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Substantial Compliance with Contractors Licensing Statutes: *Latipac, Inc. v. Superior Court* (Cal. 1966)

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property of the husband under California community property law seems unnecessary. In any case, it produces a result not usually intended when the revocable inter vivos trust is used as an estate planning device. That is, it produces an immediate change of ownership in a situation where none is intended or desired. The possibility that a trust agreement may accomplish a transmutation, where the parties do not so intend and do not so expressly provide, raises serious questions of draftsmanship with respect to this popular estate planning device.

Katz is instructive however, in that it indicates the type of provision that would have avoided the result. From all indications, the court would have been satisfied with trust provisions clearly indicating that the husband's powers over the trust were limited by the rights the wife would have over such property when not held in trust.

William H. Spruance

**SUBSTANTIAL COMPLIANCE WITH
CONTRACTORS LICENSING STATUTES:
LATIPAC, INC. V. SUPERIOR COURT
(CAL. 1966)**

INTRODUCTION

Under section 7031 of the California Business and Professions Code, a person who has acted as a contractor may not bring or maintain an action for compensation for an act or contract requiring a license unless he proves he was properly licensed at all times during such performance.¹ Armed with this statute, defendants in contractors' suits have attempted to close the courts to contractors who have not operated in literal compliance therewith, only to have

¹ CAL. BUS. & PROF. CODE § 7031, as written when this action arose, stated: "No person engaged in the business or acting in the capacity of a contractor may bring or maintain any action in any court of this State for the collection of compensation for the performance of any act or contract for which a license is required by this chapter without alleging and proving that he was a duly licensed contractor at all times during the performance of such act or contract, except that such prohibition shall not apply to contractors who are each individually licensed under this chapter but who fail to comply with Section 7029. Until the expiration of six months from the date of a suspension of a license pursuant to Section 7068, the provisions of this section do not apply to any person whose license was suspended pursuant to Section 7068 for failure to notify the registrar within the 10-day period, if such failure was due to inadvertence."

the courts say the contractor is not foreclosed because "substantial compliance" has been found.

In *Latipac, Inc. v. Superior Court*,² the California Supreme Court outlined the essential ingredients of substantial compliance. The result appears to be an extension of the doctrine. This writing will explore the validity of the court's rationale.

LATIPAC

In March 1962, J. W. Lee & Co., the plaintiff and real party in interest, contracted to fill lands belonging to defendant, Latipac, Inc. At the time of contracting, plaintiff held a valid contractors license by virtue of the qualifications of its responsible managing officer, Mr. Lee, and it held such license until automatic expiration on June 30, 1963. Work continued until completion, April 1964. The license was not renewed until June 1964 and plaintiff alleged that the omission was inadvertently brought about by the fact that the office manager, to whom renewal matters had been relegated, suffered a nervous breakdown which kept him from the exercise of this obligation. It was further found that Mr. Lee concurrently acted as the qualifying officer for another corporation, San Leandro Rock Co., which corporation at all times during plaintiff's lapse enjoyed a valid contractors license. Defendant sought a writ of prohibition to restrain the court from entertaining a suit by plaintiff on the ground that plaintiff was barred under section 7031. The California Supreme Court denied the writ and concluded that there was substantial compliance.

In justifying the application of substantial compliance, the court reasoned that where it can be shown that the public policy underlying the statute has been upheld, strict construction is unnecessary. The court stated that the purpose of this statute is to protect the health and safety of the public, and that the purpose is effectuated by an administrative determination that contractors evidence the requisite competence and responsibility. Such evidence is embodied in a license. It was next noted that evidence of the requisite competence and responsibility is shown in this case because plaintiff possessed a valid license at the time of contracting and it continued to hold such license for approximately seventeen months thereafter. Authority for this reasoning appears to flow from *Gatti v. Highland Park Builders, Inc.*³ In that case, two individually licensed contractors completed their contract as a partnership with-

² 64 A.C. 289, 411 P.2d 564, 49 Cal. Rptr. 676 (1966).

³ 27 Cal. 2d 687, 166 P.2d 265 (1946).

out obtaining a partnership license. The court allowed the contractors to maintain their action and said that since there was evidence of qualification in one license, the obligor had received the protection contemplated.

Evidence of plaintiff's continuing competence and responsibility during the lapse, in *Latipac*, is shown by uncontested renewal of its license. Reliance rests again on *Gatti*. There, great importance was attached to the subsequent uncontested issuance of the partnership license to the individual contractors.⁴

The court further stated that the compliance demanded by the code is provided by Mr. Lee. The reasoning runs thus: section 7068.1 of the Business and Professions Code states that the responsibility for compliance with provisions of the code rests with the one who qualifies.⁵ The licensed corporation enjoys its status by virtue of the competence and experience of its qualifying officer. Therefore, if the corporation has the services of a qualified person, the corporation evidences the requisite competence and responsibility. One question remains: is Mr. Lee qualified? The court answered the question affirmatively on the ground that he was a qualifying officer of another corporation which was duly licensed throughout the lapse. The court relies on *Citizens State Bank v. Gentry*⁶ and *Gatti* for support of this proposition.

In *Gentry*, an individually licensed contractor requested renewal of his license, not in his name, but in the name of a corporation formed by him. When he attempted to recover on the contract into which he had entered in his individual capacity, the court concluded that the contractor and the corporation should be considered as one. The defendant's motion for non-suit, on the ground the contractor's license had lapsed, was denied. The court in *Gatti* reasoned that "Any matters which might form the basis of legitimate inquiry by the licensing board as a condition precedent to the issuance of . . . [the additional license] to plaintiffs . . . were necessarily considered . . . [in the issuance of the other license] and a favorable action was taken thereon."⁷

THE DISSENT IN LATIPAC

The dissent asserts that section 7031 must be strictly construed, on the basis of four major propositions. The first contention is that

⁴ *Id.* at 689, 166 P.2d at 266.

⁵ CAL. BUS. & PROF. CODE § 7068.1.

⁶ 20 Cal. App. 2d 415, 67 P.2d 364 (1937).

⁷ 27 Cal. 2d 687, 689, 166 P.2d 265, 266 (1946).

the common thread running through the cases supporting the contractor's right of action is that in each, there was at all times a duly licensed contractor on the job. *Loving & Evans v. Blick*⁸ and *Bierman v. Hagstrom Constr. Co.*⁹ are cited as authority. In *Blick*, two persons entered into and fulfilled a contract as a partnership. No partnership license was obtained until the completion of the contract and only one of the two was licensed during performance. The court held that, under the force of section 7031, the contractors could not maintain their action. The court in *Blick* distinguished the case from *Gatti* on the ground that in *Gatti* there was at all times a duly licensed contractor. In *Bierman*, the contractor's license had lapsed for one month during the course of the contract; the court affirmed a summary judgment against the plaintiff contractor and stated that the case differed from *Gatti* and *Gentry* for in those cases the partnership or corporation was not licensed but the individuals at all times were.

The *Latipac* dissent next relies on the statement in *Lewis & Queen v. N. M. Ball Sons*¹⁰ that:

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.¹¹

The fact situation and holding in *Lewis & Queen* are essentially identical to that in *Blick*.

In further support of strict construction, the *Latipac* dissent notes that section 7031 set forth only two exceptions at the time this case arose; that the facts of the case did not fall within either exception;¹² and that the second, the legislative exception pertaining to inadvertence, was subsequently deleted in 1965.¹³ The conclusion is that by the process of inclusion and deletion of these exceptions, the Legislature negated others. It is additionally noted that in 1937, when *Gentry* was heard, the contractor was only required to prove that he was a duly licensed contractor *at the time the cause of action arose*.¹⁴

The final objection to the majority opinion is that the present

⁸ 33 Cal. 2d 603, 204 P.2d 23 (1949).

⁹ 176 Cal. App. 2d 771, 1 Cal. Rptr. 826 (1959).

¹⁰ 48 Cal. 2d 141, 308 P.2d 713 (1957).

¹¹ *Id.* at 151, 308 P.2d at 719.

¹² The first exception is a codification of the holding in *Gatti v. Highland Park Builders, Inc.* See note 1 *supra*.

¹³ CAL. BUS. & PROF. CODE § 7031.

¹⁴ 64 A.C. 289, 304, 411 P.2d 564, 575, 49 Cal. Rptr. 676, 687 (1966).

holding allows retroactive borrowing of San Leandro Rock Co.'s license in contravention of the requirements for such use as set forth in section 7068.1;¹⁵ the result is evasion of section 7031.

ANALYSIS

The *Latipac* dissent points out that the majority opinion agrees that two elements must be present in order to find substantial compliance. These are (1) that the party held a valid license at the time of entering into the contract, and (2) that renewal of the license was secured without any further examination.¹⁶ A third, and disputed element, which the dissent contends is basic to all of the cited cases that upheld the contractor's right to recovery, is the statement set forth in section 7031, "that he was a duly licensed contractor at all times during the performance of such act or contract"

Whether the third element is a common thread running through the cases may be illustrated by an analysis of the decisions cited in *Latipac*. The majority opinion in *Latipac* relies, in part, on the precedent of the *Gatti* case in the formation of substantial compliance. There, the element was present; the contractors were at all times licensed, but they did not hold the proper form of license. The court in *Blick* distinguishes its case on the ground that there was a duly licensed contractor at all times during performance in *Gatti*. The court in *Bierman* distinguishes its case from *Gatti* and *Gentry* on the ground that in both those cases the individuals were at all times licensed. In the subsequent decision in *Weiman v. Superior Court*,¹⁷ the court said the admitted facts brought the case under *Gatti* and *Gentry* and held that the contractor had substantially complied with section 7031. In *Weiman*, John Nelson, an individually licensed contractor, incorporated during the course of perfor-

¹⁵ CAL. BUS. & PROF. CODE § 7068.1 states: "The person qualifying on behalf of an individual or firm . . . shall be responsible for exercising such direct supervision of his employer's or principal's construction operations as is necessary to secure full compliance with the provisions of this chapter and the rules and regulations of the board relating to such construction operations and such person shall not act in the capacity of the qualifying person for an additional individual or firm unless one of the following conditions exists: (a) There is a common ownership of at least 10 percent of the equity of each individual or firm for which the person acts in a qualifying capacity. (b) With respect to a firm under subdivision (b) or (c) of Section 7068, the individual has a financial interest therein amounting to at least one thousand dollars (\$1,000) or 10 percent of the ownership, whichever is the lesser. (c) The additional firm is a subsidiary or joint venture with the first (d) With respect to a firm under subdivision (b) or (c) of Section 7068, the majority of the partners or officers are the same." [Emphasis added.]

¹⁶ 64 A.C. 289, 304, 411 P.2d 564, 574-75, 49 Cal. Rptr. 676, 686-87 (1966).

¹⁷ 51 Cal. 2d 710, 336 P.2d 489 (1959).

mance and assigned the contract to John A. Nelson, Inc., the real party in interest. The corporation was licensed before completion of the job, but it was contended that there was an interval, between the time the contract was assigned and the time the corporation was licensed, when the new contractor was not licensed. The admitted facts in *Weiman* were that Nelson was at all times a licensed contractor. However, in *Gentry*, the contractor, contrary to the facts in *Gatti*, did not continue under the improper form of license but continued without any license. Such is the conclusion to be drawn from the fact that he had his individual license renewed in a corporate name but did not assign the contract to that corporation. Substantial compliance was found in that his corporate license vouched his qualifications. This reading of the cases tends to destroy *Gentry* as authority for the disputed third element and discredits the interpretation set forth in *Bierman*. As a result, the first contention of the dissent does not appear to be sustained.

The *Latipac* dissent's second citation for holding strict construction of section 7031 rests upon the statement in *Lewis & Queen*. As previously noted, the partnership in *Lewis & Queen*, as in *Blick*, was not licensed at inception of the contract and one partner never held any form of license until after completion of the contract. That case, then, fell squarely within the prohibition of section 7031. The statement in *Lewis & Queen*, that section 7031 should be strictly construed, referred to an operating contractor who had never obtained a license, and is therefore contextually distinguished from situations where the contractor is operating during a lapse.

The third point set forth by the *Latipac* dissent in support of strict construction, *i.e.*, the legislative history of section 7031, cannot be ignored although it goes unanswered in the majority opinion.

The proposition which emerges from *Latipac* is that the third element is unnecessary. The only necessity is the showing of a contract valid at inception by virtue of a then current license; uncontested renewal; and concurrent qualification in another capacity during the lapse, from which capacity the necessary qualifications may be borrowed. If this proposition be conceded, there is an immediate conflict with that portion of section 7068.1 which proscribes borrowing of qualifications unless certain mutual legal interests are shown to exist between firms or individuals. There is no evidence that the court considered and found compliance with the requirements of that section. One might therefore conclude that the court has undertaken an extension in the application of substantial compliance.

CONCLUSION

The foregoing analysis of the state of the substantial compliance doctrine leaves certain questions unanswered. The *Latipac* dissent notes that, originally, the Legislature only required proof of license at the time the cause of action arose. This seems to indicate that the Legislature did not then intend to penalize a contractor whose license lapsed during performance of the contract, provided he regained such license at the time of suit. In its present form, section 7031 evidences an intent to institute the penalty. Only one exception is now allowed, and that exception, which allows individually licensed contractors who have not obtained a partnership license to maintain an action, does not come within the facts of this case. If these points be conceded, it is reasonable to ask why section 7031 should not be afforded strict construction.

The same question may be asked concerning section 7068.1. The enumerated situations under which a person might act in the capacity of a qualifying individual for more than one firm or individual were added to the basic section in 1961.¹⁸ Surely, there was some reason for adding the conditions. From the nature of the conditions, it is reasonable to conclude that the Legislature recognized the burden that might be placed upon financially dependent enterprises if they were required to employ more qualifying individuals than absolutely necessary. However, it does not automatically follow that independent firms may share a single qualifying individual.

The majority in *Latipac* 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. The *Latipac* majority points out that, in the principal case and in those upon which it relies, two elements have been present which allow the court to find that a contractor may maintain an action for compensation although his license lapsed during the course of performance of an act or contract requiring a license. The elements are (1) that the contract was valid at inception by virtue of a then current license, and (2) that the contractor readily obtained renewal after the lapse. In all those cases in which the courts upheld the contractor's right of action, the courts found some indicia of the contractor's continuing qualification during the lapse. In *Latipac*, Mr. Lee's concurrent qualification in another corporation was part of the indicia.

Undoubtedly, the courts have recognized that a great inequity would result if a contractor who has performed properly in all

¹⁸ CAL. BUS. & PROF. CODE § 7068.1.