

Contractors, Be Sure to Maintain Your Workers' Compensation Insurance

The Dirt Report

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A contractor's failure to maintain its workers' compensation coverage can have disastrous consequences. Unless the contractor is exempt from having workers' compensation insurance, its failure to maintain such insurance results in an automatic suspension of its license. (Business & Professions Code Section 7125.2.) This, in turn, can prevent a contractor from recovering payment for work done during the period in which the license was suspended.

Section 7125.2 states: "The failure of a licensee to obtain or maintain workers' compensation insurance coverage, if required under this chapter, shall result in the suspension of the license by operation of law in accordance with the provisions of this section,...." Not having a license during its performance on the project prevents that contractor from later recovering payment for the work it did on that project, unless it can prove it substantially complied with licensing requirements. (Business & Professions Code Sections 7031(a) and (e).) Failure to maintain licensure may also result in a court ordering the contractor to disgorge all of the payments it received during construction. (Section 7031(b); *Alatriste v. Cesar's Exterior Designs Inc.*, 183 Cal.App.4th 656 (2010).) These harsh results highlight the importance of a contractor keeping its workers' compensation insurance current.

There are two key cases involving a contractor's failure to maintain workers' compensation – *Wright v. Isaak*, 149 Cal.App.4th 1116 (2007), and more recently, *Loranger v. Jones*, 184 Cal.App.4th 847 (2010) – that illustrate the need to obtain, and maintain such insurance.

Wright involved the automatic suspension of a contractor's license for failure to obtain workers' compensation insurance. The court in *Wright* concluded that a contractor intentionally and significantly underreported payroll to the State Compensation Insurance Fund to avoid the obligation to obtain workers' compensation insurance, triggering the automatic suspension under Section 7125.2 by operation of law: "[S]ection 7125.2 states that a contractor's license is automatically suspended as of the date the contractor was required to obtain workers compensation insurance but did not. This language cannot be clearer." The contractor argued that Section 7125.2 required notice from the State Contractor License Board stating its insurance had expired. Because it did not receive notice, the contractor argued Section 7125.2 was inapplicable. The court rejected that argument, finding the contractor's interpretation of the statute was incorrect – the contractor had been relying on a prior, materially different version of Section 7125.2, and the new version required notice from the registrar where there was a failure to "maintain," not "obtain" the insurance. Moreover, the court concluded that even if the failure to receive a registrar's notice overcame the automatic suspension, it

was the contractor's burden to introduce evidence of the registrar's failure to provide such notice, which the contractor failed to meet.

In *Loranger*, the court considered whether a licensed contractor who had unknowingly used an unlicensed subcontractor is subject to the Section 7031 sanctions because of an automatic suspension under Section 7125.2. Unlike *Wright*, the court concluded that under its set of facts there was *no* automatic suspension of the contractor's license.

Shane Loranger, the contractor, sued the Joneses for construction on their home, alleging the Joneses had failed to pay amounts due under the contract and, in addition, added work beyond the scope of the contract. The Joneses cross-complained for breach of contract, alleging, among other things, Loranger did not perform the work in a good and timely manner. On cross-examination at trial, Loranger conceded that he had not checked the licensing status of his electrical contractor, whom he had used on several other projects. That contractor had been unlicensed since 1993. Loranger further testified that he had his son, his son's friend and a third unlicensed individual help out with some flooring and excavation work.

At the close of Loranger's case, the Joneses moved for a directed verdict citing *Wright*, arguing that Loranger hired unlicensed subcontractors (primarily referring to the electrical subcontractor). The Joneses argued such subcontractors were de facto employees and, because workers' compensation was not provided for these subcontractors, Loranger's license was therefore automatically suspended. the Joneses contended this barred Loranger's recovery and required Loranger to disgorge money the Joneses had already paid him.

After further briefing, the trial court concluded there were insufficient grounds for the motion because Loranger had testified he was licensed and insured. The trial court denied the motion, and the Joneses moved to amend their cross-complaint to include an action for disgorgement, which the trial court reserved ruling upon until the trial's conclusion. (184 Cal.App.4th at 852.)

Ultimately, the trial court issued a statement of decision in Loranger's favor, allowing a small off-set in favor of the Joneses, distinguished *Wright* and denied the Joneses the right to amend their cross-complaint, finding insufficient evidence to show that any workers were not covered under Loranger's workers' compensation insurance. Loranger was awarded \$25,348.85.

The Joneses argued on appeal that Loranger's use of an unlicensed subcontractor and the labor of minors caused its license during construction to be automatically suspended, and that Loranger therefore forfeited the right to maintain an action for damages. Finding *Wright* distinguishable, the appellate court rejected the Joneses' arguments: "the limited facts before [that] court strongly suggest the contractor [in *Wright*] did not have and never had a policy of workers' compensation insurance, that he intentionally underreported the wages he was paying and that he did so to be excluded from the requirement of obtaining such insurance." (184 Cal.App.4th at 857.)

While *Wright* and *Loranger* presented different facts, with different results, they are consistent in their principle that a contractor needs to ensure that it follows all statutory requirements for obtaining and maintaining workers' compensation insurance.

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