

Avoid Getting Pulled Over

Contracting without a License

by Gene F. Zipperle, Jr.

In today's competitive construction market, more and more subcontractors find themselves bidding on projects in locations that were once considered too far away to be profitable. Going to different towns to find work now requires going to different states. What happens when a contractor signs a construction agreement that requires that the contractor be licensed in the state where the project is located, or the state licensing law requires it? If the principal is not properly licensed in a state where the contractor's licensing statute is designed to protect the public, the contract is void, and the surety may be able to escape liability under the bond.

As an example, West Virginia bid a large public works project to upgrade a dam on a large man-made lake in that state. Part of the project involved the construction of a structure on the face of the dam. The general contractor hired a subcontractor from out of state to bore into the face of the dam and place steel support rods in the dam. The contractor was licensed in his home state, but the primary construction con-

tract required that all subcontractors be licensed in the state where the project was being built. The general contractor was aware of this provision and that the subcontractor needed to obtain a local contractor's license. The subcontractor repeatedly took the licensure exam but always failed it. The general contractor was aware of the difficulties that the subcontractor was having to obtain a license. Approximately two months after the project started the state served a cease and desist order on the subcontractor prohibiting any further work by the subcontractor until he obtained the proper license. Not wanting to stop the critical work of the subcontractor, the general contractor hired the subcontractor as a consultant, and put the subcontractor's employees on the general contractor's payroll. Predictably, the work fell behind and the general contractor declared the subcontractor to be in default, and then put the subcontractor's surety on notice of the default.

Analysis

The issue presented by situations like the West Virginia dam project is whether a valid contract between the general contractor and the unlicensed subcontractor exists such that the subcontractor's surety is obligated to perform under the terms and conditions of its subcontract performance bond

which it issued naming the subcontractor as its principal and co-obligor, and the general contractor as its obligee.

Licensing Requirements: Public Protection versus Public Revenue

State licensing statutes can generally be divided into two classes: revenue collecting statutes or public protection statutes. The distinction is critical for the surety trying to evaluate liability under a bond issued to an improperly licensed contractor. The rule was succinctly stated in *Zandell v. Zerbe*, 528 N.Y.S. 2d 779 (1988), that where the contract that the plaintiff seeks to enforce, either express or implied, is expressly or by implication forbidden by the common law or the statutory law, especially statutes designed to protect the public, no court will give its assistance to enforce the contract. However, recovery by an unlicensed contractor has been permitted in limited situations, as where the licensing statute is expressly designed to raise revenue, the acts are *malum prohibitum*, there is no clear legislative intent to void such contracts, or there is no danger to public safety.

In *Welles v. Revercomb, et al.*, 54 S.E.2d 878 (1949), an unlicensed general contractor was employed to build a stable and house for the owners. The owners stopped paying according to the construction contract and the contractor perfected a mechanics lien and filed suit to enforce it. The defendant owners argued that the construction contract was unenforceable because the contractor was unlicensed. The question before the court was whether the licensing statute was enacted for the sole purpose of collecting revenue or whether the statute was designed to protect the public from fraud or protect the public safety. The licensing statute declared that it was unlawful for any person to engage in an activity for which a license was required without paying the license tax. The statute required a contractor to obtain such a license, and the fee was based on the amount of business the contractor did during the previous year. If a contractor did business without obtaining the required license, he or she was subject to a 10 percent penalty added on to the license fee. Further, the statute did not set out any minimum experience or qualifications that a contractor had to have before obtaining a license, nor was there any testing require-



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ment to obtain a license. The court held that the statute was not enacted to protect the public, but to collect public revenue. Therefore, the contract between the owner and the contractor was valid and enforceable.

The public policy for the licensing of contractors is generally articulated by statute and the licensing procedure is governed by that statute. For example, West Virginia's licensure statute, the West Virginia Contractor Act, provides that:

all persons who wish to perform contracting work in West Virginia must be licensed to ensure that "capable and skilled craftsmanship [is] utilized in construction projects... both public and private, fair bidding practices [are used] between competing contractors through uniform compliance with the laws of this state, and... the public [is protected] from unfair, unsafe and unscrupulous bidding and construction practices.

W. Va. Code §21-11-2. The code defines a "contractor" as:

a person who in any capacity for compensation, other than as an employee of another, undertakes, offers to undertake, purports to have the capacity to undertake, or submits a bid to construct, alter, repair, add to, subtract from, improve, move, wreck or demolish any building, highway, road, railroad, structure or excavation associated with a project, development or improvement, or to do any part thereof, including the erection of scaffolding or other structures or works in connection therewith, where the cost of the undertaking is two thousand five hundred dollars or more [and] includes a construction manager who performs management and counseling services for a construction project for a professional fee.

W. Va. Code §21-11-3(c). Under the statute, a "specialty contractor" is someone who engages in specialty contracting services that do not substantially fall within the scope of any contractor classification otherwise set forth in the statute. W. Va. Code §21-11-3(n). The statute also defines a "license" as a license to engage in business in West Virginia as a contractor in one of the classifications set out in the statute. W. Va. Code §21-11-5(h).

The West Virginia Code also provides that "no person shall engage in this state in any act as a contractor, as defined in this article,

unless such person holds a license issued under the provisions of this article. No firm, partnership, corporation, association or other entity shall engage in contracting in this state unless an officer thereof holds a license issued pursuant to this article." W. Va. Code §21-11-6(a). Finally, the code provides that "[n]o license may be used for any purpose by any person other than the person to whom the license is issued" or "be assigned, transferred or otherwise disposed of so as to permit the unauthorized use thereof." W. Va. Code §21-11-9.

Anyone who participated in the unlawful act could not recover damages for the consequences of the act.

In general, any contract or agreement that has for its effect anything that is repugnant to justice or against public policy, or contrary to the provisions of any statute, is void. *Capehart v. Rankin*, 3 W.Va. 571 (1869). A contract made in violation of a statute is void. *F.S. Bowen Electric Co. v. Foley*, 72 S.E.2d 388 (Va. 1952).

In *Poling v. Bd. of Educ. of Philippi Independent Dist.*, 49 S.E. 148 (W.Va. 1904), the court explained the purpose behind declaring contracts that violate public policy statutes to be void.

Of what avail is the statute, if the very person at whom it is aimed takes the fruit of its violation? If we say that such a contract is good in law, then we encourage such contacts, promote the vice which the law condemns, and offer a premium for it. The law books say that it is a good test of the validity or invalidity of a contract whether its enforcement would encourage the mischief condemned. If it would do so, the contract is void.

Id. at 148. No particular injury had to occur as a result of the violation of the statute to void the contract.

[P]ublic policy is that principle which holds that no one can lawfully do what is injurious to the public or against the public good. "Where a contract belongs to this class, it will be declared void though in the particular instance no injury to the public may have resulted. In other words, its

validity is determined by its general tendency at the time, and if this is opposed to the interests of the public, it will be invalid, even though the intent of the parties was good, and no injury to the public would result in the particular case.

Id. at 149 (citation omitted).

Poling cited to two early Supreme Court cases, *Harris v. Runnels*, 53 U.S. 79 (1851) and *Miller v. Ammon*, 145 U.S. 421 (1892). These cases held that if the statute prohibits and penalizes an act and is silent as to whether the contract is void and contains nothing from which the contrary may be inferred, a contract in derogation of the statute is void. The fact that the statute was violated implies prejudice.

The concepts outlined above have been applied in numerous cases in other states involving unlicensed contractors. In *RCDI Constr., Inc. v. Spaceplan/Architecture, Planning & Interiors, BA*, 148 F.Supp.2d 607 (W.D. N.C. 2001), the court held that contracts entered into by an unlicensed construction contractor in violation of the statute passed for the protection of the public were unenforceable by the contractor. Further, anyone who participated in the unlawful act could not recover damages for the consequences of the act. *White v. Miller*, 718 So.2d 88 (Ala. Civ.App. 1998), held that an express or implied contract entered into by an unlicensed general contractor is null and void because such contracts violate public policy. See also, *TOPRO Serv., Inc. v. McCarthy Western Const., Inc.*, 856 F.Supp. 1461 (D.Co. 1994) (failure to obtain a license renders contracts void against public policy); *Truitt v. Miller*, 407 A.2d 1073 (D.C.App. 1979) (contract made in violation of the state licensing statute is void); *F.S. Bowen Elec. Co.*, 72 S.E.2d 388 (Va 1952) (contract made in violation of a state licensing statute for the public protection is void) and *Comet Theatre Enter., Inc. v. Cartwright*, 195 F.2d 80 (9th Cir. 1952) (contract made by an unlicensed contractor is illegal and void).

Impact of Principal's Licensure Status on its Surety and Other Enforceability Issues

If the underlying contract with the principal is void, the surety should not be required to validate the contract by paying on the bond. A surety can argue that it is not liable on a bond issued to an unlicensed contractor. In

Kvaerner Constr., Inc. v. American Safety Cas. Ins. Co., 847 So.2d 534 (Fla.App. 2003), the court found that, as a matter of public policy, since a general contractor could not enforce its contract with an unlicensed subcontractor, it could not indirectly recover on the contract by enforcing as against a surety the obligations under the subcontract performance bond furnished by that subcontractor. Kvaerner was the general contractor on a project to build an assisted living facility in Hernando County, Florida, and entered into a \$1,173,000 subcontract with Steel Tec, a steel subcontractor, to do steel framing and decking on the project. The subcontract required Steel Tec to provide Kvaerner with a performance bond and a labor and material payment bond. These bonds were issued by American Safety. After Steel Tec started working on the project in late 1998, the owner, Hernando County, stopped its work because Steel Tec was unlicensed. Kvaerner declared Steel Tec in default for failure to have a contractor's license and for breach of its subcontract, and made a demand against American Safety under the performance bond.

The Florida Court of Appeals noted that, pursuant to state statute and case law, contracts by unlicensed contractors were unenforceable. The surety argued that, since Kvaerner hired Steel Tec knowing that it was unlicensed, Kvaerner could not enforce its contract with Steel Tec and therefore could not recover on the performance bond issued by American Safety because the liability of a surety cannot be greater than that of its principal. Under the Florida state licensing statutes, all persons or entities doing business in Florida had to have all necessary licenses prior to acting in the capacity of a contractor. Further, no contractor could allow any subcontractor to work on any job under the contractor's supervision unless the subcontractor possessed all necessary state licenses. Florida Statute §49.128, and Hernando County Ordinance 93-20 and 98-02. The court found that Steel Tec should have obtained a specialty steel erection contractor's license as defined under this statute. Kvaerner claimed that it did not know prior to the stop work order being issued that Steel Tec was not properly licensed. Steel Tec did not obtain the requisite license because Steel Tec's owner failed the licensing test. He considered his license to be 'pending' until he could take another test.

The court found it significant that Kvaerner knew Steel Tec did not have a license even before work began on the project:

This testimony shows Kvaerner knew Steel Tec had no license even before work started on the project. Kvaerner's argument that it should be absolved from any culpability because Hernando County may have been uncertain as to what license was required is without merit. The county is not privy to the details the contract requires of the parties. That is why typically it is the general contractor's responsibility under the contract with the owner to assure that subcontractors are validly licensed before they start the work.

847 So.2d at 39 (citing *Poole and Kent Co. v. Gusi Erickson Const. Co.*, 759 So.2d 2 (Fla.2d DCA 1999)). In *Gusi Erickson*, the court noted that "[i]t is the general contractor's responsibility under a contract with the owner to assure that subcontractors are validly licensed before they start the work." 759 So.2d at 11.

The court in *Kvaerner* found that, since the general contractor, Kvaerner, hired Steel Tec knowing it had no license and allowed it to work on the project without a license, Kvaerner could not enforce its contract with Steel Tec. Therefore, as a matter of public policy, the court held that the general contractor could not indirectly recover on an illegal contract by enforcing the provisions of the subcontract performance bond against the surety.

Defenses to Ameliorate the Contractor's Failure to Obtain a License

Entities attempting to enforce contracts involving an unlicensed contractor have interposed several arguments, including that:

- The unlicensed contractor was properly licensed in another state.
- The unlicensed contractor obtained a valid license subsequent to entering into the construction contract.
- The subsequent assignment of the construction contract to a properly licensed contractor.
- The party seeking to invalidate the contract is estopped from doing so, or the party has waived any claim that the contract is unenforceable.
- The actual work was done by a properly licensed individual.

The defenses generally fall into two categories, substantial compliance or estoppel. In *RCDI Construction*, 148 F.Supp.2d 607 (W.D. N.C. 2001) a construction management company, RCDI-CM entered into a construction contract with an individual to build a hotel. RCDI-CM assigned the construction contract to a wholly owned construction contractor, RCDI. RCDI was a licensed contractor in the state where the hotel was to be built, but RCDI-CM did not have a contractor's license. After a catastrophic water discharge occurred, RCDI-CM was prohibited from completing the contract and thereafter brought suit against the owner. Because RCDI-CM was an unlicensed contractor, the court refused to enforce the construction contract. RCDI-CM argued that because it was a properly licensed contractor in another state, it should be allowed to enforce the contract. The court found that under the express terms of the state licensing statute, all contractors desiring to serve as a general contractor in that state had to apply to the licensing board, but the board had the discretion to grant a license to a contractor already licensed in another state without requiring that contractor to sit for a licensing exam. Nonetheless, all contractors working in the state had to have a valid contractor's license issued by the state. Since RCDI-CM did not have the required state license, it could not enforce the contract.

The subsequent procurement of a license will not validate a contract entered into by a contractor who was unlicensed at the time. In *Brady v. Fulgham*, 309 N.C. 580, 308 S.E.2d 327 (1983), a contractor attempted to collect the remaining balance owed for the construction of a home. The unlicensed contractor entered into a written contract in February of 2000 and started construction. The contractor was not granted a license until October of 2000, when he finally passed the licensure exam on his second attempt. The court rejected the contractor's argument that he had substantially complied with the licensing statute, because the contract was illegal at its inception. The contractor's subsequent procurement of a license could not validate an initially illegal contract.

The assignment of a contract entered into by an unlicensed contractor cannot be validated by the subsequent assignment of the contract to a licensed contractor. In *Jenco v.*

Signature Homes, Inc., 468 S.E.2d 533 (N.C. Ct. App. 1996), the court held that a contract entered into by an unlicensed contractor, and then transferred to a company that was properly licensed, did not cure the initially illegal contract. *See also RCDI, supra.*

Further, the defenses of waiver and estoppel are generally not available to an unlicensed contractor. In *TOPRO Serv., Inc. v. McCarthy Western Constr., Inc.*, 856 F.Supp. 1461 (D.C. Colo. 1994), a contractor filed an action against a general contractor and its surety to recover damages for breach of contract or unjust enrichment. The general contractor and the surety claimed in their motions for summary judgment that the subcontractor could not bring suit because it was not licensed to perform the work under the applicable state statute. Initially, the court determined that the failure of a contractor to have a proper license rendered the contract void and against public policy. TOPRO argued that it even though it was not licensed it could bring suit on several bases, including estoppel and waiver, and because the general contractor knew that the subcontractor was not licensed. The court rejected this argument stating that the defenses of waiver and estoppel cannot be invoked against a contract that is void at its inception because the contractor was unlicensed.

Finally, a construction contract entered into by an unlicensed contractor is still void even if the actual work is done by a properly licensed person or subcontractor. In *TOPRO*, the unlicensed contractor had the work in issue performed by licensed subcontractors. However, the state licensing statute required that the contracting party whose contract gives rise to the claim be properly licensed. Similarly, in *RCDI*, the court held even though RCDI did the construction work, and was properly licensed at the time, RCDI was not an original party to the contract and thus the contract was still illegal. Even when an individual officer or employee of the unlicensed contractor is properly licensed, this does not inure to the benefit of the unlicensed contractor who executed an illegal contract. *Joe Newton Inc. v. Tull*, 330 S.E.2d 664 (N.C. Ct. App. 1985).

Conclusion

In situations involving contractors from different states and localities, it is important for both the surety and its principal to be familiar with the licensing statutes of the state in which the construction project is located. Although a contractor or subcontractor may be properly licensed in its home state, it may not be properly licensed in the state where the construction project is located. The state's licensing statute or the

construction contract itself may require that an out-of-state contractor comply with the local licensing statutes. If the defaulting contractor is unlicensed, its surety may be presented with an opportunity to avoid liability under the bonds if the underlying contract is void, but it needs to analyze its potential exposure. To determine if the contract is void, the surety must carefully review the particular state's licensing statute to determine if it is solely a revenue collection statute, or whether it is designed to protect the public by requiring contractors to comport with minimum standards of competency that must be demonstrated by experience or testing. If a licensing statute is a public protection statute, then the contract is void from its inception. Even if the contractor is properly licensed in another state or an officer or employee of the contractor has the proper license, or the contractor subsequently obtains the proper license, these subsequent efforts or other ameliorating factors cannot cure a contract that was illegal at the outset. Further, an illegal contract cannot be enforced based on principles of waiver or estoppel. A contract that is void cannot be enforced against the surety because to do so would validate and enforce a contract against the surety that could not be enforced against the contracting parties.

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