

Workers Compensation Insurance a Trap for Underreporting Contractor

Every employer knows, or should know, that California Law requires all employers to carry workers compensation insurance for employees. This insurance provides benefits to employees in case they are injured on the job.

Failure to carry such insurance can result in severe penalties. But the insurance is based on the amount of wages paid, and so there is a concern not only with failing to have such insurance, but also in failing to provide a full report of all wages actually paid.

A case decided earlier this year highlighted an extreme risk to contractors that accompanies underreporting the amount of wages actually paid.

A contractor did a small remodeling job for a homeowner. The contractor paid a crew of 3-5 employees approximately \$15,000 for about 4000 man hours of work on the home during a one-month period. However, the contractor had reported only a payroll of \$312 during a two year period when he actually had a payroll of \$135,000. This resulted in a very inexpensive workers compensation premium, but also had a drastic effect on his license.

California Business and Professions Code section 7125.2 provides that if a contractor fails to obtain and maintain workers compensation insurance, then the license of the contract is automatically suspended without further notice from the Contractor's State License Board. This means that CSLB records can show that a contractor's license is fully active, but that the law will consider the license to be suspended even if the contractor never receives any notice from the CSLB.

The results of an automatic license suspension can be harsh. Contractors cannot win a lawsuit to recover amounts due them if they are unlicensed. In addition, an owner is potentially entitled to recover everything paid to an unlicensed contractor under Business and Professions Code section 7031. An owner isn't limited to recovering just the amount of profit the contractor received. If the contractor wasn't licensed, then the owner is entitled to recover everything paid to the contractor, including all money paid for materials.

In the case mentioned above, the homeowner disputed the amount of the contractor's invoices, and the contractor sued the homeowner on a claim of \$11,000.00. However, because he had intentionally underreported his payroll amounts, the Court found that the contractor's license had become automatically suspended. He therefore could not recover anything from the owner. Plus, the owner had countersued the contractor by claiming that the contractor had overcharged the owner. The court awarded the owner \$27,000 in reimbursement costs, \$90,000 in attorneys fees and \$7,000 in costs, and some other damages as well.

This case is dynamite. If contractors intentionally (or perhaps even unintentionally) underreport their wages to their workers compensation carrier, then if any lawsuit is filed the contractor is at risk for returning to the owner everything the owner paid to the contractor.

The best policy? All contractors should keep workers compensation effective, in place, and up to date with accurate payroll reporting.

The Law Office of Robert B. Jacobs provides legal services in the areas of Construction, Business, and Real Estate Law. The office is located in Pleasanton, California and can be reached at (925) 847-8680. The foregoing article concerns only California law and the law of other States may be different. The article is not a complete discussion of the applicable law, and competent counsel should be consulted concerning any specific situation or issue. © 2007 Robert B. Jacobs. All rights reserved.