

**UNLICENSED CONTRACTORS ARE NOT ENTITLED  
TO PAYMENT FOR WORK PERFORMED**

**The Pinnacle**

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The California legislature has enacted and amended certain laws that require a contractor to hold a valid contractor's license issued by the Contractors State License Board ("CSLB") in order to be entitled to payment for work performed. This law is found in California Business and Professions Code Section 7031. If a contractor is required to have a valid license but fails to maintain a valid license, then the contractor effectively has no basis to sue a homeowner for any work performed by the contractor. In addition, a homeowner may recover any money paid to an unlicensed contractor. A new California case holds that a homeowner's right to recover money paid to an unlicensed contractor is not subject to being reduced for the value of the unpaid work performed by the contractor.

In this recent case, the homeowner contracted with the contractor to build a log house. At the time that the construction contract was signed, the contractor did hold a valid contractor's license as shown on the CSLB website. The contractor's license was issued in the name of a corporation, which is common for many contractors. A corporation is able to hold a valid contractor's license if one of its officers (i) holds a valid contractor's license, (ii) owns at least 10% of the outstanding stock of the corporation, and (iii) is actively involved in the construction business. The officer that meets these requirements is known as the responsible managing officer ("RMO"). All three of these requirements must be met at all times in order for the corporation to hold a valid contractor's license through its RMO.

After the construction contract was signed and construction had begun, certain disputes arose between the homeowner and the contractor. The homeowner then told the contractor to stop doing the work and that the contract was terminated. At that time, the homeowner had paid the contractor \$84,000. The contractor alleged that the homeowner still owed \$14,000 to the contractor for the work performed through the termination date. This resulted in a lawsuit between the parties, which ended up being appealed by the homeowner.

The appellate court ruled that the contractor must reimburse the homeowner the \$84,000 that the homeowner paid the contractor. Although the contractor had paid the required renewal fees and had a valid contractor's license issued by the CSLB at the time the construction contract was signed, the court determined that the license was not valid because the contractor's RMO had not been involved in the construction business for the past 2 years. In fact, the RMO had been in Peru for the past two years as a missionary. The court determined that since the RMO was not actively involved in the construction business, the contractor's license was not valid because it did not have a valid RMO. Therefore, the contractor was not entitled to keep any of the \$84,000 paid to it by the homeowner.

The contractor argued that it should be entitled to reduce the payment to the homeowner by \$14,000, which was the outstanding amount that the homeowner owed to the contractor when the homeowner terminated the contract. The appellate court ruled that the California legislature's 2001 amendment to Business and Professions Code Section 7031 intended that "all" compensation paid to an unlicensed contractor must be returned to the homeowner. The legislature did not provide for any reductions or offsets against the return of any such compensation, so the court determined that the contractor was not entitled to reduce the payment by the \$14,000 outstanding balance owed to the contractor.

This case illustrates two primary lessons. The first is that any contractor must be sure to take all steps required in order to maintain a valid contractor's license. This includes making sure that the RMO is still actively involved in the business. The second is that a homeowner must research and really get to know a contractor before signing a construction contract. Problems are going to come up in any construction project, and those problems can be resolved if the homeowner and the contractor get along with each other and have a clear understanding as to the project. This case shows what can occur if the problems cannot be resolved and the contractor has not met its obligations to maintain a valid contractor's license.

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