
Understanding California's Contractors' License Laws

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Who is a contractor? Who is exempt? When must the license be in effect? What are the penalties for lapse? What is the Disgorgement Remedy?

Introduction

Everyone knows a contractor must be licensed. Putting aside having no license, substantial criminal and civil penalties may be imposed for even a technical lapse or suspension in the validity of a license during construction. The remedial purpose of the law is designed to protect the public regardless of the equities involved.

Therefore, the question of who is a “contractor” for purposes of the licensing law becomes complex when considering modern building relationships and different legal entities. In addition, the question of who qualifies for the “owner-builder” exception requires careful examination.

The lack of, or lapse in, a valid license may require return of all compensation paid to the contractor. Indeed, there are many technical rules for which a violation may result in license suspension. Moreover, the lack of a valid license at any time during performance of work may form a complete defense to any type of legal action seeking to recover compensation for the work. The rule applies even where the owner knows beforehand that the contractor was unlicensed.¹

This article explains California’s contractor licensing laws.² It begins with a discussion of policy, who must be licensed, and who is exempt. It ends with a discussion of the penalties imposed as a result of lapse or lack of a valid license during construction.

Why is a license required?

“The purpose of the licensing law is to protect the public from incompetence and dishonesty in those who provide building and construction services.”³ “The licensing requirements provide minimal assurance that all persons offering such services in California have the requisite skill and character, understand applicable local laws and codes, and know the rudiments of administering a contracting business.”⁴

Because of the strength of this public policy, the law applies regardless of injustice to the unlicensed contractor.⁵ The statutes represent “a legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness between the parties.”⁶ As a result of the all or nothing philosophy, even a small lapse in licensure during construction may prevent recovery of all compensation due the contractor, not just a portion of it.⁷

Who must be licensed?

A contractor is synonymous with a builder. The term is broadly defined to include any person who undertakes to, or does himself or herself, or by or through others, construct, alter, repair, improve, or demolish any building, road, or other improvement.⁸ All contractors must be licensed.⁹

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In *Vallejo Development v. Beck Development*, a master developer sold residential tracts to merchant builders under purchase agreements that required the master developer to construct infrastructure.¹⁰ The court held the master developer acted in the capacity of a contractor with respect to completing the improvements. The fact that the master developer retained a licensed general contractor to construct the infrastructure was irrelevant.¹¹

In *Fifth Day, LLC v. James P. Bolotin*, a construction manager performing services under a development management agreement was held not to be a contractor.¹² In that case, the owner separately retained a general contractor to perform construction. After carefully reviewing the obligations of the development management agreement, the court held the construction manager had not undertaken any construction activities.¹³

A subcontractor is a contractor for purposes of the licensing law.¹⁴ Importantly, the contractor must have the proper license classification to perform the particular trade or work.¹⁵ An unlicensed engineer that provides design services to improve a building is a contractor.¹⁶ By contrast, a mere material supplier is not a contractor for purpose of the license law.¹⁷ And, a surety is not required to have a license in circumstances where it hires a licensed contractor.¹⁸

In *Hydrotech Systems, Ltd. v. Oasis Waterpark*, a foreign company that manufactured and assisted in installing pool wave equipment was held to be a contractor, despite the fact that the owner had retained a separate general contractor to perform the work. The court found that the equipment manufacturer was a subcontractor engaged in construction activities.¹⁹

Finally, there are myriad legal entities which may or may not be able to hold a valid license, i.e., corporate, partnership, joint venture, limited liability company, etc. Careful attention must be given to ensure that the contractor entity is properly licensed to avoid illegality.²⁰

What is the owner-builder exception?

The law contains a significant exception to the licensing requirements for owners-builders.²¹ An owner-builder is exempt if he or she builds or improves a structure on his or her property provided that none of the improvements are intended for sale and the owner personally performs the work or the work is performed by his or her employees.²² Proof of sale or offering for sale within one year creates a rebuttable presumption that the structure was undertaken for sale.²³ The presumption is conclusive where five or more structures are sold or offered for sale in one year.²⁴

Alternatively, an owner-builder who directly contracts with licensees who are duly licensed to contract for the work of the respective trades involved, and, for projects involving single-family residential structures, no more than four are intended for sale in a calendar year.²⁵ The latter provision does not apply if the owner contracts with a general contractor.²⁶

In the case of homeowners improving their principal residence, there is an exemption for improvements to the residence or appurtenance provided the work is performed prior to sale, the homeowner resides in the residence 12 months prior to completion of the work, and the homeowner has not availed himself or herself to the exemption on more than two structures during any three-year period.²⁷

In *Ranchwood v. Jim Beat*, developers of residential tracts, who were not licensed general contractors, subcontracted construction of numerous homes to various trades.²⁸ Subsequently, homeowners sued for construction defects and developers cross-complained against subcontractors based on contract and

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indemnity theories. Subcontractors filed motions for summary judgment against developers, arguing that developers were not licensed contractors. In response, developers argued they were exempt owner-builders. The court was not persuaded that developers qualified as owner-builders by performing their own work or hiring licensed subcontractors. Citing a 1989 amendment, the court found the developers were not owner-builders exempted by the statute.²⁹

Whether the exception applies to commercial owner-builders is less clear because the statute has been amended several times. In an opinion by then Attorney General Stanley Mosk, the 1961 version of the statute was found not to apply to hotels and commercial tenants, but did exempt commercial buildings constructed for occupancy by the owner.³⁰ In reaching this conclusion, Attorney General Mosk reasoned that "[t]he apparent purpose of the exemption provided by section 7044 was to strike a balance between the need for governmental regulation and freedom to deal with one's own property without unwarranted governmental interference. Under such circumstances, it is reasonable to assume that the Legislature sought to deny application of the exemption to owners constructing large motels, apartments, hotels and like buildings, while at the same time preserving the exemption to owners constructing buildings containing not more than three dwelling units, one of which would be resided in by such owner."³¹

When must a contractor be licensed?

A contractor must be licensed at the time the construction contract is entered into.³² Failure to hold a license at the time the contract is entered into subjects the unlicensed contractor to various penalties and may make the contract voidable.³³ However, and as discussed below, the contractor must be licensed at all times during the performance of the work in order to recover compensation for the work.³⁴ The judicial doctrine of substantial compliance is not a defense for failure to hold a valid license.³⁵ Instead, the statute creates a very limited exception in circumstances where the contractor was licensed before performance, acted reasonably and in good faith to maintain the license, did not know the license was no longer in effect, and acted promptly to reinstate once it learned that the license was invalid.³⁶

What are the penalties for an unlicensed contractor?

There are criminal penalties imposed against contractors who are unlicensed. Performing construction without a license constitutes a misdemeanor, with penalties increasing for repeat offenders.³⁷

On the civil side, there are significant sword and shield penalties imposed on an unlicensed contractor. The shield-aspect of the law prevents a contractor from recovering compensation for any work performed if the contractor is unlicensed at any time during the performance of the work.³⁸ Case law interprets "compensation" broadly to include not only damages based on breach of contract, but any theory of affirmative recovery, including quantum meruit,³⁹ foreclosure of mechanic's lien,⁴⁰ and even fraud.⁴¹ However, an unlicensed contractor may seek to offset amounts otherwise due.⁴²

The defense has been applied not only to disputes between owner and contractor, but all tiers in the construction process, including disputes between general contractors, subcontractors, and sub-subcontractors.⁴³ Thus, a general contractor may recover on a mechanic's lien against an owner, but only after deduction of amounts due an unlicensed subcontractor.⁴⁴ However, the shield will not prevent indemnity obligations owed to an unlicensed contractor.⁴⁵

In order to seek redress in court, the law requires the contractor to allege a valid license to recover compensation.⁴⁶ Once the issue is raised, the burden is on the contractor to prove valid licensure.⁴⁷ An unlicensed contractor cannot avoid the law by pursuing arbitration.⁴⁸

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The sword-aspect of the law allows a person who used an unlicensed contractor to recover all compensation paid to the contractor.⁴⁹ Courts broadly interpret the disgorgement remedy to encompass situations where a licensed contractor had its license technically suspended while the work was in progress.

For example, in *Wright v. Issak*, a contractor who had not paid its workers compensation insurance sued a homeowner for unpaid work. Relying on a statute that automatically suspended the contractor's license for failing to obtain required insurance, the court held that the contractor could not recover any amounts from the owner, and the owner could recover all amounts paid to the contractor.⁵⁰

In *Oceguera v. Cohen* and *White v. Cridlebaugh*, homeowners successfully recovered compensation paid to contractors who had not complied with technical requirements for their responsible managing officer or employee. The courts found the technical violations resulted in the contractors being unlicensed during the performance of the work.⁵¹ In addition, the contractor had no right to offset amounts for materials against the disgorgement remedy.⁵²

In perhaps its most forceful application, a homeowner in *Goldstein v. Barak* successfully obtained a writ of attachment against a contractor and an order preventing disposition of the contractor's residence. In that case, the contractor did not obtain his license until several months after the work commenced.⁵³

Conclusion

The business of contracting is broadly defined and highly regulated in California. Once a contractor's license is obtained, it must be properly maintained because of exposure to significant penalties for lapse or suspension. For those engaged in building activities without a license, the exposure to penalties is substantial.

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Endnotes

¹ *Hydrotech Systems, Ltd. v. Oasis Waterpark* (1991) 52 Cal.3d 988, 997.

² Bus. & Prof. Code § 7000 *et seq.*

³ *Hydrotech, supra*, 52 Cal.3d at 995, citing *Lewis & Queen v. N.M. Ball Sons* (1957) 48 Cal. 2d 141, 149-150.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.*

⁷ *MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works Co., Inc.* (2005) 36 Cal.4th 412, 426.

⁸ Bus. & Prof. Code § 7026.

⁹ *Fifth Day, LLC v. James P. Bolotin* (2009) 172 Cal.App.4th 939, 947.

¹⁰ *Id.* at 941-942.

¹¹ *Id.*

¹² *Fifth Day, supra*, 172 Cal.App.4th at 939.

¹³ *Id.* at 948.

¹⁴ Bus. & Prof. Code § 7026.

¹⁵ See *MW Erectors, Inc., supra*, 36 Cal.4th at 431-434; *Currie v. Stolowitz* (1959) 69 Cal.App.2d 771; Bus. & Prof. Code § 7055.

¹⁶ *Banis Restaurant Design, Inc. v. Serrano* (2005) 134 Cal.App.4th 1035, 1046.

¹⁷ Bus. & Prof. Code §§ 7045, 7052.

¹⁸ Bus. & Prof. Code § 7044.2; see *General Ins. Co. of Amer. v. St. Paul Fire & Marine Ins. Co.* (1974) 38 Cal.App.3d 760.

¹⁹ *Hydrotech, supra*, 52 Cal.3d at 988.

²⁰ *Lewis, supra*, 48 Cal. 2d at 147-149; *McBarron v. Kimball* (1962) 210 Cal.App.2d 218.

²¹ Bus. & Prof. Code § 7044.

²² Bus. & Prof. Code § 7044(a)(1).

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²³ Bus. & Prof. Code § 7044(b)(1).

²⁴ Bus. & Prof. Code § 7044(b)(2).

²⁵ Bus. & Prof. Code § 7044(a)(2).

²⁶ Bus. & Prof. Code § 7044(a)(2)(B).

²⁷ Bus. & Prof. Code § 7044(a)(3).

²⁸ *Ranchwood*, *supra*, 49 Cal.App.4th at 1397.

²⁹ *Id.* at 1415-1416.

³⁰ 40 Ops. Cal. Atty. Gen. 128 (1962).

³¹ *Id.* at 5.

³² *MW Erectors*, *supra*, 36 Cal.4th at 435-436.

³³ *Id.* at 440.

³⁴ *Id.* at 425-430.

³⁵ Bus. & Prof. Code § 7031(e).

³⁶ *Id.*

³⁷ Bus. & Prof. Code § 7028.

³⁸ Bus. & Prof. Code § 7031(a).

³⁹ *Lewis*, *supra*, 48 Cal. 2d at 141.

⁴⁰ *Holm v. C.H. Bramwell* (1937) 20 Cal.App.2d 332.

⁴¹ *Hydrotech*, *supra*, 52 Cal.3d at 997-1002.

⁴² *S&Q Constr. Co. v. Palma Ceia Dev. Co.* (1960) 179 Cal.App.2d 364, 371.

⁴³ *Lewis*, *supra*, 48 Cal. 2d at 152-154.

⁴⁴ *Holm*, *supra*, 20 Cal.App.2d at 332.

⁴⁵ *UDC-Universal Dev., LP v. CH2M Hill* (2010) 181 Cal.App.4th 10, 26; *Ranchwood*, *supra*, 49 Cal. App.4th at 1420.

⁴⁶ Bus. & Prof. Code § 7031(a).

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⁴⁷ Bus. & Prof. Code § 7031(d).

⁴⁸ *Loving & Evans v. Blick* (1949) 33 Cal.2d 603.

⁴⁹ Bus. & Prof. Code § 7031(b).

⁵⁰ *Wright v. Issak* (2007) 149 Cal.App.4th 1116, 1122.

⁵¹ *Oceguera v. Cohen* (2009) 172 Cal.App.4th 783; *White v. Cridlebaugh* (2009) 178 Cal.App.4th 506.

⁵² *White, supra*, 178 Cal.App.4th at 521.

⁵³ *Goldstein v. Barak* (2008) 164 Cal.App.4th 845.