1983

Wasatch Bank of Pleasant Grove, A Corporation v. Surety Insurance Company of California, a Corporation : Brief of Plaintiff-Appellant

SUPREME COURT OF UTAH

STATE OF UTAH

[illegible] BANK OF PLEASANT GROVE, a corporation,	:	
Plaintiff-Appellant,	:	
vs.	:	Case No. 19158
SURETY INSURANCE COMPANY OF CALIFORNIA, a corporation,	:	
Defendant-Respondent.	:	

BRIEF OF PLAINTIFF-APPELLANT

APPEAL FROM A SUMMARY JUDGMENT OF THE FOURTH JUDICIAL DISTRICT COURT OF UTAH COUNTY, STATE OF UTAH, HONORABLE DAVID SAM JUDGE

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SUPREME COURT OF UTAH

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Defendant and Respondent.	:	

BRIEF OF APPELLANT

NATURE OF CASE

This is an action by the bank to recover from the surety company certain sums which the bank paid to laborers and materialmen who were named beneficiaries under the surety's payment bond.

DISPOSITION IN LOWER COURT

Upon motion of the defendant, the Fourth Judicial District Court, the Honorable David Sam presiding, awarded summary judgment for the defendant, no cause of action. A copy of the Order of Summary Judgment is attached hereto as Appendix A.

RELIEF SOUGHT ON APPEAL

The plaintiff-appellant seeks to have the judgment of the [illegible] Court reversed, and to have the cause remanded for a trial [illegible] merits.

STATEMENT OF FACTS

On or about February 17, 1981, the defendant executed a

"Subcontract Labor and Material Payment Bond", a reduced copy of which is attached hereto as Appendix B. (R. 7) The named obligee on the bond, Valley Builders, was the prime contractor on a public contract for the construction of a school building. ATM Masonry Company, the principal on the bond, was a subcontractor employed by Valley Builders to do the masonry work.

To provide financing for the completion of the project, ATM Masonry sought financing from the plaintiff bank, and the bank extended a line of credit to ATM in the amount of $50,000.00. (R. 15) As security for the line of credit, ATM assigned to the bank ATM's right to receive payments from Valley Builders. Notice of the assignment was given to Valley Builders, but Valley Builders failed to comply with the assignment and made some payments directly to ATM and to laborers and materialmen. (R. 16, 34)

Pursuant to the terms of the contract between ATM and the bank, payments were made to laborers and materialmen to the extent of the line of credit. (R. 6) Because Valley Builders failed to honor the assignment of the contract proceeds to the bank, the bank was not reimbursed for the payments made to laborers and materialmen. (R. 34) The bank then brought this action to recover, from the surety company, the $50,000.00 which had been paid to laborers and materialmen. (R. 6)

ARGUMENT

POINT I

THE BANK IS EQUITABLY ENTITLED TO BE SUBROGATED TO THE RIGHTS OF LABORERS AND MATERIALMEN, WHOM IT PAID; CASES TO THE CONTRARY SHOULD BE OVERRULED.

Subrogation was developed by the courts of equity to enable

system to avoid the fixed rules of law, and to allow the equity court to achieve the natural justice of placing the burden where it ought to rest. Subrogation is pliable and capable of being molded to attain justice to compel the ultimate discharge of a debt or obligation by the party who in good conscience ought to pay it. Allstate Insurance Co. v. Ivie, 606 P.2d 1197, 1202 (Utah 1980).

The equities of the instant situation are readily apparent. The entity primarily responsible for paying the laborers and materialmen was ATM Masonry. ATM Masonry, in turn, was to receive those funds from Valley Builders. To bridge the time gap, however, between the receipt of funds from Valley Builders and the required payments for materials and labor, ATM sought a line of credit from the bank. The bank, for compensation, agreed to provide the line of credit to the extent of $50,000.00 and as security took an assignment of the contract payments from Valley Builders. The bank, therefore, undertook to provide the liquidity necessary to enable ATM Masonry to pay its debts and perform its contract prior to receiving the contract payments from Valley Builders. The bank did not, however, undertake to guarantee that the laborers or materialmen would actually be paid, or to guarantee that the contract would be completed.

The surety company, on the other hand, did undertake, for compensation, to assume the risk that the laborers and materialmen would not be paid. It is clear that, had the bank not been present in the transaction, the laborers and materialmen would not have been paid, and the surety would have been required to make payment pursuant to the terms of the payment bond. With the bank in the

transaction, the bank advanced funds for payments to the laborers and materialmen, and was to have been reimbursed pro tanto, pursuant to the terms of the assignment, from Valley Builders. If Valley Builders complied with the assignment, the bank would have been repaid in full for the line of credit thus extended. Any laborers and materialmen not paid would have had a claim against the bond.

The role of the bank, therefore, and the purpose for which it was compensated, was to provide liquidity. The role of the surety on the other hand, and the purpose for which it was compensated, was to insure against the risk of default on the part of ATM Masonry. The holding of the trial court, however, would require the bank to assume both roles. Valley Builders did not comply with the terms of the assignment of contract proceeds, and instead paid some funds directly to ATM Masonry. ATM Masonry breached the terms of its contract and failed to use those funds to pay laborers and materialmen. This was exactly the type of risk against which the surety had agreed to insure, and the surety would normally have been required to provide payment for those unpaid laborers and materialmen. However, because of the mistaken belief that Valley Builders would honor the assignment, the bank, through ATM, mistakenly paid those laborers and materialmen, but did not receive the anticipated contract proceeds in reimbursement. To require the bank to thus bear the burden of ATM's default would be manifestly inequitable and contrary to the clear intent of the surety agreement.

In Paxton v. Spencer, this Court stated as follows:

> To hold the surety liable for advancements made or money loaned to the contractors to enable them to carry out the contract without the assent of a surety, unless the facts are such that it would be inequitable to not hold the surety liable, is to read into the contract a liability not assumed by the surety and a liability clearly not contemplated by the parties at the date of the execution of the bond.

71 Utah 313, 265 P. 751, 753 (1928) (emphasis added).

This case comes within the above stated exception to the Paxton rule. The surety, and not the bank, agreed in consideration of premiums paid to insure against cost overruns and unpaid materialmen on the project. Had the bank not extended credit, no payments would have been made, and the surety would obviously have been required to honor its obligation on the bond. It would be manifestly inequitable to absolve the surety company of its contractual obligation solely because the payments must now flow to a third party beneficiary, rather than directly to the materialmen or the named obligee.

The appellant acknowledges that there is a large body of law which holds that the bank's claim for money loaned to a contractor and used to pay for labor and materials is not within the coverage of a bond which guarantees payment for that labor and materials. Annot., Money loaned or advanced to contractor as within coverage of bond of building or construction contractor, 127 A.L.R. 974 (1940). However, that rule, though old, is not sound or equitable. The original basis for the rule no longer exists and the rule now stands out as an anomaly in equity jurisprudence.

The early cases labeled banks as volunteers, and having so

labeled them, denied them any recovery against the bond. The courts apparently viewed banks as having no obligation, contractual, legal, moral, or otherwise, to pay the laborers and materialmen, and the courts therefore held that any payments made by the banks were essentially gifts. See 127 A.L.R. 989.

The volunteer rule has been soundly criticized in G. Osborne, G. Nelson, and D. Whitman, Real Estate Finance Law 605 (1979):

> The limits as well as the rationale of the volunteer rule are a matter of dispute. It has been asserted that, whenever courts for any reason deny subrogation, they characterize the unsuccessful applicant as a volunteer. Even when used with more discrimination it has sometimes been unclear whether subrogation was denied because the court found that the plaintiff did not intend any legal consequences to flow from his act, e.g., he intended a gift, or that his intervention was unsolicited and therefore officious. A critical examination of the reasons offered for using the rule to deny subrogation on payment of a creditor by a third person has revealed them to be so lacking in force as to make reasonable the suggestion that, in order for such a payment to be officious, it must be unnecessary and confer no benefit. Because of the variety and unpredictability of its application, the voluntary payment test is of little value. Except in cases in which the payor clearly intended a gift, it should be discarded.

(Footnotes omitted.) See also Hult v. Ebinger, 222 Or. 169, 352 P.2d 583, 592 (1960) ("It is obvious that the modern practice which permits free alienability of choses has robbed the 'volunteer' rule of much of its rational justification.").

Even if some aspects of the volunteer rule remain in effect, it is difficult to see how the rule can equitably be applied in the instant case. Although the bank was not coerced to provide a line of credit to the subcontractor, the bank's payments to the laborers

and materialmen were by no means voluntary within any commonly understood meaning of that word. The case of Paxton v. Spencer, 71 Utah 313, 265 P. 751 (1928), presents a more reasonable application of the volunteer rule. In that case, Paxton had contracted to build a road, and had subcontracted a portion of the work to Spencer. Spencer became financially distressed, and so Paxton then obtained a loan for the benefit of Spencer. Spencer defaulted on his contract and on the loan, and Paxton sought recovery from the bonding company. The trial court denied recovery, and this Court affirmed. The case is wholly distinguishable from the instant matter. Paxton's loan of money to Spencer was not pursuant to any contractual obligation, but was truly voluntary. In contrast, the bank in this case had a contractual obligation to pay the laborers and materialmen, and the payments cannot be considered voluntary.

A Utah case more analogous to the facts here is State Division of Family Services v. Clark, 554 P.2d 1310 (Utah 1976). The State had made payments to support children, and sought reimbursement from the fathers on a theory of subrogation. Similar to the bank's contractual obligations in the instant matter, the State had voluntarily entered into a statutory obligation to provide support for the children. The court held that the State was entitled to recover the payments from the fathers.

To the extent that Paxton v. Spencer, supra, and other similar cases hold that a person who loans money to a subcontractor is a volunteer and therefore is not entitled to subrogation, those cases should be overruled.

POINT II

A MATERIAL ISSUE OF FACT EXISTS AS TO WHETHER THE PAYMENTS WERE VOLUNTARY.

The law concerning whether a payment is voluntary is set in 73 Am. Jur. 2d Subrogation § 24 (1974):

> Generally speaking, the party making payment is a volunteer if, in so doing, he has no right or interest of his own to protect, and acts without obligation, moral or legal, and without being requested by anyone liable on the obligation. A volunteer may be, but is not necessarily, one who has nothing to do with the transaction out of which the debt grew.
>
> . . . .
>
> One is not a volunteer within the rule here considered where he pays the debt at the instance, solicitation, or request of the person whose liability he discharges, or of that person's agent or representative. And one is not a volunteer, so as to be denied subrogation, who advances money to another for the payment of claims with an express or implied agreement of either the debtor or the creditor that he shall acquire the rights which the person paid had under a bond or other contract; and this is so even though the surety or secondary obligor made no request of him or had no notice of his advancing the money.

(Emphasis added, footnotes omitted). See also Western Casualty & Surety Co. v. Meyer, 301 Ky. 487, 192 S.W.2d 388, 164 A.L.R. 769 (1946).

In the instant case, the bank certainly did not "voluntarily" hand out money to the laborers and materialmen. The bank handed checks to the laborers and materialmen at the specific request and pursuant to a contractual obligation with, ATM Masonry, discharging ATM's obligation to the laborers and materialmen. The bank thus comes squarely within the scope of the above stated law

and was therefore not a volunteer.

POINT III

THE BANK IS A THIRD-PARTY BENEFICIARY OF THE CONTRACT.

A person is a third party beneficiary of a contract if performance of the contract will satisfy a duty of the promisee to the beneficiary. Kelly v. Richards, 95 Utah 560, 83 P.2d 731, 735 (1938). In determining whether a contract was intended to benefit the third person, the court may look at the terms of the agreement and at the facts and circumstances surrounding the making of the agreement. Mel Trimble Real Estate v. Fitzgerald, 626 P.2d 453 (Utah 1981). In reviewing the terms of the agreement and in looking at the circumstances surrounding the execution of the agreement, all doubt should be resolved in favor of allowing recovery under the bond, as a contract of a surety, for hire, is strictly construed against the surety. J. F. Tolton Investment Co. v. Maryland Casualty Co., 77 Utah 226, 293 P. 611, 612 (1930); Conesco Industries , Ltd. v. Conforti and Eisele, Inc., D.C., 627 F.2d 312, 317 (D.C. Cir. 1980).

The surety company in the instant matter undertook, for compensation, to insure against the risk of default on the part of ATM Masonry. Specifically, the surety undertook to insure against loss to persons as a result of the failure of ATM Masonry to pay laborers and materialmen. The surety seeks to avoid liability by hiding behind language in the bond to the effect that the surety is obligated to claimants, and claimants are limited to those having direct contracts with ATM Masonry for labor or materials. The bank

admittedly does not have a direct contract with ATM Masonry which obligates the bank itself to provide labor or materials. The bank's claim nonetheless comes within the scope of the claims intented to be covered by the bond, and the bank must be deemed to be a third-party beneficiary of the bond.

A contrary holding would render the bond meaningless. The bond provides that "the Condition of this Obligation is such that if the Principal shall promptly make payment to all claimants as hereinafter defined, for all labor and material used or reasonably required for use in the performance of a subcontract, then this obligation shall be void; otherwise it shall remain in full force and effect . . . ." The principal did not promptly make payment to all claimants, and the bond is therefore in full force and effect, but for what purpose? Under the construction advocated by the surety, the bond no longer has any effect, even though the principal did not make prompt payment to all claimants. If the bond is to have full force and effect, as required by its terms, the bond must be used to satisfy the claims resulting from ATM's default. To the extent that the provision that the bond remain in full force and effect conflicts with the provision limiting "claimants" to only those having direct contracts with the contractor, the conflict should be resolved strictly against the surety.

CONCLUSION

The bank cannot be considered to have "voluntarily" paid money to the laborers and materialmen. The bank, by honoring checks written against the line of credit, paid the laborers and materialmen at the request of ATM Masonry, and pursuant to the

contractual obligations. Under existing law, the payments were therefore not voluntary. To the extent that Utah cases hold that such payments are voluntary, those cases should be overruled. The original basis for the volunteer rule has long since vanished, and the rule has no current justification.

In addition, the bank must be considered to be a third party beneficiary of the surety contract, and thus entitled to recover.

The decision of the trial court granting summary judgment for the defendant should be reversed, and the caused remanded for a trial on the merits.

Respectfully submitted this 1st day of August, 1983.

S. REX LEWIS, for:
HOWARD, LEWIS & PETERSEN
Attorneys for Appellant

CERTIFICATE OF MAILING

I hereby certify that I mailed a true and correct copy of the foregoing Brief of Appellant to Carman E. Kipp and Stephen F. Hutchinson, Kipp & Christian, Attorneys for Defendant, 600 Commercial Club Building, Salt Lake City, Utah 84111, this 1st day of August, 1983.

SECRETARY

[illegible] F. HUTCHINSON

[illegible] Defendant
[illegible]
SALT LAKE CITY, UTAH 84111
[illegible] 521-3773

IN THE FOURTH JUDICIAL DISTRICT COURT OF UTAH COUNTY

STATE OF UTAH

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WASATCH BANK OF PLEASANT GROVE, a corporation,	:	
Plaintiff,	:	ORDER OF SUMMARY JUDGMENT
vs.	:	
SURETY INSURANCE COMPANY OF CALIFORNIA, a corporation,	:	Civil No. 62,023
Defendant.	:	

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The Motion of defendant, Surety Insurance Company of California, having come on for hearing pursuant to notice on March 25, 1983, with Stephen F. Hutchinson, counsel for defendant, and S. Rex Lewis, counsel for plaintiff, present, and it appearing that no material facts are in dispute, and that there is good cause therefor, now, therefore,

APPENDIX A

IT IS HEREBY ORDERED:

That defendant's Motion for Summary Judgment for no cause of action should be and the same is hereby granted, with each party to bear its own costs.

DATED this 25 day of April, 1983.

BY THE COURT:

DAVID SAM, DISTRICT COURT JUDGE

Surety Insurance Company
of California

STANDARD LABOR AND MATERIAL PAYMENT BOND

Know All Men By These Presents That ATH MASONRY COMPANY
P. O. Box 470, Fremont Grove, Utah 84062

as Principal, hereinafter called Principal, and the SURETY INSURANCE COMPANY OF CALIFORNIA, a corporation organized and existing under the laws of the State of California, with its principal office in the City of Pasadena, Ca. authorized and qualified to transact business under the laws of the State of Utah, as Surety, are held and firmly bound unto

WEBER SCHOOL DISTRICT, OGDEN, UTAH

as Obligee, hereinafter called Obligee,

for the use and benefit of claimants as hereinbelow defined, in the amount of

ONE HUNDRED FIFTY THOUSAND DOLLARS AND NO/100*** Dollars ($150,000.00***),

for the payment whereof Principal and Surety bind themselves, their heirs, executors, administrators, successors and assigns, jointly and severally, firmly by these presents.

Whereas, Principal has by written agreement dated October 17, 1980
entered into a subcontract with Obligee for interior block of the exterior walls being put in place - approximately eight (8) feet high of approximately 85% of the perimeter of the building.

in accordance with drawings and specifications prepared by

Silver - Allsop & Associates

which subcontract is by reference made a part hereof, and is hereafter referred to as the subcontract.

Now, Therefore, the Condition of this Obligation is such that if the Principal shall promptly make payment to all claimants as hereinafter defined, for all labor and material used or reasonably required for use in the performance of the subcontract, then this obligation shall be void; otherwise it shall remain in full force and effect, subject, however, to the following conditions:

(1) A claimant is defined as one having a direct contract with the Principal for labor, material, or both, used or reasonably required for use in the performance of the contract, labor and material being construed to include that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment directly applicable to the subcontract.

(2) The above named Principal and Surety hereby jointly and severally agree with the Obligee that every claimant as herein defined, who has not been paid in full before the expiration of a period of ninety (90) days after the date on which the last of such claimant's work or labor was done or performed, or materials were furnished by such claimant, may sue on this bond for the use of such claimant, prosecute the suit to final judgment for such sum or sums as may be justly due claimant, and have execution thereon. The Obligee shall not be liable for the payment of any costs or expenses of any such suit.

(3) No suit or action shall be commenced hereunder by any claimant,

(a) After the expiration of one (1) year following the date on which Principal ceased work on said subcontract, it being understood, however, that if any limitation embodied in this bond is prohibited by any law controlling the construction hereof, such limitation shall be deemed to be amended so as to be equal to the minimum period of limitation permitted by such law.

(b) Other than in a state court of competent jurisdiction in and for the county or other political subdivision of the state in which the project, or any part thereof, is situated, or in the United States District Court for the district in which the project, or any part thereof, is situated, and not elsewhere.

(4) The amount of this bond shall be reduced by and to the extent of any payment or payments made in good faith hereunder.

Signed and sealed this 17th day of February A. D., 1981.

ATH MASONRY COMPANY

.....(Seal)

.....(Seal)

SURETY INSURANCE COMPANY OF CALIFORNIA

By .....(Seal)
Fred C. Carroll, Attorney-in-fact

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APPENDIX B

Surety Insurance Company of California

HOME OFFICE IN LA HABRA, CALIFORNIA

CERTIFIED COPY OF POWER OF ATTORNEY

No. 2325

Know all by these presents: That Surety Insurance Company of California, a California Corporation, having its principal office in the City of La Habra, County of Orange, State of California, pursuant to the following By-Laws duly adopted by the Board of Directors of said Company on the 9th day of April, 1969 and are now in effect, to-wit:

Section 7(b). The President shall have power and authority to appoint Attorneys-In-Fact, and authorize them to execute on behalf of the Company bonds and undertakings, recognizances, contracts of indemnity, and other writings obligatory in the nature thereof, and he may at any time in his judgment remove any such appointees and revoke the authority given to them."

Now, therefore, the President, by virtue of the authority vested in him by the By-Laws of said Company, has constituted and appointed and by these presents does make, constitute and appoint

Paul G. Carroll of Tempe, Arizona

his true and lawful agent and attorney-in-fact, to make, execute, seal and deliver for and on its behalf as surety, and as its act and deed, all of the following classes of documents, to wit:

Indemnity, Surety and Undertakings that may be desired by contract, or may be given in any action or proceeding in any court of law or equity; policies indemnifying employers against loss or damage caused by the misconduct of their employees, official surety and fidelity bonds.

THE AUTHORITY OF THIS POWER OF ATTORNEY IS LIMITED TO ONE HUNDRED FIFTY THOUSAND AND NO/100 -- ($150,000.00) — DOLLARS FOR ANY SINGLE BOND.

THIS POWER OF ATTORNEY IS VALID ONLY FOR A BOND OR UNDERTAKING EXECUTED PRIOR TO DECEMBER 31, 1981.

The execution of such bonds or undertakings in pursuance of these presents, shall be as binding upon said Company as fully and amply, to all intents and purposes as if they had been duly executed and acknowledged by the regularly elected officers of the Company at its office in La Habra, California in their own proper persons.

IN WITNESS WHEREOF, Surety Insurance Company of California has caused these presents to be signed by its duly authorized officers and its corporate seal to be hereunto affixed this 5th day of December 19 80

Surety Insurance Company of California INCORPORATED JAN 31, 1969

SURETY INSURANCE COMPANY OF CALIFORNIA

By John F. Merrill
John F. Merrill
President

STATE OF CALIFORNIA
COUNTY OF ORANGE } ss:

On this 5th day of December A.D. 19 80 before the subscriber, a Notary Public of the State of California in and for the County of Orange duly commissioned and qualified, came John F. Merrill, President of SURETY INSURANCE COMPANY OF CALIFORNIA, to me personally known to be the individual and officer described in, and who executed the preceding instrument, and he acknowledged the execution of the same, and being by me duly sworn, did depose and say that he is the officer of the said Company aforesaid, and that the seal affixed to the preceding instrument is the Corporate Seal of said Company, and the said Corporate Seal and his signature as officer were duly affixed and subscribed to the said instrument by the authority and direction of the said Corporation, and that Article IV, Section 3, By-Laws of said Company, referred to in the preceding instrument, is now in force.

IN TESTIMONY WHEREOF, I have hereunto set my hand, and affixed my Official Seal at the City of La Habra, the day and year first above written.

Linda R. Davis Notary Public

OFFICIAL SEAL
LINDA R DAVIS
NOTARY PUBLIC - CALIFORNIA
ORANGE COUNTY
My comm. expires SEP 25, 1984

CERTIFICATION

I, the undersigned, certify that I am the Secretary of SURETY INSURANCE COMPANY OF CALIFORNIA and that the foregoing Power of Attorney is in full force and effect and has not been revoked, and furthermore that Article IV, Section 3 of the By-Laws of said Company set forth in said Power of Attorney, are now in full force and effect.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the corporate seal of the said Company (SEAL)

this 17 day of February, 1981.

Secretary

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