

## **Contractor's License/Owner-Builder Exemption Issue**

**By Sue Scouton; Scouton & Scouton LLP June 2006**

As you know, we have recently encountered several projects where the party entering into residential construction subcontracts in California is a Limited Liability Company (LLC). The purpose of this correspondence is to provide a general overview of the issue.

The California Contractor's State License Board will not issue licenses to LLCs. Under California law, a Contractor must hold a valid license to construct or improve residential structures, with very limited exceptions. Pursuant to Business & Professions Code Section 7026, the term "Contractor" is "...any person who undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does himself or herself or by or through others, construct, alter, repair, add to, subtract from, improve...any building, highway...excavation or other structure, project, development or improvement...The term "Contractor" includes subcontractors and specialty contractors, and is synonymous with 'Builder'". As a general rule, a Builder (which we refer to as "Owner" in this correspondence) must either become licensed or hire a licensed General Contractor (GC). As stated above, California will not license a LLC.

As a service to your clients, whenever we identify a potential licensing violation, we raise the "red flag" to the Owners in an effort to protect the Owners from claims by consumers or their own trade contractors that the Owner was not properly licensed, which can lead to various criminal and civil penalties, not the least of which is an invalidation of contracts. It is in the property Owner's best interest to ensure that it is not violating the contractor's license law and exposing itself to the various penalties or invalidating its contracts with trades. As you know, some Owner's provide documents and information suggesting that a licensed GC will be overseeing the construction, but the Owner subsequently enters its own contracts with subcontractors. Of course, we cannot control what occurs after documents are submitted, but those Owners run the risk of violating the license law.

As mentioned above, there are very limited exceptions and/or exemptions to the general rule for licensing. Lately, some Owners are attempting to qualify for the "Owner/Builder" exemption to the licensing requirements in order to avoid obtaining a license or hiring a licensed GC. An Owner/Builder is typically considered one who is building or improving on property not intended or offered for sale, such as an individual who is building his own home. Under B&P Code 7044(b), the Owner of property can contract directly with licensed subcontractors and be exempt from the licensing requirements, but the exemption only applies to construction of 4 or fewer "single family residential structures" offered or intended for sale in a calendar year. In the event the Owner contracts with a licensed general contractor for the construction, it is exempt from the licensing requirements altogether. However, if an Owner/Builder is constructing more than 4 single family structures intended for sale in a calendar year, the Owner/Builder must either contract with a licensed General Contractor to perform the work or obtain a Contractor's License.

In one instance we received push back from an Owner developing condominiums, because the owner believed that a condominium was a "multi-family" structure rather than a "single family structure." We disagreed with the Owner's assertion based on definitions set forth in the Davis-Stirling Act, (Civil Code Sec. 1351 et. seq.) which encompasses California's condominium law. The definitions in that Act indicates that a condominium "unit" would qualify as a "structure" as used in the license law.

Unfortunately, the California license law is somewhat ambiguous in its wording, and interpretive case law is limited. Therefore, we approach our interpretation of the law by following the "plain meaning" of the words, the code's intent, and an analysis of legislative history. The license law has been on the books for decades, and the last update was in the late 1980's. Discussion of the updates was limited, but it remains clear that the license law is intended to protect consumers from unlicensed contractors. It also appears that the license law is focused upon residential construction that will be sold to members of the public, and is not applicable to construction of apartments ("multifamily") or commercial buildings which typically are owned by one entity and leased to occupants.

Since the licensing law does not target apartment construction, the licensing issue comes up since many of these buildings are now the subject of condominium conversions. Often times the structure of the apartment remains the same, and the units are simply upgraded. The license law is silent on whether a condominium conversion would fall within the requirements for licensure. However, since the law is designed to protect consumers, and a condominium is an estate that can be conveyed similarly to a single family home, it is likely a court would find that converting an apartment or commercial building and placing the units for sale would then require a license.

On the other hand, if the Owner was developing land only, and was entering direct contracts (as a LLC) with licensed trade contractors, this may not violate the license law because this Owner is not actually constructing structures, only lots. Therefore, for those "gray areas" such as land development and minor conversions, we still recommend a "best practices" approach where the Owner is either licensed or hires a licensed GC or Construction Manager. For all new residential projects, including condominiums, unless the Owner is selling 4 or fewer units in a calendar year, we maintain that an un-licensed LLC which enters into direct contracts with trade contractors is violating the license law and runs the risk of civil and criminal penalties.

As far as administering a Wrap Up program or performing risk review services for carriers, it is between the particular carrier and insured whether a licensing issue will impact coverage.