

## CONSUMER PROTECTION RELATED TO CONTRACTOR COMPETENCY AND OUT-OF-STATE CONTRACTORS - BACKGROUND MEMORANDUM

Section 5 of Senate Bill No. 2252 (attached as an appendix) directs a study of consumer protection in regard to contractor competency and out-of-state contractors licensed in the state. Senate Bill No. 2252 also revised statutory provisions relating to revocation or suspension of a contractor's license. Testimony from the standing committees indicates that the legislation was introduced in response to concerns with the ability to deal with complaints against contractors regarding poor workmanship or failure to complete projects.

### BACKGROUND

North Dakota Century Code Chapter 43-07 addresses licensing of contractors. Section 43-07-01 defines a contractor as "any person engaged in the business of construction, repair, alteration, dismantling, or demolition of bridges, highways, roads, streets, buildings, airports, dams, drainage or irrigation ditches, sewers, water or gas mains, water filters, tanks, towers, oil, gas, or water pipelines, and every other type of structure, project, development, or improvement coming within the definition of real or personal property, including the construction, alteration, or repair of property to be held either for sale or rental, and shall include subcontractor, public contractor, and nonresident contractor."

Section 43-07-01 defines a nonresident contractor as any contractor who has not an established and maintained place of business within this state, or who has not made reports to North Dakota Workforce Safety and Insurance within the previous year of employees within this state, and who has not made contributions to the North Dakota workforce safety and insurance fund accordingly, or who, during a like period has not made an income tax return in this state.

Section 43-07-02 requires a contractor to be licensed if the cost, value, or price per job exceeds \$2,000. That section authorizes the Secretary of State to request the Attorney General to bring an action to enjoin a person from acting as a contractor if the person is not licensed as required.

Section 43-07-03 designates the Secretary of State as the registrar responsible for enforcing the licensing provisions of Chapter 43-07.

Section 43-07-04 establishes the procedures for obtaining a contractor's license and for revocation of a license. That section provides that an individual who is 18 years of age or older may apply for a license to act as a contractor by completing the necessary forms and

submitting under oath a statement of the applicant's experience and qualifications as a contractor. In addition, the applicant must submit a copy of a certificate of insurance indicating liability coverage and submit a statement from Workforce Safety and Insurance that the applicant has secured satisfactory workforce safety and insurance coverage.

Section 43-07-04 also requires the Secretary of State to classify as not in good standing the license of any contractor who fails to:

1. Maintain liability insurance coverage.
2. File, renew, or properly amend any fictitious name certificate.
3. Maintain an active status of a corporation or registration as a foreign corporation.
4. Maintain an active status of a limited liability company or registration as a foreign limited liability company.
5. File or renew a trade name registration.
6. File or renew a limited liability partnership or foreign limited liability partnership.
7. File or renew a limited partnership or foreign limited partnership.

That section requires a contractor who has been notified by the Secretary of State that the contractor's license is not in good standing to cease soliciting or entering new contract projects. If the contractor does not correct the specified deficiency within 30 days or if the contractor enters new contract projects while the contractor's license is not in good standing, the Secretary of State is required to revoke the license of the contractor under the procedures set forth in the Administrative Agencies Practice Act (Chapter 28-32).

Section 43-07-04.1 provides that conviction of an offense does not disqualify a person from licensure as a contractor unless the Secretary of State determines the offense has a direct bearing upon the person's ability to serve the public as a contractor or that the person is not sufficiently rehabilitated as provided in Section 12.1-33-02.1.

Section 43-07-05 establishes four classes of licenses which define the limitations on the types of project on which a contractor may work. The holder of a Class A license is subject to no limitation as to the value of any single contract project. The holder of a Class B license may not engage in the construction of any single contract project of a value in excess of \$250,000, the holder of a Class C license may not engage in the construction of any single contract project of a value in excess of \$120,000, and the holder

of a Class D license may not engage in the construction of any single contract project of a value in excess of \$50,000.

Section 43-07-06 authorizes the administrative or governing body of any entity that enters public contracts to impose reasonable requirements and conditions as conditions precedent to the awarding of a contract for the construction or reconstruction of public works.

Section 43-07-07 establishes the license fees for the various classes of contractor licenses. The fee for a Class A license is \$300, \$200 for a Class B license, \$150 for a Class C license, and \$50 for a Class D license. Section 43-07-09 provides that a license is effective for one year.

Section 43-07-08 exempts from the contractor licensing requirements governmental representatives and any person who furnishes fabricated or finished products, material, or articles of merchandise not attached to real property by the person so as to become affixed to the property.

Section 43-07-09.1 requires a contractor to report to the Secretary of State a name change within 10 days of the change and submit a \$10 fee to the Secretary of State. That section provides that, except for a corporate or partnership entity, a licensee may not change its name if the change is associated with a change in the legal status other than a change in marital status.

Section 43-07-10 authorizes a licensee to renew a contractor's license by obtaining from the Secretary of State a certificate of renewal. When filing for a renewal, the licensee is required to file an application that includes a listing of each project, contract, or subcontract completed by the licensee during the preceding calendar year in North Dakota, and if a performance bond was required, the name and address of the issuer of the bond. In addition, the applicant is required to include with the application a copy of a certificate of liability insurance and a certification that the applicant has submitted all payroll taxes. An application for renewal must be filed by March 1 of each year. The fee for renewal of a license is equal to 20 percent of the license fee for that class of contractor. If a contractor fails to file for a renewal by March 1, the contractor is deemed to be unlicensed. However, under Section 43-07-10, the contractor has until June 1 of that year to renew a license by paying a penalty fee of 75 percent of the renewal fee and paying the renewal fee. After June 1, any license not renewed is revoked.

Section 43-07-11.1 prohibits a contractor from entering a public contract with the state or a political subdivision until the contractor has demonstrated that the contractor has paid all delinquent income, sales, or use taxes, if any, owed to the state, and which have been assessed either by the filing of an income or sales and use tax return by the contractor, or by an

assessment of additional income, sales, or use taxes against the contractor by the commissioner which has become finally and irrevocably fixed, before the date that the contract was executed by the parties.

Section 43-07-12 provides that all bids and proposals for the construction of any public contract project exceeding \$2,000 must contain a copy of the license or certificate of renewal issued by the Secretary of State enclosed in the required bid bond envelope. A contract may not be awarded to a contractor unless the contractor is the holder of a license in the class within which the value of the project falls. A contractor must be the holder of a license at least 10 days before the date set for receiving bids to be a qualified bidder. Section 43-07-12 does not apply to contracts entered by the Department of Transportation and the Public Service Commission or to water and highway projects financed by federal funds.

Section 43-07-13 requires the Secretary of State to maintain a complete indexed record of all applications, licenses, certificates of renewal, revocations, and other information maintained on contractors. The Secretary of State may dispose of an inactive contractor file after two years if no attempts have been made to apply for a new license or renew the license.

Section 43-07-14 establishes the grounds under which a complaint may be filed against a contractor, including:

1. Abandonment of any contract without legal excuse.
2. Diversion of funds or property received under express agreement for the prosecution or completion of a specific contract, or for a specified purpose in the prosecution or completion of any contract, and their application or use for any other contract obligation or purpose to defraud or deceive creditors or the owner.
3. Engaging in any fraudulent or deceptive acts or practices or misrepresentation as a contractor in consequence of which one or more persons is injured in a total amount exceeding \$3,000.
4. The making of any false statement in any application for a license or renewal, violating any provision of Chapter 43-07, or being convicted of an offense the Secretary of State determines has a direct bearing on the applicant's or licensee's ability to serve the public as a contractor.
5. Engaging in work without any trade or professional license required for that work.
6. Failure to fully refund the contracting party's advance payment if a rebuttable presumption of abandonment has arisen and the contracting party has made a request to the licensee for a refund.

Section 43-07-15 requires the Secretary of State to review all complaints filed with respect to contractors. If the Secretary of State determines that a complaint provides sufficient facts upon which a reasonable person could conclude that one or more of the acts or omissions set forth in Section 43-07-14 has been committed, the Secretary of State may initiate an adjudicative proceeding in accordance with Chapter 28-32. If, after an adjudicative proceeding or as part of an informal disposition under Chapter 28-32, the Secretary of State determines that the licensee is guilty of an act or omission charged or if the licensee admits guilt to an act or omission charged, the Secretary of State may suspend or revoke the contractor's license, order a civil penalty of not more than \$1,000, order restitution in an amount not more than \$5,000, or impose a lesser sanction or remedy. The Secretary of State may suspend the contractor's license for a period of not more than 60 months and may not renew, reinstate, or issue a new license until the licensee has paid any civil penalty or restitution imposed. The Secretary of State may bring an action in district court to recover restitution or penalties. Under Section 43-07-15, a contractor aggrieved by a decision of the Secretary of State in revoking or suspending the contractor's license or ordering restitution or penalties may appeal the decision to the district court. A licensee is prohibited from obtaining a license under any name during the period of revocation or suspension.

Section 43-07-17 provides that a licensee whose license has been revoked may not be relicensed for a period of up to five years.

Section 43-07-18 establishes penalties for violations of Chapter 43-07. A person acting in the capacity of a contractor without a license is guilty of a Class B misdemeanor. In addition, that section authorizes the Secretary of State to assess civil penalties. The assessment of a civil penalty may be appealed in the same manner as appeals under Section 43-07-04, but only on the basis that the administrative determination that the person acted as a contractor when not licensed as a contractor was clearly erroneous.

Section 43-07-19 addresses nonresident contractors. That section provides that an applicant for a contractor's license who is not a resident of North Dakota, by signing and filing the application, appoints the Secretary of State as the applicant's lawful agent upon whom may be served all lawful process in any action or proceeding against the nonresident contractor. Registered foreign corporations entitled to do business in this state according to Chapter 10-19.1, registered foreign limited liability companies entitled to do business in the state according to Chapter 10-32, foreign limited liability partnerships entitled to do business in the state according to Chapter 45-22, and foreign limited partnerships entitled to do business in the state according to Chapter 45-10.1 and having a

current registered agent and registered address on file in the Secretary of State's office are not required to appoint the Secretary of State as agent for service of process.

Section 43-07-20 provides that in all contracts, except those which involve federal-aid funds and when a preference or discrimination would be contrary to a federal law or regulation, let for state, county, city, school district, or township construction, repair, or maintenance work, there must be a provision by which the contractor must give preference to the employment of bona fide North Dakota residents with preference given first to honorably discharged disabled veterans and veterans of the armed forces of the United States who are deemed to be qualified in the performance of that work. The preference does not apply to engineering, superintendence, management, or office or clerical work. The section prohibits a contract from being let to any person refusing to execute an agreement containing the preference provisions. Section 43-07-21 provides that a violation of Section 43-07-20 is a Class B misdemeanor. Section 43-07-22 requires the Labor Commissioner to enforce Sections 43-07-20 and 43-07-21.

Section 43-07-23 provides that unless otherwise provided by law, contracts entered between persons for the performance of work to be done by a contractor are subject to a maximum retention on amounts due under the contract as follows: retention of 10 percent of each estimate presented is allowable until such time as the project is 50 percent complete, with no further retainage on estimates during the continuance of the contract. That section further provides that if the owner, governing board, or authorized committee invests the retained estimate funds, the interest earned on those retained funds is payable at the time of final payment on the contract to the contractor on whose account the money was held.

Section 43-07-24 requires a contractor to provide the contractor's license number when applying for a building permit. Section 43-07-25 provides that on request, the Secretary of State must provide city and county enforcement officials with a list of licensed contractors. That section also requires the Secretary of State to provide information on the activities of a contractor doing business in this state of which officials of Workforce Safety and Insurance, Job Service North Dakota, or the Tax Commissioner may be unaware and that may be relevant to the duties of those officials.

## **2003 LEGISLATION RELATING TO CONTRACTOR LICENSING**

Senate Bill No. 2252, which directed this study, also addressed the licensing of contractors and the revocation and suspension of contractor licenses. The bill included the requirement that an applicant for a

contractor's license must be at least 18 years of age. The bill also included additional grounds for a complaint against a contractor, including the acts of engaging in work without a trade or professional license required for that work and the failure to fully refund the contracting party's advance payment if a rebuttable presumption of abandonment has arisen and the contracting party has made a request to the licensee for a refund. In addition, the bill revised the procedures for the revocation of a license and provided that a license may be suspended under the Administrative Agencies Practice Act. The bill also included specific provisions for the imposition of civil penalties.

## **CONTRACTOR LICENSING IN NEIGHBORING STATES Minnesota**

In Minnesota, the Department of Commerce licenses and regulates residential building contractors, remodelers, roofers, and manufactured home installers. The annual license fee for those contractors is \$100. The Commissioner of Commerce, in consultation with the Builders State Advisory Council, is authorized to adopt standards for continuing education requirements for contractors. An individual who fulfills the examination and education requirements for licensure on behalf of a licensed building contractor, remodeler, roofer, or manufactured home installer must provide proof of completion of seven hours of continuing education per year.

Minnesota law grants the Department of Commerce the authority to initiate administrative proceedings for the denial, suspension, or revocation of a contractor's license if the contractor:

1. Has filed an application for a license that is incomplete in any material respect or contains any statement that, in light of the circumstances under which it is made, is false or misleading with respect to any material fact.
2. Has engaged in a fraudulent, deceptive, or dishonest practice.
3. Is permanently or temporarily enjoined by any court from engaging in or continuing any conduct or practice involving any aspect of the business.
4. Has failed to reasonably supervise employees, agents, subcontractors, or salespersons, or has performed negligently or in breach of contract, so as to cause injury or harm to the public.
5. Has violated or failed to comply with any law regulating contractors.
6. Has been shown to be incompetent, untrustworthy, or financially irresponsible.
7. Has been convicted of a violation of the state building code or, in jurisdictions that do not

enforce the state building code, has refused to correct a violation of the state building code when the violation has been certified by a Minnesota licensed structural engineer.

8. Has failed to use the proceeds of any payment made to the licensee for the construction of, or any improvement to, residential real estate for the payment of labor, skill, material, and machinery contributed to the construction or improvement, knowing that the cost of any labor performed, or skill, material, or machinery furnished for the improvement remains unpaid.
9. Has not furnished to the person making payment either a valid lien waiver as to any unpaid labor performed, or skill, material, or machinery furnished for an improvement, or a payment bond in the basic amount of the contract price for the improvement conditioned for the prompt payment to the person entitled to payment.
10. Has engaged in conduct that was the basis for a contractor's recovery fund payment that has not been reimbursed.
11. Has engaged in bad faith, unreasonable delays, or frivolous claims in defense of a civil lawsuit arising out of the contractor's activities as a licensee.
12. Has had a judgment entered against the licensee for failure to make payments to employees or subcontractors, and all appeals of the judgment have been exhausted or the period for appeal has expired.
13. If unlicensed, has obtained a building permit by the fraudulent use of a fictitious license number or the license number of another, or, if licensed, has knowingly allowed an unlicensed person to use the licensee's license number for the purpose of fraudulently obtaining a building permit.
14. Has made use of forged mechanics' lien waivers.

Minnesota law imposes bond and insurance requirements upon contractors. The bonds must be conditioned that the contractor perform the duties of the contractor and comply with applicable laws for all contracts entered. The bond for a licensed roofer must be at least \$5,000. The bond amounts for residential building contractors and remodelers vary according to the amount of gross annual receipts of the contractor. If the annual gross receipts of the contractor are \$1 million or less, the bond must be \$5,000; if the annual gross receipts of the contractor are more than \$1 million but less than \$5 million, the bond must be \$10,000; and if the gross receipts of the contractor are greater than \$5 million, the bond must be \$15,000. A licensee is also required to have public liability

insurance with limits of at least \$100,000 per occurrence.

Under Minnesota law, a nonresident may be licensed as a residential building contractor or residential remodeler if the nonresident meets the licensing requirements. Service of process on the licensee may be made upon the Commissioner of Commerce. Minnesota law also provides that a person contracting with a nonresident to perform construction work in the state must withhold 8 percent of every payment to the contractor if the contract exceeds \$100,000. The withholding provisions may be waived if the contractor gives the Commissioner of Commerce a cash surety or bond or if the contractor has done construction work in the state during the previous three calendar years and fully complied with Minnesota laws relating to payment of state income, franchise, sales, and use taxes. The bond or surety is held as a guarantee for the payment of those taxes.

Under Minnesota law, applicants for a license to act as a licensed building contractor, remodeler, roofer, or manufactured home installer must pay an annual fee to the contractor's recovery fund. The fee varies according to the gross receipts of the contractor. If the annual gross receipts of the contractor are less than \$1 million, the fee is \$100; if the annual gross receipts of the contractor are between \$1 million and \$5 million, the fee is \$150; and if the annual gross receipts of the contractor are over \$5 million, the fee is \$200.

The purpose of the contractor's recovery fund is to compensate any aggrieved owner or lessee of residential property located in the state who obtains a final judgment in any court of competent jurisdiction against a licensee on grounds of fraudulent, deceptive, or dishonest practices, conversion of funds, or failure of performance arising directly out of any transaction when the judgment debtor was licensed and performed any services on the owner's residential property or on residential property rented by the lessee, or on new residential construction that was never occupied before purchase by the owner, or which was occupied by the licensee for less than one year before purchase by the owner, and which cause of action arose on or after April 1, 1994. Minnesota law provides that nothing may obligate the fund for more than \$50,000 per claimant, nor more than \$75,000 per licensee or for claims based on a cause of action that arose before the licensee paid the recovery fund fee.

The license of a contractor is automatically suspended when a claim against a contractor is paid from the contractor's recovery fund. The license may not be reinstated until the licensee has repaid the fund, plus 12 percent interest, twice the amount paid from the fund on the licensee's account, and has obtained a surety bond in the amount of at least \$40,000.

## Montana

In Montana, a construction contractor is required to be registered with the Department of Labor and Industry. A construction contractor is defined as a person, firm, or corporation that in the pursuit of an independent business, offers to undertake, undertakes, or submits a bid to construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish for another a building, highway, road, railroad, excavation, or other structure, project, development, or improvement attached to real estate, including the installation of carpeting or other floor covering, the erection of scaffolding or other structures or works, or the installation or repair of roofing or siding. A certificate of registration in Montana is effective for two years. The fee for registration is \$70.

Montana law requires the Department of Labor and Industry, cooperatively with representatives of the building industry, to establish an industry and consumer information program to educate the building industry about the registration program and to educate the public regarding the hiring of building construction contractors. The education program is funded through dedication of 15 percent of the registration fees. The Department of Labor and Industry is required to maintain a list of registered construction contractors, which must be available to the public.

Under Montana law, a person who acts as a contractor and who is not registered is subject to a penalty of up to \$500.

## South Dakota

With the exception of the requirement to hold an excise tax license, South Dakota law does not provide any specific requirements regarding the licensing or regulation of building contractors.

## POSSIBLE STUDY APPROACH

In undertaking this study, the committee may review North Dakota laws relating to contractors and the laws of other states to determine if the current statutory provisions are appropriate and adequate. The committee may seek input from groups that represent contractors, the Secretary of State, and the Attorney General, as well as the general public.

ATTACH:1