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## Where Law Meets Equity: Evidentiary Hearings Under California Business and Professions Code Section 7031

Eric R. Reed

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## Where Law Meets Equity: Evidentiary Hearings Under California Business and Professions Code Section 7031

### Cover Page Footnote

Staff Attorney, California Court of Appeal, Second Appellate District. The author wishes to thank Beth Behnam, Sebastian Nelson, and Lisa Prince of the California State Archives for critical legislative research. The views stated in this Article are the author's alone.

# WHERE LAW MEETS EQUITY: EVIDENTIARY HEARINGS UNDER CALIFORNIA BUSINESS AND PROFESSIONS CODE SECTION 7031

*Eric R. Reed\**

*California's contractor licensing statutes severely penalize unlicensed contractors. Even a brief license disruption may result in a contractor being unable to collect unpaid invoices or having to disgorge money received for past work. Courts began developing a "substantial compliance" exception to these statutes shortly after the legislature enacted them. This institutional tug-of-war prompted the legislature to codify the exception in section 7031(e) of the California Business and Professions Code, and, later, to create a unique stand-alone procedure for adjudicating substantial compliance. Section 7031(e) refers to this procedure as an "evidentiary hearing" but gives little guidance about how to conduct such a hearing.*

*This Article first explores the evidentiary hearing's equitable roots in the judicial substantial compliance doctrine. Next, it discusses how counsel and judicial officers can use substantial compliance hearings to confront and resolve disputes involving contractors with licensing problems. Lastly, the Article concludes by proposing minor revisions to section 7031(e) that will clarify existing ambiguities, and, ideally, ensure the long-term viability of the statute and the unique procedure it created.*

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\* Staff Attorney, California Court of Appeal, Second Appellate District. The author wishes to thank Beth Behnam, Sebastian Nelson, and Lisa Prince of the California State Archives for critical legislative research. The views stated in this Article are the author's alone.

## TABLE OF CONTENTS

I. INTRODUCTION.....	558
II. BUSINESS AND PROFESSIONS CODE SECTION 7031 AND THE JUDICIAL SUBSTANTIAL COMPLIANCE DOCTRINE.....	558
A. The Origins of Business and Professions Code Section 7031.....	559
B. Courts Develop the “Substantial Compliance Doctrine” to Preserve the Standing of Unlicensed Contractors That Satisfy Certain Criteria.....	560
C. The Legislature Abolishes Judicial Substantial Compliance.....	564
D. The Legislature “Conditionally Resurrects” the Doctrine and Introduces the Evidentiary Hearing.....	565
E. Disorgement: Consumers Get a Sword.....	566
III. THE EVIDENTIARY HEARING IN CASE LAW—1993 TO PRESENT.....	568
IV. PRACTICAL CONSIDERATIONS FOR LITIGANTS AND JUDICIAL OFFICERS CONFRONTING CONTRACTOR LICENSING ISSUES...	570
A. Counsel for Contractors.....	571
1. Evaluating the Contractor’s Substantial Compliance Defense.....	571
2. Identifying Potential CSLL Violations That May Lead to Suspension of a Contractor’s License as a Matter of Law.....	573
3. Representing the Contractor Sued by a Consumer Alleging CSLL Violations.....	573
4. Representing the Contractor That Insists on Suing a Consumer Despite CSLL Violations.....	574
B. Counsel for Consumers.....	575
1. Finding a Violation.....	575
2. Violations Appearing on a Contractor’s License Record.....	576
3. Mid-Project Suspensions and Violations Not Appearing on a Contractor’s License Record.....	577
C. Judicial Officers.....	578
1. Preliminary Considerations When Confronted with Contractor Licensing Issues.....	578
2. Discovery Relating to Substantial Compliance.....	579

3. The Subdivision (e) Hearing as an Alternative to Summary Judgment or Adjudication .....	579
4. Evidentiary Hearings and Disgorgement Awards.....	581
5. Hearings During or After Trial .....	581
V. LOOKING AHEAD.....	582
VI. CONCLUSION.....	584

## I. INTRODUCTION

California law provides few protections for those who perform construction services without a license. A contractor experiencing the briefest license disruption may find him or herself unable to collect unpaid invoices or forced to disgorge money received for past work. Appellate courts spent much of the twentieth century developing a “substantial compliance” exception to protect contractors whose technical transgressions or excusable neglect did not warrant their harsh punishments under California law. The judiciary’s institutional tug-of-war with regulators prompted the legislature to codify the courts’ equitable concerns and to create a procedural tool to address these concerns without compromising the state’s regulatory aims. This procedural tool—an “evidentiary hearing” guaranteed by Business and Professions Code section 7031(e)<sup>1</sup>—is akin to a pleading challenge or dispositive motion. Little guidance is found in case law, court rules, regulations, or even section 7031 itself about how to conduct such a hearing.

This Article first explores the evidentiary hearing’s equitable roots in the judicial substantial compliance doctrine. Next, it discusses how counsel and judicial officers can use subdivision (e) hearings to confront and resolve disputes involving contractors with licensing problems. The Article concludes by proposing minor revisions to section 7031 that will clarify existing ambiguities, and, ideally, ensure the long-term viability of the statute and the unique procedure it created.

## II. BUSINESS AND PROFESSIONS CODE SECTION 7031 AND THE JUDICIAL SUBSTANTIAL COMPLIANCE DOCTRINE

Section 7031 of California’s Business and Professions Code serves as a “shield and sword” for consumers litigating with their contractors.<sup>2</sup> The shield, subdivision (a), deprives the unlicensed contractor of standing to seek compensation for services requiring a license.<sup>3</sup> This applies even if the consumer knows the contractor is not

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1. The author refers to the California Code unless noted otherwise.

2. *See White v. Criddlebaugh*, 100 Cal. Rptr. 3d 434, 443 (Ct. App. 2009) (“In 2001, the Legislature complemented the shield created by subdivision (a) of section 7031 by adding a sword that allows persons who utilize unlicensed contractors to recover compensation paid to the contractor for performing unlicensed work.”).

3. Subdivision (a) states as follows at the time of writing:

licensed and encourages performance nonetheless.<sup>4</sup> The sword, subdivision (b), allows the consumer to sue for disgorgement of all amounts paid under the contract.<sup>5</sup> This includes both labor and materials.<sup>6</sup> The legislature considers the “harsh and unfair results” to contractors outweighed by “the important public policy of deterring licensing violations and ensuring that all contractors are licensed.”<sup>7</sup>

### *A. The Origins of Business and Professions Code Section 7031*

The current section 7031 began its life in 1929 as part of the original California State License Law (CSLL).<sup>8</sup> The CSLL created the Contractors License Bureau, the predecessor of today’s Contractors State License Board (the “Board”), and contained the basic statutory framework the fledgling agency would use to better regulate the state’s quickly expanding rolls of professional builders. Section 12 of the CSLL contained much of subdivision (a)’s current “shield” language and criminalized acting in the capacity of a contractor without

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(a) Except as provided in subdivision (e), no person engaged in the business or acting in the capacity of a contractor, may bring or maintain any action, or recover in law or equity in any action, in any court of this state for the collection of compensation for the performance of any act or contract where a license is required by this chapter without alleging that he or she was a duly licensed contractor at all times during the performance of that act or contract regardless of the merits of the cause of action brought by the person, except that this prohibition shall not apply to contractors who are each individually licensed under this chapter but who fail to comply with Section 7029.

CAL. BUS. & PROF. CODE § 7031(a) (Deering 2020).

4. See *Hydrotech Sys., Ltd. v. Oasis Waterpark*, 803 P.2d 370 (Cal. 1991) (holding that an out-of-state subcontractor was barred from recovering unpaid invoices despite the client and general contractor promising to pay subcontractor regardless of licensing status).

5. Subdivision (b) states as follows at the time of writing: “Except as provided in subdivision (e), a person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor for performance of any act or contract.” CAL. BUS. & PROF. CODE § 7031(b).

6. See *Alatraste v. Cesar’s Exterior Designs, Inc.*, 108 Cal. Rptr. 3d 277, 289–90 (Ct. App. 2010) (citing *White*, 100 Cal. Rptr. 3d at 444–45).

7. *Id.* at 290; see also *MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co.*, 115 P.3d 41, 46–47 (Cal. 2005) (“Section 7031 represents a legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness between the parties, and that such deterrence can best be realized by denying violators the right to maintain any action for compensation in the courts of this state.” (emphasis omitted) (quoting *Hydrotech*, 803 P.2d at 374)).

8. See Act of Aug. 14, 1929, ch. 791, 1929 Cal. Stat. 1591, 1591–92 (“An act providing for the registration of contractors, and defining the term contractor; providing the method of obtaining licenses to engage in the business of contracting, and fixing the fees for such licenses; providing the method of suspension and cancellation of such licenses; and prescribing the punishment for violation of the provisions of this act.”).

registering with the newly-established Bureau.<sup>9</sup> Depriving unlicensed contractors of standing to enforce outstanding debts for their services was not a novel remedial concept, but rather, a repurposing of the common law tenet that a contract is void ab initio if created in violation of law.<sup>10</sup> Pre-CSLL authorities usually upheld licensing requirements in professions such as contracting and architecture so long as the regulating entity intended them to protect the public interest, and not simply generate revenue.<sup>11</sup>

*B. Courts Develop the “Substantial Compliance Doctrine” to Preserve the Standing of Unlicensed Contractors That Satisfy Certain Criteria*

It did not take long for consumers to appreciate the CSLL’s tactical potential. Anyone sued by one’s contractor for unpaid bills could gain tremendous leverage—or dispose of the case entirely—by showing the contractor ran afoul of the CSLL, and thus lacked standing under section 12.<sup>12</sup> Courts frequently found it difficult to stand aside while defendants used technical licensing transgressions to avoid paying legitimate debts for competently performed construction services. A doctrine of substantial compliance took shape within a decade. The doctrine’s progenitor is recognized case *Citizens State Bank v. Gentry*,<sup>13</sup> a 1937 intermediate appellate opinion arising out of the reconstruction of a theater property damaged during the 1933 Long Beach earthquake.<sup>14</sup>

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9. See *Holm v. Bramwell*, 67 P.2d 114, 116 (Cal. Ct. App. 1937) (“Any person who acts in the capacity of a contractor [or subcontractor] within the meaning of this act without a license as herein provided, . . . is guilty of a misdemeanor,” and shall be punished by a fine or imprisonment as described therein.” (first alteration in original) (quoting Act of Aug. 14, 1929 § 12)).

10. See *id.* (“It has been repeatedly held that a party to an illegal contract may not rest his cause or recover judgment based upon such void agreement.”).

11. See Renee A. Mangini, Comment, *The Contractors’ State License Law: From Strict Adherence to Substantial Compliance*, 9 WHITTIER L. REV. 613, 618 (1987) (“The courts have further established the rule that when a licensing statute is enacted for the protection of the public, a contract made by an unlicensed person in violation of the statute is void. In applying this rule to the [CSLL] . . . the effect is that any contract with an unlicensed contractor is void at the outset.” (citing *Wood v. Krepps*, 143 P. 691, 692–93 (Cal. 1914)); *Payne v. De Vaughn*, 246 P. 1069, 1071 (Cal. Ct. App. 1926) (citing *Levinson v. Boas*, 88 P. 825, 828 (Cal. 1907) (denying an architect’s claim for professional fees because he lacked license)).

12. See *Holm*, 67 P.2d at 115 (contractor sued owner who refused to pay for masonry work; court denied contractor’s claim because masonry subcontractor, while licensed at time of performance, did not hold license when he signed the subcontract).

13. 67 P.2d 364 (Cal. Ct. App. 1937).

14. *Id.* at 365. See generally Lawrence Jennings Imel, Comment, *Substantial Compliance with the Contractors’ State License Law: An Equitable Doctrine Producing Inequitable Results*, 34 LOY.



The contractor in *Gentry* held a license under his own name when first hired by the owner.<sup>15</sup> He renewed his license mid-project and requested the bureau re-issue it in the name of his newly formed corporation.<sup>16</sup> Later, the contractor sued the owner for unpaid bills.<sup>17</sup> The owner accused him of performing construction services without a license and moved for nonsuit because the contractor no longer held the license in place when he began working.<sup>18</sup> The trial court denied nonsuit.<sup>19</sup> The court of appeal affirmed the ruling on equitable grounds:

In our opinion, where a manifestly unjust and inequitable result would follow a holding that plaintiff contractor was without capacity to sue on his contract, the individual plaintiff in whose name the license stood at the time the contract was made and the corporate entity organized by him in whose name the license stood at the time the cause of action accrued, should be considered as one.<sup>20</sup>

The California Supreme Court encountered a similar situation nine years later in *Gatti v. Highland Park Builders, Inc.*<sup>21</sup> Gatti signed a residential building contract with defendant and hired Moore as the project's foreman.<sup>22</sup> Gatti and Moore decided for a mid-project to operate as a partnership.<sup>23</sup> Defendant consented to the arrangement but later refused to pay because Gatti and Moore, while individually licensed, violated the CSLC by not obtaining a separate partnership license.<sup>24</sup> The trial court entered judgment for the two contractors despite this violation.<sup>25</sup> The supreme court affirmed. Citing *Gentry*, it described Gatti and Moore as having "substantially complied" with the CSLC by maintaining their individual licenses during the project:

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L.A. L. REV. 1539, 1543–55 (2001) (surveying the doctrine's development over its first six decades).

15. *Gentry*, 67 P.2d at 365.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.* at 366–67.

21. 166 P.2d 265 (Cal. 1946).

22. *Id.* at 265.

23. *Id.*

24. *Id.*

25. *Id.*

If defendant is allowed to defeat plaintiffs' legitimate claim on this technical ground, resting on an unnecessarily strict construction of the statutory provision for the additional joint contractor's license and denying any effect to the combination license in fact issued to plaintiffs and a third person as above recited, the legislative scheme in relation to the licensing of contractors, intended "for the safety and protection of the public," would become an unwarranted shield for the avoidance of a just obligation.<sup>26</sup>

Lone dissenter Justice Douglas L. Edmonds characterized the decision as "directly contrary to the plain and positive language" of the CSLL.<sup>27</sup> The majority encroached on the legislature's authority to regulate the contracting business, he reasoned, by creating an ad hoc exemption to a comprehensive statutory framework:

There can be no substantial compliance with such a statute. Wisely or unwisely, the Legislature has specified that two persons individually licensed may not, as partners, engage in the contracting business without having obtained a license in the name of the partnership. Unquestionably, that requirement is within the scope of legislative action, and, therefore, beyond the reach of judicial consideration.<sup>28</sup>

Courts spent the next two decades exploring the doctrine's boundaries.<sup>29</sup> An elemental approach emerged in 1966's *Latipac, Inc. v. Superior Court*.<sup>30</sup> Justice Tobriner's majority opinion created a three-part test to determine which contractor-plaintiffs could invoke its protections:

- (1) "that plaintiff held a valid license at the time of contracting";
- (2) "that plaintiff readily secured a renewal of that license";
- and

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26. *Id.* at 266.

27. *Id.* at 267 (Edmonds, J., dissenting).

28. *Id.* (citing *Lucas v. City of Los Angeles*, 75 P.2d 599, 603-04 (Cal. 1938)).

29. *See, e.g.*, *Loving & Evans v. Blick*, 204 P.2d 23 (Cal. 1949); *Lewis & Queen v. N.M. Ball Sons*, 308 P.2d 713 (Cal. 1957); *Weiman v. Superior Ct.*, 336 P.2d 489 (Cal. 1959); *Bierman v. Hagstrom Constr. Co.*, 1 Cal. Rptr. 826 (Ct. App. 1959); *Precision Fabricators, Inc. v. Levant*, 6 Cal. Rptr. 395 (Ct. App. 1960).

30. 411 P.2d 564 (Cal. 1966).

(3) “that the responsibility and competence of plaintiff’s managing officer were officially confirmed throughout the period of performance of the contract.”<sup>31</sup>

The court’s most recent appointee, Justice Stanley Mosk, penned a dissent joined by Chief Justice Traynor and Justice McComb. He described substantial compliance as a “dangerous doctrine” and quickly picked up where now-retired Justice Edmonds left off two decades earlier.<sup>32</sup> Justice Mosk considered the latest iteration of the doctrine a foray into legislative territory that simply ignored those statutes it found troublesome.<sup>33</sup> The majority dismissed the idea that its decision created or perpetuated institutional tension: “For nearly three decades we have developed and applied to cases arising under section 7031 the doctrine of ‘substantial compliance’; during that entire period the Legislature has indicated no hint of disapproval of this construction.”<sup>34</sup>

*Latipac* left open whether contractors must satisfy all three factors to establish substantial compliance.<sup>35</sup> Subsequent lower court decisions suggested they did.<sup>36</sup> The high court next visited the doctrine in 1985. *Asdourian v. Araj*<sup>37</sup> described the *Latipac* factors as “considerations which might warrant application of the doctrine.”<sup>38</sup> Chief Justice Bird’s majority opinion described the judiciary’s core inquiry as deciding whether a contractor’s conduct satisfied the core policy of the CSLL, i.e., “to protect the public from the perils incident

31. *Id.* at 567.

32. *Id.* at 576.

33. *See id.* at 577 (Mosk, J., dissenting) (“Although one may well be sympathetic to the equitable arguments of the contractor, such arguments should be addressed to the Legislature rather than the court; the Contractors License Law . . . is a comprehensive regulatory statute the wisdom of which is not subject to our review.”). At least one contemporary commentator characterized *Latipac* as expanding rather than reciting the doctrine. *See* Paul E. Principe, Case Note, *Substantial Compliance with Contractors Licensing Statutes: Latipac, Inc. v. Superior Court* (Cal. 1966), 7 SANTA CLARA LAW. 157, 163 (1966) (“The majority . . . have relied on precedent and have somewhat ignored questions of legislative intent in sections 7031 and 7068.1. Those sections appear to require strict compliance but the courts have not so interpreted them.”).

34. *Latipac*, 411 P.2d at 567 (majority opinion).

35. *See id.* (“Since all these elements here concur, we need not determine whether any of them, singly or in more limited combination, would constitute ‘substantial compliance.’”).

36. *See, e.g.,* *Brown v. Solano Cnty. Bus. Dev., Inc.*, 154 Cal. Rptr. 700 (Ct. App. 1979); *Weeks v. Merritt Bldg. & Constr. Co.*, 114 Cal. Rptr. 209 (Ct. App. 1974); *Gen. Ins. Co. v. Superior Ct.*, 102 Cal. Rptr. 541 (Ct. App. 1972), *abrogated by Asdourian v. Araj*, 696 P.2d 95, 100 (Cal. 1985); *Frank v. Kozlovsky*, 91 Cal. Rptr. 297 (Ct. App. 1970).

37. 696 P.2d 95 (Cal. 1985).

38. *Id.* at 100 (emphasis added).

to contracting with incompetent or untrustworthy contractors.”<sup>39</sup> Like the court in *Latipac*, the majority highlighted the legislature’s silence as tacit acceptance of common law safeguards for “innocent” contractors whose technical CSLL violations prevent them from collecting valid debts: “It has now been almost five decades since the doctrine was first applied. The Legislature has manifested no disapproval. In the limited and extraordinary circumstances in which it is applied, the policies underlying the doctrine remain compelling.”<sup>40</sup>

*Asdourian* tied up *Latipac*’s loose ends by holding that a contractor need not satisfy all three factors if the facts of the case “clearly indicate substantial compliance which satisfies the policy of the Contractors License Law.”<sup>41</sup> Justice Mosk, the only remaining justice of the *Latipac* era, penned his second dissent on the subject. “To achieve what they perceive as a desirable result,” he wrote, “the majority employ equity in a simple contract action and in doing so they emasculate a legislative enactment that is clear and unambiguous.”<sup>42</sup>

### C. *The Legislature Abolishes Judicial Substantial Compliance*

*Asdourian* and its immediate progeny represented the high-water mark of judicial substantial compliance.<sup>43</sup> The legislature responded to the high court’s equitable muscle-flexing by passing Assembly Bill 841, a Board-sponsored bill introduced during the 1989–1990 session. The bill abolished the doctrine by appending twelve words to the end of section 7031 as subdivision (d): “The judicial doctrine of substantial compliance shall not apply to this section.”<sup>44</sup>

In effect, the legislature wiped fifty years of case law off the books as of January 1, 1990. This rebuke of judicial encroachment, as exemplified by *Asdourian*, served “as a warning to the courts that public policy behind [section 7031] was strong, despite its harsh

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39. *Id.* at 103 (quoting *Davis Co. v. Superior Ct.*, 81 Cal. Rptr. 453, 454 (Ct. App. 1969)).

40. *Id.* at 102.

41. *Id.* at 100.

42. *Id.* at 107 (Mosk, J., dissenting).

43. See *Knapp Dev. & Design v. Pal-Mal Props., Ltd.*, 219 Cal. Rptr. 44, 50 (Ct. App. 1985) (citing *Asdourian*, 696 P.2d at 101 (finding the presence of just one *Latipac* factor enough to establish substantial compliance)).

44. Act of Sept. 12, 1989, ch. 368, § 1, 1989 Cal. Stat. 1509, 1509 (current version at CAL. BUS. & PROF. CODE § 7031(d) (Deering 2020)).

impact upon the unlicensed person who had performed work in good faith.”<sup>45</sup> The amended statute also required contractors to establish their licensure immediately upon filing a collection action by “produc[ing] a verified certificate of licensure” from the Board or else face certain dismissal.<sup>46</sup>

*D. The Legislature “Conditionally Resurrects” the Doctrine and Introduces the Evidentiary Hearing*

Contractors with brief mid-project suspensions or other minor licensing issues found themselves without standing to initiate collection actions unless the underlying contract predated the 1990 amendment.<sup>47</sup> The industry reacted quickly. A year later the Southern California Contractor’s Association sponsored legislation “to ‘ensure that a contractor’s ability to operate as a licensed contractor is not jeopardized because of a technical error or oversight by the contractor.’”<sup>48</sup> Assembly Bill 1382 sought to amend section 7031 to include a “special exemption” for contractors who could demonstrate substantial compliance with the CSLL.<sup>49</sup> The Board initially opposed the bill out of concern it would “make life easier” for unlicensed contractors but later withdrew its opposition.<sup>50</sup> It passed unanimously in both the Assembly and Senate.<sup>51</sup> The following became subsection (d) of the newly amended section 7031:

The judicial doctrine of substantial compliance shall not apply to this section, except that a court may determine that there has been substantial compliance with licensure requirements, for purposes of this section, ***if it is shown at an evidentiary hearing*** that the person was a duly licensed

45. Edmund L. Regalia, *Is the Substantial Compliance Doctrine in Licensing of Contractors Still Alive and Well?*, 14 MILLER & STARR, REAL EST. NEWSALERT, May 2004, no. 5, at 1, 2.

46. Act of Sept. 12, 1989, § 1.

47. See G.E. Hetrick & Assoc., Inc. v. Summit Constr. & Maint. Co., 13 Cal. Rptr. 2d 803, 809 (Ct. App. 1992) (“In the case at bar, Hetrick, Inc. is entitled to rely on the statutorily disapproved doctrine of substantial compliance with the Contractors License Law, under the authority of *Hydrotech*. The contract and performance at issue in this suit precede the 1989 amendments to section 7031, which are not to be applied retroactively.”).

48. Constr. Fin., LLC v. Perlite Plastering Co., 61 Cal. Rptr. 2d 574, 581 (Ct. App. 1997) (quoting S. COMM. ON BUS., PROF. & ECON. DEV., ASSEMBLY BILL NO. 1382, 1991–1992 Reg. Sess., at 2 (Cal. 1991) (amended May 15, 1991)).

49. S. COMM. ON BUS., PROF. & ECON. DEV., ASSEMBLY BILL NO. 1382, at 2.

50. DEP’T OF CONSUMER AFFS., ASSEMBLY BILL NO. 1382, 1991–1992 Reg. Sess., at 2 (Cal. 1991).

51. See *id.* at 1.

contractor during any portion of the 90 days immediately preceding the performance of the act or contract for which compensation is sought, that the persons' category of licensure would have authorized the performance of that act or contract, and that noncompliance with the licensure requirement was the result of (1) inadvertent clerical error, or (2) other error or delay not caused by the negligence of the person.<sup>52</sup>

With statutory substantial compliance in place, the legislature turned its attention to another problem created by the 1990 amendment. The glut of certificate requests received by the Board in the wake of the amendment caused a six-month backlog at the agency.<sup>53</sup> Many *licensed* contractors began losing their cases only because they could not produce a certificate in time.<sup>54</sup> The Board sponsored an amendment to section 7031 during the 1992–1993 session requiring contractors to produce a certificate only when the opposing party controverted the contractor's license status.<sup>55</sup> The Board sponsored yet another amendment during the 1993–1994 session to clarify that “contractors still had the burden of proving licensure and there was no need for persons they were suing for compensation to produce the verified certificate.”<sup>56</sup>

### *E. Disgorgement: Consumers Get a Sword*

The flurry of amendments in the 1990s did not change section 7031's defensive character. It remained focused on the contractor, or rather, on depriving unlicensed contractors a forum in which to enforce their legal rights. The statute served as a shield to ward off collection lawsuits but stopped short of providing a remedy to aggrieved consumers. These consumers still needed to pursue out-of-pocket losses against an unlicensed contractor in the same manner as they would against a licensed contractor, i.e., by prevailing in a conventional breach of contract or construction defect action.

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52. Act of Oct. 8, 1991, ch. 632, § 1, 1991 Cal. Stat. 2936, 2937 (emphasis added).

53. See *Womack v. Lovell*, 188 Cal. Rptr. 3d 471, 479 (Ct. App. 2015).

54. See *id.*; see also *Buzgheia v. Leasco Sierra Grove*, 70 Cal. Rptr. 2d 427, 437 (Ct. App. 1997) (quoting ASSEMB. COMM. ON CONSUMER PROT., GOV'T EFFICIENCY AND ECON. DEV., ANALYSIS OF ASSEMBLY BILL NO. 2413, 1991–1992 Reg. Sess. (Cal. 1992)).

55. See Act of July 16, 1992, ch. 229, § 1, 1992 Cal. Stat. 1019, 1019.

56. *Womack*, 188 Cal. Rptr. 3d at 480 (emphasis omitted) (citing Act of Oct. 4, 1993, ch. 797, § 1, 1993 Cal. Stat. 4357, 4358).

This changed when the legislature passed Assembly Bill 678, which “add[ed] a sword remedy to the hiring party’s litigation arsenal.”<sup>57</sup> The bill added the following subdivision to section 7031 effective January 1, 2002: “A person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all compensation paid to the unlicensed contractor for performance of any act or contract.”<sup>58</sup>

The bill’s final floor analysis cited a recent Court of Appeal opinion as highlighting the need for a built-in consumer remedy to round out the statute’s defensive provisions:

According to the sponsor, this bill is intended to address the recent case of *Cooper v. Westbrook Torrey Hills, LP* (2000) 81 Cal. App. 4th 1294, in which the court . . . referred to the Business and Professions Code, Section 7031(a) prohibiting an unlicensed contractor from recovering fees, but not requiring any refund of compensation already paid to the contractor. *Cooper* relied on *Culbertson v. Cizek* (1964) 225 Cal. App. 2d 451, 473, in which the court permitted the unlicensed contractor to offset “as a defense against sums due the plaintiffs any amounts that would otherwise be due Cizek under his contract.” This bill is intended to clearly state that those using the services of unlicensed contractors are entitled to bring an action for recovery of compensation paid.<sup>59</sup>

The initial version of Assembly Bill 678 denied disgorgement “if the person knew that the contractor was unlicensed prior to making any payments to the contractor.”<sup>60</sup> The Senate removed this provision from the final bill.<sup>61</sup> This meant subdivision (a) remained a complete defense and placed the risk of bad faith “squarely on the unlicensed contractor’s shoulders.”<sup>62</sup> Contractors found themselves subject to

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57. *Alatrister v. Cesar’s Exterior Designs, Inc.*, 108 Cal. Rptr. 3d 277, 284 (Ct. App. 2010) (emphasis omitted).

58. Act of Sept. 4, 2001, ch. 226, § 1, 2001 Cal. Stat. 2094, 2095.

59. ASSEMB. COMM. ON THE JUDICIARY, ASSEMBLY BILL NO. 678, 2001–2002 Reg. Sess., at 2 (Cal. 2001) (as amended July 3, 2001).

60. *Id.* at 1.

61. *See id.* at 3.

62. *Hydrotech Sys. Ltd. v. Oasis Waterpark*, 803 P.2d 370, 376 (Cal. 1991).

disgorgement even if “induced to enter and perform an illegal contract by a false promise to pay.”<sup>63</sup>

### III. THE EVIDENTIARY HEARING IN CASE LAW—1993 TO PRESENT

Section 7031’s substantial compliance provision—originally codified at subdivision (d), and now at (e)—has evolved but remains largely intact since its 1993 enactment.<sup>64</sup> The subsequent decades produced dozens of published opinions in the high court and all appellate districts analyzing the doctrine’s tortuous evolution and applying the statute’s multi-part test in diverse factual and legal contexts.<sup>65</sup> The statute and its annotations, however, devote little attention to how or when the trial court and litigants should *actually conduct* evidentiary hearings under the statute.

Only a minority of published opinions describe the lower court conducting a stand-alone, pre-trial hearing dedicated to taking evidence about a contractor’s substantial compliance.<sup>66</sup> The most common practice is using summary adjudication or summary judgment procedures in lieu of, or as a proxy for, a subdivision (e)

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63. *Id.*

64. *See* S. COMM. ON BUS., PROS. & ECON. DEV., ASSEMBLY BILL NO. 1793, 2015–2016 Reg. Sess., at 1–2, 4 (Cal. 2016). A minor revision to subdivision (e)’s multi-part substantial compliance test in 2016 eliminated element 3 of (e), i.e., that the contractor “did not know or reasonably should not have known that he or she was not duly licensed when performance of the act commenced.” *Id.* at 4. The change “clarifie[d] existing law to ensure that properly licensed and law abiding construction firms are not placed at fatal monetary risk, by limiting the recovery time and disgorgement amount to monies paid to the contractor for work performed while the contractor was not properly licensed.” *Id.* at 6.

65. *See, e.g.*, *MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co.*, 115 P.3d 41 (Cal. 2005); *Womack v. Lovell*, 188 Cal. Rptr. 3d 471 (Ct. App. 2015); *Alatrisme v. Cesar’s Exterior Designs, Inc.*, 108 Cal. Rptr. 3d 277 (Ct. App. 2010); *White v. Criddlebaugh*, 100 Cal. Rptr. 3d 434 (Ct. App. 2009); *WSS Indus. Constr., Inc. v. Great W. Contractors, Inc.*, 76 Cal. Rptr. 3d 8 (Ct. App. 2008); *Smith v. Workers’ Comp. Appeals Bd.*, 116 Cal. Rptr. 2d 728 (Ct. App. 2002); *Buzgheia v. Leasco Sierra Grove*, 70 Cal. Rptr. 2d 427 (Ct. App. 1997); *Vallejo Dev. Co. v. Beck Dev. Co.*, 29 Cal. Rptr. 2d 669 (Ct. App. 1994).

66. *See* *Constr. Fin., LLC v. Perlite Plastering Co.*, 61 Cal. Rptr. 2d 574 (Ct. App. 1997) (three-day evidentiary hearing followed by statement of decision); *see also* *Cooper Crane & Rigging Inc. v. Pavex-Myers Joint Venture*, No. C077272, 2017 WL 656762, at \*3 (Cal. Ct. App. Feb. 17, 2017) (trial court determined at pre-trial evidentiary hearing that subcontractor substantially complied with the CSLL and could pursue claims against the general contractor).



hearing.<sup>67</sup> At least one opinion describes the trial court deciding the issue during the first phase of a bifurcated trial.<sup>68</sup>

A pair of Second District Court of Appeal opinions show how abruptly the need for a subdivision (e) hearing might arise even in the advanced stages of litigation.<sup>69</sup> The defendant in *WSS Industrial Construction, Inc. v. Great West Contractors, Inc.*<sup>70</sup> moved for nonsuit at the close of plaintiff's case because plaintiff's own evidence showed it did not possess a contractor's license when work began.<sup>71</sup> This compelled the court to conduct an evidentiary hearing mid-trial to determine whether defendant's case would proceed.<sup>72</sup> The defendant in *ICF Kaiser Engineers, Inc. v. Superior Court*<sup>73</sup> did not invoke subdivision (e) until after plaintiff obtained \$800,000 in damages at arbitration and petitioned to affirm the award.<sup>74</sup> The trial court took the petition off calendar and re-opened evidence on plaintiff's licensing problems.<sup>75</sup> It ruled on the issue of substantial compliance after considering—and granting—defendant's subsequent petition to vacate the award.<sup>76</sup>

The First District Court of Appeal's *Judicial Council of California v. Jacobs Facilities, Inc.*<sup>77</sup> is the only decision to explore the procedural parameters of a subdivision (e) hearing in earnest.<sup>78</sup> Defendant Jacobs provided maintenance services at plaintiff Judicial Council's office building.<sup>79</sup> Judicial Council sued for disgorgement after Jacobs allowed its license to lapse following a corporate

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67. See, e.g., *MW Erectors, Inc.*, 115 P.3d at 41 (lack of substantial compliance determined on summary adjudication; affirmed in part, reversed in part); *Alatriste*, 108 Cal. Rptr. 3d at 277 (lack of substantial compliance determined on summary adjudication; affirmed); *Opp v. St. Paul Fire & Marine Ins. Co.*, 64 Cal. Rptr. 3d 260 (Ct. App. 2007) (lack of substantial compliance determined on summary judgment; affirmed); *Pac. Custom Pools, Inc. v. Turner Constr. Co.*, 94 Cal. Rptr. 2d 756 (Ct. App. 2000) (lack of substantial compliance determined on summary judgment; affirmed in part).

68. See *Zinchik v. Moore*, No. A129548, 2011 WL 5128180, at \*3 (Cal. Ct. App. Oct. 26, 2011).

69. See *WSS Indus. Constr., Inc.*, 76 Cal. Rptr. 3d at 8; *ICF Kaiser Eng'rs, Inc. v. Superior Ct.*, 89 Cal. Rptr. 2d 88 (Ct. App. 1999).

70. 76 Cal. Rptr. 3d 8 (Ct. App. 2008).

71. *Id.* at 12.

72. *Id.*

73. 89 Cal. Rptr. 2d 88 (Ct. App. 1999).

74. *Id.* at 89–90.

75. *Id.* at 90.

76. *Id.* at 89.

77. 191 Cal. Rptr. 3d 714 (Ct. App. 2015).

78. *Id.* at 738–41.

79. *Id.* at 719.

restructuring.<sup>80</sup> Jacobs requested a substantial compliance hearing, but the court decided to proceed with a jury trial first.<sup>81</sup> The jury found in favor of Jacobs, which rendered Jacobs' substantial compliance defense moot.<sup>82</sup>

The court of appeal reversed and instructed the trial court to conduct "a full evidentiary hearing on the issues relevant to the elements of substantial compliance under subdivision (e)."<sup>83</sup> It described the jury's verdict in Jacobs' favor "as an attempt to reach an equitable resolution, given the harsh consequences to defendants from the strict application of section 7031."<sup>84</sup> The substantial compliance doctrine, though now codified in a "restricted" form, remained an equitable issue for the court to decide rather than a legal issue for the jury.<sup>85</sup>

The court rejected Judicial Council's argument that Jacobs forfeited the right to a hearing by not renewing its request after trial.<sup>86</sup> It held Jacobs preserved this right by: (1) raising substantial compliance as an affirmative defense in its answer to the complaint; and (2) requesting the hearing before trial.<sup>87</sup> It instructed the trial court to impose section 7031 penalties on remand only if it determined Jacobs failed to satisfy subdivision (e)'s factors.<sup>88</sup>

#### IV. PRACTICAL CONSIDERATIONS FOR LITIGANTS AND JUDICIAL OFFICERS CONFRONTING CONTRACTOR LICENSING ISSUES

Codifying judicial substantial compliance factors tethered many of the doctrine's original tenets to the CSLL's policy aims. This legislative compromise eased the tension created by a law that expected judges to ignore their equitable instincts when enforcing an unduly punitive statute. Adding a disgorgement cause of action to

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80. *Id.* at 721.

81. *Id.*

82. *Id.* at 718.

83. *Id.* at 738.

84. *Id.* at 737.

85. *Id.* at 728; *see id.* at 739 ("Reflecting trial courts' similar understanding of this language, the statutory substantial compliance determinations reviewed in reported appellate decisions have been made by judges, rather than juries."); *see also id.* at 741 ("Alternatively, as asserted by defendants in response to JCC's claim for disgorgement, substantial compliance is an equitable defense to JCC's claim. Either way, the doctrine is equitable in nature. Accordingly, defendants have no constitutional right to its determination by a jury.").

86. *Id.* at 738.

87. *Id.* at 737–38.

88. *Id.* at 738, 741.

section 7031, however, transformed a historically defensive statute into an effective weapon for consumers. Counsel on both sides of the aisle in a construction dispute should survey the landscape for CSLL violations as their first order of business. As discussed above, neither subdivision (e)'s text nor case law gives contractors, consumers, or judicial officers procedural guidance if such violations come into play. This Part of the Article identifies the unique issues and opportunities the statute creates for each of these three groups.

### *A. Counsel for Contractors*

Counsel for contractors should advise their clients to delay or even forego collection actions on projects performed during periods when CSLL violations occurred—especially if the contractor collected significant amounts from the consumer. Initiating a lawsuit will invite a disgorgement cross-claim that could exceed the amount owed. The contractor should proceed only if confident that he or she can satisfy each of subdivision (e)'s substantial compliance factors at an evidentiary hearing.<sup>89</sup>

#### 1. Evaluating the Contractor's Substantial Compliance Defense

Questions such as these will help counsel determine whether the client accused of violating the CSLL is likely to prevail under subdivision (e):

- Does the contractor's certified license history reflect a suspension or revocation?
- If yes, did the suspension or revocation occur while the contractor was working on the project in dispute?
- Did any of the contractor's officers or employees know about the suspension or revocation?
- If yes, when did the officer or employee first discover the suspension or revocation?

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89. See CAL. BUS. & PROF. CODE § 7031(e) (Deering 2020). Subdivision (e) states as follows at the time of writing: “[T]he court may determine that there has been substantial compliance with licensure requirements under this section if it is shown at an evidentiary hearing that the person who engaged in the business or acted in the capacity of a 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, and (3) acted promptly and in good faith to remedy the failure to comply with the licensure requirements upon learning of the failure.” *Id.*

- Did the Board send a written notice of suspension or revocation? What other communications and documents show what happened?
- Did the contractor contact the Board to discuss the issue? By phone? Email?
- What steps did the contractor take to fix the issue?
- Which of the contractor's officers or employees were responsible for maintaining the entity's license?
- Has any consumer filed a complaint with the Board in the past five years?
- If yes, did that complaint result in Board discipline for the contractor?

The last two questions raise particularly important concerns. Civil cases between a contractor and consumer often run parallel with Board disciplinary proceedings arising from the same dispute. This usually occurs when the consumer files a complaint against the contractor with the Board before or during litigation. The Board may refer the complaint to the Attorney General for accusation—i.e., formal administrative proceedings—after investigating the complaint.<sup>90</sup> Contracting with a suspended license is cause for Board discipline on top of any civil or criminal penalties the contractor could face for those violations.<sup>91</sup> The findings of the administrative tribunal may have collateral estoppel effects which, for better or worse, may influence the trial court's substantial compliance determination.<sup>92</sup> For this reason, counsel should advise contractor clients to defer collection actions until they resolve pending Board complaints or accusation proceedings.<sup>93</sup>

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90. *See id.* §§ 7090–7124.6.

91. *See id.* § 7114.2 (“Any licensed or unlicensed person who commits any act prohibited by Section 119 is subject to the administrative remedies authorized by this chapter. Unless otherwise expressly provided, the remedies authorized under this section shall be separate from, and in addition to, all other available remedies, whether civil or criminal.”); *see also id.* § 7117.5(b) (contracting with a suspended license constitutes cause for discipline).

92. *See Pac. Lumber Co. v. State Water Res. Control Bd.*, 126 P.3d 1040, 1054–55 (Cal. 2006) (findings of an administrative agency may have collateral estoppel effect if the proceedings were of a “judicial character”); *People v. Sims*, 651 P.2d 321 (Cal. 1982) (holding that welfare hearing was “judicial” in nature; parties permitted to subpoena, examine and cross-examine witnesses under oath, and present oral and written argument; hearing officer issued written ruling that applied law to the facts of the case).

93. California's four-year limitations period for breach of written contract under Code of Civil Procedure section 337 should accommodate such proceedings under most circumstances.

## 2. Identifying Potential CSLL Violations That May Lead to Suspension of a Contractor's License as a Matter of Law

A contractor is not out of the woods because his or her license history does not reflect a suspension or revocation. Courts may suspend a contractor's license as a matter of law if the evidence shows a contractor violated the CSLL. This happens most commonly in two situations. The first is when an owner-contractor is caught evading workers' compensation requirements by falsely claiming he or she has no employees.<sup>94</sup> The second is when a contractor does not notify the Board of an unpaid money judgment within ninety days.<sup>95</sup> A similar problem could occur if the client's \$15,000 contractor's bond is not renewed.<sup>96</sup> Therefore, counsel should confirm the contractor consistently maintained its bond and workers' compensation coverage over the relevant period, or, if claiming exemption on the latter, that the contractor completed the project without employees or workers paid "under the table." Counsel should also ask whether the client was a party to any legal proceedings in the preceding four or five years, and if so, confirm no reportable judgments exist.

## 3. Representing the Contractor Sued by a Consumer Alleging CSLL Violations

A contractor cannot delay or forego litigation when the consumer sues first. If the complaint alleges a licensing violation, the contractor must raise substantial compliance as an affirmative defense in its

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94. CAL. BUS. & PROF. CODE § 7125.2 ("The failure of a licensee to obtain or maintain workers' compensation insurance coverage, if required under this chapter, shall result in the automatic suspension of the license by operation of law in accordance with the provisions of this section . . ."); *see* *Wright v. Issak*, 58 Cal. Rptr. 3d 1, 3 (Ct. App. 2007) (finding a contractor's license suspended by operation of law when he systematically underreported payroll to avoid purchasing workers' compensation insurance).

95. CAL. BUS. & PROF. CODE § 7071.17 ("[T]he board shall require . . . that an applicant, previously found to have failed or refused to pay a contractor, subcontractor, consumer, materials supplier, or employee based on an unsatisfied final judgment, file or have on file with the board a bond sufficient to guarantee payment of an amount equal to the unsatisfied final judgment or judgments. The applicant shall have 90 days from the date of notification by the board to file the bond or the application shall become void."); *see* *Pac. Caisson & Shoring, Inc. v. Bernards Bros. Inc.*, 187 Cal. Rptr. 3d 337 (Ct. App. 2015) (affirming a finding that contractor did not substantially comply with CSLL when the Board suspended its license for failing to notify the Board of unpaid judgment).

96. CAL. BUS. & PROF. CODE § 7071.6(a) ("The board shall require as a condition precedent to the issuance, reinstatement, reactivation, renewal, or continued maintenance of a license, that the applicant or licensee file or have on file a contractor's bond in the sum of fifteen thousand dollars (\$15,000).").

answer to avoid waiver.<sup>97</sup> While *Jacobs Facilities* held the contractor could request a subdivision (e) as late as trial call, counsel should consider broaching the topic during the initial case management conference.<sup>98</sup> This will enable the parties and court to discuss whether to resolve the issue of substantial compliance before starting construction defect discovery or other resource intensive activities. Counsel can also discern whether the assigned judge is familiar with the CSLL, and to ask whether he or she would accept supplemental briefing on the subject or a proposed case management order describing how the matter should proceed.

#### 4. Representing the Contractor That Insists on Suing a Consumer Despite CSLL Violations

The contractor client with license issues may nevertheless elect to proceed with collection despite the risk of dismissal or a retaliatory cross-claim for disgorgement. The priority in these circumstances is to properly plead the contractor's claim while preserving the substantial compliance defense in the event of a section 7031 challenge.

The initial hurdle is the requirement that a contractor allege he or she "was a duly licensed contractor at all times during the performance of that act or contract" for which he or she seeks payment.<sup>99</sup> Failing to do so exposes the contractor's complaint to demurrer.<sup>100</sup> Case law does not address how a contractor with a past suspension or revocation, but who believes he or she substantially complied with the CSLL, can truthfully allege to have been "duly licensed" at all times.<sup>101</sup> Pleading as follows may satisfy both the pleading requirement and the contractor's duty of candor to the court:

The Contractors State License Board issued plaintiff general building contractor license number 991850 on September 9, 2015. Plaintiff's license remained active at all times relevant to this action except that period of suspension between November 13, 2019 and December 1, 2019. Plaintiff alleges

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97. See *Jud. Council of Cal. v. Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d 714, 737–38 (Ct. App. 2015).

98. See *id.*

99. CAL. BUS. & PROF. CODE § 7031(a).

100. See *Fraenkel v. Trescony*, 309 P.2d 819, 823 (Cal. 1957) ("[P]laintiff, as an unlicensed contractor, was properly held to be precluded from maintaining the present action.").

101. *Id.* at 824 (Schauer, J., dissenting).

it substantially complied with licensure requirements under Business and Professions Code section 7031, subdivision (e) despite this period of suspension, and hereby requests an evidentiary hearing on that issue prior to entry of judgment.

A more succinct allegation like the following may also enable the contractor to survive a pleading challenge:

“Plaintiff alleges it substantially complied with contractor licensure requirements under Business and Professions Code section 7031, subdivision (e), and hereby requests an evidentiary hearing on that issue prior to entry of judgment.”

In summary, counsel should explain to contractor clients how severely the CSLL punishes licensing gaps. The briefest suspension may prove fatal if the contractor cannot piece together a credible factual narrative that satisfies subdivision (e)’s three-factor test. Counsel should encourage the contractor to divulge all communications and documents relating to the mistake or oversight to counsel. In addition, counsel should advise leadership not to blame or discipline employees whose conduct precipitated the suspension—a mail clerk who misfiled a money judgment, for example—but rather instruct them to cooperate with counsel’s investigation to fix the mistake. A loyal and penitent employee’s testimony can serve as the centerpiece of the contractor’s substantial compliance defense.

### *B. Counsel for Consumers*

Section 7031 remains a powerful weapon for consumers. A consumer facing a contractor’s collection lawsuit quickly gains the upper hand if he or she can cast a shadow over the contractor’s license status. The statute provides one of the few opportunities under California law for a litigant to prevail regardless of the strength of their opponent’s claims and defenses, or the weakness of their own.

#### 1. Finding a Violation

Counsel for the consumer should check a contractor’s license status as soon as a dispute arises. The Board’s online “Check a License” database provides immediate access to basic data about all licenses issued since the 1940s.<sup>102</sup> This includes a contractor’s current

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102. *Check a Contractor License or Home Improvement Salesperson (HIS) Registration*, CA.GOV, <https://www.cslb.ca.gov/onlineservices/checklicenseII/checklicense.aspx> (last visited Nov. 22, 2020).

license status, pending and past discipline, bond information, and the contractor's workers' compensation insurance or claim of exemption.<sup>103</sup> Counsel should also request a certified license history.<sup>104</sup> This will indicate whether the Board revoked or suspended a license in the past and whether the contractor maintained the required insurance and bond throughout its existence.<sup>105</sup> If counsel discovers an anomaly—particularly a suspension or revocation during the time the contractor worked for the consumer—counsel should contact the Board's consumer hotline to confirm whether the information provided in these public resources is correct.

## 2. Violations Appearing on a Contractor's License Record

The degree to which a consumer can leverage his or her contractor's CSLL violation depends on the violation's timing and severity. Most vulnerable to attack is a contractor that began working on a project without an active license. This often occurs when a contractor accepts work while waiting for the Board to process his or her initial application and expecting to receive a license mid-project.<sup>106</sup> If sued, the contractor cannot establish the first substantial compliance factor, i.e., that it was licensed "prior to the performance of the act or contract."<sup>107</sup> Likewise, the contractor cannot maintain a cross-claim against the consumer because he or she cannot allege he or she "was a duly licensed contractor at all times during the performance."<sup>108</sup> Defending the action or pursuing a collection claim

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103. *Id.*

104. See Form, Request for Certified License History, Contractors State License Bd., State of Cal. (last revised Feb. 27, 2013), <https://www.cslb.ca.gov/Resources/FormsAndApplications/RequestForCertifiedLicenseHistoryVerifiedCertificate.pdf>.

105. *Id.*

106. See, e.g., *Twenty-Nine Palms Enters. Corp. v. Bardos*, 149 Cal. Rptr. 3d 52 (Ct. App. 2012) (finding the owner of a contracting entity did not substantially comply with CSLL because he did not apply for license when contract was signed and work commenced).

107. See CAL. BUS. & PROF. CODE § 7031(e) (Deering 2020) ("[T]he court may determine that there has been substantial compliance with licensure requirements under this section if it is shown at an evidentiary hearing that the person who engaged in the business or acted in the capacity of a contractor (1) *had been duly licensed as a contractor in this state prior to the performance of the act or contract.*" (emphasis added)). But see *Brown v. Solano Cnty. Bus. Dev., Inc.*, 154 Cal. Rptr. 700 (Ct. App. 1979) (finding a contractor satisfied first substantial compliance factor even though license lapsed shortly after he began performing contract; pre-statute case); *Vitek, Inc. v. Alvarado Ice Palace, Inc.*, 110 Cal. Rptr. 86 (Ct. App. 1973) (finding a contractor who received his license after signing contract, but before starting work, could demonstrate substantial compliance; pre-statute case).

108. CAL. BUS. & PROF. CODE § 7031(a).



is futile. Counsel for the consumer can negotiate a prompt and favorable settlement under these circumstances. If the contractor plods ahead regardless, the consumer can file a demurrer to the complaint and request judicial notice of the contractor's license history.<sup>109</sup> Counsel should also consider filing a preemptive request for evidentiary hearing concurrently with the demurrer. This will place the contractor on notice of subdivision (e) and provide an opportunity to gather evidence about its license, thereby foreclosing an appeal on the grounds the court did not provide an evidentiary hearing before entering judgment of dismissal.<sup>110</sup>

### 3. Mid-Project Suspensions and Violations Not Appearing on a Contractor's License Record

A consumer's section 7031 challenge is more complicated if the contractor loses its license mid-project or if the consumer bases its challenge on a CSLL violation that does not appear on the contractor's license record. As discussed earlier, a contractor can plead around mid-project license gaps in its complaint or answer by alleging substantial compliance. A consumer seeking to revoke the contractor's license as a matter of law—by proving the contractor falsely claimed exemption from workers' compensation requirements, for example—will need to shepherd evidence supporting this theory.<sup>111</sup> Such fact-intensive inquiries are often resolved by summary adjudication and summary judgment under Code of Civil Procedure 437c.<sup>112</sup> This is a lengthy and expensive process. A party can file its motion no sooner than sixty days after the opposing party appears in the action.<sup>113</sup> The

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109. See CAL. CIV. PROC. CODE § 430.30(a) (“When any ground for objection to a complaint, cross-complaint, or answer appears on the face thereof, or from any matter of which the court is required to or may take judicial notice, the objection on that ground may be taken by a demurrer to the pleading.” (emphasis added)).

110. See *Jud. Council of Cal. v. Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d 714, 737–38 (Ct. App. 2015) (finding a contractor entitled to full evidentiary hearing prior to entry of judgment on disgorgement claim).

111. See *Wright v. Issak*, 58 Cal. Rptr. 3d 1 (Ct. App. 2007); *Zinchik v. Moore*, No. A129548, 2011 WL 5128180, at \*1 (Cal. Ct. App. Oct. 26, 2011). *But see Loranger v. Jones*, 109 Cal. Rptr. 3d 120 (Ct. App. 2010) (declining to suspend contractor's license by operation of law where homeowners alleged their contractor used unreported employees on job site and sought disgorgement under Business and Professions Code sections 7125.2 and 7031 subdivision (b) because contractor possessed workers' compensation; showing discrepancies in contractor's payroll reports to workers' compensation insurer did not constitute a failure to obtain insurance under section 7125.2).

112. See CAL. CIV. PROC. CODE § 437c(a).

113. *Id.*

consumer would need to provide the contractor at least seventy-five days' notice and prepare a notice of motion, a motion, points and authorities, separate statement, supporting declarations, compendium of exhibits, and any request(s) for judicial notice.<sup>114</sup>

A substantial compliance evidentiary hearing can serve as a more efficient alternative. Nothing in subdivision (e) prevents the consumer rather than the contractor from initiating the evidentiary hearing process and pursuing pre-trial relief under section 7031 before litigating other issues. Resolving license-related issues earlier serves the consumer's interests, especially if the consumer has a meritorious CSLL claim, but cannot front the fees and costs associated with a traditional dispositive motion. The contractor's due process rights are likewise protected because he or she is afforded the "full evidentiary hearing" contemplated by *Jacobs Facilities*.<sup>115</sup>

### C. Judicial Officers

Section 7031's legislative history and annotations encourage courts to view subdivision (e)'s "evidentiary hearing" as a concept rather than a rigid procedural mandate.<sup>116</sup> The hearing represents the need to guard contractors' due process rights when the CSLL affords consumers every advantage. The dearth of procedural guidance allows judicial officers to confront licensing issues in a manner best suited to the circumstances. The challenge faced today is the same faced by Chief Justice Gibson's court in *Gatti* and Chief Justice Tobriner's court in *Latipac*—how to discern which violations deserve the CSLL's severe penalties and which deserve leniency.<sup>117</sup> The legislature's 1993 amendments to section 7031 tacitly acknowledged California's courts are better suited to make these nuanced determinations.

#### 1. Preliminary Considerations When Confronted with Contractor Licensing Issues

When a litigant raises an opponent's potential licensing violation, the court should first determine if the issue might resolve the case in whole or in part. A half-day subdivision (e) hearing conducted

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114. *Id.* § 437c(a)–(b); *see also* Cal. R. Ct. R. 3.1350.

115. *Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d at 737–38.

116. CAL. BUS. & PROF. CODE § 7031(e) (Deering 2020).

117. *Gatti v. Highland Park Builders, Inc.*, 166 P.2d 265 (Cal. 1946); *Latipac, Inc. v. Superior Ct.*, 411 P.2d 564 (Cal. 1966).

concurrently with a demurrer hearing, for example, may suffice if the contractor's license history reflects a brief suspension caused by a simple office error. Eliciting the testimony of a handful of witnesses might produce an evidentiary record sufficient to rule fairly. An early finding of substantial compliance with the CSLL would permit the parties to move forward on the case's remaining claims and defenses without wondering if a subsequent ruling will render those matters moot. Conversely, finding the contractor did not comply could narrow the case by jettisoning the contractor's claims or even dispose of the case entirely. As discussed above, the initial case management conference provides an opportunity for the court and litigants to discuss how alleged CSLL violations may impact the case and whether a subdivision (e) hearing is needed.

## 2. Discovery Relating to Substantial Compliance

Less clear-cut CSLL violations may require the parties to conduct discovery before jumping into an evidentiary hearing. The court should limit the subject matter of such discovery to evidence relevant to (1) the alleged violation or violations; (2) how the violation or violations affected the contractor's license, e.g., a suspension between dates *X* and date *Y*; and (3) whether the contractor satisfied subdivision (e)'s three-factor test. The court should specify in its case management order or stipulated discovery order that such restrictions do not reduce the number of written discovery requests available to the parties under the Discovery Act or prevent them from re-deposing witnesses who testified about the issues above.<sup>118</sup> The order should schedule a status conference at which the parties can discuss the progress of CSLL discovery, identify the key factual issues the court must resolve, estimate how much time the parties will need to present their evidence, and agree on the date for the subdivision (e) hearing.

## 3. The Subdivision (e) Hearing as an Alternative to Summary Judgment or Adjudication

As discussed above, section 7031's annotations show courts frequently use summary judgment or adjudication to decide

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118. See CAL. CIV. PRO. CODE § 2025.290(a) (setting seven-hour maximum for oral deposition of a witness); *Id.* § 2030.030 (limiting parties to thirty-five specially prepared interrogatories in unlimited civil matters); *id.* § 2033.030(a) (limiting parties to thirty-five requests for admission relating to "matters that do not relate to the genuineness of documents").

substantial compliance. Inertia may explain this fact. Courts and litigants seem to assume they must fire up the cumbersome but familiar machinery of section 437c if they want to resolve a claim or defense before trial.<sup>119</sup> However, subdivision (e)'s use of the phrase "shown at an evidentiary hearing" rather than "shown at trial" indicates the legislature did not contemplate dispositive motions or trial as the exclusive means of adjudicating substantial compliance.<sup>120</sup> The statute's laconic text invites judicial officers to shed the Code of Civil Procedure's rigid conventions and to handle the issue like a chancellor in equity.

Further, two provisions of section 437c appear to conflict with section 7031. First, section 437c requires the parties to submit all supporting evidence *in advance* of hearing, whereas subdivision (e) provides for the parties to present evidence *at hearing*.<sup>121</sup> The parties moving and opposing summary judgment or adjudication must submit evidence by way of affidavit or judicial notice and cannot use live testimony "unless the court orders otherwise for good cause shown."<sup>122</sup> In contrast, subdivision (e) does not mention pre-hearing filings or even the need to proceed by noticed motion under Code of Civil Procedure section 1005. Second, different burdens apply under each statute. Section 437c places the initial burden of proof on the movant, whether plaintiff or defendant, and shifts the burden only after the movant has proven a lack of triable issue of material fact as to the subject claim or defense.<sup>123</sup> Section 7031 requires the contractor—never the consumer—to prove licensure whenever the issue is controverted.<sup>124</sup> As such, the court should clarify each side's burdens in advance if the parties decide to proceed by dispositive motion under

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119. See *Aguilar v. Atl. Richfield Co.*, 24 P.3d 493 (Cal. 2001) ("The purpose of [§ 437c] . . . is to provide courts with a mechanism to cut through the parties' pleadings in order to determine whether, despite their allegations, trial is in fact necessary to resolve their dispute.").

120. CAL. BUS. & PROF. CODE § 7031(e).

121. Compare CAL. CIV. PROC. CODE § 437c(a)–(b), with CAL. BUS. & PROF. CODE § 7031(e).

122. Cal. R. Ct. R. 3.1306(a).

123. CAL. CIV. PROC. CODE § 437c(p).

124. CAL. BUS. & PROF. CODE § 7031(d) ("Nothing in this subdivision shall require any person or entity controverting licensure or proper licensure to produce a verified certificate. When licensure or proper licensure is controverted, the burden of proof to establish licensure or proper licensure shall be on the licensee."); see *Womack v. Lovell*, 188 Cal. Rptr. 3d 471, 480 (Ct. App. 2015) ("Assembly Bill No. 628 . . . clarified that contractors still had the burden of proving licensure and there was no need for persons they were suing for compensation to produce the verified certificate." (emphasis omitted)).

section 437c in lieu of, or in addition to, exhibits and testimony at a separate substantial compliance hearing.

#### 4. Evidentiary Hearings and Disgorgement Awards

One area not yet explored by case law is how section 7031 subdivision (b)'s disgorgement remedy dovetails with subdivision (e)'s hearing requirement. Finding a contractor substantially complied with the CSLL despite a license lapse would presumably dispose of a consumer's disgorgement claim entirely. The opposite finding would confirm the defendant's status as an "unlicensed contractor" under subdivision (b) and would entitle the consumer to disgorgement as a matter of law, with only the amount of disgorgement left for the court to determine.<sup>125</sup> *Jacobs Facilities* did not suggest any further proceedings were required to impose section 7031's penalties once the contractor obtained the requested hearing.<sup>126</sup> Compelling the consumer to take the additional step of moving for summary adjudication or proceeding to trial on its disgorgement claim seems needless, and further, could easily cost the consumer more than the award itself—especially because section 7031 does not provide for an award of attorney fees to the prevailing party.<sup>127</sup>

The court should consider taking evidence at the hearing about the amounts the consumer paid to the contractor and the timing of those payments. This will enable the court to calculate a disgorgement award if the contractor fails to show substantial compliance.<sup>128</sup>

#### 5. Hearings During or After Trial

Resolving substantial compliance in advance of trial is not always necessary or better, especially when the contractor does not seek to collect from the consumer. The evidence presented by the parties in a consumer's action for construction defect or fraud, for example, may overlap in significant part with evidence related to substantial compliance. The parties may prefer not to spend time and money on an evidentiary hearing when the monetary damages sought by the

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125. CAL. BUS. & PROF. CODE § 7031(b).

126. *Jud. Council of Cal. v. Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d 714, 741 (Ct. App. 2015) (instructing trial court to enter judgment for disgorgement figure sought by plaintiff if defendant did not demonstrate statutory substantial compliance after hearing on remand).

127. *Id.* ("Unless the prevailing party can demonstrate a valid basis for an award of attorney fees other than those already asserted by the Jacobs entities, it shall not be awarded attorney fees.")

128. *See* discussion *infra* Part V regarding the calculation of disgorgement.

consumer greatly exceed the potential subdivision (b) claim or might be swallowed by offset. In those circumstances, the court may consider bifurcating trial so evidence relevant only to substantial compliance—a purely equitable issue—is heard before or after the jury trial, or outside the presence of jurors altogether.<sup>129</sup> The court could then rule on the disgorgement claim or take the matter under submission at the close of evidence.

## V. LOOKING AHEAD

Subdivision (e)'s evidentiary hearing embodies a compromise between the legislature's police powers and the judiciary's equitable powers. While section 7031 served one master during its first five decades—the consumer—the legislature's 1992 amendments repurposed the statute as a mechanism the courts can use to balance the interests of *both* consumers and contractors. The legislature's frequent amendments since that time reveal the delicacy of this balance. One proposing yet more changes to the law must take care not to tip the scales with well-intended "improvements." Subdivision (e)'s austere text and procedural flexibility may be one of its greatest strengths. That said, the following three issues deserve the legislature's attention should it consider amending the statute.

First, section 7031 should address how a substantial compliance determination under subdivision (e) impacts a case in which the consumer seeks disgorgement under subdivision (b). The original statute provided the consumer with a purely defensive remedy, i.e., a pleading challenge that robbed the plaintiff contractor of its standing to sue the consumer. The doctrine and its statutory successor developed in response to this defensive remedy. When the legislature added a disgorgement remedy in subdivision (b) it neglected to synthesize the provision with subdivision (e). The court's ruling at a subdivision (e) hearing may not end the matter but in fact raise new

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129. *Jacobs Facilities* dedicated a significant part of its analysis to the equitable nature of substantial compliance and the court's obligation to resolve the issue separately from the parties' legal claims if tried together. See *Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d at 740 ("Whichever approach is adopted, equitable issues retain their character, despite being raised in the context of a legal claim. A litigant has no constitutional right to a jury determination of an equitable issue merely because it is raised in the context of a claim at law."). This distinction is not always easy to discern. See *Buzgheia v. Leasco Sierra Grove*, 70 Cal. Rptr. 2d 427, 438 (Ct. App. 1997) (finding that a jury decision whether contractor used a "sham" responsible managing employee as qualifying individual impacted contractor's license status and substantial compliance with CSLL).

questions. For example, should the court dismiss the consumer's disgorgement claim immediately if it finds the contractor substantially complied? Should it enter a directed verdict for the consumer if it finds the contractor did not, then immediately proceed to take evidence on the correct amount of disgorgement?

Second, in the event the legislature blends or coordinates subdivisions (b) and (e) to allow for a summary disgorgement procedure, it should clarify the degree of discretion the court may exercise when deciding the *amount* a contractor must disgorge if he or she cannot show substantial compliance. This issue comes to the fore when the case involves a mid-project lapse. The current subdivision (b) allows the consumer to "recover all compensation paid to the unlicensed contractor for performance of any act or contract."<sup>130</sup> On one hand, the court could interpret this as requiring a contractor with a brief license lapse to disgorge all amounts received over the course of the entire project. On the other hand, the court could interpret this as requiring a contractor to disgorge only those amounts paid during the lapse.

Third, section 7031 appears to relieve the consumer of their burden to prove its right to disgorgement by requiring the contractor to *disprove* the consumer's licensing allegations. Failing to do so leads to a near-certain disgorgement judgment. The statute should clarify the consumer's obligation to establish the appropriate amount of disgorgement in the event the contractor cannot demonstrate substantial compliance under subdivision (e).

The following proposed amendments to subdivisions (b), (d), and (e) may enable these provisions to work better in concert:

(b) Except as provided in subdivision (e), a person who utilizes the services of an unlicensed contractor may bring an action in any court of competent jurisdiction in this state to recover all—that portion of compensation paid to the ~~unlicensed~~ contractor for performance of any act or contract while unlicensed.

...

(d) If licensure or proper licensure is controverted, then proof of licensure pursuant to this section shall be made by production of a verified certificate of licensure from the

Contractors' State License Board which establishes that the individual or entity bringing the action was duly licensed in the proper classification of contractors at all times during the performance of any act or contract covered by the action. Nothing in this subdivision shall require any person or entity controverting licensure or proper licensure to produce a verified certificate. When licensure or proper licensure is controverted, the burden of proof to establish licensure or proper licensure shall be on the licensee. Any person seeking to recover compensation under subdivision (e) shall have the burden of proof to establish the appropriate amount of compensation paid to the contractor while unlicensed.

...

(e) The judicial doctrine of substantial compliance shall not apply under this section where the person who engaged in the business or acted in the capacity of a contractor has never been a duly licensed contractor in this state. However, notwithstanding subdivision (b) of Section 143, the court may determine that there has been substantial compliance with licensure requirements under this section if it is shown at an evidentiary hearing that the person who engaged in the business or acted in the capacity of a 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, and (3) acted promptly and in good faith to remedy the failure to comply with the licensure requirements upon learning of the failure. The court may, in its discretion, adjudicate the contractor's liability for disgorgement under subdivision (b) concurrently with the issue of the contractor's substantial compliance under this subdivision.

## VI. CONCLUSION

Codifying the judicial substantial compliance doctrine eased a decades-long tug-of-war between California's legislative and judicial branches. Permitting courts to exercise their equitable discretion within a well-defined legal framework enables California to maintain a hard line against unlicensed contracting without punishing those whose licensing problems resulted from good faith errors. The



evidentiary hearing under subdivision (e) allows litigants and judicial officers to blend law and equity, and in doing so, to resolve contractor licensing issues promptly and efficiently. The handful of minor revisions proposed here would clarify the statute's ambiguities and allow the current line of authorities to evolve rather than break.

