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OFFICE OF THE ATTORNEY GENERAL  
State of California

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| OPINION                 | : | No. 81-619              |
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| of                      | : | <u>JANUARY 20, 1982</u> |
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THE HONORABLE RICHARD ROBINSON, MEMBER OF THE STATE ASSEMBLY, has requested an opinion on the following question:

Does a surety's payment of a claim filed against a contractor's bond pursuant to Business and Professions Code section 7071.11 constitute grounds for disciplinary action against the contractor where the contractor denies liability for such claim?

CONCLUSION

A surety's payment of a claim filed against a contractor's bond pursuant to Business and Professions Code section 7071.11 does not in and of itself constitute grounds for disciplinary action against the contractor where the contractor denies liability for such claim.

## ANALYSIS

The Legislature has enacted a comprehensive statutory scheme (Bus. & Prof. Code §§ 7000-7173)<sup>1</sup> known as the Contractors License Law (§ 7000) to protect the public against the consequences of incompetent workmanship and deception practiced by unreliable building contractors. (See *Lewis & Queen v. W. M. Ballsons* (1957) 48 Cal.2d 141,149; *Steinbrenner v. Waterbury (J. A.) Constr. Co.* (1963) 212 Cal.App. 661, 666.) The statutory provisions are administered by the Contractors' State License Board (§§ 7000.5, 7010) and the registrar of contractors (§ 7011).

The question presented for analysis is whether the payment by a surety of a claim filed against a contractor's bond pursuant to section 7071.11 constitutes grounds for disciplinary action against the contractor where the contractor denies liability for the claim. We conclude that such payment in and of itself does not constitute grounds for disciplinary action. In reaching this conclusion, we will first examine the relevant statutory provisions dealing with contractor disciplinary actions and then the provisions concerning contractor's bonds.

Under the provisions of section 7090, the registrar is authorized to "investigate the actions of any contractor or home improvement salesman within the state and may temporarily suspend or permanently revoke any license or registration if the holder, while a licensee or registrant or applicant hereunder, is guilty of or commits any one or more of the acts or omissions constituting causes for disciplinary action."<sup>2</sup>

Besides ordering the temporary suspension or permanent revocation of a license, the registrar may impose upon the contractor "such specific conditions as may be just in connection with his operations as a contractor." (§ 7095, subd. (c).)

The Legislature has specified various "causes for disciplinary action," including "[a]bandonment without legal excuse of any construction project or operation engaged in or undertaken by the licensee as a contractor" (§ 7107), "[d]iversion of funds or property received for prosecution or completion of a specific construction project or operation" (§ 7108), "[w]illful departure from or disregard of plans or specifications" (§ 7109), "[w]illful or deliberate disregard and violation of the building laws of the state" (§ 7110), and "[f]ailure to make and keep records showing all contracts, documents, records, receipts and disbursements by a licensee of all of his transactions as a contractor"

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<sup>1</sup> All section references hereafter are to the Business and Professions Code.

<sup>2</sup> Section 7028 states in part: "It is a misdemeanor for any person to engage in the business or act in the capacity of a contractor within this state without having a license therefor, unless such person is particularly exempted from the provisions of this chapter."

(§ 7111). (See *Mickelson Concrete Co. v. Contractors' State License Bd.* (1979) 95 Cal.App.3d 631, 634-635; *Bailey-Sperber, Inc. v. Yosemite Ins. Co.* (1976) 64 Cal.App.3d 725, 728-729.)

Facts that constitute "causes for disciplinary action" are proved at an evidentiary hearing (§ 7091), resulting in "disciplinary action" being taken by the registrar, principally the suspending or revoking of the contractor's license. (§ 7095.)<sup>3</sup>

Against this background concerning the discipline of contractors by the registrar, we examine the specific requirements for the issuance of contractors' bonds. Under the provisions of section 7071.6, a bond<sup>4</sup> in the sum of \$10,000 is required for swimming pool contractors and in the sum of \$5,000 for all other contractors at the time of "the issuance, reinstatement, reactivation, or renewal of a license."<sup>5</sup>

A higher amount is required where the contractor's license has been previously suspended or revoked. Section 7071.8 states:

"If application for a license, or for restoration of a license, is made by

"(1) Any person whose license has been suspended or revoked as a result of disciplinary action for violation of this chapter,

"(2) Any person who was an officer, director, member, partner or qualifying individual for a licensee at any time during which cause for disciplinary action occurred resulting in suspension or revocation of said licensee's license and who had knowledge of or participated in the act or omission which was the cause for such disciplinary action for violation of this chapter,

"(3) Any partnership, corporation, firm or association of which any officer, director, member, partner or qualifying person has had his license suspended or revoked as a result of disciplinary action for violation of this chapter, or

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<sup>3</sup> An alternative procedure is authorized whereby the registrar merely issues a "citation" which "may contain an order of correction fixing a reasonable time for correction of the violation and may contain an assessment of a civil penalty." (§ 7099.)

<sup>4</sup> A cash deposit may be substituted for the bond. (§§ 7071.5-7071.12.)

<sup>5</sup> An additional \$5,000 bond or cash deposit is required where the licensee qualifies through a "responsible managing employee," such as where the licensee is a corporation. (See §§ 7068, 7068.1, 7071.9, 7071.10; Cal. Admin. Code, tit. 16, § 790.)

"(4) Any partnership, corporation, firm or association of which any officer, director, member, partner or qualifying person was a member, officer, director, partner or qualifying person of a licensee at any time during which cause for disciplinary action occurred resulting in suspension or revocation of said license, and who had knowledge of or participated in the act or omission which was the cause for such disciplinary action for violation of this chapter, *the board shall require as a condition precedent to the issuance, reissuance or restoration of a license to such applicant, or removal of suspension, that such applicant file or have on file a contractor's bond or cash deposit in a sum to be fixed by the registrar based upon the seriousness of the violation, but which sum shall not be less than three times nor more than 10 times that amount required by Section 7071.6.*

"Such bond shall remain on file or in lieu thereof cash deposit be posted with the registrar for a period of at least two years and for such additional time as the registrar may determine.

"Each applicant or licensee shall be required to file only one contractor's bond of the type described in this section.

"Nothing contained in this section shall apply to a person or firm whose license has been suspended or revoked for a failure to comply with Section 7083." (Italics added.)

Although it has been broadly stated that "[t]he purpose of the bonding provisions of the contractors' law [is] to remedy the losses sustained by owners due to the improper or fraudulent activities of contractors" (*Boliver v. Surety Co.* (1977) 72 Cal.App.3d Supp. 22, 33), the law specifies that four different groups of persons may recover against a contractor's bond:

"(a) Any homeowner contracting for home improvement upon his personal family residence damaged as a result of a violation of this chapter by the licensee.

"(b) Any person damaged as a result of a willful and deliberate violation of this chapter by the licensee, or by the fraud of the licensee in the execution or performance of a construction contract.

"(c) Any employee of the licensee damaged by the licensee's failure to pay wages.

"(d) Any express trust fund, or the trustees of any express trust fund, established pursuant to a collective-bargaining agreement and to which the licensee is obligated to make payments on account of fringe benefits, damaged as the result of the licensee's failure to pay fringe benefits . . . ." (§ 7071.5.)

While a surety is obligated to satisfy the claims of each of the four groups, its liability is limited by the extent of the liability of the contractor (*Boliver v. Surety Co.*, *supra*, 72 Cal.App.3d Supp. 22, 30) and by the conditions imposed by law (*FAJ, Inc. v. Surety Co. of the Pacific* (1977) 68 Cal.App.3d Supp. 20, 22).

The statute that governs our discussion of the issue presented is section 7071.11. It provides in part:

"Any person claiming against any bond or cash deposit required by this article may maintain an action at law against the licensee and the surety or the cash depository. If any bond or cash deposit which may be required is insufficient to pay all claims in full, the sum of the bond or cash deposit shall be distributed to all claimants in proportion to the amount of their respective claims with priority to claims for wages and fringe benefits . . . .

*"If the surety desires to make payment without awaiting court action, the amount of any bond filed in compliance with this chapter shall be reduced to the extent of any payment or payments made by the surety in good faith thereafter. The partial payment of any claims shall not be considered satisfaction of such claims and the claimants may institute appropriate legal action for payment of any unpaid balance in any other manner provided by law, and the registrar may continue suspension or revocation of any license involved until such time as said claims and any other claims arising out of an action against such bond or cash deposit are satisfied in full.*

"The aggregate liability of the surety for all claims of said persons shall, in no event, exceed the penal sum of the bond.

"Upon the cancellation by a licensee of any bond required by this article, the surety thereon shall notify the registrar immediately of such cancellation.

*"Upon failure of a licensee to maintain in full force and effect any bond or cash deposit required by this article the registrar shall issue an order*

*suspending or revoking such license, which shall not be reinstated until a new bond or cash deposit has been filed.*

"When the surety makes payment on any claim against a bond required by this article, whether or not payment is made through a court action or otherwise, the surety shall, within 30 days of the payment, notify the registrar. The notice shall contain, on a form prescribed by the registrar, the name and license number of the contractor, the surety bond number, the amount of payment, the statutory basis upon which the claim is made, and the names of the person or persons to whom payments are made.

*"Any judgment or admitted claim against any bond or cash deposit required by this article shall constitute grounds for disciplinary action against such licensee. Such license may not be reissued or reinstated while any judgment or admitted claim in excess of the amount of the bond or cash deposited remains unsatisfied. Further, such license may not be reissued or reinstated while any surety remains unreimbursed for loss and expense sustained on any bond issued for such licensee or for any entity of which any officer, director, member, partner, or qualifying person was an officer, director, member, partner, or qualifying person of such licensee while such licensee was subject to disciplinary action under this section. The board shall require the licensee to file a new bond in an amount as required pursuant to Section 7071.8 or to increase his cash deposit to such an amount.*

"....." (Italics added.)

While the various provisions of section 7071.11 do not appear to be concisely and clearly set forth, we believe that they may be harmonized when read together. "It is fundamental that legislation should be construed so as to harmonize its various elements without doing violence to its language or spirit." (*Wells v. Marina City Properties, Inc.* (1981) 29 Cal.3d 781, 788.)

Essentially, two distinct sets of consequences result when a surety pays a claim filed against a contractor's bond without a court judgment having been entered establishing liability for the claim. Depending upon whether the contractor admits the validity of the filed claim, separate provisions of section 7071.11 are applicable.

If the contractor denies liability for the claim, the surety may nonetheless make payment under the statute. The question that arises, however, is whether payment in such circumstances may be considered to be made "in good faith" by the surety. Although we have found no case directly in point, two lines of cases in the area of subrogation support

conflicting answers. (Compare *Ragghianti v. Sherwin* (1961) 196 Cal.App.2d 345, 350-351; *Schlitz v. Thomas* (1923) 61 Cal.App. 635, 638 with *Employers etc. Ins. Co. v. Pac. Indem. Co.* (1959) 167 Cal.App.2d 369, 376-381; *Grant v. de Otte* (1954) 122 Cal.App.2d 724, 729.) The better view appears to be that where liability is "possible," even though denied by the principal, a surety's payment of a bond claim may be considered to be made "in good faith."

The consequence of such a determination is that with the automatic deduction of the "good faith" payment from the full sum of the bond, the contractor will no longer have a bond "in full force and effect" under the statute<sup>6</sup>, and the registrar must therefore "issue an order suspending or revoking such license, which shall not be reinstated until a new bond or cash deposit has been filed."

The obvious purpose of this automatic suspension or cancellation provision of section 7071.11 is to ensure the protection of the public through maintenance of each contractor's bond in full force and effect, even where a contractor denies liability for a claim paid by a surety. When the statutory minimum for the bond is again met by the contractor, the automatic suspension or cancellation of the contractor's license is lifted under the terms of the statute.<sup>7</sup>

An entirely different procedure is set forth in section 7071.11 where the contractor admits the validity of the claim paid by the surety. Such an admission on the part of the contractor has the effect of a court judgment entered against the contractor by the person claiming under the bond. The consequences of the contractor's admission of liability are: (1) the admission constitutes "grounds for disciplinary action against such licensee," (2) "such license may not be reissued or reinstated while any surety remains unsatisfied for loss and expense sustained on any bond issued for such license," (3) the "license may not be reissued or reinstated while any . . . claim in excess of the amount of the bond . . . remains unsatisfied," and (4) the contractor must obtain a "bond in an amount as required pursuant to Section 7071.8."

The above analysis is predicated upon the determination that only the contractor may "admit" liability for a claim against the bond that would constitute grounds for disciplinary action against the contractor. The key language of section 7071.11 requiring interpretation is: "Any judgment or admitted claim against any bond . . . required by this article shall constitute grounds for disciplinary action against such licensee."

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<sup>6</sup> We are informed by the registrar that contractors' bonds are never filed in an amount in excess of the statutorily required minimum.

<sup>7</sup> Section 7071.11 does allow the registrar to continue the suspension or cancellation under certain specified circumstances even though the contractor may deny liability for the claim.

It may be argued that an "admitted claim against any bond" must refer to an admission of liability by the surety, while an "admitted claim in excess of the amount of the bond" in the next sentence of section 7071.11 must refer to an admission of liability by the contractor. Although a surety may make payment on a bond without authorization by the contractor and the surety has no control over the amount of a claim in excess of the bond amount, we nevertheless reject the argument.

First, no statutory or decisional law requires such an interpretation. "Admitted claim" does not have a settled and well recognized definition in this area of the law, and thus the term requires some construction.

Second, concluding that a surety's "admission" constitutes grounds for disciplinary action against the contractor would lead to absurd results. As previously indicated, only "good faith" surety payments reduce the penal sum of a contractor's bond under section 7071.11. Payments made in bad faith would not result in the automatic revocation or suspension of the contractor's license under the terms of the statute. Accordingly, such a surety's "admission" could not logically trigger and provisions (1) requiring a new bond under section 7071.8 and (2) prohibiting the license from being "reissued or reinstated" while the surety remains unreimbursed. A construction that renders statutory language useless or absurd is to be avoided. (*Fields v. Eu* (1976) 18 Cal.3d 322, 328; *Estate of McDill* (1975) 14 Cal.3d 831, 837.)

Third, such an argument would raise the constitutional issue of whether the contractor has been denied procedural due process. (See *Bell v. Burson* (1970) 402 U.S. 535, 539-542; *Skelly v. State Personnel Bd.* (1975) 15 Cal.3d 194, 207-214; *Berkeley v. Alameda County Board of Supervisors* (1974) 40 Cal.App.3d 961, 969.) This issue may be avoided by determining that the contractor must "admit" the validity of the claim in order for such "admitted claim" to constitute grounds for disciplinary action against the contractor.

The registrar may of course undertake an investigation and find grounds for disciplinary action even though the contractor denies the validity of the bond claim. After appropriate notice and hearing, disciplinary action may be imposed under section 7095.<sup>8</sup>

In answer to the question presented, we conclude that a surety's payment of a claim filed against a contractor's bond pursuant to the provisions of section 7071.11 does not in and of itself constitute grounds for disciplinary action against the contractor where the contractor denies liability for such claim. \*\*\*\*\*

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<sup>8</sup> Where the contractor admits liability, all that need be proved at the evidentiary hearing is the fact of the admission.