

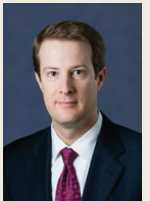


Lenders And Developers Need To Understand How Louisiana's Private Works Act Applies To Their Projects

A recent opinion from the United States Bankruptcy Court in Baton Rouge, Louisiana shows that even experienced lenders and developers may not always understand how Louisiana's Private Works Act applies to their project, and how much leverage a properly filed notice of contract can provide to a general contractor. Tuscany Reserve, LLC ("LLC") was formed by sophisticated developers for the purpose of developing a new apartment complex in Baton Rouge. LLC obtained acquisition and construction financing from a bank (1st Bank), which properly recorded its mortgage on the project before work commenced. LLC hired "Contractor" to build the complex; Contractor recorded its notice of contract in the parish mortgage records. As often happens, a dispute developed between LLC and Contractor regarding the work performed and lack of payment. Contractor stopped work and filed a lien on the property under the Louisiana Private Works Act for \$1.17 million. Contractor eventually agreed to cancel its lien in exchange for a promissory note and guarantees from LLC's principals and collateral provided by an LLC affiliate. Once the lien was cancelled, 1st Bank funded two draw requests on the construction loan. LLC needed more money for the project and turned to a new lender (2nd Bank) for additional financing. 2nd Bank secured its loan with a collateral mortgage on the immovable property for the project; there were no liens in the property records when 2nd Bank recorded its mortgage. The relationship between LLC and Contractor soon soured, again, and Contractor filed two liens on the project, one for the original claim amount, plus interest, and another for \$250,000.00. Contractor sued LLC and its principals on the matured promissory note, and also sued LLC based on its rights under the recorded construction contract and the Louisiana Private Works Act. LLC eventually filed for chapter 11 bankruptcy in the Middle District of Louisiana.

In LLC's bankruptcy case, Contractor initiated an adversary proceeding to determine the validity and priority of its lien vis-à-vis 2nd Bank's mortgage. The Bankruptcy Court applied the provisions of Louisiana's Private Works Act and found that the Contractor's liens ranked ahead of 2nd Bank's mortgage – even though the liens were filed later in time – because the liens' effective date relates back to the date the notice of contract was filed. The net result was that 2nd Bank's mortgage, filed when there were no liens on the project, ranked behind Contractor's claim for more than \$1.3 million.

2nd Bank made several arguments for why Contractor's liens should not relate back to the date the notice of contract was filed. 2nd Bank argued that Contractor's agreement to take a promissory note in lieu of payment after the first lien was filed, and Contractor's subsequent cancellation of its lien, was a novation of Contractor's claims and transformed those claims "from a construction contract claim secured by Private Works Act liens into an unsecured claim" based on the promissory note. The Bankruptcy Court disagreed. The Court found that the parties' agreement did not expressly state that a novation was intended, so no novation occurred. The original debt and related rights remained in place.



J. ERIC LOCKRIDGE
Partner
225.389.3756
eric.lockridge@keanmiller.com

The Court also rejected 2nd Bank's argument that Contractor abandoned its privilege by cancelling its initial lien and accepting LLC's promissory note and other consideration in payment of that debt. The Court noted that there is no authority for 2nd Bank's proposition that a contractor is barred from filing a second lien for the same work referenced in an earlier lien that the Contractor cancelled. So long as a notice of contract is on file, the contractor has the right to file a lien on the project, and that lien will outrank any mortgage put on the project after the notice of contract was filed. See *Shreve Land Constructors, LLC v. Tuscany Reserve, LLC, et al. (In re Tuscany Reserve, LLC)*, Adv. No. 10-1042 (Bankr. M.D. La., March 3, 2011).

How can a lender considering a new loan on an existing project avoid the same fate that befell 2nd Bank? First and foremost, thoroughly review the mortgage records before advancing funds. The absence of liens on the project does not necessarily mean that all is clear. If there is a notice of contract for the project in the mortgage records, the new lender should require the contractor to terminate that contract or subordinate its rights to the new lender as a condition of advancing funds.