California Court Upholds Strict Contractor Licensing Rule

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Two recent Court of Appeal opinions remind general contractors in California of the critical importance of being properly licensed during all phases of a construction project. I have previously written on the seminal California Supreme Court decision, Hydrotech Systems, Ltd. v. Oasis Water Park (1991), which held that the California statute prohibiting an unlicensed contractor from recovering money damages under a contract for which a contractor's license is required did not contain any implied exception for foreign licensed contractors or other "exceptional" circumstances. Hydrotech also set forth that a contractor without a California license could not even recover its contract damages based on the alleged fraud of the project owner consisting of the fact that it was aware that the contractor was not licensed in this state.

Thereafter, the Supreme Court again addressed the issue of proper licensing in the case of MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works Co., Inc. (2005). Even though the subcontractor, MW Erectors, had obtained the proper specialty license a mere eighteen days after commencing work on the project, the Court held that it could not recover any compensation whatsoever because it did not strictly comply with the statute. MW had not been properly licensed "at all times during the performance of that act or contract." (Business and Professions Code §7031 (a).) The court did, however, reject the argument of general contractor Niederhauser, which had hired MW, that the subcontractor should also be denied recovery because it was not properly licensed when the contract was entered into. The Court said no, proper licensing need not be in effect at the time the contract was executed, so long as proper licensing is in place during the entire time when the actual work was performed.

Recently, two cases touched upon aspects of the contractor licensing scheme in California, but neither decision shows any indication of softening the effect of the consumer-protection based licensing laws.

In the case of White v. Cridlebaugh (2009), Cridlebaugh contracted with White to construct a retirement home. White, as property owner, was the nominal general contractor but believed that Cridlebaugh would follow existing written plans and specifications to construct the facility. White had disputes with Cridlebaugh, ultimately terminating him from the project without making full payment. Cridlebaugh's company then recorded a mechanic's lien against the property.

Evidence at the lien foreclosure trial showed that Cridlebaugh's company held both Class A and B contractor's licenses. However, the licenses were both held in the name of one Robert Diani as RMO (Responsible Managing Officer) and RME (Responsible Managing Employee). Unfortunately for Cridlebaugh, however, Diani had left the country on a church mission two years before the White job began and Diani had no knowledge of the White contract or project. The court noted that under §7068.2 of the Business and Professions Code, if an RMO or RME disassociates from the licensed company, then the company has 90 days to replace the qualifying licensee. If the qualifying individual is not replaced within 90 days, the entity's contractor's license is automatically suspended. Not only did Cridlebaugh not succeed on appeal, but the Court imposed disgorgement penalty provisions of §7031 (b) to require Cridlebaugh to pay back the $84,621.45 it had received from White, plus interest and court costs. The Court reasoned that the unqualified terms of the statute made it clear that it applied, regardless of the prejudice imposed.

More recently still, in the case of Alatriste v. Cesar's Exterior Designs, Inc. (April 6, 2010), the Court of Appeal held in favor of the plaintiff, homeowner Alatriste. Alatriste had contracted with Cesar's to perform landscaping work. Cesar's was unlicensed at the time it began work on the Alatriste home, a fact which

Cesar's maintained Alatriste was well aware of. Following a dispute, Cesar's quit the job after five months. Alatriste, the owner, then sued Cesar's under various fraud theories, including a claim under Business & Professions Code §7031 (b) to recover all monies paid to Cesar's.

Alatriste sought recovery for the total amount paid to the contractor, because Cesar's was unlicensed at the time it performed the work. Cesar's argued that under §7031 (b), Alatriste should be barred from obtaining reimbursement for all monies paid because he had prior knowledge that Cesar's was an unlicensed contractor.

Citing Hydrotech Systems, Ltd., the Court held that §7031 (a)'s "shield" provision provides a complete defense to a claim for payment by an unlicensed contractor, and it applies equally to the "sword" provision of §7031 (b). Therefore, Alatriste's knowledge that Cesar's was unlicensed did not bar his claim for reimbursement of payments made for the unlicensed work. The appeals court affirmed the judgment that Alatriste's prior knowledge of Cesar's unlicensed status did not bar his §7031 (b) claim.

Second, the appeals court rejected Cesar's claim that Alatriste should not be reimbursed for work or materials paid for by Alatriste during.the time that Cesar's was properly licensed during performance of the work. Cesar's had obtained a proper license two months prior to the termination of its work. The Court reasoned that even though §7031 (b) does not mirror the exact language of §7031 (a) in that it does not indicate the contractor must be licensed during the performance "at all times" in order for the contractee to have a complete defense to any offsets to recovery, the legislature's intent was to provide for such. §7031 (b) broadly reads that "a person who utilizes the services of an unlicensed contractor may bring an action...to recover all compensation paid to the unlicensed contractor for performance of any act or contract." This does not mean that the right to reimbursement could be offset by work the contractor performed with a valid license or, the appeals court reasoned, the legislature would have clearly said so. The Court affirmed the judgment that Alatriste was entitled to recover payments for materials and labor because Cesar's was not licensed during the entire performance of the contract.

Conclusions and Recommendations

These two cases illustrate that efforts are being made by contractors to either enforce payment or avoid disgorgement, even when they are not in strict compliance with the contractor licensing laws. Despite the harsh and seemingly inequitable results, the courts have remained consistent in their interpretation of the statute and the Supreme Court's rulings in this area. Efforts by contractors to argue they should be paid for parts of projects during which they had obtained a license have been rebuffed. Similarly, attempts to avoid disgorgement and reimbursement have failed as well, even when the theory of offset, rather than direct recovery, has been put forth.

For contractors and specialty contractors, always ensure that you have proper licensing in place at all times, at the very least during the entirety of the performance of the work. For owners and general contractors who utilize subcontractors, always check the entire license history of a claimant to see if there has been a fatal lapse in licensing or an improper license for the specialty work performed.