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Construction Litigation Defenses in Iowa: A Checklist of Contractual and Statutory Defenses

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Stephen D. Marso

Available defenses to construction-related claims and lawsuits can be varied and many, depending on the specific facts in the dispute. Notwithstanding, there are a checklist of contractual and statutory defenses that attorneys should consider in defending a construction claim or lawsuit. This Article discusses some of these defenses under the American Institute of Architects (AIA) form contracts and under Iowa Code Chapters 572 and 573.

AIA FORM CONTRACTS

Approximately every 10 years, the AIA issues revised versions of its family of form contracts. The current version is the 2007 family of forms, which will be replaced in about one year with the 2017 family of forms. This Article will discuss some of the available defenses under the AIA A-201 (2007) General Conditions of the Contract for Construction between an owner and general contractor. [2]

- Waivers of subrogation (Section 11.3.7): this Section contains a waiver of subrogation provision. In general, a waiver of subrogation bars the injured party from seeking damages against an

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EDITORS

WHAT'S INSIDE

IDCA President's Letter

Noel McKibbin
IDCA President

Having just attended the Defense Research Institute (DRI) Leadership Conference, I thought it would be beneficial to describe the DRI and share a few of the ideas presented in the conference and by doing so illustrate the mutual benefits that an IDCA and DRI membership presents.

To introduce DRI, to those of you who may be unfamiliar, it is an organization of defense attorneys and in-house counsel. The DRI has 22,000 plus members and like IDCA they have a substantial committee structure representing substantive law topics. DRI also has a database of more than 65,000 experts.

DRI has served the defense bar for more than 50 years and focus on the five main goals, as follows:

1. **Education:** To teach and educate and to improve the skills of the defense law practitioner.
2. **Justice:** To strive for improvement in the civil justice system
3. **Balance:** To be a counterpoint to the plaintiff's bar and seek balance in the justice system in the minds of potential jurors on all fields where disputes are resolved.
4. **Economics:** To assist members in dealing with the economic realities of the defense law practice, including the competitive legal marketplace.
5. **Professionalism and Service:** To urge members to practice ethically and responsibility, keeping in mind the lawyer's responsibilities that go beyond the interest of the client to the good of American society as a whole.

The DRI mission statement provides that the DRI is the international membership organization of all lawyers involved in the defense of civil litigation. DRI is committed to: enhancing the skills, effectiveness, and professionalism of defense lawyers; anticipating and addressing issues germane to defense lawyers and the civil justice system; promoting appreciation of the role of the defense lawyer; and improving the civil justice system and preserving the civil jury.

As is apparent, that the DRI and IDCA are most compatible from an ideological view point. To further illustrate, IDCA has had three former Presidents that went on to be Presidents of DRI: Edward F. Seitzinger, Robert L. Fanter and most recently, J. Michael Weston. These former presidents of IDCA and DRI recognized the commonality of the respective organization's objectives and encouraged additional resource allocation and growth. DRI expands the IDCA networking opportunities and expands resource affluence. If you are not a member of DRI or IDCA, it would be a great investment in yourself to request applications.

Organizations—Why?

We all have talent and skills…so why do we need to be a member of any organization?

One of the reasons for being a member resides within the term community. Networking is a means that expands your community and provides to you opportunity. The sole practitioner or the multi-line adjuster who were able to singularly perform services to support themselves within their community are now considered an anachronism. Contemplate the impact of Netflix upon Blockbuster; Uber on cab companies; and any number of similar "world-shift" events that have taken place over a relatively short span of time. Social, economic, and technology changes have fueled the need to reinvent to stay relevant in our respective professions.

How does one reinvent to stay relevant? The answers are within your network community. This community likely has members who have already begun the analysis required to become more effective and efficient and thus more relevant within their respective businesses. The larger your community the more likely these ideas have expanded, multiplied, and aged to enable you to find means to ***reinvent and remain relevant*** in **your** business. Members' network and share ideas with other members of their community.

An excellent reason to be a member of IDCA and DRI.

Noel McKibbin

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at-fault party for a loss if insurance covers the loss. Iowa courts have concluded that public policy favor waivers of subrogation in construction contracts because they "'avoid[] disrupting the project and eliminate[] the need for lawsuits. . . ." *Fed. Ins. Co. v. Woodruff Constr.*, 2012 U.S. Iowa App. LEXIS 1023, at *15 (Iowa Ct. App. 2012) (quoting *Lexington Ins. Co. v. Entrex Comm. Servs., Inc.,* 749 N.W.2d 124, 135 (Neb. 2008)). As a result, Iowa has adopted the majority view that "make[s] no distinction between damages to 'work' and 'non-work' property. Instead, . . . [it] consider[s] whether the insurance policy was broad enough to cover damages to work and non-work property and whether the policy paid for the damages. If the answer to both questions is yes, the waiver applies." *Id*. at *8.

- Contractual limitations period (Section 13.7): although a statute of limitations is usually a matter of statutory law, see Iowa Code Section 614.1, the A-201 General Conditions has a contractual limitations period at Section 13.7. That Section requires all claims and causes of action to be initiated no later permitted under applicable law, "but in any case not more than 10 years after the date of Substantial Completion of the Work." Iowa courts enforce such contractual limitations periods. *Douglass v. Am. Fam. Mut. Ins. Co.,* 508 N.W.2d 665, 666 (Iowa 1993) (italics added) (citations omitted), *overruled on other grounds by Hamm v. Allied Mut. Ins. Co.,* 612 N.W.2d 775, 784 (Iowa 2000).

- Notice of claims (Section 15.1.2): this Section contains a claim-notice provision which requires claims to be "initiated by written notice to the other party and to the Initial Decision Maker with a copy sent to the Architect, if the Architect is not serving as the Initial Decision Maker . . . within 21 days after the occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later." Although Iowa appellate courts have not specifically addressed the enforceability of claim-notice provisions in construction contracts, other courts have held that they are enforceable. *Plumley v. U.S., 226 U.S. 545, 548 (1913); U.S. v. Cunningham*, 125 F.2d 28, 30-31 (D.C. Cir. 1941); *Cameo Homes v. Kraus-Anderson Constr. Co.,* 394 F.3d 1084, 1087-88 (8th Cir. 2005); *Buchman Plumbing Co. v. Regents of Univ. of Minn.,* 215 N.W.2d 479, 486 (Minn. 1974); see Intervision Sys. Techs. v. Intercall, Inc., 2015 Neb. App. LEXIS 168, at *7-*14 (Neb. Ct. App. 2015). Iowa case law suggests that Iowa appellate courts would enforce them too. *Dailey v. Holiday Distrib. Co.*, 151 N.W.2d 477, 487-88 (Iowa 1967) (holding that timely written notice of faulty conditions satisfied warranty=s notice provision); *Smith v. Am. Ins. Co.,* 198 N.W. 48, 50 (Iowa 1924) (holding that oral notice of cancellation of policy was ineffective where policy required written notice).

- Waiver of consequential damages (Section 15.1.6): this Section contains a mutual waiver of consequential damages, including in the context of termination. Iowa courts enforce such waivers. *Westbrook v. Reeves & Co.,* 111 N.W. 11, 14 (Iowa 1907); *Boone Valley Coop. Processing Assoc. v. French Oil Mill Mach. Co.,* 383 F. Supp. 606, 612 (N.D. Iowa 1974).

- (Another) contractual limitations period (Section 15.2.6.1): although Section 13.7 contains a contractual limitations period, as discussed above, Section 15.2.6.1 contains another (and shorter one). It requires a party to demand mediation within 30 days of decision by the Initial Decision Maker lest "both parties waive their right to mediate or pursue binding dispute resolution proceeding with respect to the initial decision." In conjunction with Section 15.2.5, the failure of a party to demand mediation within the 30-day period makes the initial decision final and binding on the parties. Although there is a paucity of cases addressing this provision, at least one court has held it is enforceable. *Key Restoration Corp. v. Union Theological Seminary*, 2014 N.Y. Misc. LEXIS 770, at *6-*11 (N.Y. Sup. Ct. 2014). Furthermore, if courts would enforce the claim-notice provision at Section 15.1.2 as discussed above, it is reasonable to conclude they would enforce this provision too.

IOWA CODE CHAPTER 572

Iowa's mechanic's lien statute is located at Iowa Code Chapter 572. It contains a variety of defenses that can be utilized in a mechanic's lien dispute.[3]

- Collateral security (Iowa Code Section 572.3): this Section precludes lien rights to those who "take any collateral security" on their contract "at the time of making a contract . . . or during the progress of the work." Obtaining personal guaranties from persons who are not obligated on the contract constitutes "collateral security" under the statute. *Builders Kitchen & Supply Co. v. Pautvein*, 601 N.W.2d 72, 72, 74-76 (Iowa 1999).

- Statute of limitations for perfecting lien (Iowa Code Section 572.9): this Section requires a claimant to post its lien within two years and ninety days "after the date on which the last of the material was furnished or the last of the labor was furnished." Failure to post a lien within the limitations period bars the lien claim. *Thorson v. Hoyland,* 2012 Iowa App. LEXIS 46, at *15-*16 (Iowa Ct. App. 2012).

- Extent of liens posted after 90 days (Iowa Code Section 572.11): under this Section, if a claimant posts its lien more than 90 days after the last date it furnished materials or labor (but within the two year and ninety day period in Section 572.9), the amount of the lien is limited "only to the extent of the balance due from the owner to the general contractor or from the owner-builder's buyer

to the owner-builder at the time of the service of such notice. . . ." If the amount owed at that time is zero, then the lien is worthless. *Griess & Ginder Drywall, Inc. v. Moran,* 561 N.W.2d 815, 816-17 (Iowa 1997).

- Owner notice on residential construction projects (Iowa Code Section 572.13): this Section applies only to residential construction projects, and it requires a general contractor to give a specified "notice in writing in boldface type of a minimum size of ten points" along with the "internet site address and toll-free telephone number of the mechanics' lien registry." A general contractor's lien rights are barred if it fails to comply with this notice requirement. See *Frontier Properties Corp. v. Swanberg,* 1992 Iowa Sup. LEXIS 272, at *6-*10 (Iowa 1992)(discussing prior version of Section 572.13 that used to be located at Section 572.13(2)); see also *Roger W. Stone, Mechanic's Liens in Iowa - Revisited,* 49 Drake L. Rev. 1, 28-30 (2000).

- Notice of commencement of work on residential construction projects (Iowa Code Section 572.13A): this Section applies only to residential construction projects, and it requires a general contractor or owner-builder to post notice of commencement "no later than ten days after commencement of work on the property," and to send it to the owner. A general contractor who fails to post or send a notice of commencement as required by the Section loses its lien rights. If a general contractor or owner-builder fails to post a notice of commencement, a subcontractor may post one and send it to the owner. Labor or materials furnished before the posting of a notice of commencement are not lienable.

- Subcontractor preliminary notice on residential construction projects (Iowa Code Section 572.13B): this Section applies only to residential construction projects, and it requires a subcontractor to post a preliminary notice. A subcontractor who fails to post the preliminary notice as required by the Section loses its lien rights. A subcontractor's lien is "enforceable only to the extent of the balance due the general contractor or owner-builder at the time of the posting of the preliminary notice," and, on property not owned by an owner-builder, is also "enforceable only to the extent of the balance due the general contractor at the time the owner actually received the notice. . . ." This is true even if a subcontractor posts its lien within 90 days of its last date of furnishing materials or labor. Iowa Code Section 572.14; see *Louie's Floor Covering, Inc. v. De Phillips Interests, Ltd.,* 378 N.W.2d 923, 925-27 (Iowa 1985) (discussion prior version of Section 572.13B that used to be located at Section 572.14(2)).

- Contractual limitations on owner's payment obligations (Iowa Code Section 572.16): this Section states that nothing in Chapter 572 shall be construed to "require an owner to pay a greater amount or at an earlier date than is provided in the owner's contractor with the general contractor, unless the owner pays a part or all of the contract price before the expiration of the ninety days" after the last date the subcontractor claimant furnished materials or labor. On residential construction projects, the same rule applies "unless the owner pays a part or all of the contract price to the general contractor after the owner receives" the preliminary notice required by Section 572.13B. Because most general contractors will require the owner to pay at least part of the contract price early in the project or require progress payments, this Section may not be applicable in most cases. However, the Iowa appellate courts have interpreted this Section to provide a potential signficant defense that is not apparent from the face of the Section. They have interpreted the Section as follows: "[W]here the principal contractor commits such a substantial breach that he is not entitled to payment, the right of the subcontractors to enforce their liens is also lost." *Central Iowa Grading, Inc. v. UDE Corp.,* 392 N.W.2d 857, 859 (Iowa Ct. App. 1986) (citing *Kawneer Mfg. Co. v. Renfro & Lewis,* 173 N.W. 899, 900 (Iowa 1919)); *Carson v. Roediger,* 513 N.W.2d 713, 716-17 (Iowa 1994) (approvingly citing to *UDE Corp.*).

- Statute of limitations for foreclosing lien (Iowa Code Section 572.27): this Section requires an action to foreclose a mechanic's lien to be brought within "two years and ninety days from the expiration of ninety days after the date on which the last of the material was furnished or the last of the labor was performed." *Keith Young & Sons Constr. Co. v. Victor Senior Citizens Housing, Inc.,* 262 N.W.2d 554, 556 (Iowa 1978); *U.S. v. Gomez,* 2004 U.S. Dist. LEXIS 31880, at *6 (N.D. Iowa 2004).

- (Another) statute of limitations upon serving demand (Iowa Code Section 572.28): under this Section, if an owner serves the lien claimant with a written demand to bring an action to foreclose the lien, then the claimant must bring the action within 30 days of service of the demand or it is barred. *Woodruff & Son v. Rhoton,* 101 N.W.2d 720, 722-24 (Iowa 1960); see *Emmetsburg Ready Mix Co. v. Norris,* 362 N.W.2d 498, 499-500 (Iowa 1985); *Barber Lumber Co. v. Celania,* 674 N.W.2d 62, 63 (Iowa 2003).

- Notice requirement on commercial construction projects (Iowa Code Section 572.33): this Section applies only to commercial construction projects, and it requires a "person furnishing labor or material to a subcontractor" to furnish a general contractor or owner-builder "in writing with a one-time notice" as described in the Section "within thirty days of first furnishing labor or materials for which a lien claim may be made," and then support its lien "with a certified statement" that it timely furnished the general contractor or owner-builder with the required notice.

IOWA CODE CHAPTER 573

Iowa's public construction lien statute is located at Iowa Code Chapter 573. Like its mechanic's lien cousin, it contains various defenses that can be utilized in a public construction lien dispute.[4]

- "Itemized" written claims (Iowa Code Section 573.7): this Section requires written claims to be "itemized." *Trs. of the Iowa Laborers Dist. Council Health & Welfare Trust v. Ankeny Cmty. Sch. Dist.,* 2011 Iowa App. LEXIS 924, at *18-*19 (Iowa Ct. App. 2011); see *McWater v. Ebone,* 350 S.W.2d 905, 906 (Ark. 1961) (discussing concept of itemized statement). Although a claim that is not itemized should be unenforceable, see *McGillivray Bros. v. Twp. of Barton,* 65 N.W. 974, 975 (Iowa 1896); *Indep. Sch. Dist. of Perry v. Hall,* 140 N.W. 855, 857 (Iowa 1913); *Francesconi v. Sch. Dist. of Wall Lake,* 214 N.W. 882, 884-85 (Iowa 1927), the Iowa Court of Appeals has effectively interpreted the "itemization" requirement out of Section 573.7. *Trs. of the Iowa Laborers*, 2011 Iowa App. LEXIS 924, at *10-*11, *18 (holding that union trust funds satisfied the itemization requirement by providing lump-sum amounts alleged to be owed each of them without breaking down the amounts at all and without providing any other information or documentation about the amounts).

- "Verified" written claims (Iowa Code Section 573.7): this Section requires written claims to be "verified," which means they must be supported by an oath, i.e., notarized. *Francesconi v. Sch. Dist. of Wall Lake,* 214 N.W. 882, 885 (Iowa 1927); *Trs. of the Iowa Laborers Dist. Council Health & Welfare Trust v. Ankeny Cmty. Sch. Dist.,* 2011 Iowa App. LEXIS 924, at *19-*20 (Iowa Ct. App. 2011). An unverified claim is unenforceable. *McGillivray Bros. v. Twp. of Barton,* 65 N.W. 974, 975 (Iowa 1896); *Indep. Sch. Dist. of Perry v. Hall,* 140 N.W. 855, 857 (Iowa 1913); *Francesconi,* 214 N.W. at 884-85.

- Prohibition on claims by certain materialmen (Iowa Code Section 573.7): this Section states that a "person furnishing only materials to a subcontractor who is furnishing only materials is not entitled to a claim" under the Chapter. *Star Equip., Ltd. v. State,* 843 N.W.2d 446, 455 (Iowa 2014); *Accurate Controls, Inc. v. Cerro Gordo County Bd. of Supervisors,* 627 F. Supp. 2d 976, 998 (N.D. Iowa 2009).

- Statute of limitations on filing claims (Iowa Code Sections 573.10 & 573.11): these Sections contain a limitations period along with two limited exceptions. The limitations period is found in Section 572.10(1), and it requires claims to be filed no later than "30 days immediately following the completion and final acceptance of the improvement." *Lumberman's Wholesale Co. v. Ohio Farmers Ins. Co.,* 402 N.W.2d 413, 415 (Iowa 1987). The first exception is found in Section 573.10(2), and it allows claims to be filed after expiration of the 30-day period "if the public corporation has not paid the full contract price. . . , and no action is pending to adjudicate rights in and to the unpaid portion of the contract price." This exception, however, is available only to those claimants who have contracts directly with the general contractor, *Lumberman's Wholesale Co. v. Ohio Farmers Ins. Co.,* 402 N.W.2d 413, 415 (Iowa 1987), and is only available to such claimants if there was at least one claim filed within the 30-day period. *Cities Service Oil Co. v. Longerbone,* 6 N.W.2d 325, 328-29 (Iowa 1942); *Iowa Supply Co. v. Grooms & Co. Constr., Inc.,* 428 N.W.2d 662, 667 (Iowa 1988); *Northwest Limestone Co. v. State Dep't of Transp.,* 499 N.W.2d 8, 11 (Iowa 1993); *Emp'rs Mut. Cas. Co. v. City of Marion,* 577 N.W.2d 657, 661-62 (Iowa 1998). The second exception is found at Section 573.11, and it says that a "court may permit claims to be field with it during the pendency of the action . . . if it be made to appear that such belated filing will not materially delay the action." *Emp'rs Mut.,* 577 N.W.2d at 662; *Longerbone,* 6 N.W.2d at 329. Logically, if the first exception in Section 573.10(2) is limited to claimants who hold contracts directly with general contractors and requires at least one claim to be timely field under Section 573.10(1), then the second exception Section 573.11 should also be so limited. Otherwise, it would effectively render section 573.10(2) meaningless or it would give a later-filing claimant under Section 573.11 greater rights than an earlier-filing claimant under Section 573.10(2).

- Notice requirements for claimants who furnish materials (Iowa Code Section 573.15): this Section says that "[n]o part of the fund due the contractor shall be retained . . . on claims for material furnished, other than materials ordered by the general contractor or the general contractor's authorized agent, unless such claims are supported by a certified statement that the general contractor had been notified within thirty days after the materials are furnished or by itemized invoiced rendered to contractor during the progress of the work, of the amount, kind, and value of the material furnished for use upon the said public improvement. . . ." This Section contains two notice options, one requiring notice within thirty days after the materials are furnished, and the other one requiring notice "during progress of the work." The "progress of the work" option is not limited by the 30-day period in the "30-day" option, *Eccon. Forms Corp. v. City of Cedar Rapids,* 340 N.W.2d 259, 264 (Iowa 1983), and it "ordinarily provides the last deadline for providing adequate notice, because that alternative does not expire until completion of the particular 'subproject' or 'that portion of the work in which the materials for which claim is made are utilized,' which may well be much more than thirty days after the materials were 'furnished.'" *Accurate Controls, Inc. v. Cerro Gordo Cnty. Bd. of Supervisors,* 627 F. Supp. 2d 976, 1003-04 (N.D. Iowa 2009). It refers to the "progress of that portion of the work in which the materials for which claim [was] made [were] utilized," *Lumberman's Wholesale Co. v. Ohio Farmers Ins. Co.,* 402

N.W.2d 413, 415 (Iowa 1987), it requires invoices to be provided to the "general contractor prior to completion of the particular subproject for which those material were supplied." *Marquart Block Co. v. Denis Della Vedova, Inc.*, No. 05-1952, 2006 Iowa App. LEXIS 1248, at *9 (Iowa Ct. App. 2006), and notice given under it is untimely if given after completion of the portion of the project involving the claimant's materials even though the overall project was not yet completed. *Lumberman's,* 402 N.W.2d at 415. A federal court in Iowa has held that Section 573.15 applies not only to claims made by suppliers (who furnish only material) but also to the material portion of claims made by claimants who provide both labor and material. *Accurate Controls,* 627 F. Supp.2d at 995-98. The federal court also concluded that Section 573.15 only exempted those material suppliers who furnished materials "by a direct request of the general contractor (or its authorized agent) to the material supplier, for example, pursuant to a contract directly between the general contractor and the material supplier or a purchase order directly from the general contractor to the material supplier," *id.* at 999, and that "substantial compliance" was not the proper standard by which to judge compliance with the notice requirements. *Id.* at 1004. , The federal court also held that the claimant itself is responsible for providing notice to the general contractor, and concluded that invoices provided by a claimant to its subcontractor, who in turn provided them to a general contractor, did not satisfy the notice requirements. *Id.* at 1005-06.

- Statute of limitations to bring action on claim (Iowa Code Section 573.16): under this Section, a claimant must file an action on its claim "at any time after the expiration of thirty days, and not later than sixty days, following the completion and final acceptance of said improvement. . . ." This limitations period is not only short (sixty days after completion and final acceptance of the improvement), *NW Limestone,* 499 N.W.2d at 11-12, but it also bars claimants from filing suit <u>too soon</u> (after expiration of thirty days following completion and final acceptance).

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[2]Many defenses available to an owner against a general contractor under the A-201 General Conditions are also available to a general contractor against a subcontractor, assuming the subcontract between the general contractor and subcontractor is the AIA A-401 Subcontract Agreement. Section 1.1 of the A-401 Subcontract Agreement makes all of the contract documents between the owner and general contractor part of the subcontract documents between the general contractor and subcontractor, and Article 2 flows down to the general contractor the defenses available to the owner under the general contract documents.

[3]For detailed articles on Iowa Code Chapter 572, see Roger W. Stone, Mechanic's Liens in Iowa, 30 Drake L. Rev. 39 (1980) & Roger W. Stone, *Mechanic's Liens in Iowa - Revisited,* 49 Drake L. Rev. 1 (2000).

[4]For a detailed article on Iowa Code Chapter 573, see Stephen D. Marso, *Public Construction Liens in Iowa: A History and Analysis of Iowa Code Chapter 573,* 60 Drake L. Rev. 101 (Fall 2011).

Overview of Public Bonding in Iowa

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Drew Gentsch

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When reviewing a bonded construction project in Iowa, there are many considerations that may arise. This article lays out some of the most common considerations. Note that this article is not meant to provide in-depth coverage of the topic, but rather a general overview.

Identifying the Type of Undertaking

Of course, the first step in the analysis is to determine whether the project is public or private. If it is private, it is important to note that Iowa does not have any statutory authority regarding payment bonds on private projects. Iowa's mechanic's lien statutes do, however, permit a party to bond off a lien and then proceed against the bond. The provisions of private bonds frequently track the language of the mechanic's lien statute. Nevertheless, it is imperative to analyze the contract language for a private project.[1] Public-project bonds will be governed by one of two statutes. If the project is federal, then the Miller Act will govern payment and performance bonds.[2] Bonding for state improvement projects, meanwhile, is governed by Iowa's Little Miller Act, which is located in Iowa Code Chapter 573. Iowa's Little Miller Act primarily protects suppliers and subcontractors. Contract remedies are generally the only remedies available for general contractors of public improvement projects. Additionally, Iowa's mechanic's lien statutes, Iowa Code Chapter 572, do not apply to public projects. Thus, subcontractors and suppliers on a public improvement must look to Chapter 573 for their remedies.

Because Iowa has no statutory requirements for bonding on private projects,[3] this article will focus on bonding for state projects.

Amount of Bond

Usually, a bond on a public improvement must cover at least 75 percent of the contract price of the project.[4] However, if no part of the contract price is paid until after the project is complete, then the bond need only cover at least 25 percent of the contract price.[5]

Projects Covered

Chapter 573 applies only to contracts for "construction" of a "public improvement" when the contract price exceeds $25,000.[6] In addition to its ordinary meaning, "construction" includes repair, alteration, and demolition.[7] A "public improvement" is an improvement whose cost "is payable from taxes or other funds under the control of the public corporation."[8] It is important to note that a project is a "public improvement" when it is paid for by any funds controlled by the public corporation; the funding need not come from taxes.

Labor and Material Covered

Claims may be filed by "any person, firm, or corporation who has, under a contract with the principal contractor or with subcontractors, performed labor, or furnished material, service or transportation, in the construction of a public improvement."[9] However, a person furnishing only materials to a subcontractor who has furnished only materials is not permitted to make a claim against the retainage or bond and is not a protected person under the bond.[10] Furthermore, health, welfare, and pension trusts are entitled to make claims under Chapter 573 "for unpaid sums which subcontractors on the public improvement were obligated to pay for their employees."[11]

In addition to the ordinary meaning of "materials," Chapter 573 defines "materials" to also include "feed, gasoline, kerosene, lubricating oils and greases, provisions and fuel, and the use of forms, accessories, and equipment."[12] The term does not include "personal expenses or personal purchases of employees for their individual use."[13]

The statute also defines "service," which, in addition to its ordinary meaning, includes "the furnishing to the contractor of workers' compensation insurance, and premiums and charges for such insurance shall be considered a claim for service."[14] Outside of the Chapter 573 context, courts have held that the term "services" is synonymous with labor,[15] and that "service" means "any result of useful labor which does not produce a tangible commodity."[16]

Finally, the statute originally required claims be for work done "for the construction of a public improvement." The statute now requires all claims be for work done "in the construction of a public

improvement."[17] The Iowa Supreme Court has held that, when the claim is one for material, the material must have been "used in any proper way in connection with the work of constructing the improvement." For practical purposes, this means that one can make a claim for things such as gasoline, oils, greases, and equipment used either in the improvement, or directly in connection with improvement, but the claimant must prove the "definite portion" of the material that actually went, directly or indirectly, into the improvement.[18]

Filing a Claim

All claims[19] must be filed "with the officer, board, or commission authorized by law to let contracts for such improvement."[20] The claims must be itemized, sworn, and in writing.[21] In practice, this means the claimant should submit a notarized affidavit that (1) provides a detailed statement of the claim and (2) contains the phrase "sworn to" or "under penalty of perjury."

Time of Filing Claim

Iowa Code section 573.10 gives claimants two[22] options. First, they may file at "any time before the expiration of thirty days immediately following the completion and final acceptance of the improvement. Second, they may file any time after the thirty-day period "if the public corporation has not paid the full contract price . . . and no action is pending to adjudicate rights in and to the unpaid portion of the contract price." While both of these options are available, it is best practice to file the claim in accordance with the first option to avoid any unforeseen pitfalls. Additionally, a claimant who does not have a contract with the principal contractor (e.g. a supplier whose contract is with a subcontractor) cannot utilize the second option.[23]

Finally, a special notice requirement applies to claimants who are not in privity with the general contractor and will be making a claim for materials.[24] In order for the public corporation to retain funds for claims on materials, and before a claim for materials may proceed, the general contractor must be given a 30-day notice that materials have been furnished for use on the project.[25]

Filing Suit

A claimant may file suit "at any time after the expiration of thirty days, and no later than sixty days, following the completion and final acceptance of [the] improvement."[26] The action is brought in equity in the county where the improvement is located.[27]

Iowa Code section 573.16 permits a general contractor to serve a written demand upon a claimant to bring suit. The written demand must be served in the same manner as notice in a lawsuit.[28] If the claimant does not bring suit within 30 days of the demand, both the claim and the suit are barred, and "retained and unpaid funds due the contractor shall be released" within 20 days of the public corporation receiving the release from the general contractor.[29]

If the public corporation fails to release the unpaid funds within 20 days, then interest accrues thereafter.[30] In order to establish that the public corporation has received the release, the general contractor should provide the public corporation with (1) a copy of the written demand served, (2) the return of service, and (3) proof from the court that the claimant did not file suit within 30 days of service of the written demand.

Finally, even if a claimant does file suit, a general contractor may still obtain a release of the retainage and unpaid funds from the public corporation by filing a bond, "conditioned to pay any final judgment rendered for the claims so filed," with the owner for double the amount of the claims filed.[31]

Who Must Be Parties to the Suit?

The public owner, the general contractor, the surety, and all who have filed a claim for labor or materials must be parties to the lawsuit.[32]

Payment of Claims

Iowa law dictates the order in which payments are made from the retainage[33] following settlement or adjudication. The order is (1) costs of the action, (2) claims for labor, (3) claims for materials, and (4) claims of the public corporation.[34] The costs of the action include reasonable attorney fees "in favor of any claimant for labor or materials who has, in whole or in part, established a claim."[35] The claimant must specifically petition the court for attorney fees when suit is filed.[36]

If the retainage is insufficient to pay all of the claims for labor or materials, then payments are made in the order of the date the claims were filed[37] and interest will not be awarded to anyone.[38] Additionally if the retainage is insufficient, the court will enter judgment against the general contractor and the surety to pay the remainder. [39]

Retainage

The retainage fund cannot exceed 5 percent of each monthly payment.[40] However, specific institutions may pay full contract price until 95 percent of the contract price has been paid, and then retain the remainder.[41]

Upon project completion, the public corporation must keep the retainage for 30 days from completion and final acceptance.[42] At the end of this 30-day period, the public corporation must release the entire retainage to the contractor if no claims have been filed.[43] If, however, claims have been filed, then the public corporation must continue to retain from the unpaid funds a sum equal to double the total amount of all claims on file, and release the remaining balance to the contractor.[44]

Iowa Code section 573.15A provides for an alternative procedure for releasing the retainage and permits early release of the retainage. Once the contract has reached 95 percent completion, the public corporation must retain the funds for 30 days.[45] If at the end of the 30-day period, a claim has been filed with the public coproraiton by a subcontractor or sub-subcontractor, then the public corporation must conintinue to retain from the unpaid funds a sum equal to double the total amount of all claims on file.[46] The public corporation must then release the remaining balance to the contractor, and if no claims have been filed, then the entire unpaid fund must be released to the contractor.[47]

After the 30-day period, the public corporation, general contractor, surety, and anyone who has filed a claim pursuant to the above procedure, have 30 days to bring an action to determine rights to the retainage and to enforce liability on the bond.[48] Such action is brought in the same method as described in the above sections; however, the date of 95-percent completion replaces the date of final acceptance for purposes of time limitations.[49]

Miscellaneous Provisions

a. Abandonment. If a contractor abandons work or is legally excluded from the improvement, then the official cancellation date of the contract becomes the completion date for purposes of filing claims under Iowa Code section 573.10. This provision does not affect time

b. Prompt Pay. Contractors and sub-contractors are due payments within specified time frames by statute, and interest accumulates to contractors and sub-contractors for late payments.

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[1]*Bourette v. W.M. Bride Construction Co. Inc.*, 84 N.W.2d 4, 5–6 (Iowa 1957).

[2]40 U.S.C. § 3131 et seq.

[3]For an overview of Iowa's mechanic's lien statutes, which are applicable to private projects, see Marso, Stephen D., "Construction Litigation Defenses in Iowa: A Checklist of Contractual and Statutory Defenses," *Defense Update*, Vol. XVIII, No. 1, Winter 2016.

[4]IOWA CODE § 573.5.

[5]*Id.*

[6]IOWA CODE § 573.2. A public corporation may, but is not required to, demand a bond for projects whose contract price is below $25,000.

[7]IOWA CODE § 573.1(1).

[8]IOWA CODE § 573.1(4). The Code also defines "public corporation," as "the state, all counties, cities, public school corporations, and all officers, boards, or commissions empowered by law to enter into contracts for the construction of public improvements."

[9]IOWA CODE § 573.7.

[10]*Id.*

[11]*Dobbs v. Knudson, Inc.*, 292 N.W.2d 692 (Iowa 1980).

[12]IOWA CODE § 573.1(2).

[13]*Id.*

[14]IOWA CODE § 573.1(5).

[15]*State v. Gorman*, 464 N.W.2d 122 (Iowa 1990).

[16]*Elk Run Telephone Co. v. Gen. Telephone of Iowa*, 160 N.W.2d 311 (Iowa 1968).

[17]*Rainbo Oil Co. v. McCarthy Imp. Co.*, 212 Iowa 1186 (1931).

[18]*Id.*

[19]Special rules apply to claims for work performed on county highway projects and farm-to-market highway systems. See Iowa Code § 573.8 for these special rules.

[20]IOWA CODE § 573.7.

[21]*Id.*

[22]Iowa Code section 573.11 provides another option for filing "belated" claims after an action has been brought. Because we do not recommend relying on this option, it will not be fully addressed in this article.

[23]*Lumberman's Wholesale Co. v. Ohio Farmers Ins. Co.*, 402 N.W.2d 413 (Iowa 1987).

[24]IOWA CODE § 573.15

[25]*Id.*

[26]IOWA CODE § 573.16.

[27]*Id.*

[28]IOWA CODE § 573.16.

[29]*Id.*

[30]*Id.*

[31]*Id.*

[32]IOWA CODE § 573.17.

[33]When something other than money is held as retainage or a part of the unpaid portion of the contract price, then the court may dispose of the property to satisfy the judgment. Iowa Code § 573.20.

[34]IOWA CODE § 573.18.

[35]IOWA CODE § 573.21.

[36]*Econ. Forms Corp. v. Cedar Rapids*, 340 N.W.2d 259 (1983).

[37]IOWA CODE § 573.19.

[38]*So. Surety Co. v. Jenner Bros.*, 237 N.W.500 (Iowa 1931).

[39]IOWA CODE § 573.22

[40]IOWA CODE §573.12.

[41]*Id.*

[42]IOWA CODE §573.14

[43]*Id.*

[44]*Id.*

[45]IOWA CODE § 573.15A(2).

[46]*Id.*

[47]*Id.*

[48]IOWA CODE § 573.15A(3).

[49]*Id.*

National Surety Corp. v. Westlake Investments: On the Road to Right Reasoning

by Richard J. Kirschman, Whitfield & Eddy, PLC, Des Moines, IA

Richard J. Kirschman

On July 8, 1999, the Iowa Supreme Court issued its opinion in *Pursell Constr., Inc. v. Hawkeye-Security Ins. Co.,* 596 N.W.2d 67 (Iowa 1999). Pursell involved an insured contractor's request for a defense and coverage from its insurer for an action by a general contractor alleging that Pursell had breached its contract and negligently failed to construct the lowest level of two houses at the elevation required by local ordinance. *Pursell Constr.,* 569 N.W.2d at 68. In response to the contractor's claims, Pursell pursued a declaratory judgment action against its insurer, Hawkeye, seeking a defense and coverage under its CGL policy. Subsequent to the district court's finding that there was coverage for the claims against Pursell, Hawkeye appealed to the Iowa Supreme Court, contending that the claims did not satisfy the policy's "occurrence" requirement and, further, that several pertinent exclusions precluded coverage if an occurrence was found.

In reviewing this matter, the Iowa Supreme Court noted that comprehensive general liability ("CGL") policies provide significant coverage pursuant to a broad insuring agreement. *Id.* at 69. The court further noted that determining whether coverage under a CGL policy applies to a particular claim involves a three-part process, set forth as follows:

> [I]t appears our framework of analysis for determining coverage may involve three steps. First, we look to the insuring agreement. If there is coverage, we look next to the exclusions. Last, if any exclusions apply, we then consider whether the[re are any applicable] exception[s] to the exclusion. Here, our analysis ends with the first step because for reasons that follow we conclude that under the insuring agreement there was no coverage.

Pursell, 596 N.W.2d at 69. The court defined that first step for determining coverage as an evaluation of whether "personal injury" or "property damage" was caused by an "occurrence," the defining terms of a CGL policy insuring agreement. *Id.* at 70. Similar to all CGL policies, the Hawkeye policy defined "occurrence" as "an accident including continuous or repeated exposure to substantially the same general harmful conditions." *Id.* Iowa courts have defined the term accident, as utilized in CGL policies, "to mean an undesigned, sudden, and unexpected event." *Id.* Accordingly, to determine whether coverage has been triggered, a court needs to evaluate whether there was personal injury or property damage caused by an accident. If so, coverage has been triggered and consideration of the second step, whether any pertinent exclusions preclude coverage, is required.

The supreme court characterized the claims against Pursell as allegations of faulty or defective workmanship. Despite the absence of any finding that the work was intentionally performed in a defective or deficient manner, the court determined that it was unnecessary to consider the second step of the analysis because "mere faulty workmanship, standing alone, cannot constitute an occurrence as defined in the policy." *Id.* at 69-71. Based on operation of pertinent exclusions, which hold that defective work performed by an insured is not covered by the policy, concluding that an occurrence had not transpired is contrary to the policy definition of occurrence as generally applied by courts. This holding in Pursell has led to numerous subsequent opinions by federal courts and the Iowa Court of Appeals applying Iowa law broadly and perhaps incorrectly under a strict application of the actual policy terms, finding that allegations of defective workmanship cannot constitute an occurrence under a CGL policy. E.g., *Liberty Mut. Ins. Co. v. Pella Corp.,* 650 F.3d 1161, 1175-76 (8th Cir. 2011); *Norwalk Ready Mixed Concrete v. Travelers Ins. Cos.,* 246 F.3d 1132-1137 (8th Cir. 2001) (holding that defective workmanship, regardless of who is responsible, cannot be characterized as an accident under Iowa law).

In *Nat'l. Surety,* the Iowa Court of Appeals reconsidered the rationale of the *Pursell* decision and its own subsequent decisions holding similarly. *Nat'l Surety Corp. v. Westlake Invs.,* LLC, No. 14-1274, 2015 Iowa App. LEXIS 982 (Iowa Ct. App. Oct. 28, 2015). In *Nat'l. Surety,* the insured, MLP Management ("MLP"), was the developer for an extensive apartment complex that it sold to Westlake Investments ("Westlake"). Subsequent to close of the sale, latent construction defects, which caused multiple problems at the development, were discovered. Westlake brought suit against MLP seeking recovery for lost profits, repair costs and related damages. MLP, in turn, sought coverage from its primary and excess carriers for Westlake's claims. The primary CGL insurer assumed MLP's defense while the excess carrier, National Surety, filed a declaratory judgment action

seeking a ruling that there was no duty to defend or indemnify MLP under its policy. Pursuant to a consent judgment, which included an assignment of policy rights from MLP, Westlake proceeded in the declaratory judgment action seeking indemnification pursuant to MLP's rights under the policy. The trial court found in favor of Westlake and awarded $12,439,500, the balance remaining under the consent judgment. National Surety appealed. The Iowa Court of Appeals defined the key issue as "whether the commercial general liability policy purchased by MLP provided coverage for the damages incurred by Westlake following widespread water penetration in Westlake Apartments."

The court began its analysis by discussing standard contract interpretation and construction principles, focusing on the insuring provisions of the underlying policy and the excess policy, which followed form. The court stated that the present circumstances were distinguishable from Pursell, which did not address whether a liability policy provided coverage when alleged defective workmanship causes damage beyond the insured's work product as the result of an accident. Unlike Pursell, Westlake alleged property damage extending beyond the insured's work product, primarily water penetration that resulted in widespread water damage. The court found that absent evidence to the contrary, it was assumed that the insureds intended to complete the work properly. As a result, the damage sustained was unforeseeable and, thus, satisfied the policy definition of "occurrence," which was defined as an accident. The court further found that the majority of jurisdictions that had considered this issue have expressly found that inadvertent faulty workmanship by a subcontractor can be an occurrence covered by a CGL policy. The court also noted that several policy exclusions that preclude coverage for property damage arising from work performed by an insured, contain exceptions for work performed by subcontractors, even if that work was performed on the insured's behalf. Consequently, based on the insuring provisions that trigger coverage for property damage that was caused by an occurrence, i.e. an accident, the court found that the occurrence requirement was satisfied and that coverage would only be precluded if required by the terms of an applicable exclusion. Critical to this determination was the court's finding that the damages "were caused in whole or large part, by faulty workmanship of subcontractors – property damage expressly covered by the CGL policy in this case."

If further review of the Westlake decision is granted, the Iowa Supreme Court may adopt the reasoning set forth by the Iowa Court of Appeals, which is the majority position. The first step in determining whether coverage has been triggered is examining whether property damage resulted from an accident. Unless a contractor or subcontractor deliberately or with gross negligence performs its work in a manner that was intended or expected to cause damage, an occurrence should generally be found. The CGL policy exclusions, however, typically preclude coverage for faulty or defective work performed by the insured. However, if damage results from a subcontractor's work, those same exclusions do not preclude coverage. Accordingly, the court's rationale in Westlake recognizes the manner in which the CGL policy functions, pursuant to the three-step process identified by the Iowa Supreme Court in Pursell, and gives effect to all terms of the CGL policy. Pursuant to the language of a CGL policy, if an insured contractor's work damages the contractor's project, there is no coverage under a CGL policy based on operation of pertinent exclusions, even if the occurrence definition is satisfied. Conversely, when a subcontractor's deficient workmanship causes damage to the contractor's work or project or work performed by other subcontractors, the CGL policy may provide coverage.

NEW LAWYER PROFILE

In every issue of *Defense Update,* we will highlight a new lawyer. This month, we get to know Megan R. Dimitt, Lederer Weston Craig, PLC, in Cedar Rapids.

Megan Dimitt is a senior associate at Lederer Weston Craig PLC, where she practices in the areas of insurance defense, product liability, municipal law, and employment law. Raised on a farm in southwestern Kansas, Megan graduated from Grinnell College in 2006 with a degree in Psychology. She earned her law degree from the University of Iowa College of Law in 2010, where she served as an editor on the Journal of Corporate Law and was captain of the trial team.

Megan sits on IDCA's Membership Committee and serves as a coach to the University of Iowa College of Law trial team. She has co-written an amicus brief on behalf of the IDCA, provided case law updates at annual meetings, and has written an article for the DRI Employment Law newsletter.

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