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Responsible Managing Employee Rules Are No Joke Failure to Adhere to Responsible Managing Employee Requirements May Result in Waiver of the Contractor's Right to Compensation for Work Performed

For the second time in calendar year 2022, the Court of Appeal of California has found California Contractors State Licensing Laws bar contractors from collecting for work performed. (See Smith, Currie & Hancock LLP Partner Daniel McLennon's [Law Note](#) on *Kim v. TWA Construction, Inc.* (2022) 78 Cal.App.5th 808, finding that licensed contractor could not collect payment for work performed by an unlicensed subcontractor notwithstanding that the contractor was itself licensed to perform that work.)

In an opinion that should be a warning to all contractors in California, the Court of Appeal upheld a trial court's decision to vacate an arbitration award of over \$100,000 to a contractor because the contractor did not carry its burden to prove that its purported Responsible Managing Employee was in fact a bona fide Responsible Managing Employee. (*Vascos Excavation Grp. LLC v. Gold* (Cal. Ct. App., Dec. 21, 2022, No. B315205) 2022 WL 18398783.) All corporate contractors in California should be aware that failure to have a bona fide Responsible Managing Employee automatically suspends the contractor's license, resulting in the inability to collect for the work performed.

Executive Summary

The Court of Appeal of California held that the contract containing the arbitration clause was illegal, because the contractor effectively was not licensed due to a sham Responsible Managing Employee ("RME"). It therefore affirmed the vacating of the contractor's arbitration award.

The Court of Appeal held:

1. A contractor bears the burden of proof to establish that the contractor was licensed at all times during the performance of the contract;
2. The contractor in this case did not meet the burden because it did not provide sufficient evidence to show that the purported RME was in fact a bona fide RME;
3. The arbitration award must be vacated because the award exceeded the arbitrator's powers, since the lack of the RME rendered the contractor unlicensed and the contract illegal.

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Factual Background

Vascos Excavation Group, LLC (“Vascos”) entered a contract with Robert Gold (“Gold”) to provide excavation, grading, and concrete work on Gold’s property in the Pacific Palisades (“Project”). The contract contained an arbitration provision. A dispute arose between the Parties over the amount Gold owed Vascos. As a result, Vascos recorded a mechanics lien on the property and filed a complaint against Gold to enforce the lien. Gold petitioned to compel arbitration, and the trial court entered an order compelling Vascos and Gold to arbitrate the dispute.

During the arbitration, Gold argued that Vascos was barred from seeking compensation for its work because Vascos was not a licensed contractor since Vascos did not have a valid RME on the Project as required by B&P § 7068(b) (4). In response, Vascos filed a certified copy of its license that showed Vascos had a valid license for the work and that John Matthew Welch (“Welch”) acted as Vascos’ RME. Vascos also filed a declaration of the Project’s project manager stating that Welch was Vascos’ RME and attaching two videos of Welch at the jobsite.

The arbitrator issued an award in Vascos’ favor for \$111,440.29. Importantly, the arbitrator further found that Welch was a legitimate RME because he visited the job site at least once and made administrative decisions from his home office.

Trial Court Vacates Award

Gold petitioned the trial court to vacate the arbitration award. Gold argued that Vascos did not have a valid license during work on the Project because Vascos did not meet its burden to show Welch met the requirements for an RME.¹ Therefore, the arbitration award should be vacated since the underlying contract was illegal. The trial court agreed with Gold and vacated the award.

Vascos appealed the trial court’s decision.

Court of Appeal Affirms

Vascos argued on appeal that the trial court erred in holding (1) that Vascos bore the burden of proof to show it held a valid license and (2) that Vascos did not meet its burden to prove that Welch was a legitimate RME. Vascos argued it met the burden of proof because it provided a verified certificate of licensure under B&P § 7031(d). Therefore, the burden shifted to Gold to show that Welch was a sham RME.

First, the Court of Appeal held that Vascos had the burden of proof to show that it was duly licensed during its work on the Project, and therefore the trial court applied the proper burden of proof. The Court stated that Vascos bore the burden to prove it was duly licensed because Vascos’ licensure through a bona fide RME “is an element of its [breach of contract] cause of action.” (*Vascos Excavation Grp. LLC v. Gold* (Cal. Ct. App., Dec. 21, 2022, No. B315205) 2022 WL 18398783, at *4.) Further, the Court reasoned the burden to show that an RME is legitimate should be on the contractor because the contractor has greater access to evidence like payroll records, timesheets, and the identity of employees who can testify to the activities of the RME. (*Id.* at 5.) Therefore, the Court held, “[t]he contractor has burden of proof on the issue of whether it has a bona fide RME.” (*Id.* at 4.)

The Court of Appeal also held that Vascos did not meet its burden to show that Welch was a legitimate RME despite providing a certified license history. The Court of Appeal found that simply providing the certificate was insufficient because “production of the certificate is necessary, but insufficient if the point is controverted.”² (*Id.*, citing *Buzgheia v. Leasco Siera Grove* (1997) 60 Cal.App.4th 374, 389.)

¹ Under B&P § 7068(c)(1), an RME must be a bona fide employee of the LLC and must be actively engaged in the work for which the LLC has a license.

² The Court found that the point was controverted by Gold because the challenge to Vascos’ license was raised in the arbitration.

Also, the Court pointed out that Vascos did not provide any evidence to show that Welch was a permanent employee of the company or that he worked the required amount of time. As referenced above, Vascos presented a declaration from its project manager that showed Welch on the jobsite on at least two occasions. The Court found this evidence insufficient to show Welch was a valid RME. Therefore, the Court held Vascos did not meet its burden. As a result, under B&P Code § 7068.2(a), Vascos was unlicensed during the Project and therefore the contract was illegal.

Summarizing, the Court stated, “[t]he trial court applied the correct burden of proof and reached the right result” because the illegal contract could not provide the arbitrator jurisdiction over the dispute. Consequently, the Court upheld the decision to vacate the arbitration award.

Practical Takeaway

Construction contractors should be aware of California’s requirements for an RME or RMO and be sure to maintain records showing that the contractor’s RME meets the requirements under the licensing laws³ or risk being unable to sue for compensation.

Further, construction attorneys should be certain to provide sufficient evidence to prove their client was duly licensed and, if applicable, the client’s RME is legitimate. As the Court highlighted, a simple declaration could have avoided the Court’s vacating the arbitration award:

The trial court correctly noted that ‘Vascos could have easily submitted a declaration from Welch establishing that he was a bona fide RME.’ Vascos could have met its burden, the trial court stated, with a ‘five sentence declaration’ from Welch. We agree with the trial court’s observation. The burden on Vascos was not high, yet it failed to meet it.

(*Vascos Excavation Grp. LLC*, supra, at *5.)

At the end of the day, this decision is a stark reminder that California Courts may strictly enforce the Contractors State Licensing Laws even when it results in a windfall for an owner. (See Also *Kim v. TWA Construction, Inc.* (2022) 78 Cal.App.5th 808, finding that licensed contractor could not collect payment for work performed by an unlicensed subcontractor notwithstanding that the contractor was itself licensed to perform that work.)

Reminder About AB 830

Effective January 1, 2022, the legislature enacted AB 830, in part, to lighten an RME’s responsibilities. AB 830 amended B&P Code § 7068.1 subsection (a) to remove the requirement that the RME’s supervision and control be “direct,” and amended subsection (c)(3) to allow delegation of RME duties. Therefore, the new amended statute makes an RME’s duties slightly more manageable.

However, AB 830 also created new confusion for contractors. AB 830 modified B&P Code § 7068.1(d) to require a new “employment duty statement” (“EDS”) for the RME signed by the employer or principal of the employer. While the Contractors State Licensing Board has yet to provide guidance on what must be included in the EDS, the question remains open whether failure to complete an EDS is the type of violation that would invalidate an RME, and thus trigger B&P Code § 7031. Based on *Vascos*, a court could find that failure to complete an EDS renders the RME a sham, and therefore the contractor’s license would be automatically suspended under B&P Code § 7068.2 after 90 days of failure to comply. Therefore, contractors should be aware of the EDS requirement and create an EDS if they have not already. ■

³ “An RME must satisfy two basic requirements. The individual must be (1) a ‘bona fide employee’ of the LLC and (2) ‘actively engaged’ in the work for which the LLC has a license. (§ 7068, subd. (c)(1).) ‘Bona fide employee’ of the LLC means an employee who is ‘permanently employed.’ (§ 7068, subd. (c)(2)(A).) ‘Actively engaged’ means working 32 hours per week, or 80 percent of the total hours per week that the [LLC’s] business is in operation, whichever is less. (§ 7068, subd. (c)(2)(B).)” (*Vascos Excavation Grp. LLC v. Gold* (Cal. Ct. App., Dec. 21, 2022, No. B315205) 2022 WL 18398783, at *3.)