# STATUTORY PAYMENT BONDS UNDER THE LOUISIANA PUBLIC WORKS ACT: NO PAY-WHEN-PAID DEFENSE PERMITTED

By
JAMES A. PRATHER
CHRISTIE L. LAPORTE*

GALLOWAY JOHNSON TOMPKINS BURR & SMITH, PLC
#3 Sanctuary Boulevard, Suite 301
Mandeville, Louisiana 70471
Telephone: (985) 674-6680
Facsimile: (985) 674-6681
Email: jprather@gjtbs.com

## 1. Purpose of the Statutory Bond under the Louisiana Public Works Act

Unlike the remedy afforded by its counterpart, The Private Works Act, The Louisiana Public Works Act, La.R.S. 38:2241 et seq., does not permit a claimant to file a lien against land owned by the public entity. Instead, The Public Works Act protects those performing work or furnishing materials for public works projects by requiring that the general contractor furnish a surety bond of not less than fifty percent of the project's value for payment by the contractor to claimants on the contract.[1]

Further, The Louisiana Public Works Act is considered to be *sui generis*, or unique. Its provisions afford the exclusive remedies to potential claimants.[2] Nonetheless, claimants must still adhere to strict procedural guidelines of the Act, which require notice of a pending claim and subsequent recordation of that claim prior to bringing suit.[3] The bond issued pursuant to The Public Works Act also aims to insulate the public entity from suit, loss, or expense arising from the contractor's failure to pay.[4] Thus, a public entity can be held liable under a public works action, only when a surety is insolvent or insufficient, or when the governing authority fails to pay claimants with recorded claims in preference to the general contractor.[5]

## 2. Development of the Public Works Act concerning a Surety's Payment Defenses

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* James Prather is a Director with Galloway, Johnson, Tompkins, Burr & Smith and Christie Laporte is an Associate with the firm's Mandeville office. *See* www.gjtbs.com.

1 La R.S. 38:2241.

2 *Orleans Parish School Bd. v. Scheyd, Inc.*, 737 So.2d 954, 958 (La.App. 4 Cir.,1999).

3 *Id.* at 957; *See also Daigle v. Donald M. Clement Contractor, Inc.*, 533 So.2d 1064, 1066 (La.App. 4 Cir.,1988); *Martin Marietta Materials of Louisiana, Inc. v. U.S. Fidelity and Guar. Co*., 940 So.2d 152, 157, 41,280 (La.App. 2 Cir. 9/27/06).

4 *Scott v. Red River Waterway Com'n*, 926 So.2d 830, 835, 41,009 (La.App. 2 Cir. 4/12/06); La. R.S. 38:2241.

5 *Continental Cas. Co. v. Caldwell*, 120F.2d 742 (1941); See also La R.S. 38:2241; *See also Wilkin v. Dev Con Builders, Inc.*, 561 So.2d 66, 71 (1990); and *Napko Corporation v. Marshall-Koehl, Inc. et al.*, 329 So.2d 472, 474 (La. App. Cir. 4. 1976).

In the event that a claimant satisfies the notice and recordation requirements, it can then proceed to enforce its rights against the surety's bond. Under suretyship law, however, the surety is generally not liable to a creditor unless and until the principal, or the initial obligor, becomes liable for the obligation and a surety is normally afforded any defense that the principal could assert. In effect, the surety is permitted to step into the shoes of the prime contractor.[6]

With public works contracts, a general contractor frequently executes contracts with various subcontractors for performance of specific scopes of work on the public project. The most typical form of contract utilized is the American Institute of Architects form, better known as an AIA contract. Typically, the AIA Subcontract agreement will condition payments to the subcontractor, especially final or retainage payments, upon the suspensive condition that the general contractor firstly receives payment from the Owner. This is commonly referred to as a "pay-when-paid" or "pay-if-paid" provision. These conditions permit the prime contractor to minimize its risk of financing the project by passing that risk along to the subcontractor.[7]

Prior to May 2011, Louisiana courts had not considered whether a surety could rely upon a "pay-if-paid" provision to defeat payment to a subcontractor on a Public Works project. While some states have permitted a surety to assert the defense where it has been incorporated into a state's payment bond provisions, the majority of states, however, have rejected these clauses as a defense to payment on a lien by the surety.[8] Now, Louisiana has also rejected this defense for public works contracts.

In *Glencoe Educ. Foundation, Inc. v. Clerk of Court and Recorder of Mortgages for Parish of St. Mary*, 65 So.3d 225, 2010-1872 (La.App. 1 Cir. 5/6/11), the Glencoe Charter School contracted with Lamar, the general contractor, to build a school in Franklin, Louisiana.[9] Thereafter, Lamar contracted with several subcontractors. After Lamar failed to pay some of the subcontractors, they filed Statements of Claim or Privilege. After a hearing on the merits of the subcontractors' claims, the trial court entered judgment in favor of two of the subcontractors in the full amount of their claim, plus interest and attorney's fees, and against Lamar's Surety, Hartford Casualty Insurance Company ("Hartford").

Hartford appealed to the Louisiana Court of Appeal for the First Circuit, not to contest the amounts owed, but to argue that it should not be liable to the subcontractors based upon the "pay-if-paid," suspensive conditions in the subcontractors' contracts[10] The specific provision of the subcontract provided the following language:

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[6] William Schwartzkopf, *Practical Guide Construction Contract Surety Claims*. Surety Defenses to Payment Bond Claims, § 7.01. *See also* William R. Joyce, Peter C. Halls, Thomas J. Vollbrecht, Julie P. Shelton, James J. Hartnett, Timothy M. O'Brien, Patrick M. Miller, Michael B. Lapicola, Bernard (B.J.) E. Nodzon, Mark A. Voigtmann, Patrick J. O'Connor, Rikke Dierssen-Morice, Carl R. Pebworth, and J. David Arkell are partners, and Stephen A. Wichern, Charles T. Switzer, Brian P. Clifford, Blake J. Lindevig, Evan A. Fetters, and Jason R. Lawrence, C.O.N.B.R.I.E.F. *2011 Construction Review*, Construction Briefings No. 2012-3 (March 2012).

[7] *Practical Guide Construction Contract Surety Claims* at p. 8.

[8] *See also Moore Brothers Company v. Brown & Root, Inc.*, 207 F.3d 717,723 (4th Cir. 2000); *Brown & Kerr, Inc. v. St. Paul Fire and Marine Insurance Company*, 940 F.Supp. 1245 (N.D. Ill. 1996); *OBS Company, Inc. v. Pace Construction Corporation*, 558 So.2d 404 (Fla. 1990); *Everett Painting Company, Inc. v. Padula & Wadsworth Construction, Inc.*, 856 So.2d 1059 (Fla.App. 4th Dist. 2003).

[9] *Glencoe Educ. Foundation, Inc. v. Clerk of Court and Recorder of Mortgages for Parish of St. Mary*, 65 So.3d 225, 2010-1872 (La.App. 1 Cir. 5/6/11), (writ denied 73 So.3d 383 (Mem), 384 (La. 2011).

[10] *Glencoe* at 230.

> Payment by Owner to General Contractor shall be a suspensive condition (condition precedent) to the obligation of the General Contractor to pay the Subcontractor. The Contractor shall not be obligated to make any payment to Subcontractor under this contract unless and until General Contractor from the Owner receives payments.[11]

Ultimately, the *Glencoe* Court held that a surety cannot rely on a "pay-if-paid" clause in a principal's subcontract to defeat its payment obligation.[12]

The *Glencoe* Court explained that the payment bond for public works serves to insure against unpaid claims by the parties supplying labor and materials.[13] Further, because the Public Works Act mandates that the public entity require the contractor to furnish a bond with a solvent surety, the payment bond is thus considered to be a statutory bond.[14] To that end, the bond requirements also serve to protect the public entity from loss and expense arising out of a contractor's failure to faithfully perform its contractual obligations.

**3. Potentially Different Outcome for Surety involved in a Private Works Claim**

Louisiana courts have, however, reached different results in suits involving a private works claim. The end result depends on whether the surety relies on a "pay-when-paid" or a "pay-if-paid" provision and how the provision is drafted in the subcontract. For example, in *Southern States Masonry, Inc. v. J.A. Jones Const. Co*.,[15] the subcontract provided the following payment provisions:

> 3. ... Contractor shall pay to Subcontractor, *upon receipt of payment from the Owner,* an amount equal to the value of Subcontractor's completed work, to the extent allowed and paid by Owner on account of Subcontractor's Work....
>
> 4. *Final payment.* A final payment, consisting of the unpaid balance of the Price, shall be made within forty-five (45) days after… (c) *final payment by Owner to Contractor under the Contract*.... (Emphasis added)[16]

After the owner filed bankruptcy in *Southern States,* subcontractors demanded payment for their completed work, but the contractor and its surety, Fidelity and Deposit Company of Maryland, relied upon the above provisions and refused to make final payments.

The *Southern States* case made it to the Louisiana Supreme Court, which ultimately held that the contract provisions were not suspensive conditions, but instead provided terms for payment, which only delayed the general contractors' obligations and only for a reasonable period of time.[17] Further, the Louisiana Supreme court reasoned that to construe the provisions as requiring the subcontractors to wait for payment for an indefinite period of time, or until

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11 *Id.* at 228.
12 *Id*.
13 *Id.* at 231.
14 *Id.* at 230.
15 *Southern States Masonry, Inc. v. J.A. Jones Const. Co.*, 507 So.2d 198, 205 (La.,1987).
16 *Id.* at 200.
17 *Id.*

payment from the owner, which may never occur, would give the provisions an unreasonable construction, which the parties did not intend at the time the subcontract was executed.[18]

On the other hand, in *Vector Elec. & Controls, Inc. v. JE Merit Constructors, Inc.*, the Louisiana Court of Appeal for the First Circuit found the terms of the subcontract before it clear and unambiguous in providing "condition precedent" language.[19] There, the language in the subcontract provided:

> Receipt of payment by [G.C.] from [Owner] shall be a condition precedent to the right of [Vector Electric/Subcontractor] to receive payment.

The *Vector* court held that the "condition precedent" language in the subcontract was clearly distinguishable from the terms of payment language found in the *Southern States* case. The subcontract before the *Vector* court mandated that until actual receipt of payment by the contractor from the owner occurred, the right of the subcontractor to receive payment from the contractor was premature. Thus, under private works claims, Louisiana Courts will consider the distinction between clauses that dictate the timing of *when* payments should occur and clauses that dictate events that must occur *if* payments are to be made when determining if payment from the contractor is premature.

**4. Conclusion**

A surety likely appreciates that it agrees to be bound with its principal, jointly and severally, upon its issuance of a payment bond. However, the *Glencoe* holding now prevents a surety, who has issued a statutory bond under the Louisiana Public Works Act, from relying upon a defense arguably afforded to the principal in the underlying contract. Thus, sureties, subcontractors, and suppliers performing services related to a Public Works contract should be cognizant that Louisiana, like the majority of jurisdictions, has now determined that a "pay-when-paid" or "pay-if-paid" clause cannot defeat or retard payment to a subcontractor under the Louisiana Public Works Act.

In addition, subcontractors and suppliers working on projects covered by the Private Works Act should pay careful attention to their contract's clauses concerning payments. Specifically, subcontractors and suppliers should consider whether a potential payment clause dictates when payment should be made or dictates events that must occur if payments are to be made.

The specific facts that apply to your matter may make the outcome different than anticipated by you. Thus, we recommend that you consult with an attorney familiar with the issues and the laws. For further information concerning this article, the firm of Galloway, Johnson, Tompkins, Burr and Smith invites you to contact its authors.

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[18] *Id.* at 205 *citing Thomas J. Dyer Co. v. Bishop International Engineering Co.*, 303 F.2d 655 (6th Cir.1962).

[19] *Vector Elec. & Controls, Inc. v. JE Merit Constructors, Inc.*, 2006 WL 3208462 (La. App. 1 Cir.).