Can an Unlicensed Contractor Recover Damages under Virginia Law?

by Courtney Moates Paulk

Two recent opinions, both applying *Code of Virginia* § 54.1-1115, discuss whether unlicensed contractors are entitled to recover damages in the Commonwealth of Virginia. The first, *R.R. Gregory Corporation v. Labar Enterprises of Rochester Inc., et. al.*, 2008 WL 3376642 E.D.Va. 2007 (November 8, 2007), appears to conclude in the affirmative. The second, *Daniel Jones Remodeling LLC v. Johnny Cheng-Teh Chiu, et al.*, 2008 WL 2227791 Fairfax Circuit Court (May 21, 2008), clearly holds in the negative. Both opinions apply exactly the same subsection *Va. Code* § 54.1-1115(C), but focus on entirely different language included in that subsection.

Subsection (B) states that any person who undertakes contracting work without a valid license shall be fined up to five hundred dollars per day for each day that the person is in violation ...

Code § 54.1-1115 relates to the regulation of contractors and defines acts that are prohibited and considered to be Class 1 misdemeanors. Subsection (A) identifies particular acts that constitute the commission of a Class 1 misdemeanor. For example, "contracting for, or bidding upon the construction, removal, repair or improvements to or upon real property owned, controlled or leased by another person without a license or certificate, or without the proper class of license as defined in § 54.1-1100 for the value of work performed" is considered a Class 1 misdemeanor. Subsection (B) states that any person who undertakes contracting work without a valid license shall be fined up to five hundred dollars per day for each day that the person is in violation, in addition to any penalties for the commission of a Class 1 misdemeanor.

Subsection (C) is relatively short, but appears to have provided enough fodder and ambiguity for discussion in both the *Gregory* and *Daniel Jones* cases. Subsection (C) states: "[n]o person shall be entitled to assert the lack of licensure or certification as required by this chapter as a defense to any action at law or suit in equity if the party who seeks to recover from such person gives substantial performance within the terms of the contract in good faith and without actual knowledge that a license or certificate was required by this chapter to perform the work for which he seeks to recover payment. Failure to renew a license or certificate issued in accordance with this chapter shall create a rebuttable presumption of actual knowledge of such licensing or certification requirements."

In the *Gregory v. Labar* opinion, Judge T.S. Ellis III in the Alexandria Division of the Eastern District of Virginia address the language in subsection (C) regarding "substantial performance" but fails to focus on the "good faith" or "actual knowledge" requirements. *Gregory* involved a breach of contract action that arose as a result of alleged delay and unsatisfactory work on the part of the subcontractor (Labar).

Gregory, the general contractor on a project to construct Leeland Elementary School in Stafford County, subcontracted with Labar to perform the site work on the project. During construction, on September 26, 2005, Gregory terminated Labar's subcontract as result of Labar's delay and entered into another subcontract with Rice Contracting to complete Labar's work. Gregory filed suit against Labar alleging breach of contract. Gregory sought damages in the amount of $925,000 as a result of additional costs incurred by Gregory in paying Rice Contracting to complete Labar's contract work. Labar filed a separate suit against Gregory, also alleging breach of contract, in which it sought payment for work it performed on the project in August and September 2005, prior to termination of the contract. The cases were consolidated.

In response to the suit filed by Labar, relying on *Code* § 54.1-1115(C), Gregory argued that

Labar was precluded from asserting its claim for unpaid invoices from August and September 2005 because Labar did not have a contractor's license at the time of the project. The court stated: "Virginia allows a party to assert an adversary's lack of licensure as a defense in a suit for unpaid balances only where the unlicensed adversary has not given 'substantial performance within the terms of the contract.'"

In addressing Labar's performance, the court said : "The parties dispute the meaning of the statutory phrase 'substantial performance' in this context. The record shows that Labar performed approximately 65 percent of the subcontract work. Labar argues that it has therefore performed the substantial part of the work contemplated by the subcontract. Gregory urges a more formalistic approach, arguing that 'substantial performance' means performance 'in good faith and in compliance with the contract except for minor and relatively unimportant deviations.' 17A Am. Jur. 2d Contract § 619. Gregory suggests that performance of only 65 percent of the subcontract work does not meet the standard definition of substantial performance."

Prior to addressing the substantial performance issue, the court concluded that Labar breached its subcontract with Gregory by failing to complete work on time. As a result, the court unfortunately declined to address head-on Gregory's argument relative to Labar's failure to have a valid Virginia contractor's license. The court stated: "In the circumstances, it is unnecessary to resolve this dispute, for even if Labar is not barred from bringing its claim, it has failed to introduce sufficient evidence to allow a determination of that claim. More to the point, because Labar breached its contract prior to Gregory's alleged failure to pay, such a failure would not constitute a breach of contract even if it were established by the evidence. *Horton v. Horton,* 487 S.E.2d 200, 204 (Va. 1997) (holding that a party committing a material breach cannot thereafter enforce the contract)."

The Virginia Board for Contractors reports that Labar did not obtain its initial contractor's license until December 2005. Yet, in reading the opinion, it does not appear that either side argued the actual knowledge language included in subsection (C). Moreover, the court never concludes whether 65 percent performance would constitute substantial performance under the contract. So, why did the court even discuss the competing arguments relative to substantial performance if it did not intend to rule on the issue? If the court believed Gregory's argument to be dispositive—that Labar was precluded from asserting its claim because it did not have a contractor's license—it would have included this as an additional basis for denying Labar's claim. Yet, it did not.

In the *Daniel Jones* case, the issue before Judge Charles J. Maxfield in the Fairfax Circuit Court was whether the plaintiff, a Class B contractor, could maintain an action on a contract valued at $128,600 with additional claims as a result of change orders totaling $62,355.42. Pursuant to *Code* § 54.1-1100, a Class B contractor is permitted "to perform or manage construction, removal, repair, or improvements when (i) the total value referred to in a single contract or project is $7,500 or more, but less than $120,000."

The plaintiff was paid $128,913.51 for work it performed on the project — an amount greater than the original contract amount of $128,600 and also greater than the statutory cap for the value of allowable work to be performed by a Class B contractor on a single contract or project.

Relying on *Code* §§ 54.1-1100 and 54.1-1115, the defendant filed a plea at bar asserting that the plaintiff, as a Class B contractor, could not maintain an action on a contract valued at an amount greater than $120,000.

In response, the plaintiff argued that the lack of case law involving a contractor who exceeded his licensing limitations required that the court overrule the plea in bar. Alternatively, the plaintiff argued that *Code* § 54.1-1115(C) "saves" the contract because the plaintiff was unaware of the monetary restriction placed on his license.

In considering the plea in bar, the court adhered to "strict construction rules so as to give effect to legislative intent" to *Code* §§ 54.1-1115 and 54.1-1100. Further, the court stated "Under the plain meaning doctrine, where a statute is written in 'words that are clear and unambiguous, courts may not interpret them in a way that amounts to a holding that the legislature did not mean what it actually has expressed.'" (citations omitted)

The court first focused on *Code* § 54.1-1100 and the value of work permitted to be performed

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by a Class B contractor. The court then considered *Code* § 54.1-1115(A)(1) which states that "contracting for . . . construction, removal, repair or improvements to or upon real property owned . . . by another . . . without the proper class of license . . ." shall be considered a Class 1 misdemeanor. The court stated: "Virginia has long held that 'a contract made in violation of a police statute enacted for public protection is void and there can be no recovery thereon' . . . The statutory scheme of Section 54.1-1100 *et seq*. is designed to protect the public and is a valid exercise of police powers" (citations omitted).

Addressing the plaintiff's argument regarding the absence of case law, because the language "without the proper class of license" was recently added to the statute in 2004, the court was not concerned about the lack of case law addressing the point. The court also held that this recent addition "evidenced a legislative intent to protect the public from contractors who exceed their authorization just as it protects the public from contractors without licenses. The deficiencies on the part of the contractor are treated identically under the statute."

In response to the plaintiff's other argument, relative to actual knowledge, the court held that subsection § 54.1-1115(C), "which protects good faith violations of the chapter, does not apply to the case at bar." The court stated: "Clearly this section is designed to protect innocent contractors and places a burden on them to know when their license expires. It creates no exception for a contractor innocently or otherwise exceeding the monetary limits of his [license] and the court cannot read such a saving provision into the statute."

Ultimately, the court sustained the plea in bar and dismissed the plaintiff's case.

Virginia attorneys should always ensure that contractor clients hold valid licenses and are operating within the confines of their class of license.

The *Gregory* case involved a commercial project, whereas the *Daniel Jones* case involved a residential project. While neither the statutes nor the courts discuss a distinction in applying the law to commercial versus residential projects, the *Daniel Jones* opinion focuses on the violation of police statutes and protecting the public from contractors who exceed their authorization. Despite no such distinction in the statutes, this perhaps leaves the door open for unlicensed contractors performing work on commercial projects to argue that they should not be held to the same standard as unlicensed contractors performing work on residential projects.

An additional argument could be made that upstream contractors on a commercial project should know better than to enter into a contract with an unlicensed subcontractor. However, it is uncertain whether such arguments would be successful considering the plain language of the statutes.

While not addressed in either case, *Code* § 54.1-1115(B) was modified again in 2008 to include language that any person who undertakes work without a valid Virginia contractor's license "shall also constitute a prohibited practice in accordance with 59.1-200 provided the violation involves a consumer transaction as defined in the Virginia Consumer Protection Act, and shall be subject to any and all of the enforcement provisions of the Virginia Consumer Protection Act." This provision only applies to unlicensed contractors and not to persons holding the improper class of license. This addition should be of particular concern to unlicensed contractors performing work on residential projects, as a violation of the Virginia Consumer Protection Act could result in an award of treble damages and attorneys fees.

Further, this amendment may support an argument that unlicensed contractors performing work on residential projects really are held to a higher standard than those performing work on commercial projects. However, this language attempts to address that distinction by providing an additional and quantifiable remedy to consumers involved in residential projects.

Virginia attorneys should always ensure that contractor clients hold valid licenses and are operating within the confines of their class of license. When confronted with a claim, the first inquiry should be to confirm the licensing status of the individual or entity attempting to recover.

I recently defended two instances in which contractors were not operating with appropriate licenses. First, a subcontractor holding a Class B license and performing work under a contract valued at greater than three hundred thousand dollars attempted to assert a claim against a general contractor on a commercial project. Second, a residential contractor that attempted to assert a claim against a homeowner had allowed its license to lapse, no longer employed its employee who took the licensing exam, had yet to notify the Board for Contractors that it no longer employed this particular employee and had failed to hire a new employee who had passed any level of contractor's exam.

These facts, in light of *Code* 54.1-1115 and the *Daniel Jones* case, provided two compelling, and hopefully successful, arguments against the ability of these contractors to recover from my clients. ■