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A Contractor's Change In Business Form Does Not Create A Gap In Licensing Or Require Disgorgement Under Business And Professions Code Section 7031, If The Contractor Remains Duly Licensed At All Times During The Performance Of Work Under The Construction Contract

From 1982 through 2015, John D. S. Stone (Stone) held a California general contractor's license and did business under that license as Stone Construction Company, a fictitious business name for his sole proprietorship. In early 2015, Stone and Yosef Manela (Manela) began discussing a major home remodeling project on the Manela's property. On January 4, 2015, Stone, as a sole proprietor doing business as Stone Construction Company, signed a contract with Manela regarding the project. The contract provided that, "Stone Construction Company will perform the work specified herein..." and included a price and estimated completion date of December 2015.

On February 11, 2015, after work on the project began, Stone formed JDSS, a corporation doing business under the same fictitious business name as Stone's sole proprietorship, Stone Construction Company. Stone was the sole shareholder of the corporation. He applied to the Contractors State License Board (CSLB) to reissue his existing contractor's license to JDSS. While waiting for the CSLB to reissue the license, on March 15, 2015, Stone executed an agreement between himself and JDSS that purported to formally assign to JDSS all of his "rights and obligations" under the contract with Manela. The CLSB reissued Stone's license to JDSS on June 22, 2015. The first invoice from JDSS to Manela was dated August 15, 2015, which is after JDSS was licensed by the CLSB; all subsequent invoices to the Manelas are from JDSS as well.

Throughout the course of the project, Manela requested numerous change orders that expanded the scope of the project, increased the cost, and delayed the estimated completion date. In late 2018, the project still was not completed and the Manelas stopped paying JDSS's invoices. The Manelas then filed a complaint against Stone and JDSS alleging they had performed defective work. Stone, on behalf of himself and JDSS, recorded a mechanic's lien on the Manela property for the allegedly unpaid invoices, and filed an action to foreclose on the lien.

The Manelas initial complaint did not include allegations based on lack of licensure. However, they amended their complaint to add allegations that JDSS and "possibly Stone," had performed work on the project without a contractor's license in violation of Business and Professions Code

Section 7031. Section 7031, subdivision (a) prohibits any “person engaged in the business or acting in the capacity of a contractor” from recovering compensation where a license is required, if they were not duly licensed at all times during the performance of the contract. Subdivision (b) of the section further requires disgorgement of compensation already paid under such circumstances. The Manelas argued that the assignment of the construction contract prior to the licensure of JDSS created a gap in the licensure even if Stone was always the person performing the contract work. The trial court agreed with the Manelas and ordered the removal of the mechanic’s lien. Stone filed an immediate petition for writ of mandate challenging the court’s order.

The appellate court found that Stone’s assignment of the construction contract to JDSS did not create a gap in licensure and JDSS’s assignment did not trigger Section 7031 forfeiture. The appellate court further found that allowing a change in business form to create a gap in licensing would lead to “absurd results” and would preclude licensed sole proprietors from lawfully incorporating at any time during a construction period. The licensing law’s purpose is not to forbid change from individual to corporate form but to assure that a qualified person conduct the actual construction work. The court reversed the order of the trial court removing the mechanic’s lien and instructed the lower court to enter a new order confirming the validity of the lien.

Manela v. Stone (2021) 66 Cal.App.5th 90.

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