

CONTRACTORS BEWARE: UNDERREPORTING PAYROLL CAN MAKE YOU UNLICENSED

By: Sharice B. Marootian
Abdulaziz, Grossbart & Rudman

The conversation often goes like this: Lawyer to client – “You can be deemed unlicensed” Client to lawyer – “But I have a contractor’s license...see!” Lawyer to client – “Yes, I know. But you can be deemed unlicensed by *operation of law*.” In my practice, I have come across many situations where a contractor is surprised to learn that failure to obtain or maintain workers compensation insurance can mean that his or her contractors’ license is suspended.

If you have employees, you must obtain and maintain workers’ compensation insurance for all of your employees. Under *Business and Professions Code* Section 7125.2, the failure to do so results in “the **automatic suspension of the contractor’s license by operation of law**.” The ramifications are harsh – not only can the contractor not collect for work performed, but it can be sued for disgorgement. Disgorgement is defined as “the act of giving up something such as the profits obtained by illegal or unethical acts on demand or by legal compulsion. The court can order wrongdoers to pay back illegal profits to prevent unjust enrichment.”

Even if it appeared on the records of the Contractor's Board that the person was validly licensed, that license is subject to automatic suspension as a matter of law for not properly maintaining worker's compensation insurance.

In a 2007 California Court of Appeal case, *Wright v. Issak*, a dispute had arisen from a home remodeling project, where the contractor, Laurence Wright, sued the homeowners for breach of contract and related causes of action. The homeowners answered by alleging that the contractor was not a licensed contractor and filed a cross-complaint for fraud and related causes of action. The contractor worked on the defendants' home during a four month period in 2004. In June, he paid a crew of three to five employees approximately \$15,000 for approximately 4000 man hours. State Compensation Insurance Fund records for November 2003 through August 2004 showed that the contractor reported, under penalty of perjury, a payroll of \$312 while having an actual payroll of \$135,000. The homeowners attorneys showed that 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 Court found that the contractor’s underreporting was not inadvertent and that it was his pattern and practice from the first moment he applied for workers’ compensation insurance. It held that a “contractor's underreporting of payroll resulted in **automatic suspension of his license**, thereby precluding his action against homeowners.” The Court also found that if a contractor underreported his payroll, he did not obtain worker’s compensation insurance and his license was automatically suspended. The Court confirmed that “[a] case about underreporting payroll is, by definition, a failure-to-obtain case rather than a failure-to-maintain case.”

Section 8152.2 has two failure prongs: failure to “obtain”; and failure to “maintain.” The Code section goes on to state the effective suspension dates for the two prongs: the failure-to-maintain prong’s effective date of suspension is the date that coverage lapses; whereas the failure-to-obtain prong’s effective date of suspension is the date that coverage should have been obtained. A registrar's notice is only required if the suspension is for failure to maintain. Since the contractor had workers’ compensation insurance but underreported payroll, he failed to obtain workers compensation insurance. Therefore, he would not have received notice from the Registrar. He could not expect it nor rely on the lack of notice as a defense.

The bottom line is if you have employees, you must *properly* obtain workers compensation insurance by reporting your accurate payroll, and you must maintain the insurance without any lapses. Just because you have a contractor’s license in hand, does not mean you cannot be deemed unlicensed by operation of law.



Sharice Marootian is an attorney and licensed real estate broker, practicing in the areas of construction and real estate law. Sharice assists contractors, subcontractors, and material suppliers in various construction disciplines prevent and resolve construction related disputes. She also counsels and represents owners involved in private construction projects and real estate disputes. Abdulaziz, Grossbart & Rudman provides this information as a service to its friends & clients and it does not establish an attorney-client relationship with the reader. This document is of a general nature and is not a substitute for legal advice. Since laws change frequently, contact an attorney before using this information. Sharice Marootian can be reached at Abdulaziz, Grossbart & Rudman: (818) 760-2000 or by E-Mail at sbm@agrlaw.com, or at www.agrlaw.com

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