

Recent Arizona Court Decision:

Court of Appeals Says Licensing Statute Still Has Teeth

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A recent decision by the Arizona Court of Appeals makes clear that the failure to be properly licensed at all times throughout a project will bar subsequent claims by the unlicensed contractor except in rare cases. The owner's full knowledge of the contractor's licensing situation does not matter.

The Substantial Compliance Test

By statute, Arizona does not allow unlicensed contractors to bring actions for unpaid work. A.R.S. § 32-1 153. The legislature enacted the bar "to protect the public from unscrupulous, unqualified, and financially irresponsible contractors." *Aesthetic Property Maintenance, Inc. v. Capitol Indemnity Corp.*, 183 Ariz. 74, 900 P.2d 1210 (1995). Over the years, Arizona courts have required strict compliance with the licensing statutes, and even minor lapses have caused unlicensed contractors to forfeit claims for payment no matter how harsh the result.

The Arizona Supreme Court, however, appeared to soften the rule in 1995 with the *Aesthetic Property* case. There, the Court allowed an unlicensed contractor to maintain a claim for payment because the contractor (a) lost his license temporarily through no fault of his own (the Registrar had sent his license renewal notice to the wrong address); (b) immediately moved to rectify the problem once it was discovered; and (c) was financially responsible while unlicensed. The court concluded that the contractor had "substantially complied" with the licensing statutes, and that was good enough to maintain its claim.

Substantial Compliance Exception Is A Narrow One

If a temporary license lapse caused by the Registrar can be substantial compliance, what about a contractor that obtained its license shortly after a project had begun, but the owner knew the contractor was unlicensed and the contractor was suing only for work done while properly licensed?

That was issue recently addressed by the Court of Appeals in *Crowe v. Hickman 's Egg Ranch, Inc.*, 369 Ariz. Adv. Rep. 3, 41 P.3d 651 (App. 2002). Crowe was an out-of-state builder of commercial hen houses. It was licensed in Mississippi only, a fact known by the owner, who encouraged Crowe to build in Arizona. Crowe applied for an Arizona license before the project started and obtained it long before the project finished. It also sued only for payment for work completed while it was properly licensed.

The court held that these extenuating circumstances did not constitute substantial compliance and barred the claim. The court noted that unlike the contractor in the *Aesthetic Property* case, the Registrar of Contractors did not contribute to Crowe's lack of licensing. More importantly, Crowe failed to present evidence that it was financially responsible during the unlicensed period. Although no one was claiming that Crowe was financially irresponsible, it was his burden to show that he had maintained "his liability insurance, surety bond, and workman's compensation during the unlicensed period; 'failing that, there can be no substantial compliance.'"

The *Crowe* decision thus makes clear that only in rare instances will unlicensed contractors be able to avoid the absolute bar of A.R.S. § 32-1153. The contractor must be unlicensed through no fault of his own; immediately act to rectify the problem; and maintain its financial responsibility while unlicensed.

What About Crowe's Subcontractors?

Although not a part of the **Crowe** case, would Crowe's lack of a license affect its subcontractors' ability to sue for payment? Could those subcontractors bring lien foreclosure actions, for example, against the *owner*?

Surprisingly, that issue was considered nearly 70 years ago in *Hunt v. Douglas Lumber*, 41 Ariz. 276, 17 P.2d 815 (1933). The court framed the question as follows: “what, if any, effect does the failure of the [general] contractor to secure a license have upon the rights of [its subcontractors and suppliers]?”

The *Hunt* court answered that if the down-the-chain contractors and suppliers knew the general was unlicensed, then their suits would be barred. If those subcontractors and suppliers provided labor and materials to the project in good faith without such knowledge, then the general’s lack of a license was no obstacle to their suits.

Having the Wrong Type Of License Is Equally Fatal

A contractor also cannot sue if he has the wrong kind of license. In *Sanders v. Foley* 190 Ariz. 182, 945 P.2d 1313 (1997), the court held that a B-1 General Commercial license did not permit the contractor to sue—either under its contract or by foreclosing *on its lien*—for compensation for remodeling work done on a residence.

Practical Advice

Although obvious to most contractors, the statutes and case law make clear that contractors:

should only perform work within the scope of their licenses; and

- should keep their licenses current and work immediately to rectify any lapses.

If a subcontractor or supplier discovers that the party with whom it has contracted is not properly licensed, then that subcontractor or supplier needs to understand that its lien rights *could* be in jeopardy.

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