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California Appellate Court Confirms that Certain Construction Managers Need Not Be Licensed Contractors

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In a March 30, 2009 decision, California's Second District appellate court concluded that the Legislature had not defined the term "contractor" to include construction managers who take responsibility for many aspects of construction project management, but who stop short of undertaking the actual modifications to real property. As such, these construction managers are not required to hold a contractor's license.

A case of first impression, *The Fifth Day, LLC v. Bolotin*, 09 C.D.O.S. 4019 (March 30, 2009), considered whether an entity that provided construction management services to a private owner was required to be licensed under the California Contractor's State License Law, Business & Professions Code section 7026. In a 2-to-1 decision, the *Fifth Day* court concluded that the services contemplated under the agreement in question did not cause the entity to fall under section 7026's definition of "contractor."

The Fifth Day Construction Management Agreement

In *Fifth Day*, plaintiff The Fifth Day, LLC (the "Construction Manager") entered into an agreement with Industrial Real Estate Development Company (the "Owner") "to provide certain 'industrial real estate development and construction project management' services with respect to real property." The Construction Manager contracted to perform a wide array of services, including assisting, on behalf of the Owner, in coordinating the activities of the various work forces to enable them to complete their assigned tasks in an organized and efficient manner, on time and on budget; maintaining records such as insurance certificates, as well as the financial books and records for the project; keeping the Owner apprised of the status of the project; being the on-site "point person" to respond to issues as they arose; and generally acting as the Owner's agent with respect to the various parties connected with the development project.

The Construction Manager did not perform or agree to perform any actual construction work on the project, and did not enter into any contracts with contractors, subcontractors or design professionals. The Owner contracted directly with the general contractor, listing the Construction Manager as the Owner's

"representative." Otherwise, the Construction Manager made undertakings on almost every aspect of the construction project *except* the hiring of the general contractor and subcontractors who performed the actual construction modifications to the real property.

Following the project, the Construction Manager sued the Owner, alleging the Owner had not paid it in full. The trial court sided with the Owner, holding that a license was required for the work undertaken by the Construction Manager and that, as the plaintiff was unlicensed, it was precluded from maintaining its action. The Construction Manager appealed the decision.

The Majority Opinion

On appeal, the Owner argued that California Business & Professions Code sections 7026 and 7057 required the Construction Manager to be a licensed contractor. Section 7026 defines a "contractor" as any entity that performs or undertakes to perform construction, alteration, demolition, repair or improvement of real property, either directly or "by or through others."

Acting Presiding Justice Armstrong, joined by Justice Kriegler, concluded that the Construction Manager "had no responsibility or authority to perform any construction work on the project, or to enter into any contract or subcontract for the performance of such work." It read section 7026 literally, holding that because the Construction Manager "neither contracted with [the] Owner to perform any of the activities listed in the section 7026's definition of a contractor, nor performed any of those activities," section 7026 did not require it to be a licensed contractor.

The majority held that section 7057's definition of a "general building contractor" did not affect this result. Section 7057 defines a "general building contractor" as "a contractor whose principal contracting business is in connection with any structure built . . ., or to do or *superintend* the whole or any part thereof" (emphasis added). Because "Section 7057 provides that any contractor who engages in the listed activities is a general building contractor, not that any 'person' or 'entity' that does so comes within the definition," the majority held it did not matter that the Construction Manager had superintendent responsibilities concerning the project—since the Construction Manager was not a "contractor" under section 7026 in the first place.

The majority noted that California Government Code section 4525(e) expressly requires construction managers on *public* projects to be *either* a licensed architect, a registered professional engineer, or a licensed contractor, and is entirely silent as to *private* projects. This statute "strongly suggests that the Legislature determined that licensure of construction managers was not necessary in [the private] arena." It concluded, "Unless and until the Legislature does so, its failure to expressly address the issue must be the last word."

The Dissent

Justice Mosk filed a lengthy dissent to the majority opinion. He relied heavily on the public policy behind the contractor licensing requirement, specifically "to prevent unqualified and unscrupulous contractors from preying on people." Under the majority's approach, "unqualified, unscrupulous and unlicensed contractors have a loophole in the license requirement that will facilitate their illicit or incompetent activities – they need merely call themselves 'construction managers' rather than 'contractors' and, regardless of the services they perform, the licensing requirement will not apply."

The dissent declared that such tasks as supervision and coordination of work of contractors, obtaining building and special permits, assisting the general contractor with the subcontractor bidding process, conducting daily on-site inspections, and "most significantly," the Construction Manager's agreement to "use commercially reasonable efforts to achieve satisfactory performance from each of the Contractors and Subcontractors," constitute "construction services" that fall within the definition of Section 7026.

Justice Mosk drew further support from section 7057, arguing that the Construction Manager did "'superintend' a part of the construction project"; from section 7026.1, a supplementary definition of "contractor" that uses the word "includes"; and from section 7139.1, dealing with "construction management education." He also noted that other states, including Nevada, Idaho and South Carolina, require construction managers to hold contractor licenses.

The dissent's response to Government Code section 4525(e) was that only a public works construction manager who performed work requiring a contractor's license would need to be so licensed; if such work was not undertaken, that construction manager could be a licensed architect or a registered professional engineer instead. "Whether a [contractor's] license is required depends on the duties that person undertakes to perform."

Commentary

Construction managers play important roles in the development of California real estate. As the dissent pithily put it, they often perform "the nondesign functions of the architect and engineer and the nonconstruction activities of the general contractor."

For years, many construction managers in California have taken the position that they are not required to be licensed. They rested their conclusion on the literal language of section 7026, which defines a "contractor" as one who performs, or undertakes to perform, modifications to real property.

There are precedents holding that an employee of an owner of real property acting as a construction manager need not be licensed. *See Dorsk v. Spivack*, 107 Cal. App. 2d 206 (1951); 57 Ops. Cal. Atty. Gen. 421 (1974). However, those precedents did not involve persons not in an employer-employee relationship. The *Fifth Day* decision confirms a literal reading of section 7026 that is more generally applicable to construction managers.

Not everyone who calls himself or herself a "construction manager" can take advantage of the *Fifth Day* decision. It is important to note that section 7026 cannot be avoided by a construction manager's undertaking work but delegating all of the construction activities to subcontractors. Section 7026 applies to entities who undertake to perform the subject work "by or through others." *Vallejo Development Co. v. Beck Development Co.*, 24 Cal. App. 4th 929, 940 (1994).

Regardless of the contracting structure, if the construction manager is "at risk," i.e., if its compensation is based on the general contractor's or subcontractor's price or schedule, it may be beyond the protection of the Fifth Day decision, and may need a contractor's license. In *City of Inglewood-L.A. County Civic Center Authority v. Superior Court*, 7 Cal. 3d 861, 866 (1972), involving the public competitive bidding laws rather than the licensing laws, the Supreme Court held that the "duties and obligations which were required of the management contractor in this case, including its guarantee of the outside price based on the subcontract bids, persuades us that the management contracting procedure as proposed and followed here is … closely akin to a traditional lump sum general construction contract."

The dissent's approach would create substantial uncertainty in the industry as to what superintendent activities are sufficiently extensive to require licensure. On public works governed by Government Code section 4525, a determination would need to be made whether the construction manager is acting more like an architect, in which case an architect's license would suffice, or sufficiently like a contractor, in which case a contractor's license would be required.

The dissent is correct that other states require construction managers to be licensed. But in many cases, that is because their Legislatures have unequivocally said so. In Nevada, the statute expressly includes construction managers in the definition of "contractor" (Nev. Rev. Stat. § 624.020(4)); in South Carolina, construction managers are required to be either a licensed contractor or a licensed engineer or architect (S.C. Code Ann. § 40–11-320); and in Idaho, as in California, the Legislature enacted a separate licensing scheme applicable to construction managers who work on public works projects (Idaho Code § 54–4503 et seq.).

The majority concluded that any regulation of construction managers' activities should be left to the Legislature. It is possible that the California Supreme Court, or the Contractors' State License Board, will take an interest in the *Fifth Day* decision even earlier.

Experienced legal counsel can enhance your understanding of the implications of the *Fifth Day* decision and can assist you in achieving and maintaining compliance with the contractor regulations.

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