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February 19, 2013

Senator John A. Alario, Jr.
President of the Senate
P.O. Box 94183
Baton Rouge, Louisiana 70804

RE: SR NO. 158 of 2012

Dear Mr. President:

The Louisiana State Law Institute respectfully submits herewith its report to the legislature in response to 2012 Senate Resolution No. 158, relative to Louisiana lien laws (Private Works Act).

Sincerely,

A handwritten signature in black ink, appearing to read "W. E. Crawford".

William E. Crawford
Director

WEC/puc

cc: Senator Conrad Appel

e-mail cc: David R. Poynter Legislative Research Library
drplib@legis.la.us

LOUISIANA STATE LAW INSTITUTE

SECURITY DEVICES COMMITTEE

REPORT TO THE LOUISIANA LEGISLATURE IN RESPONSE TO SR NO. 158 OF 2012 LOUISIANA LIEN LAWS (PRIVATE WORKS ACT)

Adopted by the Council

**February 15, 2013
New Orleans**

**L. David Cromwell, Reporter
Claire Popovich, Staff Attorney**

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SENATE RESOLUTION NO. 158

BY SENATOR APPEL

A RESOLUTION

To urge and request the Louisiana State Law Institute to study Louisiana's lien laws.

WHEREAS, a lien is a form of security interest granted over an item of property to secure the payment of a debt or performance of another obligation; and

WHEREAS, liens are used routinely by numerous business entities, including owners, contractors and sub-contractors, vendors, lenders and land title companies; and

WHEREAS, the proper recording, prioritizing and perfection of liens as well as the recording of other documents and their ranking in relation to each other is critical to the conducting of commerce and business activity and growth in this state; and

WHEREAS, Louisiana's lien law as a whole has not recently been comprehensively reviewed or updated; and

WHEREAS, Louisiana's law currently contains more than 600 references to liens, scattered across various sections of Louisiana's Civil Code, Code of Civil Procedure and Revised Statutes.

THEREFORE, BE IT RESOLVED that the Legislature of Louisiana does hereby urge and request the Louisiana State Law Institute to study and review the placement and structure of Louisiana's lien law, including the documents that are required to be recorded, the types of liens currently provided for in Louisiana law, the placement of such provisions, and the manner in which Louisiana law currently requires that liens be recorded, perfected and prioritized, and further to develop recommendations to provide continuity within Louisiana's lien law and to simplify and better organize Louisiana's lien law to be consistent and understandable.

BE IT FURTHER RESOLVED that as part of its study the Louisiana State Law Institute shall compare proposed modifications to Louisiana's lien law to the lien laws of other states in an effort to ascertain the best possible expression of law as related to national trends and business practices.

BE IT FURTHER RESOLVED that the Louisiana State Law Institute shall report its findings and recommendations to the Louisiana Legislature on or before February 1,

SR NO. 158

ENROLLED

2013.

BE IT FURTHER RESOLVED that a copy of this Resolution be transmitted to the director of the Louisiana State Law Institute.

PRESIDENT OF THE SENATE

**REPORT TO THE LOUISIANA LEGISLATURE
ON LOUISIANA LIEN LAWS
(PRIVATE WORKS ACT)**

SR NO. 158 OF THE 2012 REGULAR SESSION

SR No. 158 of 2012 requested the Louisiana State Law Institute to study and review "the placement and structure of Louisiana's lien law, including the documents that are required to be recorded, the types of liens currently provided for in Louisiana law, the placement of such revisions, and the manner in which Louisiana law currently requires that liens be recorded, perfected and prioritized." SR No. 158 of 2012 was assigned for study to the Security Devices Committee of the Law Institute.

The recitals to the resolution describe a "lien" as a "form of security interest granted over an item of property to secure the payment of a debt or performance of another obligation."¹ If the recitals of the resolution are taken to define the scope of the study the Legislature has requested, then the breadth of the study would be expansive indeed, for it would necessarily involve all kinds of real security countenanced by Louisiana law, including mortgages, security interests, pledges, privileges, and any other forms of security that are permitted by or arise under the law in all types of property, movable and immovable, corporeal and incorporeal. Despite the breadth of the scope of the recitals of the resolution, members of the Committee understand, from conversations with the resolution's author,² that the primary focus of the resolution is actually on the Louisiana Private Works Act,³ and the bulk of this report will address that Act. Nonetheless, in view of the wide scope of the recitals of the resolution, it is appropriate at the outset to observe that the Legislature, acting on recommendations of the Law Institute that were the product of considered study, has already made significant progress over the last two decades in the modernization and revision of Louisiana's security device laws. Significant steps that have been taken in this process of study and revision include the following:

- Act 652 of 1991, together with Act 1132 of 1992, represented a comprehensive revision and modernization of the articles of the Civil Code bearing on the law of mortgage,⁴ including revision of related provisions of the Civil Code Ancillaries. One of the innovations of this revision was the introduction of the mortgage to secure future

¹The term "lien" is not a civilian term and has no consistent definition in Louisiana law. In its broadest, non-technical sense, the term is commonly understood to have the meaning given in SR No. 158 of 2012. Often, however, the term is used to denote a privilege, which has a much narrower definition in Louisiana law. The Louisiana Civil Code, borrowing almost verbatim from the French Civil Code, defines a privilege as a right which the nature of a debt gives to a creditor and which entitles him to be preferred before other creditors, even those who have mortgages. C.C. art. 3186. Thus, privileges arise only by operation of law and cannot be created contractually. Examples of privileges on immovables are those interests that arise in favor of claimants upon an owner's property under the Louisiana Private Works Act, which is discussed in detail *infra*. A definition of the term "lien" is given in Chapter 9 of the Uniform Commercial Code, and that term, rather than the civilian term "privilege," is used throughout Chapter 9 for the sake of uniformity with the law of other states. The non-uniform definition in Chapter 9 corresponds to the meaning of a privilege on movable property. R.S. 10:9-102(d)(9).

²Sen. Conrad Appel, III.

³R.S. 9:4801 et seq.

⁴See C.C. arts. 3278-3337 (1992).

obligations, which ranks as to all present and future obligations from the time of its initial recordation. In practice, this concept has worked well over the last two decades, and this form of mortgage has been widely embraced by lenders, borrowers, and practitioners alike, particularly in commercial transactions.

- On recommendation of the Law Institute, the Legislature adopted Acts 1995, No. 962, a comprehensive revision of the law governing privileges arising from the drilling and operation of oil, gas, and water wells.⁵
- In furtherance of the nationwide revision of Article 9 of the Uniform Commercial Code, the Law Institute, following a careful study and analysis of each provision of the revised model act, adapted it for use in Louisiana. This process led to the enactment of Act 128 of 2000, a comprehensive revision of Chapter 9 of the Louisiana Commercial Laws,⁶ effective July 1, 2001, the nationwide effective date of the revision of Article 9 of the model Uniform Commercial Code.
- Act 169 of 2005, also recommended by the Law Institute, enacted a comprehensive revision of Louisiana laws bearing on registry, including the registry of mortgages.⁷ The revision also modernized procedures for cancellation of mortgages and other encumbrances.
- In response to SCR No. 122 of 2008, requesting the Law Institute to study security interest priority issues faced by farmers, lenders, and grain elevators, the Law Institute recommended, and the Legislature adopted, Act 378 of 2010, addressing substantial inconsistencies, anomalies, and lacunae that previously existed in the law governing secured interests in crops.
- Act 450 of 2012 was a Law Institute-recommended revision of Chapter 9 of the Louisiana Uniform Commercial Code to include a set of nationwide changes and additions to model Article 9 of the Uniform Commercial Code. This revision addressed a number of technical issues that had arisen since the promulgation of revised Article 9 a decade earlier.

In addition to this work in the area of real security, the Law Institute and Legislature have also modernized the Louisiana law of suretyship, which is a form of personal security, through a comprehensive revision of the applicable Civil Code articles.⁸

⁵R.S. 9:4861 et seq.

⁶Louisiana was the last state to adopt Article 9 of the Uniform Commercial Code. See Acts 1988, No. 528, as substantially amended by Acts 1989, No. 135, adopting "Chapter 9 of the Louisiana Commercial Laws," effective January 1, 1990. The Louisiana Commercial Laws, found in Title 10 of the Revised Statutes, are now formally known in Louisiana law as the Uniform Commercial Code. See R.S. 10:1-101 (as amended by Acts 2006, No. 533).

⁷See C.C. arts. 3338-68 (2005).

⁸See C.C. arts. 3035-70, as amended by Acts 1987, No. 409, effective January 1, 1988. HCR 93 of 2012 has requested the Law Institute to study specific issues concerning enhanced protection for the surety of an obligation that is also secured by a security interest in a movable.

Though much progress has been made in the area of security devices, the work of revision is not yet complete, and the Law Institute's work in this vital area of the law is on-going. The Law Institute has drafted, and will soon recommend to the Legislature, a new title of the Civil Code treating the general topic of security, along with a comprehensive revision of both the Civil Code articles bearing on the law of pledge and of R.S. 9:4401, which governs the assignment and pledge of leases and rents of an immovable. The proposed revision of the law governing the pledge of the lessor's rights in the leases and rents of an immovable - an important security device in modern commercial financing transactions - will streamline and clarify the law through the adoption of a set of plainly written articles of the Civil Code. In addition, detailed research has already commenced in preparation for a comprehensive revision of the codal articles treating the law of privilege. This is one of the few areas of the Civil Code of 1870 that have yet to be revised in the course of the Civil Code revision that has progressed steadily over the last several decades.

The balance of this report will address the Louisiana Private Works Act.

BACKGROUND OF THE PRIVATE WORKS ACT

The current Private Works Act was drafted by the Law Institute and enacted by Acts 1981, No. 724. The 1981 enactment represented a comprehensive modernization of the predecessor statute that had been enacted almost sixty years earlier in 1922.⁹ The 1922 legislation was itself a comprehensive revision and consolidation of the laws regulating the rights and liabilities of persons who contract for the improvement or modification of an immovable.¹⁰ The Act serves as the framework for the implementation of two fundamental policies.¹¹ The first

⁹Acts 1922, No. 139. For an account of the efforts of the legislature to arrive at a satisfactory balancing of the many policies involved before the 1922 Act, see Daggett, *Louisiana Privileges and Chattel Mortgages*, (1942) page 218. The provisions of the 1922 Act were modified by Act No. 298 of 1926; however, the basic approach and underlying principles remained intact.

¹⁰To achieve the objective of the protection of those who furnish labor or materials in the improvement of an immovable, the Civil Code followed a wholly different approach which, though not expressly repealed, has been effectively superseded by the Act and its predecessors. Under the regime of the Civil Code, a special privilege on an immovable is granted to "[a]rchitects, undertakers, bricklayers, painters, master builders, contractors, subcontractors, journeymen, laborers, cartmen and other workmen employed in constructing, rebuilding or repairing houses, buildings, or making other works," as well as to "[t]hose who have supplied the owner or other person employed by the owner, his agent or subcontractor, with materials of any kind for the construction or repair of an edifice or other work, when such materials have been used in the erection or repair of such houses or other works." C.C. art. 3249 (1870). The privileges of these privileged creditors ranked concurrently (C.C. art. 3272) and enjoyed a preference over all mortgages, provided that they were filed in a timely manner. C.C. art. 3274 (1870). These privileges were not directly ranked against vendor's privileges, but instead the Civil Code provided for a separate appraisal procedure, with the vendor being paid the amount of the "appraisal on the land," and the other privileged creditors receiving "the appraisal of the building." C.C. art. 3268. The Supreme Court long ago observed that this separate appraisal procedure, protecting a contractor who subsequently performed work upon the immovable against the pre-existing privilege of the vendor, "exemplifies the intelligent sense of justice which distinguishes the civil law." *City of Baltimore v. Parlange*, 23 La. Ann. 365 (1871). This protection no longer exists in the case of a vendor's privilege that becomes effective against third persons before a work begins, for the Private Works Act, like its predecessor statutes, gives priority under those circumstances to the vendor's privilege over all Private Works Act privileges other than those in favor of laborers. See R.S. 9:4821.

¹¹ For an analysis of the present Act, see Rubin, *Ruminations on the Louisiana Private Works Act*, 58 La. L.

is that persons who contribute to the improvement of an immovable are entitled to legal protection so that neither an owner nor his creditors appropriate the value of their efforts without compensating them. The second policy is that owners, who initiate and will benefit from the work, should take reasonable steps to see that their contractors and suppliers are paid and that contractors do not appropriate the price of the work and leave subcontractors, laborers, and suppliers unpaid.¹² These basic policies devised by the Legislature have, for the most part, survived the test of time.

The basic means of accomplishing the policy objectives of the Act are quite simple. First, contractors, laborers, suppliers of materials, and others who deal directly with the owner of an immovable or who contribute to its improvement are granted a privilege on the immovable to secure the price of their work or materials.¹³ Secondly, owners who have work done on an immovable through a general contractor are expected to require the contractor to record a notice of his contract and to provide a surety bond protecting those persons who perform work or supply materials under the contract.¹⁴ The owner who fails to comply with these provisions is not only made personally liable for the claims that would otherwise be protected by the surety bond, but his property is subjected to a privilege to secure these personal claims against the owner. The Act also imposes personal liability upon a contractor for these claims, regardless of whether notice of contract is filed.¹⁵ In addition, a penalty is inflicted upon the general contractor who does not record notice of his contract. If the contract is over \$25,000, he is denied a privilege on the immovable for the price of his work.¹⁶ The contractor's failure to record notice of his contract does not affect the personal liability of the owner or contractor, nor the privilege enjoyed by those who deal with the contractor.

The mechanisms of the Act work quite well if the owner requires the contractor to comply with the Act by filing a timely notice of contract with a proper bond attached. Upon completion of the work, a notice of termination is filed in the mortgage records by the owner.¹⁷ Anyone who worked on the project or supplied materials and was not paid may file a statement of his claim and send a copy of it to the owner.¹⁸ If no claims are filed within thirty days after the filing of the notice of termination, the owner obtains cancellation of the contract of all claims except that of the contractor, and thirty days later the owner may have the contract completely cancelled from the mortgage records.¹⁹

If claims are filed, then the owner or any interested person can convoke a concursus against the contractor, the surety, and all of the claimants.²⁰ If the owner demonstrates that a

Rev. 569 (1998).

¹²*Exposé des Motifs*, Title IX: Civil Code Ancillaries, p. 96 (West 2013).

¹³ R.S. 9:4801.

¹⁴ R.S. 9:4802.

¹⁵ R.S. 9:4802(A).

¹⁶ R.S. 9:4811(D). "A general contractor shall not enjoy the privilege granted by R.S. 9:4801 if the price of the work stipulated or reasonably estimated in his contract exceeds twenty-five thousand dollars unless notice of the contract is timely filed."

¹⁷ R.S. 9:4822.

¹⁸ R.S. 9:4822(A).

¹⁹ R.S. 9:4832.

²⁰ R.S. 9:4841(A). "After the period provided by R.S. 9:4822 for the filing of statements of claims or

proper bond has been given by a solvent surety and that the owner has paid all he owed the contractor for the work, he may obtain an order directing the clerk to cancel the contract and all of the claims and privileges from the records.²¹ Thereafter, the owner has no further liability or concern in the matter, and the claimants litigate the validity of their claims with the contractor and the surety.²²

Often, however, for a variety of reasons, an owner fails to require the contractor to file notice of contract or to provide a surety bond. Work on immovables, particularly when involving individual residences, is often done on a small scale involving unsophisticated parties. In many, if not most, of those cases, the owner may be wholly unaware of the requirements of the Act and may not think it necessary to obtain legal advice. The employment of plumbers, painters, roofers, and similar workers seldom causes the owner to resort to the procedures necessary to protect himself – even though he may have some idea that such things as "mechanic's liens" or "construction liens", as they are popularly called, exist. Even when an owner is aware of the provisions of the Act and his potential liability for failing to require the contractor to provide a surety bond, it is often not financially feasible to obtain a surety bond. In many cases, the contractor might be unable to obtain a bond at any cost. In all of these cases, an owner is at risk if he pays his contractor before confirming that the contractor and his subcontractors have paid all workers and suppliers, even those whose identities are not known to the owner.

Under the Act, the owner's property is not only subject to a privilege for the amounts owed to unpaid claimants, but he is personally liable to them for these amounts. When notice of contract is not recorded and a bond is not given, a privilege by a subcontractor, laborer or supplier may be filed for up to sixty days after the work has been completed.²³ If the owner is unaware of the risk, it is likely that he will have already paid his contractor the full price of the work, thus exposing the owner to the risk of having to pay twice and to then pursue his contractor, who, if he has not paid the suppliers and subcontractors, is not likely to be available

privileges has expired, the owner or any other interested party may convoke a concursus and shall cite all persons who have preserved their claims against the owner or their privileges on the immovable, and shall cite the owner, the contractor and the surety if they are not otherwise parties to establish the validity and rank of their claims and privileges."

²¹R.S. 9:4841(C).

²² R.S. 9:4841(D). "If the court determines that the owner has properly deposited all sums owed by him to the contractor; that the owner has complied with this Part by properly and timely filing notice of a contract and bond as required by R.S. 9:4811 and R.S. 9:4812; that the bond complies with the requirements of this Part, or if it finds that any of the claims or privileges have not been preserved, it shall render a judgment on the rule directing the claims or privileges to be cancelled by the recorder and declaring the owner discharged from further liability for such claims or limiting the claims and privileges to the amounts as may be owed by the owner or otherwise granting such relief to the owner as may be proper."

²³ R.S. 9:4822(C). "Those persons granted a claim and privilege by R.S. 9:4802 for work arising out of a general contract, notice of which is not filed, and other persons granted a privilege under R.S. 9:4801 or a claim and privilege under R.S. 9:4802 shall file a statement of their respective claims and privileges within sixty days after: (1) The filing of a notice of termination of the work; or (2) The substantial completion or abandonment of the work, if a notice of termination is not filed." An amendment to the Act now makes an exception in the case of suppliers of materials on a residential project for which notice of contract is not filed: they are given a period of seventy days within which to file. R.S. 4822(C)(2) (added by Acts 1991, No. 1024).

to reimburse the owner.

Several arguments have been made to support the Act's imposition of personal liability on the owner to persons with whom there is no privity of contract, even after the owner has paid his contractor. First, and most importantly, the Act gives the owner a means to avoid personal liability by recording notice of contract and requiring a surety bond. Secondly, the presence of the bond permits, indirectly, the owner to agree to make his payments as the work progresses, or even after it is finished, and still permits the contractor to obtain credit for the cost of the work as it progresses. In the absence of some assurance of payment, subcontractors and suppliers are less likely to extend credit to the contractor, who would then need to have sufficient capital to complete the job. In a sense, the credit extended to the contractor is in effect credit extended to the owner, for in the absence of the contractor's ability to obtain services and supplies on credit, the contractor would demand that the owner fund costs in advance, rather than in periodic, after-the-fact progress payments. Moreover, it is obviously advantageous to the owner to defer paying until after the work or some definable part of it is finished, particularly since financial institutions are unlikely to lend even part of the funds without some assurances of completion and freedom from claims. The Act's balancing of interests among the contractors, those from whom they obtain services and supplies, the owner, and lenders, has proved to be essentially effective for more than a hundred years. This balancing of interests is ultimately founded in the policy judgment, which pervades many areas of Louisiana law, that one who receives an unmerited enhancement of his property should compensate those persons who cause that enhancement.²⁴

The Legislature has recognized that owners are often unaware of or unable to comply with the Act's requirement of a surety bond. To afford added protection to the owner, while not relieving him of the claims and privileges provided by the Act, the Legislature has passed legislation to force the contractor to pay his workers and suppliers. R.S. 9:4814, added in 1997, imposes civil penalties of up to one thousand dollars for each one thousand dollars of misapplied funds.²⁵ In addition, criminal statutes may be used against a contractor.²⁶ These provisions, however, offer small consolation to the owner who is forced to pay twice for the improvements, and they provide no real level of additional protection to unpaid subcontractors and suppliers. A provision of law known as the Residential Truth in Construction Act²⁷ seeks to make owners aware of potential claims and privileges under the Act by requiring contractors for residential home improvements to give owners prior notice of "lien rights". However, even though

²⁴ See C.C. art. 2298.

²⁵ R.S. 9:4814(A), enacted by Acts 1997, No. 861, provides: No contractor, subcontractor, or agent of a contractor or subcontractor, who has received money on account of a contract for the construction, erection, or repair of a building, structure, or other improvement, including contracts and mortgages for interim financing, shall knowingly fail to apply the money received as necessary to settle claims to sellers of movables or laborers due for the construction or under the contract. Any seller of movables or laborer whose claims have not been settled may file an action for the amount due, including reasonable attorney fees and court costs, and for civil penalties as provided in this Section" See also R.S. 37:2175.1 et seq. (home improvement contracting.) Licensed contractors are required to apply payments from the owner to suppliers and workers or they are subject to civil penalties and loss of license.

²⁶R.S. 14:202 (misapplication of payments prohibited). A contractor who misapplies funds received from the owner or lender may be imprisoned for up to five years.

²⁷R.S. 9:4851 et seq.

penalties are provided against a contractor who fails to give the required notice, the Residential Truth in Construction Act expressly provides that a contractor's failure to comply with its provisions does not deprive anyone of a privilege or claim arising under the Private Works Act.²⁸ A provision of law was added in 1991²⁹ to require the seller of movables sold for use in the improvement of an immovable for residential purposes to give notice to the owner at least ten days before filing his statement of claim or privilege; however, by that time the seller's privilege will have already attached and the owner's personal liability arisen. Thus, this requirement appears to be of only marginal benefit to the owner.

It should be borne in mind that claims arise under the Private Works Act not just when the general contractor fails to pay for work or materials but also when a subcontractor fails to do so.³⁰ Under these circumstances, the general contractor may be just as free from fault as the owner, for he may have fully paid all persons who dealt directly with him. Like the owner, however, the general contractor is nonetheless made personally liable to the unpaid claimant and thus risks having to pay twice for the same work or supplies.³¹ Indeed, if the general contractor is solvent, he ultimately bears the entirety of the risk, because he is obligated by the Act to indemnify the owner against these claims.³²

THE NEED FOR TECHNICAL CORRECTIONS TO THE PRIVATE WORKS ACT

In the thirty years since its last comprehensive revision, the Act has been amended, or proposed for amendment, in most sessions of the Legislature, and in some sessions by more than one act.³³ Though those amendments have, for the most part, preserved the basic structure and policies of the Act, they have modified its details and procedures to deal with specific problems caused by the jurisprudence, changing economic conditions and business and financing practices, or the desire of certain classes of persons affected by the Act to correct what they perceived to be its deficiencies or unfairness as the Act applied to them in particular cases. However well-intentioned, these piecemeal changes to certain specific provisions of the Act have sometimes been made in a fashion that does not comport with the overall thrust of the Act. Some changes have introduced statutory language that is either imprecise or ambiguous or different from the words used to describe the identical concepts elsewhere in the Act. Some amendments have

²⁸R.S. 9:4854.

²⁹R.S. 9:4802(G)(2) (added by Acts 1991, No. 1024).

³⁰The terms "contractor," "general contractor" and "subcontractor" are defined in R.S. 9:4807.

³¹R.S. 9:4802(A) and (E).

³²R.S. 9:4802(F). Cognizant of the risk faced by the general contractor and owner in the case of the lessor of a movable used in the work, the Act requires the lessor to deliver a copy of the lease to the contractor within ten days after the leased movables are placed on site. By subsequent legislation, a provision was added requiring a claimant who sold movables to a subcontractor to give notice of non-payment to the contractor and owner within 75 days from the last day of the month in which materials are delivered, but not beyond the expiration of the period for filing claims. R.S. 9:4802(G)(3).

³³See Acts 1983, No. 589; Acts 1984, No. 388; Acts 1985, No. 556, 711, 903; Acts 1986, No. 424; Acts 1987, Nos. 685, 897; Acts 1988, Nos. 685, 713, 904, 999; Acts 1989, No. 41; Acts 1990, No. 952; Acts 1991, Nos. 353, 370, 1024; Acts 1995, Nos. 31, 666, 1155; Acts 1997, No. 861; Acts 1999, No. 1134; Acts 2001, No. 1105; Acts 2003, No. 729; Acts 2004, No. 209; Acts 2005, No. 169; Acts 2010, Nos. 601 and 638; and Acts 2012, Nos. 394 and 425.

used the words "claim" and "privilege" almost interchangeably, even though these two concepts have entirely different meanings and consequences under the Act.³⁴ Notice requirements have been added to the Act in a variety of places, rather than in a central location, with the unintended effect of creating traps for the unwary claimant. Some of these notice provisions appear to fail to achieve any real benefit, while others arguably allow a period of time for notice that is too long to allow the owner or general contractor to protect themselves.³⁵ The Law Institute has also noted the existence of a number of changes to the Act that do not appear to state what was likely intended, leaving courts to struggle with the proper interpretation of the revision.

Of course, no argument could be reasonably made that the Act as originally adopted was insusceptible of improvement, or that the legislative changes over the years were necessarily inappropriate either in their substantive effect or in their wording. However, to restore the integrity and cohesiveness of the Act, the Law Institute feels that more comprehensive review of the Act as a whole is warranted, particularly with respect to the numerous changes that have been enacted over the last three decades. The Law Institute intends to undertake this task and make recommendations to the Legislature in the near future for specific changes in the wording of the Act. It is not envisioned that this process will result in a wholesale revision of the Act as occurred in 1981, nor that the recommended changes will have far-reaching substantive effects. Rather, it is anticipated that the recommended changes will remove certain ambiguities or inconsistencies in the wording of the Act that have either have caused, or have the potential to cause, the Act to be interpreted in a manner that likely was not intended.

Though additional time will be needed for the Law Institute to conduct a comprehensive review of the statute and to draft the necessary statutory corrections, the Security Devices Committee has, at this point, identified a number of areas that should be addressed. In addition, the Law Institute is grateful to the study resolution's author for identifying other areas of concern. The issues discussed below either have already been considered or are presently undergoing consideration. Two preliminary caveats are in order. First, the enumeration of issues below is not intended to be exhaustive or to limit the scope of the Law Institute's review of the Act in response to the broad directions of the Legislature given in SR No. 158 of 2012. Secondly, where policy judgments are implicated, the inclusion in the discussion below of competing arguments is offered merely to illuminate the issues involved and is not intended to express an opinion by the Law Institute or the Committee on the underlying policy judgments. Any perceived appearance of favoring one side of a policy argument over another is wholly unintended.

1. Should a general contractor who has filed a timely notice of contract with proper surety bond attached be afforded a simple means of causing the cancellation of record of a statement of claim or privilege?

If a proper notice of contract and bond are filed before work begins, the owner is relieved of any personal claims by persons who are not in privity of contract with him, and no privileges

³⁴The distinction is made apparent by R.S. 9:4802(B).

³⁵See discussion *infra*.

in favor of those persons bear upon his property.³⁶ Persons who provide services or supplies on the project are instead protected by the contractor's surety bond. Nonetheless, it is a customary practice for owners and their lenders, before making final payment to contractors, to require cancellation of record of any statements of claim or privilege that may have been filed. Under the Act, the contractor accomplishes this by filing yet another surety bond that is specific to each statement of claim or privilege that is to be released.³⁷ It has been suggested that there is no need to require a contractor to produce a new bond to remove each statement of claim or privilege that may have been filed, for the payment bond that the contractor furnished initially should stand good for the very same claims.

On the other hand, it might be countered that the surety bond filed with the notice of contract is not necessarily for the full amount of the contract. The Act applies a decreasing scale in the determination of the required amount of the initial surety bond.³⁸ For projects of more than \$1,000,000 in amount, the amount of the bond is only 25% of the total contract price. At the time of the request for cancellation of a filed statement of claim or privilege, it might not be clear whether the aggregate of all claims will exhaust the initial surety bond, particularly if the period for filing statements of claim or privilege has not yet expired.

Moreover, the statutory qualifications of the surety providing the initial bond differ from those of the surety whose bond is provided to cause the cancellation of a filed statement of claim or privilege. For the surety bond filed with notice of contract, the surety need only be "a solvent, legal surety,"³⁹ whereas the surety whose bond is used to cancel a filed statement of claim or privilege must be "a lawful surety company authorized to do business in the state."⁴⁰ A statutory obligation is imposed upon the recorder of mortgages to review the bond filed to cancel a filed statement of claim or privilege,⁴¹ but no such obligation is imposed upon the recorder with respect to the initial surety bond filed with the notice of contract. The policy reason for these enhanced requirements seems to be a desire to protect a claimant before permitting the divestiture, against his will and perhaps even without his knowledge, of a right that has already arisen in his favor against the owner and the owner's property. By contrast, when the initial surety bond is filed, no rights have yet arisen in favor of persons who will later do work on the project, and the owner will ultimately be put to the task of establishing, through judicial proceedings that follow proper notice to claimants, that the surety bond the contractor provided with the notice of contract complies with the Act and that their claims and privileges are discharged.⁴²

The foregoing notwithstanding, in the vast majority of cases, the initial surety bond is

³⁶R.S. 9:4802(C).

³⁷The procedure whereby a contractor or other interested party can post a bond or other security in order to obtain the cancellation of a filed statement of claim or privilege appears in R.S. 9:4835.

³⁸R.S. 9:4812.

³⁹R.S. 9:4812(A). C.C. Art. 3043 defines a legal suretyship as "one given pursuant to legislation, administrative act or regulation, or court order." As comment (e) to R.S. 9:4812 explains, any bond given to comply with the Act is in effect a legal suretyship.

⁴⁰R.S. 9:4835A. Alternatively, the person seeking to cancel the statement of claim or privilege may provide as security "a federally insured certificate of deposit."

⁴¹R.S. 9:4835B.

⁴²R.S. 9:4841(C).

provided by "lawful surety company authorized to do business in the state," and the bond is often for the full amount of the construction contract. In the course of its on-going study of the Act, the Law Institute intends to consider whether a streamlined procedure should be introduced to permit a contractor or other interested party to "bond off" a filed statement of claim or privilege in certain instances, such as when the initial surety bond was issued by a lawful surety company authorized to do business in the state and was issued in the full amount of the contract price.

2. *Should the notice provisions of the Act be consolidated in a central location and adjusted to better accomplish their intended purpose?*

The Act, as it has been revised over the years, contains at least seven different provisions requiring or permitting a claimant to give notice to the owner or contractor, usually with language indicating that a failure to give the required notice causes a loss of the claimant's claim or privilege.⁴³ All but one of these provisions was added after the initial adoption of the Act in 1981.

As can be readily seen from these notice provisions, the various periods within which notice must be given run from different events and for differing periods of time. Most notices must be given within a certain period *after* specified events occur, but one notice must be given at least a certain number of days *before* action is taken.⁴⁴ Two provisions mandate a particular means of giving notice,⁴⁵ even though the Act contains a general provision that specifies the requirements of all notices that are given under it.⁴⁶ Scattered about as they are in the Act, these varying notice provisions arguably create unnecessary pitfalls for claimants.

On the other hand, it might be argued that some of the notice provisions allow periods that are too long to accomplish the purpose intended. As an example, the Act appears to provide that persons supplying materials to subcontractors must give notice of non-payment to the contractor and owner within 75 days from the last day of the month in which the materials were delivered.⁴⁷ It has been suggested to the Security Devices Committee that, if notice of non-payment is not given until the end of the 75-day period, the contractor often will have already paid the subcontractor who failed to pay the supplier. In that case, the notice might come too late to allow the contractor to act on it by withholding the amount due from what is paid to the subcontractor.

In the course of its on-going study, the Law Institute intends to consider whether these various notice provisions should be harmonized, whether they all serve a useful purpose and whether the periods of time specified for giving notice should be altered.

3. *Should a contractor under a construction contract for more than \$25,000 be deprived of any privilege upon the immovable if he fails to file a timely notice of contract?*

⁴³R.S. 9:4801(5); R.S. 9:4802(A)(5)(B); R.S. 9:4802(G)(1); R.S. 9:4802(G)(2); R.S. 9:4802(G)(3); R.S. 9:4822(J); and R.S. 9:4822(K).

⁴⁴R.S. 9:4802(G)(2).

⁴⁵R.S. 9:4802(G)(3) and R.S. 9:4822(J).

⁴⁶R.S. 9:4842.

⁴⁷R.S. 9:4802(G)(3).

The Act provides that the contractor under a construction contract for more than \$25,000 is denied a privilege upon the owner's property if he fails to file a timely notice of contract.⁴⁸ The reason for this requirement is to promote the protection of third persons, by giving the contractor a compelling incentive to see that notice of contract is filed. Third persons who are protected by the filing of a notice of contract certainly include potential claimants, to whom the information contained in the notice of contract will be useful in knowing when and how to present their claims for work done or materials supplied on the project. Perhaps more importantly, the filing of the notice of contract at the inception of the work benefits vendees, mortgagees and other third persons who might deal with the owner during the interim period between the commencement of work and the expiration of the period allowed for filing of statements of claim or privilege arising out of the work. It is significant that most privileges arising under the Act are effective against third persons from the time notice of contract is filed or the time the work begins, provided that a timely after-the-fact statement of claim or privilege is filed.⁴⁹ Thus, during the interval of time from the inception of the project until the expiration of the period for filing statements of claims or privileges after completion of the work, the privileges that arise under the Act are "hidden liens" that are effective against third persons *even though they do not appear of record*. This period of time may easily last for a year or more, depending on the nature and scope of the project involved. Giving the contractor an incentive to file notice of contract before work begins promotes the purpose of providing to third persons during this interim period a means of knowing of the possible existence of the privileges that might arise in favor of not only the contractor himself, but also subcontractors, suppliers, lessors, laborers, and other persons who are given privileges under the Act.

It has been suggested that an inequity results from the contractor's loss of his privilege merely on account of his failure to file timely notice of contract and that a possible solution to this perceived inequity would be to provide that responsibility for filing the notice should rest upon a title attorney or perhaps the construction lender. Of course, in not every construction project is a title attorney or lender involved at the time of contracting. Moreover, those parties might make legitimate arguments that it would be even more unfair to impose the burden of filing notice of contract upon them, particularly given that neither is directly a party to the construction contract. It is also significant that it is the contractor who has the ultimate responsibility for seeing that other claimants under the Act are paid and whose failure to do so will result in potential prejudice to third persons. Neither the lender nor a title attorney has this responsibility.

It might be argued that a sufficient incentive for a contractor to record notice of contract would exist if the consequence of the contractor's failure to record a timely notice of contract were that the effectiveness of his own privilege against third persons is postponed until the contractor's statement of privilege is filed.⁵⁰ In other words, rather than depriving the contractor of a privilege altogether, the Act could be amended to provide that the retroactive aspect of the

⁴⁸R.S. 9:4811(D).

⁴⁹R.S. 9:4820.

⁵⁰There are existing instances in which the effectiveness against third persons of certain privileges arising under the Act is postponed until a statement of claim or privilege is filed. See, e.g., R.S. 9:4808(C) and R.S. 9:4822(D)(1)(b).

privilege held by a contractor would be eliminated if the contractor fails to file a timely notice of contract exceeding \$25,000 in amount. In the course of its continuing study of the Act, the Law Institute will consider whether an adjustment in the provisions of R.S. 9:4811(D) is warranted.

4. *Should language be added to the Act making explicit that a personal claim against an owner is extinguished if the claimant fails to take necessary action to preserve his privilege?*

By virtue of an amendment to the Act made since its original enactment in 1981, R.S. 9:4802G(2) provides that, "[f]or the privilege under this Section or R.S. 9:4801(3) to arise," the seller of movables must give notice to the owner at least ten days before filing his statement of claim or privilege. *Standard Materials, L.L.C. v. C&C Builders, Inc.*⁵¹ held that a seller who failed to give this notice on a residential project was deprived of his privilege but was nonetheless still entitled to a personal claim against the owner.⁵² The court's rationale was that the notice requirement of R.S. 9:4802G(2) mentions only the *privilege* against the owner, and fails to mention the personal *claim*. As a practical matter, if R.S. 9:4801(G)(2) was intended to give protection to the owner, that protection is very shallow indeed, for under this holding the owner can still be held personally liable under a judgment that ultimately can be enforced by the seizure and sale of his immovable.

A similar interpretation has even more recently been given to the notice requirement applicable to equipment lessors under R.S. 9:4802(G)(1). In *Hawk Field Services, L.L.C. v. Mid America Underground, L.L.C.*,⁵³ the court held that an equipment lessor enjoyed no privilege because of his failure to comply with the notice requirements of that provision of the Act. Nonetheless, the court held that the lessor still had a valid personal claim against the owner. According to the court, a claimant under the Act has both a claim against the owner and a privilege on the immovable, and the language of R.S. 9:4802(G) clearly indicates that notice is necessary only to give rise to the *privilege* securing the claim.⁵⁴ Interestingly, as the Act was written when it was originally enacted, this result would not have obtained, for the notice provision referred to a claim, rather than to a privilege. Of course, if a claim does not arise, neither can a privilege, since the accessory nature of a privilege means that it can exist only when there is an underlying obligation.⁵⁵ The word "privilege" was substituted for "claim" by Act 1024 of 1991, at the same time that the notice provision applicable to the privilege of the seller of movables was added under R.S. 9:4802G(2). The legislative history does not reflect a discussion of the reason for this substitution,⁵⁶ which perhaps was made without a full realization

⁵¹2010 WL 5479903 (La. App. 1st Cir. 12/22/10)(not reported in the Southern Reporter).

⁵²Before reaching this holding, the court was forced to struggle with another problem with R.S. 9:4802G(2): the last sentence of the paragraph that provides that "[t]he requirements of this Paragraph (G)(2) shall apply to a seller of movables sold for use or consumption in work on an immovable for residential purposes." The court interpreted this sentence to mean that the paragraph applies *only* to immovables for residential purposes.

⁵³94 So.2d 136 (La. App. 2d Cir. 2012), *writ denied*, 2012 WL 5381898 (La. 2012).

⁵⁴Two judges dissented, believing that both the privilege *and* the claim were invalidated by the lack of notice.

⁵⁵See R.S. 9:4802(B), providing that the privileges under the Act secure the personal claims against the owner.

⁵⁶ See *Privileges on Immovables: Meeting on HB 382 Before the H. Comm. On Civil Law & Pro.*, 1991 Leg., 7-9 (La. 1991); H. 1991 Leg., at 17, 23 (La. 1991); S. 38, 17th Sess., at 1900, 2173 (La. 1991); *Digest of HB*

of the possible effect of the substitution under the Act.⁵⁷

It is surprising indeed that an owner would have a personal obligation to pay suppliers and lessors, even where no privilege exists. Moreover, among the difficulties that the 1981 revision of the Act was intended to address were inconsistent rules under prior law governing the existence of a privilege on the owner's property and the existence of personal liability on the owner's part.⁵⁸ As the Act was revised in 1981, it was not possible for personal liability to exist when a privilege had not been properly preserved, and it appears doubtful that a considered policy judgment was later made to change this rule. In the course of its on-going study of the Act, the Law Institute intends to consider whether R.S. 9:4802(G) should be amended to absolve the owner of not only the privilege but also any personal obligation when a required notice is not given.

5. *Should an outside time limitation be placed on the filing of statements of claim or privilege when a timely notice of contract has been filed, just as an outside time limitation exists when no notice of contract is filed?*

R.S. 9:4822(A) provides that, if a notice of contract is properly and timely filed, the persons to whom a claim or privilege is granted by R.S. 9:4802 have thirty days after the filing of a notice of termination of work to file a statement of claim or privilege. The courts have concluded that, if a notice of contract is filed but notice of termination is either not filed or is deficient, the filing period does not begin to run.⁵⁹ By contrast, if notice of contract is not filed, R.S. 9:4822(C) provides that the persons to whom a claim is granted by R.S. 9:4802 must file a statement of claim or privilege within sixty days after filing of notice of termination or substantial completion or abandonment of the work. Thus, the Act presents the anomaly that filing a notice of contract actually can work to the detriment of an owner, for if he then fails to follow through with filing a notice of termination, the period for filing claims against him never commences to run.

The recent case of *Thompson Tree & Spraying Service, Inc. v. White-Spunner Construction, Inc.*⁶⁰ demonstrates just how anomalous the application of these rules can be. In that case, both a notice of contract and notice of termination had been filed, but neither contained a property description of the immovable, as the Act requires. Reversing the trial court's decision that both filings were defective and that a subcontractor therefore had sixty days after substantial completion within which to file its statement of claim, the court of appeal held that the filing period had not even commenced to run. The court observed that R.S. 9:4822(C), which provides

382, House Legislative Service, 91-1406.

⁵⁷Another apparent consequence of the substitution of the word "privilege" for "claim" is that the contractor, against whom a "claim" arises under R.S. 9:4802(A), lost the benefit of the notice provisions in R.S. 9:4802(G).

⁵⁸*Exposé des Motifs*, Title IX : Civil Code Ancillaries at 97.

⁵⁹*In re Whitaker Constr. Co., Inc.*, 439 F.3d 212 (5th Cir.2006)(in so holding, observing that "it is not our prerogative to dictate to the Louisiana legislature where to strike the balance between the rights of sureties and construction creditors"); *Bernard Lumber Co., Inc. v. Lake Forest Constr. Co., Inc.*, 572 So.2d 178 (La. App. 1 Cir.1990); and *Rowley Co., Inc. v. Southbend Contractors, Inc.*, 517 So.2d 1260 (La. App. 4 Cir.1987).

⁶⁰68 So. 3d 1142 (La. App. 3d Cir. 2011), writ denied, 71 So. 3d 290 (La. 2011).

the sixty-day period, applies only to those situations in which an effective notice of contract has not been filed. In this case, the court found the notice of contract to be effective, despite the absence of a property description, because the lack of a property description did not prejudice the subcontractor. On the other hand, the court found that the notice of termination, which suffered from the same absence of a property description, was *not* effective. Thus, according to the court's reasoning, an effective notice of contract had been filed, and the thirty-day claim period of R.S. 9:4822A applied. However, the period had not commenced to run since an effective notice of termination had not been filed.

This reasoning, which appears supportable by the existing text of the Act, nonetheless yields a result that is certainly surprising and will impair the stability of land titles. It is a common practice in many areas of the state for the full construction contract, with no property description attached, to be filed at the inception of the work, and for an architect's certificate of substantial completion, also without a property description, to be filed once the work is complete. Application of the *Thompson Tree & Spraying Service* holding means that, in all of those instances, the period for filing claims never begins to run. A simple means of remedying this problem would be to remove the premise upon which the *Thompson Tree & Spraying Service* holding rests: that where a notice of contract is filed, the period for filing claims does not commence to run until a proper notice of termination is filed. It is curious indeed for R.S. 9:4822(A) to provide that the period is triggered only by filing of notice of termination of a work, for the filing of a notice of contract should benefit, rather than penalize, the owner. In the course of its continuing study of the Act, the Law Institute intends to consider whether R.S. 9:4822(A) should be amended to impose an outside deadline for filing statements of claims and privileges, in a fashion similar to R.S. 9:4822(C).

6. *Should the Act be amended to address the level of specificity that a claimant must include in a statement of claim or privilege?*

The Act requires a claimant's statement of claim or privilege to set forth "the amount and nature of the obligation giving rise to the claim or privilege and reasonably identify the elements comprising it including the person for whom and to whom the contract was performed, materials supplied, or services rendered."⁶¹ As the official revision comments to the Act indicate:

The purpose of a statement of claim or privilege is to give notice to the owner (and contractor) of the existence of the claim and to give notice to persons who may deal with the owner that a privilege is claimed on the property Technical defects in the notice should not defeat the claim as long as the notice is adequate to serve the purposes intended.⁶²

Recent cases have become increasingly stringent in interpreting these requirements, one case holding that a supplier's claim for materials "consisting of but not limited to trim, millwork, etc." was invalid where the amount of the claim was given but no itemized invoices were

⁶¹ R.S. 9:4822(G)(4).

⁶² Official revision comment (g) to R.S. 9:4822.

attached.⁶³ In the course of its study of the Act, the Law Institute intends to consider whether interpretive legislation should be adopted to clarify the degree of specificity that a claimant must include in his statement of claim or privilege in order to give sufficient notice of his claim.

7. Should the Act explicitly state that a contractor enjoys no right of subrogation to the claims and privileges of his own laborers?

In *Pringle-Associated Mortgage Corp. v. Eanes*,⁶⁴ the Supreme Court held that a general contractor is not entitled to assert by subrogation the laborer's privileges of his employees.⁶⁵ The rationale for this holding was reaffirmed in a crop setting in *Bayou Pierre Farms v. Bat Farms Partners, III*.⁶⁶ Nevertheless, in the recent case of *Tee It Up Golf, Inc. v. Bayou State Construction, LLC*,⁶⁷ a court of appeal appears to hold that, even if a general contractor is deprived of a privilege by his failure to file notice of a construction contract exceeding \$25,000 in amount,⁶⁸ the general contractor can still assert the privileged claims of his employees who performed work on the project." Not only does this in effect excuse the contractor from the consequences of his failure to comply with the express requirement of the Act to file notice of contract, but a necessary implication of the *Tee It Up Golf* holding⁶⁹ is that a general contractor's privilege will enjoy the priority of a laborer's privilege and will therefore outrank all competing mortgages and vendor's privileges to the extent that it is based on money paid by the contractor to laborers.⁷⁰ In the course of its on-going study of the Act, the Law Institute intends to consider whether interpretive legislation should be adopted to clarify that a contractor cannot assert through subrogation the laborer's privileges of his employees.

8. Are additional protections for homeowners warranted?

Recognizing the inequity that exists when a homeowner pays his contractor and is then forced to pay again if his contractor does not pay subcontractors or suppliers, the Legislature passed HCR 259 of 2004, urging the Law Institute to study this issue and to recommend legislation to protect homeowners under these circumstances. In the course of its study in

⁶³*Jefferson Door Company, Inc. v. Cragmar Construction, L.L.C.*, 81 So. 3d 1001 (La. App. 4th Cir. 2012). Cf. *Hibernia National Bank v. Belleville Historic Development LLC*, 815 So. 2d 301 (La. App. 4th Cir. 2002), in which the same court had found to be valid a statement of claim reciting that the claimant was due sums under a contract "to furnish labor, material to construct 21 condominium units." That holding was distinguished in *Bradley Electrical Services, Inc. v. 260I, L.L.C.*, 82 So. 3d 1242 (La. App. 4th Cir. 2011), which found invalid a statement of claim for a lump sum amount due "for services rendered," thus lacking even a general description of the nature of the debt.

⁶⁴226 So. 2d 502 (La. 1969).

⁶⁵C.C. art. 1829 describes the circumstances in which subrogation takes place by operation of law. Citing *Pringle*, comment (d) to Article 1829 observes that "a creditor who pays another creditor is not legally subrogated to the rights of the latter if the former was the principal obligor of the debt." Thus, a contractor, who is the principal obligor of the obligation to pay the wages of his employees, can enjoy no right of subrogation to their wage claims.

⁶⁶693 So. 2d 1158 (La. 1997).

⁶⁷30 So. 3d 1159 (La. App. 3d Cir. 2010).

⁶⁸See R.S. 9:4811(D).

⁶⁹It might be argued that the court's holding on this point was dicta, since the contractor's claim was defective for want of a sufficient property description and was thus held invalid on that basis.

⁷⁰See R.S. 9:4821(2), which gives priority to laborers over all other Private Works Act claimants and even over pre-existing mortgages and vendor's privileges.

response to the 2004 resolution, the Law Institute considered several alternative protections, such as (i) excluding residential work in an amount under a certain threshold from the Act altogether; (ii) limiting claims against the owner to those persons who have contracted directly with him; (iii) excluding the claims of remote claimants; and (iv) excluding homeowners. In its report to the Legislature in response to the 2004 study resolution,⁷¹ the Law Institute recommended efforts to educate the public of the risks involved, rather than an outright amendment to the Act.⁷² Though the present study resolution does not indicate any specific concern by the Legislature over this particular issue, the Law Institute's continued study of the Act will include further consideration of whether protection of homeowners against the risk of double payment is warranted and, if so, possible means of providing that protection.⁷³

ANALOGOUS STATUTORY REGIMES OF OTHER STATES

During the course of its study in response to SR No. 158 of 2012, the Law Institute reviewed analogous statutory provisions of a number of other states, including Texas, Mississippi, Florida, and the other states whose laws are mentioned in the discussion below on escrow and retainage requirements. Though certain provisions of those statutes might appear to favor specific parties under certain circumstances, and from the perspective of those parties might appear to be an improvement over Louisiana's Act, other parties might level criticism against those statutes for the very same reasons. No statutory regime is perfect, and the Security Devices Committee did not discern that any of the statutory regimes reviewed was an obvious improvement over the Act.⁷⁴ The Committee could find no compelling reason for abandoning

⁷¹ Louisiana State Law Institute Security Devices Committee, Thomas A. Harrell, Kerry Triche, REVISION OF THE LOUISIANA REVISED STATUTES REPORT TO THE LEGISLATURE PURSUANT TO THE INSTRUCTIONS OF HOUSE CONCURRENT RESOLUTION NO. 259 OF 2004, POSSIBLE REVISIONS TO THE PRIVATE WORKS ACTS (LA. R.S. 9:4801 ET SEQ.) 5-8 (2006).

⁷²As an alternative legislative solution, the report suggested a possible amendment to the Act to protect individual homeowners against claims by persons with whom they do not contract in residential construction projects for a price of less than \$5,000.

⁷³The Committee has noted, for instance, that the Florida Construction Lien Law, Fl. St. §713.001 et seq., contains a number of provisions designed to protect owners against the risk of double payment, primarily by mandating notices of possible lien rights to be given by various parties during the construction process. Any contract for more than \$2,500 on certain residential projects must contain a statutorily-prescribed notice in capitalized, bold-face type on the front page of the contract or on a separate page signed by the owner. Fl. St. §713.015. The authority issuing building permits must print on the face of each permit card a statutorily-prescribed notice in capitalized, bold-face type and provide the owner with a summary of the Construction Lien Law. Fl. St. §713.135. Every lienor, other than a laborer, who is not in privity of contract with the owner must serve upon the owner, no later than 45 days after commencing to furnish services or materials, notice of the lienor's name and address, along with a description of the nature of the services or materials to be furnished and a statutorily-prescribed warning of the provisions of the Construction Lien Law. Fl. St. § 713.06. The same provision permits the owner, in making final payment to the contractor, to rely upon the contractor's affidavit that all lienors who have given timely notice have been paid in full. Florida law also permits an owner to demand from a lienor a sworn statement of account, with a forfeiture of the lienor's lien if the statement is not furnished under oath within 30 days. Fl. St. §713.16.

⁷⁴ For a blunt criticism of the Florida Construction Lien Law by an appellate court of that state, see *American Fire and Casualty Company v. David Water & Waste Industries, Inc.*, 358 So. 2d 225, 225 (Fla. App. 1978). The Texas Supreme Court has remarked that its state's mechanics lien statutes "are very lengthy, have been subjected to several revisions, and are not exactly a model of clarity." *First National Bank in Graham v. Sledge*, 653

nearly a century of Louisiana legal tradition in order to embrace a statute of another state. That is not to say, however, that specific concepts of other states' law are unworthy of consideration for inclusion in the Act. In the course of its on-going review of the Act, the Committee will continue to consult the laws of other states and will remain open to suggestions from interested parties of specific concepts that merit consideration.

ESCROW AND RETAINAGE REQUIREMENTS⁷⁵

Parties to a construction contract may mitigate risks inherent in large-scale building projects through a variety of means. From the owner's perspective, a significant risk in any construction contract is that the contractor will not properly and timely complete the work he has contracted to perform. To guard against the risk of non-performance, owners commonly withhold a percentage from each progress payment made to the contractor. Payment of the withheld portion—known as a "retainage"⁷⁶—is delayed until the work has been satisfactorily finished and proof is furnished that no privileges have been or will be filed. Likewise, it is customary for a construction lender to hold back, and not advance, a percentage of the loan proceeds until it receives evidence that the work has been satisfactorily finished and no privileges have been or will be filed. In recent years, the practice of withholding retainage has been called into question,⁷⁷ as groups representing the construction industry have sought to persuade state legislatures to protect contractors and subcontractors against what they perceive as the unfairness inherent in retainage provisions.⁷⁸ In several states, this effort has succeeded in persuading state legislatures to respond with legislation. In 2010, the Louisiana Legislature enacted R.S. 9:4815,⁷⁹ essentially requiring that in most construction contracts retainage must be deposited on an on-going basis by the owner into an interest-bearing escrow account under the control of an escrow agent. The 2010 legislation did not, however, explicitly address whether this requirement is one of public policy. In the 2012 regular session, proposed legislation was introduced, but not enacted, to prohibit the parties from agreeing to a waiver of these statutory provisions.⁸⁰

One question the Committee considered is whether the escrow requirement of R.S.

S.W. 2d 283, 285 (Tex. 1983).

⁷⁵The reporter gratefully acknowledges the contributions of Committee members Professor Elizabeth Carter of the LSU Law Center faculty and Adam J. Swensek in the research for and principal drafting of numbered sections 1 through 3 of this portion of the report.

⁷⁶See e.g. Joseph T. Getz & Michael I. Less, 27 TENN. PRAC. CONST. LAW §2.26 (2012 ed.) ("Retainage is the contract amount withheld by the owner...from the person or entity they have agreed to pay for labor, materials, or other services."); David E. Rosengren, 13 CONN. PRAC., CONSTRUCTION LAW §1.9 (2012 ed.) ("Retainage is a portion of a contractor's earned funds that is withheld from each progress payment until the project is complete"). See also C. Kelly Skraback & Heather A. Jones, *The State of Retainage*, CONSTRUCTION BRIEFINGS, No. 2005-4 (April 2005).

⁷⁷See e.g. *States Debate Retainage and Payment Laws*, 34 CONSTRUCTION CONTRACTS LAW REPORT 117 (2010); Dennis C. Bausman, *Retainage Practice in the Construction Industry*, Foundation of the American Subcontractors Association, Inc. (2004), available at:

<https://www.asaonline.com/eweb/upload/Retainage%20Report%20for%20CKD.pdf>

⁷⁸See *Retainage - It Gets the Job Done*, The Surety & Fidelity Association of America, available at: <http://c.ymcdn.com/sites/www.surety.org/resource/resmgr/govrel-pub/retainagedoc.pdf>

⁷⁹Acts 2010, No. 638.

⁸⁰SB 340 of 2012.

9:4815 implicates a matter of public policy and, thus, should not be susceptible of waiver by the parties. However, this question is really part of a larger question: *whether the Act should address retainage, and, if so, how?* In its analysis of these questions, the Committee considered the effect of actual retainage practice and, in turn La. R.S. 9:4815, on the overall balance of competing interests sought to be achieved by the Act.

1. Modern Retainage Practice and Criticisms

Historically, owners and their lenders have used retainage provisions to ensure timely and satisfactory completion of a construction project.⁸¹ In particular, owners rely on retainage to create a reserve of funds to complete the work in the event of a contractor's breach or insolvency.⁸² The holdback of retainage also serves as a mechanism to guard against the risk that a general contractor is not paying its subcontractors and suppliers. This practice obviously benefits owners and their lenders. It also benefits bonding companies.⁸³ From the perspective of contractors, this benefit comes at their detriment.⁸⁴

It should be observed that there is no practice of retainage that is uniformly followed in the private works context.⁸⁵ Traditionally, retainage of ten percent was withheld from each progress payment; however, five percent retainage provisions are now common. Retainage is not necessarily withheld on all progress payments; often no additional retainage is withheld, or the percentage withheld decreases, after a certain point in the construction process. Through bargaining, the parties sometimes agree that retainage will not be withheld on large items that represent significant cash outlays contractors must pay to third party suppliers. Practices differ as to when retainage is released: whether at substantial completion, at final completion, or at the expiration of the period allowed third parties to file statements of claims. Sometimes, contractors successfully bargain for no retainage at all.

One common criticism of retainage advanced by contractor and subcontractor groups is that current practices place an undue hardship on contractors and subcontractors—who some argue are in a weaker bargaining position than the owner. Critics of retainage feel that the burden of a retainage provision is passed down the line to the weakest—and least financially secure—party. In most retainage arrangements, the owner reduces each payment to the contractor by the amount of the negotiated retainage percentage,⁸⁶ which sometimes exceeds the

⁸¹ Richard A. Stockenberg & Jennifer S. Woodbury, *Retainage Revisited: A Time to Revise and Reform*, 16 CONSTRUCTION LAWYER 41, 41-42 (1996).

⁸² Bausman, *supra* note 77, at 1.

⁸³ See *Prairie State Nat. Bank v. U.S.*, 164 U.S. 227, 233 (1896) in which the United States Supreme Court observed that the proposition that "a stipulation in a building contract for the retention, until the completion of the work, of a certain portion of the consideration, is as much for the indemnity of him who may be guarantor of the performance of the work, as for him for whom the work is to be performed, that it raises an equity in the surety in the fund to be created . . . is amply sustained by authority." (citing the English case of *Calvert v. Dock Co.* (1838) 2 Keen, 638).

⁸⁴ Bausman, *supra* note 77, at 2.; Stockenberg & Woodbury, *supra* note 81.

⁸⁵ Bausman, *supra* note 77, at 5.

⁸⁶ *Inflexibility in Contracting and Retainage Practices Could Hurt Construction Industry*, Report No. 00-26, Florida Legislature Office of Program Policy Analysis and Government Accountability (hereinafter "OPPAGA Report") (Dec. 2000), available at <http://www.oppaga.state.fl.us/reports/pdf/0026rpt.pdf>; Bausman, *supra* at 2.

contractor's profit margin.⁸⁷ The contractor, in turn, often passes on the cost of his retainage to his subcontractors by withholding retainage on payments to the subcontractors for work they perform.⁸⁸ In some instances, a general contractor will withhold retainage from his subcontractors even in the absence of a contractual retainage requirement by the owner.⁸⁹

Contractors and subcontractors complain that retainage provisions negatively affect their cash flow, thus increasing the cost of doing business and increasing the likelihood of default and insolvency.⁹⁰ According to this view, retainage provisions may actually increase the risk of the occurrence of the exact contingencies for which they are designed to afford protection. Some studies by contractor trade groups support these complaints, concluding that retainage "reduces profitability, increases borrowing costs, precludes investment in additional work or equipment, and increases contractor bankruptcies."⁹¹ Subcontractors who complete their work early in the construction project bear an even greater burden because they must sometimes wait until completion of the entire project before collecting their retainage.⁹²

Another common criticism of retainage leveled by contractors and subcontractors is that owners have begun to use retainage provisions for purposes beyond merely insuring against a contractor's insolvency or failure to perform in a timely manner. This shift has caused considerable controversy over the merits of retainage practice in the construction industry.⁹³ Three particular uses of retainage are specifically criticized by contractors and subcontractors: (1) the use of retainage to gain what some view as unnecessary and inappropriate protection for the owner; (2) use of retainage as leverage in later disputes; and (3) use of retainage as a form of interest-free financing.

The first two criticisms are illustrated by a common practice in the construction industry. Specifically, owners often use retainage to insure against faulty work discovered after the completion of the project.⁹⁴ A retainage provision may allow the owner to refuse to deliver the retainage in the event of some defect or poor performance. Some critics argue that this type of provision provides the owner with unnecessary and inappropriate protection. Specifically, these critics argue that the practice is an improper substitute for existing legal remedies directed at protecting the owner while striking a fair balance between the interests of the owner and the contractor.⁹⁵ In their view, the law already provides an owner ample protection in the form of warranties and contractor liability for faulty construction.⁹⁶ These critics believe that retainage provisions used in this manner may circumvent the process established by law and upset the

⁸⁷ Bausman, *supra* note 77, at 2.

⁸⁸ OPPAGA Report, *supra* note 86; at 2; Bausman, *supra* note 77; at 2.

⁸⁹ Bausman, *supra* note 77 at 2.

⁹⁰ *Best Practices Guidance for Retainage*, Associated General Contractors of America: Special Contractors Council (hereinafter "AGCA") (Oct. 2009) available at: <http://www.agc.org/galleries/about/SCC%20Best%20Practices%20Guidance%20for%20Retainage.pdf>; Bausman, *supra* note 77, at 2.

⁹¹ Bausman, *supra* note 77, at 8.

⁹² See Bausman, *supra* note 77, at 8; OPPAGA Report, *supra* note 86; at 2.

⁹³ Bausman, *supra* note 77, at 1.; Stockenberg & Woodbury, *supra* note 81.

⁹⁴ See Stockenberg & Woodbury, *supra* note 81. See also Skraback & Jones, *supra* note 2.

⁹⁵ See Stockenberg & Woodbury, *supra* note 81, at 41; Skraback & Jones, *supra* note 2, at FN 5.

⁹⁶ Stockenberg & Woodbury, *supra* note 81, at 41.

balance the law seeks to strike. They see an owner's unilateral action in deciding to withhold retainage on account of allegedly defective work as a means of shifting the owner's burden of proving faulty work. A contractor could certainly dispute the owner's contention in court—but it is argued that the effect of the retainage provision is to reverse the balance of power and interests struck by the law.

Using a retainage provision as a form of insurance against faulty work gives rise to a second major criticism made by contractors and subcontractors: that owners use retainage as leverage to resolve later disputes. Although having leverage in a negotiation does not necessarily implicate a policy concern, contractors and subcontractors claim that this practice often turns abusive.⁹⁷ Contractors claim that some owners arbitrarily refuse to pay retainage or refuse to pay retainage even if the defect or poor performance does not fall within the scope of the contractor's control or responsibility.⁹⁸ In the view of contractors, owners use retainage as leverage to force the contractor to either remedy the work at his own cost or agree to some other unfavorable terms.⁹⁹ Contractors and subcontractors also complain that owners withhold retainage to gain leverage in disputes over claims or charges for additional work or to force a settlement agreement that is unduly favorable to the owner.¹⁰⁰ Although the contractor can seek redress in court, he has a disincentive to do so because of the time and costs associated with litigation and also because of the continued negative effect on his cash flow resulting from the owner's withholding of retainage.

Another complaint made by critics of retainage is that it functions as a source of interest-free financing for the owner.¹⁰¹ "In essence, retainage operates partially to finance an owner's project by permitting the owner to withhold (and use) a percentage of a contractor's profits until the project is substantially complete."¹⁰² This practice is criticized for several reasons. For example, the contractor bears the risk that the owner will become insolvent before the contractor is able to collect the retainage.¹⁰³ Moreover, retainage may result in a cash-flow problem for the contractor. As one survey explained: "What was particularly offensive to some was that if a contractor reported income based upon the percentage of completion method, they [*sic*] were actually paying income tax on funds not yet received, thereby further aggravating the cash flow burden."¹⁰⁴

Not surprisingly, owners and lenders disagree with contractors and subcontractors on the scope of these problems and whether they are abusive.¹⁰⁵ In their view, "[r]etainage is often the only leverage the lender and the borrower have to guarantee adequate and complete performance of contracts and subcontracts."¹⁰⁶ Toward the end of the project, the retainage gives the

⁹⁷ Bausman, *supra* note 77, at 23.

⁹⁸ *Id.*

⁹⁹ *See id.*

¹⁰⁰ *Id.*

¹⁰¹ Bausman, *supra* note 77, at 8.

¹⁰² Skraback & Jones, *supra* note 2, at FN 4.

¹⁰³ Bausman, *supra* note 77, at 8.

¹⁰⁴ *Id.*

¹⁰⁵ Bausman, *supra* note 77, at 23.

¹⁰⁶ Dianne S. Coscarelli, *The Construction Loan Agreement: Six Provisions Important to Lender's Counsel*, 15 PROB. & PROP. 30, 30 (2001).

contractor a much more powerful incentive to complete the work than the remaining contract balance.¹⁰⁷ Owners argue that late completion or defective work exposes the owner to significantly higher interest expense until the work is completed, in addition to the cost of correcting faulty work, and that "ten percent retainage with respect to contractor and subcontractor payments is a small hedge indeed against these risks."¹⁰⁸ An owner also faces the obvious risk of personal liability and a charge on his property if the contractor or those working under him fail to pay for services or supplies; retainage is viewed as a ready source of security against this risk. Owners challenge the notion that the elimination of retainage will result in reduced construction costs, asserting that not only would the amount they borrow during construction have to increase if retainage were eliminated, but the rate of interest itself would increase since construction lenders would perceive increased risk.¹⁰⁹ Owners also take issue with the premise that retainage represents the contractor's money, pointing out that the contractor is not delivering a finished product when he is paid each progress payment, but rather is being paid for a work in progress, the final completion of which may be months away.¹¹⁰

Both owners and bonding companies disagree with the argument that surety bonds are an effective substitute for retainage. Owners see recourse against a surety bond as a cumbersome and expensive remedy.¹¹¹ In arguing against efforts to eliminate retainage, bonding companies point out that they actually rely on the presence of retainage in gauging their own risk, and that the cost of bonds is decreased by the presence of retainage.¹¹²

As a matter of prudent lending practices or regulatory requirements, the vast majority of construction lenders require in their loan documents a holdback of a percentage of the value of the work completed. Because the completed project is the lender's collateral for the loan, the lender has a vested interest in lien-free completion of the project. Lenders have argued that a mandatory law eliminating or prohibiting retainage, or requiring escrowed retainage, would cause the cost of borrowed funds to increase and would impede financing of projects.¹¹³

2. Legislative Responses

Many jurisdictions have considered modern retainage practice in both the public and private works context. In response to the concerns listed above, a number of states have enacted legislation seeking to effect what they consider to be a better balance of the interests of the owners and contractors. Several legislative approaches are common: (1) statutory limits on the amount of retainage; (2) time-related limits on retention of retainage and/or prompt pay acts; and (3) requirements of the use of escrow accounts for retainage.¹¹⁴ Many states use more than one

¹⁰⁷ The Surety & Fidelity Association of America, *supra* note 78.

¹⁰⁸ Joseph Colagiovanni, Retainage: Myth and Reality, American Bar Association Forum on the Construction Industry (2002), available at: <http://www.legalist.com/aba/sf/speakers/colagiovanni/colagiovanni.pdf>

¹⁰⁹ *Id.* at 12-13.

¹¹⁰ *Id.* at 6.

¹¹¹ *Id.* at 10.

¹¹² The Surety & Fidelity Association of America, *supra* note 78.

¹¹³ See, e.g., *Escrow of Funds due under Contract and Non-waiver of Provisions by Owner or Contractor: Hearing on S.B. 340 Before S. Comm. Jud. A*, 2012 Reg. Sess. (statements of Julia Terry and David Boneno, S. Comm. Jud. A)

¹¹⁴ Stockenberg & Woodbury, *supra* note 81.

approach. Some state statutes explicitly state that their retainage rules are a matter of public policy and may not be waived.¹¹⁵

(a) Statutory Limits on the Amount of Retainage.

Perhaps the most popular legislative approach to addressing retainage issues is a statutory limit on the amount of retainage allowed in any contract. However, there is substantial variation in this approach. Some states impose limits only at the owner-contractor level. Some states extend protection to subcontractors. Most states providing for a statutory limit on retainage make the limit non-waivable. For example, Connecticut prohibits retainage provisions in excess of five percent.¹¹⁶ Idaho similarly limits retainage to five percent but provides for an exception when the contractor fails to provide a performance bond—in which case the limit is inapplicable.¹¹⁷ Idaho explicitly provides that waiver of the five percent limit violates public policy.¹¹⁸ Maryland limits retainage to five percent and extends the limit to subcontractors as well as providing some additional protections.¹¹⁹ Minnesota allows retainage up to five percent unless the contract provides otherwise.¹²⁰ Montana limits retainage to five percent and further limits the retainage that a contractor may withhold from a subcontractor to the same amount that the owner withheld from the contractor.¹²¹ North Carolina does not impose any limit on retainage generally, but does limit a contractor's withholding from subcontractors to the amount of the owner's retainage on the contractor.¹²² Alabama and North Dakota both limit retainage to ten percent until the work is fifty percent complete, at which point no further retainage is allowed.¹²³ Utah limits retainage to five percent and limits the ability of contractors to withhold retainage from subcontractors.¹²⁴

On the other hand, Texas actually *requires* an owner to retain ten percent of the contract price in any project in which a mechanic's lien could be claimed.¹²⁵

(b) Time-Related Limits on Retention of Retainage and/or Prompt Pay Acts

Prompt Pay Acts (PPAs) are another popular legislative response.¹²⁶ Many states have

¹¹⁵ See e.g. AL. CODE §8-29-3, §8-29-5 (imposing an interest penalty for late payment of retainage and prohibiting waiver of the right to receive interest in advance); CAL. CIV. CODE §8714; §8820; IDAHO CODE §26-115(6) (*providing*: "It shall be against public policy for any party to require any other party to waive any provision of this statute."); TENN. CODE §66-34-101; -701 (limiting retainage to 5%, imposing civil and criminal penalties for late payment or noncompliance, requiring an escrow account in some circumstances, and prohibiting waiver). UTAH CODE §13-8-5 (limiting retainage to 5% and imposing penalties for late payment) ("A party to a construction contract may not require any other party to waive any provision of this section.")

¹¹⁶ CONN. GEN. STAT. §42-158K

¹¹⁷ IDAHO CODE §29-115

¹¹⁸ *Id.*

¹¹⁹ MD. CODE, REAL PROP. §9-304

¹²⁰ MINN. STAT. §337.10

¹²¹ MONT. CODE §28-2-211

¹²² NC GEN. STAT. §22C-4.

¹²³ AL. CODE §8-29-3; ND CENT. CODE §43-07-23.

¹²⁴ UTAH CODE §13-8-5.

¹²⁵ TEX. PROP. CODE §53.101.

¹²⁶ See e.g. ALA. STAT. §8-29-1 *et seq.*; ARIZ. REV. STAT. §32-1129 *et seq.*, FLA. STAT. 715.12, ME. REV. STAT. §1111, MD. CODE, REAL PROP. §9-301 *et seq.*, MISS. CODE §87-7-3, *et seq.*, NEB. REV. STAT. §45-1201 *et seq.*;

some form of PPA, but their scope varies significantly. These statutes specifically require prompt payment to contractors and subcontractors and are often written in a manner to include retainage. The statutes are generally gauged to address the concerns of contractors and subcontractors that owners and their lenders will intentionally withhold payments for as long as feasible. Failure to comply with a PPA usually results in penalties, interest, and payment of attorney's fees for the prevailing party. Many states prohibit waiver of the provisions of the applicable statutes in advance. For example, the Georgia Prompt Pay Act¹²⁷ requires payment to contractors and subcontractors within 15 days of receipt of any payment request for completed work.¹²⁸ The Georgia act also provides for interest on late payments and attorneys fees.¹²⁹ Maine's prompt payment laws require payment of retainage to the contractor within 30 days after final acceptance of the work and in turn require the contractor to pay to his subcontractors or material suppliers within seven days after receipt of the retainage, imposing interest, penalties, and liability for attorney's fees in the event of non-compliance.¹³⁰ Louisiana has not enacted any comparable legislation.

(c) *Retainage Escrow and Trust Accounts*

Although escrow of retainage is fairly common in public works legislation,¹³¹ only a few states specifically address the use of escrow and trust accounts for retainage in the private works context. Among those jurisdictions that do address the use of escrow accounts in the private works setting, approaches vary. In addition to Louisiana, California,¹³² Connecticut,¹³³ and Tennessee¹³⁴ mandate the use of escrow accounts for retainage in some circumstances. It appears that New Mexico required the use of escrow accounts for retainage in private works until 2007.¹³⁵

NEV. REV. STAT. §624.606 *et seq.*, PA STAT. §73:301 *et seq.*, S.C. CODE §29-6-10 *et seq.*, TENN. CODE §66-32-101 *et seq.*

¹²⁷ GEORGIA CODE §13-11-1 *et seq.*

¹²⁸ GEORGIA CODE §13-11-4.

¹²⁹ GEORGIA CODE §13-11-7, -8

¹³⁰ ME. REV. STAT. §1116

¹³¹ See generally, Richard A. Stockenberg & John M. Limbaugh, *Fifty-State Review of Retainage Laws*, 22 CONSTRUCTION LAW 24 (2002).

¹³² California requires owners in large construction projects to provide security to contractors in the form of a bond, escrow account, or irrevocable letter of credit. The security requirement is not limited to construction contracts involving retainage. The requirement is expressly a matter of public policy and cannot be waived. Cal. Civ. Code §8700 *et seq.*

¹³³ Connecticut General Statute §42-158p provides that "[a]n escrow account shall be required for all retainage..." Although the statute does not explicitly address whether this requirement is a matter of public policy, the statute does impose a 1.5% penalty on the owner for failure to deposit or release retainage. Conn. Gen. Stat. §42-158p. Connecticut General Statute §42-158k affords additional contractor protection by prohibiting construction contracts providing for retainage in excess of five percent. Further, a party seeking to enforce any provision of the Connecticut retainage law may be awarded court costs and attorney's fees. Conn. Gen. Stat. §42-158r.

¹³⁴ The Tennessee Prompt Pay Act, Tenn. Code §66-34-101 *et seq.*, requires retainage be placed in an escrow account for certain construction contracts. Tenn. Code §66-34-104. The requirement cannot be waived by contract. Tenn. Code §66-34-701. Penalties, interest, and criminal sanctions may be imposed for non-compliance with the Act. Tenn. Code §66-34-103; 66-34-104.

¹³⁵ NEW MEX. STAT. §57-28-4 (*repealed* June 14, 2007)

Contractors and subcontractors maintain that requiring the deposit of retainage into an escrow account protects their rights in the funds while simultaneously accomplishing the incentivizing goals of the owner/lender.¹³⁶ From the contractor's perspective, an escrow account provides significant protection from cash flow problems that an owner might experience. If the funds are in escrow the owner cannot use them to inappropriately finance other projects. Perhaps most importantly, the escrow account provides the contractor with significant protection in the event of an owner's bankruptcy because the escrowed funds will not be property of the debtor/owner's estate.¹³⁷ But these benefits do not come without cost. Because construction lenders typically do not fund retainage during construction, the owner must do so out of his own funds, in addition to having to fund his equity investment in the property. There is also an expense in maintaining the escrow, compensating the escrow agent, and finding a title company or other institution willing to take on the responsibilities and potential liabilities of an escrow agent. Moreover, in the face of conflicting instructions from the owner and contractor, a prudent escrow agent might be expected to convoke a concursus against the owner and contractor, who would then be put to the expense of litigating over the funds and of compensating the escrow agent for his litigation expenses. Finally, the escrow of retainage due to a contractor on account of a subcontractor's work does not, in and of itself, protect the subcontractors or suppliers. Just as a contractor may be worried that an owner's cash flow will be diverted to other projects, owners and their lenders may have concerns that a contractor will not appropriately use advances to pay his subcontractors and suppliers on the project in question.

3. Louisiana's Current Approach

In Louisiana, R.S. 9:4815, which imposes an escrow requirement, appears to be the *only* statute aimed at protecting the interests of contractors in withheld retainage on private works projects. Unlike other states that have sought to provide statutory protection to contractors, Louisiana does not impose a statutory limit on retainage in the private works context, nor has Louisiana enacted a PPA. Even the escrow requirement is subject to wholesale exemptions of a wide array of industries. It is significant that the Louisiana escrow provision fails to provide any enforcement mechanism or penalty for non-compliance.

4. The Issue of Waiver

The unsuccessful proposal in 2012 to amend the Act to provide that its escrow requirements are not waivable¹³⁸ arose from a recognition that, since 2010, a number of owners and contractors have agreed upon a waiver of those escrow requirements.¹³⁹ This practice gives rise to both the interesting *legal* question of whether the escrow requirements of the Act - as it is presently written - are waivable as well as the broader *policy* question of whether they should be

¹³⁶ Stockenberg & Woodbury, *supra* note 81, at 44-45.

¹³⁷ See e.g. *In re Jazzland, Inc.*, 322 B.R. 610 (E.D. La. 2005) (holding that retainage funds in an escrow account belonged to the contractor and were not property to the debtor/owner's bankruptcy estate under 11 U.S.C. §541).

¹³⁸ SB 340 of 2012.

¹³⁹ *Escrow of Funds due under Contract and Non-waiver of Provisions by Owner or Contractor: Hearing on S.B. 340 Before S. Comm. Jud. A*, 2012 Reg. Sess. (statements of Sen. Conrad Appel, III, S. Comm. Jud. A, and Derrell Cohoon).

waivable.

The ability of the parties to agree upon a valid waiver of the escrow requirements depends on whether R.S. 9:4815 imposes a suppletive or an imperative rule. If the law is suppletive, it can be waived by agreement of the parties. If it establishes an imperative rule – one rooted in public-policy considerations – it cannot.¹⁴⁰ Louisiana courts balance two factors when considering whether laws are suppletive or imperative.¹⁴¹ The first considers whether the language of the statute states the rule in unequivocal, imperative terms or whether the law is merely directive or contains a limiting proviso, such as "unless otherwise stipulated" or "except as otherwise provided."¹⁴² The other factor – espoused "by those with reservations about the consistency of legislative drafting" – examines the content of the statute to determine whether the rule is directed to the protection of an interest vital to the public order.¹⁴³

Applying these principles, it might be argued that, as R.S. 9:4815 is presently written, the practice of waiver violates the express terms of the statute, which is framed in mandatory terms¹⁴⁴ and contains no provisos indicating that its dictates are subject to alternative agreements. Moreover, the law itself arguably presents a rule of public order, addressing perceived inequities within the construction industry. On the other hand, arguments could be made to the contrary. The Legislature's exemption of a wide range of construction projects from the escrow provisions of R.S. 9:4815, thus in effect waiving the escrow provisions for contractors in those projects, arguably suggests that the considerations that prompted it to enact the escrow requirements in 2010 might not rise to such a level of public order that they cannot be waived by the parties. The failure of the 2010 legislation to include either a penalty for non-compliance or express language making the escrow requirements non-waivable, as well as the Legislature's refusal to enact a bill in 2012 that would have expressly made the escrow requirements non-waivable, also might be cited in support of an argument of waivability. Additional support might be found in the fact that, under the Act and the cases interpreting it, other contractor rights, including the right to a privilege itself, can be waived.¹⁴⁵ This report expresses no opinion on the relative merits of these competing legal arguments; indeed, interpretation of the statute as written is a judicial function.

The broader policy question – whether La. R.S. 9:4815 *should* be waivable – involves a more complex series of considerations. Freedom of contract is one of the cornerstone principles of the Louisiana law of conventional obligations. It is enshrined in the Civil Code:

¹⁴⁰ *E.L. Burns Co. v. Cashio*, 302 So. 2d 297, 301 (La. 1974); *see also* La. C.C. art. 7.

¹⁴¹ *E.L. Burns Co.*, 302 So. 2d at 301.

¹⁴² *Id.*

¹⁴³ *Id.* For an example of a Civil Code article that uses, without qualification, the apparently imperative term "must," while at the same time explaining in a comment that the rule of the article is merely suppletive, *see* C.C. art. 2463 (buyer "must" bear the expenses of the sale).

¹⁴⁴ "When . . . a contract in the amount of fifty thousand dollars or more is entered into between an owner and a contractor and if in accordance with the terms of such contract funds earned by the contractor are withheld as retainage by the owner . . . such funds *shall* be deposited by the owner into an interest bearing account." La. R.S. 9:4815. For the meaning of the word "shall" as mandatory, *see* R.S. 1:3, and for an example of the Supreme Court's application of that provision to interpret a statute imposing a duty imposed upon an insurer, *see Oubre v. Louisiana Citizen's Fair Plan*, No. 2011-c-0097, 79 So. 3d 987, 997 (La. 2011).

¹⁴⁵ *See* discussion *infra*.

Parties are free to contract for any object that is lawful, possible and determined or determinable.

C.C. Art. 1971. Citing freedom of contract as a "bedrock" principle, the Supreme Court explained Article 1971 as follows:

[P]arties are free to contract for any object that is lawful, possible, and determined or determinable. La. C.C. art. 1971. "Freedom of contract" signifies that parties to an agreement have the right and power to construct their own bargains. In a free enterprise system, parties are free to contract except for those instances where the government places restrictions for reasons of public policy. The state may legitimately restrict the parties' right to contract if the proposed bargain is found to have some deleterious effect on the public or to contravene some other matter of public policy.¹⁴⁶

Of course, freedom of contract is not absolute, as the Civil Code itself recognizes in Article 7:

Persons may not by their juridical acts derogate from laws enacted for the protection of the public interest. Any act in derogation of such laws is an absolute nullity.

C.C. Art. 7. The comments to Article 7 of the Civil Code explain that it is "a self-evident proposition" that a private person may renounce a right or privilege unless renunciation is expressly or impliedly forbidden, affects the rights of others, or is contrary to public good. There are numerous instances in which the Legislature has limited parties' freedom of contract in order to promote some other strong public policy, most often where one party is viewed as being in a disparate bargaining position with respect to the other party¹⁴⁷ or where a certain contractual provision might impair a party's ability to earn a livelihood.¹⁴⁸ There are instances in which this has occurred in the law governing building contracts.¹⁴⁹

¹⁴⁶*Barrera v. Ciolino*, 636 So.2d 218, 223 (La. 1994) (quoted and re-affirmed in *In re Katrina Canal Breaches Litigation*, 63 So.3d 955 (La. 2011)). See also *Salles v. Stafford, Derbes & Roy*, 137 So. 62 (La. 1931): "The policy of the law is that all men of lawful age and competent understanding shall have the utmost liberty of contracting, and their contracts, when freely and voluntarily made, are not lightly to be interfered with by the courts."

¹⁴⁷See, e.g., the Louisiana Consumer Credit Law, R.S. 9:3510 et seq., which limits rates of interest and provides other protections to consumers in loan transactions, specifically providing that "a consumer may not waive or agree to forego rights or benefits under this chapter except that a claim, if disputed in good faith, may be settled by compromise or agreement." R.S. 9:3513.

¹⁴⁸ See, e.g., R.S. 23:921 (limiting parties' freedom to contract for non-competition agreements).

¹⁴⁹ See, e.g., R.S. 9:2779, which prohibits parties to the contract for a public or private work involving construction in Louisiana from choosing the law of another jurisdiction to govern their dispute, or from choosing an out-of-state forum to resolve a controversy arising out of the contract, if one of the parties is domiciled in Louisiana. A similar prohibition specifically applicable to public works appears in R.S. 9:2778. See also R.S. 9:2775, which invalidates clauses excluding claims for "consequential damages" in a contract for the sale of equipment or machinery to be incorporated in construction project.

The question of whether the escrow requirements of the Act should be non-waivable ultimately turns upon this issue: *do the public policy considerations that prompted the Legislature to enact the escrow requirements outweigh, and therefore justify an intrusion upon, the competing public policy of freedom of contract?*

As discussed at length above, contractors view retainage as a potential vehicle for abusive practices by owners. In some instances, they are also concerned about the possible risk of an owner's insolvency before final payment for work is made. These concerns have led to a proliferation of rules in other states designed to protect contractors. The policy arguments behind the enactment of those rules in other states were explored in detail in the discussion above and will not be repeated here. To the extent that those same concerns prompted the Legislature to enact R.S. 9:4815, contractors would make the policy argument that it would be incongruous indeed for the Legislature to enact a rule to protect contractors from what they view as abusive retainage practices by owners but nonetheless permit those same owners to insist that these statutory protections be waived.

Owners might counter with an observation that the law permits any Private Works Act claimant to waive his privilege.¹⁵⁰ Indeed, by his mere failure to record notice of a contract having a price of more than \$25,000,¹⁵¹ the contractor effectively waives his privilege. Owners might contend that a much starker incongruity would exist if a contractor had the ability under the Act to waive his privilege outright but did not have the ability, if he so chooses, to waive the benefit of the escrow provisions of R.S. 9:4815. Owners might also observe that, from the standpoint of the contractor, a building contract is *always* a commercial transaction and that it is the type of transaction that is central to his business. Thus, owners would urge that contractors can be expected to know and understand the governing legal principles and to be guided accordingly in making an intelligent decision as to whether or not to agree to a waiver of the escrow requirements. Finally, owners might argue that making the escrow procedure non-waivable in all cases might have the unintended effect of impairing the ability of certain owners to contract for improvements to their property, even with a contractor who would otherwise be willing to waive the benefit of the escrow procedures. Construction lenders typically do not fund retainage; thus, the owner must pay the retainage from his own funds. Making the escrow provisions non-waivable would mean that those owners who for one reason or another have insufficient cash to fund retainage as work progresses would simply not be able to contract at all.

Of course, the weight of the public policy arguments for mandating escrow arrangements considers only one side of the scale: on the other side weighs the principle of freedom of contract. Arguments are made that retainage is "a method that has been developed through the open and competitive private marketplace"¹⁵² and that, even if abuses are found in retainage, "they should be addressed in contract terms in the marketplace."¹⁵³ Allegiance to the principle of freedom of contract is not an issue that neatly divides owners from contractors. Indeed, during the Senate committee's consideration of SB 340 of 2012, which would have included express

¹⁵⁰See, e.g., *Wardlaw Bros. Garage v. Thomas*, 19 La. App. 241 (1932).

¹⁵¹R.S. 9:4811(D).

¹⁵²Colagiovanni, *supra* note 107, at 14.

¹⁵³The Surety & Fidelity Association of America, *supra* note 78.

language in the Act making its escrow requirements non-waivable, one senator, identifying himself as a general contractor, voted against the bill, commenting that retainage is a term of contract that should not be subject to governmental interference.¹⁵⁴

It should be observed that, even if the contractor has the ability to waive the escrow requirements of R.S. 9:4815, a waiver of those requirements does not result in a waiver of the claims or privileges of subcontractors, laborers, suppliers, or other Private Works Act claimants. No provision of the Act permits a contractor to waive the claims or privileges of other persons who furnish services or supplies in connection with a work, nor are those claims or privileges dependent on either retainage or the placement of retainage into escrow. Regardless of whether retainage is funded into an escrow account, subcontractors, suppliers, and other Private Works Act claimants will nonetheless still be protected under the core provisions of the Act by the personal claim they have against the owner as well as the privilege upon his property.¹⁵⁵ Moreover, even if the escrow requirements are waived, the contractor himself will still have the benefit of his personal claim against the owner as well as a privilege upon the owner's property securing the remaining amounts due to the contractor.

It is readily apparent that the issue of whether the escrow requirements of R.S. 9:4815 should be susceptible of waiver by the parties to a construction contract involves a multitude of conflicting interests and policy arguments. Though the Committee has given due consideration to those arguments, and has attempted to illuminate the competing concerns in this report, it was ultimately led to the conclusion that the underlying policy judgment is one that should be entrusted to the competence of the Legislature itself, as the elected representatives of the people.

CONCLUSION

The Private Works Act works well in furthering its fundamental goal of protecting persons who contribute to the improvement of an immovable so that an owner or his creditors do not appropriate the value of their efforts without compensating them. The Act provides a unified set of largely cohesive rules that delicately balance the interests of owners, lenders, contractors, and other persons providing services or supplies in connection with private works. However, the Law Institute has identified a number of areas in which technical changes are warranted to eliminate unintended consequences of certain amendments that have been made to the Act over the last three decades, to state more precisely the substance of a number of those amendments, to harmonize conflicts that have arisen between provisions of the Act as amended, and to modify certain provisions of the Act in order to better achieve their purpose. Following its well-established process for drafting legislation of this importance, the Law Institute intends to make recommendations to the Legislature in the form of specific changes to the Act after having fully considered each of the issues presented and how best to address them. However, the policy judgment of whether the escrow retainage requirements of the Act should be susceptible of waiver by the parties is one best determined by the Legislature itself.

¹⁵⁴ *Escrow of Funds due under Contract and Non-waiver of Provisions by Owner or Contractor: Hearing on S.B. 340 Before S. Comm. Jud. A, 2012 Reg. Sess.* (statement of Sen. Jack Donahue, S. Comm. Jud. A).

¹⁵⁵ R.S. 9:4802.