



Construction & Infrastructure Law Blog

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Courts Uphold Disgorgement Penalty For Unlicensed Contractors

By [*Candace L. Matson*](#)

As most construction professionals know, California law requires that any person engaged in the business of a contractor, or that acts in the capacity of a contractor, must be properly licensed by the Contractors State License Board ("CSLB"). Cal. Bus. & Prof. Code § 7028. A contractor is defined broadly, as follows:

. . . a contractor is any person who undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does himself or herself or by or through others, construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, parking facility, railroad, excavation or other structure, project, development or improvement, or to do any part thereof, including the erection of scaffolding or other structures or works in connection therewith, or the cleaning of grounds or structures in connection therewith, or the preparation and removal of roadway construction zones, lane closures, flagging, or traffic diversions, or the installation, repair, maintenance, or calibration of monitoring equipment for underground storage tanks, and whether or not the performance of work herein described involves the addition to, or fabrication into, any structure, project, development or improvement herein described of any material or article of merchandise. "Contractor" includes subcontractor and specialty contractor. "Roadway" includes, but is not limited to, public or city streets, highways, or any public conveyance.

Cal. Bus. & Prof. Code § 7026.

Harsh penalties may be assessed against an unlicensed contractor for performing work in

California requiring a license, and are reputedly designed to protect the public against incompetency and dishonesty in those who providing construction services. Hydrotech Systems, Ltd. v. Oasis Waterpark, 2 Cal. 3d 988, 995 (1991). For example, an unlicensed contractor may be subject to both civil and criminal penalties. See, e.g., Cal. Bus. & Prof. Code § 7027.3 (one year imprisonment and/or \$10,000 fine for intentional use of another person's license with intent to defraud), Cal. Bus. & Prof. Code § 7028 (contracting without a license is a misdemeanor; penalty for second offense is \$4,500 minimum and 90 day county jail time), Cal. Bus. & Prof. Code § 7028.7 (CSLB citation and fine of \$200-\$15,000), Cal. Bus. & Prof. Code § 7117 (CSLB disciplinary action); and Cal. Lab. Code §§ 1021-1023 (civil penalty of \$200/day per employee performing work for unlicensed contractor).

In addition, section 7031 of the California Business & Professions Code precludes an unlicensed contractor from maintaining a lawsuit to recover compensation for its work. Section 7031(a) states, in relevant part:

[N]o person engaged in the business or acting in the capacity of a contractor, may bring or maintain any action, or recover in law or equity in any action, in any court of this state for the collection of compensation for the performance of any act or contract where a license is required by this chapter without alleging that he or she was a duly licensed contractor at all times during the performance of that act or contract, regardless of the merits of the cause of action brought by the person . . .

Finally, perhaps the most onerous penalty of all is that an unlicensed contractor may be required to disgorge any compensation it has previously been paid for performing work requiring a license. Cal. Bus. & Prof. Code § 7031(b). Under section 7031(b), "[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." There is little case law interpreting the so-called "disgorgement" penalty since its addition to Section 7031 is relatively recent (added by amendment in 2001). The four opinions published to date which address disgorgement, directly or indirectly, are discussed below.

In the first case, Wright v. Issak, 149 Cal. App. 4th 1116 (2007), a contractor sued two homeowners for unpaid amounts in connection with a home remodeling project. The homeowners responded with a cross-complaint against the contractor seeking, among other things, the return of all amounts they had paid him on the ground he did not have a valid contractor's license. Although the contractor held a California contractor's license, he grossly underreported his payroll to the State Compensation Insurance Fund, and never obtained workers compensation for his crew working on the home remodeling project.

Both the trial court and court of appeal agreed with the homeowners that, under Business & Professions Code section 7125.2, the contractor's license was automatically suspended for his failure to obtain workers compensation insurance for his employees. Both courts rejected the contractor's argument that such suspension could not take effect until the contractor received a

notice of suspension from the registrar of contractors. Because the contractor failed to properly report his payroll and obtain insurance for his workers before, during, and after the home remodeling project, the contractor was not properly licensed. The homeowners were entitled to recover all amounts paid to the contractor under Cal. Bus. & Prof. Code section 7031(b), compensatory and punitive damages for fraud, and contractual attorney's fees.

A year later, the Court of Appeal issues its opinion in Goldstein v. Barak Construction, 164 Cal. App. 4th 845 (2008). In this case, Homeowners entered into a contract with Barak Construction to remodel their home in mid-June 2004. Barak began work on the project right away, but did not obtain a contractor's license for the first time until mid-September 2004. Homeowners paid Barak \$362,629.50 before Barak abandoned the incomplete project. Homeowners then filed suit under Business and Professions Code Section 7031(b), seeking a writ of attachment against Barak for the full amount paid, plus an amount for attorneys' fees and costs. The superior court granted the writ of attachment.

Barak appealed the order granting the attachment and the court of appeal affirmed. It concluded that the homeowners' recoupment action satisfied all of the requirements for a prejudgment attachment set forth in Code of Civil Procedure Section 483.010. It rejected Barak's contention that the recoupment action was punitive in nature rather than a claim for money based upon a contract that will support a writ of attachment. Because a contract for services lies at the heart of a claim against the unlicensed contractor, such a claim is fundamentally contractual in nature and can be the basis for obtaining an attachment order. It also rejected Barak's contention that the amount of the attachment was improper and excessive because Barak had passed along most of the money it received to laborers or material suppliers for the project. Though the court recognized the draconian nature of the recoupment action, the Contractors License Law allows recovery of *all* compensation paid to the unlicensed contractor regardless of whether the amounts paid are ultimately retained by it. And the court of appeal rejected the contention that the amount of the attachment should be reduced by the amount earned by Barak after it became a licensed contractor. The court reiterated that to recover for work performed on a project, a contractor must be licensed *at all times* during which it performs the contractual work.

A third unlicensed contractor scenario was discussed in Oceguera v. Cohen, 2009. WL 756 296 Cal. App. 2d 2009. There, the contractor was a general partnership consisting of three general partners. Only Mr. Golen, the RME, was licensed as a contractor. Mr. Golen executed a disassociation notice in accordance with section 7076(c) of the California Business & Professions Code which provides that "a partnership license shall be canceled upon the disassociation of a general partner or upon the dissolution of the partnership . . . [T]he remaining general partner or partners may request a continuance of the license to complete projects contracted for or in progress prior to the date of disassociation or dissolution for a reasonable length of time . . . "

After Mr. Golen filed his disassociation notice, the partnership embarked on a residential construction project. Following completion, the project owner sued the partnership for defective construction. In addition to seeking damages for repair of the defective work, she also sought disgorgement of the \$32,000 paid under section 7031(b) of the California Business and Professions Code. The issue on appeal was limited to whether the trial court erred in entering a

judgment in favor of the owner on the refund of the \$32,000. The court of appeal affirmed that defendants did not establish that the substantial compliance doctrine applied because they were never licensed before entering into and performing the June 2003 contract, and because Golen's association with the partnership ended on May 24, 2003, the date stated in the application for replacing the qualifying individual filed by Golen. Neither of the other individuals in the partnership could satisfy the substantial compliance doctrine because neither was licensed before entering into the June 2003 contract. In contrast, the partnership was licensed at one time and so did meet the first prong of the substantial compliance doctrine. However, it did not meet the remaining requirement: both partners knew they were not licensed, knew the RME had executed a disassociation, and did not act with prompt good faith efforts to secure a license.

The most recent case is White v. Cridlebaugh, F053842 (July 29, 2009). In it the Whites retained Cridlebaugh and JC Master Builders, Inc. (collectively, the “contractor”) to build them a log cabin. Due to concerns over the contractor’s billing and competency, the Whites terminated the construction contract. The parties filed complaints against one another, the contractor to foreclose on its mechanic’s lien, among other things, and the homeowners to recover disgorgement of amounts paid, among other things. On appeal, the court considered, among other things, “whether the Whites properly brought a claim for reimbursement under section 7031(b).”

The appellate court concluded that the contractor was not qualified to be licensed because it did not have a qualified responsible managing officer or employee in place, and that its license therefore was suspended by operation of law. Hence, disgorgement under section 7031(b) was authorized. The court further considered “whether “the recovery of compensation authorized by section 7031(b) [may] be reduced by offsets for materials and service provided or by claims for indemnity and contribution?” The court concluded that it may not, and that under the express terms of the statute, “unlicensed contractors are required to return all compensation received without reductions or offsets for the value of the materials or serviced provided.”

The above-described opinions make it clear that disgorgement under Section 7031(b) is a penalty against unlicensed contractors that has been accepted by the courts despite its draconian nature. The lesson for contractors is clear: they must be scrupulous in maintaining proper licensure at all times. Otherwise, in the event of a lawsuit with its customer, a contractor with a lapsed or suspended license could be forced to return to the customer all compensation received for work on the project. Such a scenario could bankrupt the business.

Authored By:

[Candace L. Matson](#)

(213) 617-5489

cmatson@sheppardmullin.com

Candace L. Matson is a partner in Sheppard Mullin's Los Angeles office where she specializes in construction law.