REPORT TO THE

UTAH LEGISLATURE

Report No. 2000-01

A Performance Audit of the Residence Lien Restriction and Recovery Program

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A Performance Audit of the Residence Lien Restriction and Recovery Program

The Residence Lien Restriction and Recovery Fund Act has protected some homeowners from liens and has helped contractors and suppliers of construction materials recover lost money. However, we have significant concerns with the efficiency and effectiveness of this program. We believe some aspects of the act are flawed, and we recommend that the Legislature consider adding the issues identified in this report to the interim study agenda. Officials from the Department of Commerce agree with the concerns in this report. In fact, at the beginning of this audit, they indicated their belief that the lien recovery program has serious structural flaws and they welcomed our review. Further study of the issues in this report can help the Legislature determine how problems caused by financially negligent contractors can either be prevented or more effectively resolved.

The law was designed to protect homeowners against mechanics' liens and also provide recovery options for contractors and suppliers who are not paid by a general contractor. Although the program has protected some homeowners, contractors and suppliers, its deficiencies are significant and necessitate further legislative study. Specifically, this report discusses the following concerns:

- Total costs incurred to resolve claims are excessive
- Some homeowners are protected under the law but improvements are needed
- Contractors are frustrated with the lien recovery process
- Suppliers receive a disproportionate benefit from the program
- Options exist to enhance or replace the current program and should be explored

Chapter II - Total Costs of Resolving Claims Are Excessive

For every $1 paid out in qualified services–or principal claim amount–the lien recovery fund incurs and expends between $1.41 and $1.95 in other costs. This means that at least 59% and as much as 66%

of all money flowing out of the lien recovery fund represents lien recovery payroll costs, division and department support costs, and reimbursement to claimants for attorneys' fees and interest. In our opinion, this total level of costs to resolve claims is unreasonably high and prevents the lien recovery program from operating efficiently. Some changes have either been made or proposed recently which should help reduce these costs. However, we believe more needs to be done to improve program cost-effectiveness by reducing the level of costs to resolve claims and/or by increasing the volume of claims that are processed.

Chapter III - Law Protects Some Homeowners but Can Become More Effective

Some homeowners have been protected under the law, but many seemed to qualify by chance because they had no up-front knowledge of the requirements necessary for lien protection. If homeowners do not understand these requirements at the beginning of the building process, they may not select a licensed contractor or demand a written contract, both of which are necessary to qualify for protection. Better education at the beginning of the building process is needed to inform homeowners about mechanics' lien rights and make them aware of the steps necessary to qualify for lien protection. In addition, ambiguity in the current law can cause problems between homeowners and lien claimants regarding when homeowner compliance is established. We believe the process of determining how, when, and how quickly homeowner compliance is established needs to be reviewed by the Legislature.

Chapter IV - Contractors Express Frustration with the Lien Recovery Fund

At least 90% of a sample of contractors who have filed claims express frustration and dissatisfaction with the lien recovery fund. They indicate that filing claims is a difficult and time-consuming process, is unforgiving if deadlines are missed, and is too costly in many instances. Many contractors feel their only real option is to absorb their losses rather than attempt an expensive and uncertain recovery process. In addition, contractors who have not filed claims against the fund express a lack of basic knowledge and understanding of how the program works, in spite of educational efforts made by lien recovery program personnel. We understand that educating all contractors about the law is a difficult task, but we believe all education and training options should be explored. We anticipate more contractors would use the program if they are better educated and if the Legislature can simplify and streamline the recovery process.

Chapter V - Recovery Fund Benefits Suppliers More Than Contractors

Suppliers of construction materials receive a disproportionate benefit from the lien recovery fund compared to contractors. Suppliers receive 71% of fund payouts compared to 29% for contractors; in contrast, suppliers only contribute 1% of the fund's revenues while contractors provide 95% of the revenue. In addition, one supplier has used the lien recovery fund to a significantly greater extent than any other supplier or contractor, yet has paid the same assessment fee into the fund. In our opinion, the practice of assessing all members a flat rate should be modified so that those who use the fund more also pay more in assessments.

Chapter VI - Alternatives to the Current System Should Be Considered

Options exist to modify and enhance the program which could make it more efficient and effective and which are imperative if the current program structure is retained. Specifically, the cost-effectiveness of resolving lien recovery claims must improve, and better education about the law is needed for all parties involved. Alternatively, other options that more completely restructure and replace the current program also exist and could be considered. However, before the Legislature chooses some other model to replace the current system, we recommend further study of all advantages and disadvantages of the options as we were limited in time from performing such an analysis. Although the current program has serious flaws, it does offer protection to homeowners. In our opinion, homeowner protection is valuable and needs to be included in some form in whatever program the Legislature adopts.

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Chapter I
Introduction

The Residence Lien Restriction and Recovery Fund Act has protected some homeowners from liens and has helped contractors and suppliers recover lost money. However, we have significant concerns regarding the efficiency and effectiveness of this program as detailed in the chapters of this report. Specifically, we believe the program is not cost-effective as it is currently operating and must become more efficient. Better education to homeowners and contractors is also necessary to enhance program effectiveness, and the overall process of recovering claims needs to be streamlined and simplified. In addition, those who use the fund more should be paying more for the protection they are receiving.

These concerns must be studied by the Legislature in order to determine more effective methods of resolving problems caused by financially irresponsible contractors. Options exist to modify and enhance the current program, which should promote efficiency and greater effectiveness. Alternatively, other options that more completely restructure the current program also exist and could be considered. Before the Legislature chooses some other model to replace the current system, however, we recommend further study of all advantages and disadvantages of the options available.

Background and History of the Lien Restriction and Recovery Fund Law

The Lien Restriction and Recovery Fund Act was created from legislation passed in the 1994 General Session. The act was patterned after a similar program in the state of Michigan and serves two essential purposes:

The law provides lien protection for homeowners as well as recovery options for unpaid parties.

- First, the law was designed to protect homeowners—who had met certain requirements—from having mechanics' liens maintained on their property by a sub-contractor or supplier who had not been paid by a general contractor. This aspect of the law is referred to in this report as the Lien Restriction Act, or LRA.

The LRF acts as a fund of last resort and requires parties to pursue other avenues of collection first.

- Second, the law established a recovery fund which was to be financed by the construction industry. This fund would provide a method for contractors and suppliers to recapture losses incurred if they were not paid by the general contractor and if the homeowner had met the requirements for lien protection. This part of the law is referred to in this report as the Lien Recovery Fund, or LRF.

The lien restriction and recovery fund law was passed because of perceived inequities for homeowners involving traditional mechanics' lien laws. Prior to the inception of the lien restriction and recovery fund law, a mechanic—a tradesman of any sort who had provided services on or materials to a residential construction project—could place a lien on the property if he was not paid by the party with whom he had contracted (either a general contractor or a sub-contractor). The justification for this lien right was that if a mechanic was not paid by the party with whom he had contracted, he could lien the property involved because he had helped enhance its value through performing services or supplying materials.

Homeowners faced the possibility of having to pay twice for services under the old mechanics' lien law.

The fundamental concern with the mechanics' lien law was that homeowners ultimately suffered the consequences by having to pay twice for services. If a homeowner had paid a general contractor in full for all services provided and that contractor failed to pay his debts to a sub-contractor or supplier, the homeowner would have to pay *a second time* to have a lien removed. Otherwise, the homeowner would face the prospect of losing his property through legal enforcement of the lien. Consequently, the lien restriction and recovery fund law was enacted to provide help for homeowners as well as unpaid parties.

The LRF operates as a fund of last resort. Thus, unpaid contractors and suppliers must pursue collection from the non-paying party before coming to the LRF. Specifically, they must either obtain a civil judgement against the non-paying party stating that they have made reasonable efforts to collect, or they must show proof that the non-paying party has filed for bankruptcy. At that point, the unpaid party may make claim against the LRF, which then triggers another often lengthy process of determining whether the claimant has met all requirements for financial recovery. If approved, claimants are awarded

the principal amount of unpaid debt (referred to as qualified services), and typically receive reimbursement for attorneys' fees and court costs as well as interest on the principal debt.

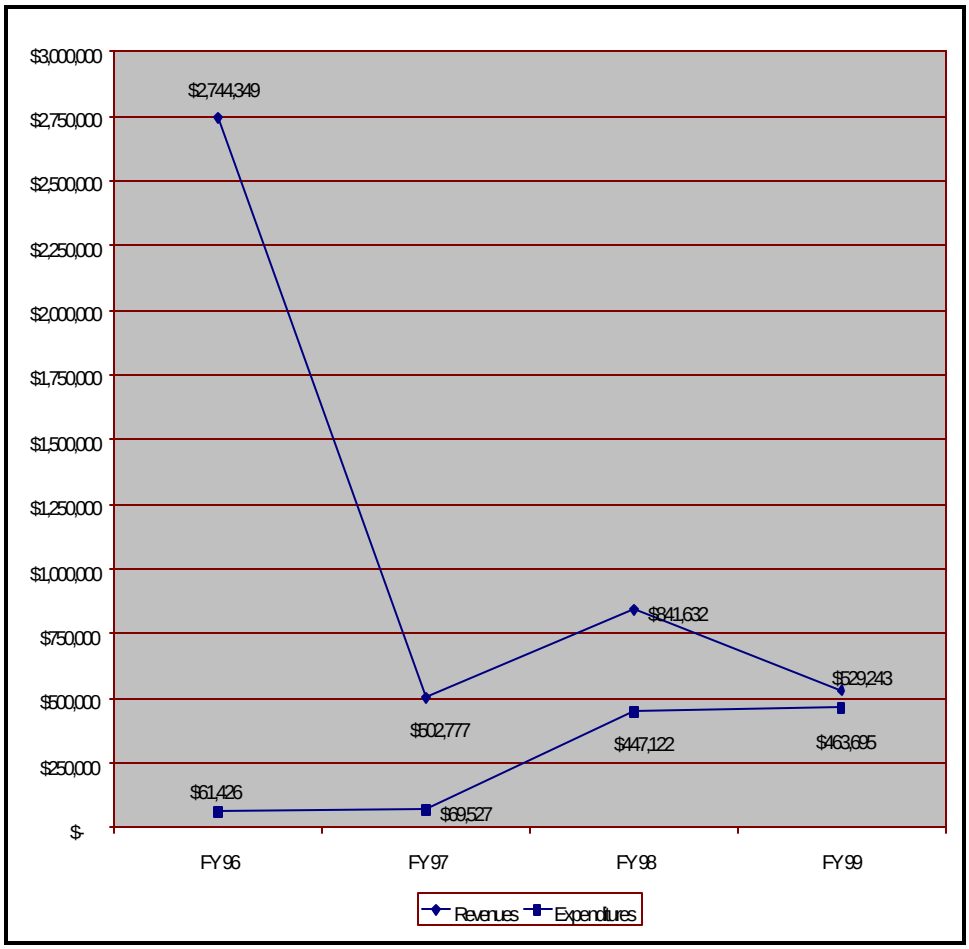
The LRF is administered by the Division of Occupational and Professional Licensing (DOPL) and employs a fund coordinator, a claims examiner, and a secretary. In addition, a seven-member advisory board comprised of suppliers and contractors, as well as one citizen representative, reviews and votes on all claims. Finally, all claims are submitted to the DOPL division director where they are ultimately either approved or denied.

Recovery Fund Balances Are Healthy

The LRF is funded primarily by a mandatory assessment of $195 on most categories of contractors licensed by DOPL. In addition, an identical assessment is required for others, such as suppliers, architects and engineers, if they choose to join the fund for recovery protection. The law also provides for special assessments to be made if the fund balance falls below $1.5 million. However, special assessments have never been necessary due to robust fund balances, which currently exceed $3.5 million. Other revenue to the fund includes a $75 non-refundable application fee each time a claim is filed, as well as interest earnings.

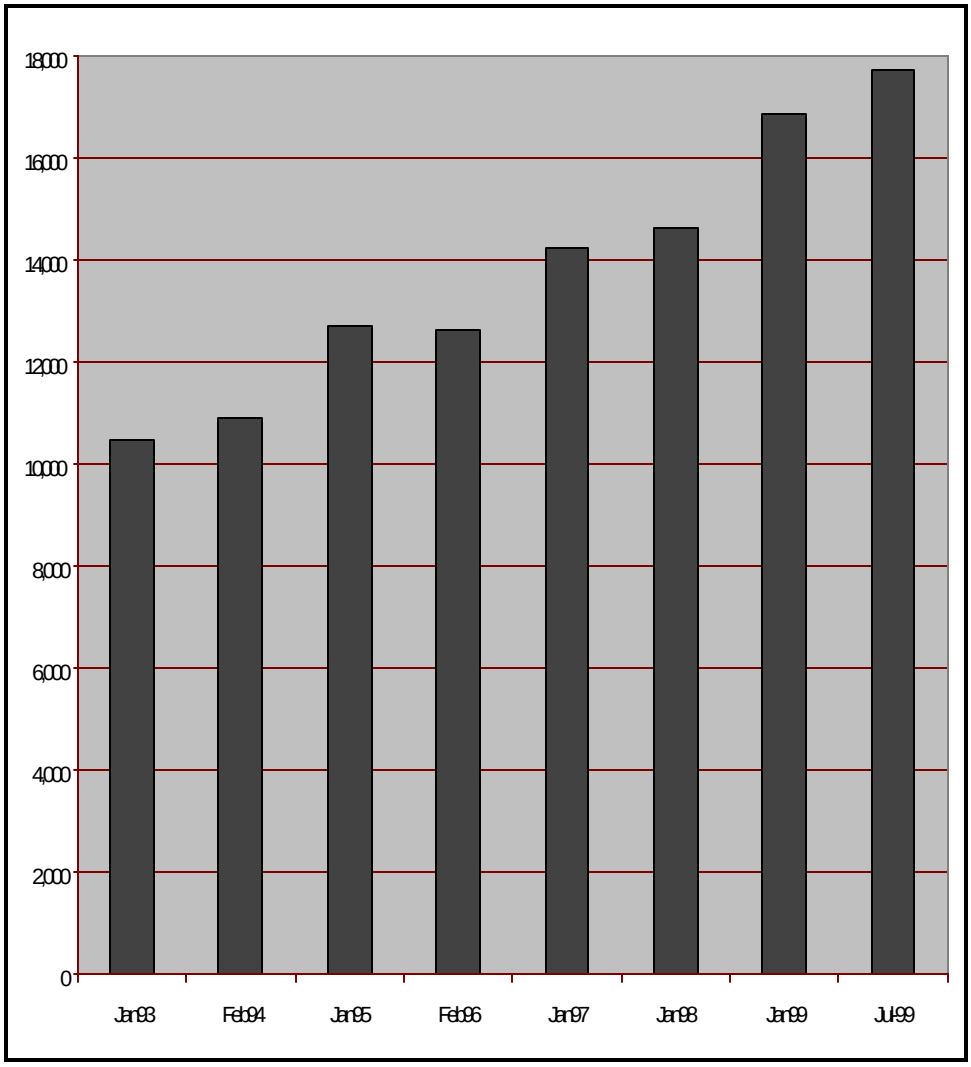
The following figure shows the relationship between fund revenues and expenditures.

Figure 1. Lien Recovery Fund Revenues and Expenditures. LRF revenues have exceeded expenditures each year since the fund became operational.



As shown in Figure 1, annual LRF expenses—which include all claims payouts plus costs of administering the fund—have never exceeded revenues. One reason that revenues exceed expenditures is due to the steady growth of licensed contractors in the state, as shown in the next figure.

Figure 2. The Number of Contractors Licensed by DOPL.
The number of licensed contractors who have paid into the LRF has steadily increased since 1993 to approximately 18,000.



Over 20,000 contractors have paid into the LRF.

Figure 2 shows that the steady rise in the number of licensed contractors has created a consistent source of revenue for the fund. In fact, over 20,000 contractors have paid into the fund since its inception.

Law Has Been Amended over Time

Since the inception of the Lien Restriction and Recovery Fund Act, the Legislature has made annual revisions to the law. For example, limits have been imposed on the amount that can be awarded for interest on claims, and the number of requirements necessary for homeowners to be

protected under the law has been reduced. In addition, a task force comprised of members from DOPL, the LRF advisory board, and other industry personnel recently concluded discussions about ways to improve the operation of the program. Many of the task force proposals are included in a bill to make further changes to the law, which is scheduled to be introduced in the 2000 legislative session. While we attended all task force meetings to keep abreast of the issues discussed, our audit was conducted independent of any task force involvement.

The audit was conducted independent of task force involvement.

Audit Scope and Objectives

This audit was requested to determine whether the lien restriction and recovery fund law has operated as intended by the Legislature. One concern mentioned was that the fund has built large balances because recovering money from the LRF is a difficult and discouraging process. We spent much of our time on this audit interviewing contractors and suppliers, many of whom have had experience with the LRF, but some of whom have not made claim against the fund. We also contacted several homeowners who either had been protected by the law or who have had mechanics' liens placed on their homes within the last two years. In addition, we analyzed statistical information kept by DOPL regarding LRF claimants and payout amounts.

Limited time on this audit prevented us from fully exploring solutions to problems.

We were asked by legislative leadership to have this report ready by the beginning of the 2000 General Session. As a consequence, we were unable to spend the time necessary to fully explore and recommend solutions to the many concerns we have with the current law as outlined in this report. However, we do provide some recommendations and present what information we could gather on options to the present system.

Specifically, we attempted to achieve the following objectives in this audit:

- Determine how cost-effective the current lien recovery program is.

- Determine how well homeowners understand the lien restriction law and how well they feel protected by it.

- Determine how well both contractors and suppliers understand the LRF and how effectively they feel it is operating.

- Discuss options that exist to either modify and enhance the existing program or more fully restructure it if that is the Legislature's wish.

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Chapter II
Total Costs of Resolving Claims Are Excessive

At least 59% and as much as 66% of all money flowing out of the Lien Recovery Fund (LRF) represents costs to resolve and pay principal claim amounts. Because of this, we believe the LRF program does not operate efficiently and will not until the cost-benefit ratio improves.

Some claim resolution costs are necessary but currently overshadow the recovery benefit.

Claim resolution costs are necessary to operate a fund of last resort and were always intended to be paid by the LRF. In addition, there has been some downward trend in the amount paid for at least some of these costs over time. Without information from other states, we do not know how these costs compare to similar recovery fund programs. However, we believe the costs currently being incurred to resolve claims are unreasonably high when compared to the amount of principal claim dollars being paid. We further believe the Legislature and DOPL need to determine how the current system of resolving problems caused by non-paying contractors can become more cost effective.

Claim Resolution Costs Are Too High Compared to Recovery Benefit

For every $1 paid out in qualified services—or principal claim amount—the LRF incurs and expends at least an additional $1.41 in other costs. If we allocate all support costs as estimated by the DOPL Division Director, the cost of settling claims could be as high as $1.95 for each $1 paid in qualified services. In our opinion, this range of cost is excessive. Improvements to the cost-effectiveness of the LRF need to be made, either by reducing the level of costs to resolve claims and/or by increasing the volume of claims that are processed.

The costs of resolving contractor non-payment problems consist of the following components:

- **Qualified Services** - The principal amount of debt that was owed and not paid by a contractor to either a sub-contractor or a supplier.
- **Claim Resolution Costs** - Additional costs incurred to resolve and pay claims for qualified services. These include:

  - **LRF Payroll Costs** - Costs of division personnel to review and approve claims and operate the program.

  - **LRF Support Costs** - Costs of division, department, and attorney general personnel to support the program.

  - **Supplemental Claim Costs** - Costs awarded to claimants as reimbursement for other expenses. These include:

    - **Attorneys' Fees** - Money reimbursed to claimant for legal resources used in pursuing the case civilly and with the LRF.

    - **Interest** - Paid to the claimant on qualified services for all or some portion of time the debt was outstanding. Historically, this rate has been as high as 27%, but was capped in 1999 at 12% for all claims.

    - **Court Costs** - Money reimbursed to claimant for actual expenses of pursuing case civilly, such as serving complaint to non-paying party, providing photocopies of documentation, etc.

Claim resolution costs must exist to some degree to operate the LRF program, especially since it is a fund of last resort. However, the level these costs have reached is concerning and should be cause for legislative review.

Figure 3 shows a conservative estimate of the costs incurred to resolve and pay principal claim amounts.

Figure 3. Claim Resolution Costs for FY 1999. For every $1 paid in qualified services, at least an additional $1.41 is incurred and paid in other costs.

		Claim Resolution Costs			
	Qualified Services (Principal)	LFR Payroll Costs[1]	LFR Support Costs[2]	Supplemental Claim Costs[3]	Total
FY 99 Amount	$207,336	$157,717 +	$44,853 +	$89,638 =	$292,208
Costs per $1 Paid in QS	$1	$.76 +	$.22 +	$.43 =	$1.41

1 - Includes salary and benefit costs of LRF personnel.

2 - Consists primarily of charges to the LRF for attorney general support. Does not include any allocation of support costs of division and department personnel and services which is not currently done by DOPL.

3 - Includes reimbursement to claimants for attorneys' fees and court costs generated in pursuing payment from general contractor as well as interest on principal amount of claim.

$1.41 in claim resolution expenses for every $1 in qualified services does not reflect the full cost of program operation.

As shown above, the LRF expends at least an additional $1.41 for each $1 paid in qualified services. This means that 59% of all fund expenditures are made for something other than qualified services. The $1.41 is actually understated because it does not include a full allocation of support costs that are attributable to the operation of the LRF. For instance, there is no reflection of time spent by the DOPL director or division legal counsel, or of dollars spent on building maintenance and operation. A portion of these and other division and department expenses could all legitimately be allocated to the LRF because the fund uses these resources to operate.

Full Allocation of Support Costs Adds Much More to Overall LRF Expenses

A full allocation of support costs—which currently does not occur at DOPL—could increase claim resolution expenses to $1.95 for every $1 paid in qualified services. This would mean that 66% of all LRF expenditures are made for something other than qualified services.

The division does not allocate any of its costs to any of the bureaus or programs that it operates. Therefore, we do not know the amount of

Controversy over fund effectiveness increases division support costs for the LRF.

support costs that should be attributed to the LRF. However, DOPL's Division Director believes that due to the degree of interest and controversy surrounding the effectiveness of the LRF, the program occupies a considerable amount of division resources and time. In fact, based on general business consulting models, the director believes it is very reasonable to assume that for every $1 in payroll costs, there is another $1 spent in all other support costs to operate a program such as the LRF. He believes that if the program had to operate on a stand-alone basis, it would be difficult to do so on less of a total budget than twice its current payroll costs. If this type of model suggested by the director is used, the amount attributable to resolving claims increases by 38%.

Figure 4 shows the potential magnitude of resolution costs using the model suggested by the DOPL director.

Figure 4. Potential Magnitude of Claim Resolution Costs for FY 1999. For every $1 paid in qualified services, as much as $1.95 in additional costs might be incurred and paid.

		Claim Resolution Costs			
	Qualified Services (Principal)	**LFR Payroll Costs[1]**	**LFR Support Costs[2]**	**Supplemental Claim Costs[3]**	**Total**
FY 99 Amount	$207,336	$157,717 **+**	$157,717 **+**	$89,638 **=**	$405,072
Costs per $1 Paid in QS	$1	$.76 **+**	$.76 **+**	$.43 **=**	$1.95

1 - Includes salary and benefit costs of LRF personnel.

2 - Based on model proposed by DOPL director that for every $1 spent in payroll costs, there is another $1 incurred for all other program support costs.

3 - Includes reimbursement to claimants for attorneys' fees and court costs generated in pursuing payment from general contractor as well as interest on principal amount of claim.

Claim resolution costs could be as high as $1.95 for every $1 paid in qualified services.

Since no official allocation of support expenses is made by DOPL (and because we were limited in our time from performing such an analysis), we do not know what the true costs of resolving claims are per $1 paid in qualified services. However, they are greater than the $1.41 indicated in Figure 3, since those calculations do not capture all LRF support costs, and they may be as high as $1.95.

Some LRF Costs Are Decreasing But Overall Cost Effectiveness Must Still Improve

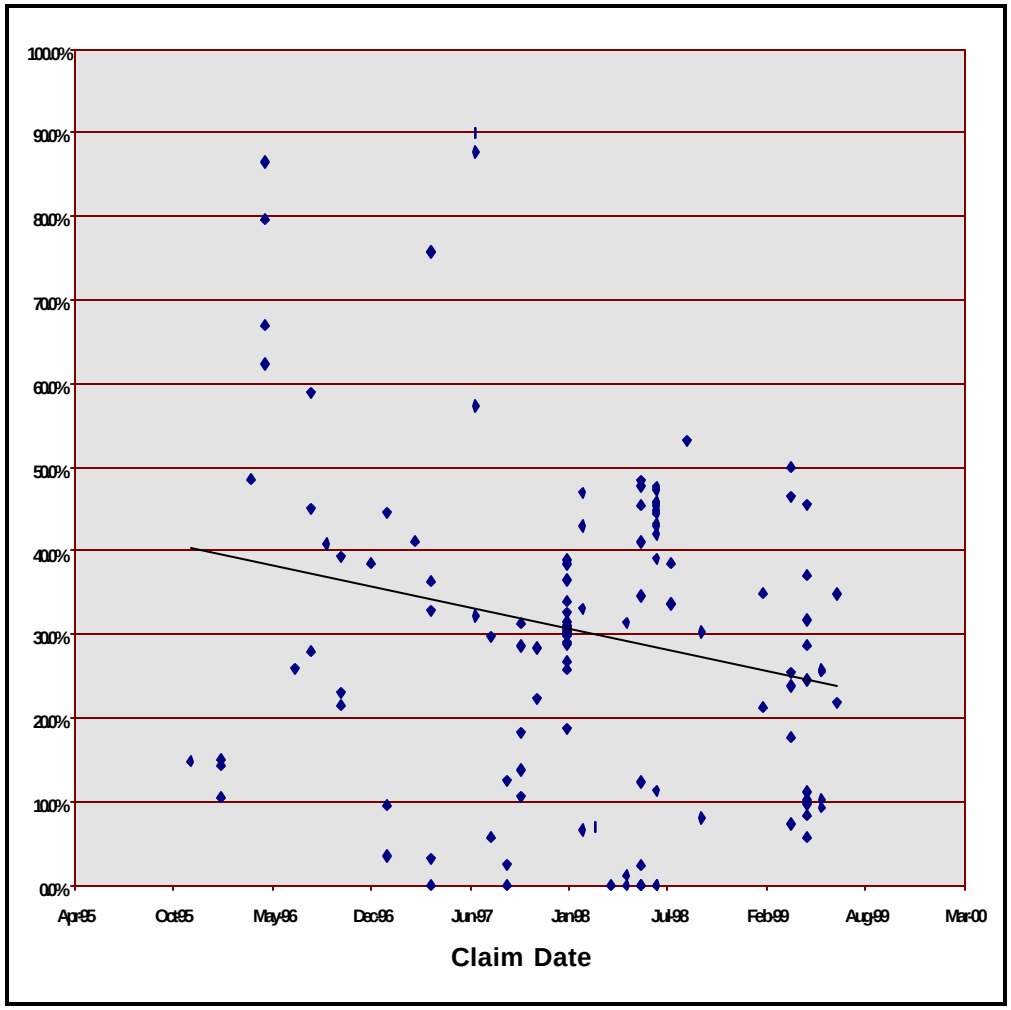
LRF cost-effectiveness should be reviewed by the Legislature.

Some claim resolution costs appear to have decreased over time. However, the aggregate amount of costs is still excessive, and enough claims have been processed and paid by the LRF for the Legislature to review the cost-effectiveness of the program.

As mentioned later in Chapter V, one positive note to this cost information is that the LRF law was recently amended to limit the interest rate awarded to claimants to 12%. In addition, recent proposals have been made to limit the amount of attorneys' fees that can be awarded in claim payouts.

The following figure suggests that these claim resolution costs have been decreasing over time, and the recent and proposed modifications to the LRF law should help keep them down.

Figure 5. Some Claim Resolution Costs Have Been Decreasing. The percent of each paid claim representing attorney fees, interest and court costs has been declining.



It is encouraging that some costs have been decreasing.

As shown in the above figure, the percent of each paid claim that is for attorney fees, interest, and court costs has been decreasing since the fund's inception. Limitations are also being proposed on the amount that can be paid for attorneys' fees, and we believe this idea deserves strong consideration by the Legislature. Limiting awards for attorneys' fees, coupled with the changes already made to awards for interest, should help promote LRF cost-effectiveness.

Because of limited time available for gathering benchmark information, we cannot discuss the level of claim resolution expenses in comparison to

programs in other states. However, the LRF is incurring and paying up to $2 in all overhead costs for every $1 in qualified services (or principal amount of claim) that is resolved and paid. In our opinion, this is not an efficient or cost-beneficial picture; more needs to be done to improve the cost-effectiveness of the LRF program if it is to continue operating.

Recommendations:

1. If the current program structure is retained, we recommend that the Legislature, through interim study, adopt some method of limiting awards made for attorney fees so they are tied to the amount of qualified services or principal debt.

2. If the current program structure is retained, we recommend that the Legislature and DOPL explore additional ways to improve the LRF cost-benefit ratio. Otherwise, other methods of resolving problems caused by non-paying contractors should be researched.

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Chapter III
Law Protects Some Homeowners But Can Become More Effective

Since its inception, the LRF has paid more than $792,000 to 51 suppliers or sub-contractors to clear construction claims or liens against 110 homeowners. The law has provided a significant benefit to these homeowners, who otherwise would have had to pay twice for the same supplies or services to get liens removed. However, most homeowners we contacted had no knowledge of the Lien Restriction Act (LRA) prior to having liens or other legal action taken against their property. We found that some homeowners met the qualifications of the law more by chance than by advanced notice or knowledge on their part. Because few homeowners seem to be aware of the law, many may not take steps necessary to qualify for lien protection requirements if their contractor becomes financially insolvent. In our opinion, the concept of protecting homeowners from having to pay twice for construction is certainly worthwhile. However, more has to be done to make the program effective, particularly in the way of better homeowner education. In addition, the current process of determining if homeowners are protected by the LRA presents some problems and should be reviewed to see where improvements can be made.

Providing homeowner protection is valuable but the process needs improvement.

Most Homeowners Are Unaware of Requirements for Lien Protection

Most of the homeowners we contacted were not aware of the LRA or the requirements for lien protection prior to construction. Although several of these homeowners were protected by the LRA, it seems that it was more by coincidence than by plan that they met the requirements.

Legally contractors are required to notify homeowners of lien requirements. However, this notification process is flawed.

Further, the law requires contractors to notify the property owner of the lien recovery law, which includes the qualifications for lien protection. In our opinion, however, this notification process is flawed and does not work for a variety of reasons. In particular, it is inconsistent to expect a contractor who may be the cause of non-payment problems to inform homeowners of the steps necessary for lien protection. Consequently, we

believe a better system of educating homeowners regarding the LRA is necessary.

Few Homeowners Contacted Knew of Requirements for Protection Prior to Construction

Homeowners typically learned of the LRA after construction problems arose.

We contacted 36 homeowners who either had mechanics' liens placed on their property or had one or more suppliers or sub-contractors apply for financial reimbursement under the LRF. Most of the homeowners we spoke with had no knowledge of the requirements for lien protection, as set forth by statute, prior to the commencement of construction. They typically learned about the LRA after a lien was threatened or filed against their property, or they became aware that payment for construction bills was delinquent.

According to **Utah Code** 38-11-204, the LRA requires homeowners to meet all of the following criteria in order to be protected under the law:

- Utilize a licensed contractor for the performance of qualified services.
- Enter into a written contract with the contractor or with a real estate developer.
- Pay in full the contractor or real estate developer in accordance with the written contract and any amendments to the contract.

72% of homeowners had no knowledge of the requirements for lien protection.

One of our primary concerns was homeowners' general lack of knowledge at the beginning of the building process about the LRA and the requirements necessary to qualify for protection. Of the 36 homeowners contacted, at least 26 (72%) indicated they were not informed of the LRA either by their contractor or by any other party prior to construction.

This lack of up-front knowledge is concerning because it indicates that homeowners qualify for lien protection by coincidence, not because they know about the lien restriction law. Many of the homeowners we spoke with learned about the law *after* problems arose, typically through lien notification, an official in a financial institution, or someone familiar with the construction industry such as an attorney. Homeowners need information about the LRF before construction begins in order to properly qualify for protection under the law.

Law Requiring Contractors to Notify Homeowners of the LRA Is Flawed

Current LRA law requires contractors to notify homeowners of their rights under the act. However, according to our sample, such notification is taking place infrequently, which is likely why some homeowners told us they felt fortunate to qualify for lien protection.

Utah Code requires contractors to educate homeowners of qualifications for lien protection.

Utah Code 38-11-108 requires contractors to educate homeowners regarding the LRA at the beginning of the building process; it states:

> *the original contractor . . . shall state in the written contract with the owner what actions are necessary for the owner to be protected. . . . from the maintaining of a mechanics' lien or other civil action against the owner [and] . . . to recover monies owed for qualified services.*

The beginning of the building process is the most important time for homeowners to understand statutory qualifications for lien protection. Requirements one and two (listed on the previous page) involve selecting a licensed contractor and entering into a written contract, and these need to be understood and in place prior to initiating construction.

In our opinion, there are a number of problems that prevent contractors from notifying homeowners:

- *First,* we believe many contractors may not be familiar enough with the law to adequately inform homeowners of their rights. Chapter IV details concerns expressed by contractors about the lien recovery law—a lack of education and understanding regarding the program is one such concern.

Several factors may prevent contractors from notifying homeowners of the requirements for lien protection.

- *Second,* there is no consequence set forth in statute for contractors who fail to make homeowners aware of their rights under the law. Even if contractors are aware of the law and their obligation to notify homeowners, there is no penalty if they do not provide this information.

- *Third*—and most significant—there is a basic conflict in requiring contractors to inform homeowners about the law, since contractors

are often the party who is or will be at fault if sub-contractors and suppliers are not paid. It seems unlikely that contractors who are not licensed, who do not want to enter into a written contract, or who are experiencing financial difficulties would inform their clients of the requirements for lien protection.

We think the state is relying on the wrong party to inform homeowners of lien protection requirements, and notification does not seem to be happening often. We believe a better method for informing homeowners about the LRA is necessary.

Better Methods of Educating Homeowners Need to be Developed

Protection for homeowners needs to improve with better up-front information. As mentioned, very few homeowners we contacted were notified about the LRA by their contractor or in advance of the building process. We found that many homeowners who did qualify for protection did so by chance. In addition, we found that several other homeowners in our sample did not meet one or more of the requirements and would not have qualified for lien protection had they needed it. If more homeowners were aware of their rights under the law, more could be protected in the event that problems arise. Furthermore, homeowners might be more careful in selecting a contractor and in controlling construction payments which could prevent some problems from occurring in the first place.

Because many homeowners seem to be unaware of the LRA, it is logical to conclude that many may not meet the requirements for protection if their contractors were to become financially delinquent. To gain a better understanding of this problem, we contacted 20 homeowners with mechanics' liens on their homes (part of the entire sample of 36 homeowners contacted). The sample was obtained from a legal publication containing mechanics' lien information. Each homeowner provided us with information about their lien, how it was resolved, and whether they were familiar with the LRA.

As many as 60% of homeowners sampled did not meet the lien protection requirements.

Eight (40%) of these homeowners indicated that they did not meet one or more of the three requirements for lien protection. Another four (20%) were unsure if they had met all requirements. Consequently, as many as 12 (60%) would have been at risk if their liens had not been resolved.

Fortunately, most of these homeowners did not have to pay twice for services to have liens removed. However, two of these homeowners did have to pay to get liens removed, so at least 10% of this sample actually needed the protection of the LRA.

Better up-front education to homeowners would lead to increased protection.

We understand this is a limited sample that only includes homeowners with mechanics' liens on their homes. However, this is the population most likely to need the protection offered by the LRA. We believe a better method of educating homeowners *up-front* as to their rights under the law is necessary and would make the lien restriction program more effective.

Process for Determining Homeowner Protection Needs Review

A primary concern with the law is that the process for determining whether homeowners have met the requirements for protection can be difficult and lengthy. Current statutory language does not clearly indicate when a homeowner becomes protected or how that determination should be made. Often, the most problematic aspect of this determination is confirming whether the contractor was paid in full, as is required by law for homeowner protection.

The current process of determining homeowner compliance can be difficult and lengthy.

Determining homeowner compliance with the law is not necessarily a problem in all cases involving mechanics' liens. However, it was a main agenda item identified and discussed by the LRF task force. In addition, we spoke with both attorneys and homeowners who expressed concern about the problems involved in determining homeowner protection.

If this process for determining homeowner protection can be expedited, both homeowner and lien claimant (or lien holder) can know in a more timely fashion if liens are enforceable.

Statutory Language Is Vague about Determining Homeowner Protection

Current LRA language states very generally how homeowner protection is to be determined. One of the primary purposes of the LRA is to protect homeowners who meet three basic requirements (listed on page 18) from having liens maintained on their residence. A person qualified to file a lien

cannot maintain the lien if a homeowner has met these requirements. However, the law only indirectly addresses the issue of homeowner compliance for the purpose of lien removal; it states:

> *a lien claimant. . . is not liable for costs and attorney fees. . . or for any damages arising from a civil action related to the lien filing. . . if the lien claimant removes the lien within ten days* ***from the date the owner established compliance with the requirements of [the law].***

The problem with the statute is that it potentially places the lien claimant in a difficult position. He has to decide whether or not to remove the lien—and either decision carries risks—before he knows officially whether the homeowner is protected by the law as determined by a court. (This concern is explained more on page 23.)

Payment in Full Is a Particular Obstacle in Establishing Homeowner Protection

Homeowners must pay contractors in full to be protected by the law.

One of the biggest obstacles in establishing statutory compliance can be determining if the homeowner paid the original contractor in full accordance with the contract and its amendments. Payment in full is typically established by a court judgement where a finding of fact is made. In the case of a bankrupt contractor, the LRF advisory board adjudicates the claim, unless attorneys for both the defaulting contractor and the lien claimant have agreed to the facts.

Disputes may arise between homeowners and contractors regarding payment of contractual amendments.

If the general contractor provides an affidavit stating payment in full has been made by the homeowner, then the matter is basically settled. However, getting such a statement from the contractor can take time, especially if the contractor cannot be located or has left the state. If the contractor does dispute the issue of payment in full—which may occur due to contractual amendments—a final determination may take more time to obtain. As a consequence, liens may be left on homes until a final judgement is received because the lien holder usually wants to preserve all methods of enforcement in order to obtain payment for services rendered. If the court judgement finds the homeowner has met the qualifications for protection, then the lien is not enforceable. However, if the court judgement does not find in favor of the homeowner, then he will likely have to pay to get the lien removed.

Various Sources Express Concern about Lien Removal and Homeowner Protection

Several sources we contacted during the audit indicated that determining homeowner protection can be a problem. For example, the LRF task force designated this issue as a main item to be discussed because "currently the Act does not specify how and who will make the determination that the homeowner is protected." Members discussed concerns about disputes between homeowners and claimants occurring until the courts can make a determination and indicated that "when payment in full is a question, the program cannot really go forward with the claim."

Attorneys are frustrated over problems that arise in establishing homeowner protection.

In addition, attorneys we contacted spoke about problems with the current process of lien removal and homeowner frustrations. One supplier attorney, who is a member of the LRF advisory board as well as the LRF task force, indicated his "single biggest problem" is a demand from homeowners to release a lien because they are protected by the LRA. However, suppliers feel they cannot release the lien until a court judgement declares that the homeowner is protected. Furthermore, attorneys could face a malpractice claim if they choose to release a lien before an official determination of homeowner compliance has been made.

We also spoke with other supplier attorneys who stated that disputes arise regarding payment in full which complicate the issue of determining homeowner protection. At least two attorneys told us that deciding when to remove a lien is difficult because it is hard to know if homeowners have truly met the requirements for lien protection. If liens are removed and the courts determine that the homeowner *is not* protected, lien claimants have no recourse for payment. If they maintain the lien and the homeowner *is* determined to be protected, lien claimants risk having to pay the homeowner's attorney fees as stipulated by law. In either case, they feel they are being placed in a "risky situation" and have to make a "judgement call" about whether to maintain or remove the lien prior to having a court judgement.

Homeowners are also concerned about problems with lien removal.

We also spoke with homeowners who expressed concern with the issue of unresolved liens. For instance, one homeowner "protected" by the lien restriction law experienced a lot of problems when his contractor declared

bankruptcy during the course of construction. As a result, 24 liens were placed on his home by unpaid contractors and suppliers. Most liens were placed on his home during 1997 and resolved in either 1998 or 1999, but it took *an average* of 486 days per lien before they were removed. He expressed frustration with the amount of time it took for anything to happen in his case and complained that there were a lot of delays.

Homeowners and lien claimants may not agree on whether the homeowner has met the lien protection requirements.

Another homeowner actually contacted us during the audit to express his frustration. He contracted to have his home built in late 1998 but experienced problems when his contractor became financially delinquent which led to the placement of a lien and a lawsuit on his property. He explained that he has already spent considerable money in attorney fees trying to resolve these problems and has ample documentation showing he has met the requirements of the law. The problem is he has had no success in getting the lien/suit holders to remove their claims. We contacted one of the lien claimants who indicated he is pursuing collection, with some success, against the non-paying party. However, he is unwilling to remove the lien until a court judgement, if needed, is obtained stating that the homeowner has met the requirements for lien protection. The concern is that homeowners tend to have a different definition of when compliance to the statutory requirements is established than that of the lien claimant.

Unresolved liens can cloud owner title and compromise the purpose of the law.

Because of the limited scope of this audit, we do not know how often liens are left on homes for inordinate lengths of time. When contractors default on payment, homeowners will experience liens in many cases for at least some period of time. We believe the law needs to be reviewed to eliminate ambiguity and streamline the process for determinating whether homeowners have met the qualifications for lien protection. Otherwise, unresolved liens can cloud property title and, in our opinion, compromise the original intent of the lien restriction program.

Recommendations:

1. If the current program is continued, we recommend the Legislature, through interim study, develop ways of improving the delivery of up-front information to homeowners regarding the LRA. For example, the Legislature could require by law that brochures containing information on the lien restriction law be

distributed through lending institutions to all homeowners borrowing money for construction.

2. If the current program is continued, we recommend that the Legislature amend the language in **Utah Code** 38-11-107 (3) to clarify how and when homeowner compliance is established.

3. If the current program is continued, we recommend that the Legislature study ways of expediting the process of determining whether homeowners have met the requirements for protection under the LRA.

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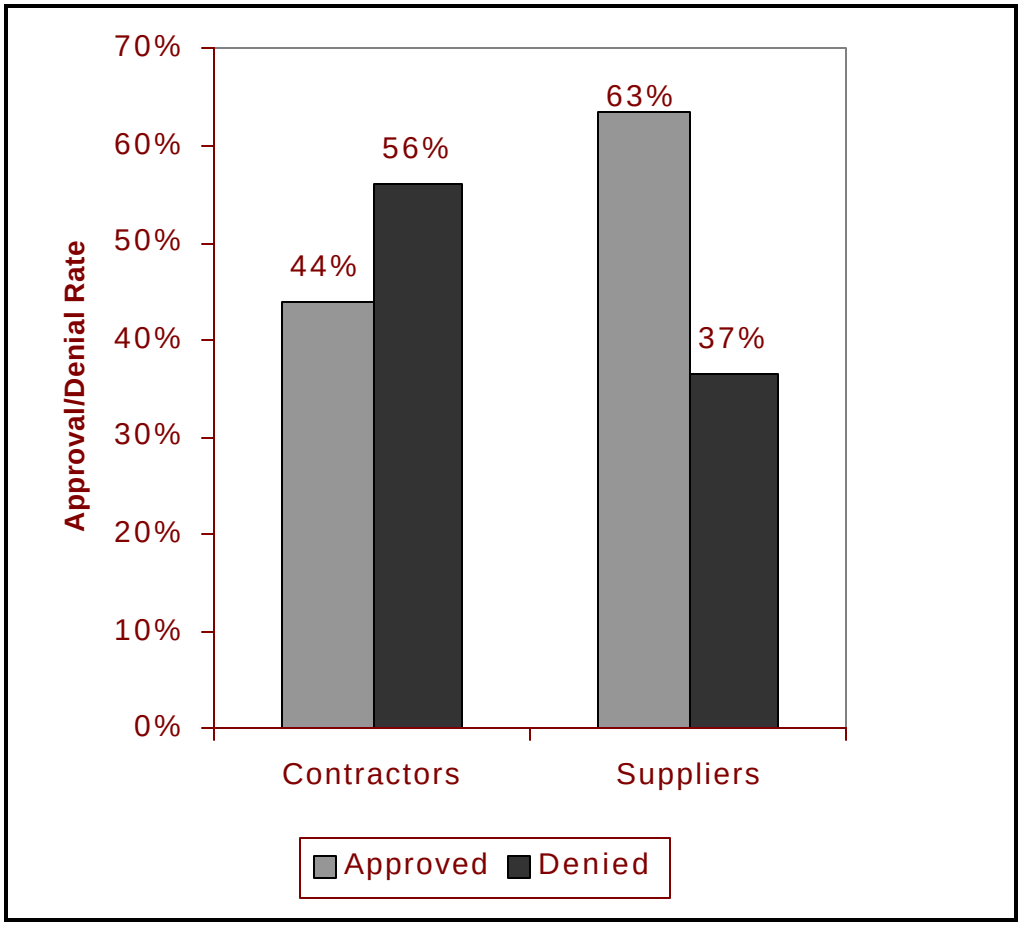
Chapter IV
Most Contractors Express Frustration with the Lien Recovery Fund

Most contractors we spoke with are frustrated with the lien recovery fund even though some of them have been helped by it. Through our discussions, we learned that most contractors felt applying for claims against the LRF was not an effective option. In general, they said it was too time consuming and complicated. In addition, we learned that many contractors do not understand the lien recovery fund process very well.

Contractors find it difficult to recover any claims from the LRF.

Although one purpose of the fund is to provide recovery assistance to qualified beneficiaries (those who have paid into the fund), contractors tell us it is difficult to actually receive any recovery from the fund. This information is based on a sample of 45 contractors from around the state who were asked for their comments and concerns about the LRF. Some distinct patterns surfaced from speaking with these contractors indicating they are frustrated with the LRF process and do not understand it very well. About half of these contractors (21/45) had actually applied for recovery assistance with the LRF, and 90% of them said it was a difficult process with a variety of problems. The difficulty in ultimately recovering a claim is evidenced by the fact that 56% of contractors' claims have been denied by the fund compared to 44% that have been approved for payment (as shown in Figure 6). Through November 1999, the LRF had paid 44 claims to 31 different contractors for a total of about $230,000 (29% of all fund payouts).

Figure 6. Total LRF Claims Processed. Less than half of all contractor claims to the LRF have been approved for payment since the inception of the program.



One reason the percentage of claims approved for contractors is lower than for suppliers may be that contractors generally do not have the time needed to prepare their claims and submit the necessary documentation. Unlike suppliers, contractors are typically small business owners without a lot of time or money to pursue their claims through the long and complicated recovery process. For them to pursue a claim means taking time off work and losing potential income for the uncertainty of recovering anything. Contractors also may not have access to an attorney for assistance, where suppliers often do.

Contractors Feel Lien Recovery Fund Is Not an Effective Option

The LRF was established to provide recovery assistance to qualified contractors and suppliers who have paid into it. We discussed the LRF with 21 contractors who had applied for recovery assistance and whose claims were either approved or denied. They generally felt the LRF was not an effective option for them. They expressed a number of concerns with the fund and said it was a difficult and challenging process that did not give them adequate protection or assurance of recovery.

Contractors feel the LRF is just another obstacle for them to deal with in claim recovery.

In addition, the fact that the LRF was established as a fund of last resort is frustrating to many contractors because they cannot apply for recovery assistance unless they have already gone through a lengthy, frustrating, and costly civil judgement process. They are discouraged about the prospect of having to go through another lengthy and complicated process with the LRF for an uncertain outcome. Contractors say this process is unfair because they pay into the fund in good faith, but there seem to be many obstacles placed in their way to prevent them from getting a claim recovered. They tell us the fund does not provide them with any significant protection.

In the days prior to the LRF, contractors (and suppliers) simply filed a lien and went to court to await a judgement. If, after the judgement was issued, the plaintiff failed to pay, the claimants still had the lien against the homeowner's property. With the current lien restriction law, homeowners are protected against liens and the claimants have no recourse against the property. If a claimant wishes to continue with claim recovery, he must file with the LRF after having already gone through the courts, adding additional cost to the recovery process.

Contractors Expressed a Variety of Concerns

Those contractors who had experienced the LRF process firsthand were very frustrated with it for several reasons. They explained the process was frequently too:

- Time consuming and complicated
- Constrained by deadlines, and
- Costly

Because of these concerns, contractors generally do not consider the LRF to be an effective option. Rather than apply to the LRF, many feel their best option is to accept their losses and move on to other clients.

About 90% of the contractors feel the LRF process is too time consuming and complicated.

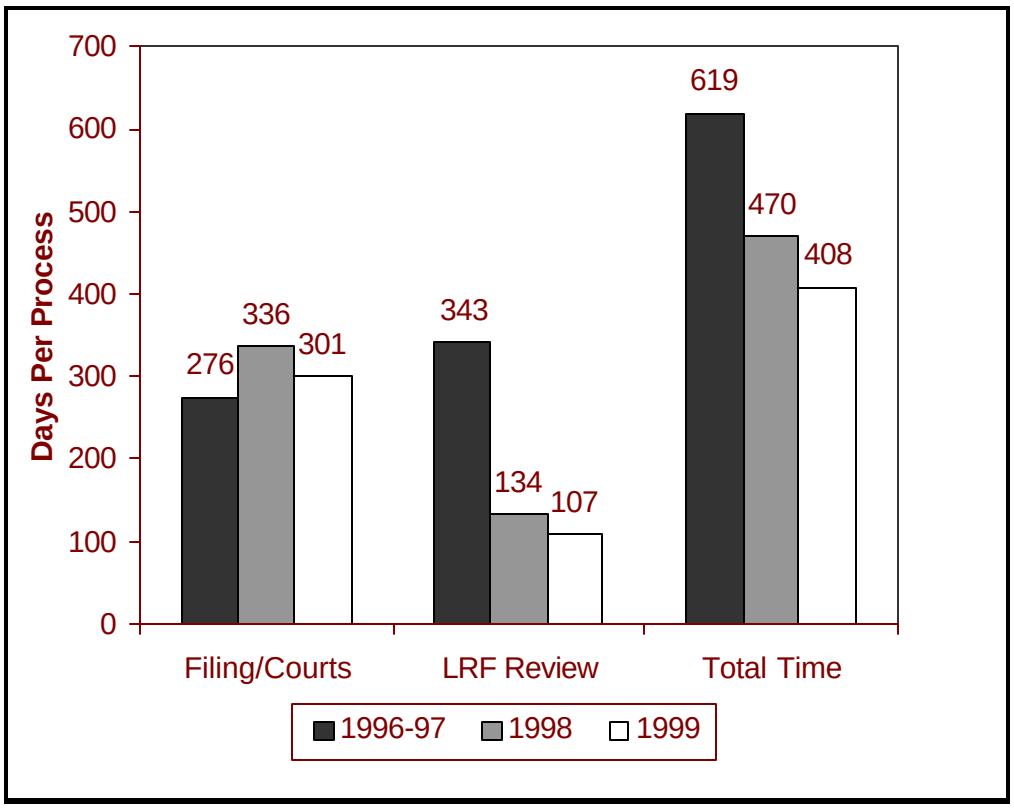
The Process Is Too Time Consuming and Complicated. Of the contractors we spoke with who had filed claims with the LRF, 90% (19/21) of them said the process was time consuming and/or complicated. Contractors are frustrated because it takes a lot of time to collect the documentation and prepare the paperwork for a claim. If the paperwork is not complete, it will be returned with a request for more information, and this adds more time to the process. Before a claim can be filed with the LRF, there must be a civil judgement from the courts, and the judgement could take months or even more than a year to obtain. If contractors are unfamiliar with the whole process, they could spend many hours collecting documentation and preparing an application for a claim which may ultimately be denied.

We reviewed a sample of 77 paid claims from 1996 through 1999 to determine the average claim resolution time from the date of last construction until the payment request date. The cases included claims filed with the LRF from contractors and suppliers. The claim resolution time consists of several variables including claimant preparation and filing time, court processing time, and LRF processing time.

Claim resolution time improved considerably from 1996 through 1999.

As shown in the following figure, the total average claim resolution time has been reduced significantly from 619 days in 1996, to 408 days in 1999. The average time for filing and court processing has remained more or less constant, but the LRF processing time has been shortened considerably.

Figure 7. Claim Recovery Processing Time. In 1999 it took an average of 408 days to go through the entire process of recovering a claim from the date of last construction until payment was made.



The 343 days of LRF process time, shown in Figure 7 for 1996-97, is not an accurate reflection of the real process time. During the early years of the program, there were few staff and the process was not well established; consequently, claims took far longer to review. LRF staff have improved process time from 134 days in 1998 to 107 days in 1999, and DOPL officials agree that these numbers more accurately reflect the time it takes to review and approve a case. Since this is a relatively new program, we expect process time will continue to improve. We do not have a standard to compare with, but in our opinion, 408 days of total process time as shown above for 1999 is still an unreasonably long time for claim resolution and is a primary factor in why contractors are so dissatisfied with the recovery process.

408 days is a substantial length of time for claim resolution.

One contractor told us he thought his time was wasted because his claim was rejected. He submitted all the paperwork to DOPL within the deadlines, but his claim was rejected for reasons he did not clearly

understand. This contractor said he spent a lot of time and effort calling DOPL to get information about the LRF and preparing the paperwork in order to recover his claim. He was disappointed and frustrated with the LRF because his claim was denied after he had expended considerable time and effort on the complicated recovery process.

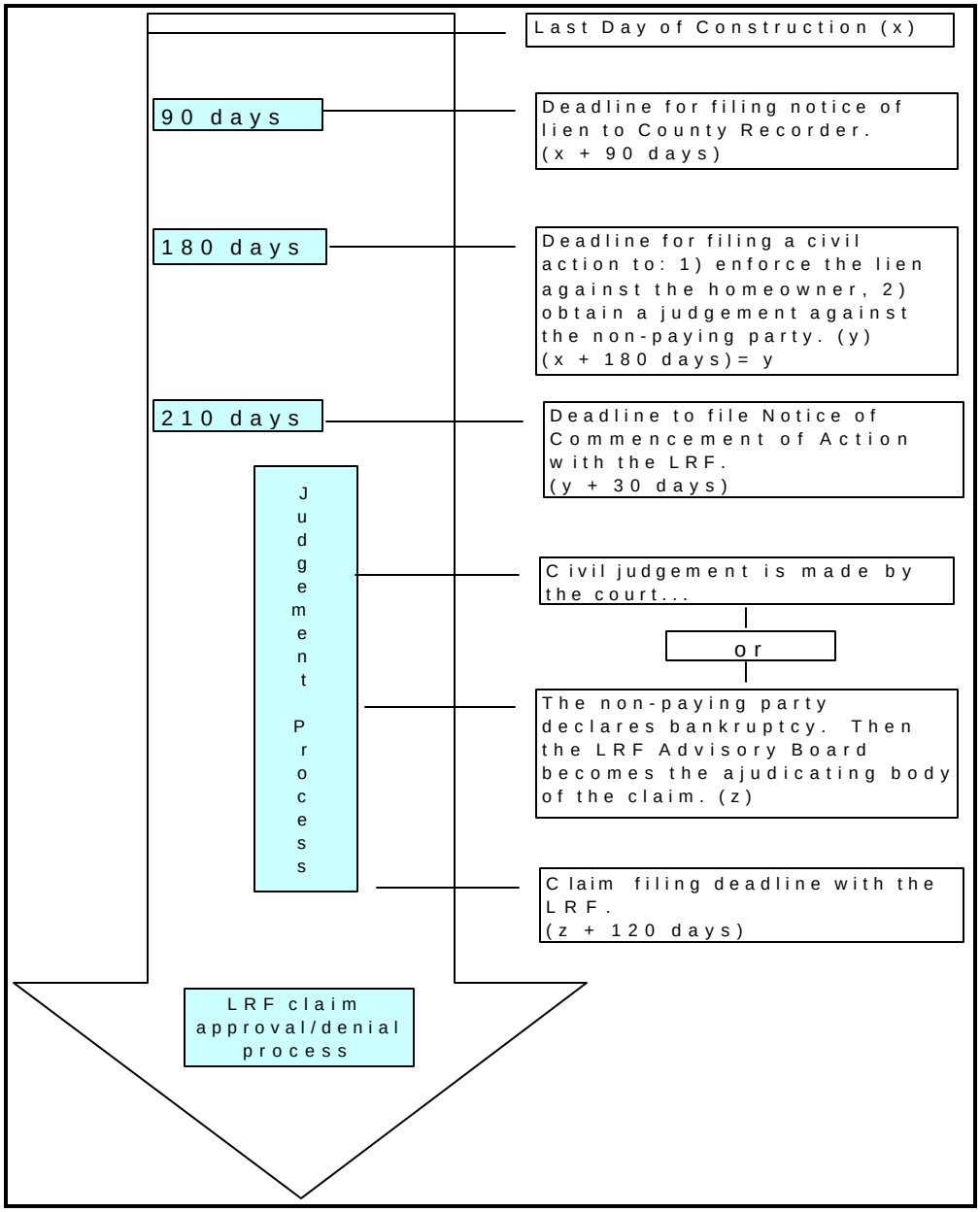
Contractors typically need an attorney to help them with the LRF process.

Contractors say they cannot understand or complete the process without hiring an attorney, and even some attorneys say the process is time consuming and burdensome. One attorney told us the LRF process had recently become much more complicated than it was in the past. He said the process is now more strict because it requires certain legal documents from the homeowners which are difficult to obtain. The process also requires more evidence and documentation to verify that the homeowner is protected and the contractor is eligible for recovery assistance.

If the deadlines are missed, the claim is denied.

The Process Has Too Many Deadlines. Contractors, attempting to recover claims, must go through a filing and application process that is full of paperwork and deadlines. There is the deadline for filing a notice of lien with the county recorder. There is another deadline for filing a civil action with the courts, both to enforce the lien and bring a suit against the non-paying party. Once the civil action has been filed, there is a deadline to file a notice of commencement of action with DOPL. Finally, after completing the court process and obtaining a judgement, there is a deadline for filing a claim with the LRF. If any of the deadlines is missed, the claim may automatically be invalid. Contractors are frustrated with the whole filing process and feel the deadlines are unfair. Of the 21 contractors we spoke with who had experience with the fund, at least four (about 20%) felt the deadlines were a problem. In the following figure we show the LRF process with the procedures and deadlines that must be adhered to.

Figure 8. Time Line for the LRF Process. Claimants must follow the outlined series of steps in the claim recovery process within the deadlines, or the claim will be invalid.



As shown by the outlined series of steps, the process has several critical deadlines which cannot be missed. Failure to file at the various stages of the process can invalidate the application for claim recovery, a point that is

quite frustrating to contractors and their attorneys. (For a detailed explanation of each step in the filing process see Appendix A.)

One contractor's attorney said the filing requirements are a burden and the deadlines are difficult to meet. He said it is frequently difficult to get cooperation from the homeowners. In providing the necessary documentation, homeowners are often upset with the sub-contractors for having placed liens on their homes. They are reluctant to cooperate with the sub-contractors and typically refer them to their attorneys. Involving more parties can make collecting documentation take even longer and may make deadlines more difficult to meet. Another attorney stated that the issue of missed deadlines had been discussed at BAR association meetings. The main frustration for attorneys concerns the unforgiving deadlines that must be met. In addition, one attorney who is a member of the LRF advisory board expressed concern about the potential for a malpractice suit if an attorney misses any of the deadlines. Consequently, he felt some attorneys may be hesitant to accept these cases.

Homeowners may be reluctant to cooperate with subcontractors who have placed liens on their property.

Other contractors told us they had missed opportunities to file with the LRF because, by the time they learned of the option and collected the necessary documentation, they had missed the deadline for filing. One contractor said that in order to fill out the paperwork correctly, one needs to hire a full-time person to track the process and meet the deadlines.

We realize that DOPL faces a difficult challenge in trying to appease claimants with regard to application deadlines. Contractors complain that the deadlines are too short, but they are required by statute and extending them would lengthen the total time for the claim recovery process. We believe, and DOPL officials agree, that some of the deadlines can be eliminated and the entire process could be streamlined and simplified. We recommend the Legislature consider simplifying and streamlining the process by assigning an interim committee to study the issues identified in this report.

Contractors cannot afford the additional expense of legal fees that accompany the lien recovery process.

The Process Is Too Costly. About 33% of the contractors we spoke with who had experience with the fund said the cost of the process was a significant problem. One LRF requirement is that claimants must first file a civil complaint against the non-paying party, obtain a court judgement, and make reasonable efforts to collect money owed from that party. That

process is costly enough, but contractors are further frustrated because they must still go through a complicated LRF claim recovery process for which they will spend more time and money and have no assurance of recovery.

Many claimants feel the LRF is not an option unless the claim amount is $2,000 or more.

One contractor told us that pursuing a claim through the legal system for little chance of success, and then spending more money to apply to the LRF was like "throwing good money after bad." He said he would not apply to the LRF again unless the claim was at least $5,000 because of the costly legal fees. Many other contractors, as well as suppliers, told us the LRF is not even an option unless the dollar amount of the claim is $2,000 or more.

Many contractors are small business owners who do not have the time or resources to fight claims in court because it requires them to hire an attorney and take time off work which causes them to lose even more money. One contractor told us he went out of business because of uncollected claims. He filed 8-12 liens on homes built by one developer, but he did not have the money to hire an attorney and pursue claims against the developer in court. Consequently, he was ineligible to submit any claims to the LRF because he had not been through the legal system and exhausted other avenues. He was told it was of no use to even apply to the LRF because he would not get anything. He is no longer in the contracting business because of his losses.

Despite DOPL's Efforts Contractors Are Not Effectively Educated

Many contractors do not know how to qualify or apply for funds from the LRF.

In spite of DOPL's efforts to provide information and conduct training and education seminars, many contractors do not know how to qualify or apply for funds from the LRF. We contacted 24 contractors who had not filed claims with the LRF. All of them had filed mechanics liens in the past and had a general understanding of mechanics lien laws. However, the majority of them did not have a good understanding of the LRF process, and several admitted they did not know anything about it. They have not used the fund before, and they are somewhat unaware and unfamiliar with

it. One reason they are unfamiliar with it is because they have not been effectively educated and trained.

Learning about the LRF is a low priority for most contractors.

Contractors do not have time to take off work and attend a training seminar, especially if they are not faced with the prospect of filing a lien or pursuing claim recovery. Unless they are faced with this task, learning about the lien recovery process is a low priority for most contractors. Assuming that contractors are not willing to put forth the time to learn about the LRF, DOPL's training efforts may have limited impact.

Over one-half of contractors contacted have little understanding of the LRF process.

More than half (14/24) of the contractors who had not filed claims with the LRF said they lacked knowledge about the fund. Several of them told us they knew very little or nothing at all about the fund, except that they had to pay an assessment for it when they were licensed. They recalled hearing something about the fund when they were assessed the fee, but they did not remember anything specific because, at the time, they were not in a situation where they were filing liens or claims against other contractors or developers. One contractor said he only learned specific details about the LRF after he had filed a mechanics' lien on a home and was later contacted by the homeowner's attorney and told he had to remove the lien because the homeowner was protected by the law. Another contractor said he did not know the process well enough to file a claim with the LRF. The process was confusing to him, and he missed the deadlines before he could file. He also incorrectly believed he could file only one time with the LRF, and he did not want to waste his one opportunity unless the claim was significant in size.

DOPL Has Made Efforts to Provide Education

DOPL is making efforts to educate contractors and others about the LRF.

Since the inception of the program, DOPL has provided information and education to contractors and other groups regarding the LRF. These efforts have included mailers explaining the purpose of the program to all contractors as well as educational seminars provided to groups in the construction industry. For example, DOPL presented about 11 workshops in 1999 around the state to homeowners, homebuilders associations, attorney groups, credit organizations, and business groups, and has presented similar seminars in previous years. We were told that each workshop was attended by an average of 30 to 40 people. In spite of that effort, however, DOPL has only been able to educate about 800

people on the LRF through workshops since the program's inception, a relatively small number compared to the 18,000 contractors (not to mention other interested groups) who are currently licensed in the state.

Although LRF information is distributed, contractors do not understand the LRF process.

DOPL also mails out a newsletter twice a year to all licensed contractors which contains information about the LRF, and they distribute brochures to consumer protection agencies and libraries. They have an Internet web-site where anyone can learn about the LRF, and they also provide informational pamphlets to anyone upon request. Evidently, there are about 10 to 15 requests per month for such information. Division officials also told us that LRF brochures were recently mailed to all contractors in conjunction with re-licensure notice, but we were unable to adequately document such a mailing. Assuming the brochures were mailed, however, there is no assurance that each contractor received and read the information. In addition, because the law is so complex, it is questionable whether contractors even understand such literature if they do take the time to read it. Despite DOPL's efforts, the fact remains that many contractors do not understand the LRF process. The problem is that DOPL has limited resources for training and their efforts thus far have not effectively educated many contractors.

DOPL also includes a question regarding the LRF on the legal part of the contractors' license examination. However, in our opinion, the question on the current examination does not reflect the type of information that contractors need to know regarding the operation of the fund. We believe DOPL needs to examine the type of questions asked and consider adding more LRF-related questions to the examination. More meaningful questions on the examination could help new contractors better understand the fund.

The Legislature and DOPL should explore ways of simplifying the LRF process and providing better education.

It is clear that DOPL has an extremely difficult task educating all the involved parties. However, we believe DOPL needs to do more in this area if the LRF is to be successful. First, DOPL must include meaningful questions on the LRF in the testing and licensing process for new contractors. Second, DOPL needs to continue the education of existing contractors and explore ways of more effectively providing that education. We do not believe the fund will be successful without the education of contractors. Finally, the Legislature needs to address the issues identified

in this chapter to streamline the recovery process and make the fund more accessible to contractors.

Recommendations:

If DOPL continues the LRF program as it is currently legislated:

1. We recommend that the Legislature assign an interim committee to study the issues identified in this chapter to make the LRF more accessible to claimants. Specifically they need to address the issues of how to streamline and simplify the:
    a. Time consuming and complicated nature of the LRF process, and
    b. Constraining deadlines of the LRF.

2. We recommend that DOPL continue to provide education and training on the LRF program to contractors and explore all options of improving educational outreach.

3. We recommend that DOPL increase the emphasis on questions regarding the LRF on the contractors' licensing examination.

Chapter V
Recovery Fund Benefits Suppliers More Than Contractors

Construction material suppliers receive 71% of all payouts from the LRF even though they only provide 1% of the revenues that support the fund. In contrast, contractors only receive 29% of all dollars paid from the fund while they provide 95% of the program's revenues. Suppliers have significant exposure on construction jobs and typically have more resources to access the LRF, if needed, than most contractors. In our opinion, however, the imbalance between revenues provided and benefits obtained for suppliers and contractors needs to be addressed to make the LRF operate more equitably. One supplier in particular has used the fund to a significantly greater extent than any other supplier or contractor; such heavy use raises concerns about the fairness of a flat member assessment to finance the LRF and raises questions about supplier business practices. Recent proposals to change the LRF process can help resolve some of these concerns. However, we believe certain issues must be addressed legislatively to create a more fair recovery process.

The imbalance between supplier and contractor use of the fund needs legislative review.

Suppliers Receive a Disproportionate Benefit from the Lien Recovery Fund

The majority of claim dollars being paid by the LRF is going to construction material suppliers. Suppliers are legitimate beneficiaries of the LRF as long as they have paid into the fund. It is concerning, however, that in the aggregate suppliers successfully access the fund significantly more than contractors, yet suppliers only provide a nominal amount of revenue into the LRF.

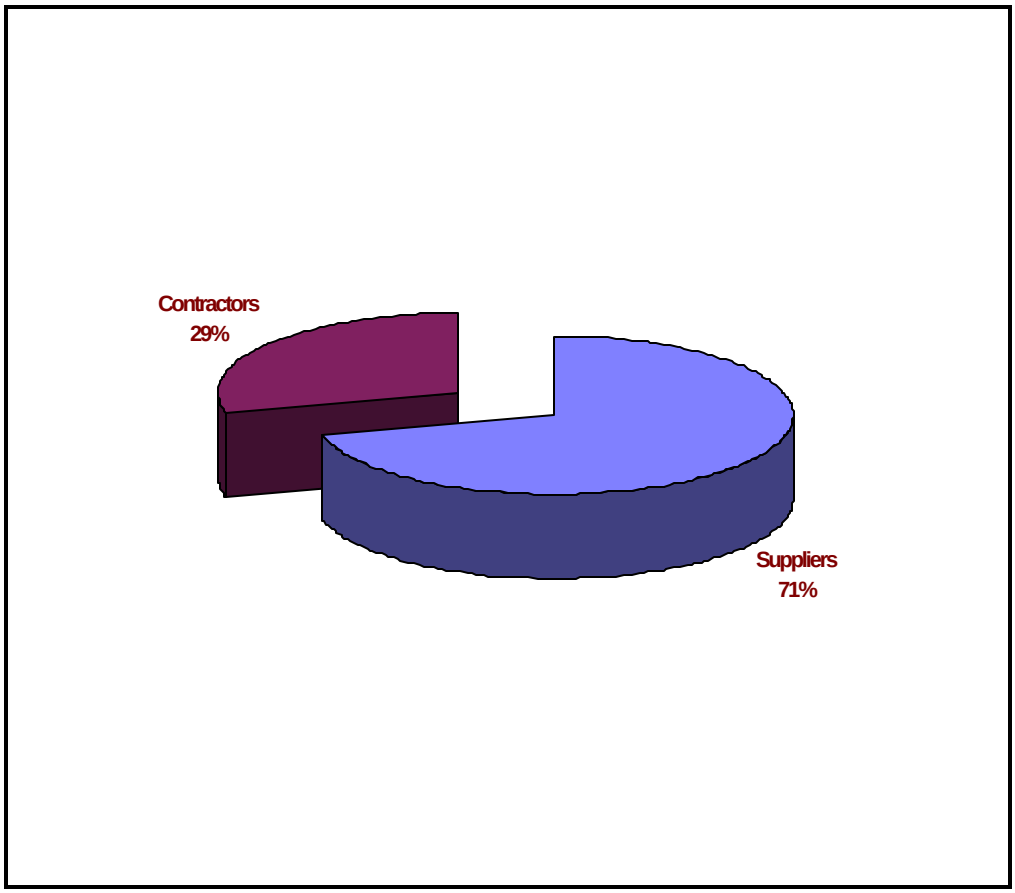
The LRF is financed by mandatory contractor assessments and voluntary assessments from other professions.

The LRF is financed by an initial assessment of $195, which is mandatory for most all categories of contractors licensed by DOPL. The intent of the original program was to have contractors fund the LRF since they are the cause of problems when sub-contractors and suppliers are not paid. In addition, other professions such as engineers, architects, land surveyors,

and suppliers of construction materials may choose to be protected by the fund by paying the same $195 assessment. Because the state has seen steady growth in the number of contractors becoming licensed (see Figure 2 on page 5), the LRF has generated over $4 million in assessment revenues and has always had a healthy balance.

The following figure shows the amount of money paid in claims to both suppliers and contractors.

Figure 9. Comparison of Claim Dollars Paid by the LRF. Suppliers have received over two-thirds of the $792,000 paid out by the fund through November 1999.

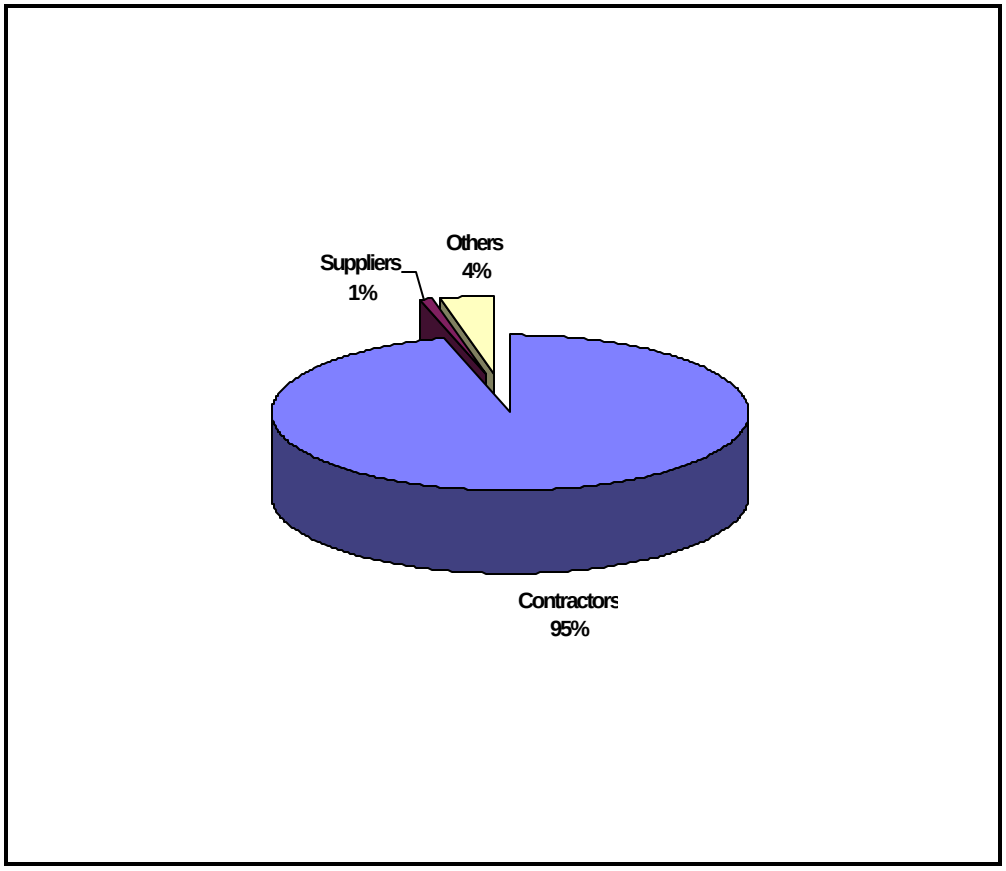


Suppliers receive 71% of LRF dollars while contractors only receive 29%.

As shown in Figure 9, 71% of the recovery dollars paid by the LRF is going to suppliers while only 29% is going to contractors. While most of the relief and protection have gone to suppliers, only a fraction of the

revenues that provide the protection has been generated by supplier assessments as shown in the next figure.

Figure 10. Comparison of LRF Assessment Revenue by Profession. The $4.2 million in assessment revenue through November 1999 has come almost exclusively from contractors.



Over 20,000 contractors have paid into the LRF as compared to 187 suppliers.

Figure 10 shows that only 1% of LRF revenues is provided by suppliers while contractors generate 95% of the dollars that fund the program. (The other 4% of revenue comes from voluntary assessments from a small number of other professions.) As mentioned earlier in this chapter, LRF balances have always been healthy because the state has had a continuous stream of new contractors becoming licensed and paying into the fund. In fact, over 20,000 contractors have paid $195 each into the LRF since its inception; in contrast, only 187 suppliers have paid that same amount into the fund.

Suppliers Receive More in Supplemental Reimbursements than Contractors

Supplier size and resource level helps in collecting other costs through the LRF.

Suppliers are also generally more successful than contractors in being awarded attorneys' fees, interest and court costs on top of principal claim amounts. This appears to be the case because, as mentioned in Chapter IV, suppliers most often are larger businesses that retain attorney services. In comparison, contractors are often much smaller in size than suppliers and may not have easy access to an attorney. In addition, suppliers protect themselves through standard language on written contracts when they sell materials. It is often the terms of these contracts—specifically providing for reimbursement of attorneys' fees and a specific interest rate on unpaid balances—that determine what is awarded to suppliers by court judgement.

Figure 11 compares these additional awards to both suppliers and contractors.

Figure 11. Comparison of Supplemental Reimbursements Awarded to Fund Claimants. Suppliers, on average, receive over double what contractors receive in attorneys' fees, interest and court costs.

Written contracts help protect suppliers in the event of non-payment.

	Average Paid Claim	Average Principal Amount of Claim	Supplemental Awards Per $1 in Principal	% of Claim Awarded for Overhead Costs
Suppliers	$6,599	$4,297	$.54	35%
Contractors	$5,257	$4,325	$.22	18%

Source: ULAG computations of LRF paid claims database.

As Figure 11 shows, suppliers receive well over twice as much in reimbursements for attorneys' fees, interest and court costs as do contractors for every dollar paid in qualified services. In fact, 35% of total claims paid to suppliers represent these extra awarded costs while that figure is only 18% for contractors. While the LRF was designed to pay these costs, it is concerning that suppliers receive so much more than contractors.

One Supplier Uses the Fund Significantly More Than Other Users

Dominant use of the fund by one supplier raises questions and concerns.

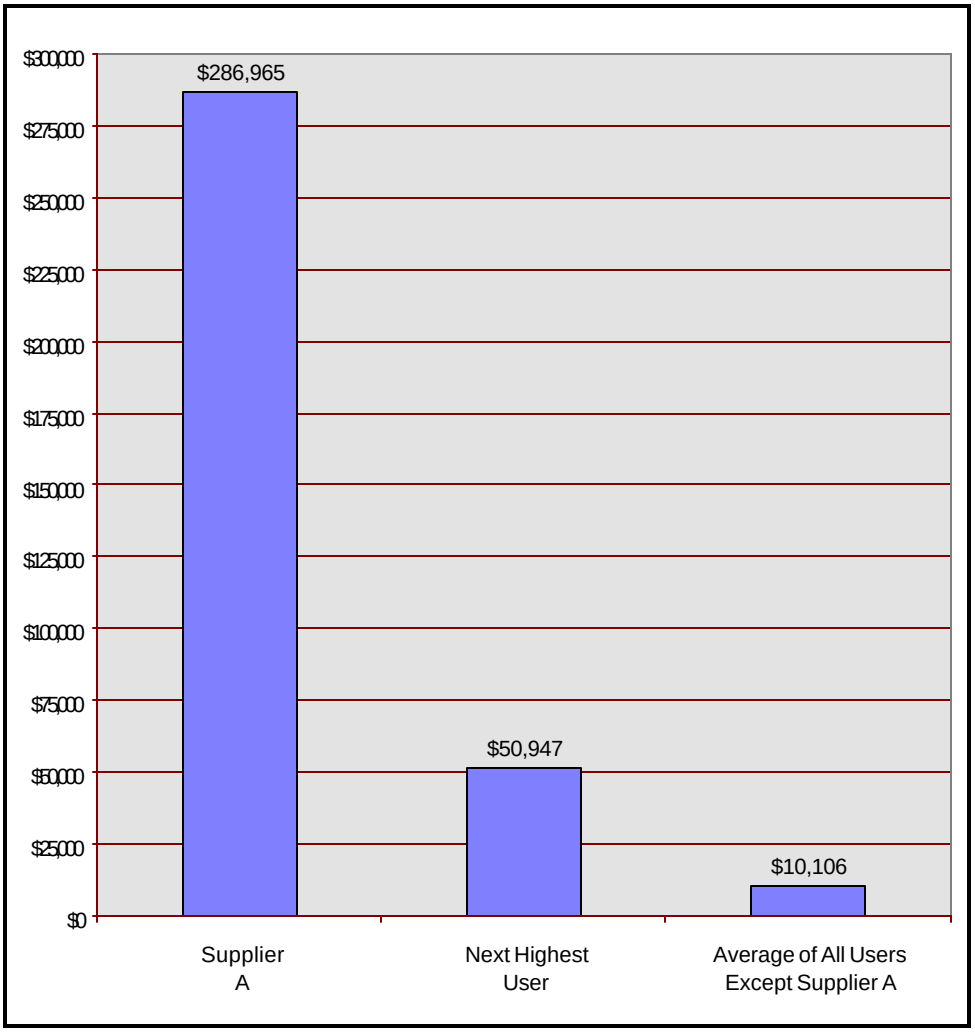
One supplier of construction materials has used the LRF to a much greater extent than any other supplier or contractor. While this use may be legitimate based on the size of the supplier, it has raised questions and concerns regarding supplier credit practices. Also, as discussed in the next section of this chapter, the equity of a flat assessment for all members regardless of use, as well as a lifetime cap that limits total payouts to fund members, must also be addressed.

"Supplier A" has received 36% of all LRF claim dollars that have been disbursed.

Since the inception of the LRF, one supplier (hereafter referred to as "Supplier A") has recovered more dollars from the fund than any other supplier or contractor. "Supplier A" has had 30 claims paid out (23% of all 129 claims paid through November 1999) for a total of about $287,000. This amount represents about 36% of all money the LRF had paid out through November 1999. Since the fund's inception, the other 50 suppliers and contractors who have successfully accessed the LRF at least once have each received an average of about $10,000.

Figure 12 compares use of the LRF by "Supplier A" with the next highest user and the average use of all other suppliers and contractors who have recovered from the LRF.

Figure 12. Comparison of Fund Use by "Supplier A" to Other Claimants. "Supplier A" has used the LRF 28 times as much as the average use of all other claimants.



"Supplier A" has used the LRF more than five times as much as the next highest user.

Such heavy use of the LRF by one supplier creates the simple question of "why?" It may be largely based on the amount of sales they have and their exposure in the construction industry. "Supplier A" has indicated to us that high sales volume is the main reason for their use of the fund. To compare fund use, we attempted to get sales information from the suppliers we contacted; the general numbers we were given do indicate that "Supplier A" has a higher sales volume than the other suppliers. However, we cannot rely on the validity of this information because it is a

self-reported estimate which has not been verified. In addition, several other variables among suppliers may affect the comparability of the numbers such as the amount of sales that is cash vs. credit, contractor vs. general public, and residential vs. commercial construction.

Variation in Supplier Credit Practices May Be a Factor in Use of the LRF

High interest rates and reimbursement of other expenses may make the LRF a "good investment" for claimants.

There has been some concern expressed about variations in credit practices among suppliers and about whether the perception of the LRF as some sort of safety net has created any incentive for suppliers to be less careful in extending credit to contractors. The possibility of loose credit practices was a concern to the audit team for various reasons. First, one supplier is using the fund to a much greater extent than any other fund member. Second, several suppliers and at least one homeowner expressed their opinion that "Supplier A" does have loose practices in extending credit to contractors. Finally, all claims paid to "Supplier A" include interest on principal debt owed (usually at 21%) as well as reimbursement for attorneys' fees and court costs. These facts have raised some question as to whether the LRF—by paying such high interest rates and reimbursing other claimant expenses—is perceived as a "good investment" by some claimants.

The suppliers we spoke with defend their own credit practices and claim it is not in their best interest to extend credit to contractors they feel might be risky. Many mentioned that because the LRF is so difficult to access, there is hardly an "incentive" to try to recover from the fund. As mentioned, we were unable to obtain any valid indicators—such as sales data or bad debt ratios—that might help determine whether use of the fund by certain suppliers is reasonable. Consequently, we cannot conclude that the existence of the LRF has necessarily changed supplier credit practices.

Recent Code Modification Should Help Protect Fund Integrity. The LRF law was recently changed to award a flat 12% interest on all claims, regardless of what is stipulated in the court judgement. Evidently, this flattening was a compromise and the result of concerns about claimants being awarded such high interest rates by the courts based on contractual arrangement with the non-paying party. The amendment to flatten

interest rates should help control the amount of costs awarded by the LRF beyond the principal amount owed, and it should act as a mitigating factor if there is any "incentive" for suppliers to extend credit loosely believing they can come to the fund if the contractor defaults on payment.

In addition, recent proposals have been discussed by the LRF task force to limit the amounts allowed for attorneys' fees reimbursement based on principal claim size. The current system typically pays attorneys' fees as awarded by court judgement, and these fees are not necessarily subject to any particular limit. The proposed system establishes a tiered schedule that would limit reimbursement for attorneys' fees based on the size of the claim. As with the changes made to interest rates allowed, this proposal is also based on concern that attorneys' fees awarded by the courts in some judgments have seemed excessive compared to the amount of principal debt. In our opinion, limiting attorneys' fees based on claim size is a good idea which should further act to protect the integrity of the LRF and which deserves legislative consideration. (This was made as a formal recommendation in Chapter II.)

A proposal has been made to limit the award for attorneys' fees based on claim size.

Certain Issues Should Be Addressed to Allow the LRF to Operate More Equitably

At least two issues which affect the fairness of how the LRF operates should be addressed by the Legislature. They are user assessments and the lifetime cap. In our opinion, user assessments should take into consideration the level of benefit realized from the fund by members; doing so would help make the LRF a more equitable program. In addition, the lifetime cap, which limits the amount any one claimant can recover from the fund, needs to be reviewed for issues of legality and fairness.

Assessments to LRF Members Should Consider Member Use and Benefit of the Fund

We believe that assessments paid into the LRF by members should somehow reflect individual member use of the fund. The LRF was designed to be financed principally by a base assessment to the thousands of contractors statewide involved in residential construction. We believe

this is a reasonable starting point, but we also believe that actual use of the fund by members should be a consideration in determining how assessments are made. We are not suggesting that legitimate fund use be discouraged or penalized by an unreasonable assessment; we only recommend that use be a consideration in determining member assessments.

Because of healthy fund balances, no special assessment has yet been needed.

Currently, all members of the LRF have paid an initial assessment of $195 into the fund. The original task force that helped establish the LRF settled on this somewhat arbitrary figure that would be applied uniformly to all fund members to get the LRF capitalized. LRF law further states that a special assessment will be imposed if the fund dips below $1.5 million, and LRF administrative rules state that "claims history against the fund" shall be considered in determining special assessment amounts. However, the current LRF balance is about $3.5 million, and there has never been a need for a special assessment.

We believe that those who use the fund more—such as "Supplier A"—should pay a greater assessment than those who use it less or not at all. We also believe there is ample claims history to this point to reasonably conclude that the assessment schedule should be reviewed now rather than waiting until the fund balance dips below $1.5 million.

Current Member Lifetime Cap Needs to Be Reviewed

The current lifetime cap creates legal concerns.

The legality of the current lifetime cap should be reviewed to address concerns over loss of protection under the law if the cap is reached by LRF members. When the LRF was established, a provision was written in the law to limit each member to $500,000 in total lifetime payments from the fund. The cap was imposed to prevent abuses of the fund by claimants using it as a substitute for thorough credit practices. However, the cap raises some issues regarding protection rights, and it is of particular concern to "Supplier A." "Supplier A" has used nearly 60% of its $500,000 limit and is the only claimant anywhere close to exhausting its ability to recover from the LRF. Officials from "Supplier A" feel the cap is unconstitutional because once it is reached, they will be unable to recover from the LRF *and* their lien right will be invalid against any homeowner who is protected by the lien restriction law. Legal sources we contacted indicate that the cap does present a problem of constitutionality because it

means that once reached, claimants would not have equal protection under the law.

One proposal is to allow LRF members to select coverage amounts and pay corresponding premiums.

Recent proposals by the LRF task force have been made to address both the lifetime cap and user assessments. One suggestion is to allow members to choose the amount of coverage they want each year under the LRF and then pay a corresponding premium. All fund members could assess their exposure and risk in the market, select an appropriate amount of protection, and pay the fee associated with the coverage. Members would then be limited to using the LRF each year based on the amount of coverage selected.

We believe the two issues of user assessments and the lifetime cap must be addressed by the Legislature in order to create a more equitable recovery process.

Recommendations:

1. If the current program structure is retained, we recommend that the Legislature develop, through interim study, an assessment method—beyond some mandatory base amount for all members—that takes into consideration individual fund use and benefit.

2. If the current program structure is retained, we recommend the Legislature establish a defensible and equitable method of limiting the total amount of money that any one member can recover from the LRF. In order to be constitutional, this limit will likely need to be renewable on some sort of periodic basis (i.e., annually) so that it does not represent a permanent ban from fund use.

Chapter VI
Alternatives to Current System Should Be Considered

Various alternatives exist for the Legislature to consider in deciding how to best address problems caused by non-paying contractors. This chapter outlines some options available to either enhance the existing program or more completely restructure it. Because of the limited time available to complete this audit, however, we were not able to provide detailed information about the advantages and disadvantages with each of these options. We do not recommend any one option over another because the selection of options is a policy decision.

Alternatives to the current system need further study to fully understand their costs and benefits.

The current program does have some serious flaws which we believe must be corrected if it is to operate effectively and efficiently. However, it does have value because it provides protection to homeowners and mechanics, and, as a fund of last resort, it requires claimants to exhaust other avenues and discourages the application of frivolous claims. If the Legislature desires a major restructuring of the current program, we recommend further review of the options that exist since we were limited from fully exploring the costs and benefits of all the alternatives.

Options to Retain and Enhance the Current System Should Be Considered

Several options exist which could be used to modify and enhance the current lien restriction and recovery law in Utah. Each of the nine states we contacted have somewhat unique mechanics' lien laws and/or recovery fund programs. Some of the options listed below are based on programs in these other states.

Retain Current System with Some Specific Modifications

One alternative is to keep the basic structure of the lien restriction and recovery law while modifying the program to enhance efficiency and effectiveness. This option would recognize that the law can and does provide homeowner protection, and the LRF—as a fund of last resort—

can and does provide recovery assistance for claimants once they have exhausted other avenues. In our opinion, the current system is not well suited for smaller dollar claims and is not necessarily meant to resolve every instance of contractor non-payment.

At a minimum, the following issues should be addressed to make the current system more effective:

- Identify ways to improve the cost-effectiveness of the LRF process.
- Limit the amounts awarded for attorneys' fees based on principal size of claim.
- Amend LRA law to eliminate ambiguity regarding when homeowner compliance is established.
- Identify ways of more quickly determining whether or not homeowners have met the requirements for protection.
- Identify ways in which the process for filing a claim may become less burdensome and time-consuming.

Increased education can aid contractors, suppliers and homeowners in better handling, or even avoiding, problems.

- Identify ways to provide better education about the law to homeowners, contractors and suppliers. For example, both Arizona and Florida allocate monies toward recovery fund education for press releases, advertising and media blitzes.
- Restructure the LRF assessment method so that assessments are in some way tied to use - those who recover more from the fund should pay more into the fund.
- Restructure the lifetime cap so it is legally and constitutionally defensible and equitable for claimants of all sizes.

Bonding Initiatives

Bonding relies on the private sector to determine financial stability of contractors.

Another alternative would be to require all contractors to be bonded by the surety industry. This option has already received discussion from DOPL and some members of the Legislature. The requirement of a bond would most likely co-exist with, rather than replace, the LRF. A

contractor bond would serve at least two purposes. First, it would to some degree impose a standard of credit worthiness and financial responsibility on contractors and help filter out those who cannot meet some minimum financial requirements. The bond issuer would conduct the necessary financial review on some regular basis (i.e., annually) to determine the financial solvency and credit risk of the contractor. One advantage to this method is that it would provide an on-going process of contractor review to help screen out disreputable tradesmen who might otherwise cause problems through non-payment. Currently, DOPL is unable to conduct regular financial reviews, other than at initial licensure, due to a lack of staff.

Bonding would also provide some monetary protection for unpaid parties.

The other benefit to a bonding system is that it would provide some monetary protection to sub-contractors or suppliers if they have not been paid by a general contractor. Bond amounts would have to be determined by the Legislature and DOPL, but would provide some recapture of losses to offset a total reliance on the LRF for recovery.

Of the states we contacted, Arizona uses both a recovery fund and a bonding system. The bonds helps unpaid parties recover some money from the general contractor after which the recovery fund may be accessed. Also, Oregon and Washington both require some type of surety bond by contractors for homeowner protection.

Monitoring Programs Through Construction Lenders

This option would utilize the construction financing process to help oversee outflows from the account and help see that money is properly routed to sub-contractors and suppliers. This oversight could help assure the homeowner, although not perfectly, that the loan is being used to pay sub-contractors and suppliers, and this might prevent problems from occurring.

Construction loan monitoring programs can be helpful but may be difficult to implement.

We spoke with representatives from one bank that offers this type of oversight of construction loans. However, they mentioned several problems with relying on such an approach to prevent problems. For example, most banks do not provide much oversight of cash outflows, mainly because it is more costly, and they offer no assurance to borrowers that sub-contractors and suppliers are being paid by the general contractor. Consequently, all banks would have to be required to offer

this type of monitoring program in order for it to be cost-competitive and fair. This type of regulation would very likely be opposed by the industry. Also, this option would offer no protection for people financing their construction or remodeling with cash.

Another option we heard from various parties during the audit, involving lenders, would be to require dual signatures on all checks by the contractor and by the secondary party, either the supplier or the sub-contractor. Checks must be signed by both parties in order to be cashed. This alternative also helps protect the homeowner by making sure that the sub-contractors and suppliers are getting paid.

Require Pre-lien Notification to Homeowners

Requiring a pre-lien notice to homeowners from sub-contractors and suppliers can at least make homeowners aware of the possibility of having a lien placed on their home. The desired result would be that homeowners are more careful whom they choose as a general contractor and take more control over cash disbursements.

Pre-lien notification would inform homeowners of contractor and supplier lien rights.

Oregon's Legislature passed a law requiring primary contractors to provide an **Information Notice** regarding lien rights to homeowners if the cost of construction is greater than $1,000. In addition, a **Notice of Right to Lien** is required by all sub-contractors and suppliers to be given to the homeowner. If the sub-contractor or supplier does not provide notice to the homeowner prior to providing materials or labor, then penalties may ensue and the contractor will lose his/her lien rights. California also requires that any laborer or materials supplier contracting directly with the homeowner provide a preliminary lien notice.

One cost to requiring pre-lien notification would be the increased administrative expense for suppliers to track materials for each project and send notice to every homeowner.

Require Homeowners to Purchase Title Insurance

Extended title insurance for homeowners would protect them if mechanics' liens are placed on their property. Obtaining title insurance could significantly reduce the demand on the LRF, although it would be at an increased expense for homeowners. Title insurance is similar to

bonding in that the private industry would determine risk and would assume the possibility of a contractor defaulting on his debts. In order to be effective, title insurance would have to be extended to cover both recorded and unrecorded liens against the property. One downside to this option is the increased expense to homeowners who may already be at or over budget in building their home.

Options to Restructure or Replace the Current System Also Exist

If the Legislature determines that the present lien recovery system is too ineffective, other options that more completely restructure or replace the current program can be considered. Of the states that we contacted, the majority have a recovery fund or program that is unique when compared to Utah's. Again, we were unable to thoroughly review the costs and benefits of these options because of limited time. Therefore, we recommend these options be studied further if they are seriously considered.

Adopt a Homeowner Recovery Fund

Most states we contacted operate a fund that is accessed by homeowners.

As with the current law, this option would provide protection to homeowners, contractors, and suppliers. However, it would require that homeowners, not contractors and suppliers, come to the fund if they have suffered financial losses during construction. Five of the six states that we contacted who have recovery funds all require that the homeowner, rather than the contractor or supplier, come to the fund and demonstrate the need to recover damages. Homeowners have no protection from liens with this type of fund; the homeowner, however, can access the fund to recover money used to pay for the removal of liens.

There is an obvious advantage with this type of fund for contractors and suppliers because they can use the relatively simple process of lien enforcement to recover losses. The burden of proving financial loss and resolving problems caused by delinquent contractors, however, shifts to the homeowner.

Shift Away from a Fund of Last Resort

A fund of first resort might simplify the recovery process, but costs would increase significantly.

One option might be to not have the LRF represent a last-resort method of recovery. Such a fund would not necessarily require a claimant to obtain a court judgment or to exhaust all other means of collecting money before being able to recover losses. The court judgment might be replaced with an administrative hearing process for all claims. One cost of this option would be an increased expense to hold administrative hearings. Also, there would likely be a substantial increase in the number of claims being paid which would have to be offset by more frequent member assessments. In addition, some party would have to assume responsibility for pursuing collection from the delinquent contractor—costs will increase if that burden shifts to the state.

Because of limited time, the audit team was unable to gather much information on this type of process. However, the state of California has attempted to adopt a recovery system that is essentially a "fund of first resort."

Keep Lien Protection for Homeowners But Eliminate the Recovery Fund

Eliminating the LRF while preserving lien restriction raises concerns of unconstitutionality.

This option would still provide protection for homeowners against liens if they have met the associated requirements. However, it would eliminate the entire recovery fund and the processing of claims and would essentially leave contractors and suppliers with little possibility of recapturing losses if their liens were not enforceable. The positive side to this option is retaining protection for homeowners without the complicated and costly process of trying to sort out claims and administering the LRF. Also, this option would force contractors and suppliers to be more careful in deciding who they do business with and make them more responsible for their own business decisions.

The tradeoff—which would be significant—is that contractors and suppliers would be precluded from any sort of lien rights or LRF recovery option when homeowners are protected by the law. Contractors and suppliers would need to attempt other avenues for recovery, such as pursuing the non-paying party in court. However, if the non-paying party files for bankruptcy, contractors and suppliers would be unable to collect their unpaid monies. This option would raise serious questions of constitutional rights for contractors and suppliers regarding equal protection under the law.

Abolish the Current Law and Program

Abolishing the current law would not be an appealing option because it would eliminate protection for homeowners.

If the Legislature believes the current process is too costly and too ineffective, the entire Lien Restriction Act and Recovery Fund could be eliminated. Doing so would mean reverting to the historical system of mechanics' liens being enforceable if homeowners do not require their contractors to post a bond. The obvious drawback to eliminating the current process is that homeowners would once again be without protection from liens and may have to pay twice for construction services. We believe that providing protection to homeowners is a very worthwhile effort, and we do not see elimination of the program as an appealing option.

Recommendations:

1. We recommend the Legislature include in interim study an assessment of how effectively the current lien restriction and recovery fund program is operating, based on the information in this report.

2. If the Legislature chooses to retain the structure of the current program, we recommend that the modifications and other enhancements suggested in the first section of this chapter be seriously considered to make the program more efficient and effective.

3. If the Legislature believes an alternative to the current system is needed, we recommend that further study of the options suggested in the second section of this chapter—along with any others developed—be studied more carefully.

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Appendix

Appendix A
Steps for Filing Claim Recovery

1. **Last Day of Construction** - The last day of construction is the day the sub-contractor or supplier last performed services or provided materials on the residence. Many claim filing deadlines are measured from this date.

2. **Deadline for Filing the Notice of Lien** - The deadline for filing the notice of lien to the county recorder is due within 90 days of the last day of construction. *Filing a lien is not a requirement to file a claim with the LRF*. Filing a lien, however, is typically what triggers homeowners into action, and it does protect the sub-contractor or supplier if the homeowner is not protected by the LRA.

3. **Deadline for Filing Civil Action** - There are two specific civil action deadlines that a claimant needs to address within 180 days of the last day of construction. First, a claimant must file a civil action in order to enforce the lien against the residence and make the lien valid (this preserves the lien right if it is ultimately determined through court judgement that the homeowner has not met the requirements for lien protection). Second, the claimant must file a civil action against the non-paying party for the money owed. (A court judgment stating that the plaintiff has made reasonable effort to collect against the non-paying party on money owed but has been unable to do so is required in order to file a claim with the LRF.) If the contractor has filed for bankruptcy, the court process is halted and the claim is adjudicated by the LRF advisory board.

4. **Notice of Commencement of Action (NCA)** - The notice of commencement of action should be sent to DOPL within 30 days of filing a civil action suit with the court. The NCA makes DOPL aware of which sub-contractors and suppliers are pursuing civil action against the non-paying party and may be filing claims with the LRF. The NCA was initially required in order to assure that all sub-contractors and suppliers would be paid for their work on a pro-rated basis if the $75,000 per residence claim payout limit was reached. The NCA deadline has since been amended to not represent an absolute requirement, but rather to be an assurance that a claimant will recover something in the event the $75,000 cap is reached.

5. **Deadline for Filing a Claim with the LRF** - The deadline for filing a claim with the LRF must be made within 120 days of obtaining a court judgment or from date of bankruptcy. The claimant submits the claim and awaits the LRF process of claim approval or denial. A conditional denial letter may be sent to the claimant if insufficient evidence was submitted. The claimant then has 30 days to make the corrections and resubmit the necessary documentation.

Agency Response

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Michael O. Leavitt
Governor
Douglas C. Borba
Executive Director

January 19, 2000

Wayne L. Welsh, Auditor General
Office of the Legislative Auditor General
130 State Capitol
Salt Lake City, Utah 84114

Dear Mr. Welsh:

Subject: Response to Legislative Audit 2000-01

The Department of Commerce (Department) would like to thank the Office of the Legislative Auditor General for their diligence in completing the referenced Audit. We commend you and your staff on your professionalism and your willingness to listen to our views and to share our experience achieved while administering the Lien Recovery Fund.

We concur with the Audit recommendations and we look forward to a study by the Legislature to conduct reforms necessary to address the concerns noted in the Audit. It should be noted that a majority of the concerns addressed by the Audit had been previously identified by the Division of Occupation and Professional Licensing (DOPL) as longstanding issues that require legislative action to correct. The Residence Lien Restriction and Lien Recovery Fund Act (Act) has noble objectives; however, with the experience gained by DOPL during its administration and as the Audit shows, it requires significant changes.

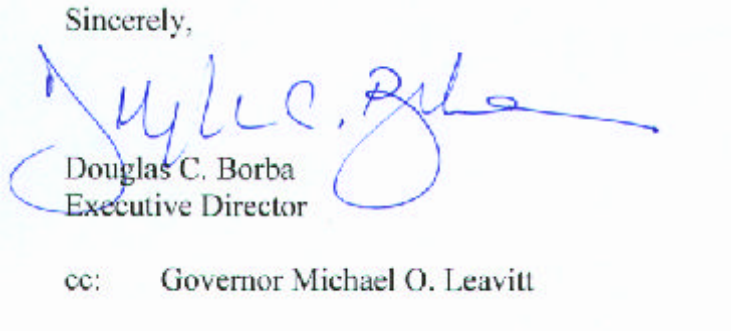
While the Audit is styled as a "performance audit," the Department perceives it as in effect a "program audit." The primary focus of the Audit was to determine the soundness of the Lien Recovery Fund Program. The deficiencies noted are not', for the most part, attributable to DOPL. Instead, DOPL has struggled long and hard to administer the law with its enormous complexity, to the best of its ability, and will continue to do so. The Department and DOPL will welcome solutions recommended by the Legislature..

Care must be taken in evaluating the Audit's statistical data out of context. It should be noted that although the law passed in 1994, it was not funded until 1995. It then took most of 1995 to draft rules, policies, and procedures to implement the Act, to levy and collect the initial assessment to create the Lien Recovery Fund, and finally, to draft forms for claims against the Fund. Moreover, initial claim filings involved a huge learning curve for the claimants, their attorneys, and for DOPL. Finally, while both processing time and denial rates have steadily

declined, the complexities and requirements of the statute make it extraordinarily unpopular, and drive, more than any other factor, the long processing times and high denial rates which continue to exist.

The Department is committed to providing the best protection possible to the homeowners of Utah while administering a fast, fair and equitable program to all other parties involved. Be it during this current session of the Legislature, or during an Interim Study, we pledge our support in this endeavor.

Sincerely,



Douglas C. Borba
Executive Director

cc: Governor Michael O. Leavitt