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April 16, 2018

The Honorable Jerry Hill, Chair, and Members
Senate Committee on Business, Professions and Economic Development
State Capitol, Room 2053
Sacramento, CA 95814

Re: SB 1465 (Hill) – SUPPORT

Dear Chair Hill and Members:

As you know, the company that constructed the Berkeley apartment building whose balcony collapsed in 2015, killing six people and injuring at least seven others, reportedly paid out an astonishing $26.5 million in settlements in just three years, yet the state agency tasked with protecting consumers from possibly lethal construction—the Contractors' State License Board (CSLB)—remained ignorant of such settlements:

> The company that built the downtown Berkeley complex, Segue Construction Inc. of Pleasanton, oversaw projects in which legal settlements over construction defects totaled $26.5 million in the past three years. The Contractors' State License Board, however, was unaware of the cases, The Chronicle reported Monday. State law did not require Segue to report the cases to the board, which grants and renews contractors' licenses.[1]

SB 1465 (Hill) asks the following question:

Does a pattern of being sued and settling cases for significant sums possibly reveal problems with a contractor?

The answer is, of course it does, which is why state law requires so many licensees to self-report such events and which is why, as discussed below, SB 1465 (Hill) is an important consumer protection measure.

Center for Public Interest Law

The Center for Public Interest Law (CPIL) is a nonprofit, nonpartisan, academic center of research, teaching, learning, and advocacy in regulatory and public interest law based at the University of San Diego School of Law. Since 1980, CPIL has studied the state's regulation of business, professions, and trades, and monitors the activities of state occupational licensing agencies, including the regulatory boards within the Department of Consumer Affairs (DCA). CPIL publishes the *California Regulatory Law Reporter*, which chronicles the activities and decisions of 12 California regulatory agencies, including CSLB.

[1] http://m.sfgate.com/bayarea/article/Construction-company-goes-to-court-over-Berkeley-6358256.php

CPIL's expertise has long been relied upon by the Legislature, the executive branch, and the courts where the regulation of licensed professions is concerned. For example, after numerous reports of problems at the Medical Board of California (MBC) were published in 2002, the DCA director named me as MBC's Enforcement Monitor, charged over a two-year period with an in-depth investigation and review of all of the Board's practices, policies, and operations. Several major pieces of reform legislation have been enacted, mirroring the Monitor's many recommendations. As noted below, I also served as the principal consultant to CSLB's Enforcement Monitor from 2001 to 2003, and CPIL has served in a similar role at the State Bar.

Licensure Is About Harm Prevention

Licensure is a significant disruption into the market. By restraining the type of people who may easily enter a profession through testing, academic qualifications, and by barring the unlicensed from lawfully practicing the profession, consumers have fewer choices, and licensees are able to charge higher prices and enjoy increased profits as a result.

The market-distorting consequences of licensure, therefore, are warranted for those professions that, if practiced incompetently or dishonestly, injure consumers or patients in such a way that after-the-fact damages cannot reliably make a harmed consumer or patient truly whole. If, for example, an incompetent physician kills a patient, no amount of civil damages can revive the dead, making the widow or widower truly whole. If an engineer incompetently designs a bridge and it fails, killing drivers, the same is true. Examine the DCA licensed professions, and what is common among them is the particular need to *prevent harm* from occurring in the *first place*. This is why licensees must fulfill minimum experience and education requirements and must pass an exam before they can lawfully practice.

Thus, the point of a disciplinary action against a professional's license is not punishment. Nor is it to make the licensee's victim whole. The entire point of being given a license is that it can be taken away from the unqualified licensee, so that *future consumers or patients will not be harmed* by allowing the licensee to continue to practice in the licensed profession. In other words, licensing protects consumers and patients from harm by ensuring that at any given time the only individuals lawfully allowed to practice in a licensed profession are competent, honest and fair.

For these reasons, the DCA occupational licensing boards and bureaus are generally responsible for licensing various trades and professions, setting standards for the practice of those trades and professions, and—importantly—enforcing those standards through a disciplinary program designed to detect and investigate licensee misconduct and, in appropriate cases, revoke, suspend, or restrict occupational licenses to protect the public. To this end, AB 269 (Correa) (Chapter 107, Statutes of 2002) clarified that public protection is the highest priority—indeed, the "paramount" priority—for all DCA agencies in exercising their licensing, standard setting, and enforcement authorities.

Licensing Boards and Their Complaint Processes

Licensing board enforcement is reactive, driven by complaints from consumers and other information that comes to the licensing board's doorstep. Literally anybody can file a complaint about a licensee with a licensing board and a board is duty-bound to consider it. Some complaints and information that come to boards, however, are more potentially weighty than others. Thus,

many boards currently have laws that require licensees (and sometimes their insurers as well) to report civil judgments, settlements, and arbitration awards that may reveal potential patterns and problems with a licensee and may prove more indicative of problems than random complaints. *See, e.g.,* Business and Professions Code **§ 801.01** (requiring physicians, osteopaths, podiatrists, and physician assistants to self-report medical malpractice judgments and arbitration awards in any amount, and settlements over $30,000; additionally, the same section requires insurers of those licensees to file the same report); **§ 5063** (requiring accountants to self-report settlements or arbitration awards in excess of $30,000, and judgments in any amount involving dishonesty, fraud, negligence, breach of fiduciary responsibility, embezzlement, and preparation of fraudulent financial statements; additionally, **§ 5063.2** requires insurers of accountants to file those same reports); **§ 5588** (requiring architects to report judgments, settlements, and arbitration awards in excess of $5,000 in actions involving fraud, deceit, negligence, incompetence, or recklessness by the licensee in the practice of architecture; additionally, **§ 5588.1** requires insurers of those architects to file those same reports); **§ 5678** (requiring the same of landscape architects; additionally, **§ 5678.1** requires insurers of landscape architects to file those same reports); **§ 6770** (requiring engineers to self-report felony convictions, convictions of crimes related to duties and functions of engineers, civil action settlements or administrative actions in excess of $50,000 relating to fraud, deceit, misrepresentation, breach or violation of contract, negligence, incompetence, or recklessness by the licensee in the practice of professional engineering, and civil judgments, binding arbitration awards or administrative actions relating to those topics in excess of $25,000; additionally, **§ 6770.2** requires insurers of engineers to file those same reports); and **§ 8776** (requiring the same of land surveyors; additionally, **§ 8776.2** requires insurers of land surveyors to file those same reports).

SB 1465 (Hill)

SB 1465 (Hill) would impose similar—but more relaxed and limited—reporting requirements upon contractors and their insurers.

According to our reading of the bill, SB 1465 would require contractor self-reporting (and insurer reporting) to CSLB of civil judgments, settlements, and arbitration awards that meet **ALL** of the following requirements: (1) the action alleges fraud, deceit, negligence, breach of contract or express warranty, misrepresentation, incompetence, recklessness, wrongful death, or strict liability by the act or omission of a licensee while acting in the capacity of a contractor; **AND** (2) the amount of the judgment, settlement, or arbitration award is $1,000,000 or more; **AND** (3) the action is the result of a claim for damages to a property or person that allegedly resulted in a failure or condition that would pose a substantial risk of a failure in the load bearing portions of a multifamily residential structure, which portions of the structure are not constructed in compliance with the codes in effect at the time of construction; **AND** (4) the action is a result of a claim for damages to a property or person that was allegedly caused by a licensee's construction, repair, alteration to, subtraction from, improvement of, moving, wrecking, or demolishing of, any part of a multifamily rental residential structure; **AND** (5) the action has been designated as complex because it involves a claim of construction defect or insurance coverage arising out of a construction defect claim.

As such, SB 1465 is much narrower than self-reporting (and insurer reporting) laws applicable to other licensed trades and professions, in that its threshold reporting requirement is $1,000,000 and the reportable misconduct applies only to multifamily residential structures.

There is simply no public policy reason why engineers and architects should be required to report judgments, settlements, and arbitration awards, but not the licensees who actually build what the engineers and architects design.

SB 1465 Is Modest Compared to the 2001 Recommendations of the CSLB Enforcement Monitor

SB 1465 would implement—in part—a 2001 recommendation of the CSLB Enforcement Monitor. As a result of the Legislature's 1999–2000 sunset review of CSLB, SB 2029 (Figueroa) provided for the appointment of a CSLB Enforcement Monitor and designated as his duty "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." Business and Professions Code section 7092(c)(1). DCA Director Kathleen Hamilton appointed Thomas A. Papageorge, then Head Deputy District Attorney in charge of the Consumer Protection Division of the Los Angeles County District Attorney's Office, as CSLB Enforcement Monitor; I served as Mr. Papageorge's principal consultant during the two-year project that ran from 2001–03 and produced four reports.

In their initial report, we analyzed all aspects of CSLB's enforcement program and made several findings about the precise issues that are the subject of SB 1465. Specifically, the Monitor found: "The flow of information into CSLB about licensee misconduct is generally inadequate…. CSLB … lacks mandatory reporting statutes applicable to other agencies (*e.g.*, Business and Professions Code § 800 *et seq*. applicable to the Medical Board). CSLB and the Legislature should consider enacting statutes requiring the reporting to CSLB of contractor criminal arrests and convictions, civil judgments and settlements, bankruptcies, debarments by government entities, and private arbitration awards, to enable CSLB to make more informed licensing and enforcement decisions."[2] To remedy this problem, the Enforcement Monitor made a specific recommendation (Recommendation #8 at pages 110-112 of the Initial Report) that CSLB seek "enactment of mandatory reporting statutes (similar to Business and Professions Code section 800 *et seq*. applicable to the Medical Board), and … requiring license renewal reporting of relevant criminal convictions by adding a question to the contractor license renewal form regarding conviction of crime since the last renewal."[3]

The Monitor also noted: "This flow of information is simply that—information. Not all of it is immediately disclosed to the public, and the Medical Board does not necessarily take disciplinary action against each reported licensee in every circumstance. However, this flow of information greatly enhances the Board's ability to detect patterns of misconduct and make more informed licensing and discipline decisions."[4] The Monitor recommended that "[t]o better protect the public, CSLB and the Legislature should strongly consider 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; criminal arrests and convictions; bankruptcy filings; and debarments by government entities."[5]

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[2] Thomas A. Papageorge and Julianne D'Angelo Fellmeth, *Initial Report of the CSLB Enforcement Program Monitor* (October 1, 2001) ("Initial Report") at 77-78. (Available at http://www.cpil.org/download/CSLB_Monitor_Initial_Report.pdf.)
[3] *Id.* at 110-11.
[4] *Id.* at 111.
[5] *Id.* at 112.

Thus, SB 1465's self-reporting requirements are modest compared to laws applicable to other trades and professions and to the recommendations of the CSLB Enforcement Monitor. The bill would simply enhance the flow of relevant information about contractor misconduct into CSLB so that the Board has an opportunity to investigate.

The Legislature has charged CSLB with public protection as its highest and "paramount" priority (Business and Professions Code section 7000.6), and the deaths of the six students in Berkeley prove that CSLB is not able to fulfill that mission without a better flow of information into the agency so that the Board simply has the opportunity to better protect consumers from contractors who cause harm.

CSLB's December 2017 Study Required by SB 465 (Hill)

Shortly after the July 2015 Berkeley balcony collapse, Senator Hill amended his then-pending SB 465 to require contractor self-reporting of judgments, settlements, and arbitration awards similar to the requirements operative for architects, engineers, and land surveyors. Vocal opposition by the construction industry halted the bill in 2015.

In 2016, Senator Hill amended SB 465 to require (1) self-reporting by contractors of felony convictions and convictions of other crimes that are substantially related to the qualifications, functions, and duties of a licensed contractor; (2) required sharing of information between Cal-OSHA and CSLB concerning Cal-OSHA's assessment of citations and fines against licensed contractors; and (3) a study to be conducted by CSLB "to determine if the board's ability to protect the public as described in Section 7000.6 would be enhanced by regulations requiring licensees to report judgments, arbitration awards, or settlement payments of those claims."

CSLB issued that study in December 2017. The bottom-line recommendation of CSLB is that it believes its ability to protect the public, as described in Business and Professions Code section 7000.6, "would be enhanced by regulations requiring licensees to report judgments, arbitration awards, or settlement payments of construction defect claims for rental residential units."[6] "At its December 7, 2017 meeting, the Board specifically found that requiring licensees to report judgments, arbitration awards, or settlement payments of construction defect claims is a good idea and would be a good investigative tool in the Board's 'tool box.'"[7]

Additionally, CSLB surveyed licensees, consumers, and insurers to assess whether CSLB's consumer protection mission would be enhanced by regulations requiring licensees to report judgments, arbitration awards, or settlement payments of construction defect claims for rental residential units. "Out of 3,479 licensees, 1,869 respondents (53.72%) and 1,610 responded "no" (46.28%). Out of 2,273 consumers, 2,175 responded "yes" (95.69%) and 98 responded "no" (4.31%). Out of 143 insurers, 90 responded "yes" (62.94%) and 53 responded "no" (37.06%)."

SB 1465 is closely tied to the findings and conclusions in CSLB's December 2017 study. CPIL does not agree that SB 1465—as narrow and limited as it is—would require the Board to hire 13 additional employees to screen these reports and investigate them. This estimate is likely inflated

[6] http://www.cslb.ca.gov/Resources/Reports/SB_465_Report.pdf at 37.
[7] *Id.* at 41.

since it is based on the large number of settlements, not the much smaller number that will meet the high damage minimum. Moreover, ever if all 13 are necessary, the $1 to $2 million in expense pales in comparison to the damage from a single major failure—as the Berkeley balcony collapse exemplifies. This additional resource will be directed at the monitoring and detection of major construction failures with irreparable harm implications. The prevention of this harm sits at the center of applicable regulatory purpose.

If a pattern of settling cases for significant sums just might shed a poor light on a contractor's competence, then CSLB should know about the settlements, with licensees knowing that CSLB will, like its sister boards, review such information proportionately and appropriately.

Sincerely,

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Staff Counsel
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cc: Dave Fogt, CSLB Registrar
Dean R. Grafilo, DCA Director