

CONSTRUCTION LAW 101 IN NORTH DAKOTA

June, 2014

By Douglas R. Hookland*

Oil and gas production, and the process of “fracking”, have created opportunities in North Dakota for everyone in the construction industry. Oregon based contractors, subcontractors, and material and equipment suppliers venturing into North Dakota, and their attorneys, should get educated on key aspects of North Dakota construction law. This article provides basic information on North Dakota contractor licensing requirements, construction liens, and how North Dakota statutes and case law treat some important construction contract provisions and situations.

Contractor Licensure:

Chapter 43-07 of the North Dakota Century Code (“NDCC”) regulates contractors. In summary, a “contractor” is defined as any person in the business of constructing, repairing, altering, or demolishing every type of structure, project, development, or improvement coming within the definition of real or personal property. NDCC 43-07-01 1. No person may engage in the business or act in the capacity of a contractor when the price per job exceeds \$2,000, nor may they maintain any claim, action, suit or proceeding in any court related to their business or capacity as a contractor without first having a contractor license. NDCC 43-07-02. Contact the North Dakota Secretary of State about construction contractor licensing at www.nd.gov/sos/licensing/. The telephone number is (701) 328-3665.

To obtain a license, a contractor must complete and submit an application specifying the class of license desired, copy of a certificate of liability insurance, and a statement from the North Dakota Workforce Safety and Insurance Department that the contractor has secured adequate workforce safety and insurance coverage. NDCC 43-07-04 1. There is no license bond requirement. There are four (4) license classes to choose from. Class A: no limitation on value of any single contract project. Class B: the holder cannot perform any single contract project in excess of \$250,000. Class C: the holder cannot perform any single contract project in excess of \$120,000. Class D: the holder cannot perform any single contract project in excess of \$50,000. NDCC 43-07-05. The statute exempts from the licensing requirement only material suppliers and authorized representatives of Federal, State, and local governments. NDCC 43-07-08.

Each contractor’s license expires on March 1st of every year. NDCC 43-07-09. To renew its license, a contractor must obtain a certificate of renewal from the Secretary of State, which is accomplished by filing an application that includes a list of each project, contract, and subcontract completed by the contractor during the preceding calendar year in the state over \$25,000 and the nature of the work of each such project, contract, or subcontract. The contractor must also submit a certificate of liability insurance and a certification that it has submitted all payroll taxes due at the time of renewal. NDCC 43-07-10 1. The renewal application must be submitted to the Secretary of State by March 1st of each year; otherwise, the contractor’s license is not in good standing and the contractor is considered unlicensed. NDCC 43-07-10 3. Within sixty (60) days after March 1st, the contractor must be

notified by mail that its license is not in good standing, and the contractor then has until June 1st to renew by paying a penalty fee and submitting its application for renewal with the renewal fee. After June 1st, any license not renewed is revoked. NDCC 43-07-10 3.

Notice of Defect on Residential Projects:

Like many states, North Dakota requires contractors and owners involved with residential improvements to take certain action prior to taking formal legal action related to alleged defects in construction. The controlling statute is NDCC 43-07-26. The statute applies to the construction of one and two family dwellings, and improvements exceeding \$2,000 to a dwelling. Before making any non-emergency repair or instituting any action for breach of warranty, a purchaser or owner of a dwelling must give written notice by mail to the contractor within six (6) months after knowledge of a defect, advising the contractor of the defect and giving the contractor a reasonable time to comply with the statute. Within a reasonable time after receiving the notice, the contractor must inspect the defect and provide a response to the purchaser or owner and, if appropriate, remedy the defect within a reasonable time thereafter. A contractor must provide the purchaser or owner written notice of the requirements of NDCC 43-07-26 at the time of sale closing or at the time of completion of the improvement. The statute defines "reasonable time" to mean thirty (30) business days after the notice is mailed or any shorter period of time as may be appropriate under the circumstances.

Indemnity Clauses:

Unlike many states, North Dakota does not prohibit the parties to a construction contract from requiring the indemnitor to indemnify the indemnitee against damages caused by the indemnitee's negligence. If the indemnity clause is broadly and clearly worded, it is likely that a prime contractor will be obligated to indemnify and defend a property owner from claims and/or liability arising from the property owner's negligence, and that a subcontractor will be similarly obligated to a prime contractor for claims and/or liability arising from the prime contractor's negligence. In Specialized Contracting, Inc. v. St. Paul Fire & Marine Ins. Co., 825 NW 2d 872, 2012 ND 259 (2012), the North Dakota Supreme Court applied the statute for rules interpreting indemnity contracts (NDCC 22-02-07) to an indemnity clause in a contract between the City of Valley City and an engineer. The clause required the engineer to indemnify the City from liability arising out of the engineer's negligence. A subcontractor sued to recover for additional compensation to remove and replace concrete the engineer had rejected. The indemnity clause only required the engineer to indemnify the City for liability arising out of the engineer's negligence, and it did NOT require the engineer to indemnify the City against claims. At trial, the subcontractor did not establish its claim for additional compensation, and the engineer was not found negligent. Nevertheless, the City incurred substantial attorney fees and costs defending the lawsuit, and it sought recovery of those fees and costs from the engineer under the indemnity clause. In denying the City recovery, the court interpreted NDCC 22-02-07, and concluded that by limiting the indemnity obligation to situations where negligence and liability have been established, the parties intended that the engineer would only be liable for indemnity if it was found negligent.

In Myers v. ANR Pipeline Co., 959 F. 2d 1443 (8th Cir. 1992), the prime contractor was engaged to design and construct a gas metering station, and employed a subcontractor to install the electrical equipment and wiring. After an explosion killed one person, the prime contractor third partyed in the subcontractor claiming indemnification for attorney fees and costs to defend the personal injury suits. The subcontract contained an indemnity clause requiring the subcontractor to indemnify the prime contractor for all loss or damage sustained as a result of the subcontractor's operations and to pay all costs and expenses and attorney fees arising or allegedly arising out of the subcontractor's performance. The subcontract also required the subcontractor to defend the prime contractor from all suits or claims to recover damages on account of any injury caused by any act or omission with respect to the subcontractor's work. The subcontract also required the subcontractor to insure the prime contractor. The Myers court noted that under North Dakota law an indemnity agreement will not be interpreted to indemnify a party against the consequences of its own negligence unless that construction is very clearly intended. Myers, 959 F.2d at 1445. In holding the subcontractor was obligated to indemnify the prime contractor for the attorney fees and costs the prime contractor incurred to defend the personal injury suits, the court found that the parties clearly intended the subcontractor must indemnify the prime contractor against its own negligence because the indemnity clause broadly and clearly included damages arising out of the prime contractor's negligence, and because the subcontract also included hold harmless and insurance obligations by the subcontractor. Id. at 1448.

Based on NDCC 22-02-07, Specialized Contracting, and Myers, an indemnity clause broadly requiring an indemnitor to indemnify and hold an indemnitee harmless from ALL claims and liabilities arising or related to the work, coupled with an obligation to defend and insure the indemnitee, should be enforceable such that the prime contractor should be obligated to fully indemnify a property owner even for claims arising out of the property owner's negligence, and a subcontractor should be obligated to fully indemnify a prime contractor even for claims arising out of the prime contractor's negligence.

Conditional Payment Clauses:

North Dakota courts have not specifically addressed whether or to what extent "pay when paid" or "pay if paid" clauses are enforceable. However, if clearly worded, these clauses are probably enforceable. In Gift v. Ehrichs, 284 N.W. 2d 435, 439-440 (ND Supreme Court 1979), the court held payment was due on a promissory note within a reasonable time where the promise to pay was absolute yet called for annual payment whenever the corporation realized sufficient net profits to lawfully declare and pay a dividend and was lawfully able to purchase its own shares in accordance with the applicable statute. The court reasoned that the provision calling for payment whenever sufficient profits were realized addressed only when and how payments would be made, and did not create a condition precedent to the payment obligations. Id.

A clearly worded "pay when paid" clause should permit the prime contractor a reasonable period of time to obtain payment from the owner before being obligated to pay a subcontractor. Likewise, a clearly worded "pay if paid" clause, that makes the prime contractor's payment obligation expressly conditioned upon first receiving payment from the property owner for the subcontractor's work, should be enforceable.

No Damages for Delay Clauses:

These clauses are probably enforceable on private and public projects. See Markwed Excavating, Inc. v. City of Mandan, 791 NW 2d 22, 2010 ND 220 (2010). In this case Markwed contracted with the City of Mandan to install a storm sewer improvement. Their contract included a clear, unambiguous no damages for delay clause, which permitted Markwed an extension of time only for any and all delays cause by the City or its design professional, and that Markwed was not entitled to any compensation for such delays. Markwed incurred delays by the City and the engineer failing to timely obtain easements for Markwed to access the land. In holding the no damages delay clause enforceable, the court concluded that exculpatory clauses are strictly construed against the benefitted party and will not be enforced if they are ambiguous, but that parties are bound by clear and unambiguous language evidencing intent to extinguish liability. The court also noted NDCC 9-07-19, which requires that any ambiguity in a contract between a public body and a private person always be construed against the private person.

Prompt Pay Act:

North Dakota's Prompt Pay Act applies on public works projects, and is set forth in NDCC 13-01.1. The public body must pay for goods and/or services on the date required in the contract, and if the contract does not specify a payment date, within forty-five (45) days after receipt of the invoice for the goods and/or services. NDCC 13-01.1-01. Interest accrues at the rate of 1.75% per month (21% per annum), unless a different rate is specified in the contract. NDCC 13-01.1-02. This obligation to pay interest does not apply if the failure to pay timely is because of a dispute between the public body and prime contractor, or between the prime contractor and a subcontractor or supplier, over the amount due or compliance with the contract or subcontract. If resolution of the dispute is in favor of the prime contractor, subcontractor, or supplier, interest must accrue and be paid as provided by the statute. NDCC 13-01.1-05. A prime contractor must pay its subcontractors and suppliers within forty-five (45) days after receiving payment from the public body, or pay interest to its subcontractors and suppliers at the rate of 1.75% per month (21% per annum), unless the contract with the subcontractor or supplier provides a different interest rate. NDCC 13-01.1-06.

Construction Liens:

North Dakota has separate statutes for lien rights for (a) oil or gas wells or pipelines, and (b) all other improvements. This article provides information only on lien rights for improvements that are NOT oil or gas wells or pipelines.

A person has lien rights who, at the request of the property owner, agent or trustee of the property owner, the prime contractor, or any subcontractor of any tier, furnishes labor, materials, rental equipment, architectural services, construction staking, engineering, land surveying, mapping, or soil testing, to build, alter, remove, repair, or demolish any improvement upon or beneath the surface of any land, or in grading, seeding, sodding, or planting for landscaping purposes, or in equipping any

improvement with fixtures or permanent apparatus. NDCC 35-27-01 7. and 35-27-02. As defined by statute, "subcontractor" may include a supplier, so a supplier to a supplier may have lien rights.

North Dakota is a "derivative" lien state, which means any lien is only for the difference between the price paid by the property owner to the prime contractor and the price or value of the contribution to improve the land, and no lien is allowed if the property owner has paid the full price or value of the total contribution to improve the land. See NDCC 35-27-02; and Kirkland v. Oberquell, 405 NW 2d 21 (ND Supreme Court 1987).

At least ten (10) days before recording a lien, all lien claimants must send to the property owner a written notice by certified mail stating that a lien will be claimed. NDCC 35-27-02. A lien must be recorded within 90 days after all the lien claimant's contribution is done. NDCC 35-27-13. Trifling or small amounts of work may count, but it is suggested the 90 day period to record be run from a full day of work that is not warranty or repair work. The lien must describe the property, state the amount due, provide dates of first and last contribution, and the name of the person/entity with whom the lien claimant contracted. NDCC 35-27-13. The lien must be notarized, and it is recommended it also be verified. A lien claim can be recorded after the 90 day period, but it is void as to (a) good faith purchasers or encumbrancers whose rights accrued before the lien is recorded, and (b) the property owner to the extent of the amount paid to the prime contractor before the lien is recorded. NDCC 35-27-14.

The lien claimant must give the property owner written notice of the intent to enforce the lien by foreclosing it. If written notice is given by personal service, the lien claimant must give the notice at least ten (10) days before foreclosing its lien. If the written notice is given by registered mail, the lien claimant must give the notice at least twenty (20) days before foreclosing the lien. NDCC 35-27-24. A lawsuit to foreclose the lien must be commenced no later than three (3) years after the lien is recorded. NDCC 35-27-25. If the lien claimant receives written demand to commence suit on the lien within thirty (30) days from the property owner, agent of the property owner, or the prime contractor, the lien becomes invalid unless the lien claimant commences suit within thirty (30) days. NDCC 35-27-25. A property owner who successfully contests the validity or accuracy of a lien in court is entitled by statute (NDCC 35-27-24.1) to recover its reasonable attorney fees, but a successful lien claimant is NOT entitled to recover its reasonable attorney fees. As such, to recover their attorney fees, any lien claimant should include an attorney fee clause in its contract and contract only with solvent persons or entities.

Bonding Off Liens:

North Dakota permits a property owner to remove a construction lien recorded against its property by following the procedure set forth in NDCC Chapter 35-21. The owner of the property, or of a substantial interest in the property, must file with the District Court for the County in which the lien has been filed an application for the release of the lien, and an affidavit describing the owner's interest in the property and stating the owner has a defense against the collection of the lien, or a part of it, that a disagreement exists between the parties as to the amount or validity of the lien, and that the owner desires to discharge the lien from the records. NDCC 35-21-02. The property owner must also file an

undertaking (bond) in an amount not less than the lien, with two sureties, to the effect that the property owner will pay any amount that may be recovered by the lien claimant, plus all costs. NDCC 35-21-02.

A copy of the application for release of lien, the affidavit, and the undertaking (bond), together with a notice of when exception to the sureties must be made, must be served on the lien claimant, its agent, or its attorney personally or by registered mail. NDCC 35-21-03. If the court clerk receives an exception to the sufficiency of the sureties within seven (7) days of the date of service, the clerk shall schedule a hearing at which the sureties may be justified. NDCC 35-21-04. The clerk provides notice of the hearing to the lien claimant and the applicant for discharge of the lien. If the clerk does not timely receive an exception to the sufficiency of the sureties, the clerk issues an order stating the lien is discharged by undertaking and directing the recorder to file the order of discharge to terminate the lien and to remove the lien from any computerized index system on which it appears. NDCC 35-21-04. If the sureties justify at a hearing, and if the undertaking is approved, the judge enters an order that the lien is discharged by the undertaking and directs the recorder to file the order of discharge and terminate the lien on any computerized index system. After the order, the lien is of no effect. Query: if the lien has no effect, what legal theory does the lien claimant assert (lien foreclosure, breach of contract, etc.) against the property owner and sureties to collect on its claim for payment?

The statute does not permit a lender, prime contractor, subcontractor, or any other interested party, to apply to bond off. Query: how can a prime contractor or subcontractor having a contractual obligation to bond off a lien, do so? For an unknown reason, the statute also requires two sureties on the bond.

Conclusion:

Construction law in North Dakota is unique. Oregon attorneys having clients providing, or considering providing, labor, materials, equipment, or professional services on projects in North Dakota would be prudent to have their clients speak with competent North Dakota counsel to reduce risk and increase the prompt and cost effective resolution of disputes when they arise.

*Douglas R. Hookland has been licensed to practice in North Dakota since 2012. This article should be used as general information only, and not as legal advice for any specific or general situation or matter.