus-oriented approach which all stakeholders should strive to implement to better serve the public and to advance the cause of greater professionalism in the construction industry.



## Chapter V

# CONCLUSION

This report has presented two fundamental conclusions of the CSLB Enforcement Program Monitor regarding the state of CSLB's enforcement system and of consumer remedies for contractor misconduct:

**CSLB's enforcement system is now headed in the right direction but cannot truly improve until it receives the necessary resources and statutory tools.** CSLB and its management and staff have succeeded in dramatically altering the direction of the agency's enforcement program. At the direction of CSLB's public-spirited Board, new Registrar Stephen Sands, Deputy Chief Linda Brooks, newly appointed Enforcement Chief David Fogt, and their colleagues have fully embraced all 33 recommendations presented by the Enforcement Monitor in his Initial Report, and have added important new system improvements of their own. The Monitor is entirely satisfied that CSLB is headed into a new era of effective law enforcement and public service.

But this new direction can only meet with success if CSLB receives the resources which are absolutely essential to getting this job done. These resources include immediate approvals for limited but vital law enforcement hiring, and changes to its statutory authority (proposed in current sunset legislation) which will permit CSLB to increase fees modestly to improve its enforcement program, and to implement critical law enforcement tools such as fingerprinting for accurate criminal history verification of prospective licensees.

**Consumer remedies for contractor misconduct are woefully inadequate, but the legislative proposals in this report can provide substantial improvements which should be acceptable to all industry participants.** Almost no one is satisfied with the remedies available to California homeowners today, who too often face the problems of double payments for home improvements and inadequate consumer restitution in cases of contractor fraud or misconduct. The

Monitor has presented a package of four interrelated legislative proposals which, taken together, hold out a genuine prospect for improving the remedies available to consumers in the home improvement context (the source of most contractor complaints). These remedies include a new home improvement contractor's bond exclusively for the benefit of homeowners, a new legal defense to protect homeowners from double payments in home improvement contracts, and related remedies.

All improvements of this kind involve a measure of cost and call for compromise among industry participants. But in the final analysis, *all* Californians are consumers of construction services, and *all* Californians — homeowners and contractors; consumers and businesspersons — are beneficiaries of a healthy, efficient, and ethical construction industry. Improvements to consumer welfare in this industry should be important to everyone, and improved professionalism is beneficial not only to consumer-customers but to every honest participant in the construction industry.

The Monitor urges all those who work with or within the construction industry to set aside differences and work together constructively to identify and support changes which will help move this industry to a higher level of professionalism and public service.

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**APPENDIX A**

THOMAS A. PAPAGEORGE, ESQ.  
CSLB Enforcement Program Monitor  
(213) 580-3305 (office)

December 12, 2001

Kathleen Hamilton, Director  
Department of Consumer Affairs  
400 R Street, Suite 3000  
Sacramento, California 95814

Re: Hiring Freeze Exemption Requests of Contractors  
State License Board

Dear Director Hamilton:

I write in my capacity as Enforcement Program Monitor for the Contractors State License Board (CSLB) to support CSLB's request for selected exemptions from the present State of California hiring freeze.

As the following comments will indicate, CSLB serves a important law enforcement function in California. It is vital that CSLB be permitted to fill current vacancies in its law enforcement and investigations staff. Further, filling these vacancies will not adversely affect the state's General Fund, as CSLB is an entirely fee-funded agency. In my judgment, this is not a routine agency request for hiring freeze relief, but rather an urgent plea for assistance made necessary by chronic enforcement problems at this agency and by a pressing mandate from the Legislature and this Administration.

CSLB Enforcement Monitor Project: Mandate and Scope

As you know, I am the Head Deputy District Attorney in charge of the Consumer Protection Division of the Los Angeles District Attorney's Office. In April of 2001, you appointed me to the position of CSLB Enforcement Program Monitor. Through the courtesy of Los Angeles District Attorney Steve Cooley, I will serve in this capacity part-time for the two-year term of the position.

The CSLB Enforcement Monitor's project is the result of the state Legislature's 1999–2000 sunset review of CSLB. Senate Bill 2029, authored by Senate Business and Professions Committee Chair Liz Figueroa, established the position of Enforcement Monitor and set as the Monitor's mandate:

*Kathleen Hamilton, Director*

*December 12, 2001*

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“To evaluate the Contractors’ State License Board discipline system and procedures, making as his or her highest priority the reform and reengineering of the board’s enforcement program and operations, and the improvement of the overall efficiency of the board’s disciplinary system.”<sup>91</sup>

The project, which began on April 5, 2001, and will continue through January 31, 2003, is thus the product of a mandate by this Legislature and the administration of Governor Davis.

The staff of the Monitor project have undertaken a comprehensive review of the law enforcement functions of CSLB, during which review we have:

- Analyzed all 14 previous studies/reports on CSLB published since 1973;
- Interviewed more than 80 experts and witnesses to date;
- Gathered and analyzed a large volume of documents and statistical data; and
- Conducted extensive research into initial issues and concerns relating to CSLB’s disciplinary process.

On October 1, 2001, the Monitor project published the *Initial Report of the CSLB Enforcement Program Monitor*. This report, a copy of which has been previously delivered to you, is a 136-page analysis of the CSLB’s enforcement program, featuring a detailed description of that program, a number of findings and concerns grouped into eleven categories, and a total of 33 recommendations for improvement in the enforcement program. (The *Initial Report* is available on the Department of Consumer Affairs Web site at [www.dca.ca.gov](http://www.dca.ca.gov).)

### Significance of the Contractors State License Board and Its Staffing

The Contractors State License Board is the California consumer protection agency charged with licensing construction contractors who work in the state, handling consumer complaints, and enforcing state laws pertaining to contractors. CSLB licenses approximately 45 categories of contractors and registers home improvement salespersons.

Created in 1929, and now an independent board within the California Department of Consumer Affairs, CSLB had in 2000–2001 an operating budget of \$45.6 million and 466 authorized staff positions. The agency is virtually entirely funded by contractor fees, and as a result its hiring practices have no impact on the state General Fund.

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<sup>91</sup> Bus. & Prof. Code § 7092(c)(1).

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CSLB serves an important law enforcement function. During the past year CSLB regulated more than 278,000 licensees, administered examinations to approximately 41,000 license applicants, received 24,313 complaints, and closed 23,271 complaints. The subject matter of these regulatory efforts — construction work by California’s contractors — is a \$30-billion dollar industry which has an enormous impact on the lives of consumers, whose homes, finances, and personal safety are at stake in these transactions.

In addition to administering examinations which test prospective licensees and issuing licenses, CSLB plays a key role in the process of state law enforcement by investigating complaints against licensed and unlicensed contractors, issuing citations and suspending or revoking licenses, and seeking administrative, criminal, and civil sanctions against law violators. These enforcement activities are central to CSLB’s mission, and crucial to California’s overall efforts against consumer fraud and abuse.

#### Previous Studies and the Documented Need for Enforcement Resources

As Chapter IV of the *Initial Report* describes, over the past three decades CSLB has been the subject of no fewer than fourteen independent (non-CSLB) published reports,<sup>92</sup> and the findings and concerns of these reports have been remarkably consistent. Of greatest relevance to this exemption request, these prior studies concluded that:

- Unsatisfactory delays, long cycle times, and backlogs have plagued CSLB’s complaint handling, investigation, and prosecution processes; and

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<sup>92</sup> See Arthur Andersen & Co., *Report on Management Review of Operations and Personnel Requirements* (1973); Department of Finance, *A Review of the Investigatory Function and Measurement of Productivity of the Contractors State License Board* (1975); Office of the Auditor General, *Contractors State License Board: Need for Improved Administration of the Complaint Processing Program* (1979); Department of Finance, *Report on the Joint Department of Finance/ Contractors State License Board Field Operations Task Force on Complaint Handling* (1980); Department of Finance, *Zero-Based Budget Study* (1982); Price Waterhouse, *Management Review of the Contractors State License Board* (1984); Price Waterhouse, *Report on Interim Workload and Staffing Standards for the Contractors State License Board* (1985); Arthur Young, *Contractors State License Board: Final Report on Field Office Operations, Workload Standards, and Staffing Requirements* (1989); Assembly Consumer Protection Committee Report (1993) (CSLB “critically deficient in protecting consumers from unscrupulous or unqualified contractors”); Joint Legislative Sunset Review Committee, *Contractors’ State License Board: Board Overview, Issues, Findings and Recommendations* (1997); Price Waterhouse, *Transition Review of the California Contractors State License Board* (1998); Joint Legislative Sunset Review Committee, *Contractors’ State License Board: Joint Legislative Sunset Review Committee 2000 Sunset Review Report* (2000); Bureau of State Audits, *Department of Consumer Affairs: Lengthy Delays and Poor Monitoring Weaken Consumer Protection* (2000); NewPoint Group, *Contractors State License Board: Reengineering Project Assessment* (2001).

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*December 12, 2001*

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- As a result, *additional resources must be directed to CSLB's complaint handling and investigation functions to better protect the public from fraud and abuse.*

(See *Initial Report*, at pp. 37–40.)

### Findings of CSLB Enforcement Monitor Relating to Hiring Needs

As Chapter VI of the *Initial Report* demonstrates, the Monitor has found the same circumstances today at CSLB: Due to critical vacancies in key enforcement positions, especially investigators, this agency is unable to meet the Legislature's mandate for improved consumer protection. (See *Initial Report*, at pp. 83–87.)

In particular, CSLB has a cadre of hardworking investigators (now designated as Enforcement Representatives or ERs) who perform the field investigations in support of criminal, civil and administrative enforcement actions. Sadly, this investigative phase of the enforcement process is now, and has regularly been, plagued by excessive investigator caseloads, unsatisfactory cycle times, and case backlogs. Current cycle times and case delays are at unacceptable levels: The 2000–2001 average for investigation closure is 221 days (compared with a goal of 90 days) — an increase of 28 days since 1998 — and the number of pending licensee complaints in the system has increased by 30% (from 5,308 to 6,976) in the past two years, as reflected in Exhibit VI-A of the *Initial Report*.

The current statewide ER vacancy rate of at least 16% (17 of 118 positions vacant) — indicated in Exhibit VI-B of the *Initial Report* — is the heart of this problem. Until current investigator vacancies are filled, there can be no further progress toward acceptable caseloads and satisfactory cycle times and backlogs. Serious law enforcement matters will remain unresolved while these shortages continue. In part as a result of past and existing enforcement staff shortages, CSLB is plagued by:

- Serious lapses in screening out undesirable, high-risk contractors (such as the recent Crown Builders matter in San Diego);
- Inadequate detection and punishment of unscrupulous contractors, some of whom continue to prey upon the public;
- A continuing problem of unlicensed contracting;
- Consumer satisfaction levels for CSLB which have declined from a modest 63% satisfaction rate to a troubling 54% rate. (See *Initial Report*, at Chapter VI, subchapter F.)

*Kathleen Hamilton, Director*  
*December 12, 2001*  
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In summary, our report documents that, although there is much that is good at CSLB today — including a dedicated staff, a highly capable new management team under new Registrar Stephen Sands, a public-spirited Board, and significant improvements in a number of operational areas — CSLB still faces serious shortcomings in meeting its statutory obligation to protect California consumers from contractor fraud and other law violations.

#### Report Recommendations and the Exemption Requests

Pursuant to the Legislature's mandate in Bus. & Prof. Code section 7092, the *Initial Report* offers 33 initial recommendations for improvement to CSLB's enforcement program. (See generally, *Initial Report*, at Ch. VII.)

Of special relevance here are Recommendation #17 (increasing investigator staff) and Recommendation #2 (filling key enforcement program supervisorial positions). As indicated in the discussions of those recommendations, new demands by the Legislature and the public for improved speed and quality of service (now codified as Bus. & Prof. Code § 7011.7) cannot be met until CSLB fills these enforcement vacancies. Indeed, these new guidelines may ultimately require additional complaint and investigative staff above those presently budgeted.

At an absolute minimum, CSLB must restore staff to fill its 16% vacancy rate in the crucial field investigator job classification. Such hiring has full support throughout the industry and the enforcement community. (In fact, there is strong industry support for increased licensing fees if used for better enforcement.) Filling these enforcement vacancies should be CSLB's first priority and the CSLB exemption requests are targeted at this pressing need.

#### Conclusion

CSLB serves an important law enforcement function in California. CSLB investigators address an estimated \$60 million-\$100 million in fraud cases per year, many of which involve massive consumer losses and family homes rendered uninhabitable. CSLB is an important partner in the California law enforcement system, and public safety is truly at stake here.

Our study — and fourteen others over the past thirty years — have shown the pressing need for major improvements in CSLB's law enforcement program. The mandate from the state Legislature and the Davis Administration is clear: CSLB must improve its law enforcement program and must do so now. The Board and new CSLB management have embarked on a much-needed plan to make major improvements in this agency's enforcement capabilities. But these plans are now stalled by the current hiring freeze, notwithstanding that these fee-funded expenditures would have no impact on the state budget.



*Kathleen Hamilton, Director*

*December 12, 2001*

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In summary, CSLB is an integral part of the state law enforcement process, and the requested exemptions are essential if CSLB is to adequately protect the California public from consumer fraud and abuse in the construction industry. I urge you to consider favorably the modest enforcement-related exemptions proposed by CSLB management.

Please do not hesitate to contact me (213-580-3305; E-mail: [tpageo@da.co.la.ca.us](mailto:tpageo@da.co.la.ca.us)) with any questions you may have in this regard.

Thank you for your consideration of these comments.

Very truly yours,

THOMAS A. PAPAGEORGE  
CSLB Enforcement Program Monitor

c: Lynn Morris, Deputy Director, Department of Consumer Affairs  
Minnie Lopez-Baffo, Chair, Contractors State License Board  
Stephen P. Sands, Registrar, Contractors State License Board

## APPENDIX B

### **Draft Legislative Proposal: Sunset Extension and CSLB Mandate**

Amend Business and Professions Code section 7000.5 as follows:

(a) There is in the Department of Consumer Affairs a Contractors' State License Board, which consists of 15 members.

(b) The repeal of this section renders the board subject to the review required by Division 1.2 (commencing with Section 473). However, the review of this board by the department shall be limited to only those unresolved issues identified by the Joint Legislative Sunset Review Committee.

(c) This section shall become inoperative on July 1, ~~2003~~ 2007, and, as of January 1, ~~2004~~ 2008, is repealed, unless a later enacted statute, which becomes effective on or before January 1, ~~2004~~ 2008, deletes or extends the dates on which it becomes inoperative and is repealed.

Add section 7000.6 to the Business and Professions Code, as follows:

7000.6 . Protection of the public shall be the highest priority for the Contractors' State License Board in exercising its licensing, regulatory, and disciplinary functions. Whenever the protection of the public is inconsistent with other interests sought to be promoted, the protection of the public shall be paramount.

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## APPENDIX C

### Draft Legislative Proposal: Licensing Fees

Amend Business and Professions Code section 7137 as follows:

The Board shall set fees by regulation. The amount of the fees prescribed by this chapter shall not exceed ~~be fixed by the board according to~~ the following schedule:

(a) The application fee for an original license in a single classification shall not be more than ~~two hundred fifty~~ three hundred dollars ~~(\$250)~~ (\$300).

The application fee for each additional classification applied for in connection with an original license shall not be more than ~~fifty~~ seventy-five dollars ~~(\$50)~~ (\$75).

The application fee for each additional classification pursuant to Section 7059 shall not be more than ~~fifty~~ seventy five dollars ~~(\$50)~~ (\$75).

The application fee to replace a responsible managing officer or employee pursuant to Section 7068.2 shall not be more than ~~fifty~~ seventy-five dollars ~~(\$50)~~ (\$75).

(b) The fee for rescheduling an examination for an applicant who has applied for an original license, additional classification, a change of responsible managing officer or responsible managing employee, or for an asbestos certification or hazardous substance removal certification, shall not be more than ~~fifty~~ sixty dollars ~~(\$50)~~ (\$60).

(c) The fee for scheduling or rescheduling an examination for a licensee who is required to take the examination as a condition of probation shall not be more than sixty dollars (\$60).

(ed) The initial license fee for an active or inactive license shall not be more than ~~one hundred fifty~~ eighty dollars ~~(\$150)~~ (\$180).

(de) The renewal fee for an active license shall not be more than ~~three hundred~~ sixty dollars ~~(\$300)~~ (\$360).

The renewal fee for an inactive license shall not be more than one hundred ~~forty~~ eighty dollars (~~\$150~~) (\$180).

(~~ef~~) The delinquency fee is an amount equal to 50 percent of the renewal fee, if the license is renewed more than 30 days after its expiration.

(~~fg~~) The registration fee for a home improvement salesperson shall not be more than ~~forty~~ seventy-five dollars (~~\$50~~) (\$75).

(~~gh~~) The renewal fee for a home improvement salesperson registration shall not be more than ~~seventy-five~~ dollars (~~\$75~~).

(~~hi~~) The application fee for an asbestos certification examination shall not be more than ~~forty~~ seventy-five dollars (~~\$50~~) (\$75).

(~~ij~~) The application fee for a hazardous substance removal or remedial action certification examination shall not be more than ~~forty~~ seventy-five dollars (~~\$50~~) (\$75).

## APPENDIX D

### **Draft Legislative Proposal: Reserve Fund**

Amend Business and Professions Code section 7138.1 as follows:

7138.1. Notwithstanding Section 7137, the board, ~~on or before July 1, 1997,~~ shall reduce the amount of fix fees to be collected pursuant to that section in order to generate revenues sufficient to maintain the board's reserve fund at a level ~~approximately equal to three months~~ not to exceed approximately six months of annual authorized board expenditures. ~~Thereafter, similar fee collection adjustments shall be made on a biennial basis.~~

## APPENDIX E

### **Draft Legislative Proposal: Annual CSLB Enforcement Reporting**

Section \_\_\_ is added to the Business and Professions Code:

SECTION \_\_\_\_: Annual enforcement report to the legislature; contents

The Contractors State License Board shall report annually to the Legislature, no later than October 1 of each year, the following statistical and case aging information for the prior fiscal year. Data shall be gathered on complaints against licensed contractors, registered home improvement salespersons, and unlicensed persons acting as licensees or registrants:

(a) complaint intake data: the number of complaints received, itemized by source (public, trade/profession, government agency, board-initiated) and by type of complaint (workmanship, abandonment, financial, technical, nonlicensee, other);

(b) complaint handling data:

(1) the number of complaints closed prior to referral for field investigation, itemized by reason for such closure (lack of jurisdiction, insufficient evidence to proceed, no violation, closed after intervention/mediation, referred for mandatory arbitration, referred for voluntary arbitration, other); and

(2) the number of complaints referred for field investigation, itemized by type of complaint (workmanship, abandonment, nonlicensee, other);

(3) for all cases reported under (b)(1) and (b)(2), a further identification of cases closed and referred alleging a violation of Section 7159 (excessive down payments on home improvement contracts), Section 7121.5 (qualifiers on revoked or suspended licenses), or Section 7121 (employment of unlicensed executives);

(c) investigation data:

(1) the number of complaints closed after referral for field investigation, itemized by reason for closure (insufficient evidence to proceed, no violation, closed after intervention/mediation; referred for mandatory arbitration, referred for voluntary arbitration, other);

(2) the number of citations issued to licensees, itemized by type of violation (workmanship, abandonment, contract violation, other) and by type of citation (citation/order of abatement only, citation/order of abatement and fine), including total amount of fines assessed and total amount of fines collected, and number of citations vacated or withdrawn;

(3) the number of citations issued to nonlicensees, itemized by type of citation (citation/order of abatement/cease & desist order only, citation/order of abatement/cease & desist order with fine), including total amount of fines assessed and total amount of fines collected, and number of citations vacated or withdrawn;

(4) the number of complaints referred to local prosecutors for criminal investigation or prosecution, itemized by type of case (licensee or nonlicensee); and

(5) number of complaints referred to the Attorney General for the filing of an accusation;

(6) for all cases reported under (c)(1)–(c)(5), a further identification of cases closed, referred, or cited for a violation of Section 7159 (excessive down payments on home improvement contracts), Section 7121.5 (qualifiers on revoked or suspended licenses), or Section 7121 (employment of unlicensed executives);

(d) prosecution data, including the number of accusations and petitions to revoke probation filed by the Attorney General, and including an itemization of all cases alleging a violation of Section 7159 (excessive down payments on home improvement contracts), Section 7121.5 (qualifiers on revoked or suspended licenses), and Section 7121 (employment of unlicensed executives);

(e) actions taken: the number of disciplinary actions taken by way of accusation, itemized by type of action (revocation, suspension, probation, other disciplinary action, accusation dismissed or withdrawn); and including an itemization of all actions taken for a violation of Section 7159 (excessive down payments on home improvement contracts), Section 7121.5 (qualifiers on revoked or suspended licenses), and Section 7121 (employment of unlicensed executives);

(f) automatic disciplinary actions:

(1) the number of automatic disciplinary actions for failure to pay arbitration award, itemized by type of action (suspension or revocation);

(2) the number of automatic disciplinary actions for failure to pay citation, itemized by type of action (suspension or revocation);

(3) the number of all other automatic suspensions and revocations, itemized by type of action (suspension or revocation);

(g) the number of interim suspension orders under Section 494 and temporary restraining orders under Sections 125.5, 125.7, and any other applicable sections of law, including number of such orders sought and number granted;

(h) the amount of cost recovery sought under Section 125.3, the amount ordered, and the amount collected;

(i) average caseloads for program technicians, consumer services representatives, and enforcement representatives at the beginning of the fiscal year and quarterly throughout the fiscal year, itemized by board office;

(j) case aging data, including aging data from each of the major stages of the enforcement process:

(1) the average and median number of days from complaint filing to case closure or other disposition by intake/mediation, itemized by intake/mediation center in northern and southern California and by type of case (workmanship, abandonment, nonlicensee, other);

(2) the average and median number of days from complaint filing to completion of an investigation, itemized by investigation center and by type of case (workmanship, abandonment, nonlicensee, other);

(3) the average and median number of days from complaint filing to referral of completed investigation to the Attorney General, itemized by investigation center and by type of case (workmanship, abandonment, nonlicensee, other);



(4) the average and median number of days from referral of a completed investigation to the Attorney General to accusation filing, itemized by major metropolitan office of the Attorney General;

(5) the average and median number of days from accusation filing to first day of hearing;

(6) the average number of from accusation filing to submission of administrative law judge's proposed decision to the registrar;

(7) the average and median number of days from the registrar's receipt of proposed decision to final decision;

(k) by month, the number of cases pending that are over 180 days old;

(l) the number of cases pending at the end of the fiscal year distributed over length of time pending (1–60 days, 60–120 days, 120–180 days, etc.), and the percentage of total cases pending represented by the numbers in each those timeframe categories; and

(m) staff productivity, as measured by the total number of complaints closed per expended personnel year dedicated to the enforcement program.

**APPENDIX F****Draft Legislative Proposal:  
Fingerprinting Requirement**

SECTION 1. Section 144 of the Business and Professions Code is amended to read:

144. (a) Notwithstanding any other provision of law, an agency designated in subdivision (b) shall require an applicant to furnish to the agency a full set of fingerprints for purposes of conducting criminal history record checks. Any agency designated in subdivision (b) may obtain and receive, at its discretion, criminal history information from the Department of Justice and the United States Federal Bureau of Investigation.

(b) Subdivision (a) applies to the following boards and committees:

- (1) California Board of Accountancy.
- (2) State Athletic Commission.
- (3) Board of Behavioral Sciences.
- (4) Court Reporters Board of California.
- (5) State Board of Guide Dogs for the Blind.
- (6) California State Board of Pharmacy.
- (7) Board of Registered Nursing.
- (8) Veterinary Medical Board.
- (9) Registered Veterinary Technician Committee.
- (10) Board of Vocational Nursing and Psychiatric Technicians.

- (11) Respiratory Care Board of California.
- (12) Hearing Aid dispensers Advisory Commission.
- (13) Physical Therapy Board of California.
- (14) Physician Assistant Committee of the Medical Board of California.
- (15) Speech-Language Pathology and Audiology Board.
- (16) Medical Board of California.
- (17) State Board of Optometry.
- (18) Acupuncture Board.
- (19) Cemetery and Funeral Programs.
- (20) Bureau of Security and Investigative Services.
- (21) Division of Investigation.
- (22) Board of Psychology.
- (23) The California Board of Occupational Therapy.
- (24) Contractors State License Board.

SECTION 2. Section 7069 of the Business and Professions Code is amended to read:

7069. (a) An applicant, and each officer, director, partner associate and responsible managing employee thereof, shall not have committed acts or crimes which are grounds for denial of licensure under Section 480.

(b) As part of an application for a contractor's license, the board shall require an applicant to furnish a full set of fingerprints for purposes of conducting criminal history record checks. Fingerprints furnished pursuant to this subdivision shall be submitted in an electronic format where readily available. Requests for alternative methods of furnishing fingerprints are subject to the approval of the registrar. The board shall use the fingerprints furnished by an applicant to obtain criminal history information on the applicant from the Department of Justice and the United States Federal Bureau of Investigation, including any subsequent arrest information available. This subdivision shall become effective on January 1, 2004.

SECTION 3. Section 7153.1 of the Business and Professions Code is amended to read:

7153.1. (a) The home improvement salesman shall submit to the registrar an application in writing containing the statement that he desires the issuance of a registration under this section. The application shall be made on a form prescribed by the registrar and shall be accompanied by a fee fixed by this chapter.

(b) The registrar may refuse to register the applicant under the grounds specified in Section 480.

(c) As part of an application for a home improvement salesman, the board shall require an applicant to furnish a full set of fingerprints for purposes of conducting criminal history record checks. Fingerprints furnished pursuant to this subdivision shall be submitted in an electronic format where readily available. Requests for alternative methods of furnishing fingerprints are subject to the approval of the registrar. The board shall use the fingerprints furnished by an applicant to obtain criminal history information on the applicant from the Department of Justice and the United States Federal Bureau of Investigation, including any subsequent arrest information available. This subdivision shall become effective on January 1, 2004.

**APPENDIX G**

**Draft Legislative Proposal:  
Access to Employment Development Department Information**

Amend Unemployment Insurance Code section 1095 to read:

1095. The director shall permit the use of any information in his or her possession to the extent necessary for any of the following purposes and may require reimbursement for all direct costs incurred in providing any and all information specified in this section, except information specified in subdivisions (a) to (e), inclusive:

(a) To enable the director or his or her representative to carry out his or her responsibilities under this code.

(b) To properly present a claim for benefits.

(c) To acquaint a worker or his or her authorized agent with his or her existing or prospective right to benefits.

(d) To furnish an employer or his or her authorized agent with information to enable him or her to fully discharge his or her obligations or safeguard his or her rights under this division or Division 3 (commencing with Section 9000).

(e) To enable an employer to receive a reduction in contribution rate.

.....

(t) To enable the Contractors State License Board to verify the employment history of an individual applying for licensure pursuant to Business and Professions Code section 7068.

(tu) Nothing in this section shall be construed to authorize or permit the use of information obtained in the administration of this code by any private collection agency.

(trv) The disclosure of the name and address of an individual or business entity that was issued an assessment that included penalties under Section 1128 or 1128.1 shall not be in violation of Section 1094 if the assessment is final. The disclosure may also include any of the following:

- (1) The total amount of the assessment.
- (2) The amount of the penalty imposed under Section 1128 or 1128.1 that is included in the assessment.
- (3) The facts that resulted in the charging of the penalty under Section 1128 or 1128.1.

## APPENDIX H

### **Draft Legislative Proposal: Home Improvement Contractor's Bond**

SECTION 1. Section 7150.3 of the Business and Professions Code is amended to read:

7150.3. (a) In order to qualify for certification as a home improvement contractor, an applicant shall do all of the following:

(1) Apply to the board on a form prescribed by the registrar.

(2) Hold a current and valid contractor's license.

(3) Take and pass an ~~open book~~ examination on the business and contracting skills and laws related to home improvement contracting, as prescribed by the registrar. In the case of a partnership, corporation, or other entity, in a situation in which the contractor's license has been obtained by the appearance of a qualifying individual, that qualifying individual shall take and pass the examination.

(4) Have on file a home improvement contractor's bond as required in Section 7150.4.

~~(b) This section shall remain in effect only until January 1, 2004, and as of that date is repealed, unless a later enacted statute, that is enacted before January 1, 2004, deletes or extends that date.~~

SECTION 2. Section 7150.4 is added to the Business and Professions Code, to read:

7150.4. (a) Except as provided in Section 7071.8, the board shall require as a condition precedent to the issuance, reinstatement, reactivation, renewal, or continued maintenance of a certification as a home improvement contractor, that the contractor have on file a home improvement contractor's bond in the sum of seven thousand five hundred dollars (\$7,500). This bond shall be in addition to any other bond required by the Contractor's State License Law.

(b) The home improvement contractor's bond required by this section shall be executed by an admitted surety in favor of the State of California, in a form acceptable to the registrar and filed with the registrar by the contractor.

(c) The home improvement contractor's bond shall be exclusively for the benefit of any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the contractor. Any benefit obtained by a homeowner from a home improvement contractor's bond shall not bar or limit the homeowner's recovery of any non-duplicative benefit from any other bond provided by this article.

(d) No home improvement contractor's bond shall be required of a holder of a certification as a home improvement contractor whose licensed has been inactivated on the official records of the board during the period the license is inactive.

(e) The home improvement contractor's bond required by this section shall be governed by the provisions of this article relating to the contractor's bond required by Section 7071.6, including Sections 7071.7, 7071.8, 7071.9, 7071.10, 7071.11, 7071.12, 7071.13, 7071.14, 7071.15, 7071.17, except to the extent those provisions are inconsistent with this section.



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## APPENDIX I

### **Draft Legislative Proposal: Good Faith Payment Defense for Consumers**

SECTION 1. Section 3119 is added to the Civil Code, to read:

3119. (a) This section applies to any home improvement contract, as defined in Section 7151.2 of the Business and Professions Code, in an amount of twenty-five thousand dollars (\$25,000) or less.

(b) Notwithstanding any other provisions in this title, the aggregate amount of mechanic's liens and stop notices that may be enforced in a case of a home improvement contract against the homeowner's property or construction funds is limited to the amount remaining due and unpaid to the original contractor under the contract. Payments made to the original contractor in good faith discharge the owner's liability to all claimants to the extent of the payments.

(c) If a home improvement contract executed in the amount provided in subdivision (a) later exceeds that amount because of change orders, modifications, or amendments to the original contract, the protection for the owner's good faith payments provided by this section is limited to the amount in subdivision (a).

## APPENDIX J

### **Draft Legislative Proposal: Clarified Bond Payout Standard**

SECTION 1. Section 7071.5 of the Business and Professions Code is amended to read:

7071.5 The contractor's bond required by this article shall be executed by an admitted surety in favor of the State of California, in a form acceptable to the registrar and filed with the registrar by the licensee or applicant. The contractor's bond shall be for the benefit of the following:

(a) Any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the licensee.

(b) Any person damaged as a result of a willful ~~and deliberate~~ act in violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

(c) Any employee of the licensee damaged by the licensee's failure to pay wages.

(d) [Unchanged]

(e) As used in this section, "willful" means simply a purpose or willingness to commit the act, or make the omission referred to, and does not require any intent to violate the law, or to injure another, or to acquire any advantage. For the purposes of this section "willful" shall be interpreted in a manner consistent with the meaning of "willfully" provided by Section 7(1) of the Penal Code.

SECTION 2. Section 7071.10 of the Business and Professions Code is amended to read:

7071.10 (a) The qualifying individual's bond required by this article shall be executed by an admitted surety in favor of the State of California, in a form acceptable to the registrar and filed with the registrar by the qualifying individual. The qualifying individual's bond shall be for the benefit of the following persons:

(1) Any homeowner contracting for home improvement upon the homeowner's personal family residence damaged as a result of a violation of this chapter by the licensee.

(2) Any person damaged as a result of a willful ~~and deliberate~~ act in violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

(3) Any employee of the licensee damaged by the licensee's failure to pay wages.

(4) [Unchanged]

(5) As used in this section, "willful" means simply a purpose or willingness to commit the act, or make the omission referred to, and does not require any intent to violate the law, or to injure another, or to acquire any advantage. For the purposes of this section "willful" shall be interpreted in a manner consistent with the meaning of "willfully" provided by Section 7(1) of the Penal Code.

(b) The qualifying individual's bond shall not be required in addition to the contractor's bond when the qualifying individual is himself or herself the proprietor under subdivision (a) or a general partner under subdivision (b) of Section 7068.

## APPENDIX K

### **Draft Legislative Proposal: Automatic Expungement of Invalid Mechanic's Liens**

SECTION 1. Section 3144 of the Civil Code is amended to read:

3144. (a) No lien provided for in this chapter binds any property for a longer period of time than 90 days after the recording of the claim of lien, unless within that time an action to foreclose the lien is commenced in a proper court, except that, if credit is given and notice of the fact and terms of such credit is recorded in the office of the county recorder subsequent to the recording of such claim of lien and prior to the expiration of such 90-day period, then such lien continues in force until 90 days after the expiration of such credit, but in no case longer than one year from the time of completion of the work of improvement.

(b) If the claimant fails to commence an action to foreclose the lien within the time limitation provided in this section, the lien automatically shall be null and void and of no further force or effect.

(c) On the expiration of any applicable period specified in subsection (a), if a notice of pendency has not been recorded in accordance with the provisions of Chapter 1 (commencing with Section 405) of Title 4.5 of Part 2 of the Code of Civil Procedure, any lien that has become void under the provisions of this section shall be expunged by operation of law and shall be removed from the record by the county recorder or official responsible for the recording of liens provided for in this chapter.