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

Louisiana Construction Law and News Update

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Construction Law Update

Proposed law to suspend contracts post-Katrina and Rita scrapped by Louisiana Legislature

Louisiana House of Representatives House Bill No. 32 of the First Extraordinary Session of 2005, which would have allowed suspension of contracts entered into prior to the occurrences of Hurricanes Katrina and Rita, was pulled from consideration by its author before a final vote. The law was aimed at allowing a contracting party – where the partial or full performance of the contract was made "impracticable" by the consequences of one or both of the hurricanes – to put the contract on hold until such time as the conditions were more favorable for performance. The law excluded contracts where the parties had specifically included language to account for the risk of hurricane impact on the contract.

The bill recognized that Louisiana law on the subject of "impracticability" of performing a contract favored the enforcement of contracts over termination or suspension. This is to be contrasted with the doctrine of "impossibility" of performance (Louisiana Civil Code 1873), which courts have interpreted to allow avoidance of contractual obligations but to require circumstances which literally make obligations impossible for anyone to satisfy in order to trigger the termination under the law.

Many standard contract documents – such as the A201-1997 general conditions – contain provisions which are arguably triggered by the events surrounding Hurricanes Katrina and Rita. These include rights to terminate, as well as claims for additional contact sums and extensions of time. The various items which may support these rights to terminate or to seek change orders vary greatly, not only from contract document to contract document, but also from job to job. In each case, care must be taken to examine

- the express contract language in the entirety of the "contract documents" (as that term is defined in the paperwork) for the project;
- the circumstances surrounding various governmental actions and orders as those actions might have affected a job;
- the actual physical effects of the storms on the project sites; and,
- the actions of project owners during and following the storms that may have affected the work (including, for example, use of the site for a shelter or other non-traditional operation on the property).

This list is not necessarily exhaustive of the various facts which need to be considered before asserting contractual rights to terminate or to seek additional money or time.

Liability insurance more comprehensive than insurer hoped

When the liability of a contractor is based solely on poor construction and the cost to repair that, Louisiana courts often decline to find an "occurrence" under a contractor's CGL policy, and, thus, determine that no liability coverage exists to protect the damaged party. The court in *Broadmoor Anderson v. National Union Fire Insurance Company of Louisiana*, 912 So.2d 400 (La. App. 2nd Cir. 2005), addressed this question in the

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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 and Non-Louisiana Cases

Aeroplate Corp. v. U.S., 67 Fed. Cl. 4 (2005)

The Air National Guard issued a solicitation for bids to repair and/or construct a maintenance hanger in Fresno, California. Though Aeroplate's bid was apparently the lowest, the chief contracting officer of the ANG rejected the bid as nonresponsive, in part because Aeroplate's surety, Arch Insurance Company, informed the ANG that it did not authorize a bond in the amount of the bid. The chief contracting officer of the ANG issued the bid rejection after it was informed by Arch Insurance representatives that Arch Insurance agreed to provide a bond for up to $5.5 million, significantly less than Aeroplate's $7.3 million bid.

After Aeroplate representatives conceded to the ANG that Arch Insurance would not provide the performance and payment bonds required for the contract, Aeroplate found a new surety to bond the contract. The ANG rejected Aeroplate's bid as nonresponsive after determining that the new surety was not approved by the Treasury Department. Aeroplate challenged the rejection, arguing that when the bid guarantee is proper on its face, the bidder has satisfied its obligations. Whether the surety will actually issue the performance and payments bonds if the contract is awarded is another question. The ANG argued that the purpose of the regulation is to provide assurance that the bidder will execute a written contract and furnish required bonds, and that the language of "firm commitment" and "acceptable to the Government" allows the contracting agent to look behind the face of a facially valid bond.

An administrative board upheld the ANG's rejection of Aeroplate's bid. However, the Court of Federal Claims reversed. The court found that the regulations requiring the bidder to "furnish a bid guarantee in the form of a firm commitment, *e.g.*, a bid bond supported by good and sufficient surety or sureties acceptable to the Government" were satisfied. FAR § 52.228-1. According to the court, the "determinative question" on the validity of the bid guarantee is whether, at the time of opening the bid, the bond is enforceable against the surety should the bidder fail to meet its obligations. The federal regulations provide a mechanism for terminating a bid if the bidder fails to furnish the requisite bonds: if Aeroplate did not furnish the bond when required to commence work, the ANG could terminate the bid. The court refused to interpret the regulation to allow the government to reject a bid as nonresponsive if the bond is facially valid, even when the surety does not intend to furnish the bond.

Mullin v. Hartford Accident & Indemnity Company, 2005 WL 1429305 (E.D. Tenn. 2005)

Is a "statutory" bond converted to a common law bond when the surety signs a separate agreement (here, a "Consent of Surety to Final Payment") with the owner which declares the surety's responsibility for outstanding or potential claims? In *Mullin v. Hartford Accident & Indemnity Company*, the federal

district court faced the issue and decided in favor of the surety, preserving the "statutory" status of the bond. Hartford issued a bond to general contractor CMC Construction in relation to a project for a state community college in Oak Ridge, Tennessee. Mullin, a subcontractor and the plaintiff, obtained a judgment against CMC when CMC refused to pay Mullin for its services, and sued Hartford alleging breach of its bond obligation for failing to pay Mullin after CMC refused to pay.

Hartford argued that Mullin's claim was barred by the applicable six-month statute of limitations under Tennessee law. Under Tennessee law, when the surety bond contains the "minimum requirements of the Code and no more," it is a "statutory bond" subject to the six-month statute of limitations. If, however, the bond, according to its terms, extends greater privilege to the claimant than required by statute, it is a common law bond and is not subject to the statute of limitations.

Mullin argued that Hartford's execution of an agreement with the owner regarding final payment (including terms entailing that final payment did not relieve the surety of any of its obligations, "including any outstanding or potential claims...") extended the bond beyond the terms of the statute, thereby rendering the bond a common law bond. Rejecting Mullin's argument, the court held that the agreement did not transform the bond into a common law bond for two reasons: (1) no document other than the bond itself can transform an otherwise statutory bond into a common law bond, and (2) in any event, the language of the agreement did not provide rights beyond those contained in the statutes (the language merely restated the surety's existing statutory obligations). Mullin's suit was held to be time barred.

Wellington Power Corporation v. CNA Surety Corporation, 614 S.E.2d 680 (W.Va. 2005)

Construction subcontracts many times contain a "pay-if-paid" provision, requiring the general contractor on a project to pay subcontractors only when the contractor is paid. In *Wellington Power Corporation v. CNA Surety Corporation*, a subcontractor attempted to recover on the surety bond posted for the general contractor although the subcontract contained a pay-if-paid provision and the general contractor had not been paid.

General contractor Dick Corporation subcontracted with Wellington Power Corporation to provide services in the construction of the West Virginia University Life Sciences Building in Morgantown, West Virginia. The subcontract contained a "pay-if-paid" clause, providing that payment owed to the subcontractor would not be paid unless and until the general contractor actually received payment from West Virginia University. The general contractor obtained a payment bond from CNA Surety. Wellington sued CNA under the bond when it was not paid for services rendered on the project.

The West Virginia Supreme Court ruled that Wellington could not recover against CNA on the bond, despite arguments by Wellington that the pay-if-paid provision in the subcontract was in violation of the public policy of the state to protect suppliers of labor and materials. The plaintiff's public policy argument was rejected, the court noting that a more compelling public policy of West Virginia is to encourage "freedom of contract" between parties.

In the alternative, Wellington argued that CNA could not rely on the pay-if-paid provision of the subcontract because the provision was not literally incorporated into the payment bond. The court also dismissed that argument, holding that a surety is not liable on a contract if the principal is not liable and may plead any defense available to the principal. The claims against CNA were dismissed.

Fidelity & Guaranty Insurance Company v. Southern Mechanical Service Corporation, 2005 WL 2417050 (E.D. Tenn.)

In yet another case of a forged signature on an indemnity agreement, the court in *Fidelity & Guaranty Insurance Company v. Southern Mechanical Service Corporation*, 2005 WL 2417050 (E.D. Tenn.), ruled against the surety on its claims – even though the court rejected the testimony of the wife of the alleged indemnitor on the critical facts.

The surety, FGIC, sued Southern Mechanical and its two individual principals, for losses sustained by FGIC on bonds issued to Southern Mechanical pursuant to a general indemnity agreement allegedly executed by defendants Southern Mechanical, Sharen Debusk and David Debusk. An insurance agent and broker who assisted the Debusks in obtaining the FGIC bonds for Southern Mechanical testified that both the Debusks signed the indemnity agreement in his presence. In contrast, the Mrs. Debusk testified that David Debusk did not sign the agreement, was not present when she signed the document for herself, for the company and for her husband, and the Debusks contended that Mrs. Debusk's

signature on behalf of her husband was not binding. The court stated that it found "itself in the unique position of concluding that neither witness who testified regarding the execution of the Indemnity Agreement was credible as to key, relevant facts…" and that the indemnity agreement "…belies either version of how it was executed." Accordingly, the court found that FGIC failed to meet its burden of proof that David Debusk was bound by the indemnity agreement, requiring dismissal of the claims against him.

Kelo v. City of New London, 125 S.Ct. 2655 (2005)

The United States Supreme Court's decision in *Kelo v. City of New London* sparked nationwide debate over the right of the government to expropriate private property for public use. The Fifth Amendment to the U.S. Constitution grants the government the so-called power of "eminent domain," whereby the government may take private property for a public purpose and for just compensation. The Kelo decision marked the Court's greatest expansion of the doctrine of eminent domain in many years.

The city of New London, Connecticut, approved a development plan to revitalize its economy by taking certain private lands for private development, such as restaurants, museums, urban housing, and a riverwalk. After purchasing much of the targeted land from private owners, the city proposed the use of eminent domain to acquire the remainder of the property from owners unwilling to sell, in exchange for "just compensation" as required by the Fifth Amendment. The landowners of the condemned property brought suit to enjoin the city from taking their land, arguing that private development of land did not serve a "public purpose" under the Fifth Amendment.

The Supreme Court observed that its earlier decisions on the topic defined "public purpose" broadly, reflecting a long-standing policy of deference to legislative judgment. After reviewing several of its previous opinions, which all afforded "great respect" to the legislature's authority to determine the public use of a proposed private development plan, the Court held that New London's comprehensive development plan served a public purpose. Additionally, the Court refused to question the city's basis for targeting specific lands for development, stating that "[w]hen the legislature's purpose is legitimate and its means are not irrational, our cases make it clear that empirical debates over the wisdom of takings… are not to be carried out in the federal couts." *Id*. at 2667.

The *Kelo* decision represents a significant clarification, if not also an expansion, of the government's right to take private land for private development projects, by granting great deference to local governing bodies to determine whether a particular proposed project serves a public purpose.

U.S. v. Zoucha, 2005 WL 2604174 (E.D. Cal.)

The Miller Act, 40 U.S.C. §§ 3131-34, applies to public contracts with the federal government, and provides that "every person that has furnished labor or material in carrying out work provided for" in a contract subject to the act, when not paid in full for work within 90 days, "may bring a civil action on the payment bond for the amount unpaid at the time the civil action is brought and may prosecute the action to final execution and judgment for the amount due." The question before the court in *U.S. v. Zoucha* was whether the plaintiff claiming under the Miller Act had a prejudgment right to attach property of the surety under state laws governing attachment.

EAI International was the prime contractor on two projects for the U.S. government, and Peter Fuller Construction was a subcontractor on both jobs. James Zoucha, individually, was the individual surety on two payment bonds for the labor, materials, and services provided by Fuller on both projects. Fuller claimed that Zoucha owed $384,227.94 for services performed on the contracts. Plaintiff Fuller applied to the court for a prejudgment attachment order, which the federal court granted.

Under the California Code of Civil Procedure, an attachment may issue on a claim for money based on a contract where the total amount of the claim is fixed or readily ascertainable. In order to obtain an attachment order, the plaintiff must establish the "probable validity" of the claim, meaning the plaintiff will more likely than not obtain a judgment against the defendant on the claim. Fuller provided sufficient evidence showing that all work called for on the projects was completed, the prime contractor received contract payments on the projects from the government, and that payment had been due and owing for some time.

Zoucha's last-ditch effort to defeat plaintiff's claim for prejudgment attachment was an argument that the full amount of the claim was not yet due (the owner had not yet inspected the work in question). The court disagreed with Zoucha's argument, holding that any "amount unpaid" for work performed could be the subject of a Miller Act claim.

context of a claim by a general contractor against its subcontractor's CGL policy, on which policy the general contractor was an "additional insured."

The subcontractor, Tiede-Zoeller Inc., was hired by Broadmoor Anderson to perform tile work in the bathrooms of a hotel project at Hollywood Casino Shreveport. After completion, the owner discovered leaks throughout the areas where the subcontractor performed work. The general contractor performed the repairs which in turn brought suit against Tiede-Zoeller's CGL carrier (which earlier had denied coverage for the costs of those repairs). Broadmoor Anderson sought and obtained in the trial court a partial summary judgment on the issue of coverage, which the insurer appealed.

The insurer argued that there cannot be a covered "occurrence" under its policy where the insured is contractually obligated to repair its own work or that of its hired subcontractor. In finding the faulty subcontractor work a covered "occurrence," the court held that:

- the language of the CGL policy was clear that coverage is extended to the general contractor for sums it became legally obligated to pay for property damage caused by an "occurrence;"
- the policy defined "occurrence" as an accident, including continuous or repeated exposure to substantially the same general harmful conditions; and,
- the subcontractor's work, which caused repeated damage to the hotel from leaking water, was found to constitute an "occurrence" under the policy.

The court also found that although the "occurrence" merely gave rise to the general contractor's contractual responsibility to ensure the proper work of its subcontractors, the policy did not make any express distinction between tort or contractual liability resulting from an "occurrence."

Too many cooks spoil the home warranty

The Louisiana New Home Warranty Act, Louisiana Revised Statute 9:3141 *et seq*., provides a warranty for a new home purchaser and defines the responsibility of the builder to that purchaser (and to subsequent purchasers) during the warranty periods. The definition of a "builder" is contained in the statute, and means anyone which constructs a home or addition thereto. Attorney's fees are available in suits brought under the statute.

The Louisiana Court of Appeal for the Second Circuit was confronted with the question of whether a contractor which constructs only a portion of a home is a "builder" under the NHWA. In *Allstate Enterprises, Inc. v. Brown*, 907 So.2d 904 (La. App. 2 Cir. 2005), homeowners based the construction of their new home on plans obtained from the internet, and the defendant contractor agreed to frame the home in accordance with the plans and to construct the roof therefor. The homeowners refused to make final payment to the contractor because of alleged substandard workmanship. Suit followed with claims by both sides, and, although the trial court found the NHWA applicable and ruled in favor of the homeowners, it did not award attorney's fees to the homeowners.

The contractor argued that its role as contractor for only a portion of the total construction (the homeowners dealt individually with other trades for the remainder of the construction of the new home) did not make it a "builder" under the statute. The appellate court agreed, interpreting the NHWA's definition of a "builder" to apply only when the entire structure is built by a single builder. Since the contractor did not a build a "functional, completed home" for the homeowners, the NHWA did not apply and the homeowners could not recover attorney's fees.

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News and Notes

Upcoming Construction Law Seminars

Shields Mott Lund L.L.P. is pleased to announce these upcoming seminars in which its lawyers are participating:

Zoning, Subdivision and Land Development Law Seminar (Lorman Education Services), Lafayette, Louisiana, February 21, 2006, 9:00 a.m. – 4:30 p.m.

19th Annual Construction Law Conference (State Bar of Texas, Construction Law Section), March 2-3, 2006, Dallas, Texas, 8:30 a.m. - 5:15 p.m.

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

Proving Damages Caused by Mold Infestation (National Business Institute), April 6, 2006, New Orleans, Louisiana, 9:00 a.m. – 4:30 p.m.

AIA Contracts Seminar (Lorman Education Services), April 18, 2006, Baton Rouge, Louisiana, 9:00 a.m. – 4:30 p.m.

Basic Real Estate Development (Lorman Education Services), April 25, 2006, Baton Rouge, Louisiana, 9:00 a.m. – 4:30 p.m.

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, or the NBI seminar at www.nbi-sems.com.

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