SHIELDS MOTT LUND L.L.P.
ATTORNEYS AND COUNSELLORS AT LAW

Louisiana Construction Law and News Update

Fall 2005

In this issue:

WE WILL REBUILD OUR GREAT CITY!

We at Shields Mott Lund L.L.P. hope that you are faring well after the tragic devastation of our great city and our neighbors in Mississippi and Alabama. We know that you share our unwavering confidence that our homes, neighborhoods and lives will rebound and proceed stronger than ever. The spirit, optimism and compassion of the people of our communities and our nation will ensure that. We, too, will do what we can to assist the progress of rebuilding and rejuvenating our great city.

As a result of conditions caused by Hurricane Katrina, the firm has opened a Lafayette office. All of our data was backed up and we have been operating since the week of the storm. The firm will continue to operate the Lafayette office, although most of our attorneys and staff will be working back in our downtown New Orleans offices starting October 31. We sincerely thank our friends in Acadiana that have shown (and continue to show) the most incredible and selfless hospitality to the firm.

The address of the firm's Lafayette office is:
Shields Mott Lund L.L.P.
300 Industrial Trace
Broussard, Louisiana 70518
337-839-8533 (telephone number)
337-839-9416 (facsimile number)

All of the firm's email addresses remain the same:
Lloyd N. Shields: lnshields@shieldsmottlund.com
Norman A. Mott: mofomotz@aol.com
Daniel Lund, III: dlund@shieldsmottlund.com
Elizabeth L. Gordon: elgordon@shieldsmottlund.com
William J. Perry: wjperry@shieldsmottlund.com
Sean Bracken: spbracken@shieldsmottlund.com
Rick A. Houston: rahouston@shieldsmottlund.com
Adrian D'Arcy: aad'arcy@shieldsmottlund.com
Stephen Morel: sdmorel@shieldsmottlund.com
Andrew Vicknair: agvicknair@shieldsmottlund.com
Catherine Davidson: cldavidson@shieldsmottlund.com
Michael Lane: mdlane@shieldsmottlund.com

We look forward to speaking with you and hope all is well with you.

Business Interruption Insurance

An important issue to insurers and insureds alike, in particular because of the effects of Hurricane Katrina, is business interruption insurance. The nature of business interruption insurance is to indemnify the insured business for economic losses sustained from its inability to use the insured premises as a result of destruction or damage to the premises. Virtually all business interruption policies allow insured businesses to recover economic losses and extra expenses caused by a physical damage to the insured property. For example, when part of a hotel is destroyed by fire and the hotel must remain closed while repairs are completed, business interruption insurance would be triggered, and the hotel could recover lost revenue and additional expenses incurred as a result of continued operations, if any. In addition to recovery for economic losses from damage to an insured's property, business interruption policies may also cover economic losses due to physical damage to a business's suppliers, often called "contingent business interruption." Very importantly, most such policies require physical damage to the insured property as a trigger to coverage. However, the policy may have certain "additional coverage" provisions which come into play even in the absence of physical damage.

Business interruption policies may also cover economic losses that are the result of an order of civil authority, such as prohibiting ingress and egress to a particular damaged area or a mandatory

continued on page 6

Letter From the Partners

We are pleased to deliver to you the latest edition of "Louisiana Construction Law and News Update." This newsletter is provided to keep you and your company current on legal topics that affect the construction industry. The firm hopes you find this information insightful and relevant to your work.

The newsletter is published on a quarterly basis by the firm and is distributed to the construction industry. We encourage suggestions and ideas for articles from our readers so that this publication can be as current and useful as possible.

We appreciate the opportunity to provide this newsletter to you. If you know of others in the industry whom you think might enjoy receiving the publication, please let us know so that we can add them to our industry list.

Lloyd N. Shields
Norman A. Mott
Daniel Lund, III
William J. Perry
Elizabeth L. Gordon
Sean P. Bracken
Richard A. Houston
Andrew G. Vicknair
Adrian A. D'Arcy
Stephen D. Morel
Catherine L. Davidson
Michael D. Lane
Cary J. Deaton
Thomas W. Glass

The lawyers of
Shields Mott Lund L.L.P.

Surety Decisions and Non-Louisiana Cases

Care and feeding of the bankrupt principal

Upon contractor/principal default, many sureties will continue to work with the original contractor on pending construction projects, even through a bankruptcy. Doing so may create confusion as to the fiduciary duties of the debtor-contractor. The court in *In re McIntosh*, 320 B.R. 22 (M.D. Fla. 2005), held that a debtor's obligation to indemnify the surety was dischargeable in bankruptcy, despite what might otherwise be a technical breach of the fiduciary duties owed by the debtor to the surety to preserve funds from bonded jobs.

In the case, in order to continue the operations of this financially strapped contractor, principals of the contracting firm spent monies from bonded jobs for typical company expenses. The surety argued that the payment of non-job-related expenses – even if necessary to keep the company open – constituted defalcation under the bankruptcy laws and entitled the surety to object to the debtor's discharge. Evidence showed, however, that the surety was in a position that it at least should have known about the payment of the expenses and arguably agreed (through the surety's consultants working on the project) to the payment of the expenses. In any event, the court found that the surety could not on one hand ask the contractor to remain in business for purposes of completing bonded jobs without expecting that monies would be needed to pay contractor's basic costs of overhead not specifically related to the bonded jobs.

Modified total cost methodology for the new Millennium

Courts generally require that a party asserting claims for increased costs prove amounts owed to a reasonable mathematical certainty. The Chicago Millennium Park project ran more than $300 million over budget and four years behind schedule. In an effort to fast track the project, construction had begun before plans were complete. Contractors faced numerous modifications to the plans, which often required changes to work already completed. When a certain contractor in *G.W. Harston Construction Co., Inc. v. City of Chicago*, 371 F. Supp. 2d 949 (N.D. Ill. 2005), sought payment for increased costs, the City of Chicago wanted to pay only a percentage of the original bid price with no adjustments for changes not written down in a change order or for costs incurred by delay. Plaintiff wanted compensation based on the work it had done, including the cost of the various delays and changes. Though the city demanded it, plaintiffs could not tie all of their costs to specific versions of the plans because the plans had changed so much.

Given the nature of the project, the court refused to adopt the city's hard line. The court instructed the parties to utilize a modified total cost methodology, even though courts do not favor the method, opining that the contractor was "entitled to adjustment [even though it] cannot prove the increased costs to which it is entitled to a mathematical certainty." (The court also rejected the city's position on the strength of Illinois case law wherein contract clauses requiring written change orders can be waived by conduct, as well as the fact that the City adjusted the claims of similarly situated contractors by paying many of those.) The court concluded that both parties had to rigorously prove the reasonableness of the amounts they either demanded or defended against, and encouraged mediation.

Owner beware: statutory employer defenses are not on your side – plan accordingly

In *Beaver v. ExxonMobil Corporation*, 361 F. Supp. 565 (M.D. La. 2005), the project owner, ExxonMobil, sought the protection of the statutory employer worker's compensation doctrine from injuries claimed by the employee of a subcontractor. The doctrine offers statutory protection from claims made by workers employed not by the company against which the claim is made, but, rather, which are employed by an entity with which the company contracted. ExxonMobil entered into a contract with Fluor Daniel to modify ExxonMobil's refinery. Fluor Daniel, in turn, contracted with a subcontractor to perform services at the refinery.

During the course of the construction, an employee of the subcontractor was injured, and subsequently filed suit against ExxonMobil. ExxonMobil defended against the claim by asserting that it was merely the "statutory employer" of the injured employee under the "two contract" theory, citing its contract with Fluor Daniel and Fluor Daniel's subcontract.

The "two contract" defense is established in La. R.S. 23:1061(A)(2), which provides that a statutory employer relationship exists whenever the immediate employer (here, the subcontractor) is performing services or work contemplated by or included in a contract between the "principal" and any person or entity other than the employee's immediate employer. Here, the plaintiff argued that the defense applied only to the "principal" who contracted with his employer, namely, Fluor Daniel.

The court rejected ExxonMobil's use of the defense on the basis that ExxonMobil was not itself obligated under a contract with someone else to perform the work in question, but, rather, was merely the owner of the project. The court contrasted an earlier case involving the New Orleans Convention Center wherein the Convention Center, as owner, had subcontracted a portion of certain work to a plaintiff's employer but the Convention Center itself was obliged to perform the work for one of its convention clients. (Additionally, the court declined to extend the ruling in *Orillion v. Alton Ochsner Medical Foundation*, 96-494 (La. App. 5. Cir. 11/26/94), 685 So.2d 329, to the case.)

Louisiana Revised Statute 23:1061 provides, in pertinent part, that absent the "two contract" situation, the principal and the contractor may specifically state in their written contract language recognizing the principal as a statutory employer or the employees of the contractor. When such a clause is in place, then a rebuttable presumption of that relationship exists, which may be overcome only by showing that the work in question is not an integral part of or essential to the ability of the principal to generate its goods, products or services. The recent decision in *Olsen v. Citgo Petroleum Corporation*, 127 Fed.Appx. 137 (5th Cir. 2005), upholds the applicability of the cited statute to an owner who had not employed the injured employee.

General contractor gets fat; subcontractor gets lien

In *Shaw Constructors v. ICF Kaiser Engineers, Inc.*, 395 F.3d 533 (5th Cir. 2004), the court ruled that a general contractor's failure to pay a subcontractor dissolved the subcontract, allowing the subcontractor to assert lien rights against the owner and its property even though the subcontractor had waived its lien rights within the subcontract.

Under Louisiana law, contracting parties cannot simply decide between themselves to dissolve a contract without the agreement of a third party beneficiary who asserts his rights stemming from that agreement. Here, the owner was a third party beneficiary of a "no liens" clause in the subcontract between the general and the subcontractor for the construction of a $58 million nitric acid facility.

On the other hand, Louisiana law grants an unpaid party (like the subcontractor) the right either to compel performance (*i.e.*, payment) or to dissolve the contract. Here, the unpaid subcontractor opted to dissolve the contract. The court reasoned that since the contract was dissolved, the "no lien" clause ceased to exist, and the owner was not entitled to any third party benefits from a non-existent "no lien" clause. This case muddies the water as it pertains to lien waivers contained in contracts, although it should not have an effect upon individual lien waivers tied to specific payment applications for which payment is actually made.

Owner required to award Convention Center job after lowest bid deemed unresponsive

The Louisiana Public Works Act requires public entities to hold an open and public bidding process for jobs, and then to accept the lowest responsible bid. In our Summer, 2004, edition of this newsletter we reported on the case involving the bids for Phase IV of the New Orleans Convention Center, the leading case in Louisiana on public bid defects and what a public entity can and can't do about those defects. In the follow-up decision, *Broadmoor, L.L.C. v. Ernest N. Morial New Orleans Exhibition Hall*, 896 So.2d 251 (La.App. 4th Cir. 2005), the Court of Appeal refused the public owner's efforts to rebid the project and required an award to the second low bidder.

Three contractors bid on the project. The second low bidder, Broadmoor, had challenged the award to the lowest bidder Yates/Landis, and the Louisiana Supreme Court ruled that the Yates/Landis bid was non-responsive. *Broadmoor, L.L.C. v. Ernest N. Morial New Orleans Exhibition Hall*, 867 So.2d 651 (La. 2004). Following the Supreme Court's decision rejecting the low bid, the Exhibition Hall rejected the remaining two bids, prompting Broadmoor to seek a hearing on the matter.

The appellate court held that once the low bid was deemed defective, the Exhibition Hall was required to accept the next lowest bid. The Exhibition Hall could have rejected all bids within 45 days, as specified in La. R.S. 38:2215, but could not reject all bids after that time had passed. Broadmoor was awarded the project.

As an alternative, the Exhibition Hall challenged the responsiveness of Broadmoor's bid. Arguments ranged from assertions that Broadmoor had not included a proper insurance form to claiming that Broadmoor had used the wrong color ink and had a stray pen mark on the page. While those arguments were viable from a timing perspective, the court rejected the arguments based upon the facts and the law.

Be careful for what you bid

A Louisiana appellate court upheld a trial court's denial of a contractor's request for more money on a project to remove trash and debris from a former construction landfill so that a Bass Pro Shop could be constructed on the site. In *Roy Sattler Const., Inc. v. City of Bossier City*, 903 So.2d 503 (La.App. 2d Cir. 2005), Bossier City had requested bids for a job to clean up a tract of land adjacent to the Red River. One contractor bid $69,880 and another bid $121,650. Plaintiff, Sattler, bid $27,000. Upon being questioned on the very low bid, Sattler explained that it thought it could burn the trees on site after pulling them down and that it could sell off some of the dumped materials. Sattler was also interested in larger jobs with the city in the future.

Sattler, however, underestimated the size, cost and complexity of the project, as the trees had grown into various subsurface materials such as concrete, I-beams, and rebar. Sattler requested additional funds from the city, which agreed to pay more per yard of debris removed. Sattler's first three invoices totaled $79,718.40. Change orders ensued and city paid those invoices, but the final invoice for $288,367.20 caught the attention of the city. The city refused to pay, and Sattler sued.

In denying Sattler's claim for relief, the court reasoned that Sattler's additional charges for removal of the subsurface materials constituted a "change order" which, according to the Louisiana Public Bid Law, was outside the scope of the original contract. Under Louisiana law, all change orders in excess of $100,000 shall be let for public bid. Hence, the change order was deemed null and void. The court provided some relief to Sattler in the form of *quantum meruit* (that is, recovery outside of a contract which prevents, in this case, the owner from receiving something for nothing or becoming unjustly enriched). In keeping with *quantum meruit* tenets, however, and in view of the illegality of the improper proposed change order, the court awarded only actual costs to the plaintiff and denied all claims for additional profit.

Louisiana Public Works Act substantial completion conundrum resolved by U.S. Fifth Circuit

Under the Louisiana Public Works Act, a surety bond is required for public works in excess of $25,000, in part to protect the contributions of the subcontractors and suppliers who are not in direct privity with the public entity. In order for a subcontractor or supplier to assert its claim, it must file a sworn statement of the amount due with the appropriate governing authority within 45 days after the recordation of acceptance of the work. La. R. S. 38:2242.

This matter – *In re Whittaker Const. Co.*, 411 F3d 197 (5th Cir. 2005) – involved renovations to Independence Stadium in Shreveport and the alleged early filing of a certificate of substantial completion. Following the filing, work on the project continued for quite some time, with final completion not occurring until more than three months after the filing. Lien claimants which then filed their statements of claim in the public records were informed by the general contractor that the claims were filed too late based upon the date of filing of the certificate of the substantial completion.

The aggrieved claimants cited in their lawsuit La. R.S. 38:2241.1, which had been amended in 1991 stating that substantial completion shall be filed "within 30 days of the completion of the project…" While the claimants argued that the added language entailed that the design professional could issue substantial completion no earlier than 30 days before the actual completion date (*i.e.*, the law had been amended to avoid just the problem about which the claimants were complaining), the general contractor argued that the 30-day window was to prevent architects from delaying issuance of the certificate of substantial completion for more than thirty days following the completion. The court sided with the claimants on this point. However, the court did not adopt a hard-and-fast rule on premature filing of the notice, but fashioned a means of curing a prematurely filed certificate of substantial completion (rather than simply declaring such a filing null and void).

Relying on Louisiana Supreme Court precedent (although not directly on point), the court held that a prematurely filed certificate of substantial completion is merely "inchoate," entailing that the filing would become effective upon actual completion or substantial completion (noting that such a ruling avoided imposition of a penalty upon the surety, which would be improper). Unfortunately for the claimants, the parties had agreed that final completion was a date certain, and none of the claims before the court had been filed within 45 days of that date. Thus, although claimant's legal theories were accepted in part by the court, none of the claimants prevailed in the case.

Recent Decisions on Toxic Mold Claims

Texas court requires an expert in mold cases

A Federal District Court in Texas granted defendant insurer's motion to strike expert summary judgment proof and, concurrently, granted the insurer's motion for summary judgment, ruling that the insured plaintiffs could not specify expert witnesses after the deadline to do so had passed. In *Qualls v. State Farm Lloyds*, 226 F.R.D. 551 (N.D. Tex. 2005), plaintiffs sought recovery under their homeowners insurance policy for toxic mold damage, allegedly caused by a leaky sewer pipe under their home. During pre-trial proceedings, the plaintiffs' counsel informed the court that none of their witnesses would be experts. Defendant later moved for summary judgment on the basis that, without experts, plaintiffs could not prove that the leaky pipe had caused the toxic mold.

The court agreed with the defendants, on the theory that, under Texas law (indeed, under almost any state's law), plaintiffs needed an expert opinion to prove that toxic mold caused damages. A lay opinion would not suffice to prove causation. Plaintiff's efforts to then add experts to the witness list (arguing that plaintiffs originally did not think experts were required) were rebuffed by the court. The court noted that the defendant insurer had for some time argued that expert testimony was required, and that the court had already granted leave to the plaintiff to designate untimely disclosed fact witnesses.

Trailer owner must arbitrate toxic mold claim

A Louisiana appellate court held in *Snyder v. Belmont Homes*, 899 So.2d 57 (La. App. 1st Cir. 2005), that a signatory to a mobile home sales contract must arbitrate – as provided for in the contract – rather than litigate a tort claim based on mold damage. The plaintiff had purchased a mobile home that allegedly grew mold and caused injury. Rather than initiating arbitration, the purchaser filed suit. The seller and manufacturer objected.

The issue of subjecting a tort-based mold claim to arbitration was one of first impression for the Louisiana court. The court reasoned that the mold claim, just like a claim for breach of contract or for redhibition, arose from the sales agreement and fell within the contract language declaring that "any dispute, controversial claim of any kind or nature…" would be resolved by arbitration. The court allowed other residents' tort claims, however, on the basis that none of them had signed the sales contract (although those parties lost any contract claims they were asserting).

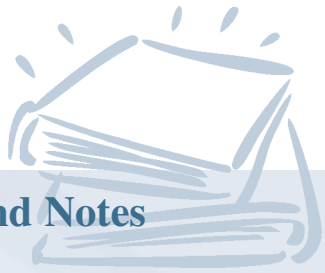
The Louisiana court looked to a California case for guidance on the ruling, suggesting that the matter of whether compelling arbitration of a tort action which has "its roots" in a contract containing an arbitration clause was one of "first impression" in the state appellate courts. This case seems to make it clear that persons in construction contracts with similarly broad arbitration clauses may not split their causes of action between tort and contract in such way as to pursue claims at once both in court and in arbitration.

Mold by any origin is still mold

In *Morgan v. Auto Club Family Ins. Co.*, 899 So.2d 135 (La. App. 3rd Cir. 2005), an insured homeowner filed a claim with its insurer after noticing mold accumulation in the attic. Auto Club's investigator concluded that faulty workmanship in the installation of the metal roof had caused the poor ventilation in the attic, and that poor ventilation had allowed mold to grow. Auto Club denied the claim, as the policy excluded coverage for faulty workmanship and mold. The homeowner filed suit.

At trial, the homeowner relied on the earlier decision in *Dawson Farms, L.L.C. v. Millers Mutual Fire Ins. Co.*, 794 So.2d 949 (La. App. 2nd Cir. 2001), wherein a court granted recovery to farmers who had lost sweet potatoes to mold which grew because of condensation from a faulty moisture barrier. Though the farmers' policy contained several exclusions, the *Dawson Farms* court ruled that the "all risks" policy covered all risks of agribusiness not explicitly excluded. Condensation was not expressly excluded, so the farmers were covered for the sweet potato loss.

Although the homeowner in *Morgan* tried to define the cause of the damage as "condensation" rather than "mold that grew as a result of condensation," the court did not allow the claim, holding that the explicit mold exclusion within the insurance policy trumped any argument that the mold might be an "ensuing loss" from another covered cause.



News and Notes

Upcoming Construction Law Seminars

Shields Mott Lund L.L.P. is pleased to announce these upcoming seminars:

Addressing the Practical and Legal Issues of Water Intrusion and Mold Problems in Louisiana (Lorman Education Services), November 17, 2005, Baton Rouge, Louisiana, 9:00 a.m. - 4:30 p.m.

Managing Construction Projects (Lorman Education Services), March 30, 2006, Baton Rouge, Louisiana, 9:00 a.m. - 4:30 p.m.

Basic Real Estate Development (Lorman Education Services) (date in 2006 TBD), Baton Rouge, Louisiana

These seminars are designed to address the legal issues that the construction industry faces and to zero in on the options that make the best legal sense. Understanding these issues and choices and being prepared for potential problems are the best ways to avoid pitfalls. We sincerely hope you can attend one of these seminars. Additional information on the seminars can be obtained by contacting Dan Lund at Shields Mott Lund (504-581-4445) or, for the Lorman Education Seminars, Lorman on-line at www.lorman.com.

Business Interruption Insurance continued from cover

evacuation order. Litigation in this area has primarily arisen from urban riots in the 1960s and the terrorist attacks on 9/11, where the insured businesses sought recovery for economic losses when the civil authorities shut down sections of the city, thereby preventing businesses in those areas from operating. In the aftermath of Hurricane Katrina, this area of coverage will again be the focus of litigation, as many parishes/counties and cities in southeastern Louisiana, Mississippi, and Alabama were closed to residents for a substantial period of time and many remain closed today.

Under civil authority clauses, the courts have generally required the insured to show two things: (1) access to the insured property was prevented by order of a civil authority, and (2) a direct causal relationship with physical damage to property other than the insured property. The first prong is generally met when a civil authority orders a mandatory evacuation or prohibits ingress/egress from an affected area. The mandatory evacuation order for many southeastern Louisiana parishes, for example, would meet this requirement.

Most litigation arises under the second prong, which requires a direct causal relationship between the order of the civil authority and damage to property (other than the property covered by the policy). In one example, an insured restaurant owner sued to recover under its business interruption policy when it was required to evacuate because of an impending hurricane. *Assurance Co. of Am. v. BBB Serv. Co.*, 593 S.E.2d 38 (Ga. Ct. App. 2002). The Georgia appellate court found the requisite property damage to property other than the insured property based on testimony that Hurricane Floyd had caused damage in the Bahamas and southern Brevard County, Florida and that the insured's property was located in the projected path of the storm. Since the county ordered the evacuation on these grounds, the court found a direct relationship between the evacuation order and physical damage to property. However, in the majority of cases examining the causal link between physical damage and order of civil authority, particularly cases connected to the 9/11 attacks, courts have ruled that the order of the civil authority (*e.g.*, closure of roads and airport traffic) must be the direct result of physical loss or damage to recover under the policy. See, *City of Chicago v. Factory Mut. Ins. Co.*, 2004 WL 549447 (N.D. Ill. Mar. 18, 2004); *The Paradies Shops, Inc. v. Hartford Fire Ins. Co.*, No. 1:03-CV-3154-JEC, (U.S. Dist., N.D. GA., Atlanta Div.) (Dec. 15, 2004).

The business interruption cases spawned from the 9/11 attacks are a good example of the courts' analyses of the direct causal relationship required between physical damage to property other than that covered and the order of the civil authority. The majority of courts deciding business interruption cases in the context of 9/11 have ruled that the roads and airports were shut down due to the threat of future terrorist attacks, not physical damage to property. Since the civil authority orders were based on reasons other than physical damage to property, the link was found weak by those courts and the insureds were denied recovery. The direct causal relationship requirement between physical damage and order of civil authority is present in all business interruption cases, not just 9/11 litigation. Although most courts have denied recovery when this issue is contested, the link between the order of civil authorities in the areas affected by Hurricane Katrina (primarily evacuation orders and the prohibition against the return of evacuees) and the physical damage to property (as in the Hurricane Floyd case) should be reviewed if making a claim under a business interruption policy.

In the wake of the devastation of Hurricane Katrina, many parishes, counties, and cities along the Gulf Coast were closed for a significant time or still remain closed. Businesses in the areas affected by the storm will incur economic losses since many will suffer a decline in business operations or, in some cases, a complete halt. A flood of litigation is likely to arise in response to the devastation caused by Hurricane Katrina, so insurers and insureds should be familiar with the concept of business interruption insurance. The jurisprudence in the area depends heavily on the language contained in the insurance policy, mandating a close review of policies to determine what coverage is available.

SHIELDS MOTT LUND L.L.P.
ATTORNEYS AND COUNSELLORS AT LAW

650 Poydras Street • Suite 2400 • New Orleans, Louisiana 70130
300 Industrial Trace • Broussard, Louisiana 70518

ADDRESS SERVICE REQUESTED