
LLCs Can Finally Become Licensed California Contractors

by Robert A. James and Amy L. Pierce

California law directs the Contractors' State License Board, no later than January 1, 2012, to begin processing applications by limited liability companies for contractors' licenses. The Board has recently provided guidance on the licensing requirements for LLCs, which differ from those for other types of business organizations.

In 2010, then-Governor Arnold Schwarzenegger signed Senate Bill 392 (Statutes of 2010, chapter 698), which at last allows a limited liability company (LLC) to obtain a California construction contractor's license. The new law directs the California Contractors' State License Board (the "Board") to begin processing LLC applications "no later than January 1, 2012." Almost immediately, the Board warned that it was not presently accepting such applications. Recently, however, the Board released guidance on the standards it will use when the process does commence.

For Seventeen Years, LLCs Were Not Permitted to Obtain a California Contractor's License

The reader might reasonably ask why, seventeen years after the introduction of the LLC into California law (Beverly-Killea Limited Liability Company Act of 1994, codified at Cal. Corps. Code § 17000, *et seq.* (the "LLC Act")), LLCs are only now becoming able to obtain a contractor's license. It is here that a page of history is worth a volume of logic.

When the LLC Act was being debated, some legislators expressed concern that the standards for piercing the organizational veil to reach the assets of LLC members or managers had not yet been established. That concern drove a decision not to allow LLCs to be used for certain businesses subject to professional licensing requirements. The original LLC Act and later amendments provided that the law should not be construed to permit an LLC "to render professional services, as defined in subdivision (a) of Section 13401 of the Corporations Code in this state" (now codified at Corps. Code § 17375). Section 13401 in turn defines "professional services" as "any type of professional services that may be lawfully rendered only pursuant to a license ... authorized by the Business and Professions Code." A companion law in 1994 (S.B. 2053) amended the Business & Professions Code to authorize LLCs for automotive repair shops, accountancy firms and certain other licensed businesses, but did not so amend the contractor's license

chapter. The Board itself sought in later bills the authority to grant LLC licenses, but the relevant language was struck from the versions passed by the Legislature (such as S.B. 141 in 1995).

Faced with these facts, for many years the legal office of the Department of Consumer Affairs, in which the Board is housed, took the position that the Board was without authority to grant licenses to LLCs. In fact, that office also held that the Board should not grant licenses even to general partnerships or limited partnerships, if any general partner was itself an LLC. The fact that a particular LLC might be well insured, bonded and capitalized was wholly irrelevant. Explaining this peculiar disability to bewildered out-of-state contractors became part of the stock in trade of California construction lawyers.

S.B. 392 – the 2010 Authorizing Legislation

S.B. 392 amends the LLC Act to provide that LLCs may engage in licensed businesses wherever permitted by the applicable Business & Professions Code provisions (Corps. Code § 17002(c)). It then makes numerous amendments to the Contractors' State License Law (Bus. & Profs. Code § 7000, *et seq.*) to achieve that result. S.B. 392 begins by stating the Legislature's intent that the corporate veil-piercing doctrine apply to LLCs, but acknowledging that "there is not yet case law establishing this principle in California." Therefore, the act imposes surety bond, insurance and personnel liability requirements on LLC licensees that are not imposed on licensees that are corporations, partnerships or sole proprietors.

S.B. 392 generally extends to LLCs the same status and rights that are enjoyed by corporations under the Contractors' State License Law. For example, a responsible managing manager, responsible managing officer, responsible managing member or responsible managing employee of the LLC may apply to act as the "qualifying person" for the LLC. As is the case for corporations, if a LLC was formed under the laws of a state other than California, it will have to register to do business and be in good standing with the California Secretary of State in order to apply for a California contractor's license.

Special Requirements for LLCs Applying for a Contractor's License

The Legislature's veil-piercing concern is evidenced by several provisions that apply only to LLC licensees. First, new Section 7071.6.5 requires that an LLC applicant or licensee file or have on file with the Board a \$100,000 surety bond for the benefit of any employee damaged by his or her employer's failure to pay wages, interest on wages or fringe benefits (and welfare fund contributions, pension fund contributions and apprentice program contributions, if a collective bargaining agreement applies).

Second, new Section 7071.19 requires the LLC applicant or licensee to maintain insurance that covers "acts, errors, or omissions arising out of the contracting services it provides" on either a claims-made basis or an occurrence basis. For an LLC with five or fewer persons identified as associated with the LLC in the records of the Board (its "personnel of record"), the aggregate limit on this insurance must be at least \$1 million; for an LLC with more than five personnel of record, an additional \$100,000 of insurance must be obtained for each person listed as personnel of record of the LLC (apparently including even the first five), to a maximum of \$5 million less amounts paid in defending, settling or discharging claims.

Finally, new Section 7076.2 provides that if an LLC's license is suspended due to its failure to be registered and in good standing with the California Secretary of State, each "person within the company" shall be personally liable up to \$1 million for damages resulting to third parties in connection with the LLC's performance, during the period of suspension, of any act or contract that requires a contractor's license. A "person within the company" includes each of the "personnel of record" as well as each officer, manager, responsible managing employee, responsible managing member, responsible managing member and responsible managing officer of an LLC. Personal liability will not attach if there has been "substantial

compliance” with the licensure requirements, as contemplated by Section 7031. Even though this section applies only to acts and contracts after an LLC violates its Secretary of State registration duties and the Board registrar gives notice to the LLC, and even though it is subject to the substantial compliance doctrine, the prospect of very significant liability for each named employee—as well as for each LLC manager and member—may dissuade some from serving as “personnel of record” of an LLC licensee. The LLC or its parent entities may need to provide indemnities and security to induce parties to be so designated.

Recent Board Guidance to LCC Applicants

In 2010, the Board simply warned that it was not yet processing LLC license applications. Recently, the Board issued some preliminary guidance at www.cslb.ca.gov/GeneralInformation/About/LLC.asp, though still warning that no applications are being accepted. Some highlights of the new guidance follow:

- The new \$100,000 bond benefitting employees is in addition to the \$12,500 bond that LLCs and any other entities must post securing more generally the licensee’s compliance with the Contractors’ State License Law.
- Every person who is an officer, member, director or “responsible manager” must be listed on the application of an LLC as “personnel of record.”
- The license number of a sole proprietorship or corporation may be transferred to an LLC under certain circumstances (citing Bus. & Prof. Code § 7075.1).
- “LLCs may serve as a general partner on a partnership license provided the LLC meets the above requirements relating to the additional surety bond and liability insurance. An LLC serving as a limited partner on a partnership license is not required to meet the additional surety bond and liability insurance requirements.”

For LLCs formed and maintained by sophisticated contractors, the additional surety bond, liability insurance and personnel liability exposures in S.B. 392 and the Board guidance should be manageable—and at long last, California construction obligations can be undertaken by an efficient and favored form of business organization. Conversely, the incremental requirements may lay and set traps for the unwary.

If you have questions, contact the Pillsbury attorney with whom you regularly work, or the authors below.

Robert A. James (bio)
San Francisco
+1.415.983.7215
rob.james@pillsburylaw.com

Amy L. Pierce (bio)
Sacramento
+1.916.329.4765
amy.pierce@pillsburylaw.com

This publication is issued periodically to keep Pillsbury Winthrop Shaw Pittman LLP clients and other interested parties informed of current legal developments that may affect or otherwise be of interest to them. The comments contained herein do not constitute legal opinion and should not be regarded as a substitute for legal advice.

© 2011 Pillsbury Winthrop Shaw Pittman LLP. All Rights Reserved.