

The Year 2010 In Review: Contractor Licensing

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1. *Loranger v. Jones*, 184 Cal. App. 4th 847 (3d Dist. May 2010)

Jones, a licensed contractor, had a workers' compensation policy covering his employees. Jones unknowingly used an unlicensed subcontractor and knowingly permitted two minors without work permits, and another person without a contractor's license, to help perform work for Loranger. Loranger refused to pay the final invoice and Jones filed suit for breach of contract. Loranger cross-complained alleging defects and sought disgorgement of monies paid.

However, the Court of Appeal, affirming the trial court, held that Jones' license had not been automatically suspended under Business and Professions Code Section 7125.2 and accordingly, Jones was not subject to the sanctions of Section 7031 subdivisions (a) and (b). Loranger largely relied upon *Wright v. Issak*, 149 Cal. App. 4th 1116 (6th Dist. 2007) in arguing that Jones could not bring suit and was subject to disgorgement. However, the Court found *Wright* distinguishable because in that case the contractor intentionally reported zero payroll to avoid obtaining workers' compensation insurance. In the instant case, however, Jones had workers' compensation coverage when he began the project. At worst there may have been a lapse of coverage; however, without notice of a lapse of coverage from the registrar, there was no effective suspension of the contractor's license. The Court also expressly rejected a reading of *Wright* to find "any" underreporting of payroll tantamount to a failure to obtain workers' compensation coverage and thus an automatic suspension of a contractor's license.

2. *In re Yehuda Sabban*, 600 F.3d 1219 (9th Cir. BAP, April 2010)

A homeowner won a judgment against an unlicensed contractor under Business and Professions Code Sections 7031(b) (disgorgement for non-licensure) and 7160 (contract induced by falsity or fraud) in state court. After the trial, the contractor filed for bankruptcy under Chapter 7 of the Bankruptcy Code (liquidation of all non-exempt personal property to pay off creditors). The individual filed an adversary action to determine the dischargeability of the debt. He argued that both awards imposed a remedy for violations of statutes punishing the contractor for debts obtained by fraud and

therefore, pursuant to 11 U.S.C. § 523(a)(2)(A), those debts were not dischargeable. The bankruptcy court partially rejected that argument, holding that the 7031(b) award was dischargeable and finding the smaller award under 7160 was non-dischargeable. The Ninth Circuit, in affirming the bankruptcy court ruling, held that the 7031(b) award was not traceable to fraud, and was not premised on fraud, and so it was dischargeable. Thus, an award against an unlicensed contractor under Business and Professions Code Section 7031(b) is dischargeable in bankruptcy.

3. *Alatraste v. Cesar's Exterior Designs, Inc.*, 183 Cal. App. 4th 656 (4th Dist. April 2010)

A homeowner employed a landscaping contractor which it knew did not have a contractor's license at commencement of work. The contractor stopped work when the homeowner refused to make payments. The homeowner brought suit to recover the money he had already paid to the contractor. The contractor contended that the homeowner's claim was barred because he knew about the contractor's unlicensed status.

The Court of Appeal rejected the contractor's argument, stating that Business and Professions Code Section 7031(a) provides a complete defense to a claim for payment from an unlicensed contractor, even when the customer knew the contractor was unlicensed. The Court applied that rationale to the "sword provision" of 7031(b), holding that knowledge of unlicensed status does not provide a defense to a claim for disgorgement of payments made for unlicensed work. Furthermore, the Court rejected the contractor's argument that it was entitled to retain payment for work performed after it obtained a license, noting that 7031(b) provides for disgorgement if a contractor was unlicensed at *any time* during the performance of work. The homeowner was entitled to recover the total amount paid, including payment for materials.

4. *UDC-Universal Development, L.P. v. CH2M Hill*, 181 Cal. App. 4th 10 (6th Dist. Jan. 2010), *rev. denied*, 2010 Cal. LEXIS 4141

UDC-Universal Development, L.P. entered into two contracts with CH2M Hill, pursuant to which CH2M agreed to provide engineering and environmental planning services for UDC's condominium development. The contracts included an indemnity provision that covered all of UDC's losses to the extent that they arose from, or were connected to, any negligence or omission by CH2M. A duty to defend clause obligated CH2M to defend any suit, action or demand brought against UDC on any claim "covered herein" upon written request from UDC. After completion of the development, the homeowners association brought suit against UDC for "defective conditions" due in part to negligence attributable to CH2M. CH2M rejected UDC's tender of defense, and UDC cross-complained against CH2M for indemnity.

CH2M argued that UDC's indemnity claim was barred because UDC lacked a contractor's license when it entered into the contracts. However, the Court of Appeal held that the term "compensation" as used within Business and Professions Code Section 7031(a) means sums claimed as an agreed price or fee earned by performance, and not indemnification for claims related to a subcontractor's work. Accordingly, the Section 7031(a) bar on actions to recover compensation for work performed by an unlicensed contractor does not apply where the contractor is seeking indemnity for damages paid as a result of a subcontractor's defective work. Regardless of whether a developer is properly licensed, where a contract imposes on a subcontractor a duty to defend against any claim implicating the subcontractor's work, the duty arises as soon as a defense is tendered.

5. Licensing Now Available to LLCs (SB 392)

Effective January 1, 2011, section 7025 of the Business & Professions Code is amended to allow limited liability companies to obtain contractor licenses in California. The License Board is required to begin processing applications therefor not later than January 1, 2012. In order for an LLC to hold a license, it must file and maintain a surety bond in the amount of \$100,000 for the benefit of employees to ensure payment of wages and fringe benefits (in addition to the contractor's license bond required of all licensees.) Further, if the LLC is a signatory to a collective bargaining agreement, the new bond must cover fringe benefit trust fund contributions. Finally, a licensed LLC must maintain and furnish proof of specified insurance coverage in an amount between \$1-5M, depending on the number of personnel of record.

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