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Unlicensed contractors: The law versus the unfortunate reality

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California requires all contractors to hold a valid contractor's license and there are harsh penalties for those who are found to have contracted without a license. Contracting without a valid license is considered a crime and may be punishable by jail time, a fine or both.



In addition to the criminal ramifications, anyone who contracts without a license is prohibited from suing to recover any amounts agreed by the customer to be paid for the construction work provided.

In fact, the law goes further, entitling this customer to sue the unlicensed contractor to recover all amounts paid to the contractor for work that required a license. Even if the customer hires an unlicensed contractor knowing that the contractor has no license, the customer may still avoid any obligation to pay any amount to the unlicensed contractor, and may sue to recover any amounts paid.

While these laws may be harsh, many persons without a valid contractor's license successfully evade the law.

Unlicensed contractors often try to avoid the license requirement by approaching homeowners and offering to provide home improvement construction as an employee or as a consultant, which, they explain, will be cheaper than hiring a licensed contractor.

They create written contracts that label themselves as an "employee" or as a "consultant" and they agree within the contract to be paid by the hour for whatever quantity of labor they provide.

In concept, this is potentially in compliance with the law, as a property owner is entitled to obtain a building permit on his own and to perform all work himself and/or with persons who are truly employees of the owner.

A person who agrees to show up each day at 9 a.m. and who works entirely at the direction of the owner is likely to be deemed an employee. The reality, however, is that most persons who approach property owners and offer to serve as employees are not truly taking on the role of an employee. They typically approach an unsophisticated owner, bragging of their construction experience and claiming that hiring a licensed contractor would be more expensive. They convince the owner to apply for an "owner-builder" building permit, for which no license is required, while promising to take full responsibility for running the entire project and for providing an end result.

This is not a contract of employment -- it is a construction contract wherein the services provided involve more than just serving as an employee under the direction of the homeowner. Performance under such a contract requires a valid contractor's license to be held by the person or business that is providing the construction services.

The San Diego County Department of Planning and Land Use's application for an owner-builder permit makes reference to this common practice by unlicensed contractors. The application notes that contracting without a license is illegal and warns of the potential liability of a property owner for physical injuries and/or property damage that results from the project.

However, this warning is buried within the application document and is not always reviewed. When it is reviewed it may not be given the attention it deserves, perhaps because most persons are working on a budget and must keep costs down.

When a property owner files a lawsuit seeking to avoid any payment obligation to an unlicensed contractor, the court must decide the "contractor or employee?" issue. The label attached to the person within a written contract is only one small factor the court considers. More important to the court are the actual tasks performed and the responsibilities assumed. Other factors may involve whether the person is hiring and directing additional people

who are working on the job, whether the person is paying for materials expenses himself rather than having the owner pay for them, and whether the person is making on-the-job decisions himself rather than taking direction from the owner on each decision that arises.

These factors are very similar to the factors that legally determine whether a person in any business is working as an employee or as an independent contractor.

While the harsh language of the laws affecting unlicensed contractors go a long way toward dissuading persons from contracting without a license, the laws are not perfect.

Owners face high legal fees and uncertain trial outcomes if they fight the fact-based contractor-versus-employee issue in court.

Further, while the "no obligation to pay for work performed by an unlicensed contractor" rule appears to give strong protection to the owner, there are separate laws that impose potentially harsh consequences on an owner who hires an unlicensed contractor. An owner who hires an unlicensed contractor is likely liable to compensate any injuries to persons who work through the unlicensed contractor, as these persons are likely to be treated under the law as the employees of the property owner.

Likewise, any unlicensed contractor who causes any damages to a third party while working for the owner will be treated as an employee of the owner, making the owner liable to the third party.

Licensed general contractors also have a disincentive to intentionally hire an unlicensed contractor with the hope of avoiding the obligation to pay for the work provided. Any licensed contractor who knowingly hires an unlicensed subcontractor is subject to fines and other forms of discipline.

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