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It's Not Just About Doing Good Work—License Suspension for Failing to Obtain or Maintain Workers' Compensation Coverage

In 2007 Wright v. Issak¹ shocked the construction industry by ruling that a licensed contractor who underreported payroll to its workers' compensation insurer was subject to an automatic retroactive suspension of its contractor's license, barred from suing to recover for work performed while unlicensed and could be compelled to return all compensation received from its customers while conducting business as an unlicensed contractor. (Ref., Business & Professions ("B&P") Code sections 7125.2, 7031(a) and (b).)

Left unanswered by the court's ruling in Wright was whether contractors can be held **strictly liable** for the failure to obtain or maintain workers' compensation insurance even when an unintentional or good faith mistake occurs. For instance, would retroactive license suspension apply to a general contractor unaware that one of its subs lost its license during performance of a contract? Under Wright the harsh answer is yes!

In May, 2010, Wright's impact was refined under Loranger v. Jones². Loranger concludes that automatic license suspension will not apply under circumstances where (a) the contractor can show it otherwise obtained and maintained workers' compensation insurance for its actual employees, and (b) there is no evidence to suggest that either unreported *de facto* employees or actual employees would not be covered. Loranger recognizes that sometimes, when a discrepancy is revealed or a mistake occurs in payroll reporting to workers' compensation insurance, the contractor should not be subject to strict liability and the impact of Wright.

Loranger involved a change order payment dispute on a residential construction project. Loranger Construction (the general contractor) filed a suit against the homeowners (the Joneses) who then filed a cross-complaint. The Joneses asserted that Loranger hired unlicensed subcontractors and used two teenagers to perform work on the project. Using these facts, the Joneses argued Wright should apply because Loranger failed to report payroll to its workers' compensation insurer for its *de facto* employees and for the two teenagers. The Joneses concluded that they were not only excused from paying for disputed extras, but also entitled to a return of all monies paid to Loranger. During trial, however, Loranger proved it had maintained workers' compensation insurance during the time it worked at the Joneses' home and that the *de facto* employees and teenagers would be covered by its workers' compensation policy.

¹ (6th App. Dist., 2007) 149 Cal.App.4th 1116

² No. C061517 (C.A. 3rd, April 23, 2010, certified for publication, May 13, 2010). A copy of Loranger can be found by following this link: <http://bit.ly/8XkO6S>.



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The trial court ruled in Loranger's favor, the Joneses appealed and the Appellate Court affirmed the trial court's judgment.

The main distinction between Wright and Loranger is that the contractor in the Wright case clearly engaged in a pattern of deceptive practices bordering on insurance fraud whereas Loranger acted in good faith to maintain workers' compensation coverage. In Wright, the contractor reported payroll of \$312.00 while having an actual payroll of \$135,000.00. Further, the contractor was found to have established a pattern and practice of intentionally under-reporting its payroll to its workers' compensation carrier³. Under Loranger however, the Court found that although there may have been unreported *de facto* employees and the teenagers' wages were unreported, when placed in a larger context with Loranger's demonstrated history of having workers' compensation insurance throughout the project, coupled with a lack of evidence to suggest that the *de facto* employees and teenagers would not be covered by the insurance policy, automatic license suspension under Wright would not apply.

To avoid the harsh consequences of the Wright case, contractors with employees must (1) obtain and maintain workers' compensation for their employees, (2) accurately report their payroll to their workers' compensation carriers, (3) take immediate action to correct any reporting mistakes, (4) obtain certificates of workers' compensation insurance from subcontractors, (5) routinely verify license status and insurance status for subcontractors, and (6) verify that a contractor who reports "exempt" from workers' compensation insurance with the Contractors' State License Board isn't merely trying to duck the requirement for workers' compensation insurance to avoid covering its workers.

If you have any questions or comments regarding this article, please do not hesitate to contact Scott Green at The Green Law Group, LLP.

Please note that this article is only intended to provide some general educational information. For your particular legal questions, be sure and consult with an attorney.

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³ Wright 149 Cal.App.4th at 1119.