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Departments // Law

Contractor Registration Acts Apply to Subcontractors as Well as General Contractors

Subcontractors often ask whether they are required to register with the state and, if so, why they should register. The short answer to the former question is yes—subcontractors are generally required to register with the state pursuant to statutory enactments such as Washington's Contractor Registration Act (CRA), Title 18.27 RCW. Subcontractors fall within the CRA's definition of contractors, who are required to register with the state. The answer to the latter question is more involved and informative.

The CRA's purpose is to afford protection to the public from unreliable, fraudulent, financially irresponsible, or incompetent contractors. Do you know of any subcontractors that look upon themselves as unreliable, fraudulent or incompetent, thereby rendering the purpose of the CRA relevant to them? (Note that "financially irresponsible" is omitted from the previous observation.) Probably not. So what incentives are available to entice subcontractors to register with the state?

INCENTIVES

The first incentive is compliance with the law. Registration allows subcontractors to avoid the misdemeanor conviction and penalties prescribed in the CRA for advertising, bidding or working as a subcontractor without registration, and the two-year audit and monitoring program that accompanies an infraction. Weighing the costs and efforts associated with the penalty process and the registration process, most subcontractors should prefer the latter, which involves less time and expense, allows the subcontractor to procure and perform work within the state, and complies with the law.

Contractor registration is a relatively painless process. For example, contractors in Washington must: 1) complete an application and submit it to the Department of Labor and Industries; 2) obtain a continuous surety bond in the amount of \$12,000 for general contractors or \$6,000 for specialty contractors, or assign a security deposit in the same amount in the form of a savings account to the state; 3) obtain public liability and property damage insurance and submit the insurance certificate to the state; and 4) pay the registration fee. Registrations must be renewed every two years. These requirements vary from state to state. Refer to the your state's regulations or your attorney for specific registration information.

LIEN RIGHTS

The next incentive for subcontractors to register is compensation for work performed. Residing at the bottom of the contract chain, subcontractors are dependent on upper-tier contractors for payment. Subcontractors have limited leverage in negotiating contracts and consequently must often accept onerous payment terms. They need all the leverage possible to assure payment for services rendered. Regardless of registration status, subcontractors are not precluded by the CRA from filing a lawsuit for compensation against upper-tier contractors with whom they contract, and vice versa. However, most

subcontractors also rely on their statutory lien rights as leverage for payment. These lien rights are not available to an unregistered subcontractor. The ramifications are financially significant.

For example, if the prime contractor on a project purposefully or inadvertently fails to register under the CRA and the project owner refuses to pay the prime contractor, the ramifications inevitably flow down to subcontractors. Unpaid prime contractors often create unpaid subcontractors. The unregistered prime contractor cannot bring a lawsuit against the owner and is unable to pay its subcontractors. The unregistered subcontractors can bring lawsuits against the unpaid prime contractor, but not against the owner. The registered subcontractors can bring lawsuits against the unpaid contractor and lien foreclosure actions against the owner. The chances of success for the subcontractors are significantly increased with registration.

SUBCONTRACTOR BENEFITS

An additional incentive for subcontractors to register with the state is the increased number of projects available to the registered subcontractor. GCs are barred from retaining unregistered subcontractors and generally retain only bonded and insured subcontractors. This minimizes chances of the GC's insurance carriers invoking policy exclusions regarding work performed by uninsured subcontractors. In addition, if a general contractor retains a registered subcontractor whose registration expires or is suspended or revoked before the work is completed, the GC must terminate the subcontractor upon notice from the state that the subcontractor's registration is not current. Finally, in some states, public entities are barred from retaining unregistered contractors and are subject to a fine (\$10,000 in Washington) for failing to verify a contractor's registration before issuing a building permit. Work opportunities for unregistered subcontractors are limited.

With the foregoing incentives in place to entice subcontractors and contractors to register with the state, a brief overview of some of the subtleties and effects of the CRA is appropriate.

OVERVIEW

Contracts between unregistered contractors and project owners are not rendered void under the CRA. Rather, unregistered contractors are precluded from seeking redress through the courts or through arbitration if the owner refuses to pay the unregistered contractor. This includes all claims for payment such as breach of contract and unjust enrichment. In addition, the CRA does not preclude claims by an owner against an unregistered contractor, and the unregistered contractor is not prevented from defending against the owner's claims. The CRA does not require the unregistered contractor to refund payments previously made by the owner.

The issue of "substantial compliance" is often raised in the CRA context. There are numerous facts and circumstances that arise in which the courts may deem a contractor to be in "substantial compliance" with the CRA. A finding of substantial compliance may apply where a contractor inadvertently allowed its registration to lapse for a short time period or where administrative errors prevented registration renewal. However, before a court can even consider whether there is substantial compliance, the contractor must show that it has a current bond or other security as required under the CRA, it has current insurance as required under the CRA, and that the state has all of the information on record that is required in the registration application. This helps ensure that the CRA's purpose of protecting the public is fulfilled in the event the court deems the contractor in substantial compliance.

The bottom line recommendations for contractors and subcontractors regarding the CRA are register with the state and keep the registration current. Keeping current generally requires registration renewal every two years and maintaining the requisite and unimpaired surety bond and insurance. A lack of vigilance can result in the contractor's loss of the ability to get paid for work performed, penalties imposed pursuant to applicable regulations, and suspension or revocation of the registration. A rudimentary risk management analysis mandates vigilance in this area. Check the regulations of your state to assure timely compliance.

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