Court Rules Loan Documents Unenforceable Due to Unlicensed Contractor, But Key Protection May Shield Lenders

By Stephen B. Schrock, Taylor S. Benatar and Melanie Tate

Georgia law provides that a contractor cannot enforce a contract for performing work if the contractor does not hold the required license for that work. This seems straightforward and logical. So, how did a Georgia court use it to void all the loan documents related to unauthorized construction?

In *McMillan v. Rodriguez* (376 Ga. App. 280), the Court of Appeals of Georgia held that a promissory note, deed to secure debt, and guaranty were all unenforceable because of their connection to unlicensed work by a contractor. The loan structure in this case was unconventional, to say the least.

It started with a self-described multi-millionaire who believed he urgently needed a bunker before a mass-casualty event. He found a contractor to build the bunker on commercial property that he owned in Dallas, Georgia, and was undeterred by the fact that the contractor lacked a license. Work began, but the initial funding wasn't sufficient, so the contractor agreed to provide a loan in the form of advancements for the bunker project. Work continued but was eventually halted by the City of Dallas because of a preexisting stop order on the property and a lack of permits. The contractor called in the debt and threatened foreclosure, but his client never paid and then sued him, claiming that the contractor's lack of a license made *all* the contracts unenforceable.

The contractor argued that the construction agreement was separate from the agreements related to the loan. The note, guaranty, and deed to secure debt "are all *different* contracts, executed at different times, and include *different* parties." He also argued that he wasn't required to hold a license simply to loan money in the form of advancements to fund the construction project. The court was not convinced.

The court examined whether the debt instruments involved were for the performance of work and concluded that they were. It described them as "nothing more than a financing arrangement by which [the contractor] recouped and secured his costs, expenses, and profit arising from his unlicensed work." Going further, the court also disregarded language in the guaranty intended to separate it from the underlying obligations in the other documents: although the guaranty stated that no defense as to the enforceability of the underlying obligations would affect the guarantor's obligations, the court reasoned that the guaranty still advanced the objective of ensuring the contractor was paid for unlicensed work.

However, the court didn't stop there in its analysis, making broad statements about public policy and illegal consideration. The court noted that when the consideration for a contract is illegal, the entire promise fails. Because the consideration underlying the guaranty was unlicensed construction work, the court found that "the guaranty and the deed to secure debt are unenforceable for this reason alone."

Additionally, the court held that the guaranty and deed to secure debt were void as a matter of public policy. The court viewed these documents as merely a financing arrangement for the contractor's illegal construction services and stated that "a contract to do an immoral or illegal thing is void."

From the court's analysis, this case may appear to have broad implications for lenders if a contractor is unlicensed. However, the relevant Georgia statute (O.C.G.A. 43-41-17(b)) prohibiting unlicensed contractors from enforcing contracts for work provides important protection for other parties that should give lenders peace of mind. The statute states: "This subsection shall not affect the rights of parties other than the unlicensed contractor to enforce contract, lien, or bond remedies." While the court's arguments push the definition of "contracts for work" beyond its traditional scope – as the dissent notes, by basic definitions, a note and a guaranty are not contracts for work – the underlying statute should allow a lender to enforce its remedies under its loan documents, even if a contractor cannot. That said, the court did not explicitly clarify that its public policy arguments apply only to enforcement by a contractor, which may give lenders some pause.

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