

# Louisiana Law Review

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Volume 35 | Number 2

*The Work of the Louisiana Appellate Courts for the  
1973-1974 Term: A Symposium  
Winter 1975*

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## Private Law: Security Devices

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### Repository Citation

Thomas A. Harrell, *Private Law: Security Devices*, 35 La. L. Rev. (1975)  
Available at: <https://digitalcommons.law.lsu.edu/lalrev/vol35/iss2/11>

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## SECURITY DEVICES

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## LESSOR'S PRIVILEGE

The Fourth Circuit Court of Appeal in *Gastel Corp. v. Rand Laboratories, Inc.*<sup>1</sup> affirmed the rule, first enunciated in *Bistes v. Checker Cab Co.*,<sup>2</sup> that the lessor of an immovable who sells the leased premises loses the privilege he enjoys as security for unpaid and past due rent upon the movables of his tenant located on such premises. The court in *Bistes* had analyzed the problem by analogy to the situation in which the lessor permits the tenant to take his movables off the premises which, under article 2705 of the Civil Code, is considered an abandonment of the privilege by the lessor.<sup>3</sup> The court in the *Bistes* case had said it could see no distinction between removing the movables from the lessor and the lessor's removing himself from the movables. The Fourth Circuit, following this reasoning, further explained that since the lessor's privilege is a form of pledge, the sale of the premises by the lessor is equivalent to a voluntary surrender of property by a pledgee, noting that there was no evidence in the record that the lessor had retained any interest in the lease after the sale.

Despite the plausible logic of these two opinions, an examination of their underlying premises tends to cast doubt upon the conclusions reached. In neither case was the lessee complaining that his possession had been disturbed; indeed, in each it appears to have been assumed that the purchaser of the property had either assumed the obligations of the lessor under the lease or had at least recognized its existence. A lease is not an interest in an immovable but a personal contract with the lessor. The lessor does not warrant title to the property leased but only the peaceful possession of the lessee and in the absence of a disturbance the lessee cannot ordinarily contest the title of his lessor. A sale of the leased premises does not, in itself, relieve the lessor of his obligations under a lease, including the duty to maintain the lessee in possession.<sup>4</sup> Accordingly, since the lessee's

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1. 289 So. 2d 880 (La. App. 4th Cir. 1974).

2. 126 So. 712 (La. App. Or. Cir. 1930).

3. "[T]he lessor may seize the objects subject to his privilege before the lessee removes them from the leased premises, or within fifteen days after they have been removed by the lessee *without consent of the lessor*. . . ." LA. CIV. CODE art. 2705 (emphasis added).

4. *Knapp v. Guerin*, 144 La. 754, 81 So. 302 (1919). See also A. YIANNPOULOS, PROPERTY §95 in 2 LOUISIANA CIVIL LAW TREATISE 275 (1966) for a discussion as to the juridical nature of the contract of lease.

possession and consequent right to maintain his movables upon the premises exist because of a contract with the lessor who would have to respond in damages if such possession were disturbed and who has never said in the first instance that he owned the premises, it is difficult to see how a sale of the premises which neither disturbs such possession nor relieves the lessor of his obligations can be said to be the equivalent of the lessor's "removing himself" from anything. Why the lessor should not continue to enjoy the privilege for the enforcement of rent which is still due to him seems hard to justify. It may be that the court was concerned about the effect of recognition of the privilege upon the claims of the purchaser of the property for rent due under the lease for succeeding periods. However, this problem, when it arises, should present no greater difficulty than would any other case where two or more debts are secured by the same mortgage, pledge or privilege and the creditor transfers the right to receive one of them.

#### MORTGAGES

In *Calloway v. Taylor*,<sup>5</sup> the defendant committed a simple error which he then compounded into a disaster. He accepted a conveyance of property, on which he held a mortgage, in settlement of the debt secured by the mortgage without checking the records as to his mortgagor's title. Unknown to the defendant, after his mortgage had been recorded but prior to the conveyance to him, the plaintiff recorded a judgment against the mortgagor in the mortgage records of the parish where the property was located.

After the property was conveyed to the defendant, the plaintiff executed upon his judgment by seizing and selling the property at a judicial sale at which he became the purchaser. He then filed an action against the defendant claiming the right to possession of the property as a result of the judicial sale. The defendant filed a reconventional demand asserting that by virtue of the transfer from the mortgagor he became the owner of the property free of the judicial mortgage. It is unclear whether he thought the transfer to him in settlement of the debt was equivalent to a judicial execution upon the first mortgage which extinguished the inferior judicial mortgage or whether he thought the judicial mortgage was simply invalid as to a subsequent transferee of the property. The court properly rejected his contentions, holding the judicial mortgage remained effective against the property notwithstanding its transfer to the defendant and that under article 3741 of the Code of Civil Procedure a judgment creditor

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5. 286 So. 2d 156 (La. App. 1st Cir. 1973).

has the right to execute upon a judicial mortgage in proceedings conducted against the judgment debtor without regard to a transfer of title by the latter. The court also gratuitously noted that no issue had been presented regarding the possible security rights of the defendant in the property. This latter remark may have been prompted by *Pugh v. Sample*,<sup>6</sup> in which, under similar circumstances, the Louisiana supreme court indicated that the existence of a judicial mortgage against property transferred in settlement of a prior mortgage debt was such an imperfection in title as to prevent extinction of the mortgage by confusion, or, at least, to permit its revival upon rescission of the sale. The court in that case said:

[W]hilst one cannot be, at the same time owner and mortgagee of the same property, if the title which, apparently conveying perfect ownership, is supposed to destroy the mortgage by confusion turns out to be no title, or an imperfect title, the mortgage which was suspended, and apparently destroyed, upon assumption of perfect ownership in the mortgagee is revived. . . .<sup>7</sup>

However, it would also appear to be essential to rescind the transfer to the mortgagee since, even though the mortgage may not be extinguished by confusion because of the intervening judicial mortgage, the giving in payment of the property extinguishes the obligation which the mortgage secures and this also would extinguish the mortgage.<sup>8</sup>

In the present case it may be inferred that the proceedings for execution upon the property by the plaintiff were conducted contradictorily with the judgment debtor and that the defendant had no notice of them until after the sale. Although article 3741 of the Code of Civil Procedure creates a statutory pact de non alienando with respect to mortgages and does away with the hypothecary action properly so called, article 3742 establishes an important qualification to this rule as it relates to the enforcement of legal and judicial mortgages. In case of a conventional mortgage, notice of the proceedings is not required to be given the third possessor, and the mortgagee can proceed directly against his mortgagor as if the property were still owned by the mortgagor. However, article 3742 expressly provides that in the case of legal and judicial mortgages the seizing creditor must cause notices of the seizure to be served by the sheriff upon both

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6. 123 La. 791, 49 So. 526 (1909).

7. *Id.* at 797, 49 So. at 528.

8. "Mortgages are extinguished . . . 2. By the creditor acquiring ownership of the thing mortgaged . . . 4. By the extinction of the debt, for which the mortgage was given. . . ." LA. CIV. CODE art. 3411.

the original debtor and the then-owner of the property. Assuming such notice had not been given to the defendant, it would appear that his remedy should have been to set aside the judicial sale as being invalid for lack of such notice and to demand that the transfer to him by the mortgagor be rescinded thus restoring him to the position of a creditor of the mortgagor with his debt secured by a first mortgage on the property.

#### ASSIGNMENT OF ACCOUNTS RECEIVABLE AND THE PRIVATE WORKS ACT

Some of the problems implicit in the apparently growing practice of assigning amounts due under construction contracts as security for loans made to the contractor were involved in *Central Bank v. Builders Service, Inc.*<sup>9</sup> The plaintiff bank agreed to loan money to Milton Hale, who as security for such loans assigned the bank the amounts to become due him under a contract with the defendant, Builders Service, Inc., the general contractor upon a construction job for which Hale was the electrical subcontractor. The bank from time to time loaned Hale the monies required to meet the expenses he incurred in performance of his subcontract, but at some point declined to make any further loans. Hale then told Builders Service he would be unable to complete the job for lack of funds. Builders Service thereafter made several payments directly to Hale, with the understanding that the latter would use the funds to pay his laborers and the suppliers of materials used in performance of his contract. After completion of the job by Hale the bank brought suit against Builders Service claiming the amounts paid to Hale had been assigned to it and accordingly such payments were not binding upon it. The court expressly found Builders Service had made the payments to Hale solely to protect itself in completion of the electrical subcontract; that had it failed to do so Hale would have defaulted and it would have cost Builders Service a substantial premium to have the work performed by another subcontractor. It also found the bank was unaware Builders Service was making payments to Hale.

The court concluded that Builders Service could have protected itself by making the payments due Hale directly to the bank, and it was thus responsible for the amount lost by the bank as a result of diverting the funds to Hale. The court relied upon *Bossier Bank & Trust Co. v. Natchitoches Development Co.*<sup>10</sup> as authority for the proposition that a contractor who has paid funds to suppliers of a subcontractor who has assigned his accounts remains liable to the

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9. 291 So. 2d 530 (La. App. 3d Cir. 1974).

10. 272 So. 2d 731 (La. App. 3d Cir. 1973).

assignee. The court apparently did not consider relevant the fact that the amounts paid Hale were to be applied to the payment of wages incurred and materials used by him in the performance of the contract, and that satisfaction of such claims would ordinarily be a condition to Hale's right to receive the amounts due under the terms of the contract. Nor did it consider whether the acknowledged inability of the subcontractor to complete his contract might have relieved the general contractor of the obligation of making payments to the bank under the assignment. The general contractor appears to have assumed that if the subcontractor had not paid his laborers or suppliers of materials, liens would have been filed against the job which it would have had to satisfy. Rather than forcing the sub-contractor to default and then attempting to pick up the pieces, it followed what would be the normal inclination of most contractors and advanced Hale funds necessary to pay his laborers and materialmen to complete the job. The court's suggestion that the defendant could have "protected itself" by paying the amounts to the bank is certainly doubtful if it would thereafter have had to pay the same amounts over to the laborers or materialmen of its subcontractor. Moreover, such action, by forcing the subcontractor to default, thus increasing the cost of completion to the contractor and giving rise to a claim for damages against an insolvent subcontractor, does not appear to have been a very viable alternative.

Two cases providing an interesting contrast to *Central Bank* and further illustrating what appears to be a general uncertainty among the courts as to the nature of the relationships among the contractor, his subcontractors and the laborers and suppliers of materials of the latter are *Harris Paint Co. v. Quinn Construction Co.*<sup>11</sup> and *Cox v. W.W. Heroman & Co.*<sup>12</sup> In the *Cox* case the defendant, a general contractor, paid the claims of certain of the suppliers of materials to Cox, a subcontractor and then claimed credit for the payments against the amounts due Cox under his contract. A dispute existed between Cox and his materialmen as to the amount owed them and he had been refusing to pay, apparently hoping to effect a settlement of their claims. Needless to say, the defendant's action in paying the money directly to the materialmen did not meet with Cox's approval. Cox resisted the credit claimed by the defendant by arguing that the payment was not authorized by his subcontract, that the contractor was not subrogated to the claims of the materialmen and accordingly could not assert a right to recover such amounts by way of credit. In

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11. 282 So. 2d 543 (La. App. 4th Cir. 1973).

12. 282 So. 2d 734 (La. App. 1st Cir. 1973), *aff'd*, 298 So. 2d 848 (La. 1974).

this regard he relied upon Civil Code article 1924 which provides that although a stranger may pay the debt of a third person he will not be subrogated to the creditor's rights against the debtor. The First Circuit Court of Appeal,<sup>13</sup> after finding that the amounts paid the materialmen had been clearly owed by Cox, agreed with Cox that subrogation did not exist, but then pointed out that a right of reimbursement (as distinguished from subrogation) exists in favor of the third person who pays a stranger's debt under general concepts of unjust enrichment, relying upon the opinion of Justice Tate in *Standard Motor Car Co. v. State Farm Mutual Automobile Insurance Co.*<sup>14</sup> It thus allowed the credit to the contractor.

The Louisiana supreme court granted writs in the case and held that the right of indemnity allowed the defendant by the court of appeal exists only where the payment made by the third person completely extinguishes the debt and that if a conventional or legal subrogation is present the debt is technically not extinguished but is transferred to the party subrogated. It then determined that the correspondence between the defendant and the materialmen showed an intention to conventionally subrogate the former to the latter's rights when the payments were made. However, no specific agreement to subrogate was shown to have been present at the time payment was actually made and much of the court's opinion is occupied with resolving the question of whether subrogation actually occurred and whether one could be subrogated to part of a claim against another. It finally determined a conventional subrogation did exist and permitted the credit claimed.

Justice Dixon, dissenting from the decision, pointed out that since the contractor is obligated to pay the materialmen if the subcontractor does not, a legal subrogation under article 2163(3) of the Civil Code should exist. He then, however, qualified his opinion by noting "there is something fundamentally wrong in allowing a debtor to pay another person instead of his creditor over the strong protest of the creditor," and would have refused the credit.

In the *Harris* case the court of appeal held that under the provisions of the Private Works Act,<sup>15</sup> a supplier of materials to a subcontractor has a direct cause of action against the general contractor for the amount due him by the subcontractor, even though he has not filed a lien, if he gives written notice of his claim to the general contractor within thirty days of the date a notice of acceptance of the

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13. 282 So. 2d 734 (La. App. 1st Cir. 1973).

14. 97 So. 2d 435 (La. App. 1st Cir. 1957).

15. LA. R. S. 9:4801-17 (1950), *as amended*.

job is filed in the records. This case is clearly in accord with the statute.<sup>16</sup>

If the *Harris* decision is correct, as the author believes, then it is difficult to see why Justice Dixon was not correct in his view that a contractor who pays the laborers and materialmen of his subcontractor would be legally subrogated to the claims of such parties against the subcontractor. However, it is also suggested that the entire approach to the problem taken by the courts in both the *Cox* and *Central Bank* cases, as well as the *Bossier Bank* case decided earlier, misses the question at issue.

A contractor (or subcontractor) who undertakes the performance of a job must certainly be held to impliedly warrant not only that he will perform the work in a good and workmanlike manner but that he will do so without additional cost or expense to the person with whom he contracts. Who would contend that the owner who pays his contractor in full and is thereafter required to again pay the materialmen or laborers who supplied the materials or performed the work would not have an action against the contractor for a breach of his contract? Can it not be said that an owner, faced with the raucous cries of unpaid materialmen threatening suit and a contractor who says he can or will do nothing about it, is any less entitled to take action to repair the situation than is the owner whose building contains a noisy and defectively constructed air-conditioner blowing only hot air and a contractor who admits he will not or cannot make it work properly?

By the same token can it be contended that a contractor can be held to the full contract price by either a subcontractor or his assignee if the subcontractor has failed to construct a component part of the work he has undertaken or admits he cannot or will not do so to the contractor who must then construct the thing himself to fulfill the contract he has made with the owner? If the subcontractor constructs

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16. "Before any person having a direct contractual relationship with a subcontractor but no contractual relationship with the contractor shall have a right of action against the contractor. . . he must record his claim. . . or give written notice to said contractor within 30 days from the recordation of the notice of acceptance by the owner of the work. . . ." LA. R.S. 9:4814(C) (1950), as amended by La. Acts 1960, No. 111 §3. See also *Arrow Const. Co. v. American Employer Ins. Co.*, 273 So. 2d 582 (La. App. 1st Cir. 1973); *Apex Sales Co. v. Abraham*, 201 So. 2d 184 (La. App. 4th Cir. 1967). Although the statute implies that the giving of notice or filing of a claim is a prerequisite to the "right of action" of the subcontractor (§ 4814), the act as a whole clearly indicates that filing a claim or giving of the notice merely serves the purpose of perpetuating a liability created by the statute and there seems to be no reason why the contractor, if he chose to do so, could not acknowledge the claim and waive written notice of it.

the component but fails to pay for it under circumstances where the law will impose the obligation of payment upon the contractor, where is the difference? If the subcontractor or his assignee sues for the contract price, the contractor's defense to the claim is not by way of subrogation or compensation — it is for reduction of the contract price based upon the premise that having failed to perform what he contracted to do, the subcontractor can only recover what is due him in excess of the damages or loss caused by his failure. To express it somewhat differently, the subcontractor's right is only to recover what is due him to the extent he has performed his contract.<sup>17</sup> The approach of the courts in *Cox*, *Central Bank* and *Bossier Bank* of treating the plea by the contractor (or owner) that he does not owe the full contract price because of the subcontractor's (or contractor's) default as if he were attempting to claim compensation of the contract price because the debtor is indebted to him on a different obligation only creates confusion and will continue to lead to inequitable and unsatisfactory results.<sup>18</sup>

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17. A contractor may recover the value of the work which has inured to the benefit of the owner although the work is defective or unfinished, if a price has been agreed upon and the remedy of the owner is a reduction in price to an amount necessary to perfect or complete the work according to the contract. *Brandin Slate Co. v. Bannister*, 30 So. 2d 877 (La. App. Orl. Cir. 1947).

18. Furthermore, to exalt the position of assignee of the subcontractor to a position superior to that of its assignor as was done in the *Central Bank* and *Bossier Bank* cases is clearly erroneous. The precise issue presented in those cases was long ago rejected for reasons substantially similar to those advanced here in *Pullis Bros. Iron Co. v. Parish of Natchitoches*, 51 La. Ann. 1377, 26 So. 402 (1899), involving a claim by an assignee of a contractor to funds in the hands of the owner as against the claims of materialmen of the contractor under LA. CIV. CODE arts. 2772-77, which are the predecessors of the Private Works Act. Although the pattern of the latter differs substantially from that set forth in the Code and has impliedly repealed them, the principles involved, particularly as they relate to the position of the assignee of the contractor, are still valid.