

A Legal View - A Homeowner Can Recover all Compensation Paid to
an Unlicensed Contractor, Even if The Homeowner Knew the
Contractor Did Not Have a License

by Craig B. Forry, Esq.

Q: I hired a landscaper knowing he did not have a contractor's license and after I paid for several months of work at my house, I want to terminate the contract and recover all of the compensation I paid the landscaper. Can I retain the benefits of the work performed and also recover the amount I paid the landscaper, even though I knew he was unlicensed when I hired him?

A: Yes, although it seems unfair that a homeowner may retain the benefits of work performed by the landscaper even though the homeowner knew he was not licensed before the work began, section 7031 of California's Business and Professions Code provides the hiring party with both a defensive *shield* against any claim for payment by the unlicensed contractor, and an affirmative *sword* to sue the unlicensed contractor for all compensation paid under the contract. Equitable defenses such as unclean hands, estoppel, unjust enrichment, and even claims of fraud by the hiring party, will normally not be available to the unlicensed contractor, even if they are based upon the hiring party's prior knowledge of the unlicensed status.

The Contractors' State License Law is intended to be a comprehensive legislative scheme governing the construction business in California and it provides that contractors performing construction work must be licensed, unless certain limited exemptions apply. The licensing requirements are designed to provide minimal assurance to the public that all persons offering such services have the requisite skill and character, understand applicable local laws and codes, and know the rudiments of administering a contracting business. The law is designed to protect the public from incompetent or dishonest providers of building and construction services, and places the burden on the contractor to be properly licensed before entering into a contract for construction services.

The statutory scheme encourages licensure by subjecting unlicensed contractors to criminal penalties and civil remedies. The civil remedies affect the unlicensed contractor's right to receive or retain compensation for unlicensed work. The *shield* contained in section 7031, subdivision (a), was enacted more than 70 years ago, and it provides that a party has a complete defense to claims for compensation made by a contractor who performed work without a license. The California Supreme Court has given a broad, literal interpretation to the *shield* provision for many years, and has ruled that section 7031(a) applies even when the person for whom the work was performed *knew* the contractor was unlicensed. In effect, this enables the hiring party to knowingly retain an unlicensed contractor, allow the contractor to perform services worth tens of thousands of dollars, and then legally refuse to pay.

The justification for this result is based upon the presumption that unlicensed

contractors have knowledge of the law's requirements, and a contractor cannot circumvent section 7031(a) by alleging the hiring party's false promise to pay despite the contractor's lack of a license. Section 7031(a) bars a person from suing to recover compensation for *any* work he or she did under an agreement for services requiring a contractor's license unless proper licensure was in place *at all times* during such contractual performance. It represents a legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness to the unlicensed contractor, and that such deterrence can best be realized by denying violators the right to maintain any action for compensation.

In 2001, the Legislature amended section 7031 to provide a *sword* remedy to the hiring party to allow it to pay for the services, and then sue to obtain reimbursement. This *sword* remedy, contained in section 7031, subdivision (b), currently reads: "Except as provided in subdivision (e), a person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor for performance of any act or contract."

Section 7031(b) is designed to treat persons who have utilized unlicensed contractors consistently with section 7031(a), regardless of whether they have paid the contractor for the unlicensed work. In other words, a hiring party who has not paid is protected by the *shield* remedy from being sued for payment, and a hiring party who has paid may recover all compensation under the *sword* remedy. Therefore, unlicensed contractors are not able to avoid the full measure of the statutory scheme's civil penalties by either requiring prepayment before undertaking the next increment of unlicensed work, or by retaining progress payments relating to completed phases of the construction.

Although section 7031(b) does not specifically state whether a hiring party's prior knowledge of the contractor's unlicensed status is relevant to a recovery, courts have held that the Legislature specifically intended to permit full recovery by the hiring party even if the hiring party had actual knowledge that the contractor was unlicensed for several reasons.

First, section 7031(a) has long been interpreted to allow a hiring party to apply the *shield* to any recovery despite the homeowner's knowledge of a contractor's unlicensed status. For similar reasons, the Legislature enacted section 7031(b) to ensure the same penalties apply for an unlicensed contractor regardless whether the contractor is a plaintiff seeking payment from the hiring party, or a defendant in a suit by the hiring party seeking reimbursement for compensation paid.

Second, section 7031(b) provides a reimbursement right for all amounts paid to an unlicensed contractor if the contractor was unlicensed at any time during the performance. There is no specified exception to this rule based upon the prior knowledge by the hiring party of the contractor's lack of a license.

Furthermore, a contractor who is unlicensed at the time the services began cannot rely upon the obtaining of a license during the course of work to defeat the *shield* or *sword* remedies of section 7031. Courts interpreting section 7031(a) have long held that a contractor is ineligible to recover *any* compensation under the terms of that statute, if, *at any time* during performance of an agreement for contractor services, he was not duly licensed. In other words, a contractor cannot recover compensation for any services if it began the services before it obtained a license, even though it became licensed during any portion of the remaining scope of work.

This stiff all-or-nothing penalty for unlicensed work prevents unlicensed contractors from segregating acts performed in furtherance of the contract into discrete tasks to avoid the civil penalties of section 7031. This penalty applies even when the hiring party for whom the work was performed has taken *calculated advantage* of the contractor's lack of licensure, because it does not matter that the beneficiary of the contractor's labors knew that the contractor was unlicensed.

The penalty applies to both the services and the value of the materials provided. The authorization of recovery for "all compensation paid to the unlicensed contractor for performance of any act or contract" means that unlicensed contractors are required to return all compensation received without reductions or offsets for the value of materials or services provided.

Permitting reimbursement may appear to be harsh and unfair to an unlicensed contractor and could be viewed as unjust enrichment to the hiring party, but the courts have interpreted section 7031 in this manner because of the view that the rule is essential to effectuate the important public policy of deterring licensing violations and ensuring that all contractors are licensed. If an unlicensed contractor enters into a contract and provides services, then he does so at his own risk of not being paid for the services provided or the materials he purchased.

Under California law, a hiring party is protected against claims for payment by an unlicensed contractor even if the hiring party knows of the unlicensed status when he enters into the contract and substantially benefits from the work performed. However, this rule should not be viewed as encouragement for the hiring party to knowingly hire unlicensed contractors because it is always preferable that the hiring party has work performed by an experienced, insured, and licensed contractor. But it is worthwhile to know that if a hiring party enters into a contract with an unlicensed contractor, with or without knowledge of the lack of a license, no payment can be compelled or retained by the unlicensed contractor in any legal action.

The opinions expressed in this article are those of the author and not the Daily News, and they do not create an attorney-client relationship or constitute legal advice. Individual circumstances may vary and professional advice is recommended before

*making any decisions concerning legal matters. E-mail your comments or questions to
Forrylaw@aol.com. Rev. 4-12-10*