Construction Law Newsletter

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ORS 279.023: Potential Pitfall For Unwary Public Agencies

Few attorneys, their construction clients, and public agencies are fully cognizant of ORS 279.023 and its potential impact. This statute requires that all public improvements be constructed at the least possible cost to the public agency. Another way to look at this requirement is that it mandates construction of public improvements at the least possible cost to the taxpayers. To achieve this reasonable goal, the Oregon legislature has required all public agencies to identify all public improvements to be funded for the next fiscal year, identify if the project will cost more than or less than $50,000, and whether the project will be constructed by the public agency's forces or put out for bid. If a project is estimated to cost more than $60,000 and the public agency elects to construct it with its own forces, then the public agency must show its decision to do so will be at the least possible cost to the public. This information must be filed with the Oregon's Bureau of Labor and Industries not less than 30 days prior to the adoption of the next fiscal year's budget for the public agency.

In February 1989, the Oregon-Columbia Chapter of the Associated General Contractors of America (AGC) and Copenhagen Utilities & Construction, Inc., a member of AGC, brought a declaratory judgment and injunction action against the City of Portland for its failure to comply with ORS 279.023. The lawsuit settled before the Court heard AGC's motion for summary judgment, and, for the reader's reference, a copy of the Judgment agreed to by the parties follows this article. The case alleged that the City of Portland repeatedly violated ORS 279.023 by failing to timely file the requisite information, filing incomplete information, and, in 1987, not filing at all. The City of Portland initially defended its practices under the guise that prior violations of the statute, if any, were moot. Since it timely filed its information for 1989, the City argued there was no case or controversy. Judge Londer rejected this argument made in the City's motion to dismiss. He also rejected the City's argument that AGC lacked standing to maintain the case. Even if the City's case or controversy argument had merit, it did not resolve the issue whether the information filed complied with the substantive requirements of ORS 279.023. The City then filed its Answer, a general denial, and the plaintiffs moved for summary judgment. The case settled before the motion was heard.

Following is the edited text of a speech given by F. Gordon Allen of Allen, Kilmer, Schrader, et al., to the Construction Law Section of the Oregon State Bar during the 1989 Annual Meeting in Seaside. Mr. Allen was retained by AGC and Copenhagen to bring the lawsuit against the City; he filed the case, then ran off to Alaska leaving others in his office to pick up the cause and bring it to a successful conclusion. Mr. Allen then returned from the colds of Anchorage to accept the awards and give what many have described as a scintillating and inspiring speech. By Mr. Allen:

"ORS 279.115 says, 'All public contracts shall be based upon competitive bids except. . . .' Fortunately, no one seriously disputes the wisdom of this requirement, despite the fact that many lawyers are employed to resolve the disputes which arise because of it. At the request of the AGC, this firm became involved with the exception to ORS 279.015, found in ORS 279.023.

"Section 1 of ORS 279.023 states the policy that public improvements are to be constructed at the least cost to the public agency. It also states that public agencies are to make every effort to accomplish that result. ORS 279.011 defines public agency very broadly.

"Section 2 of ORS 279.023 requires public agencies to publish a list of all anticipated public improvements 30 days before the next fiscal year's budget is adopted. Legislative history suggests the reason for the 30-day requirement is to give all persons who object to the project or the public agency's intention to do the work in-house to go before the budget committee of the public agency and argue against approving a proposed budget. An issue which we did not reach in our case is whether a court might deny relief to a contractor seeking an injunction unless the contractor is able to show that it availed itself of the opportunity to go before the public body and make an objection. You lawyers who represent public bodies might file that idea away for future consideration.

"We now come to the distinctions in the statute between projects estimated to cost more than $50,000, and those estimated to cost less than $50,000. This statute is not intended to place projects under $50,000 beyond challenge. Aggrieved persons have the same right to argue with the public agency and seek judicial relief on the subject of projects under $60,000.

"Where a public agency decides to do a project in-house which is estimated to cost over $50,000, 'the agency shall also show its decision conforms to the policy stated in subsection (1) of this section.' Thirty days before budget adoption a public agency desiring to do a project over $50,000 in-house must not only publish a description of the project, but must also publish information showing the project will be constructed at the least cost to the public

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body.

"Subsection (3) of ORS 279.023 describes information which the public body must make available before doing a project over $50,000. I assume that this is the information which must be published 30 days before budget adoption, but that is not exactly what the statute says. This is another idea which you public sector lawyers might file away for future thought. But, I would also give you this warning, if you interpret this language to permit publication of plans and specifications and unit costa later than 30 days before budget adoption, then you extend the time when injunction actions may be filed, and you may negate your argument that a contractor must present its objections to the public agency before the budget is adopted.

"Abigissueis themeaningof'estimatedunit costof each classification of work.' Obviously, contractors and their lawyers want this information as detailed as possible so that the public agency decision can be verified. My new is that public agencies which are making decisions to do work in-house in a responsible manner must have detailed historical and present cost information at their disposal. Those who do not have such information should not be allowed to let public contracts. In my opinion, public agencies which do not already do so will be required to bid in-house projects over $60,000 as a private contractor would do it.

"The publicagencyisrequiredtoincludeinits estimated costa the investment cost of any equipment used. This statute not only gets the work for the least cost but also levels the playing field between the public agency forces and private contractors. One question which I do not see addressedin the statuteis whether the public agency must show its labor at prevailing wages. Public bodies do not have to pay prevailing wages. I do not know how the wages they pay to construction workers compare *to* prevailing wages.

"After estimating the work *to* find out how much it is really going *to* cost the public agency, the agency needs to determine how much it would cost a private contractor and why. Having determined their own unit costs for each classification of the work the logical next step is *to* determine what the unit costs for each classification of the work would be if done by a private contractor. I am not sure how a public body does this without putting a job out to bid, unless the agency has a data base of historical costs for similar work done in previous years.

"Subsection 3(b) requires the public agency to keep true and accurate accounts of the costs ofperforming the work. This is averyinterestingprovisionbecause public agencies do not have the same incentive that a private contractor has to perform the work for the estimate. In other words, if a public agency using its own full-time employees exceeds its labor estimate, what are the consequences? If this subsection is enforced, one consequence will be a published record showing the overrun. If not, an argument can be made that the estimate is not in good faith.

"Now to tell you a little about the case we filed. Jack Kalinoski, as the managingdirectorof the local AGC chapter, was instrumental in the amendment of ORS 279.023, and he has been monitoring compliance. He can give you the details, but a number of the big public agencies with lots of public work have not been complying with the law. Some do not publish any information; some are late; and many do not publish an adequate explanation for doing work in-house. Jack Kalinoski has told me there are over 1700 public agencies covered by the statute and 96% are not in compliance with the statute, including the State of Oregon.

"Amongthe offenders, in AGC's opinion, was the City of Portland. The City filed late in 1986 and 1988 and did not file at all in 1987. In February of this year, the AGC and one of its members filed suit for declaratory and injunctive relief requiring the City to comply with the statute. Ruth Spetter represented the City.

"We sued under the declaratory judgment statute and ORS 279.067 which permits 'any bidder adversely affected' *to* file suit to require compliance or prevent violation of numerous sections of ORS 279, including 279.023. Note that 279.067 provides for attorney's fees.

"Judge Londer found the AGC had standing to sue. After we filed suit, the City made its filings on time for 1989, and claimed the case was, therefore, moot. The court didn't buy that.

"We filed for summary judgment. The case was settled before the City responded to the motion.

"We have attached the order that was entered pursuant *to* the settlement reached by the parties. It is not as specific as it might have been, but it was satisfactory to the AGC, which felt it had madeita point. Also, I think Jack Kalinoski became convinced in his discussions with Ruth Spetter that the City intends to comply with the spirit of the statute. Attachedas exhibits to the Judgment are the forms which the City has agreed to complete with respect *to* each project over $60,000, and which the City intends to do with its own forces. The City will fill out the form with detailed costa for each item of work for each project.

"Jack Kalinoski intends to put pressure on other noncomplyingpublic agencies with the hope of achieving compliance with ORS 279.023 by all public agencies. Apparently, he has a long way to go. Thank you."

For those readers who work for or represent public agencies, ORS 279.023 can be a pitfall. The vast majority

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of public agencies do not comply with the statute. Many agencies, such as the Portland School District, Lane County, and Klamath County, for example, do a lot of their public improvements in-house. Their failure to comply with the statute can lead to litigation and, potentially, tying up a fiscal year's budget until compliance is attained. All public agencies should, therefore, begin to use the forms attached to the Judgment entered against the City of Portland, and fill them out in detail, work item by work item, for each project where the estimated cost exceeds $60,000, and where the public agency plans to do the work in-house.

Although this statute may seem like just another excuse for paperwork, it is designed to make each public agency take a hard look at every public improvement project it plans to build in the coming year to be sure it is going to be constructed at the least cost possible. By making compliance with the statute a part of the pipeline for every public improvement project and the annual budgeting process, the forms can be completed on a timely basis and with a minimum amount of extra work for the agencies. Most importantly, compliance with the statute will provide a better measure of assurance to the taxpayers that public improvements are being constructed at the least cost possible.

F. Gordon Allen
Barry W. Dod
Allen, Kilmer, Schrader, Yazbeck & Chenoweth, P.C.

In the Circuit Court **of** the State **of** Oregon
For the County **of** Multnomah

OREGON-COLUMBIA CHAPTER OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, INC., an Oregon nonprofit corporation; and COPENHAGEN UTILITIES & CONSTRUCTION, INC., an Oregon corporation, Plaintiffs, v. THE CITY OF PORTLAND	) No. A) JUDGMENT

Pursuant of defendant's offer of judgment filed by defendant on July 7, 1989, and pursuant to ORCP 54E, judgment shall be entered in the case as follows:

1. The City of Portland agrees to file with the Bureau of Labor and Industries the information required by ORS 279.023. The City of Portland shall include in its filing the information required by FORMS WH-118 (10/82) and WH-119 (10/82) (copies attached as Exhibits 1 and 2), or reasonable facsimile thereof, issued by the Bureau of Labor and Industries for the use of local governments in complying with provisions of ORS 279.023.
2. The City of Portland agrees to file its report by the date required by ORS 279.023.
3. Attorney fees of $2,500.00 shall be awarded to plaintiffs
4. No costs to either party.

DATED August 9, 1989.

The Contractors Registration Act Requires Registration of *All* Contractors by January 1, 1990

The 1989 Oregon legislature amended ORS Chapter 701 to require registration of all contractors prior to January 1, 1990. The 1989 Act is known as the Contractors Registration Act (the "Act"). Previously, the Oregon "Builders Board" registered and regulated the business only of residential builders. Under the Act, the Board's name has been changed to the "Construction Contractors Board," and its jurisdiction has been extended to include general contractors and specialty contractors in addition to residential contractors.

REGISTRATION REQUIREMENTS

Generally, the Act requires all contractors to register with the Construction Contractors Board by January 1, 1990. The Act broadly defines "contractor," as

> "...a person who undertakes or offers to undertake or submits a bid to construct, alter, repair, add to, subtract from, improve, move, wreck or demolish, for another, any building, highway. ..excavation, or other structure.. .or improvement attached to real estate or to do any part thereof. .." ORS 701.005(2).

Persons exempt from registration include persons performing construction services on any site or reservation under the jurisdiction of the Federal Government, persons performing casual, minor or inconsequential work with a value of less than $600, and owners who contract for work to be performed by a registered contractor, provided the owner does not construct for compensation or with the intent of offering the structure for sale before, during or after completion. An individual who acts as his own general contractor must register if the impmvement is constructed for sale. Additional exemptions are found in ORS 701.010.

If a property owner claims an exemption for construction work performed by the owner which is not performed in the pursuit of an independent business or with the intent of offering the structure for sale, the governmental entity issuing the building permit must obtain a statement from

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the applicant in the form prescribed by ORS 701.055(4) prior to issuing the permit.

Three categories of contractor are established for registration:

> "General contractor" means a contractor whose business operations require the use of more than two unrelated building trades or crafts that the contractor supervises or performs in whole or part. "General contractor" does not include residential contractors and does not include specialty contractors or individuals who perform building trades or crafts personally and without employees. ORS 701.005(3).
>
> "Specialty contractor" means a contractor who performs work on a structure, project, development or improvement and whose operations as such do not fall within the definition of "general contractor.""Specialty contractor" does not include residential contractors. ORS 701.005(6).
>
> As under the prior law, a 'residential contractor" (formerly "builder") is anyone who works on or offers to work on, in almost any respect, a residential structure consisting of four living units or less. ORS 701.005(4). The new amendments permit a limited amount of work to be done on a small commercial structure by a residential contractor.

The Construction Contractors Board has prepared registration application forms for general contractors and specialty contractors which are available upon request. Contact the Construction Contractors Board, 700 Summer NE, Suite 300, Salem, Oregon 97310-0161. The application form requires data such as federal employer ID numbers, withholding, workers compensation and unemployment insurance tax account numbers, the names of corporate officers or partners, and "a list of unsatisfied judgments resulting from bond claims and litigation involving the applicant or its principals within the prior five years." ORS 701.075. A partnership or joint venture is deemed to be registered for the purpose of offering to undertake work as a contractor on a **nonresidential structure** if any one of the partners or joint venturers whose name appears in the name under which the partnership does business is registered. However, for residential work, the partnership or joint venture itself must be registered with the Board. ORS 701.055(1).

Registration is required by January **1,** 1990. Registration is extremely important, because the statute prohibits the filing of any lien or claim for compensation or breach of contract unless the contractor was registered at the time the contractor bid or entered the contract and continuously thereafter. The Act provides that a court "may choose not to apply this section" **if** application "would result in substantial injustice to the unregistered contractor." ORS 701.065(2). A contractor is also precluded from hiring unregistered subcontractors. ORS 701.055(12).

Registration requires the posting of a surety bond and maintenance of public liability and property damage insurance. The bond penal **sum** is $10,000 for general contractors and class "A" residential contractors, and $6,000 for specialty contractors and class "B" residential contractors. ORS 701.085(1), (2) and (3); ORS 701.300(1). Minimum insurance limits are $600,000 for general and specialty contractors, and $100,000 for residential contractors. ORS701.105. All contractors are required to maintain lists of subcontractors on all projects, including registration numbers, and to cooperate with compliance inspections. ORS 701.055(11).

The registration bonds provide new security in construction disputes, including disputes involving claims of or against owners and subcontractors. However, claims that are covered by public works bonds may not be asserted against the registration bond required by the Act. ORS 701.300(4).

CLAIMS PERTAINING TO RESIDENTIAL CONSTRUCTION

Under prior law, one of the responsibilities of the Builders Board was to participate in disputes between owners and contractors for residential construction. Under the Act, the Board's role in dispute resolution remains limited to residential construction. ORS 701.140.

The Board has jurisdiction of the following types of disputes arising out of residential construction:

Claims by the owner against a contractor for negligent or improper work and breach of contract. ORS 701.140(1). Claims arising from the construction of a new structure must be filed with the Board within one year after the structure is occupied or two years after completion, whichever first occurs. ORS 701.145(3)(a). Claims arising from improvements made to existing structures must be filed within one year of substantial completion. **ORS** 701.145(3)(b). If a claim is filed by an owner because the contractor failed to commence construction, the claim must be filed within one year of the date of the contract. ORS 701.145(3)(c). If an owner files a claim because the contractor fails to complete the work, the claim must be filed within one year after the contractor ceased working. ORS 701.145(3)(d).

Claims by the owner against a contractor to discharge or recoup funds expended in discharging liens, provided that the owner has paid the contractor and the contractor

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has failed to pay the lien claimant. ORS 701.140(2). This type of claim must be filed within the time limits specified in paragraph (1) above.

Claims against a registered subcontractor by a registered contractor for negligent or improper work, or for breach of contract. ORS 701.140(3). These claims must be filed within one year after the structure was occupied or two years after completion, whichever comes first, unless the claim arises because the subcontractor fails to substantially complete the work, in which case it must be filed within one year after the subcontractor ceased work on the project. ORS 701.145(3)(d) and (f).

Claims by persons furnishing labor to a contractor. ORS 701.140(4). These claims must be filed within one year after the date the registrant incurred the indebtedness. ORS 701.145(3)(g).

Claims, as limited by the Board, but not exceeding $2,000, by persons furnishing material or renting or supplying equipment to a contrador. ORS 701.140(5). This type of claim must be filed within one year after the registrant incurred the indebtedness. ORS 701.145(3)(g).

Upon acceptance of a claim, the Board must give notice to the contractor. ORS 701.145(4). If the claim against the contractor is subject to arbitration, the contractor must initiate arbitration proceedings within 30 days after notification by the Board. Failure to so do is a waiver of any right to arbitrate. ORS 701.180. If, after investigation, the Board determines that a violation of the Act has occurred, and issues a final order requiring the registrant to pay compensation, which is not appealed, the claim must be satisfied by the surety from the bond. ORS 701.150. If more than one claim must be paid, the priority for payment is set forth in ORS 701.150.

No suit may be filed against the surety until 30 days after the Board notifies the surety that payment is due on the claim. ORS 701.085(9). In any suit on the bond, the court may award costs and attorney fees against the surety. In addition, if the court finds that the surety arbitrarily and capriciously refused to pay the amount ordered by the Board, the court may award damages against the surety equal to twice the amount of damages ordered by the Board. ORS 701.085(10).

CLAIMS PERTAINING TO NON-RESIDENTIAL STRUCTURES

The Board has no jurisdiction over claims against contractors arising from non-residential construction. Claims pertaining to non-residential structures *may* be brought against the bond under the Act, and *shall* be resolved by a court. ORS 701.140; 701.300(5)(b). In order to have an actionable claim on the bond against a general or specialty contractor, the claimant must deliver a copy of the complaint to the Board and the surety immediately after filing, by certified mail, return receipt requested. ORS 701.300(6). The surety is not joined as a party in the litigation, but has the right to intervene. Proper notice binds the surety to the judgment. ORS 701.300(6). The date the Board receives a copy of the complaint is the date used to establish the priority of the claim. ORS 701.300(6). Claims against the bond by the owner of a residential structure have priority over claims arising from non-residential construction filed within the same 90-day period. ORS 701.300(13)(a). The priority of other types of claims is established in ORS 701.300(13)(c).

If a court issues a judgment against the contractor, the plaintiff must deliver a certified copy of the judgment to the Board and the surety within 30 days of the date of entry of the judgment. ORS 701.300(7). The Board then issues an order according to the judgment. ORS 701.300(8). If the surety fails to pay within 30 days after notification by the Board, the claimant can commence an action against the surety. The court may award costs and attorney fees against the surety as well as damages equal to twice the amount ordered by the Board, if the court finds the surety's refusal to pay to be arbitrary and capricious. ORS 701.300(12).

SANCTIONS

As noted above, a contractor who is not continuously registered during bidding and construction may be unable to assert a lien or file a claim for compensation or for breach of contract. ORS 701.065. The Board may suspend the registration of or refuse to register any corporation, partnership or individual if any individual who is an owner, shareholder or officer of the business was an owner or officer of a previously registered business that owes any amount pursuant to a final order of the Board, or has an unsatisfied judgment that was obtained against the business' registration bond. ORS 701.137.

Board authorized inspectors who become aware of any noncompliance with the Act may, after notice and opportunity to prove compliance, stop the work of the non-complying contractor. ORS 701.225(3).

ORS 701.135 provides that the Board may revoke, suspend or refuse to issue or reissue a certificate of registration and may assess a civil penalty of up to $1,000 for each violation of the Act if, after notice and an opportunity for hearing, the Board determines any of the following.

The contractor has violated ORS 701.055 (registration requirements);

The contractor has failed to pay in full any final judg-

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ment on claim adjudged by the Board or a court of competent jurisdiction;

The contractor has failed to keep in effect the required amount of public liability or property damage insurance;

The contractor has failed to keep in effect the required surety bond;

The registrant or applicant has engaged in conduct as a contractor that is dishonest or fraudulent which the Board finds injurious to the public welfare;

The registrant has violated a rule or order of the Board;

The registrant has knowingly assisted an unregistered person to act in violation of ORS Chapter 701;

Alien was filed under ORS 87.010 to 87.060 and **87.076 to** 87.093 because the registrant or applicant wrongfully failed to perform a contractual duty to pay money to the person claiming the lien; or

The registrant or applicant bas made a misrepresentation on the application for registration or renewal.

Finally, the Board may direct the Attorney General or the district attorney of the county in which the act, practice or transaction occurred to seek an injunction restraining future violations. ORS 701.135(2)

CONCLUSION

Effective January 1,1990. virtually all contractors who provide construction services in Oregon must be registered and bonded. Failure to register can have serious consequences, including an inability to pursue a lien or claim for payment.

The above is intended as an overview of the Act. Construction contractors and owners and their attorneys are urged to familiarize themselves with the Act, prior to its effective date. A registered contractor can obtain a summary of the Act from the Board at cost. Residential contractors must deliver a copy of this summary to the owner when work commences on a residential structure. ORS 701.055(-13).

Elizabeth Yeats
Seifer, Yeats. Whitney & Mills

Surety Prevails Over Trustee in Bankruptcy

The United States District Court, for the Western District of Washington, at Seattle, recently issued a decision reversing an order of the United States Bankruptcy Court. ***United Pacific Insurance Company u. Mottner,*** C89-524 (W.D. Wash. August 2, 1989) ("Mottner"). The opinion represents a significant decision for the surety industry, not only in the State of Washington, hut in the entire United States.

In summary, the facts were as follows. United Pacific Insurance Company ("'United Pacific") provided the contractor with Washington Public Works payment and performance bonds. Prior to the issuance of the bonds, the contractor and United Pacific signed a standard form indemnity agreement. Prior to the completion of the project, various subcontractors filed claims with the contractor and the surety. Before United Pacific paid any claims, the contractor had completed construction of the project and filed bankruptcy under Chapter 11 of the United States Bankruptcy Code. Subsequent to the bankruptcy filing United Pacific paid various subcontractor claims. United Pacific claimed the final progress payment, as did the bankruptcy trustee.

In the Bankruptcy Court, both the trustee and United Pacific filed motions for summary judgment. The bankruptcy court found that the trustee was entitled to the final progress payment because it believed that United Pacific's equitable rights dated from the time United Pacific paid the contractor's debts and because United Pacific first paid a subcontractor's claim after the contractor filed bankruptcy.

On appeal to the United States District Court, the Bankruptcy Court decision was reversed. First, the Court, citing ***Pearlman u. Reliance Insurance Company,*** 371 U.S. 132, 83 S. Ct. 232, 9 L. Ed.2d 190 (1962) ("Pearlman"), set forth the proper inquiry:

> Property interest in a fund not owned by a bankrupt at the time of adjudication, whether complete or partial, legal or equitable, mortgages, liens, or simple priority of rights, are of course not a part of the bankrupt's property and do not vest in the trustee. The Bankruptcy Act simply does not authorize a trustee to distribute other people's property among a bankrupt's creditors. So here if the surety at the time adjudication was, as it claimed, either the outright legal or equitable owner of this fund, or had an equitable lien or prior right to it, this property interest of the surety never became part of the bankruptcy estate.

371 US. at 135-136

The court went on to note that the law of suretyship and equitable subrogation provides that the right of subrogation comes into existence "when the surety becomes obligated; but such right of subrogation does not become a cause of action until a debt is finally paid". ***Mottner,*** Slip Op at 5 *citing* Simpson, *Law of Suretyship,* §47 (1950) and

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10 Appleman, *Insurance Law* & Practice, §6609 at 466. When a contractor defaults, the surety's equitable rights attach and relate back to the date the surety executed its bond. Prairie *State* Bank *v.* United States. 164 U.S. 227, 17 S. Ct. 142, 41 L. ed. 412 (1896); United *Pacific Insurance* Company v. First National Bank of Oregon, 222 F. Supp. 243, (D. Or. 1963) ("First National Bank").

The Court noted that the Oregon Bankruptcy Court had previously considered and resolved the exact question presented in Mottner in favor of the surety. In re *Pacific* Marine Dredging and *Const.*, 79 BR 924,928 (Bankr. D. Or. 1987).

Thus, the Court found that United Pacific's lien on the progress payment dated back to the execution of the payment and performance bond, and therefore, the contractor did not have any legal or equitable interest in the progress payment at the time it filed bankruptcy. Mottner, Slip Op at 7-8. Accordingly, the Court found that the progress payment was not property of the bankruptcy estate under 11 U.S.C. §641, and that the trustee should turn the progress payment over to United Pacific.

The trustee tried to avoid the application of Pearlman by distinguishing it on two grounds. First, the trustee noted that the Bankruptcy Code §541 is more encompassing than §70(a) of the Bankruptcy Act. Thus, the cases cited under the Act are invalid. Second, the trustee pointed out that *Pearlman* involved retainage proceeds, rather than progress payments. See *In* re Glouer Construction Company, *Inc.*, 30 BR 873 (Bankr. W.D. Ky. 1983) and In re Universal Builders, Inc., 63 BR 183 (Bankr. Tenn. 1986).

The Bankruptcy Appellate Panel of the Ninth Circuit has reaffirmed the continuing validity of Pearlman under the Bankruptcy Code. In *In* re E.R. Fegert, *Inc.*, 88 BR 268 (9th Cir. BAP 1988), the court was faced with the issue of whether a debtor's payment to two subcontractors constituted voidable preferences where the subcontractors released their unsecured claims against the debtor and the claims against the surety. First, the court noted that the trustee had conceded that Pearlman had continuing validity as applied to cases filed under the Code. Id. at 260. Nevertheless, the trustee, like here, argued that *Pearlman* does not apply to Miller Act "progress payments", but only retainage. In response, the Bankruptcy Appellate Panel stated

> We conclude that the surety would have been entitled to assert a lien for both any unpaid progress payments or funds held as retainage. *National Shawmut Bank of Boston v.* New Amsterdam Cattle Company, supra, 411 F.2d at 848. See also American Fire & Casualty Company v. First *National Bank of New* York, 411 F.2d 766,768 (1st Cir. 1969). Also, we doubt that any court would rely on the distinction between progress payments and retainages in cases such as this where the party seeking to assert such a superior right, vis-a-vis a surety, is a Chapter 7 trustee concerned solely with liquidation of the estate and not in fulfilling the contractual commitments of the debtor. See In re Glover Construction, *Inc.*, supra, 30 BR at 878 (Chapter 11 case); In re Universal Builders, Inc., supra, 63 BR at 183 (Chapter 11 case).

Id. at 261. In short, the court rejected the trustee's attempt to limit the application of Pearlman to cases decided under the Bankruptcy Act in situations involving retainage.

In addition, even in the cases cited by the trustee, holding that the contract balance is property of the estate, the Court refused to allow either the debtor or the trustee to use the funds for any purpose until laborers and materialmen had been paid and the surety's rights to subrogation satisfied. In re Ram Construction Company, *Inc.*, 32 BR 768 (Bankr. W.D. Penn. 1983); In re Glouer Construction Company, *Inc.*, 30 BR 873 (Bankr. W.D. Kenn. 1983).

Finally, the Court found as a matter of equity and public policy that United Pacific should have a superior lien on the progress payment. Mottner Slip Op at 7. The Court found that but for the contractor's filing of bankruptcy, United Pacific would have clear possession of the funds. The Court found that it makes no sense to "punish a surety for paying claims after a contractor declares bankruptcy, and the equitable rights of subrogation exist to protect a surety in just these circumstances". Mottner, Slip Op at 7.

> [T]he existence of this equitable lien in the law of suretyship is an absolute necessity in this day and age of municipal corporations and others requiring the posting of bonds on public and other construction work. If no such right or a lien existed, it would be difficult, if not impossible, to entice another to act as a surety.

First National Bank, 222 F. Supp at 260.

Washington has thus joined the clear majority of other states in giving priority to the surety's claims, whether they arise as a result of performance or payment. In addition, the validity of Pearlman has been reaffirmed in the Surety's ongoing battles with the trustee in bankruptcy.

Jan D. Sokol
(Mr. Sokol represented United *Pacific* Insurance Company in connection with this case.)

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