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FEATURE COMMENT:

Disgorgement And Other Dilemmas Of A Suspended License

Written by Barry D. Brown, Esq., this Feature Comment identifies issues related to unlicensed contractors.

In today's difficult economic times, a contractor's failure to pay attention to minor issues can result in a loss of income as a result of having their license suspended. If a contractor is unlicensed while performing work for a property owner, he or she is faced with the possibility of not recovering compensation for the work performed, or alternatively, if paid, may be faced with a lawsuit by the property owner for disgorgement of all monies paid to the contractor for the work performed. This is the case even when the property owner knowingly hires an unlicensed contractor before the contract was entered into.

Most states provide a statutory scheme which is intended to protect property owners from contractors who are unlicensed. In these states, a contractor may not bring or maintain any action for the collection of compensation for the performance of any act, contract or licenses required without alleging that he or she was a duly licensed contractor during the performance of that act or contract, regardless of the merit. Furthermore, it provides that an individual 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.

The unlicensed status of the contractor includes any periods during which a contractor's license has been suspended by its states' licensing authority. Although there are many causes for a license suspension, some of the more common circumstances are:

- 1) failure to maintain an adequate bond;
- 2) failure to maintain adequate Workers' Compensation Insurance;

- 3) failure to report a judgment to the licensing authority within a specified time;
- 4) failure to satisfy a final judgment in a timely manner;
- 5) failure to replace a disassociated Responsible Managing Officer (RMO) or Responsible Managing Employee (RME) within a stated time from the date of disassociation.

In a case where the status of the license is challenged, the contractor has the burden of proof to establish that its license was active during the entire period of work performed. If there has been a lapse in licensing during the period of work, the contractor may still prevail under the judicial doctrine of substantial compliance. However, the doctrine of substantial compliance may not apply if the contractor has never been a duly licensed contractor in their state.

In most states, to apply the doctrine of substantial compliance, the contractor would need to establish the following:

- 1) that the contractor has been duly licensed as a contractor in the state prior to the performance of the act or contract;
- 2) that the contractor acted reasonably and in good faith to maintain proper licensure;
- 3) that the contractor did not know or reasonably should not have known that he or she was not duly licensed when performance of the act of contract commenced;
- 4) that the contractor acted promptly and in good faith to reinstate his or her license upon learning it was invalid.

Over the years, the court's interpretation and application of these requirements has been very restrictive. It is a rare case where the courts have found that a contractor's license has been suspended that met the doctrine's requirements as noted above.

ICF Kaiser Engineers, Inc. v. Superior Court, 75 Cal. App. 4th 226, 89 Cal. Rptr. 2d 88 (2d Dist. 1999), is one of the rare cases in

which a California appellate court found that the contractor had met the requirements of the doctrine. The Court of Appeal then ordered the trial court to vacate its judgment against *ICF Kaiser*, and held that the trial court's finding that the contractor did not substantially comply with licensing requirements was not supported by substantial evidence.

The Court of Appeal noted that:

- 1) no one at Kaiser knew that its license had been suspended;
- 2) documents sent by the CSLB to Kaiser suggested that nothing further needed to be done to properly submit a new RME as the licensee in place of a prior RME who had left the company;
- 3) a required bond was in full force and effect at all times;
- 4) the Board itself was unaware of the suspension;
- 5) had anyone asked the Board about Kaiser's licensing status, it would have answered that Kaiser license was in good standing.

In numerous other cases, the courts have been reluctant to find that the contractor had substantially complied, finding against the contractor.

The lessons of these cases are clear. A contractor's license is extremely valuable. Entering into a contract before a license is valid or to operate with a suspended license opens the door to a slew of issues and financial consequences for the contractor. As a result, a contractor must be diligent in making sure that it does not fall into any of the seemingly innocuous traps that can result in the suspension of its license.

Acknowledgements—Barry D. Brown, Esq. is an attorney at Gray•Duffy, LLP in the firm's Redwood City, California office, and has a diverse practice with extensive litigation experience. He has successfully represented hundreds of individuals and businesses in the areas of premises liability, construction defect, product liability, personal injury, and property damage litigation. He can be reached at bbrown@grayduffylaw.com or (650) 365-7343.

This article also appears in *The Contractor's Compass*, the quarterly education journal of the Foundation of the American Subcontractors Association, Inc., and has been reprinted with permission.

Cases & Decisions

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Subcontractor's Insurer Owed No Duty To Defend Or Indemnify Under Restrictions In Additional Insured Endorsement

CONTINENTAL CAS. CO. v. AMERICAN SAFETY CAS. INS. CO., 365 S.W.3D 165 (TEX. APP. HOUSTON 14TH DIST. 2012), REH'G OVERRULED, (MAR. 21, 2012)

A subcontractor ("Sub") was working under the general contractor ("Contractor") in a road-construction project for the City of Houston. An employee of Sub ("Worker") was injured by a vehicle driven by a third party while working on the project. Worker sued Contractor, Sub, and the third-party driver for negligently causing his injuries. The insurance policy issued to Sub by its insurer ("Sub-Insurer") contained an additional-insured endorsement. For Worker's claims against it, Contractor sought coverage from Sub-Insurer as an additional insured under this endorsement. Sub-Insurer refused coverage, asserting that Worker's claims against Contractor were either not covered or excluded under the terms of the policy.

Contractor's liability carrier ("Prime-Insurer") provided a defense to Contractor against Worker's claims. The underlying lawsuit eventually went to trial. The jury found that Contractor was among those whose negligence caused Worker's injuries. Prime-Insurer ultimately paid Worker \$250,000 to settle his claims against Contractor.

On May 27, 2009, Prime-Insurer sued Sub-Insurer. Asserting claims of contractual and equitable subrogation, contribution, and breach of contract, Prime-Insurer sought the recovery of Contractor's defense costs (\$133,715), the