

Construction Newsletter

[Presented by the Law Offices of Ashley A. Baron]

Legal News for Construction Industry

California Allows LLC's to be Licensed Contractors

Finally, the California legislature has passed Senate Bill 392 which permits a limited liability company ("LLC") to be licensed as a contractor. This puts California in line with the majority of states who have previously allowed LLC's to obtain contractors' licenses. Previously, only sole proprietorships, partnerships, joint ventures (where both joint venture partners were licensed) and corporations could be licensed under California law.

The governor signed Senate Bill 392 into law in September of 2010. However, before you rush out to form a new LLC it should be noted that the California State Contractors Board is not issuing licenses to LLCs at this time. The staff, according to their web site, is developing new application procedures, creating applications and putting in place important programming changes necessary for the new program.

An LLC, for those unfamiliar with this type of entity, is a fictitious entity which combines the properties of a corporation and a partnership. The relative ease of formation, flexibility and tax treatment make it a preferred entity for many small business owners seeking to avoid personal liability.

While the law took effect on January 1, 2011, it does not require the California State Contractors Board to begin processing applications for

licenses for LLCs before January 1, 2012. Thus, it will probably take until late 2011 before the California State Contractors Board actually sets up the mechanism by which an LLC can be licensed as a contractor. No date has been set by the Contractors State License Board at this time.

The bad news is that the new legislation requires that in order for a LLC to be licensed it will have to post a bond for one hundred thousand (\$100,000) to protect employees from not being paid wages. The bond is to ensure payment of wages, interest and fringe benefits to employees. Further, the bond will be required to cover fringe benefit trust fund contributions if the LLC is a signatory to a collective bargaining agreement. This bond is in addition to the twelve thousand five hundred dollar (\$12,500) contractor's bond required for all licensees. The new bond required shall be executed by an admitted surety in favor of the state of California.

This additional bonding requirement may make it difficult if not impossible for most start-up entities to choose this form of organization because they will have limited bonding capacity.

The legislative history of the bill suggests that the additional bonding requirement was put into the licensing requirement of the LLC because the limits on liability of LLC members could leave construction employees without recourse for non-payment of wages or benefits. Because there was no case law for piercing the veil of the LLC as there is with corporations there

was no mechanism for holding the LLC members liable if they diverted project assets and left employees unpaid. A corporate veil can be pierced under case law in California if it intermingles assets with the individual corporate owners, is a mere sham or conduit or does not keep up corporate formalities. Since LLCs were designed to eliminate a lot of the corporate formalities and insure flexibility in transfer of funds, the test to pierce the corporate veil would not be applicable and hence the concern.

Additionally, all LLCs will be required to carry errors and omissions insurance coverage in an amount of not less than one million (\$1,000,000) and up to five million (\$5,000,000), depending on the number of persons

Continued on Page 2



listed on the personnel of record of the LLC. If the LLC has five (5) or less members the coverage must be for one million (\$1,000,000), but for more than five (5) members it is an additional one hundred thousand (\$100,000) per additional member to the maximum of five million (\$5,000,000). The insurance coverage is for damages arising out of claims for provision of contracting services by the LLC.

The policy must be issued by an insurer licensed to do business in the state of California. The policy can be issued on a claims-made or occurrence basis. The policy may be subject to a deductible or a self insured retention. This insures that the cost of the policy can be manageable. Further, upon the issuance, reinstatement, or reactivation of a license under the LLC licensing law, the Board may post on the internet the name of the insurer(s), the policy number(s) and the aggregate limit of liability for each.

The impairment or exhaustion of the aggregate limit of liability by amounts paid under any policy in connection with the settlement, discharge, or defense of claims applicable to a designated period shall not require the licensee to acquire additional insurance coverage for that designated period. However, the aggregate limit of liability coverage required shall be reinstated by not later than the commencement date of the next designated period. Failure to do so will result in suspension of the license. Additionally, the amount to which any coverage limit is depleted may be reported on the license record.

Upon the dissolution and winding up of the LLC, the LLC shall be required to maintain or obtain an extended reporting period endorsement or equivalent provision in the maximum total aggregate limit of liability for a minimum of three years.

A LLC will be able to qualify for a license by examination of either a Responsible Managing Officer

("RMO"), manager or the LLC, member of the LLC or an employee of the LLC. The bill also provides for the transfer of an existing license number to a LLC under certain conditions if an existing licensee wants to convert their current business entity to a LLC.

The failure of a contractor licensed to do business as a LLC to be registered and in good standing with the Secretary of State shall result in the automatic suspension of the license by operation of law. Where the license of a LLC is suspended for failure to be registered and in good standing with the Secretary of State, the manager, responsible managing employee, responsible managing officer and all individuals listed in the personnel of record shall each be personally liable up to one million dollars (\$1,000,000) for damages resulting to third parties in connection with the company's performance, during the suspension, of any act or contract where a license is required.

Under Section 7029 a joint venture can now be composed of LLCs. A LLC's license shall be canceled upon the company's dissolution, merger, or surrender of its right to do business in California. The LLC shall notify the registrar in writing within 90 days of the dissolution, merger, or surrender. Failure to notify the Contractors License Board is grounds for disciplinary action.

A license number may be reissued after cancellation, revocation, suspension, or expiration beyond the renewal period to a LLC when the parent LLC has merged or created a subsidiary, the subsidiary has merged into the parent LLC, or the LLC has changed its filing status with the Secretary of State from a domestic LLC to a foreign LLC or from a foreign LLC to a domestic LLC, and the new entity is being formed to continue the business of the formerly licensed LLC. Also, the license number may be reissued to a LLC when created by immediate members

of an individual licensee's family to continue an existing deceased or absent individual licensee's contracting business or to an LLC when the LLC is formed by an individual licensee and the individual licensee maintains ownership directly or indirectly of membership interest evidencing more than 50 percent of the voting power or to an LLC that acquires a licensee pursuant to an asset sale provided that the LLC has a qualifier or to an LLC that is formed by a corporation to continue the business of the corporation subsequent to the cancellation of the corporate entity's license, provided the personnel listed for each entity are the same.

For more information or a free consultation to determine if an LLC is the right business entity for you, please contact our office.

We now have both Orange County and Park City Offices. Ashley Baron, a U.S.C. undergraduate and law school graduate, has been a lawyer for the past 29 years. Ms Baron has tried over 100 cases. The firm performs construction, business, arbitration, labor law and litigation support for developers, prime contractors, material suppliers, subcontractors, banks, title companies and other businesses in Orange, Riverside, San Bernardino, Los Angeles and San Diego Counties. For further information contact us at (714) 974- 1400 or e-mail us at ashleybaronesq@yahoo.com. Please take a look at our all new web site at: www.ashleybaron.com where you can learn more about our firm and can read and review our past newsletters.