The California Licensed Contractor

May, 1941

Items Chargeable Under "Cost Plus" and "Time and Material" Contracts

By Allen Miller, Registrar of Contractors

Considerable misunderstanding has arisen among those in the construction business as to the proper interpretation to be placed upon the phrases "cost plus" and "time and material" commonly used in construction contracts.

This article is designed to assist contractors in understanding the generally accepted meaning and interpretation placed upon those phrases by the courts, and to point out the difficulties that confront contractors who can not or do not secure adequate written contracts. The article, however, should not be considered as a final authority on the matters discussed. It is suggested that the services of an attorney be secured in preparing either contract forms or individual contracts involving cost plus and time and material jobs.

The principal problem in this type of contract is to establish the difference between overhead costs and operating expenses, and the conditions under which charges for either or both can properly be made and collection legally enforced in contracts containing these phrases or their equivalent.

In the event a contractor proceeds under a written contract which definitely and specifically provides for inclusion of items which the courts have generally rejected as not items of cost under broad phrases, such as "cost plus 10%" and "time and material," the contractor has protected his right to include in his charges those specific items. What we are here concerned with is the attitude of the courts in construing agreements which are not specific as to what may or may not be made a legal charge against the owner.

It might be well to point out prior to the discussion of the cases dealing with this subject the general principle of contract law that in the construction of any contract the court attempts to interpret it in the light of the intent of the parties, and frequently identical phrases in written contracts receive different constructions because the parties had a different intent in the use of the phrase. Custom and usage prevailing in the locality in which the controversy arose play a large part in assisting the courts in arriving at their ultimate decision as to what was the intent of the parties. Any conclusions on general principles drawn from the cases discussed are made in light of the general and common construction of the terms treated herein which are placed upon them by the Construction Industry of California.

There have been only two cases decided by the appellate courts of this State that attempt to construe what is generally referred to as the "cost plus" or "time and material" contract. These cases are: *Advance Auto Body Works* vs. *Asbury Transportation Company, Inc.*, 10 CA 2d 619, 52 Pac. 2d 958, decided by the district court of appeal in 1935, and *Citizens State Bank of Long Beach* vs. *Gentry*, 20 CA 2d 415, 67 Pac. 2d 364, decided by the district court of appeal in 1936. The Supreme Court refused a hearing in both of these cases and they may be considered as the leading and controlling authorities in the State.

In the *Advance Auto* case a manufacturer of truck bodies sued to recover on a contract

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for the manufacture of a special truck body on a "time and material cost plus 10%" basis. The only issue in the case was the legality of a charge made by the manufacturer for general overhead expense which the defendant refused to pay as not being a proper charge under the contract. The items of overhead charged for included nonproductive labor (probably salaries of executives and clerks), shop supplies, heat, light, power, water, depreciation on machinery, insurance, rent, taxes (sales tax not included), towel supplies and depreciation of factory equipment. The trial court held these items properly chargeable under the contract and gave judgment for the plaintiff. The appellate court, the court of last resort, reversed the trial court and held that they were *not* properly chargeable. It reached this decision after analyzing the intent of the parties and concluded from all the evidence that the parties did not intend to have such items included as costs. The court called attention to the fact that as originally drafted the contract provided for "cost plus 10%," and before actual execution of the contract this phrase was crossed out and the phrase "on a time and material cost plus 10%" inserted in its place. In this regard the court said:

> "By this change in phraseology it is apparent that appellant attempted to more definitely restrict the charges for which it would be liable and to avoid liability for *any* overhead charges. * * * On a time and material basis plus 10%, overhead expenses were improperly included in computation of contract charge."

Because of the injection of the element of change of language in the contract, thus indicating a definite intent of the parties, the case is weakened considerably as an authority for the proposition that items of overhead are not properly chargeable under contracts "on a time and material cost plus 10%." The fact that the case involved the improvement of personal property does not make the rule less applicable to construction contracts for the improvement of real property.

The other California case on the subject, *Citizens State Bank of Long Beach* vs. *Gentry, supra,* involved a suit by a contractor to recover moneys on a contract for the reconstruction of a theatre "on the basis of labor and material plus 10% of cost." The contractor included among his costs an item for use of equipment and for premiums for compensation and liability insurance. The owner objected to their inclusion as not legally chargeable items under the contract. Both the trial and appellate court held that they were legally chargeble items for which recovery could be had, the appellate court saying:

> "However, in our opinion, in a cost plus contract operating expenses such as are occasioned by the use of equipment are included as a part of the cost of material."

The issue of the legality of the charge for insurance premiums was not directly passed upon since the court pointed out that the contractor had billed the owner weekly for these items and she had paid them without objection and so was estopped.

Neither of these cases attempted to distinguish between a "cost plus" and a "time and materials" contract, and the only definite helpful rule we can gather from either or both of them is that a valid and legitimate charge may be made for the use of equipment on a "time and material" or "cost plus" contract.

Cases from other States are decidedly more helpful in enunciating a definite rule of interpretation of this type of contract, and it is safe to assume the California courts would follow the lead of other States whose courts have explored this field on contractual interpretation.

The leading case on the subject is that of *Lytle, Campbell and Co.* vs. *Somers, Filler & Todd,* 276 Pa. 409, 120 Atl. 409, 27 A. L. R. 41, decided in January, 1923. In this case the plaintiff, a general contractor, was suing an owner to recover the balance due on a construction contract for the remodeling of store buildings "on a time and material basis with 10% profit as compensation to the contractor, the records of the cost to be kept at all times in such a manner as to be checked and audited by the owner."

In his weekly statements to the owner the contractor, after listing the labor and materials, included an item of 10% of this amount as "overhead." The owner made payments "on account" on these weekly statements. After completion of the project the contractor billed the owner for a 10% profit in addition to the 10% of the cost of labor and material as overhead and brought the suit to collect this item. The 10% charge for overhead was an arbitrary charge claimed to be due for the following items: use of general offices where accounts were kept (from which other jobs were also being conducted), clerks, bookkeepers, personal supervision of officers of the company, liability insurance, rent, heat, light, telephone, use of building equipment, and services of one of the officers in an architectural capacity.

The court held that the 10% overhead charge was improper under the wording of the contract and gave judgment for the defendant, and in doing so pointed out that to properly interpret the contract it was required to consider the intent of the parties and to view the charge for overhead in light of the custom and usage in the business.

The court stated:

> "The term 'overhead' including salaries of executives or administrative officials, interest charges for floating bonds, carrying charges, depreciation, taxes, and the general office expense as here claimed, can not be allowed as an operating charge in 'cost plus' contracts. * * *
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> "If the charge of overhead is not brought within the terms of the agreement it must fail; and to determine this we must ascertain the intention of the parties from the contract, as we are not aided by extraneous matters. In discussing the factors of costs and charges ordinarily included by the words 'time and material basis', 'for the work to be done', without any other indication to broaden the scope, it is necessary to consider the general division and proper classification of costs and charges incurred by a business concern such as plaintiff's, and to ascertain from such classification what charges are generally accepted in the business world as coming under that designation; and the distinction there made should be borne in mind in construing 'cost plus' contracts.
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> "Overhead, or general expenses, as applied to a business concern, producing a utility possessing the quality of value or wealth as generally understood, includes all administrative or executive costs incident to the management, supervision, or conduct of the capital outlay of its business. They are to be distinguished from operating charges, or those items inseparably connected with the productive end. The latter charges contain all elements of labor and materials, which directly produce a definite end, measured by cost of value. Overhead charges are generally of a nonproductive nature in that they do not of themselves directly create a definite utility, and, while they are essential to the life of a business concern, yet in determining the value and the selling price of the utility they must not be confused with those charges which actually produce a definite end, and upon which an organization depends for its continued existence. Moreover, they are charges usually for the greater part solely within the knowledge of the executive officials. As Ruskin says, in one of his essays on the laws of Political Economy: 'A gain is unjust in a most fatal way which depends on keeping the exchangers ignorant of the exchange value of the articles'. * * *
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> "To this there was to be added a profit of 10%. This latter item was intended to take care of that proportionate share of overhead charges included in the company's 'overhead', or general expense, discussed above, as this contract related to plaintiff's general contracts, and, unless expressly written into the contract by defining exactly the overhead intended to be covered, the words 'time and material', and like expressions, will not include overhead charges, but refer solely to the wages and salaries for the men engaged in the particular work contracted for and the actual cost of the materials furnished. The words will not be extended beyond their exact meaning, and indeed they should be given a restricted meaning. At least they should be considered in the sense in which they are popularly understood. One thus contracting engages to furnish and keep in condition the tools and necessary equipment to do the work."

The court then stated the general rule as follows:

> "On the other hand, operating charges are those which may be seen as the work progresses, and are the subject of knowledge from observation. *The really essential line of distinction, as we view it, is that the one is a producing cost, capable of being ascertained by those dealing with the company, and the other is a nonproductive, or indirect charge, difficult of ascertainment, and not ordinarily within the outsider's knowledge.*"

In the case of *Johnson* vs. *Kusminsky,* Pa. (1926) 135 Atl. 220, the contractor sued to foreclose a lien securing the balance claimed due on a contract to remodel an apartment building on the basis of cost plus 15%. The question before the court was the legality of charges for overhead expense. In upholding the claim of the contractor the court stated:

> "Plaintiffs were entitled to recover for materials, whatever made up its cost including cartage, storage, operating expense, etc. In other words, so they would lose nothing on the material and in addition recover a 15% profit on both labor and material. This is especially questionable as one plaintiff spent much time on the job, for which the defendant paid nothing. Under a cost plus contract operating expenses are properly included as part of the cost of material. (Here the Lytle case is cited as authority.) Where the nature of the cost is such that the exact expense of handling material can not be shown, it may be estimated. Plaintiffs do not appear to have made excessive charges."

In the case of *Shaw* vs. *G. P. Beaumont,* N. J. (1917) 102 Atl. 151, the court had before it the question of the legality of certain overhead charges under a contract whereby the contractor was "to receive for its entire compensation for its services * * * a sum equal to 10% of the entire cost of such building." In denying the contractor's claim the court stated:

> "An effort was made to collect salaries of the president, secretary, office boy, disbursements in connection with mortgage, loans, telephone calls, carfare, stationery, etc., where the agreement provided the contractor was 'to receive for its entire compensation for its services * * * a sum equal to 10% of the entire cost of such building'. The defendant can not charge the complainant with a proportion of the salaries that it pays its officers for supervising or superintending the building The defendant is the contracting party; it had a right to employ whoever it chose to superintendent the building on its part, the work of the laborers employed by it. So, with the other items enumerated above, such as telephone calls, not allowed by the master; they were office charges of the defendant corporation; they were not costs and expenses of the building. So, the tools (and necessary appliances for the work contracted to be done) were a part of the equipment of the contractor,—a contractor, when he agrees to build, must, in the absence of a contrary agreement, furnish all the tools and necessary appliances for the work contracted to be done."

In *Isaacs* vs. *Reeve,* N. J. (1899) 44 Atl. Page 1, the court in construing the meaning of a cost plus contract stated:

> "The contractor should not be allowed to charge a sum for the mere advisory attendance of one of the contractors who did not do any actual work, in addition to the 10%, as that was what the 10% was for."

Although the decisions in these various cases appear to be somewhat in conflict as to their final result, certain broad general rules for the interpretation of cost plus or time and material contracts can be gathered from them which should be helpful to those contractors interested in the problem, and which rules we will attempt to summarize.

1. Every so-called "cost plus" or "time and material" contract is to be interpreted in the light of the intent of the parties as to what items of cost are to be included. Dealings of the parties in the past, and acquiescence by the owner in questionable charges under the contract immediately involved may be resorted to in order to gather this intent.
2. Custom and usage in the locality where the controversy arose as to the charge of debatable items may be resorted to in order to ascertain the intent.
3. The courts do not distinguish between a cost plus a percentage of cost as a measure of profit type of contract and a contract for time and material plus a percentage of these as profit. In other words, there is no apparent distinction made between the phrases "time and material" and "cost plus". The courts look to the intent of the parties in contracts embodying either of these phrases.
4. In cost plus or time and material contracts in which the parties do not speci-

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A Horrible Example

A horrible example of what inexperience and carelessness can mean to a homeowner is clearly shown by the photographs illustrating this article.

The contractor agreed to construct a modern, substantial five-room house, using a good grade of workmanship. What he actually did is portrayed by the illustrations. But they do not show that the roof was partly shingled with number two shingles before the contractor found the specifications called for number one, at which time he changed and finished the job with number one shingles, but without removing the number two shingles.

Nor do the pictures show how the strong-back over one of the main rooms of the house was constructed. The strong-back was, of course, supported above the plates by blocks of the same width as the rafters. The strong-back itself was cut too short and failed to extend to a point over the plate of the wall. It stopped at a point approximately five-eighths of an inch from the inside surface plane of the plate. The block between the strong-back and the plate, in turn, only overlapped the plate five-eighths of an inch and the portion of the block resting underneath and supporting the strong-back was only three-eighths of an inch long. Simple addition shows the entire block was only one and two-eighths inches long.

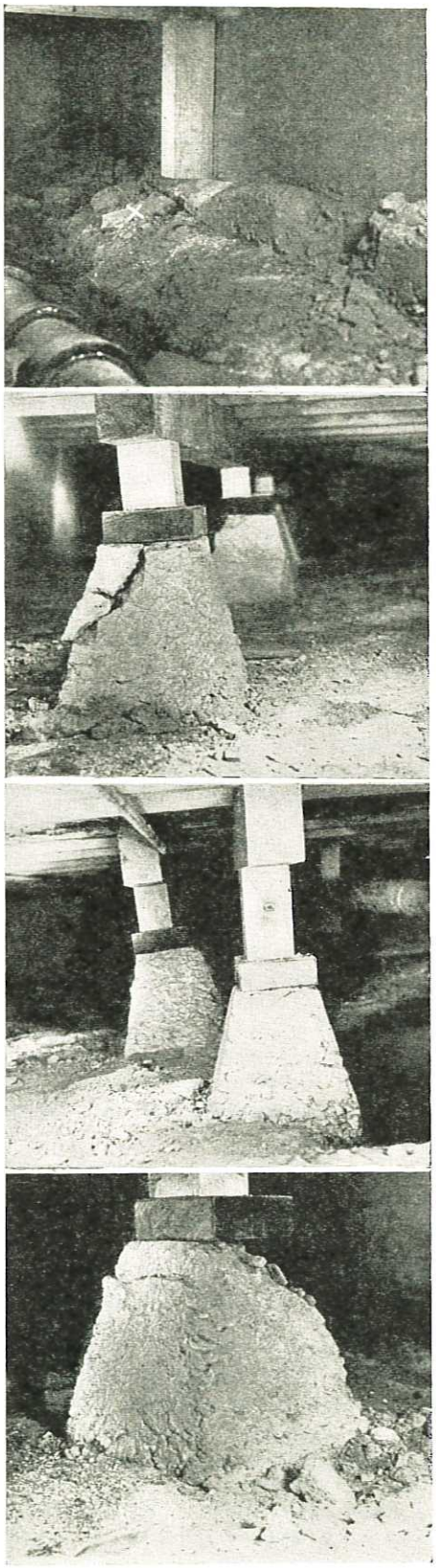
Nor do the pictures show that the garage floor and driveway were six inches lower than the grade shown upon the blue prints. The owner discovered that when the rains came.

Contractors inspecting the pictures will note that the photograph of the post supporting the end of a stringer shows a piece of broken cement which has been marked with an "X." The contractor contended the post had ample support when placed in position but that someone knocked off the piece of cement marked by the "X." On the basis of that statement, one wonders what he would call poor support. It is obvious to anyone that the post was inserted without any proper footing. The situation in this case is doubly bad because the stringer does not rest upon the top of the foundation walls and it is not recessed into the wall.

Another photograph shows not only the breakdown of concrete piers but that the piers were not placed in proper position and that the weight placed upon them was thrown off center. It is also equally plain that the assemblage of combined piers and posts are generally out of line one with the other and, therefore, some of them, at least must be considerably out of perpendicular.

The evidence which in this case resulted in revocation of the contractor's license also showed that no footings were placed under at least one-third of the piers (the inspector for the department checked one out of every three and found none) and yet the contract called for footings under all piers.

Cases of this kind forcibly show the need of prequalifying license applicants.



Examinations for General Building Contractors Show Startling Results

LICENSES ISSUED ONLY TO TWENTY PER CENT OF BUILDERS

Nine hundred ninety-one would-be contractors commenced preparation of application forms in the 90-day period, commencing December 1, 1940; 583 of them apparently decided that their qualifications were insufficient; 408 applied for the examination; only 201 passed.

The above figure refers to the general building contractors' examination, which is at present also serving as examination for speculative builders and general engineering contractors.

By far the bulk of applicants for this examination (about 80 per cent) however, have listed themselves as desirous of engaging in the general building construction, and the percentage of failures among the speculative class and engineering group are less than among the building contractors. Apparently the engineering applicant is better qualified; the better record among the speculative interests is probably due to the fact that a larger percentage of such applicants employ competent construction managers who have taken the examination for their principal.

Reduced to percentages, during the period when 991 signified a desire to secure licenses, 20 per cent were successful and secured licenses. The balance dropped by the wayside as follows: 21 per cent failed to pass the examination. The balance, or 59 per cent abandoned their intention after securing the application form and reading the information attached thereto, which outlines the requirements of applicants and the scope of the examination.

The examination consists of two parts. The first part, *and the one which has caused over half of the failures,* requires the applicant to estimate quantities of some of the more simple items used in the construction of a two-room dwelling. To the quantities must be applied given prices, and a total cost arrived at per unit. A liberal allowance is given for differences, both upward and down, to compensate for different figuring methods.

The second part is a set of 100 questions based upon the most commonly known and used provisions of the several State laws relating to construction; such as the necessity for compensation insurance covering employee; the elemental and more simple provisions of the Housing Act, which are matters of common knowledge to most construction men with reasonable experience; provisions of the labor laws relating to every-day relations with labor; the Contractor's Act itself, and a few questions on simple dimensions, and upon the recognized principles of contracting business as subscribed to by all ethical operators. Simple computations as necessarily used by all contractors are also touched upon. In addition, this portion of the examination includes the identification of the principal structural members of a typical two-story frame structure.

At the present time the percentage of application forms given out in relation to examinations taken is increasing. Some force is at work, which is more greatly discouraging applicants than was the case at the first of December. It is probably due to the spreading of information that the new examination actually constitutes a test of a man's practical ability. On the other hand, the percentage of those who actually take and pass the examination is increasing. The two trends are consistent. As the weaker would-be licensees realize that the examination may stop them from securing a license, they drop out, leaving only the stronger and better equipped men to take the test. Among those weaker ones are those who feel—possibly rightly—that the matters they would have to disclose in filing a completed application would act as a bar to securing a license.

The examinations being given specialty contractors during this same period have been the same as previously established, and as disclosed in the February 1940 issue of the California Licensed Contractor.

The next step in development of examination procedure will be the adoption of a separate examination for general engineering contractors, who at this time are being required to qualify under the building contractors' examination. This step will take place in the near future, and probably before actual distribution of this issue of the "Contractor." Until further notice, however, applicants for B-2 licenses (speculative building contractors) will be required to take the present examination now required for all building and general engineering contractors.

Every conceivable test of fairness has been given to the examination procedure.

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Why Licenses Are Suspended or Revoked

Editor's Note: This is the sixth of a series of fifteen articles to be run in a like number of issues of the California Licensed Contractor. Each will be preceded by a brief statement of all of the sections of the Business and Professions Code that constitute cause for action against a contractor's license. In each of the articles one of the sections will be featured by an explanation and by examples taken from our files.

The sections are Nos. 7106 to 7120 inclusive, and are grouped in Article 7 of Chapter 9 of Division III of the Business and Professions Code of California.

Power of suspension for violation of these sections is given the Registrar in Section 7090 of the same article, which states, "The registrar may upon his own motion and shall upon the verified complaint in writing of any person, investigate the actions of any contractor within the State and may temporarily suspend or permanently revoke any license if the holder, while a licensee or applicant hereunder, is guilty of or commits any one or more of the acts or omissions constituting causes for disciplinary action."

Consolidation

7106. The suspension or revocation of license as in this chapter provided may also be embraced in any action otherwise proper in any court involving the licensee's performance of his legal obligation as a contractor.

Abandonment

7107. Abandonment without legal excuse of any construction project or operation engaged in or undertaken by the licensee as a contractor constitutes a cause for disciplinary action.

Misuse of funds

7108. Diversion of funds or property received for prosecution or completion of a specific construction project or operation, or for a specified purpose in the prosecution or completion of any construction project or operation, and their application or use for any other construction project or operation, obligation or purpose constitutes a cause for disciplinary action.

Disregard of specifications

7109. Wilful departure from or disregard of, plans or specifications in any material respect, and prejudicial to another without consent of the owner or his duly authorized representative, and without the consent of the person entitled to have the particular construction project or operation completed in accordance with such plans and specifications constitutes a cause for disciplinary action.

Violation of laws

7110. Wilful or deliberate disregard and violation of the building laws of the State, or of any political subdivision thereof or of the safety laws or labor laws or compensation insurance laws of the State constitutes a cause for disciplinary action.

Preservation of records

7111. Failure to make and keep records showing all contracts, documents, records, receipts and disbursements by a licensee of all of his transactions as a contractor and open to inspection by the registrar for a period of not less than three years after completion of any construction project or operation to which the records refer constitutes a cause for disciplinary action.

Misrepresentation

7112. Misrepresentation of a material fact by an applicant in obtaining a license constitutes a cause for disciplinary action.

Violation of contracts

7113. Failure in a material respect on the part of a licensee to complete any construction project or operation for the price stated in the contract for such construction project or operation or in any modification of such contract constitutes a cause for disciplinary action.

Unlicensed persons

7114. Aiding or abetting an unlicensed person to evade the provisions of this chapter or knowingly combining or conspiring with an unlicensed person, or allowing one's license to be used by an unlicensed person, or acting as agent or partner or associate, or otherwise, of an unlicensed person with the intent to evade the provisions of this chapter constitutes a cause for disciplinary action.

Violation of this law

7115. Failure in any material respect to comply with the provisions of this chapter constitutes a cause for disciplinary action.

Fraud

7116. The doing of any wilful or fraudulent act by the licensee as a contractor in consequence of which another is substantially injured constitutes a cause for disciplinary action.

Personnel variance

7117. Acting in the capacity of a contractor under any license issued hereunder except: (a) in the name of the licensee as set forth upon the license, or (b) in accordance with the personnel of the licensee as set forth in the application for such license, or as later changed as provided in this chapter, constitutes a cause for disciplinary action.

Contracting with unlicensed contractor

7118. Knowingly entering into a contract with a contractor while such contractor is not licensed as provided in this chapter constitutes a cause for disciplinary action.

Lack of reasonable diligence

7119. Wilful failure or refusal without legal excuse on the part of a licensee as a contractor to prosecute a construction project or operation with reasonable diligence causing material injury to another constitutes a cause for disciplinary action.

Withholding money

7120. Wilful or deliberate failure by any licensee or agent or officer thereof, to pay any moneys, when due for any materials or services rendered in connection with his operations as a contractor, when he has the capacity to pay or when he has received sufficient funds therefor as payment for the particular construction work, project, or operation for which the services or materials were rendered or purchased constitutes a cause for disciplinary action, as does the false denial of any such amount due or the validity of the claim thereof with intent to secure for himself, his employer or other person, any discount upon such indebtedness or with intent to hinder, delay, or defraud the person to whom such indebtedness is due.

The subject matter of this article, which is the sixth in our series explaining in detail the causes for disciplinary action provided by the Business and Professions Code and applicable to the licensed contractor, states the conditions under which a license may be suspended or revoked for failure to comply with building, safety, labor or compensation insurance laws. The section reads as follows:

Preservation of records

7111. Failure to make and keep records showing all contracts, documents, records, receipts and disbursements by a licensee of all of his transactions as a contractor and open to inspection by the registrar for a period of not less than three years after completion of any construction project or operation to which the records refer constitutes a cause for disciplinary action.

ARTICLE A

Under Section 7111 it is obvious that a contractor must keep "records" of his separate jobs, and that he must keep them for not less than three years after the completion of that job, and that the records must be open to the Registrar for inspection.

A hasty reading of the section may lead to the conclusion that the law is not specific as to what records shall be kept or in what form they shall be kept. It is broadly stated by the section, however, that the contractor must "make and keep records showing all contracts, documents, records, receipts and disbursements by a licensee of all of his transactions as a contractor—". The double use of the word "all" in the section indicates that the law-makers meant not only receipts and disbursements upon each particular job, but also all receipts and disbursements and other matters in connection with the general conduct of his business. Thus it appears clear that each contractor must keep records of his payments for compensation insurance and like obligations. Records of disbursements for his office rental or the purchase of equipment and other such items would be clearly called for. In addition, all possible "job" records must be made and preserved.

Contractors have been confused, it appears, as to whether or not the records must be so kept that they show a separate picture of each individual transaction or contract or whether a general record of receipts and disbursements is sufficient without reference to particular jobs. In other words, whether or not, if the contractor is a general contractor, he must have a record showing his receipts upon each contract and his disbursements to each subcontractor, material man and laborer upon that particular job or whether he may keep a set of books which shows his account with all of the subcontractors, material men and laborers with whom he does business but without also showing the balances earned and paid upon any particular job. Putting it the other way, the contractor frequently asks whether or not he must keep "job records" or "open" (also known as "book" account) records.

A reasonable construction of the act based upon the fact that it states he must keep a record of "all of his transactions" indicates that the record must be sufficiently clear to portray in detail each of his transactions upon each job. It is obvious that the Legislature would have worded the section calling for a record of his general receipts and disbursements, rather than of "all" of his transactions if it was not the intent of the Legislature to secure a record of each transaction.

It must be conceded, of course, that where it is actually impossible to make a record, none need be kept. Few such instances occur, however, and when they do exist, it is usually because of a poor business setup, in which the contractor can not tell how much materials or labor he uses on a given job. A defense of this sort can be given but little consideration.

Furthermore, in construing the meaning of this section it is proper to consider what purpose would be served if a contractor were required to keep only broad records of his

receipts and disbursements, without keeping a record of the detail of each transaction. At the time Section 7111 was placed in the Business and Professions Code there had already existed for some time Section 7108 which prohibits diversion of funds. A contractor who diverted funds might prevent disclosure of that fact if he had no records. Certainly no one else could or would have such records. If he kept records, however, his own books could be relied upon to prove whether or not he had diverted funds. It, therefore, seems only reasonable that Section 7111 could be construed with the idea in mind that the Legislature enacted it in order to make it possible to punish the contractor who purposely failed or refused to keep records, when that failure might prevent punishment for another, diversion of funds and morally worse offenses.

In the early days of the Contractors' License Law, an Oakland gentleman was cited to appear at a hearing in San Francisco, at which time he was answering charges of diversion of funds. The hearing notice, as usual, called for production of his records. The case was rather important in that the losses upon the particular job were high in proportion to the amount involved in the contract. At the hearing the contractor was called to the stand by the complainant, under a section of the Code of Civil Procedure permitting procedure. The contractor was asked as to his books and records and stated that he did not have them, although admitting receipt of the notice to bring them. He admitted that he did keep books and records and employed a bookkeeper for that purpose, but frankly admitted he had purposely destroyed the books and records by throwing them into San Francisco Bay on his way to the hearing. There remained then no easy way of proving just what his disbursements upon the particular job had been without searching the records of every subcontractor, material man, laborer, and subcontractors' material men who had furnished any services or materials upon the job. No complete list of such contractors was available and the contractor's truthfulness and memory constituted the only means of commencing the investigation.

At that time this contractor could not be charged with failure to make and to produce records and a careful study of the act disclosed no method of punishment for his destruction of his records and it was shortly thereafter that Section 7111 was suggested to the Legislature and adopted by that body.

Frequently contractors who are cited to appear as defendants and to bring their records upon a job will show that they have made lump sum disbursements upon the particular job, such as so many dollars for plumbing, so many dollars for wiring, so many dollars for labor, so many dollars for compensation insurance. No itemization is given. The Registrar has held that such "records" are not actually a record. They can not be verified without further information, and are not acceptable.

If a record is to have any value whatsoever it must be sufficiently clear so that a party can investigate the truth of that record by scanning it and then investigating the statements it makes. Naturally, it can not be of any value if particulars are so lacking that an investigator can not even determine where he shall call to determine the correctness of an amount shown. The record is valueless; it is considered as no record. It should give the name of the party to whom moneys are paid, the amount of each particular payment, as well as the date of the payment, and should show upon which job the credit is claimed, if the debt is a job amount expense.

Likewise, the contractor's record of his labor upon a particular job, should show the names of the parties, the rate at which they are employed, the hours they work, the dates of payments to them, and the amount paid. While a contractor might have a record of all moneys paid to each of his laborers he would not have a record of all of his transactions if the record of a particular job failed to show how much he paid to each of his employees upon that particular job and thus his records would be inadequate.

It is admittedly impossible for a contractor to exactly charge the labor used upon every particular job and the Registrar's decisions in the past have taken that into account. The contractor who may be sending an employee around to clean up three or four jobs in a day's time can not exactly say how many hours he worked upon each particular job. It is, therefore, unreasonable to place upon him the burden of keeping an exact record of such details. On the other hand, if a man works for the entire day at one particular job certainly it is no burden for the contractor to show the fact.

While at first hand it would appear that Section 7111 was adopted by the Legislature in order to assist parties in tracing funds paid to a contractor it may be that the Legislature had in mind another, a secondary, but very beneficial purpose. Certainly a contractor who keeps no records of his transactions is in no position to tell whether or not he makes or loses money upon his jobs. If he can not tell this it is not very likely that he can successfully operate as a contractor. Knowledge

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Do You Know That—

By GLEN V. SLATER, Assistant Registrar

(In each edition of the "California Licensed Contractor" I will attempt to give in this column excerpts from the various laws that directly affect your contracting business. For this edition I have chosen sections from the Codes of the State, which sections are commonly termed "business law" and principally deal with contracts and with which you should be familiar for the successful conduct of your business.)

—A contract is an agreement to do or not to do a certain thing.

—It is essential to the existence of a contract that there should be: (1) Parties capable of contracting; (2) Their consent; (3) A lawful object; and (4) A sufficient cause or consideration.

—All persons are capable of contracting, except minors, persons of unsound mind, and persons deprived of civil rights.

—The consent of the parties to a contract must be: (1) Free; (2) Mutual; (3) Communicated by each to the other.

—A bid (offer) when accepted ripens into a contract.

—Actual fraud consists in any of the following acts, committed by a party to the contract, or with his connivance, with intent to deceive another party thereto, or to induce him to enter into the contract: (1) The suggestion, as a fact, of that which is not true, by one who does not believe it to be true; (2) The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true; (3) The suppression of that which is true, by one having knowledge or belief of the fact; (4) A promise made without any intention of performing it; or (5) Any other act fitted to deceive.

—A contract in writing may be altered by a contract in writing, or by an executed oral agreement, and not otherwise.

—Where a contract is partly written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and the particular contract in question, the written parts control the printed parts, and the parts which are purely original control those which are copied from a form. And if the two are absolutely repugnant, the latter must be so far disregarded.

—If no time is specified for the performance of an act required to be performed, a reasonable time is allowed. If the act is in its nature capable of being done instantly—as, for example, if it consists in the payment of money only—it must be performed immediately upon the thing to be done being exactly ascertained.

—The time of commencing action for recovery upon a contract in writing is four years, with a certain few exceptions.

—The time of commencing action for recovery upon a contract not founded upon an instrument of writing (verbal contract) is two years, with a certain few exceptions.

—The time of commencing action to recover is four years (1) upon a book account whether consisting of one or more entries; (2) upon an account stated; (3) a balance due upon a mutual, open and current account; provided, however, that where an account stated is based upon an account of one item, the time shall begin to run from the date of said item, and where an account stated is based upon an account of more than one item, the time shall begin to run from the date of the last item.

—The jurisdiction of the small claims court is confined to cases for the recovery of money only where the amount claimed does not exceed fifty (50) dollars.

—No attorney at law or other person than the plaintiff and defendant shall take any part in the filing or the prosecution or defense of such litigation in the small claims court.

(NOTE.—The foregoing is merely to acquaint you with certain sections of the law. Persons contemplating actions under these sections should be guided by the opinion of legal counsel.)

Term of S. G. Johnson as Board Member Expires

The construction industry, the Contractors' State License Board, the Registrar and his staff take this opportunity, through the columns of the California Licensed Contractor to express their thanks to S. G. "Gus" Johnson, whose term as a member of the board has expired, for his unselfish and untiring efforts in the administration of the License Law, and for bringing to the board his well recognized construction ethics.

Johnson sought passage of the legislation that placed the administration of the Contractors' License Bureau under a board and has served as a member from its inception to date.

Johnson came to the board with the express purpose of seeing a program of classification of contractors undertaken as well as the establishment of a prequalifying examination. After constantly being thwarted by legal interpretations of the law and also finding himself opposed by certain groups within the industry itself, he constantly persevered, and prior to his retirement from the board found his programs well on their way to accomplishment.

Construction circles and their associations where Johnson was well known because of his many appearances before them will well recall his oft spoken reference to the "master builder" as his idea of the truly vocational undertaking of one in the building business, as opposed to the unqualified person practicing his newly adopted livelihood upon the building public.

Avoid a 100% penalty by renewing your license before the June 30th deadline.

Informal Complaints Heavy in First Quarter

An important phase of the work of the board is the handling of "informal complaints." This work involves much of the time of the inspectors in the field and yet is not reflected in the periodic reports concerning the board's activities.

During the first quarter of this year this work has been unusually large as the following figures will indicate:

January 1, 1941, to April 1, 1941

Total complaints filed, 495; amount involved, $304,290.33.

Settlements secured, 324; amount involved, $185,453.13.

Settlements not effected, 171; amount involved, $118,837.20.

These complaints and disputes were between contractors, or owners and contractors, and were handled "informally" due to circumstances presented in each case, which did not warrant any disciplinary action being taken by the board against any of the license holders involved.

Experience has shown that but a small percentage of jobs go along without a dispute of some description arising, especially in residential construction. Many owners are unreasonable in their demands and many contractors very stubborn. A small matter becomes an aggravated one and the board's inspector is sought to adjudicate the matter.

A complete investigation of the disputed matter is made by him and he then arranges a meeting with all of the persons involved which usually results in a satisfactory settlement. Oftentimes the contractor himself makes the suggestion that the inspector be sought, knowing that a fair and equitable adjudication of the matter will be made.

Checking of Lien Recordings Undertaken

For the past three months the Board has undertaken a program which consists of a check of the liens filed in the most populous counties of the State.

A contact is made by an inspector of the Board with the person against whose property the lien has been placed. It is oftentimes found that the contractor is entirely justified in securing the nonpayment for his services by the filing of the lien, while it also is some-

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Examinations for General Building Contractors Show Startling Results

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Misleading questions have been avoided, and revisions have constantly taken place whenever a possibility of further clarification of a question has been brought to the attention of the Registrar.

As a further insurance against unfair or misleading questions, the Registrar is currently advised of the percentages of examinees who pass and fail each question and item in the examination. When it appears that a percentage failing on a certain point is excessive, a study of the particular item is made to determine whether or not the wording is absolutely clear or the diagram entirely conclusive. Where clarification has been possible, a change was made to accomplish this. No obscure questions are included. All questions are designed to be clear and understandable to anyone in the least informed upon the subject. Every available step has been taken to see that the examination properly tests an applicant as to his basic and necessary knowledge of the construction business and not as to other or extraneous matters.

Applicants for licenses who are not themselves qualified through construction experience or knowledge of the basic principles of our State construction laws, or both, are still permitted to employ a construction manager who may take the examination in place of his employer. Naturally the employer's license can only continue in force if he continues to employ the examinee who appeared for him. In the event of a separation, he may employ another party who is required to be qualified by an examination.

These figures are so very significant and have such a close relation to public losses in construction that we repeat them.

Application forms distributed to applicants indicating a desire to acquire a license_____991=100%

Applications abandoned (No examination sought) _____583= 59%

Examinations given:

Failed __207=21% of 991

Passed __201=20% of 991

408= 41%

All licensees must report to the Registrar all changes of personnel, name style or addresses within **thirty days** *after the changes are made.*

New York Studies California's License Law

Over a period of months, the New York Building Congress, Inc., has investigated the scope, success, and standing among contractors of the license laws of the various States of the Union, including that of California.

By questionnaires sent out to individuals and firms throughout the country, the Eastern association has attempted to get a fair picture in each State where there is a license law, from the standpoint of various component elements of the construction industry. The parties selected to be canvassed by the association were not chosen in a haphazard manner. Instead, considerable correspondence with a relatively large number of individuals in each State was resorted to before the actual mailing list was established and the questionnaires sent out. The New York group had no interest of a selfish nature, other than to determine what value, if any, there might be to them and to the public in emulating the actions of several States that have adopted regulatory legislation to correct abuses in construction work.

The Congress shows 19 California individuals and firms were chosen to give a representative vote. Questions of a general nature were directed to this entire group, and in addition they were supplied with some questions which could be answered only by parties within this group who were engaged in certain professions or crafts. For instance, there was a question in regard to the effect of the Contractor's Law upon unfair competition in the field of general contracting, which question was answered only by representative general contractors.

There was a similar question directed to subcontractors. So, also, there was at least one question designed to establish the attitude of labor towards the Contractor's Act, which question was of course answered only by the labor representative. Even the architectural profession was presented with a chance to express its particular viewpoint.

Hereafter we quote findings of the Congress's Committee on existing licensing laws, but only from that portion of the report which represents the complete returns from all of the representatives in California. In other words, we deal only with its questions and answers which required a vote of all the parties whose opinions were solicited.

By a vote of 16 to 3, California reported that the existing license law affords the owner better protection against dishonest or unqualified builders.

A 19 to 0 vote declared that the license law does not increase owners' costs unduly.

Better compliance with laws and codes is secured through the license law according to a vote of 17 to 2.

Sixteen of the California correspondents found that the existing license law has the effect of raising the status of the industry in the public mind through increased confidence, resulting from regulation of procedure and elimination of abuses. Two held a contrary opinion.

Items Chargeable Under "Cost Plus" and "Time and Material" Contracts

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fically provide as to what items are chargeable as part of the cost or as part of the time or materials, and where there is no indirect evidence to indicate what the intent was, the rule of construction that is generally followed is: *That actual producing costs which are capable of being ascertained by those dealing with the contractor are proper and chargeable, but those items which are nonproductive, indirect, different of ascertainment, and not ordinarily within the owner's knowledge are probably not legally chargeable.* "Overhead charges," as that term is generally understood, are usually of a nonproductive nature and hence, under the general rule of construction above recited, not chargeable.

5. Unless a contrary intent of the parties is demonstrated, it is probable that the following items of overhead are *not* properly chargeable items under the type of contract discussed:

   (a) Proportionate share of rent for the general offices where several jobs are conducted by the contractor in the office;

   (b) Proportionate share of salary of officers in advisory capacity, clerks, bookkeepers, messengers, stenographers, and other general office help maintained by the contractor for his convenience;

   (c) Proportionate share of general cost of heating, light, power, telephone, water, stationery and office supplies used by the contractor in the general course of his business;

   (d) Proportionate share of depreciation on equipment used in the busi-

ness of the contractor, or purchase cost of that equipment;

(e) Taxes (other than sales tax which can be charged direct to the job) and insurance paid by the contractor on his general business, equipment or property;

(f) Selling costs, interest on bonds, or carrying charges.

6. The following items, if they can definitely be shown to have been actually incorporated in the job, are properly chargeable:
   (a) Actual cost of labor and materials going into the construction;
   (b) Salary of superintendent while working on the specific job;
   (c) Compensation insurance premiums and payroll taxes if they can be segregated and shown to have been paid on labor actually performed on the job covered by the contract;
   (d) Cartage, storage, and actual cost incurred in obtaining, keeping and fabricating materials into the job;
   (e) Use of equipment if the actual and accurate proportion of use based upon reasonable rental value thereof can be demonstrated (the validity of this charge is open to more debate than any other item. Several of the courts in other States hold it not chargeable, but the California case of *Bank* vs. *Gentry,* heretofore cited, holds that it is chargeable, and this rule will probably be continued to be followed.)

In conclusion, it might be well to again point out for the benefit of contractors that this article treats only with those "cost plus" and "time and material" contracts in which the parties do not specifically provide in the contract, or by their actions or other indirect means, what items of cost they intend to be included or excluded, and in order to avoid any misunderstanding on the part of the contracting parties to this type of contract it would be not only wise but sound business practice to provide specifically in every such type of contract what cost items are to be chargeable.

Material and labor shortages brought about by the defense program place contractors in legal jeopardy. Bids should contain a time limit for acceptance and a clause, "subject to delays caused by shortage of materials or labor beyond control."

Why Licenses are Suspended or Revoked

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of certain job costs can only be accurately based upon previous personal experience. Lack of success on his part means disruption of his own competitive field as well as a threat of direct and indirect losses to others through business failure. Therefore, public interest can be properly considered as at stake, and the requirements of this section justified on that ground alone, if need be.

It is certainly felt by those who have studied the construction industry and its unfortunate financial record that a strict enforcement of this section is likely to reduce business failures and to improve competitive conditions. With that in mind the Registrar's policy is to strictly enforce this section even where there is no present or obvious loss being caused to anyone on the part of the contractor.

The number of cases which arise because of allegations of other sections of the act where the evidence later develops a failure on the part of the contractor to make and keep records is remarkable. In many of these instances, and probably in most of them, the contractor is not inherently crooked. His difficulties are technical in nature but they are, nevertheless, difficulties which have injured him as well as others. It is significant to note that there is a high percentage of contractors who are suspended who also have failed to keep records. The conclusion is that their difficulties have partially arisen from failure to exercise a businesslike control over their operations through keeping a record that will show their conditions from time to time and that will assist them in properly bidding for work.

Incidentally, when a contractor is charged under some other section of the law and at the hearing it is determined that he has not kept records, the Registrar will permit the complaint to be amended and if the complainant does not do so the Registrar will himself amend the complaint to also allege a violation of Section 7111.

An unfortunate contractor was recently charged with the violation of a State law. At the hearing it developed that the violation of the State law was not in itself a violation of the Contractors' Act and, therefore, a motion for the dismissal for lack of jurisdiction made. Before the case had developed to the point that the motion for dismissal was made, the complaining party had called the contractor to the stand and asked for certain of his rec-

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Criminal Prosecution and Personal Liability May Result From Negligence

According to the California Safety News, published by the Industrial Accident Commission, a contractor was recently prosecuted criminally for violation of two Electrical Safety Orders, was convicted upon one of them and fined $400 and an excess award over and above normal compensation was allowed, based upon serious and wilful conduct on the part of the employer.

The story is reported in the September, 1940, issue of the "News" under the title "Violation—Conviction" and a correction of the story appears in the December, 1940, issue.

Quoting from the publication of the Commission we find that: "The accident happened when the employer's crane operated so close to a Pacific Gas and Electric Company high tension wire carrying 11,000 volts that the hoisting cable came in contact with the wire. The employer was criminally prosecuted on the ground that he had violated two Electrical Safety Orders:

1. That he had operated closer than six feet from the high tension wire, and
2. That he failed to post a certain required notice on the cab of the crane.

The first count of the complaint was based in part upon certain evidence that an officer of the employer had, prior to the accident, ascertained from the power company the cost of having the line de-energized while the crane was near it, and the cost of having the wires raised while the work was going on, but neither method was followed.

"The judge * * * gave the superintendent a suspended sentence and fined the corporation $400. In addition to this, the claims of the injured men and of the dependents of the men who were killed, received normal compensation *plus additional compensation* based on claims of serious and wilful misconduct of the employer."

There is an important warning to contractors in this unfortunate incident.

First, hazards of employment to which employees are subjected should be checked and eliminated by employers in order to avoid violation of the Industrial Accident Commission Safety Orders or the provisions of laws of the State in regard to the safety of labor. Protection of this sort is a sufficient merit unto itself, if secured, and needs no compensation. Hazards exist which are frequently not recognized and almost every employer of men may expect that from time to time his workmen will be placed in proximity to high tension wires or to unsafe banks surrounding excavations or in some other commonly found hazardous place.

The second point to be made is that normal compensation insurance does not protect the holder of the policy from the extra compensation that may be awarded over and above normal compensation if the injury was connected with serious and wilful misconduct of the employer. "Serious and wilful" does not mean the employer probably took steps to create hazards and a contractor may successfully be charged who has merely failed to take steps to eliminate hazards that exist through no act or error of his own. In addition, violation of the Safety Orders of the Industrial Accident Commission constitute grounds for criminal acts and fines assessed against contractors found guilty are not assumed by the contractor's compensation insurance carrier.

Why Licenses are Suspended or Revoked

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ords to be disclosed and the contractor admitted that he had no records. The complaint was then amended to allege a violation of Section 7111. The complaint was dismissed as to the original charge but the contractor was found guilty of failure to make and keep records and his license was suspended.

Contractors have frequently applied to the office of the Registrar for a proper source of information in setting up or in keeping records. The Registrar's office, unfortunately, can not recommend any particular system, any particular books, any particular bookkeeper or auditor. There are, however, men in every community of the State who are skilled in bookkeeping and in setting up systems. In addition, there is a trade organization for almost every division of the construction industry in California. To members of these organizations there is usually a service offered which will assist them in establishing a bookkeeping system that will be adequate but not burdensome.

Slack business methods, as shown by no records, indicate an unsafe business man—unsafe as to his own future, as well as to others. This thought directs all decisions of the Registrar involving violation of Section 7111.