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“Even where an owner takes calculated advantage of the fact that the contractor is unlicensed at the time the work is performed ... the contractor still may not maintain any action to recover for the work performed.”

Unlicensed Contractors Work for Free**THIS ISSUE**

The California Supreme Court decided a case with far-reaching implications in the construction industry, holding that a contractor unlicensed for even a small portion of a large job cannot get paid for any part of that job. The decision may have national impact.

BACKGROUND

A second-tier subcontractor on a large hotel construction job, MW Erectors, Inc., began work under a structural steel contract 18 days prior to receiving its C-51 structural steel contractor’s license. On the 19th day, however, its license was activated, and MW was properly licensed for the remainder of the year-long project. Nevertheless, the first-tier subcontractor, Niederhauser Ornamental and Metal Works Co., Inc., did not pay MW for approximately \$1 million in structural steel work, claiming MW was not licensed for the duration of the project, and therefore not entitled to payment.

MW sued Niederhauser, asserting that it had substantially complied with the licensing requirements, and that an 18-day lapse was simply inconsequential in a year-long project. Niederhauser cross-complained against the general contractor, Turner Construction, and the project owner, Disney Corporation, arguing that it was entitled to be paid for MW’s work. Niederhauser settled its claims against Disney and Turner for a substantial sum.

Despite being paid by Turner for MW’s work, however, Niederhauser continued to assert that MW’s 18-day lapse of license violated the Contractors State License Law (CSLL) and precluded MW from bringing an action to collect money owed for any portion of the contract. The trial court agreed with Niederhauser and dismissed MW’s case.

MW appealed the decision, and the court of appeal reversed the trial court’s ruling holding that MW was not entitled to

recover for the work performed during the 18 days it was unlicensed, but could recover for the remainder of the work on the theory that each day was a separate “act” under the code.

The Supreme Court, however, reversed the court of appeals. In dismissing MW’s case, the Supreme Court found that the CSLL was enacted to protect the public against unscrupulous contractors, and must be strictly enforced. In its opening statement, the Court stated:

[The CSLL] imposes strict and harsh penalties for a contractor’s failure to maintain proper licensure. Among other things, the CSLL states a general rule that, regardless of the merits of the claim, a contractor may not maintain any action, legal or equitable, to recover compensation for “the performance of any act or contract” unless he or she was duly licensed “at all times during the performance of that act or contract.”

IN BRIEF

The Court observed that the appellate courts have recently softened the impact of the CSLL, allowing contractors the opportunity to prove that they “mostly” complied with the law, or that it would be unfair or inequitable not to allow a contractor to recover for good work actually performed. Despite this trend, the Supreme Court reaffirmed a strict interpretation of the law and its penalties for a failure to maintain a license “at all times” during a project. The Court held that dividing out each day as a different part of a construction contract could not be what the Legislature had in mind. Thus, MW was not entitled to recover approximately \$1,000,000 from Niederhauser, even though Niederhauser was paid for MW’s work.

Obviously, this is a very harsh ruling for MW. But it gets even worse for contractors. The Court held that even where an owner takes calculated advantage of the fact that the contractor is

unlicensed at the time the work is performed, and even if the owner fraudulently promises to pay for the work knowing the contractor is unlicensed, the contractor still may not maintain any action to recover for the work performed. As the Court ruled:

An offer, or acceptance of a solicitation, to perform unlicensed contract work is illegal. If the work offered or solicited is performed without a license, the contractor must rely solely on the other party's good faith for payment, and a claim for compensation will be disallowed under section 7031, regardless of the balance of equities or the manner in which the claim is framed. Proper application of section 7031, and of the other sanctions provided by the CSLL, thus rightly discourages contractors from entering arrangements for unlicensed work.

The burden of this ruling on the unlicensed contractor may be even greater: No mention was made in this decision of whether MW would also have to pay the attorneys’ fees and costs of Niederhauser. But if the contract between those two entities contained an attorneys’ fees provision, then it is likely Niederhauser, as the prevailing party, will be entitled to recover all fees and costs of litigation as well as retain the money it obtained in settlement from Disney and Turner Construction for the work performed by MW.

The lesson for California contractors is simple: they must ensure that their licenses are in place, up to date, and relevant to the work performed (in this case, for example, the C-51 structural steel specialty license) before they begin any work on a project. Even a minor lapse may result in substantial loss to the contractor.

There are many ways by which a contractor may become unlicensed, either knowingly or, in some cases, unknowingly. Some examples:

Reporting Judgment Against Contractor:

- A contractor who has a construction-related judgment against him must report the judgment to the CSLB after entry of the judgment. The failure to do so results in the automatic suspension of the contractor's license. While a contractor in this circumstance might attempt to show substantial compliance with the law, (and thus entitlement to be paid) it is unlikely he will succeed if he knew of the judgment and failed to report it.

Resolving Judgment Against Contractor:

- Likewise, a contractor who reports a construction-related judgment to the CSLB will receive a notice from the CSLB that he must resolve the judgment within 90 days or his license will be suspended. The failure to resolve the judgment within 90 days of the date of the notice results in the automatic suspension of the contractor's license. Again, it is unlikely the contractor can show substantial compliance with the CSLB under this scenario.

Worker's Compensation Failure:

- Where a contractor is required to purchase workers' compensation insurance to cover his employees, and fails to do so, his license is suspended automatically by operation of law as of the date he was first obligated to purchase workers' compensation insurance. If his license is thus suspended, he must apply to the CSLB Registrar for reinstatement of the license after proving compliance with the law. Until he does so (even if he later purchases the required workers' compensation insurance, or no longer hires employees) he remains an unlicensed contractor.

A contractor must purchase workers' compensation insurance to cover any employee working for him, even temporary workers hired to clean the construction site or haul away the refuse. This is a trap for many "solo owner" contractors who feel that by doing the "construction work" themselves,

they may hire day laborers to perform the menial tasks associated with the construction project.

Corporation Not Licensed:

- A contracting entity may have no license where, for example, an individual fails to change his license status from "sole owner" to his new corporation, LLC, LLP, partnership or joint venture.

Out-Of-State Contractors:

- And, of course, where an out of state contractor fails to obtain his California contractor's license before commencing work, he would be unlicensed for all of the work.

Importantly, California amended the CSLB in 2002, making an already draconian law even more formidable for unlicensed contractors. The amended statute allows "a person who utilizes the services of an unlicensed contractor [to] bring an action . . . to recover all compensation paid to the unlicensed contractor for performance of any act or contract." Thus, an unlicensed contractor must also disgorge to the owner all monies received for the work performed – even if that money was spent on materials incorporated into the work of improvement, labor on the jobsite, or subcontractors who were themselves licensed to do the work of the subcontract.

CONCLUSION

This very harsh ruling is intended to ensure that there are no loopholes for unlicensed contractors to skirt the license requirements. It may well have implications in other states, as there are many states with laws substantially similar to California's. Meanwhile, expect that there will be substantial fallout from this decision in California construction cases. Attorneys who practice in this area must be intimately familiar with this decision and the recent amendments to the Contractors State License Laws.

NEXT ISSUE

Entity choices for contractors.

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