

**Office of  
The City Attorney  
City of San Diego**

**MEMORANDUM  
MS 59**

**(619) 533-5800**

**DATE:** September 28, 2015  
**TO:** Elif Cetin, Senior Civil Engineer, Public Works Department  
**FROM:** City Attorney  
**SUBJECT:** Fire Station No. 45 and Contractor License Lapse (Echo Pacific Construction, Inc.)

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**QUESTION PRESENTED**

Can the City of San Diego (City) seek disgorgement of money paid to Echo Pacific Construction, Inc. (Echo) whose California State contracting license lapsed during performance of the public works contract to construct Fire Station No. 45?

**SHORT ANSWER**

If the contractor cannot show substantial compliance with the state licensing requirements or retroactive reinstatement of their license, then the City could stop payments and seek disgorgement of all payments previously made during the project. However, if the contractor can prove substantial compliance with state licensing law or show retroactive reinstatement of their license, the City would not likely succeed in a legal action to seek and recover disgorgement of payments already made to the contractor.

**FACTS**

In December 2013, the City entered into a construction contract with Echo Pacific Construction, Inc. (Echo) to construct Fire Station No. 45 (Project). At the time of submitting bids and prior to award of the contract, the City verified with the California State Licensing Board (CSLB) that Echo held the required license type and that it was valid. At that time, Echo held a valid Class B License. Since the award of the contract to Echo, they have performed under their contract without incident. The Project is scheduled for completion by the end of September 2015.

On Thursday, May 21, 2015, it was brought to the City's attention that Echo was performing work on the Project with an expired license. The CSLB website showed the license had expired

on April 30, 2015. It appeared that Echo had failed to renew their contractor's license in a timely manner. The City contacted Echo about this issue and asked for an explanation. The next day, Echo informed the City that due to a clerical error, their license had not been renewed timely. They represented to the City that they had requested a renewal form from CSLB that day and would process the forms as soon as they received it and seek retroactive renewal of their license. They claimed they would receive a 90-day grace period for retroactive renewal.

On Friday, May 29, 2015, the City sent Echo a Notice of Default letter to inform them that they were in breach of their contract and had five working days to rectify the situation. By 1:45 p.m. that same day, the CSLB website reflected Echo's license as "active." There is no new or changed issue date on the website and it shows no break in service.

### ANALYSIS

In the state of California, the CSLB governs the construction business. Many of the legal requirements the CSLB enforces are found in the California Business and Professions (B&P) Code, including the requirement that contractors be licensed. Cal. Bus. & Prof. Code § 7025, et. seq. The purpose of a contractor's license is to evidence requisite skill and character. *WSS Industrial Construction v. Great Western Contractors, Inc.*, 162 Cal. App. 4th 581, 587 (2008). B & P Code section 7031 states that a contractor may not maintain any action, legal or equitable, to recover compensation for the performance of any act or contract unless he or she was duly licensed at all times during the performance of the act or contract. The legislative intent of that section "reflects a strong public policy, which favors protecting the public from unscrupulous and incompetent contractors." *Id.*

The California Supreme Court in *MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works*, 36 Cal. 4th 412 (2005), analyzed section 7031. In *MW Erectors*, the second tier subcontractor was unlicensed at the time the contract between the first tier subcontractor and second tier subcontractor was signed, and the second tier subcontractor performed work under that contract before their license was active. The first tier subcontractor then argued that under section 7031(a) of the B & P Code, they were not legally required to pay for services rendered by this second tier subcontractor and in fact this second tier subcontractor could not seek any judgment against the first tier subcontractor because they were not "a duly licensed contractor at all times during the performance of that act or contract." *MW Erectors*, 36 Cal. 4th at 425. The Court agreed with this assessment and added that "[s]ection 7031(a) will be applied, regardless of equitable considerations, even when the person for whom the work was performed has taken calculated advantage of the contractor's lack of license." *Id.* at 424. B&P Code section 7031(b) goes on to allow one to sue to recover "all" compensation paid to an unlicensed contractor for the contract. This would allow for disgorgement of payments already made to an unlicensed contractor (or subcontractor).

However, there are two exceptions from this draconian rule in the B&P Code. First, B&P Code section 7031(e) states that if a contractor can meet a four prong test and show substantial compliance with the licensing laws, the contractor will be allowed to recover all payments. The four prongs are that the contractor:

(1) had been duly licensed as a contractor in this state prior to the performance of the act or contract, (2) acted reasonably and in good faith to maintain proper licensure, (3) did not know or reasonably should not have known that he or she was not duly licensed when performance of the act or contract commenced, and (4) acted promptly and in good faith to reinstate his or her license upon learning it was invalid.

Cal. Bus. & Prof. Code § 7031(a).

In the *MWErectors* case, the second tier subcontractor could not rely on this exemption because the second tier subcontractor could not meet the first prong on the test: the second tier subcontractor did not have a license prior to performing, thus could not rely on the statutory doctrine of substantial compliance. In this situation, Echo was properly licensed at the time of award of the contract, which would meet the first prong. Echo has argued that this has not happened in the past and due to circumstances beyond their control and without their knowledge, the lapse occurred, arguably meeting the second and third prongs. Once the lapse was brought to Echo's attention, they responded promptly and were able to get their license renewed in a matter of days meeting the fourth prong.

The second exception would be retroactive reinstatement of their expired license. Under B&P Code section 7141.5:

The registrar may grant the retroactive renewal of a license if the licensee requests the **retroactive renewal** in a petition to the registrar, files an application for renewal on a form prescribed by the registrar, and **pays the appropriate renewal fee and delinquency fee** prescribed by this chapter. This section shall only apply for a **period not to exceed 90 days** from the due date and only upon a showing by the contractor that the failure to renew was **due to circumstances beyond the control of the licensee**.

Cal. Bus. & Prof. Code § 7141.5 (emphasis added).

This section gives contractors a grace period for circumstances beyond their control. According to Echo, they made representations to the CSLB that the circumstances causing the lapse were beyond their control and they paid the requisite renewal and delinquent fees and made a request for retroactive renewal. Since Echo sent their renewal on Wednesday, May 27, 2015, and their license reflected "active" by 1:25 p.m. on Friday, May 29, 2015, it would appear that their application was accepted without issue. The expiration date did not change, thus supporting the inference that CSLB accepted the representations by Echo and made their renewal retroactive.

If the City wants to pursue disgorgement of all funds paid to Echo on the Project, then the issue of licensure would fall on Echo to prove. B & P Code section 7031(d) states that if licensure is controverted, the burden of proof to establish licensure is on the licensee. Echo would need to provide proof of uninterrupted licensure with a Verified Certificate of Licensure from the CSLB.

*Pacific Custom Pools, Inc. v. Turner Construction Co.* 79 Cal. App. 4th 1254, 1260 (2000). Echo will argue both exceptions under the B & P Code, under section 7031(e) substantial compliance with the licensure requirement and under section 7141.5 retroactive reinstatement of their license with no lapse. The issue of substantial compliance will revolve around the evidence to support the second and third prongs of B & P Code section 7031(e).

As to retroactivity of license renewal, it appears from the CSLB website that Echo's application for license renewal was retroactively reinstated with the expiration date being only two years from the original expiration date. The original expiration date was April 30, 2015, and the new expiration date is April 30, 2017. They did not get a new expiration date from the reinstatement date of May 29, 2015.

The facts presented suggest that Echo can show substantial compliance and possibly retroactive reinstatement of their license as well. Therefore, the City should evaluate carefully whether to pursue legal action to recover payments already made to Echo.

### CONCLUSION

In conclusion, the general rule is that a contractor may not maintain a ny action, legal or equitable, to recover compensation for the performance of any act or contract unless he or she was duly licensed at all times during the performance of the a ctor contract. Cal. Bus. & Prof. Code § 7031. There are two exceptions to the general rule, first if the contractor can show substantial compliance with the licensure laws, meeting the four prongs of section 7031(e), they will not be deemed unlicensed for purpose of disgorgement of funds during their contract. Alternatively, if the contractor can show retroactive reinstatement of their license, in which the lapse was caused by factors beyond their control they will not be deemed unlicensed at any time during performance of the work. The facts known suggest Echo was able to get their license reinstated retroactively and that they meet the four prongs of section 7031(e) to show substantial compliance. However, whether to pursue a claim for disgorgement of compensation to Echo is a policy call for the City. Further, additional facts could change this analysis. This Office stands ready to provided you assistance should the City obtain more facts, or desire to further explore a claim against Echo.

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By           /s/ Christina Rae            
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