

PERFORMANCE AUDIT

**CONTRACTORS' RECOVERY
FUND BOARD**

A Report to the Arizona Legislature
By the Auditor General
August 1984
84-6



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STATE OF ARIZONA
OFFICE OF THE
AUDITOR GENERAL

August 14, 1984

Members of the Arizona Legislature
The Honorable Bruce Babbitt, Governor
Mr. Cliff Jensen, Chairman
Contractors' Recovery Fund Board

Transmitted herewith is a report of the Auditor General, A Performance Audit of the Contractors' Recovery Fund Board. This report is in response to an April 27, 1983, resolution of the Joint Legislative Oversight Committee. The performance audit was conducted as a part of the Sunset Review set forth in A.R.S. §§41-2351 through 41-2379.

The blue pages present a summary of the report; a response from the Contractors' Recovery Fund Board is found on the yellow pages preceding the appendix.

My staff and I will be pleased to discuss or clarify items in the report.

Respectfully submitted,

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Enclosure

SUMMARY

The Office of the Auditor General has conducted a performance audit of the Arizona Contractors' Recovery Fund Board in response to an April 27, 1983, resolution of the Joint Legislative Oversight Committee. The performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

The Recovery Fund Board was established July 1, 1981, to oversee the newly created contractors' recovery fund. The Board consists of the Registrar of Contractors, and four public members appointed by the Governor. The contractors' recovery fund was established to provide increased protection for consumers with valid complaints against licensed contractors. The recovery fund covers claims against contractors made by residential property owners. The recovery fund pays a maximum of \$15,000 per consumer and \$75,000 total per contractor. Licensed contractors pay an initial fee of \$75 upon licensure and any additional yearly assessments when their license is renewed. To receive payment from the fund, consumers must file within 2 years of the cause of action and obtain a successful court judgment against the contractor.

The Recovery Fund Board Could be Allowed to Terminate (see page 11)

The Board's limited statutory duties do not require Board oversight. The Board's statutory tasks are administrative, rather than of a policy nature. The Board has focused largely on nonstatutory tasks, primarily allocating recovery fund monies for consumer education. However, according to the Legislative Council, the Board does not have statutory authority to expend monies from the fund for consumer education. Board members agree that the Board is not necessary if limited to performing only its statutory duties.

The Registrar of Contractors could assume the Recovery Fund Board's limited statutory duties. The ROC already administers all of the recovery fund's processes. All other recovery funds we examined are managed by a parent agency and do not have separate boards.

The Legislature should consider allowing the Recovery Fund Board to terminate under the Sunset Act provisions if the Board's role is limited to its current statutory duties. If the Board is terminated, all of its duties should be assigned to the Registrar of Contractors.

Contractors' Recovery Fund Should
Be More Accessible (see page 17)

The current recovery fund process is too complicated and cumbersome. Specific statutory procedures can cause consumers difficulty with the process. Because the process is complicated most consumers utilize legal assistance, which increases the cost of recovery fund claims. Allowing the ROC to adjudicate cases would simplify the process, reduce costs, and improve the fund's accessibility.

The recovery fund process could be simplified by using administrative hearings to adjudicate claims. The Office of Manufactured Housing has a much simpler recovery fund process using administrative hearings. The Registrar noted several advantages to this method of adjudication. Claims could be processed faster and at less cost to consumers, and consumers could use a single forum to resolve problems with contractors.

The Legislature should consider modifying A.R.S. §32-1136 to allow contractors' recovery fund claims to be adjudicated through the Registrar of Contractors' administrative hearing process. In addition, the Legislature should consider eliminating the requirements that consumers 1) exhaust the contractors' license bond (A.R.S. §32-1136.C.4),

2) demonstrate that the claimant is not a spouse or personal representative of spouse (A.R.S. §32-1136.C.1), and 3) demonstrate that the licensee has no other assets (A.R.S. §32-1136.C.5) before seeking compensation from the fund. Finally, the Legislature should consider allowing the Registrar to waive the prior notice requirement if the Registrar determines it is in the public interest or the claimant has made a good faith effort.

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INTRODUCTION AND BACKGROUND

The Office of the Auditor General has conducted a performance audit of the Arizona Contractors' Recovery Fund Board in response to an April 27, 1983, resolution of the Joint Legislative Oversight Committee. This performance audit was conducted as part of the Sunset Review set forth in Arizona Revised Statutes (A.R.S.) §§41-2351 through 41-2379.

The Recovery Fund Board was established July 1, 1981 to oversee the newly created contractors' recovery fund. The contractors' recovery fund was established to provide increased economic protection for consumers using licensed contractors. The 1979 Auditor General Sunset Review determined that the bonding system favored those familiar with the legal processes involved, (usually not the consumer) and that the revenues generated by the bonding system were not available to reimburse consumers who suffer financial losses in dealing with contractors.

The recovery fund covers claims against contractors made by residential property owners. The recovery fund provides a maximum payment of \$15,000 per consumer and \$75,000 total per contractor. Licensed contractors pay an initial fee of \$75 upon licensure and any additional yearly assessments when their license is renewed. To receive payment from the fund, consumers must file within 2 years of the cause of action and obtain a successful court judgment against the contractor.

The Contractors' Recovery Fund Board consists of the Registrar of Contractors and four public members appointed by the Governor. The Board members are appointed to 3-year terms, and are eligible for reimbursement for travel expenses, but receive no compensation. A.R.S. §32-1134 establishes the following statutory duties of the Board:

- "1. Maintaining the fund at a minimum level of one hundred thousand dollars.
2. Fix assessments basing such assessments on an actuarial projection of anticipated claims and an anticipated annual inflation rate of ten percent.
3. Establish claim reserves based on the incurral date of claims and an earned basis of income.
4. Cause an examination of the fund to be made every three years.
5. File with the state insurance department an annual statement of the condition of the fund, prepared in accordance with generally accepted insurance accounting principles and showing claim reserves certified by a qualified actuary."

To carry out these responsibilities, the Board has held public meetings as needed and retains actuarial services. The Registrar performs all accounting and administrative tasks for the fund as required by statute. In addition, the Board has used advertising and printed pamphlets to inform the public about the recovery fund process.

Table 1 shows recovery fund activity, revenue and expenditures from its inception to March 31, 1984.

TABLE 1

RECOVERY FUND CASES, PAYMENTS, REVENUES AND
EXPENDITURES FOR FISCAL YEARS 1981-82 THROUGH 1983-84 YEAR-TO-DATE

	<u>FY 1981-82</u>	<u>FY 1982-83</u>	<u>FY 1983-84*</u>	<u>Total Since Inception</u>
<u>RECOVERY FUND</u>				
Claims filed	39	104	102	245
Claims paid	17	37	35	89
<u>REVENUE</u>				
Fees:				
Initial	\$ 919,096	\$156,600	\$145,732	\$1,221,428
Renewal	281,933	85,992	195	368,120
Interest	112,338	131,318	98,529	342,185
Gross Receipts	1,313,367	373,910	244,456	1,931,733
Refunds**	(7,810)	(12,911)	(9,349)	(30,070)
NET REVENUE	1,305,557	360,999	235,107	1,901,663
<u>EXPENDITURES</u>				
Travel	836	430	279	1,545
Consumer Pamphlet	1,792	-	750	2,542
Advertising	18,978	49,838	37,777	106,593
Actuarial Services	-	2,500	-	2,500
Other	203	111	20	334
TOTAL EXPENDITURES	(21,809)	(52,879)	(38,826)	(113,514)
<u>JUDGMENTS</u>	<u>(32,391)</u>	<u>(90,683)</u>	<u>(107,660)</u>	<u>(230,734)</u>
BALANCE	<u>\$1,251,357</u>	<u>\$217,437</u>	<u>\$ 88,621</u>	<u>\$1,557,415</u>

* As of March 31, 1984

** Initial recovery fund fees were returned because of an unsuccessful licensure attempt.

Audit Scope and Purpose

The purpose of our review of the Contractors' Recovery Fund Board was to address the 12 Sunset Factors set forth in A.R.S. §41-2354, and to evaluate the effectiveness of the recovery fund. Specifically, we examined:

- The extent to which the Contractors' Recovery Fund Board is necessary to oversee the recovery fund.
- The extent to which the recovery fund is accessible to consumers.

The Auditor General and staff express appreciation to the members of the Recovery Fund Board and the Registrar of Contractors' staff for their cooperation and assistance during the course of our audit.

SUNSET FACTORS

In accordance with Arizona Revised Statutes (A.R.S.) §41-2354, the Legislature should consider the following 12 factors in determining whether the Arizona Contractors' Recovery Fund Board should be continued or terminated.

1. Objective and purpose in establishing the Board

The Contractors' Recovery Fund and the Board were established in 1981 to provide monies for consumer protection. A.R.S. §32-1132.A. states:

"There is established the contractors' recovery fund, to be administered by the registrar, from which any person injured by an act, representation, transaction or conduct of a contractor, which is in violation of this chapter or the regulations promulgated pursuant to this chapter, may be awarded in the county where the violation occurred an amount of not more than fifteen thousand dollars for damages sustained by the act, representation, transaction or conduct. An award from the fund is limited to the actual damages suffered by the claimant, including reasonable attorney fees, except that an award from the fund shall not be available to persons injured by an act, representation, transaction or conduct of a contractor whose license was in an inactive status at the time of the injury."

The statutes divide the management of the fund between the Board and the Registrar of Contractors (ROC). A.R.S. §32-1132.A. requires the ROC to administer the fund. The Board, on the other hand, is charged with maintaining the financial solvency of the fund. A.R.S. §32-1134 establishes the powers and duties of the Board:

"1. Maintain the fund at a minimum level of one hundred thousand dollars.

2. Fix assessments basing such assessments on a actuarial projection of anticipated claims and an anticipated annual inflation rate of ten per cent.

3. Establish claim reserves based on the incurral date of claims and an earned basis of income.

4. Cause an examination of the fund to be made every three years.

5. File with the state insurance department an annual statement of the condition of the fund, prepared in accordance with generally accepted insurance accounting principles and showing claim reserves certified by a qualified actuary."

2. The effectiveness with which the Board has met its objective and purpose and the efficiency with which it has operated

The Board has maintained a solvent recovery fund by exercising its statutory duties. The fund balance has been so substantial that no renewal fee has been required since January 1983. The Board has met as needed, at least twice a year. The Board has no staff and no expenditures other than travel expenses.

3. The extent to which the Board has operated within the public interest

The Board has operated within the public interest by seeking legislation to increase fund payment limits. In addition, the Board has sought to make the public more aware of the fund. However, according to a Legislative Council opinion the Board has made unauthorized expenditures of recovery fund monies for advertising the fund (see page 13).

4. The extent to which rules and regulations promulgated by the Board are consistent with the legislative mandate

The Board does not have statutory authority to make rules, and no rules have been promulgated.

5. The extent to which the Board has encouraged input from the public before promulgating its rules and regulations and the extent to which it has informed the public as to its actions and their expected impact on the public

The Board does not have statutory authority to make rules. The Board has complied with the open meeting law by posting public notice of its meetings and maintaining minutes that are available to the public at the Registrar of Contractors' office.

6. The extent to which the Board has been able to investigate and resolve complaints that are within its jurisdiction

This factor is not applicable because the Board is not a regulatory agency.

7. The extent to which the Attorney General or any other applicable agency of state government has the authority to prosecute actions under enabling legislation

This factor is not applicable because the Board is not a regulatory agency.

8. The extent to which the Board has addressed deficiencies in the enabling statutes which prevent it from fulfilling its statutory mandate

The Board recommended legislation increasing recovery fund payment limits and a more specific cause of action date. In 1983, the Legislature in House Bill 2255 increased recovery fund limits from \$5,000 to \$10,000 per consumer to \$15,000 to \$75,000 maximum per contractor. Senate Bill 1084, passed in 1984, clarified the cause of action date to which the new claim limits applied.

9. The extent to which changes are necessary in the laws of the Board to adequately comply with the factors listed in the Sunset Laws

If the Legislature wishes to allow the use of recovery fund monies for advertising the fund, then specific statutory authority is needed. In addition, we identified several statutory changes that would improve consumer accessibility to the recovery fund. Claims should be adjudicated through the Registrar of Contractors' administrative hearing process rather than the courts. In addition, specific statutory requirements that complicate the recovery process could be eliminated. These include the conditions to exhaust the contractors' license bond, demonstrate that the licensee has no other assets and demonstrate that the claimant is not the contractors' spouse or personal representative of the spouse. Also, the Registrar should be allowed to waive the prior notice requirement if the Registrar determines it is in the public interest or the claimant has made a good faith effort (see page 20).

10. The extent to which the termination of the Board would significantly harm the public health, safety or welfare

If the Board is limited to its current statutory role, termination of the Board would not significantly harm the public health, safety or welfare. The Board's duties are of an administrative nature, delegated to actuaries and accountants, and could be assumed by the ROC. Other states' contractor recovery funds and similar recovery funds within Arizona use a parent agency such as the Registrar of Contractors to manage the fund.

Termination of the recovery fund statutes, on the other hand, would reduce the financial protection that is provided to consumers against insolvent or incompetent contractors. Before the recovery fund was established the only financial protection available to consumers was the contractors' license bonds. Materials suppliers and other contractors in most cases had claimed available funds by the time consumers applied for restitution.

11. The extent to which the level of regulation exercised by the Board is appropriate and whether less or more stringent levels of regulation would be appropriate

This factor is not applicable because the Board is not a regulatory agency.

12. The extent to which the Board has used private contractors in the performance of its duties and how effective use of private contractors could be accomplished.

The Recovery Fund Board has retained actuarial services to assist in performing its statutory duties. In addition, the Board has hired advertising firms to increase public awareness of the recovery fund.

FINDING I

THE RECOVERY FUND BOARD COULD BE ALLOWED TO TERMINATE

The Recovery Fund Board is unnecessary and could be allowed to terminate under the Sunset Act provisions. Its limited statutory duties do not require Board oversight. The Registrar of Contractors (ROC) already administers the fund and could assume the Board's duties.

Background

The Contractors' Recovery Fund Board and the recovery fund were established in 1981 by House Bill 2112 in the first regular session of the Legislature. The legislation was the culmination of recommendations included in the 1979 Auditor General Sunset Review of the Registrar of Contractors and the subsequent report of the Contractors' Regulatory Study Commission. The 1979 Sunset Review recommended establishment of a recovery fund. The 1980 Contractors' Regulatory Study Commission concurred with the 1979 Sunset Review recommendation and further recommended that a Contractors' Recovery Fund Board be established to oversee the recovery fund.

The Contractors' Recovery Fund Board consists of four public members appointed by the Governor, and the Registrar of Contractors. Board members are not eligible to receive compensation but are reimbursed for travel expenses.

Duties Do Not Require Board Oversight

The Board's limited statutory duties do not require oversight by a board. The Board's statutory tasks are administrative, rather than of a policy nature. The Board has focused largely on nonstatutory tasks, mainly allocating recovery fund monies for consumer education. However, according to the Legislative Council, the Board cannot expend monies from the fund for consumer education. Board members agree that the Board is not needed if limited to only performing its statutory duties.

Duties are Administrative, Not Policy Oriented - The Board's statutory tasks are administrative, rather than of a policy nature. The Board's statutory functions are outlined in Arizona Revised Statutes (A.R.S.) §32-1134:

"The board shall:

1. Maintain the fund at a minimum level of one hundred thousand dollars.
2. Fix assessments basing such assessments on an actuarial projection of anticipated claims and an anticipated annual inflation rate of ten per cent.
3. Establish claim reserves based on the incurral date of claims and an earned basis of income.
4. Cause an examination of the fund to be made every three years.
5. File with the state insurance department an annual statement of the condition of the fund, prepared in accordance with generally accepted insurance accounting principles and showing claim reserves certified by a qualified actuary."

In addition, A.R.S. §32-1133.C empowers the Board to hire staff to carry out the Board's duties:

"C. The board may employ such personnel, including attorneys and actuaries, as may be necessary to effect performance of the duties of the board."

The Board's statutory duties are delegated to accountants or actuaries. The Board does not do the work, but selects the individuals to perform the analyses and subsequently approves their conclusions.

Board Has Focused Largely on Nonstatutory Tasks - Since its inception, the Board has focused largely on tasks not required by statute. In few Board meetings have statutorily authorized tasks been performed. Most of the Board meetings have focused on consumer education and other matters.

The Recovery Fund Board met for the first time in May 1981, and through January 1984 has met 13 times. In five of these meetings the Board made decisions regarding statutory duties: two in 1981, two in 1982, and one in 1983.

In ten meetings the Board took action not related to its statutory charge. It allocated monies for consumer education, selected advertising firms or decided other matters. For example, the Board discussed and recommended an increase in the recovery fund payment limits and the date on which the new limits would take effect. Both of these issues were subsequently addressed through legislation submitted by the Registrar of Contractors. In addition, the Board discussed allowing ROC hearing officers to adjudicate recovery fund cases.

Unauthorized Expenditures for Consumer Education - The Board has expended recovery fund monies for consumer education without statutory authority. According to the Arizona Legislative Council, the Board can only expend monies for payment of valid claims against contractors.

From its inception in 1981 through March 31, 1984, the Board expended \$109,135 for consumer education. The Board has retained advertising firms, run television and radio advertisements and printed pamphlets for consumer information. The Board has allocated the following sums for consumer information since 1981.

TABLE 2

FUNDS ALLOCATED FOR RECOVERY FUND
CONSUMER INFORMATION: FISCAL YEARS 1981-82 THROUGH 1983-84

1981-82	\$22,000
1982-83	50,000
1983-84	65,000

Source: Contractors' Recovery Fund Board minutes

According to the Legislative Council, the Board has no statutory authority to expend monies for consumer education. Legislative Council concluded:

"Because the fund monies are public monies, the board and the registrar of contractors may only expend these monies if the legislature has authorized them to do so. The legislature has explicitly delineated the manner in which fund monies may be used. This delineation does not include the expenditure of fund monies for consumer education purposes."

Board Members Agree Board is Unnecessary - If limited to performing only its statutory duties, Board members agreed that the Recovery Fund Board is not needed. They classified its statutory duties as being of an accounting nature not requiring board oversight.

Registrar of Contractors
Could Assume Board Duties

The Registrar of Contractors could assume the Recovery Fund Board's limited statutory duties. The ROC already administers all of the recovery fund's processes. All other recovery funds we examined are managed by a parent agency and do not have separate boards. If the ROC assumed the Board's responsibilities, some savings would be realized.

ROC Administers All of Fund Processes - The ROC administers all of the recovery fund processes including investigative, administrative and accounting functions. The ROC's Compliance Division investigates recovery fund cases. The investigators' report is used by the ROC to help determine the validity of claims and the potential judgment amounts. The Registrar also defends the fund in court against any claim deemed by the Registrar to be excessive or in violation of statutory requirements.

The statutes require the Registrar to administer the recovery fund. A.R.S. §32-1132.A. states in part:

"There is established the contractors' recovery fund, to be administered by the registrar . . ." (emphasis added)

The ROC maintains all recovery fund records, receives fund assessments and may authorize fund payments. In addition, the Recovery Fund Board's annual statement of the fund is prepared by the ROC.

Other Recovery Funds Managed By Parent Agency - All other recovery funds we examined are managed by a parent agency such as the Registrar of Contractors. Our analysis included other states' contractor recovery funds and other Arizona agencies' recovery funds. The following table illustrates the types of management systems used for the various recovery funds analyzed.

TABLE 3
RECOVERY FUND MANAGEMENT SYSTEMS

<u>State or Agency</u>	<u>Name of Fund</u>	<u>Managed By</u>
Other States:		
Hawaii	Contractors' Recovery Fund	Parent Agency
Virginia	Virginia Contractor Transaction Recovery Fund	Parent Agency
Arizona:		
REGISTRAR OF CONTRACTORS	Contractors' Recovery Fund	Divided-Special Board and Parent Agency
Real Estate Department	Real Estate Recovery Fund	Parent Agency
Real Estate Department	Subdivision Recovery Fund	Parent Agency
Office of Manufactured Housing	Trust Account Recovery Fund	Parent Agency

Five of the six recovery funds analyzed are managed by the parent agency. Only in the case of the Registrar does a special board share management duties with the parent agency. The two other states with contractors' recovery funds both use the parent agency to manage the fund.

ROC States it Could Assume Recovery Fund Board Duties - The Registrar of Contractors states that it could assume the Recovery Fund Board's statutory and consumer education tasks. By transferring these duties, some savings and increased efficiencies would be realized. Board travel and per diem expenses would be eliminated. In addition, the ROC could immediately implement the recommendations of actuaries or accountants. Currently, a Board meeting is held to accept and sustain these findings. Finally, the Registrar would not need to use its resources to organize and keep records of Board meetings.

CONCLUSION

The Recovery Fund Board could be allowed to terminate under the Sunset Act provisions. Its limited statutory duties do not require board oversight. The Registrar of Contractors already administers the recovery fund, and could perform the Board's limited duties as is done with most other recovery funds.

RECOMMENDATIONS

1. The Legislature should consider allowing the Recovery Fund Board to terminate under the Sunset Act provisions.
2. The Legislature should assign all Recovery Fund Board duties to the Registrar of Contractors.
3. If the Legislature wishes to allow use of recovery fund monies for advertising, it should provide the Board specific statutory authority to do so.

FINDING II

CONTRACTORS' RECOVERY FUND SHOULD BE MORE ACCESSIBLE

The Contractors' Recovery Fund could be more accessible to consumers. The current process of recovering from the fund is too complicated and cumbersome. Allowing the Registrar of Contractors (ROC) to adjudicate cases would simplify the process, reduce costs, and improve the fund's accessibility.

Current Claim Adjudication Process

Consumers must appear in court twice and file with the ROC to receive payment from the recovery fund. To initiate a recovery fund claim the consumer must file suit against the contractor in court within 2 years of the cause of action. At the commencement of the action the consumer must also notify the ROC of the suit. Upon receipt of the notification the ROC requires from the consumer copies of any contracts, receipts and canceled checks relating to the claim. In addition, the ROC asks the consumer to obtain three bids for completion or repair of the work in question. The ROC also inspects the job site. All of this information is used by the ROC to verify the claim and estimate the cost of the total damages. With this information the ROC can protect the fund in court if it appears that the claim is exorbitant.

If the consumer demonstrates to the court that he is entitled to recovery because of a violation of the contracting statutes, a judgment against the contractor may be granted. After receiving a judgment against the contractor and giving 10 days notice to the ROC, the consumer may then apply to the court a second time for an order directing payment from the recovery fund. The claimant must prove to the court that:

1. The claimant is not a spouse or personal representative of the contractor's spouse;
2. Notice of the lawsuit and request for an order allowing payment from the fund has been given to the Registrar;

3. The judgment is final and states the judgment amount and the amount of money owed to the property owner at the time the request for payment from the fund is made;
4. The property owner has proceeded against any existing bonds covering the contractor and has not collected \$15,000 or more from those bonds; and
5. The property owner is not aware of any other assets owned by the contractor that can be used to satisfy the judgment.

If the consumer successfully demonstrates the above, the court is required to direct payment from the fund. The consumer must file a certified copy of the order directing payment with the ROC, which may then authorize payment from the fund.

According to the ROC, the recovery fund process was designed to be somewhat complicated for two reasons. First, there was apprehension that the recovery fund would turn into a "big giveaway program." Second, because of this possibility, there was also concern that contractors would repeatedly be assessed the \$200 maximum recovery fund renewal fee to replenish the fund. To date, recovery fund payments have not been numerous and the fund balance has been so substantial that no renewal fee has been required since January 1983.

Current Process Too Complicated

The current recovery fund process is too complicated and cumbersome. Specific statutory procedures can cause consumers difficulty with the process. Because the process is complicated, most consumers need legal assistance, which increases the cost of recovery fund claims.

Specific Procedures Complicate Process - Specific statutory procedures complicate the recovery fund process for the consumer. We identified five procedures that cause particular difficulty and limit consumer accessibility to the fund.

Court Judgment and Payment Order - The requirement for the consumer to obtain both a court judgment and a payment order lengthens and complicates the court process. In addition, some consumers may be unwilling to participate in the court process. A consumer must obtain a judgment against the contractor and then at a later date go back into court for an order to receive payment from the fund.

Bond Exhausted - This requirement could complicate and impede the consumer's ability to obtain a recovery fund payment.* Currently, the law requires that the consumer first proceed against any remaining amounts in the contractor's license bond before recovery fund payment can be made. If there are bond monies remaining the consumer must first file suit against the bonding company and the contractor before proceeding against the recovery fund. This could cause a significant delay if the bonding company decided to fight the case in court.

Spouse/Personal Representative - This requirement may be difficult for the consumer to meet without legal assistance. The law requires that the consumer demonstrate that he is not the contractor's spouse or personal representative of the spouse. Although easy for a lawyer to prepare, most consumers are not familiar with writing affidavits to declare this. According to the Registrar, the court does not investigate or verify this information.

No Other Assets - This requirement is the most difficult for the consumer to meet. The law requires that the consumer must show that he is not aware of any assets owned by the contractor that could be used to satisfy the judgment. The current practice has been to obtain a release from stay from bankruptcy court, because most contractors have been insolvent in cases where payments are made. This requirement also has the potential to cause further consumer difficulty. According to the Registrar, the ROC could theoretically

* We recommend elimination of the bonding requirement in Registrar of Contractors Finding III (see page 33).

intervene to require the consumer to find assets or force the sale of remaining assets before recovering from the fund. The ROC, however, has the right of subrogation to pursue contractors' assets.

Prior Notice - Failure to meet this requirement could technically invalidate a case. The consumer is required to notify the ROC at the time of the commencement of the action and at least 10 days before filing for a payment order. According to the ROC, if a consumer fails to meet this requirement the case is technically invalid. In contrast, the real estate recovery fund statutes specifically authorize the commissioner to waive the prior notice requirement if the commissioner determines it is in the public interest or the claimant has made a good faith effort. The ROC does not have this authority.

Process Requires Legal Assistance - Most consumers use legal assistance because the recovery fund process is so complicated. This increases the cost of claims and may further deter some consumers from filing for restitution.

The complicated recovery fund process generally requires the claimants to use legal assistance. We found that 138 of the 178 recovery fund cases (78 percent) filed through December 13, 1983, were litigated by attorneys. As mentioned previously, several of the conditions for processing claims, such as affidavits and releases from stay, may require legal skills.

Because attorneys are utilized, the cost of claims is increased. Our analysis determined that the average attorney fee paid per successful recovery fund case was \$702. The fees ranged from \$200 for a \$398 claim to \$1,500 for a \$3,500 claim. The ROC requires documentation for fees of more than \$1,000.

Legal fees comprise a significant proportion of the total recovery fund payments. Overall, for those claims in which an attorney was used, attorney fees averaged 30 percent of actual damages awarded. We identified two claims in which attorney fees were greater than the claim amount. For one claim, damages equaled \$791.50 and attorney fees totaled \$900, for a total claim of \$1,691.50. In a recovery fund case currently pending the consumer suffered damages totaling \$853 and the attorney estimated fees of some \$3,100.

The need for legal assistance may further deter some consumers from participating in the recovery fund process. Some consumers may not have sufficient monies to sustain a claim through the complicated recovery process. In addition, consumers may not want to risk further financial loss not knowing if the claim will be successful. Moreover, consumers may be unwilling to accrue legal fees of an amount greater than the actual damage.

Administrative Hearings Would Simplify Process

The recovery fund process could be simplified by using administrative hearings to adjudicate claims. The Office of Manufactured Housing (OMH) has a much simpler recovery fund process using administrative hearings. The Registrar noted several advantages to using this method of adjudication.

OMH Has Simpler Process - The Arizona Office of Manufactured Housing has a much simpler adjudication process for its recovery fund. Claims are adjudicated internally through the agency's administrative hearing process. The agency does not have any of the various statutory requirements that complicate the ROC's recovery fund process. The OMH director noted several advantages to the agency's process.

The OMH trust recovery fund* claims are adjudicated through the agency's administrative hearing process. The assigned hearing officer evaluates all relevant, competent evidence offered by the claimant and licensee. After the hearing is concluded the hearing officer must render a decision within 15 days, denying or granting the claim. The Office of Manufactured Housing Board then pays the judgment from the recovery fund.

OMH does not have any of the requirements that complicate the ROC's recovery fund process. Because OMH uses administrative hearings to adjudicate claims, the prior notice and court judgment/payment order requirements are unnecessary. OMH does not require the claimant to verify that he is not a spouse or personal representative of the spouse, and the consumer is not required to exhaust the bond or determine that no other assets are available. OMH, through its right of subrogation, has its Attorney General representative pursue the bond or other assets in court. The following table illustrates the differences between the OMH and ROC recovery fund process requirements.

TABLE 4
A COMPARISON OF RECOVERY FUND
PROCESS REQUIREMENTS FOR OMH AND ROC

	<u>OMH</u>	<u>ROC</u>
1. Prior Notice	No	Yes
2. Court Judgment/Payment Order	No	Yes
3. Bond Exhausted	No	Yes
4. Spouse/Personal Representative	No	Yes
5. No Other Assets	No	Yes

* The OMH trust recovery fund provides monies to people damaged as a result of an act or omission of trust and escrow requirements by licensed dealers or brokers of manufactured homes or factory built buildings.

The OMH director listed several advantages to his agency's process. First, no court judgment is required. Second, consumers do not need an attorney, but both the consumer and licensee may have legal assistance if desired. Third, consumers do not have to exhaust the bond or prove the licensee has no other assets. Finally, the process is timely, requiring about 6 weeks if attorneys are not involved.

Advantages of Using Administrative Hearings - The Registrar noted several advantages of using administrative hearings to adjudicate recovery fund claims. The Registrar said that claims could be processed much faster through administrative hearings. In addition, administrative hearings would be less costly to consumers. Moreover, the consumer could apply for restitution using only one forum. If a consumer filed a complaint against a licensed contractor and the contractor did not respond to the ROC's hearing order, the consumer could then proceed directly against the recovery fund. In addition, the administrative hearing process allows petitions for rehearing and appeals to Superior Court. Consumers or contractors not satisfied with administrative hearing decisions could still have a case heard in court.

CONCLUSION

The contractors' recovery fund process can be improved to enhance consumer accessibility. Various requirements now complicate the adjudication process for the consumer. The need for legal assistance may deter some consumers seeking restitution from the fund. Using the ROC's administrative process to adjudicate claims would alleviate many of these problems.

RECOMMENDATIONS

1. The Legislature should consider modifying Arizona Revised Statutes (A.R.S.) §32-1136 to allow contractors' recovery fund claims to be adjudicated through the Registrar of Contractors' administrative hearing process.

2. The Legislature should consider eliminating the requirements that the consumer 1) exhaust the contractor's license bond (A.R.S. §32-1136.C.4), 2) demonstrate that he is not a spouse or personal representative of spouse (A.R.S. §32-1136.C.1), and 3) demonstrate that the licensee has no other assets (A.R.S. §32-1136.C.5).

3. The Legislature should consider allowing the Registrar to waive the prior notice requirement if the Registrar determines it is in the public interest or the claimant has made a good faith effort.



BRUCE BABBITT
GOVERNOR

Registrar of Contractors Contractors' Recovery Fund

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August 10, 1984

Douglas R. Norton
Auditor General
111 West Monroe, Suite 600
Phoenix, AZ 85003



Dear Mr. Norton:

The members of the Recovery Fund Board have carefully reviewed the findings and recommendations in the audit report. The Board feels your report confirms the success of the recovery fund concept as a viable remedy for the public with a minimal cost to the contractor. Given this success, under the Boards' management, the members cannot agree with recommendations #1 and #2 of Finding I.

Finding I recommends that the Legislature allow the Recovery Fund Board to terminate because of perceived limitations in the duties of the Board. As noted in the report, the Board members would agree with this recommendation if the perceived limitations were accepted. However, the Board does not agree with the report's assessment that allocating recovery fund monies for consumer education is unauthorized. Consequently, the Board cannot agree with the recommendation as stated in the report.

The assumptions relied upon by the auditors in arriving at the conclusion that the expenditures for consumer education are unauthorized are seriously flawed. The arguments presented in the report and those contained in the Legislative Council opinion are incorrect as they relate to the legal interpretation, legislative intent and conclusion that authorization to expend monies for consumer education is lacking.

The initial argument put forth by the Legislative Council is that payouts from the fund are not appropriated by the Legislature and therefore violate Article IX, Section 5 of the State Constitution and A.R.S. §35-154. This contention is not correct for the following reasons:

1. The Constitution applies to monies paid out of the state treasury. Because the monies are held in a special trust fund "for carrying out the purposes of the fund", they are not "treasury" monies as such. The State Treasurer's only function in the fund process is to invest the monies for the recovery fund.

2. The monies can not be regarded as "public monies" by the Legislative Council's own argument. The monies are held in trust for a small group of beneficiaries as opposed to the general public referred to in the opinion. Contractor license bonds are maintained for the general public whereas the recovery fund only applies to that group meeting the specific criteria outlined in the definition of "person injured" contained in A.R.S. §32-1131. This group is narrowed further by the provisions of A.R.S. §32-1136 which is recognized in another part of your report.
3. Even if the recovery fund monies are subject to appropriation, such appropriation can be implied from the language of the statutes. Per A.R.S. §32-1133, the Board may expend funds on outside professionals to "... effect performance of the duties of the Board." The contention that the Board can expend funds on only those specific duties listed in 1134 can not be sustained in light of the fact that the Board may employ attorneys yet none of the duties listed require the expertise of an attorney.

On a more practical note, it is inconceivable that the Legislature would contemplate keeping the existence of the fund quiet in view of the stated intent to enhance public protection. For the Board to accomplish its duties consistent with the intent to protect the public by compensating consumers wronged by contractors, it is necessary to adequately inform the public as to the existence of the fund. Additionally, the Arizona fund was closely patterned after the Hawaii contractors fund in which consumer awareness plays a large part.

It is also interesting to note that after all the openness with which the consumer awareness program has operated, a challenge to its appropriateness has not been put forth until now. Not only has the program been brought to the attention of all legislators as well as contractors (open letter August, 1982), but public board meetings discussing the program and published requests for bids have further exposed the program to public scrutiny. If such expenditures were not intended by the Legislature, we would have heard about it before now!

Despite the above, we do agree that the statutory authority to make the expenditures for consumer awareness is less than explicit. As a result, the Board feels that legislation similar to that enacted by the Department of Real Estate in the last legislative session should be recommended. That provision specifically authorized expenditures for consumer awareness out of the interest generated by the fund. The Board is confident that this recommendation will have the overwhelming support of the construction industry.

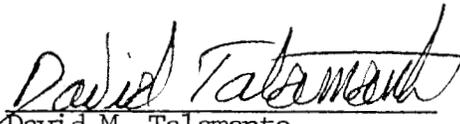
With regard to Finding II, the Board agrees with and endorses all three recommendations. However, in implementing these changes the Board feels that its continued existence is necessary for the same reasons justifying its creation. The apprehension noted in the report that the Recovery Fund

could become a "give away program" would certainly be revived by the implementation of the recommendations. By giving the Registrar direct administrative authority to order payouts from the fund, contractors may fear they will be subjected to increased and more frequent governmental control. An independent board will operate as a balance to that concern.

Finally and to reemphasize the point, those familiar with the Recovery Fund will attest to its tremendous success as a source of consumer remedy at a minimal cost to the contractors. This latter point, while not unexpected by the Board, came as a pleasant surprise to the construction industry. This Board looks forward to a continuation of this same success.

Sincerely,

RECOVERY FUND BOARD

By 
David M. Talamante
Registrar of Contractors

/hmb

APPENDIX

LEGISLATIVE COUNCIL OPINION ON RECOVERY FUND BOARD
EXPENDITURES FOR ADVERTISING

ARIZONA LEGISLATIVE COUNCIL

MEMO

May 9, 1984

TO: Douglas R. Norton, Auditor General
FROM: Arizona Legislative Council
RE: Request for Research and Statutory Interpretation (0-84-2)

This memo is sent in response to a request made on your behalf by William Thomson in a memo dated April 23, 1984.

FACT SITUATION:

The contractors' recovery fund (fund) is established pursuant to Arizona Revised Statutes section 32-1132.

The contractors' recovery fund board (board) has expended monies annually since fiscal year 1981-1982 for the purpose of consumer education. The monies specifically have been expended to retain advertising consultants, print consumer education pamphlets and place advertisements in magazines and on television. Recent legislation has provided for the expenditure of monies in a similar fund, the real estate recovery fund, to increase public awareness of that fund.

QUESTIONS PRESENTED:

1. Does the board have the authority to expend fund monies for consumer education purposes?
2. Should any expenditures from the fund other than claim payments be initially appropriated by the legislature?

ANSWERS:

1. The Constitution of Arizona provides that money shall not be paid out of the state treasury except as provided by law. Constitution of Arizona article IX, section 5. The Arizona supreme court has interpreted this provision to mean that "No money can be paid from the State treasury unless and except the legislature or the constitution itself has made an appropriation therefor, and it can only be used then for the purposes specified by the appropriation." Webb v. Frohmiller, 52 Ariz. 128, 134, 79 P. 2d 510, 513 (1938). The expenditure of state monies not authorized by an appropriation is also prohibited by A.R.S. section 35-154.

Although the monies in the fund are obtained through assessments against persons applying for a contractor's license, they are still monies in the state treasury and are subject to the restrictions contained in article IX, section 5, Constitution of Arizona, and A.R.S. section 35-154. In determining whether certain monies are public funds the use of

the monies should be examined. Monies held by a public officer for the benefit of the general public and not for a few citizens are public monies. City of Phoenix v. Superior Court, Maricopa County, 109 Ariz. 533, 514 P.2d 454 (1973), Sims v. Moeur, 41 Ariz. 486, 19 P.2d 679 (1933).

Monies in the fund are to be awarded to persons injured by any act, representation, transaction or conduct of a contractor licensed by the registrar of contractors. A.R.S. section 32-1132. Once an assessment is paid, the contractor has no claim on the monies. The monies are also not held for a select group of beneficiaries but are to be used to protect the general public from the bad acts of licensed contractors. The monies in the fund are, therefore, public monies for the purposes of article IX, section 5, Constitution of Arizona, and A.R.S. section 35-154.

Because the fund monies are public monies, the board and the registrar of contractors may only expend these monies if the legislature has authorized them to do so. The legislature has explicitly delineated the manner in which fund monies may be used. This delineation does not include the expenditure of fund monies for consumer education purposes.

A.R.S. section 32-1135 states, in part, "The assessments received by the registrar for deposit in the fund shall be held in trust for carrying out the purposes of the fund." The purposes of the fund, stated in A.R.S. section 32-1132, subsection A, are to provide monies:

From which any person injured by an act, representation, transaction or conduct of a contractor, which is in violation of this chapter or the regulations promulgated pursuant to this chapter, may be awarded in the county where the violation occurred an amount of not more than fifteen thousand dollars for damages sustained by the act, representation, transaction or conduct. An award from the fund is limited to the actual damages suffered by the claimant, including reasonable attorney fees, except that an award from the fund shall not be available to persons injured by an act, representation, transaction or conduct of a contractor whose license was in an inactive status at the time of the injury.

The method of accomplishing these purposes is set forth in A.R.S. section 32-1136. Notice must be provided to the registrar of any action which might result in collection from the fund. A person injured by a contractor must obtain and attempt to enforce a judgment against the contractor. The registrar may only authorize payment from the fund if a court orders payment of the unsatisfied judgment. A.R.S. section 32-1136, subsection E.

Because the registrar must use the fund monies for the purposes of the fund and these purposes do not include consumer education, he may not make expenditures from the fund for this purpose. The board also lacks this authority. Its duties, prescribed in A.R.S. section 32-1134, are to:

1. Maintain the fund at a minimum level of one hundred thousand dollars.
2. Fix assessments basing such assessments on an actuarial projection of anticipated claims and an anticipated annual inflation rate of ten per cent.

3. Establish claim reserves based on the incurral date of claims and an earned basis of income.

4. Cause an examination of the fund to be made every three years.

5. File with the state insurance department an annual statement of the condition of the fund, prepared in accordance with generally accepted insurance accounting principles and showing claim reserves certified by a qualified actuary.

The board's major responsibility is to maintain the solvency of the fund. The legislature has not given it the authority to expend fund monies for consumer education purposes.

This conclusion is supported by the legislature's recent action in regard to the real estate recovery fund. As noted in the statement of facts, the state real estate commissioner has been authorized to expend interest earned on monies in the real estate recovery fund to increase public awareness of that fund. Laws 1984, chapter 107, section 1. The provisions dealing with the use of monies in the real estate recovery fund are very similar to the provisions in A.R.S. sections 32-1132, 32-1135 and 32-1136. The passage of Laws 1984, chapter 107 indicates the legislature's belief that the state real estate commissioner did not have the power to make expenditures of real estate recovery fund monies to increase public awareness of that fund.

2. As discussed in the answer to question 1, payments may only be made from the fund as prescribed by A.R.S. section 32-1136. Expenditures of fund monies for any other purposes must be authorized by the legislature.

cc: William Thomson, Manager
Performance Audit Division