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### The Good, the Bad, and the Unqualified: The Public Interest and the Unregulated Practice of General Contracting in Oklahoma

A. Scott McDaniel

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**THE GOOD, THE BAD, AND THE  
UNQUALIFIED: THE PUBLIC INTEREST  
AND THE UNREGULATED PRACTICE  
OF GENERAL CONTRACTING IN  
OKLAHOMA**

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### I. INTRODUCTION

Each year, Oklahoma citizens, as purchasers and owners of real estate, are injured by the acts of unqualified, unscrupulous, or insolvent general contractors. Consider the following factual account: Saving the fruits of their labor for many years, a professional couple planned for the construction of a house. Conceived in great detail, this house was not only to serve as the vessel for their entire equity, it was to be their home for many years, and the place for raising their young children. Searching for the contractor to be entrusted with this dream, they came to meet a man who claimed expertise in this type of project. Relying on statements of a few former customers, and the assurances of the contractor, the bargain was struck to begin construction.

Numerous controversies arose during the course of construction. Although the owners retained an architect to provide plans for the home, the builder insisted on numerous changes and substitutions. The plans were general, and left much to the expertise and judgment of the contractor.

Numerous delays and missed deadlines ensued. The frustrated owners suffered inconvenience and expense in retaining temporary housing, and in twice losing their construction loan. In a weary attempt to end the matter and take possession of their home, the owners agreed to pay the final sum due the contractor upon substantial completion based upon the contractor's promise to complete all outstanding details, and to promptly respond to any difficulty that might arise.

Shortly thereafter, latent problems began to appear. Floors were sagging, the site grading was allowing surface water to pond around the house preventing access to the front porch and causing moisture

penetration into the crawl space. As additional concerns arose, the owners became alarmed and sought the advice of a construction expert.

Inspecting the visible components of the site and structure, the engineer determined that numerous violations of the building code and good construction practice were present. Further investigation revealed that no building permit was issued for the project, and no inspections were performed by the local code enforcement officer.

These owners were caught-up in a nightmare. The sum of their savings was invested in a home with obvious defects, and an indeterminate number of hidden nonconformances. The cost of the needed reconstruction was difficult to determine, but was surely significant. It soon became apparent that the promises of the contractor were hollow; no assistance or acceptance of culpability would be forthcoming. The owners were left with only one option, the expensive and time-consuming ordeal of litigation.<sup>1</sup>

Although consumers seeking the service of a general contractor are interested in the quality of the service, they often do not have the expertise to judge the quality of the service, or the qualifications of the provider. This difficulty is worsened by the expense that is needed to obtain the necessary information on which to base a prudent judgment.<sup>2</sup> With this difficulty recognized, how is the consumer to determine which contractor has the requisite knowledge and financial resources, and which may present an unreasonable risk as a party to the construction contract?

All too often, contractors abandon contracts that appear unprofitable, divert the funds paid by the owners under one contract to pay bills for material and labor incurred under another contract, and depart from the terms of their contracts without the knowledge of the owner which results in losses to the owners of property.<sup>3</sup> How is the consumer to protect himself from entering a contract with a contractor who has a history of unscrupulous business practice?<sup>4</sup>

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1. This account was taken from the files of Knox Inspection Services Inc. of Tulsa, Oklahoma, in which the author served as the inspecting engineer.

2. See Sidney L. Carroll & Robert J. Gaston, *Occupational Licensing and the Quality of Service: An Overview*, 7 LAW & HUM. BEHAV. 139 (1983).

3. Homer Clark, *Occupational Licensing in the Building Industry*, 1952 Wash. U. L.Q. 483, 522 (1952).

4. It is not the intention of this comment to cast doubt upon the thousands of honest and competent contractors who diligently construct and modify the dwellings and structures that form the infrastructure of our nation. It is the purpose of this comment to evaluate state regulation which may aid in the protection of the public from those less scrupulous.

State legislation requiring general contractors to qualify for and obtain licensing will serve to provide consumers at least a minimal standard on which to rely prior to entering into a construction contract. The present lack of such regulation constitutes a failure by the Legislature to adequately protect the safety and welfare of the citizens of Oklahoma.

## II. CONSTRUCTION TRADE LICENSING — IN GENERAL

### A. *The Development of Licensing Laws*

The wide use of licensing to regulate professions and occupations is a phenomenon of the twentieth century.<sup>5</sup> The genesis of this phenomenon was the growth of national associations which represented occupational groups during the mid-nineteenth century. Rapidly expanding, and growing in strength facilitated by advancements in transportation and communication, these associations utilized their state and local groups to lobby their respective legislatures. These efforts resulted in the passage of licensing statutes at an ever-increasing rate. Between 1911 and 1915 alone, 110 statutes licensing 24 occupations were enacted.<sup>6</sup>

Another surge of enactments has occurred in our modern era. As of 1950, 73 occupations were licensed in one or more states, with 13 licensed in every jurisdiction. This trend has continued at a significant rate. According to a study performed by the Department of Labor for the year 1969, almost 5000 different licenses were granted across the country.<sup>7</sup> These licenses covered over 500 separate occupations.<sup>8</sup>

Licensing statutes for contractors saw their origin at the same time this licensing frenzy was occurring in the early twentieth century. The first such statute was passed in North Carolina in 1925. The rationale for many of these early statutes was purely economic. The supporters of the legislation were primarily interested in limiting competition and protecting the building industry (and arguably the public) from "cut-throat" and "unethical" practices.<sup>9</sup>

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5. Daniel B. Hogan, *The Effectiveness of Licensing: History, Evidence, and Recommendations*, 7 *LAW & HUM. BEHAV.* 117, 118 (1983).

6. *Id.* at 120.

7. *Id.*

8. *Id.*

9. Clark, *supra* note 3, at 521-22. *See also* 1939 *ARK. ACTS* 124 § 22 (stating that the practice of general contracting in Arkansas is in need of regulation since contractors are being unduly penalized and are suffering irreparable injury due to unethical practices).

Presently, there are two primary methods of licensing. One is by a state-wide licensing statute incorporating centralized procedures and administration by a state agency. The other is by local or "home" rule facilitated by municipal ordinances that are promulgated under state statutory authority. A special municipal agency or one of the established branches of the local government usually administer the second type of licensing scheme.<sup>10</sup>

### B. Purpose for General Contractor Licensing Statutes

A state contractor licensing statute should protect the public interest; it should protect citizens from untrustworthy and incompetent contractors and ensure that structures are properly built.<sup>11</sup> While not guaranteeing ethical or competent practices, a licensing process does require a certain demonstration of competence, sets performance standards, and provides a mechanism for enforcement. Additionally, a licensee must demonstrate some willingness to conform to the regulatory scheme.<sup>12</sup> Economically, such a licensing scheme acts to build confidence in and integrity within the construction industry<sup>13</sup> and allows consumers to evaluate general contractors and to verify at least minimum competency.<sup>14</sup> Although Oklahoma does not presently require general contractors to be licensed, its officials have recognized the importance of the enforcement of the building code to public health.<sup>15</sup>

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10. Clark, *supra* note 3, at 489.

11. *E.g.*, 1965 ARK. ACTS 150 § 23; N.M. STAT. ANN. § 60-13-1.1 (Michie 1989 & Supp. 1993) ("The purpose of the Construction Industries Licensing Act. . . is to promote the general welfare of the people of New Mexico by providing for the protection of life and property by adopting and enforcing codes and standards for construction, alteration, installation, connection, demolition and repair work."); *Bryan Builders Supply v. Midyette*, 162 S.E.2d 507, 510-11 (N.C. 1968) (stating the purpose of North Carolina's licensing statute is to protect the public from incompetent builders).

12. Renee A. Mangini, Comment, *The Contractors' State License Law: From Strict Adherence to Substantial Compliance*, 9 WHITTIER L. REV. 613, 615 (1987).

13. *Brady v. Fulghum*, 308 S.E.2d 327, 329 (N.C. 1983). A contractor who has been required to demonstrate his qualifications and financial responsibility is less likely to engage in unscrupulous activities. Clark, *supra* note 3, at 523.

14. Beyond mere economics, however, the licensing scheme, as a framework for human interaction, should protect and meet the needs of the public. According to Professor Lon Fuller:

Conceiving of regulation in this interactive fashion helps focus on both the positive and negative impact of licensing laws. It suggests that lawmakers who want to protect the public from harm need to look at the negative impact of a law on the quality, quantity, and cost of services.

Hogan, *supra* note 5, at 133

15. 23 Okla. Op. Att'y Gen. No. 91-1, 1 (1991).

The statutory requirements to meet this minimum threshold of responsibility vary among the states. Typically, the statutes prescribe standards for knowledge of the applicable building code,<sup>16</sup> experience,<sup>17</sup> financial responsibility,<sup>18</sup> and character.<sup>19</sup> Finally, each scheme, of course, provides for enforcement. Effective enforcement minimizes the likelihood that a sanctioned contractor will engage in misconduct more than once.<sup>20</sup> Typical statutes achieve this end through provisions for license revocation,<sup>21</sup> civil penalties,<sup>22</sup> and criminal prosecution.<sup>23</sup>

### C. *Licensing Statutes as Constitutional Exercise of the State's Police Power*

Occupational licensing statutes have been challenged on the basis of the Fourteenth Amendment and similar provisions of the state constitutions which protect the individual's right to contract,<sup>24</sup> and to practice an occupation of her choice.<sup>25</sup> However, courts have held that it is within the constitutional grant of police power to the state legislatures to enact statutes which place limits on these rights when the public interest is affected.<sup>26</sup>

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16. See, e.g., ARK. CODE ANN. § 17-22-306 (Michie 1992); N.C. GEN. STAT. § 87-10 (Supp. 1993); N.M. STAT. ANN. § 60-13-16(B) (Michie 1989 & Supp. 1993).

17. See, e.g., N.M. STAT. ANN. § 60-13-14(B)(8) (Michie 1989 & Supp. 1993).

18. See, e.g., ARK. CODE ANN. § 17-22-304(a) (Michie 1992); N.C. GEN. STAT. § 87-10 (Supp. 1993); N.M. STAT. ANN. § 60-13-49 (Michie 1989 & Supp. 1993).

19. See, e.g., ARK. CODE ANN. § 17-22-305 (Michie 1992); N.C. GEN. STAT. § 87-10 (Supp. 1993); N.M. STAT. ANN. § 60-13-14(B)(2) (Michie 1989 & Supp. 1993).

20. Clark, *supra* note 3, at 523.

21. See, e.g., ARK. CODE ANN. §§ 17-22-103(b), 17-22-308 (Michie 1992); N.C. GEN. STAT. § 87-11 (Supp. 1993); N.M. STAT. ANN. § 60-13-23 (Michie Supp. 1993).

22. See, e.g., ARK. CODE ANN. § 17-22-103(e)(1) (Michie 1992); N.M. STAT. ANN. § 60-13-23.1 (Michie 1989 & Supp. 1993).

23. See, e.g., ARK. CODE ANN. § 17-22-103(a) (Michie 1992); N.C. GEN. STAT. § 87-13 (1989); N.M. STAT. ANN. § 60-13-52 (Michie 1989 & Supp. 1993).

24. Mangini, *supra* note 12, at 617.

25. Clark, *supra* note 3, at 492. The restrictions presented in the statutes are supported by the police power of the states, and can be difficult barriers to surmount. Andrew O. Schiff, Note, *The Liability of Third Parties Under Title VII*, 18 U. MICH. J.L. REF. 167, 186 (1984). An additional criticism is that the costs associated with qualification for licensing, and the cost of licensing itself present an obstacle which has disparate effects on the poor and younger segments of society. See Walter Gellhorn, *The Abuse of Occupational Licensing*, 44 U. CHI. L. REV. 6, 16 (1976); Toni M. Massaro & Thomas L. O'Brien, *Constitutional Limitations on State-Imposed Continuing Competency Requirements for Licensed Professionals*, 25 WM. & MARY L. REV. 253, 261-62 (1983); Hogan, *supra* note 5, at 121.

26. See *City of Shawnee v. Reid Bros. Plumbing Co.*, 207 P.2d 779, 780 (Okla. 1949); *State ex rel. Reynolds v. City of St. Petersburg*, 183 So. 304, 308 (Fla. 1938); Mangini, *supra* note 12, at 617.

The constitutionality question has challenged the courts to strike the delicate balance between public protection and individual rights. The courts have little difficulty in recognizing the potential harm to the public from faulty construction practices.<sup>27</sup> Acknowledging the potential harm to the public interest, the courts determined that care for the public health and welfare belongs to the domain of the state's police power.<sup>28</sup> In exercising this power, the state is authorized to prescribe all such regulations as, in its judgment, will secure or tend to secure the public from harmful consequences due to ignorance, incapacity, deception, and fraud.<sup>29</sup> The need for exercising this power is premised on the conclusion that general damages for incompetence, fraud, and breach of contract are an insufficient deterrent for improper practices within the construction industry.<sup>30</sup>

### III. LICENSING OF CONSTRUCTION TRADES IN OKLAHOMA

#### A. In General<sup>31</sup>

Oklahoma does not regulate the practice of general contracting on a state-wide basis. However, the legislature has enacted statutes to regulate several of the construction trades including contractors involved in the removal of friable asbestos material,<sup>32</sup> plumbers,<sup>33</sup> electricians,<sup>34</sup> and mechanical contractors.<sup>35</sup> Analysis of these licensing statutes reveals that they are intended to effectuate the same purposes which underlie typical general contractor licensing statutes — public

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27. "[T]he trade or business carried on by the general contractors . . . is one of paramount importance in the State of Florida . . . there can be no serious question that public welfare is vitally involved in the matter of construction of buildings of all sorts in this State." *Reynolds*, 183 So. at 309. See also *Hunt v. Douglas Lumber Co.*, 17 P.2d 815, 819 (Ariz. 1933) (stating that it is well known to those acquainted with the contracting business that abuses occur which cause injury to the public, and that a statute which discourages practices of this kind, calculated to protect the public, is a legitimate exercise of police power); *Brady v. Fulghum*, 308 S.E.2d 327, 331 (N.C. 1983) (stating the North Carolina Legislature invoked its police power by enacting the general contractor licensing statute to protect the public from fraud, incompetence, and irresponsibility).

28. *Hunt*, 17 P.2d at 818; see also *Mangini*, *supra* note 12, at 614 (stating that courts have acknowledged that when enacted for public health, safety and welfare, these regulations are a valid exercise of police powers).

29. *Hunt*, 17 P.2d at 818-19 (quoting *Dent v. West Virginia*, 129 U.S. 114, 122 (1889)).

30. *Mangini*, *supra* note 12, at 614.

31. For general background on licensing of plumbers and electricians, see *Clark* *supra* note 3, at 489-521.

32. OKLA. STAT. tit. 40, § 452 (Supp. 1993).

33. OKLA. STAT. tit. 59, § 1001 (1991).

34. *Id.* § 1680.

35. *Id.* § 1850.1. Under the Oklahoma Welding Act, welders are required to be certified by the Department of Labor; however due to the statute's limited applicability to this discussion, it has not been included. *Id.* § 1624.



welfare.<sup>36</sup> To protect the public, it was necessary to implement a system to ensure that those intending to provide these enumerated construction services meet minimum requirements of competency and responsibility.<sup>37</sup>

## B. *Common Provisions of the Trade Licensing Statutes*

### 1. Governing Boards

The State Board of Health licenses and regulates plumbing, electrical, and mechanical contractors,<sup>38</sup> while the state Department of Labor licenses and regulates friable asbestos removal contractors.<sup>39</sup> Additionally, the Board of Health can establish categories and limitations on licenses and prescribe bonding and insurance requirements.<sup>40</sup>

### 2. Examinations

To receive a license in any of the four licensed trades, an applicant must successfully complete a written examination. Examining committees under the Commissioners of Health and Labor develop uniform, practical tests sufficient to test the qualifications and fitness of applicants.<sup>41</sup>

### 3. Bonding or Insurance Requirements

The regulating agencies promulgate requirements for proof of an applicant's financial responsibility.<sup>42</sup> For example, the Plumbing Licensing Law allows the Board to establish bonding requirements such as the posting of a state bond, cash, or a certificate of deposit prior to issuance of a license.<sup>43</sup> Likewise, friable asbestos removal contractors who are engaged in the transportation of asbestos-containing materials are required to provide a certificate of insurance for a minimum of \$1 million to cover liability for environmental impairment.<sup>44</sup>

36. See Okla. Op. Att'y Gen. No. 91-1, 1.

37. See discussion *supra* part II.B. Being state-wide laws, these codes preempt conflicting local ordinances. Okla. Op. Att'y Gen. No. 91-1, 1.

38. The Plumbing License Law, OKLA. STAT. tit. 59, § 1002 (Supp. 1993); The Electrical License Act, *id.* § 1681; The Mechanical Licensing Act, *id.* § 1850.3.

39. OKLA. STAT. tit. 40, § 453 (Supp. 1993).

40. OKLA. STAT. tit. 59, §§ 1002, 1681, 1850.3 (1991 & Supp. 1993).

41. *Id.* §§ 1002, 1005, 1681, 1684, 1850.4(H)(5), 1850.6; OKLA. STAT. tit. 40, § 453(A)(2) (Supp. 1993).

42. OKLA. STAT. tit. 59, §§ 1002, 1681, 1850.3 (1991 & Supp. 1993).

43. *Id.* § 1002.

44. OKLA. STAT. tit. 40, § 452(D) (Supp. 1993).

#### 4. Violations and Enforcement Mechanisms

The Department of Labor and the Board of Health enforce the four trade licensing statutes.<sup>45</sup> The primary sanctions available are license revocation,<sup>46</sup> administrative penalty,<sup>47</sup> injunction,<sup>48</sup> and criminal prosecution.<sup>49</sup>

In accord with due process, an administrative hearing must be held prior to license revocation. Under the control of the Board of Health, hearing boards investigate violations of the plumbing, electrical, and mechanical statutes, conduct hearings, and revoke or suspend the licenses of contractors where appropriate.<sup>50</sup> Likewise, under the asbestos removal statute, the Commissioner of Labor conducts an administrative hearing before the revocation, suspension, or denial of a license.<sup>51</sup>

The hearing board, upon its own motion or in response to a private complaint, can instigate an investigation into alleged misconduct of a licensee.<sup>52</sup> Any person may submit a complaint; such a complaint must be in writing, signed by the complainant, and verifiable by the Board.<sup>53</sup>

Indicating the serious nature of malpractice in the trades, the legislature criminalized conduct in violation of the four statutes. Practice of any of the regulated trades without a license is a misdemeanor.<sup>54</sup> Licensees who violate the statutory standards may be found guilty of a misdemeanor and face license revocation.<sup>55</sup>

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45. OKLA. STAT. tit. 59, §§ 1002, 1681, 1850.5(5) (Supp. 1993); OKLA. STAT. tit. 40, § 453(A)(10) (Supp. 1993).

46. OKLA. STAT. tit. 59, §§ 1010, 1689, 1850.5(1) (Supp. 1993); OKLA. STAT. tit. 40, § 454 (Supp. 1993).

47. *Id.* §§ 1010.1(A), 1695(B), 1850.11(B).

48. *Id.* §§ 1010.1(B), 1695(C), 1850.11(C); OKLA. STAT. tit. 40, § 456(B) (Supp. 1993).

49. OKLA. STAT. tit. 59, §§ 1012, 1019, 1690(B), 1695(A), 1850.11(A) (1991 & Supp. 1993); OKLA. STAT. tit. 40, § 456(A) (Supp. 1993).

50. OKLA. STAT. tit. 59, §§ 1010, 1689, 1850.14 (Supp. 1993).

51. OKLA. STAT. tit. 40, § 454 (Supp. 1993).

52. OKLA. STAT. tit. 59, §§ 1010, 1689, 1850.14 (Supp. 1993).

53. *Id.*

54. *Id.* §§ 1012, 1690, 1850.7 (1991); OKLA. STAT. tit. 40, § 456(A) (Supp. 1993).

55. OKLA. STAT. tit. 59, §§ 1019, 1695(A), 1850.11(A) (1991 & Supp. 1993); OKLA. STAT. tit. 40, § 456(A) (Supp. 1993).

#### IV. PROPOSED ELEMENTS FOR THE OKLAHOMA GENERAL CONTRACTOR LICENSING STATUTE

##### A. Introduction

As previously explained, the purpose for general contractor licensing statutes is to promote general welfare by ensuring that structures are free from construction defects and dangers.<sup>56</sup> Oklahoma has adopted this philosophical rationale in the licensing of the primary trades; the time has come for the legislature to extend the exercise of its police power by enacting a statute to minimize the negative effects of untrustworthy and incompetent general contractors. Such a statute must create a mechanism to control the issuance of licenses, regulate the use of licenses, address the application or abrogation of common law contract principles, and provide remedies for violations.

This section provides a framework for an Oklahoma General Contractor Licensing Statute. Many of the statutory elements for this discussion were gleaned through an examination of representative statutes and case law from three states that have enacted general contractor licensing - Arkansas and New Mexico, selected for their regional applicability, and North Carolina, selected due to its enactment being the first of its type.<sup>57</sup> The evolution of North Carolina's licensing statute and its significant volume of case law dealing with licensing issues provide a valuable source for exploring this area of the law.

The North Carolina<sup>58</sup> and Arkansas<sup>59</sup> statutes focus primarily on the activities of general contractors; however, under certain circumstances, subcontractors may fall within the jurisdiction of the acts. New Mexico has taken a differing approach. By enacting the Construction Industries Licensing Act,<sup>60</sup> the New Mexico legislature consolidated the licensing programs of all of the construction trades into one administrative scheme, thereby eliminating inefficient duplication of efforts.<sup>61</sup> Comparison of these three approaches provides a greater insight into the legislative intent and practical effects of these laws.

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56. See discussion *supra* part II.B.

57. The North Carolina general contractor licensing law was first enacted in 1925. N.C. GEN. STAT. § 87-1 (Supp. 1993).

58. *Id.* See also *Florence Concrete Prod., Inc. v. N.C. Lic. Bd. for Gen. Contractors*, 437 S.E.2d 877, 880 (N.C. Ct. App. 1994) (holding that under the statute, even a subcontractor must be licensed if contracted work is § 87-1 type work).

59. ARK. CODE ANN. § 17-22-401(a) (Michie 1992).

60. N.M. STAT. ANN. § 60-13-1 (Michie 1989 & Supp. 1993).

61. *Id.* § 60-13-1.1.

## B. *Statutory Scope*

### 1. Persons or Entities Covered

Individuals, firms, partnerships, corporations, associations, and any other form of organization are covered by the licensing statute.<sup>62</sup> Entities must obtain licenses through a “qualifying individual” even though the members or officers of the entity possess individual licenses.<sup>63</sup> The qualifying individual is responsible for submission of the application for licensure, successful completion of the applicable examination, and the continued compliance of the licensee with the standards of the act.<sup>64</sup> If an entity loses its qualifying individual through separation or death, the license of the entity will be canceled unless a new individual qualifies within thirty (30) days.<sup>65</sup>

A “general contractor” is any person, firm, partnership, association, or other organization who, for a fixed price, commission, fee, or wage, attempts to or submits a bid to construct, or constructs or undertakes to construct, or assumes charge, in a supervisory capacity or otherwise, or manages the construction, erection, alteration, or repair, or has or have constructed, erected, altered, or repaired, under his direction, any building, apartment, condominium, highway, sewer, utility, grading, or any other improvement or structure on public or private property for lease, rent, resale, public access, or similar purpose.<sup>66</sup> Being a general contractor has little to do with business classifications. One becomes a contractor solely as a product of his activities. Therefore, one who undertakes to engage in any of the enumerated activities for compensation will be deemed to be a general contractor whether intended or not.<sup>67</sup>

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62. See ARK. CODE ANN. 17-22-101(a) (Michie 1992); N.M. STAT. ANN. § 60-13-2(D) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-1 (Supp. 1993).

63. See Clark, *supra* note 3, at 527. See also *Newton v. Tull*, 330 S.E.2d 664, 667 (N.C. Ct. App. 1985) (holding unlicensed corporation could not, on basis of individual license held by the president and sole shareholder, enforce its contract against defendants).

64. See, e.g., N.M. STAT. ANN. §§ 60-13-2(E), 60-13-14(A) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-10(c) (Supp. 1993).

65. N.C. GEN. STAT. § 87-10(c) (Supp. 1993). *Compare*, New Mexico provides:

[It is a] requirement that the licensee employ a qualifying party, and [if the employment] is terminated without fault of the licensee, a member of that trade who is experienced in the classification for which the certificate . . . was issued and has been employed for five or more years by the [licensee] shall be issued . . . a temporary certificate . . . and the temporary qualifying party shall be subject to passing the regular examination . . . within ninety days.

N.M. STAT. ANN. § 60-13-16(D) (Michie 1989 & Supp. 1993).

66. See ARK. CODE ANN. § 17-22-101(a) (Michie 1992); N.M. STAT. ANN. § 60-13-3 (1989 & Supp. 1993); N.C. GEN. STAT. § 87-1 (Supp. 1993).

67. Nothing in the North Carolina statute requires the general contractor:

## 2. Scope Limited By the Type and Value of Project

For the purpose of the statute, a "building" means any structure built for use or occupancy by persons or property, including but not limited to manufactured commercial units and modular homes or pre-manufactured homes designed to be placed on permanent foundations.<sup>68</sup>

The statute provides exemptions for some activities performed on one's own property. The property owner is exempt from the licensing requirement for a single-family residence or free standing storage building constructed on residential property.<sup>69</sup> Additionally, the owner may construct or alter structures on his farm or ranch which are intended for the owner's use.<sup>70</sup> To minimize abuse of an exemption, an owner/contractor must occupy the structure for a minimum of twelve months after its completion.<sup>71</sup> Although exempt from the general contractor licensing requirements, these projects must conform to the applicable building codes.

In an effort to allow small contractors to perform low cost jobs without the need for obtaining a license, the statute includes a cost exemption.<sup>72</sup> Under this provision, the contractor does not need to acquire a license until she bids on, or undertakes to perform any of the enumerated construction activities for a project with a cost over

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personally to perform all the construction work called for by the contract, nor does [the statute] require the general contractor's license to be classified in all types of work called for by the contract. . . . It also permits a general contractor to play a supervisory role, hiring subcontractors whose licenses are classified for the work in question. . . . In either case the purpose of the Act, to protect the public from incompetent and unskilled work, is fully met.

Baker Constr. Co. v. Phillips, 426 S.E.2d 679, 683 (N.C. 1993). See also Florence Concrete Prod., Inc. v. N.C. Lic. Bd. for Gen. Contractors, 437 S.E.2d 877, 880 (N.C. Ct. App. 1994) (abrogating the "control test" for determining what entities are within statute's coverage).

68. N.M. STAT. ANN. § 60-13-2(L) (Michie 1989 & Supp. 1993). See also N.C. GEN. STAT. § 87-1 (Supp. 1993) (providing that the statute applies to construction or improvement of any structure or building).

69. N.M. STAT. ANN. §§ 60-13-3(D)(10), (11) (Michie 1989 & Supp. 1993).

70. N.C. GEN. STAT. § 87-1 (Supp. 1993); N.M. STAT. ANN. § 60-13-3(D)(12) (Michie 1989 & Supp. 1993).

71. This licensing statute shall not apply to any person or firm:

or corporation who constructs or alters a building on land owned by that person, firm or corporation provided such building is intended solely for occupancy by that person [or entity] after completion; and provided further that, if such building is not occupied solely by such person [or entity] for at least 12 months following completion, it shall be presumed that the person [or entity] did not intend such building solely for occupancy by that person [or entity].

N.C. GEN. STAT. § 87-1 (Supp. 1993). See also N.M. STAT. ANN. § 60-13-3(D)(10) (Michie 1989 & Supp. 1993).

72. See Clark, *supra* note 3, at 530.

\$30,000.<sup>73</sup> A contractor may not circumvent the cost exemption by splitting the project into multiple contracts or change orders.<sup>74</sup>

### C. *Proof of License Required*

For the licensing regulations to have a pragmatic effect, a general contractor must provide proof of license to the building code official before a building permit will be issued for a non-exempt project.<sup>75</sup> Both the contractor<sup>76</sup> and the building official<sup>77</sup> may be penalized for violating this procedure.

### D. *The General Contractor Licensing Board*

#### 1. Creation and Organization

The Licensing Board has the duty to implement and administer the licensing programs. Board members receive minimal compensation,<sup>78</sup> and are appointed by the Governor,<sup>79</sup> with the advice and consent of the Senate.<sup>80</sup>

The Board shall consist of seven members, with four of the members being active contractors with not less than ten years experience. Two of the Board members shall have no ties to the construction industry, and shall represent the citizens at-large. The remaining Board position shall be filled by a structural engineer who currently practices in the construction field.<sup>81</sup>

73. See N.C. GEN. STAT. § 87-1 (Supp. 1993). It is interesting to note that North Carolina increased the cost exemption from \$30,000 to \$45,000 in 1989 N.C. Sess. Laws Ch. 109, § 1, then reversed this decision returning to the \$30,000 exemption in 1991 (Reg. Sess. 1992) Sess. Laws Ch. 840, § 1. *Id.*

74. See ARK. CODE ANN. § 17-22-101(B) (Michie 1992).

75. See, e.g., ARK. CODE ANN. § 17-22-301(b)(1) (Michie 1992); N.M. STAT. ANN. § 60-13-19(A) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-14 (Supp. 1993).

76. "Any contractor who fails to indicate his contractor's license number clearly on all written bids and when applying for a building permit. . . shall be assessed. . . a penalty fee of one hundred fifty dollars (\$150)." N.M. STAT. ANN. § 60-13-19(B) (Michie 1989 & Supp. 1993).

77. ARK. CODE ANN. § 17-22-301(2) (Michie 1992) (declaring it to be unlawful for the building inspector to issue a permit without proof of license); N.C. GEN. STAT. § 87-14 (Supp. 1993) (providing that any building inspector who violates the terms of this section is guilty of a misdemeanor and subject to a fine of not more than fifty dollars).

78. See, e.g., ARK. CODE ANN. § 17-22-201(e) (Michie 1992); N.M. STAT. ANN. § 60-13-6(B) (Michie 1989 & Supp. 1993).

79. See, e.g., ARK. CODE ANN. § 17-22-201(d) (Michie 1992); N.C. GEN. STAT. § 87-2 (Supp. 1993).

80. See N.M. STAT. ANN. § 60-13-6(A) (Michie 1989 & Supp. 1993).

81. See, e.g., ARK. CODE ANN. §§ 17-22-201(a),(b) (Michie 1992) (providing that five of the seven board members shall be contractors of not less than ten years experience, and two of the seven members shall represent the public, one of which shall be sixty years old or older also to represent the elderly); N.C. GEN. STAT. § 87-2 (Supp. 1993) (providing that five of the nine members shall be general contractors, with one of the remaining four members being a structural

## 2. Board Powers

To provide for the efficient operation of the licensing scheme, the Board has executive, legislative, and judicial powers. The Board has broad rule-making power to "flesh-out" the statutory framework. It may create bylaws, establish procedures for license application, determine license classifications, prepare and administer written examinations, and promulgate any other necessary regulations which are consistent with the legislation.<sup>82</sup>

The Licensing Board promulgates the regulations and procedures for dealing with violations of the act. The Board sets procedures for filing and recording complaints against licensees, investigates complaints, and establishes prerequisites for license suspension or revocation.<sup>83</sup> To enforce the statute, the Board may file suit for monetary<sup>84</sup> or injunctive relief,<sup>85</sup> and issue subpoenas.<sup>86</sup>

engineer, and three of the nine members shall represent the public); N.M. STAT. ANN. § 60-13-6(A) (Michie 1989 & Supp. 1993) (providing that seven of the nine members shall be practitioners, and one of the nine members shall represent the public).

One potential negative side-effect of the licensing statute is a reduction in competition for those who are duly licensed. Kenneth W. Clarkson & Timothy J. Muris, *Constraining the Federal Trade Commission: The Case of the Occupational Regulation*, 35 U. MIAMI L. REV. 77, 79 (1980). Therefore, it is essential that Licensing Board be structured to prevent domination by practitioners, who may have a tendency to act on behalf of the general contractors rather than the public. See Massario & O'Brien, *supra* note 25, at 264.

82. See, e.g., ARK. CODE ANN. §§ 17-22-203(a), -315 (Michie 1992); N.M. STAT. ANN. §§ 60-13-6(E), -13-9 (Michie 1989 & Supp. 1993); N.C. GEN. STAT. §§ 87-8, -10(b), -11(c) (1989 & Supp. 1993).

83. See, e.g. ARK. CODE ANN. §§ 17-22-103(b), -206, -308, -309 (Michie 1992); N.C. Gen. Stat. §§ 87-11, -13 (1989 & Supp. 1993); N.M. STAT. ANN. §§ 60-13-6(E)(1), -9(K) to (M), -11(E), -23, -23.1, -24, -27, -28 (Michie 1989 & Supp. 1993).

84. "The [Board] shall have the power to file suit . . . to obtain a judgment for the amount of any penalty not paid within thirty (30) days of service on the contractor of the order assessing the penalty. . . ." ARK. CODE ANN. § 17-22-103(e)(5) (Michie 1992). See also N.M. STAT. ANN. § 60-13-11(A) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-13 (1989).

85. With respect to an unlicensed contractor:

the board shall have the right to go into the proper court . . . and, upon affidavit, secure a writ of injunction, without bond, restraining and prohibiting the contractor from performance of the work then being done or about to commence.

ARK. CODE ANN. § 17-22-104 (Michie 1992). See also *id.* § 17-22-103(e)(6); N.M. STAT. ANN. § 60-13-53 (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-13.1 (1989).

86. The Board has:

the power to issue subpoenas and bring before the board as a witness any person in the state and may require the witness to bring with him any book, writing, or other thing under his control . . . to produce in evidence.

ARK. CODE ANN. § 17-22-103(c) (Michie 1992). See also N.M. Stat. Ann. § 60-13-11(A) (Michie 1989 & Supp. 1993).

Finally, the Board may adjudicate cases involving violations of the act.<sup>87</sup> The Board must hold administrative hearings in conformance with due process before it can impose civil penalties or revoke the privileges of the licensee.<sup>88</sup>

### E. *Qualifications For Licensure*

#### 1. In General

Minimum qualifications for applicants ultimately serve the purpose of the licensing statute - protection of public welfare. The licensing process will lessen the enforcement and disciplinary burdens of the statute by reducing the number of likely violators.

The primary threats posed by incompetent or unscrupulous contractors are risk of physical and financial injury. To reduce risks of physical injury, a contractor must meet certain standards of technical ability, and the Board will investigate an applicant's history of quality of workmanship.<sup>89</sup> To reduce risks of financial injury through fraud, breach of contract, or poor workmanship, the licensing Board will inquire into an applicant's experience, reputation, and history of financial responsibility.<sup>90</sup>

#### 2. Experience and "Good Moral Character"

An applicant must demonstrate his or her experience and ability by providing specific information regarding how long the applicant has been in the business of general contracting and the construction experience possessed by the individual or principals of the organization.<sup>91</sup> Each applicant must have four years, within the ten years immediately prior to application, of practical or related experience with the type of construction for which the applicant is applying for a license.<sup>92</sup>

The issue of an applicant's "good moral character" has made its way into some of the licensing statutes as a measure intended to lessen

87. See, e.g., ARK. CODE ANN. §§ 17-22-103(e)(1)(A), -309 (Michie 1992); N.M. STAT. ANN. §§ 60-13-27(C) & (D) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-11(A) (Supp. 1993).

88. See discussion *infra* part IV.F.2.

89. See Clark, *supra* note 3, at 522-24.

90. See *id.*

91. See NORTH CAROLINA LICENSING BOARD FOR GENERAL CONTRACTORS, APPLICATION FOR LICENSE TO PRACTICE GENERAL CONTRACTING IN THE STATE OF NORTH CAROLINA (Revised Jan. 1991).

92. See N.M. STAT. ANN. § 60-13-14(B)(8) (Michie 1989 & Supp. 1993) ("The Commission may by regulation provide for reducing this requirement for a particular industry or craft where it is deemed excessive, but at no time shall the requirement be less than two years.").



the likelihood of financial loss resulting from the acts of unscrupulous contractors.<sup>93</sup> Each applicant must show, to the satisfaction of the Board, that he or she is possessed of good character and integrity.<sup>94</sup> The Board may deny an applicant a license on character grounds for the commission of an act which would, if committed by a licensed contractor, result in license suspension or revocation.<sup>95</sup>

### 3. Financial Responsibility

To minimize pecuniary losses caused by under-capitalized, un-insured, or unscrupulous contractors, applicants must provide a reasonable assurance of financial solvency.<sup>96</sup> An applicant must file a financial statement with the licensing Board. Further, to renew their licenses, licensees must file periodic financial statements to demonstrate continued solvency.<sup>97</sup>

Division of the general contractor license into three classifications of project value eligibility further protects against financial loss.<sup>98</sup> An applicant who qualifies for a Limited License can contract for any single project up to a value of \$250,000; an Intermediate License holder can contract to \$500,000; and an Unlimited License holder can contract for a project of any value.<sup>99</sup>

The determination of license classification is based on an applicant's working capital.<sup>100</sup> The following minimum working capital requirements are provided for each classification: Limited- \$12,500, Intermediate- \$50,000, and Unlimited- \$100,000.<sup>101</sup> This classification

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93. See Clark, *supra* note 3, at 523-24. Presumably, a contractor who makes a showing of good character is less likely to engage in malpractice. *Id.* at 523.

94. See N.C. GEN. STAT. § 87-10(a) (Supp. 1993).

95. Additionally, the applicant must show:

[T]hat the applicant has not committed or done any act involving dishonesty, fraud, or deceit, or that the applicant has never been refused a license as a general contractor nor had such license revoked, either in this state or in another state . . . and that the applicant has never been convicted of a felony involving moral turpitude, relating to building or contracting, or involving embezzlement or misappropriation of funds or property entrusted to the applicant.

*Id.*

96. See Clark, *supra* note 3, at 523, 527, 533.

97. See ARK. CODE ANN. § 17-22-304(a) (Michie 1992); N.M. STAT. ANN. § 60-13-49(B)(3) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-10(e) (Supp. 1993).

98. N.C. GEN. STAT. § 87-10(a) (Supp. 1993).

99. *Id.* Under this section the application and renewal fees vary with the classification as well; the fees are as follows: Limited- \$50.00, Intermediate- \$75.00, and Unlimited- \$100.00.

100. "Working capital is defined as that amount of money found when subtracting the amount of total current liabilities from the amount of total current assets as shown on the Balance Sheet." NORTH CAROLINA LICENSING BOARD FOR GENERAL CONTRACTORS, LICENSING AND APPLICATION PROCEDURES AND INSTRUCTIONS 7 (1990-91) (emphasis omitted).

101. *Id.*

structure squarely reflects the reality that as the cost of a project increase, demands for expertise from and responsible behavior by the contractor increase as well.<sup>102</sup>

The complex nature of construction contracts often leads to performance related litigation. In order to compensate for the high cost of litigation and forced compliance, the applicant must post a bond underwritten by a corporate surety licensed to operate within the state.<sup>103</sup> The bond must be payable to the state in the penal sum of \$10,000 and be conditioned on the contractor's compliance with, among other things, state tax laws, local regulations, and the requirements of the state worker's compensation and employment security laws.<sup>104</sup> Failure of the licensee to maintain the bond in force is grounds for license revocation.<sup>105</sup>

To protect workers, property owners, and the public at large, the general contractor must obtain commercial general liability insurance and comply with the state's worker's compensation laws. The building inspector or political subdivision authorized to issue building permits must verify insurance coverage prior to issuing the permit.<sup>106</sup>

#### 4. Examination

Examinations are a common feature of general contractor licensing statutes and serve to guarantee "skill, training and ability to accomplish such construction in a safe and workmanlike fashion."<sup>107</sup> Therefore to receive a license, an applicant must successfully complete an oral or written examination.<sup>108</sup>

Overall, the examination measures an applicant's technical and general contracting ability. The examination evaluates an applicant's

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102. See *Sample v. Morgan*, 319 S.E.2d 607, 610-11 (N.C. 1984).

103. See David G. Paul, *The Law of Construction Bonds in Arkansas: A Review*, 9 U. ARK. LITTLE ROCK L.J. 333 (1986-87).

104. See ARK. CODE ANN. § 17-22-404 (Michie Supp. 1993). This section allows the contractor, in the alternative, to post a cash bond.

105. See ARK. CODE ANN. § 17-22-408(c) (Michie Supp. 1993); N.M. STAT. ANN. § 60-13-49(G) (Michie 1989 & Supp. 1993).

106. See N.C. GEN. STAT. § 87-14 (Supp. 1993). Additionally, violations of this requirement constitute a misdemeanor punishable by a fine of not more than fifty dollars.

107. *Brady v. Fulghum*, 308 S.E.2d 327, 330-31 (N.C. 1983) (quoting *Arnold Constr. Co. v. Ariz. Bd. of Regents*, 512 P.2d 1229, 1232 (Ariz. 1973)).

108. See, e.g., ARK. CODE ANN. § 17-22-306 (Michie 1992); N.M. STAT. ANN. § 60-13-16(A) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-10(b) (Supp. 1993).

knowledge of contracting by testing the applicant's technical competency in the areas of construction practice, building codes, and minimum standards.<sup>109</sup> Additionally, the examination determines an applicant's ability to function as a general contractor by testing the applicant's capacity to read building plans and specifications to generate a job cost estimate.<sup>110</sup> Finally, to protect the public from unscrupulous business practices, the examination should test an applicant's knowledge of the licensing act and of general business practices.<sup>111</sup>

## F. *Violations and Enforcement Mechanisms*

### 1. In General

In order for the licensing statute to protect the public from irresponsible or incompetent contractors,<sup>112</sup> it must provide a comprehensive method, not only for the licensing, but also the control of contractors. Generally, a licensing statute will provide for license suspension or revocation; administrative penalties; criminal penalties; denial of a contractor's right to enforce a contract, to recover under quantum meruit, or to enforce a lien; adherence to the doctrine of strict compliance; and preservation of common law remedies for owners.

### 2. License Suspension or Revocation

Administrative action of the Licensing Board is necessary to suspend or revoke a licensee's privilege to practice. A private individual or the Board may initiate the process by filing a verified complaint.<sup>113</sup>

109. See, e.g., N.M. STAT. ANN. § 60-13-16(B) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-10(b) (Supp. 1993). Critics often note that poorly drafted or administered licensing programs discriminate against minorities. See Hogan, *supra* note 5, at 132. Educational and experience demands must not be excessive, and the other prerequisites must be closely-related to the ability to practice general contracting. *Id.* at 129. Finally, the examination must be written so as to minimize the potential disadvantage suffered by poorly educated and foreign-born applicants. See Schiff, *supra* note 25, at 186.

110. See N.C. GEN. STAT. § 87-10(b) (Supp. 1993).

111. The New Mexico statute allows the applicant to submit a certificate of completion of a business and law course, certified by the Board, in lieu of examination on these subjects. N.M. STAT. ANN. §§ 60-13-16(B), (C) (Michie 1989 & Supp. 1993). The North Carolina statute provides that the applicant shall be tested on "ethics and other similar matters pertaining to the contracting business and knowledge of the applicant as to the responsibilities of a contractor to the public and of the requirements of the laws of the State . . . relating to . . . construction and liens." N.C. GEN. STAT. § 87-10(b) (Supp. 1993).

112. *Romero v. Romero*, 535 F.2d 618, 621 (10th Cir. 1976) (quoting *Peck v. Ives*, 499 P.2d 684 (N.M. 1972)).

113. Clark, *supra* note 3, at 532.

The grounds for a complaint include a finding of misconduct, incompetence, or willful violation of the licensing law by the licensee.<sup>114</sup>

The party charged with the violation of the statute is entitled to a hearing before sanctions affecting the right to obtain or maintain a license can be imposed. Once charges have been made against a party by way of written and sworn allegations, the Licensing Board will investigate to determine if probable grounds exist for the suspension or revocation of the license.<sup>115</sup>

Several intentional acts of licensees serve as grounds for license suspension or revocation. These grounds include the following: (1) knowingly contracting beyond the scope of the license; (2) unjustified abandonment of any contract; (3) conversion of funds or property received for completion of a certain project; (4) departure from or disregard of plans or specifications that result in code violations; (5) willful or fraudulent commission of any act resulting in substantial injury to another; and (6) aiding, abetting, or conspiring with another to evade the licensing law by allowing a contractor's license to be used by an unlicensed person.<sup>116</sup>

Additionally, persons who make intentional misrepresentations as to material facts in an application for original license or renewal are subject to penalties.<sup>117</sup> Such penalties include suspension or revocation for the licensee, or a delay in granting or refusal to grant a license to an applicant.<sup>118</sup>

With respect to the administrative hearing, the contractor is entitled to notice of the hearing and has the right to appear personally or by counsel. The contractor may cross-examine witnesses and submit evidence in defense of the claim. The revocation process is governed by the respective State's administrative procedure laws and provides for the right of judicial review.<sup>119</sup>

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114. See, e.g., ARK. CODE ANN. § 17-22-308 (Michie 1992); N.M. STAT. ANN. §§ 60-13-23, -24 (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-11 (Supp. 1993).

115. See, e.g., ARK. CODE ANN. § 17-22-309 (Michie 1992); N.M. STAT. ANN. § 60-13-27 (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-11(a) (Supp. 1993). Trivial or unfounded complaints will be dismissed, while the remaining actions will be heard by the Board.

116. See, e.g., N.M. STAT. ANN. § 60-13-23 (Michie Supp. 1993). See also ARK. CODE ANN. § 17-22-309 (Michie 1992); N.C. GEN. STAT. 87-11 (Supp. 1993).

117. See *supra* note 115.

118. See, e.g., ARK. CODE ANN. § 17-22-103(b), (e)(2) (Michie 1992); N.M. STAT. ANN. §§ 60-13-23(C), -24(A) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-11(a) (Supp. 1993).

119. *Id.* See also Clark, *supra* note 3, at 533. The following is a summary of disciplinary actions taken by the North Carolina Licensing Board from January 1, 1993 to June 30, 1993:

### 3. Administrative Penalties

After an administrative hearing, the Licensing Board may impose fines upon a finding of a violation of the licensing act.<sup>120</sup> The penalty shall be based upon the value of the contract or work performed, ranging from a minimum of three hundred dollars to a maximum of ten percent of the dollar amount of the contract or work performed.<sup>121</sup>

### 4. Criminal Penalty

Criminal sanctions for violations of the licensing statute stand as the strongest mechanism for removing unscrupulous contractors from public practice. Criminal sanctions may be imposed for: (1) contracting or attempting to contract, as defined by the statute, without procuring a license; (2) using or attempting to use the license of another; (3) giving false or forged evidence to the Licensing Board in obtaining a license; (4) impersonating another; or (5) using a revoked or expired license.<sup>122</sup> These violations constitute misdemeanors punishable by imprisonment for 90 days to six months.<sup>123</sup> In addition to imprisonment, fines may be assessed at five hundred dollars per violation.<sup>124</sup>

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New Complaint Files Opened	101
1) Permanent Revocation	3
2) Revocation for Designated Period	1
3) Suspension or Probation	7
4) Formal Reprimand	2
5) Delay or Denial of License Issuance or Right to Take Exam	10
6) Cases Awaiting Hearing	13
7) Cases Referred to District Attorney for Practice of Unlicensed Contracting	1
8) Injunctions	
a) Consent Order	1
b) Filed in Superior Court	2
c) Waiting to be Filed	6

NORTH CAROLINA LICENSING BOARD FOR GENERAL CONTRACTORS BULLETIN, Fall/Winter 1993, at 6.

120. See, e.g. ARK. CODE ANN. § 17-22-103 (Michie 1992); N.M. STAT. ANN. § 60-13-23.1(A) (Michie 1989 & Supp. 1993).

121. See N.M. STAT. ANN. § 60-13-23.1(A) (Michie 1989 & Supp. 1993) which provides that, where the contract value is \$5000 or less, the penalty shall range from \$300 to \$500; and where the contract is more than \$5000, the penalty shall be not less than \$500, nor more than ten percent of the contract. This section also provides that repeat offenders will be assessed twice the stated penalty. *Id.* § 60-13-23.1(B).

122. See, e.g., ARK. CODE ANN. § 17-22-103(a) (Michie 1992); N.M. STAT. ANN. § 60-13-52(A), (B) (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-13 (1989).

123. See, e.g., N.M. STAT. ANN. § 60-13-52(A) to (C) (Michie 1989 & Supp. 1993) (varying imprisonment term with value of contract and providing for doubling of sanctions for repeat offenders); N.C. GEN. STAT. § 87-13 (1989) (specifying three month imprisonment term).

124. N.C. GEN. STAT. § 87-13 (1989) (setting \$500 fine).

## 5. Right to Contract Enforcement

Denying a contractor's ability to enforce a contract under certain circumstances is another enforcement mechanism designed to further the purposes of the licensing statute.<sup>125</sup> It is a long-established rule of law that a party cannot enforce an illegal bargain;<sup>126</sup> the general contractor law codifies this prohibition.<sup>127</sup> Under this rule, a general contractor cannot enforce a contract where he violated the licensing statute.<sup>128</sup> Thus, if an *unlicensed* contractor enters a "contract" of a value in excess of the statutory exemption, he cannot recover in the event of a breach by the owner.<sup>129</sup> Subsequent procurement of a license will not serve to validate the "contract" or entitle the contractor to maintain the action.<sup>130</sup>

The doctrine also affects the *licensed* contractor when he contracts in violation of the statute. If a contractor suffers an owner's breach in a contract with a value exceeding his license limitation, the contractor will be barred from recovering that amount in excess of his limitation.<sup>131</sup> Likewise, if a licensed contractor's license becomes invalid during performance of the construction contract for any reason, he may recover for only the work performed during the period that his license was in force.<sup>132</sup>

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125. *Brady v. Fulghum*, 308 S.E.2d 327, 331. The doctrine causes a "salutary effect in causing obedience to the licensing statute." 6a ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1512, at 716 (1962).

126. RESTATEMENT (SECOND) OF CONTRACTS § 178 (1981); RESTATEMENT OF CONTRACTS § 607 cmt. a (1932); *see also* *Crawford v. Holcomb*, 262 P.2d 782, 785 (N.M. 1953), *overruled on other grounds by*, *State ex rel. Gary v. Fireman's Fund Indem. Co.*, 355 P.2d 291 (N.M. 1960).

127. *See, e.g.*, ARK. CODE ANN. § 17-22-103(d) (Michie 1992) (providing that no action may be brought on a contract entered into in violation of statute); N.M. STAT. ANN. § 60-13-30(A) (Michie 1989 & Supp. 1993) (requiring contractor seeking to maintain an action on contract to first allege and prove that he was properly licensed at the time the action arose). *See also* 6A CORBIN, *supra* note 125, § 1511, at 709 (stating the that language of the statute itself may answer question of unenforceability by violators).

128. *Brady v. Fulghum*, 308 S.E.2d 327, 330 (N.C. 1983). *See also* *Triple B Corp. v. Brown & Root, Inc.*, 739 P.2d 968, 970 (N.M. 1987) (holding that the licensing statute bars unlicensed contractor from bringing or maintaining a suit on a contract); 15 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACTS, § 1766, at 256-57 (1972).

129. *Vogel v. Reed Supply Co.*, 177 S.E.2d 273, 280 (N.C. 1970); *Bryan Builders Supply v. Midyette*, 162 S.E.2d 507, 511 (N.C. 1968).

130. *Brady*, 308 S.E.2d at 331.

131. *Sample v. Morgan*, 319 S.E.2d 607, 611 (N.C. 1984).

132. The North Carolina statute provides that the contractor's license expires on December 31st of each year and becomes invalid 60 days thereafter unless renewed. N.C. GEN. STAT. § 87-10(e) (Supp. 1993). *See* *Hall v. Simmons*, 407 S.E.2d 816, 819 (N.C. 1991) (interpreting this 60 day period as a window of time to allow for renewal where contractor's license has expired but is not invalid). On this basis, the courts have permitted contractors to recover for material and labor on their contracts during this 60 day period.

A contract entered in violation of the licensing statute is not void. A void contract is really no contract at all; it binds none of the parties and is a mere nullity.<sup>133</sup> Contracts involving unlicensed contractors are not without legal effect, for the innocent party may maintain an action for damages for a breach by the contractor.<sup>134</sup> This rule is based upon the principle that the innocent party is a member of the statutorily protected class, that he is not equally culpable with the unlicensed contractor, and is therefore entitled to relief.<sup>135</sup> Likewise, a contract between the unlicensed contractor and his subcontractors may be enforced because these parties are not within the protected class and the licensing statutes do not apply to the rights and obligations of contractors and subcontractors where the public interest is not involved.<sup>136</sup>

If these doctrines appear to be overly harsh, consider the words of the North Carolina Supreme Court, “[i]f, by virtue of these rules, harsh results fall upon licensed contractors who violate our statutes, the contractors themselves bear both the responsibility and the blame.”<sup>137</sup>

## 6. Right to Recovery in Quantum Meruit

Under common law, the equitable doctrine of quantum meruit implies the promise to pay as compensation the reasonable value of services rendered, where no contract exists, to prevent unjust enrichment.<sup>138</sup> Just as a contractor cannot enforce a contract made in violation of the licensing statute, a contractor will not be able to receive restitution under quantum meruit in the same circumstances.<sup>139</sup>

This denial of a recovery on quantum meruit serves the legislative intent of the licensing statute. Recovery by an unlicensed person for

133. *Bryan Builders Supply v. Midyette*, 162 S.E.2d 507, 511 (N.C. 1968) (quoting 17 AM. JUR. 2D *Contracts* § 7 (1964)).

134. *Id.* See also *Triple B Corp. v. Brown & Root*, 739 P.2d 968, 970 (N.M. 1987) (stating that the statute allows recovery for a person who is not a contractor within the meaning of the statute); 6A CORBIN, *supra* note 125, § 1510, at 707-08.

135. *Bryan Builders Supply*, 162 S.E.2d at 511.

136. *Vogel v. Reed Supply Co.*, 177 S.E.2d 273, 282 (N.C. 1970). “The reason for the rule denying enforceability does not exist . . . when persons engaged in the same . . . trade are dealing at arm’s length with each other.” 15 WILLISTON, *supra* note 128, § 1766, at 262-63.

137. *Brady v. Fulghum*, 308 S.E. 2d 327, 332 (N.C. 1983).

138. BLACK’S LAW DICTIONARY 1243 (6th ed. 1990); see also RESTATEMENT OF RESTITUTION § 1 (1937). For more on this theory as providing a measure of restitution, see Joseph M. Perillo, *Restitution in a Contractual Context*, 73 COLUM. L. REV. 1208 (1973).

139. *Bryan Builders Supply v. Midyette*, 162 S.E.2d 507, 512 (N.C. 1968). See also Allen Holt Gwyn, *Legislation Division Update: State Contractor Licensing Statutes*, THE CONSTRUCTION LAWYER, Aug. 1991, at 24-25.

the value of work and services furnished under a “contract” which the legislature has determined to be unlawful would undermine this purpose.<sup>140</sup> This policy provides harsh results, but it exists to protect the public and must override the judicial principle that disfavors unjust enrichment.<sup>141</sup>

### 7. Right to Enforce a Lien

Based on the forgoing principles, the “contract” between an owner and a contractor who is operating in violation of the licensing statutes is unenforceable. Thus, no balance is due the contractor from the owner and, therefore, there exists no right for the contractor to claim a lien upon the owner’s property.<sup>142</sup>

### 8. The Doctrine of Substantial Compliance

To ameliorate the harshness of denying an unlicensed contractor, who may be otherwise qualified, a recovery based on unjust enrichment principles, courts developed a substantial compliance doctrine.<sup>143</sup> The substantial compliance doctrine seeks to strike a balance between the legislative purpose of safeguarding the public welfare through the licensing statute and the severity of the denial of restitution because of minor, technical violations of the statute.<sup>144</sup>

The California Supreme Court articulated this doctrine in what became known as the *Latipac* test.<sup>145</sup> Application of the doctrine required that: (1) the contractor have held a valid license at the time the

140. *Bryan Builders Supply*, 162 S.E.2d at 512-513.

141. See ARK. CODE ANN. § 17-22-103(d) (Michie 1992); N.M. STAT. ANN. § 60-13-30(A) (Michie 1989 & Supp. 1993); *Bryan Builders Supply*, 162 S.E.2d at 513; *Triple B Corp. v. Brown & Root, Inc.*, 739 P.2d 968, 971 (N.M. 1987); Mangini, *supra* note 12, at 618.

142. A direct lien on real property is granted only to contractors in North Carolina who have a contract, express or implied, with the property owner for the making of an improvement thereon. Karl William Leo et al., *North Carolina Construction Law Survey II*, 22 WAKE FOREST L. REV. 481, 525 (1987). See also N.M. STAT. ANN. § 60-13-30(B) (Michie 1989 & Supp. 1993) (“Any contractor operating without a license as required by the . . . Act shall have no right to file or claim any mechanic’s lien. . . .”); *Bird v. Pan Western Corp.*, 546 S.W.2d 417 (Ark. 1977) (affirming a denial of unlicensed contractor’s lien foreclosure suit); *Davidson v. Smith*, 530 S.W.2d 356 (Ark. 1975) (reversing award of mechanic’s and materialman’s lien upon finding lien holder was an unlicensed contractor); *Daye v. Roberts*, 365 S.E.2d 660 (N.C. Ct. App. 1988) (holding unlicensed contractor was not entitled to recover from owners in lien foreclosure); *Sager v. W.M.C., Inc.*, 307 S.E.2d 585 (N.C. Ct. App. 1983) (removing unlicensed contractor’s lien on owner’s property); Gwyn, *supra* note 139, at 25.

143. Mangini, *supra* note 12, at 613.

144. Gwyn, *supra* note 139, at 23.

145. *Latipac, Inc. v. Superior Court of Marin County*, 411 P.2d 564, 567 (Cal. 1966) (Mosk, J., Traynor, C.J., and McComb, J. dissenting). The California courts were among the earliest to recognize the doctrine in 1937, and to formally adopt it in 1946. Mangini, *supra* note 12, at 620.



contract was formed, (2) renewal of the license must be readily obtained, and (3) the responsibility and competence of the supervising individual must be officially confirmed throughout the duration of the contract performance.<sup>146</sup> Additionally, under the California doctrine, a court was supposed to evaluate each situation to determine if the fundamental purpose of protecting the public would be served application of the rule. Thus, the doctrine would be applied only where the party seeking to avoid an obligation had received the full protection contemplated by the statute.<sup>147</sup>

North Carolina courts applied the doctrine of substantial compliance for a time as well, and would allow restitution when the policy of the licensing statute had been fulfilled despite minor violations by a contractor.<sup>148</sup> The rule's application proved difficult and yielded unpredictable results. To illustrate, one contractor remained unlicensed for 12 percent of a project while another remained so for 90 percent, yet lower courts found that both had substantially complied.<sup>149</sup>

Varying interpretations and applications of the doctrine significantly weakened the protection afforded by the licensing statute.<sup>150</sup> Not surprisingly, the North Carolina Supreme Court abolished the doctrine in 1983 and returned to a practice of strict compliance, stating the doctrine was difficult to apply, produced skewed results, and created uncertainty concerning rights of the parties and thus tended to generate litigation.<sup>151</sup> Similarly, the California legislature abrogated the doctrine in 1989.<sup>152</sup>

Therefore, in spite of possible harsh consequences, the Oklahoma statute should provide for strict compliance. Preclusion of judicial application of the substantial compliance doctrine is necessary to effectuate the legislative purpose of the licensing statute.<sup>153</sup>

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146. *Id.* See also *Koehler v. Donnelly*, 838 P.2d 980, 982 (N.M. 1992) (creating greater uncertainty about the doctrine by applying the *Latipac* test while acknowledging that the contractor's failure to establish all of the elements is not necessarily fatal to his claim if the court is satisfied that he has "substantially complied" with the statute).

147. *Id.*

148. *Barrett, Robert & Woods, Inc. v. Armi*, 296 S.E.2d 10, 13-14 (N.C. Ct. App. 1982), *review denied*, 299 S.E.2d 214 (N.C. 1982), *reconsideration denied*, 312 S.E.2d 649 (N.C. 1984).

149. Gwyn, *supra* note 139, at 23-24.

150. Mangini, *supra* note 12, at 613.

151. *Brady v. Fulghum*, 308 S.E.2d 327, 330 (N.C. 1983). Subsequent to the *Brady* decision, the North Carolina legislature modified the statute to provide the 60 day grace period for license renewal. This change minimized the harsh consequences suffered by innocent contractors who inadvertently allowed their licenses to expire under the previous version of the statute. N.C. GEN. STAT. § 87-1-(e) (Supp. 1993); *Hall v. Simmons*, 407 S.E.2d 816, 819 (N.C. 1991).

152. Gwyn, *supra* note 139, at 23.

153. *Brady*, 308 S.E.2d at 331.

### G. Private Remedies

As described, the licensing statute provides detailed procedures and penalties for dealing with the contractor who runs afoul of the statutory requirements. But what does this statute and process hold for the aggrieved owner? For the private party who has suffered a devastating financial loss, the ability to file a complaint with the Licensing Board and potentially affect the license status of the contractor<sup>154</sup> is of minimal value.

Fortunately, most general contractors are responsible business persons, and owners can often obtain satisfactory results through negotiation and arbitration supported by the local Builder's Associations and Better Business Bureaus. When negotiation and other forms of alternate dispute resolution fail, or the contractor refuses to participate, litigation becomes the final option. The owner can sue based on theories of breach of contract, breach of implied warranty,<sup>155</sup> negligence,<sup>156</sup> and products liability<sup>157</sup> where recognized by the legislature and courts.

The owner who successfully prosecutes his claim will obtain a judgment which may be worthless depending on the solvency of the defendant contractor. The net worth and bonding requirements of the licensing statute does not guarantee that sufficient assets will be available to satisfy a judgment.<sup>158</sup> Recovery on a contractor's surety bond can be difficult, and liability insurance coverage may be non-existent.<sup>159</sup>

Oklahoma can confront this difficulty through the legislative creation of a guarantee fund. Massachusetts and North Carolina enacted guarantee funds in 1991.<sup>160</sup> Only owners of residential units who have exhausted their civil remedies and have obtained a judgment against a

154. See, e.g., ARK. CODE ANN. § 17-22-309 (Michie 1992); N.M. STAT. ANN. § 60-13-27 (Michie 1989 & Supp. 1993); N.C. GEN. STAT. § 87-11 (Supp. 1993).

155. See ARK. CODE ANN. § 4-2-315 (Michie 1987). In North Carolina, general contractors are bound by two implied warranties. First, the warranty of skill and care is the duty of every contractor to perform in a proper and workmanlike manner. This warranty is available to anyone who enters a contract with a contractor for construction work. Second, the warranty of habitability, is presently available only to the initial purchaser of the residence. Leo et al., *supra* note 142, at 552-53.

156. See *Oates v. JAG, Inc.*, 333 S.E.2d 222 (N.C. 1985).

157. See *Blagg v. Fred Hunt Co.*, 612 S.W.2d 321 (Ark. 1981). For a discussion of contractor's strict liability, see Blaine G. Frizzell, Comment, *Strict Liability in Tort For Builder-Vendors of Homes*, 24 TULSA L.J. 117 (1988).

158. See discussion *supra* part IV.E.3.

159. See discussion *supra* part IV.E.3.

160. MASS. GEN. LAWS ANN. ch. 142A, § 5 (West Supp. 1993); N.C. GEN. STAT. § 87-15.5 (Supp. 1993).

residential contractor which remains unsatisfied may recover from these funds.<sup>161</sup> The program will be publicly administered,<sup>162</sup> and funded through permit fees paid by the contractors<sup>163</sup> and by amounts recovered through subrogated actions against the offending contractors.<sup>164</sup> Although this concept does not eliminate the need for the claimant to pursue litigation, it does provide an alternative source for the recovery of damages for those who can least afford to absorb the injury - residential property owners.

## V. CONCLUSION

This discussion has demonstrated why no one who is associated with the construction industry, either as a provider or a consumer, is ambivalent about general contractor licensing. Emotions run high when one speaks of occupational regulation, as they should, for the freedom to work as one chooses is fundamental. The difficulty is in finding the proper balance between the freedom of occupation and public protection.

It is almost common knowledge that many consumers are continuing to lose their financial futures to physical injury and lost property value at the hands of a minority of general contractors who operate in disregard of proper construction standards and business ethics. The state must act to protect the health and safety of the citizenry by enacting a regulatory scheme based on the foregoing proposals.

In striking the balance, the Legislature must take care not to create burdens in excess of benefits; it must minimize restrictions while effectively precluding from the profession incompetent or financially irresponsible persons. Those who oppose licensing on the "right to work" platform offer persuasive arguments. However, the licensing burden will be minimized by the cost exemption under which contractors can work projects up to \$30,000 without a license. Finally, the screening process will test only those attributes which are necessary to the ability to operate a general contracting service.

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161. MASS. GEN. LAWS ANN. ch. 142A, § 7 (West Supp. 1993); N.C. GEN. STAT. § 87-15.8 (Supp. 1993).

162. See MASS. GEN. LAWS ANN. ch. 142A, § 5 (West Supp. 1993); N.C. GEN. STAT. § 87-15.7 (Supp. 1993).

163. See MASS. GEN. LAWS ANN. ch. 142A, § 6 (West Supp. 1993); N.C. GEN. STAT. § 87-15.6 (Supp. 1993).

164. See MASS. GEN. LAWS ANN. ch. 142A, § 8 (West Supp. 1993); N.C. GEN. STAT. § 15.9 (Supp. 1993).

Financial responsibility is of key importance. To provide protection for the consumer, there must be a fund available in the event of breach or negligent injury. Net worth requirements can be effective, but are also subject to falsification and manipulation. Mandated insurance and bonding may be the only means to verify some measure of responsibility.

The Licensing Board must be adequately funded and staffed. The cost of administration can be dispersed to the users through permit and license fees. Waste can be minimized by consolidating the licensing of all trades into one comprehensive bureau. Persons not connected to the industry must participate in the activities of the Licensing Board. The Legislature must enable the Board to effectively enforce its mandate. This enforcement should be supported by the adoption of strict compliance principles.

The foregoing recommendations are based on themes already underlying licensing schemes found both in and out of Oklahoma. By enacting the existing trade licensing statutes, the Legislature has recognized the need to protect its citizens from the dangers created by malpractice of the major construction trades; it is now time to extend that regulatory protection to the ones who build the structure and put together the package we trust with our families and our savings — the general contractors.

*A. Scott McDaniel\**

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\* The author is a civil engineer registered to practice in Oklahoma and North Carolina. His practice has included the inspection and evaluation of hundreds of residential and commercial structures for private parties, financial institutions, and insurance companies.

