Louisiana Construction Law and News Update

Shields Mott Lund L.L.P. • New Orleans

Spring 2003 Volume 1, Issue 2

Construction Law Update

General contractor absolved from sales tax liability for items purchased for public port

The Louisiana Supreme Court held that a general contractor on a publicly bid project acting as agent of the public entity for purchasing supplies and equipment used on the project is exempt from local sales taxes under La. R.S. 47:301(8). In *F. Miller & Sons, Inc. v. Calcasieu Parish School Board*, 2003 WL 536626 (La.), the Supreme Court found that the agreement between the parties which included "all the terms and conditions" listed in Louisiana Department of Revenue form R-1020 (9/00) *("Designation of Construction Contractor as Agent of a Governmental Entity")* provided the basis for exemption of the general contractor from sales taxes, even if the risk of loss of the property remained with the general contractor (including the risk that the cost of the materials might increase). The court ultimately concluded that the appointment of the general contractor as the agent for the port was done "in accordance with the laws of mandate, and does not create a new, unintended tax loophole."

Architect absolved from liability based upon performance specifications

In a case defended by our firm for the architect, *Tri-Star Construction Company, Inc. v. Housing Authority of New Orleans*, 833 So.2d 556 (La. App. 4th Cir. 2002), a general contractor which had been terminated for failure to complete work in accordance with plans and specifications on a HANO project sued HANO and the architect. HANO and the architect filed a motion for summary judgment that was granted by the trial court and affirmed by the Court of Appeal. Defending against the summary judgment, the general contractor asserted that it was entitled to rely upon the plans and specifications and was immune from any defects in its work under La. R.S. 9:2771. However, the court found that the specifications clearly placed the burden on the general contractor to exercise its own expertise in order to determine how the objectives of the plans and specifications were to be achieved. Holding that the contract between the plaintiff and HANO clearly included performance specifications, the court determined that the general contractor's failure to resolve certain construction problems on the job constituted a breach of its obligations under its general contract, justifying the termination. Both HANO and the architect were dismissed from the case.

General contractor provided with some lien rights despite failing to record general contract

Although La. R.S. 9:4811 requires, for a general contractor to have lien rights against a private works project, that notice of any general contract in excess of $25,000.00 be timely recorded, the court in *Burdette v. Drushell*, 837 So.2d 54

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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.

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Surety Decisions in Louisiana and Beyond

Avallone Architectural Specialties, L.L.C. v. DBCS Corporation, 2003 WL 730671 (La. App. 2nd Cir.): The Court of Appeal affirmed the trial court's holding that a public owner could not seek protection against lien claims from a bid bond surety. In violation of the Louisiana Public Bid Law, the public owner (a school board) had neglected to require of the general contractor the statutorily mandated performance and payment bond for the publicly bid work. Although the owner argued that the bid bond language guaranteed that the contractor would both sign the contract and furnish the payment and performance bond, the court held that the responsibility of the bid bond surety to respond to the described failures of the contractor arises only when those failures result in the public entity being required to "expend to have someone else perform the work…"[1]

Bonavist v. Inner City Carpentry, Inc., 2003 WL 3672280 (E.D.N.Y.): The District Court held that a "pay-when-paid" provision in a payment bond violated New York public policy. The payment bond in question provided language which attempted to have the surety's liability to be co-extensive with that of the general contractor, *i.e.*, to occur only after receipt of payment by the general contractor from the owner.

Colt Engineering, Inc. v. Andrade & Associates, 288 B.R. 861 (Bankr.C.D.Cal. 2003): A surety that had issued a performance and payment bond and which had satisfied the bankrupt debtor's obligations to unpaid subcontractors and materialmen – and had secured a release of those parties' liens – obtained a right of equitable subrogation in the contract balance due to the bankrupt contractor. The contract payments were not included in the property of the bankrupt's estate, but first had to be paid to the surety to the extent necessary to satisfy the surety's equitable subrogation claim. In its ruling, the court deemed it critical that the contract from which the surety sought payment contained progress payment and retention/retainage provisions, including the ability of the party obligated to make the payments to withhold contract funds until the project was completed and "lien free." It was also clear that it was important that the unpaid subcontractors and materialmen had actually filed liens that were released by virtue of the payments made by the surety.

Blumenthal-Kahn Electric, Ltd. v. American Home Assurance Company, 236 F.Supp.2d 575 (E.D.Va. 2002): The District Court held that a surety on a general contractor's payment bond could invoke arbitration clauses in the general contractor's subcontractor agreement and compel the subcontractor (and, as a result of related contract language in other documents, lower tier subcontractors) to arbitrate, despite the fact that the surety was not a signatory to the subcontract agreement. The court analogized the relationship between principal and surety to that of a corporation and its shareholders or a parent company and its subsidiary, noting that courts in Virginia had previously allowed parties in such relationships to invoke arbitration despite the fact that the invoking party had not been an actual party to the contract containing the arbitration clause.

[1]*This case has not yet been released for publication in the permanent law reports and is subject to revision or withdrawal.*

(La. App. 1st Cir. 2003), provided relief under the Private Works Act to a general contractor which failed to follow the cited statute. The court held that a general contractor maintains certain lien rights even if it fails to timely record its contract (or notice thereof), "to the extent he performed or provided labor or services other than the supervisory work generally performed by a 'general contractor.'" In so holding, the court found that the general contractor occupied the status of an ordinary "contractor" under La. R.S. 9:4807(A) for carpentry services and related labor and material costs. The court refused, however, the claims of the general contractor for a lien and privilege for money paid to subcontractors (as those amounts were paid by the general contractor in its capacity as a "general contractor").

Court rejects property owner's defense against lien based upon lax credit practices of claimant

The defendant property owner in a lien enforcement case, *Jefferson Door Company, Inc. v. Foreman Construction, Inc.*, 836 So.2d 552 (La. App. 5th Cir. 2002), urged the court to reject the claim on the basis that the claimant (a supplier) recklessly extended credit to the general contractor. The general contractor ultimately failed to pay the lien claimant, resulting in the supplier's lien and the suit to enforce that. The court refused to debate the matter of the prudence of the credit advances, but instead held that other mechanisms – such as the ability of the property owner to require the general contractor to provide a surety bond – had been available to protect the owner but were not required by the owner. The court affirmed the trial court's decision enforcing the lien.

Sub-subcontractor on Navy job denied equitable right in bankrupt subcontractor's retainage

In *Kane Enterprises v. MacGregor (USA), Inc.*, 2003 WL 297103 (5th Cir.), the United States Fifth Circuit Court of Appeals in New Orleans dismissed the claim of a plaintiff sub-subcontractor seeking to assert rights to retainage due by the general contractor to the bankrupt subcontractor with which plaintiff contracted. Holding that the sub-subcontractor (which, by law, had no interest in the materials it provided once those had been incorporated into the Navy ship and had become property of the United States) was not, under Louisiana law, a "third-party beneficiary" to the prime contract or protected by the prime subcontract, the Court of Appeals affirmed the ruling of the Federal District Court in New Orleans, rejecting the sub-subcontractor's claim that it should be entitled to recover directly from the general contractor the retainage due the bankrupt subcontractor. Rather, the Court determined that the retainage was the property of the bankruptcy estate. The Court also rejected the sub-subcontractor's *quantum meruit* claim (recovery which may be had in the absence of an express contract) on the basis that the sub-subcontractor's remedy – although perhaps displeasing to the sub-subcontractor – was to pursue its contractual claims against the bankrupt subcontractor.

*AG*e-old issues?

Below are discussions of two recent opinions by the office of the Attorney General for the State of Louisiana, both of which bear upon the construction industry. Both decisions were issued on November 7, 2002.

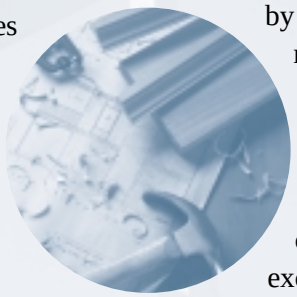
In Opinion Number 02-0145, the Office of the District Attorney for Calcasieu Parish inquired regarding its employment of a construction manager on a public project, and the manner in which the actual construction work might or might not be separately bid. According to the Attorney General, the work of the construction manager is in the nature of services and, therefore, no bid is required for the construction manager's involvement on the project. However, because the duties of the construction manager included certain responsibilities which "fall within the definition of 'contractor' set forth in R.S. 37:2150.1," the Attorney General found that the construction manager should be licensed as a general contractor as required by the Contractor's Licensing Law. As for the performance of the work, the Attorney General declared that the law does not condone for any public project valued at $100,000.00 or more the dividing up of the project into separate contracts for less than $100,000.00 in an effort to avoid the requirement for public bids. La. R.S. 38:2212H.

In Opinion Number 02-0413, the Board of Commissioners of Terrebonne Parish Consolidated Waterworks District No. 1 requested an opinion on whether the District could invoke the "emergency" provisions of the Public Bid Law to complete the construction of a water plant expansion project. The original general contractor had abandoned the project and the surety is alleged to have failed to complete the project

News and Notes

Mold: A Growth Area

Congress introduced in 2002 House Bill 5040 ("The Melina Bill"), which requires research by the EPA and CDC into health risks associated with mold exposure. The bill further directs the EPA to establish guidelines for acceptable levels of mold in residences and to establish standards in licensing requirements for mold inspection, testing and remediation work. Mold disclosures in home sales, modification of local building codes to attempt to reduce the prospects of mold in new construction and the creation of a national insurance scheme to protect victims of mold exposure are also contemplated by the bill. The bill is presently in committee for study. The full text of the bill and other summary information can be found through the legislative information site sponsored by The Library of Congress, http://thomas.loc.gov.



For its part, and in an effort to allay the concerns of insurance companies over potentially spiraling litigation over mold, Louisiana's Acting Insurance Commissioner, J. Robert Wooley, announced in late 2001 the approval by his office of insurance clauses which exclude mold as a covered loss, as well as excluding the cost of remediation (*i.e.* the cost of testing the insured premises for mold, as well as the cost of containment or fumigation of the insured premises). The Commissioner cautioned insurers, however, to develop their exclusions narrowly, and to refrain from using the exclusions to attempt to deny coverage for covered losses simply because some mold may be present. The Commissioner's advisory letter 01-02 can be found at www.ldi.state.us.

Mold Seminar

Shields Mott Lund, in connection with John Steven Verret, an industrial hygienist consultant and owner of Environmental Measurements Corporation, is pleased to announce its June 10 seminar entitled, "Louisiana Construction Defect and Mold Litigation." Sonny Shields, Dan Lund and Elizabeth Gordon of the firm will speak at the seminar.

The program, sponsored by National Business Institute, takes place at the Doubletree Hotel at 300 Canal Street in New Orleans, with registration at 8:30 a.m. The program begins at 9:00 a.m. and concludes at 4:30 p.m. Additional information on the seminar can be obtained by contacting Dan Lund at Shields Mott Lund (504-581-4445) or on line at www.nbi-sems.com.

This program is intended for persons in the construction industry as well as attorneys. We sincerely hope you can attend.

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despite demand. The District asserted as the basis for the emergency the danger posed by the prospect of extended saltwater intrusion into the plant. The Attorney General, however, opined that the extended intrusion was not "imminent" in the sense of the dictionary definition of the word, and that the mere possibility of such a problem (which problem was apparently known at the time that the construction project was first let for bid) did not constitute an emergency sufficient to invoke the emergency exemption of the Public Bid Law.

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