

Court of Appeal Rules That Construction Contractor Which Blatantly Violates Workers Compensation Laws May Be Barred From Recovering Compensation For Work Performed On The Basis That It Was Acting As An Unlicensed Contractor Even Though A Citation For Violation Of Workers Compensation Insurance Requirements Had Not Been Issued By The Registrar

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In a decision which will impact construction contractors who have blatantly violated contractor licensure requirements, the California Court of Appeal, Sixth District, recently held that a contractor which vastly underreported payroll for purposes of workers compensation insurance could be barred from recovering compensation from property owners for material and labor.

That decision, issued in the matter entitled Wright v. Issak (2007) DJDAR 5268 (herein, the "Wright" case), concerned a home remodel contractor, Laurence Wright (herein, the "contractor"), who entered into a cost plus contract with Ghyath Issak and Barbara Weber (herein, the "homeowners") to effect improvements on the homeowners' residence. The contract between the contractor and the homeowners provided that the homeowners would pay the contractor for labor and material costs plus a 12 percent mark up of those costs for overhead, plus an additional 8 percent markup of the cost-plus-overhead amount for profit.

After disputes between the parties arose, the contractor sued the homeowners for \$11,000.00 for unpaid labor and materials. The homeowners answered by primarily asserting that the contractor was not properly licensed and therefore subject to the bar under Business & Professions Code section 7031 which generally provides that an unlicensed contractor may not recover for failure to pay for labor and materials.

At trial, the contractor presented evidence that he paid employees of his approximately \$15,000.00 for approximately 4,000 hours of work at the homeowners' residence during a four month period in 2004 (which, on its face, violated minimum wage laws). The homeowners did not appear to dispute the laborer hours but pointed out that State Compensation Insurance Fund records showed that, from November 2003 through August 2004, the contractor reported, under the penalty of perjury, a payroll of \$312.00 while having an actual payroll

of \$135,000.00 and that this was part of a larger, intentional pattern. Quoting the Court of Appeal:

“[the records] show that [the contractor] reported zero or next to zero payroll for every payroll period between his initial application for workers’ compensation insurance in May 2002 and the end of 2004. [The contractor’s] underreporting was not inadvertent. It was his pattern and practice from the first moment he applied for workers’ compensation insurance.”

To make matters worse, the trial court found that the amount for labor costs that the contractor reported to the homeowners was twice the amount the contractor actually incurred.

Following an unreported court trial, the trial court found for the homeowners on the contractor’s complaint and also awarded reimbursement damages and punitive damages on a cross-complaint which the homeowners had filed. In its findings, the trial court found that the contractor was not licensed because his license had been automatically suspended for failure to obtain and maintain workers compensation insurance as required by Business & Professions Code section 7125.2

The contractor appealed arguing that he had never received a citation from the Registrar under Business & Professions Code section 7028.7 which would have resulted in an opportunity for a hearing and cited a recent published opinion wherein the Court held that a contractor could not be deemed unlicensed for failure to obtain workers compensation insurance absent notice from the Registrar. See, Smith v. Workers Compensation Appeals Board (2002) 96 Cal.App.4th 117.

The Court of Appeal affirmed.

In its holding, the Court of Appeal first noted that the contractor had the burden to prove lack of notice and the record (the trial was unreported) did not provide any contradictory evidence to contest the trial court’s findings. The Court of Appeal also held that the workers compensation code requirements under Business & Professions Code section 7125.2 (which pertain to obtaining and maintaining workers compensation insurance) had been materially amended since the Smith v. Workers Compensation Appeals Board decision was issued and found that a blatant failure to maintain workers compensation insurance could result in a finding of automatic forfeiture of a contractor’s license even without notice from the Registrar.

The Court of Appeal analogized the situation to circumstances where a contractor which maintained a license through a sham Responsible Managing Officer (which is required under Business & Professions Code section 7068) could be barred from seeking compensation for unpaid labor and materials. Buzgheia v. Leasco Sierra Grove (1997) 60 Cal.App.4th 374; see also, Construction Financial v. Perlite Plastering Co. (1997) 53 Cal.App.4th 170 (cases dealing with a Responsible Managing Officer who was actually working for a contractor unrelated to the licensee when the subject work was performed).

The Wright case will certainly have impacts on some contractors who have blatantly violated contractor licensure requirements. However, it is believed that the Wright case will most likely be limited in its reach. In that regard, it is noted that the Court of Appeal, in analogizing its decision to cases in which there was a sham Responsible Managing Officer, did not cite the 1999 Second District Court of Appeal decision in ICF Kaiser Engineers v. Superior Court (1999) 75 Cal.App.4th 226 which held that the failure to adhere to licensure requirements involving a Responsible Managing Officer would not provide an automatic bar to a fee action where the licensee was not aware of its being suspended and had otherwise substantially complied with its contractual obligations. Of course, only time will tell.

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