

# 351

UNPUBLISHED OPINION

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF UTAH

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In re	)	
DAVIDSON LUMBER SALES, INC.,	)	Bankruptcy Case No. 86C-00490
Debtor.	)	
_____	)	
ZIONS FIRST NATIONAL BANK, N.A.,	)	Adversary Proceeding No. 90PC-0044
Plaintiff,	)	
vs.	)	
CHRISTIANSEN BROTHERS, INC., DIEHL LUMBER PRODUCTS, INC., and JACOBSEN-ROBBINS CONSTRUCTION COMPANY,	)	
Defendants.	)	MEMORANDUM OPINION AND ORDER

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The matters presently before the court are Plaintiff's Motion for Summary Judgment Against Christiansen Brothers, Inc., and Christiansen Brothers, Inc.'s Motion for Summary Judgment. A hearing was held on July 25, 1991. J. Randall Call, Esq. and Sally B. McMinimee, Esq. appeared on behalf of the plaintiff, Zions First National Bank, N.A.

("Zions"). Bryce D. Panzer, Esq. appeared on behalf of defendant Christiansen Brothers, Inc. ("Christiansen"). Counsel presented argument, after which the court took the motions under advisement. The court has carefully considered and reviewed the arguments of counsel and all memoranda and affidavits submitted by the parties and has made an independent review of the pertinent authorities. Now being fully advised, the court renders this memorandum decision.

### UNDISPUTED FACTS

Based on the affidavits and memoranda filed with the court, the court finds that for purposes of the present motions for summary judgment, the following material facts are undisputed or cannot be reasonably disputed.

1. On February 6, 1986, the debtor, Davidson Lumber Sales, Inc. ("Davidson"), filed a petition under Chapter 11 of the Bankruptcy Code. The case was subsequently converted to one under Chapter 7 on April 30, 1987.

2. As of the petition date, Zions claimed that Davidson owed Zions \$1,986,316.89, evidenced by a proof of claim filed by Zions on or about June 10, 1986.

3. On February 21, 1986, Davidson and Zions executed a Stipulation and Agreement Concerning Post-Petition Financing and Security Agreement, whereby Zions agreed to make a postpetition line of credit available to Davidson in the amount of up to \$1,700,000.

4. The postpetition line of credit was secured by both a first-priority lien on all of Davidson's postpetition collateral, including accounts and inventory, senior to all liens, security interests, and other encumbrances against such collateral, and a super-priority administrative expense claim in favor of Zions.

5. The Stipulation was approved by this court by Order dated February 21, 1986.

6. Zions filed a UCC-1 financing statement with the Utah Department of Commerce, Commercial Code Division, on March 3, 1986.

7. Subsequent to the Stipulation, Zions advanced funds to Davidson in the approximate amount of \$300,000. As of February 1986, Zions was owed approximately \$300,000 on account of its postpetition advances to Davidson under the Stipulation. This obligation continued to remain owing through March of 1987.

8. Postpetition, from November 1986 until March 6, 1987, Christiansen purchased goods and materials from Davidson, which goods and materials were used in the construction of buildings, structures, and improvements for the Promontory Point Apartment Complex, also known as the High Point Apartments, located at approximately 7800 South 1100 East, Salt Lake County, Utah (the "Project").

9. Postpetition, Diehl Lumber Products, Inc. ("Diehl"), a wholesaler of lumber and building products, sold the materials to Davidson, which materials were resold by Davidson to Christiansen and were used in the Project. Davidson and Diehl agreed that Davidson's purchase orders to Diehl would reflect that the lumber was for the Project.

10. Diehl was willing to sell the materials to Davidson based upon its belief that it had the ability to lien the Project and could pursue payment under a bond, should payment not be received from Davidson. In determining whether to sell materials to Davidson, Diehl also considered the creditworthiness of Christiansen.

11. Diehl did not obtain a security interest in the materials it sold to Davidson.

12. Christiansen ordered the goods and materials for use in the Project, and Christiansen and Davidson agreed to certain terms for billing and delivery of the materials. Specifically,

a. Christiansen agreed that it would be invoiced by Davidson at the time Davidson took delivery of the lumber from Diehl, provided that the lumber was segregated at Davidson's yard.

b. Davidson kept track of what lumber had been received from Diehl for invoicing and future delivery to the Project, kept records of the delivery to the Project, and also kept track of the delivery of materials directly to the Project by Diehl.

c. Christiansen also required that the interest of Christiansen in the segregated lumber at Davidson's yard be insured.

d. Diehl specifically identified on its records deliveries to Davidson for the Project, by setting up and billing the materials to a separate customer account.

13. In determining whether to sell materials to Davidson, Diehl considered the fact that materials shipped to Davidson's yard were segregated, further facilitating Diehl's tracing of the materials supplied for the Project.

14. On or about February 27, 1987, Diehl filed a notice of mechanic's lien against the Project in the amount of \$105,679, based upon the fact that Diehl had not been paid by Davidson for materials supplied to Davidson and ultimately sold to Christiansen for use in the Project. The lien was recorded on February 27, 1987, Book 5883 Page 635 as Entry No. 4409268. The lien failed to include the dates on which the materials were first and last supplied to the Project.

15. Christiansen and Diehl entered into an Agreement dated March 11, 1987, whereby Diehl agreed to release its mechanic's lien and other claims relating to goods and materials purchased by Davidson from Diehl in consideration for Christiansen agreeing to pay directly to Diehl a sum in excess of \$134,000.

16. Pursuant to the March 1987 Agreement, Christiansen paid directly to Diehl the sum of \$134,944.13. After payment to Diehl, Diehl released its Notice of Lien.

17. Anderson Lumber also sold goods and materials to Davidson postpetition. These goods, totalling \$32,429.30, were subsequently sold to Christiansen for use in the Project. On or about February 24, 1987, Christiansen issued a check made jointly payable to Anderson Lumber and Davidson, in the sum of \$32,429.30, as payment for goods and materials purchased from Davidson and used in the Project. Davidson's president endorsed the check.

18. By letter dated March 13, 1987, Noel S. Hyde, counsel for Davidson, notified Bryce D. Panzer, counsel for Christiansen, that Davidson declined to authorize payment of the Christiansen account to any entity other than the bankruptcy estate.

19. At the time Christiansen and Diehl entered into the March 1987 Agreement, and at the time Christiansen made the payments to Diehl for a release of Diehl's lien, Christiansen had not received demand from Zions that payments on Davidson's accounts were to be made to Zions.

#### DISCUSSION

Zions contends that Christiansen's payment to Diehl was improper and that Christiansen, as Davidson's postpetition account debtor, remains obligated to pay the amount claimed to be owing to Davidson for the materials supplied to the Project. Asserting its secured status on postpetition cash collateral, Zions contends that Christiansen is obligated to pay that amount to Zions. Christiansen, on the other hand, claims that its payment to Diehl satisfied its obligation to Davidson and that nothing is owing to Davidson or Zions.

In determining which party prevails in this proceeding, the court must first turn to Utah law.

Based on the undisputed facts, it is clear that Diehl, as a sub-subcontracting supplier of lumber for the Project, was a materialman under Utah law. See Lawson Supply Co. v. General Plumbing & Heating, Inc., 27 Utah 2d 84, 493 P.2d 607 (1972).

Diehl had the right to lien the Project when it did not obtain payment for the materials it supplied to Davidson, the subcontractor. Utah Code Ann. § 38-1-3; Western Coating, Inc. v. Gibbons & Reed Co., 788 P.2d 503, 503-04 (Utah 1990); Bailey v. Call, 767 P.2d 138 (Utah Ct. App. 1989); Dugger v. Cox, 564 P.2d 300, 302 (Utah 1977); Lawson Supply Co. v. General Plumbing & Heating, Inc., 27 Utah 2d 84, 493 P.2d 607 (1972); Davis v. Barrett, 24 Utah 2d 162, 467 P.2d 603 (1970); Einerson v. Central Lumber & Hardware Co., 14 Utah 2d 278, 382 P.2d 655 (1963). Christiansen, as the general contractor of the Project, had the right under Utah law to pay Diehl, the lien claimant, the amount claiming to be owed, to obtain an immediate release of the lien, thereby creating a defense to Christiansen's obligation to pay Davidson. See Utah Code Ann. § 38-1-24; Davis v. Barrett, 24 Utah 2d 162, 467 P.2d 603, 604-05 (1970); Einerson v. Central Lumber & Hardware Co., 14 Utah 2d 278, 382 P.2d 655 (1963); Sierra Nevada Lumber Co. v. Whitmore, 24 Utah 130, 66 P. 779 (1901).

Zions contends that Diehl's notice of lien was defective inasmuch as it failed to include the dates on which materials were first and last supplied to the Project, citing Utah Code Ann. § 38-1-7. But see Projects Unlimited, Inc. v. Copper State Thrift & Loan Co., 798 P.2d 738 (Utah 1990); Graff v. Boise Cascade Corp., 660 P.2d 721 (Utah 1983). The court does not believe that under Utah law a defect in a notice of lien such as that asserted by Zions renders improper a payment to a sub-subcontracting materialman by an owner of the property or general contractor in order to obtain immediate release of a mechanic's lien filed on the property. Nor can the court find any Utah law that would

reobligate the owner or general contractor to pay the principal subcontractor or its secured creditor in the first instance, if the sub-subcontracting materialman's lien is determined to be invalid.

Having determined that Christiansen's payments to Diehl were allowed under Utah law, the court now turns to the Bankruptcy Code to determine whether the payments were otherwise precluded under the Code.

Zions asserts that Christiansen's payments violated the cash collateral provisions of 11 U.S.C. § 363. The court disagrees. Although the court is aware of the fact that a postpetition account creditor obtained payment on its account and that monies that were expected to be passed through a debtor but were nevertheless paid directly to another entity may have had a financially adverse impact upon the debtor, the court cannot find any provision that precludes the payments in this instance. The circumstances of this case, as stated by Christiansen in its memoranda, resulted from the usual and ordinary perils of commerce and state law governing the conduct of business, including that occurring postpetition.<sup>1</sup> Indeed, as the undisputed facts show, prior to Christiansen's

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<sup>1</sup>Although the following cases differ somewhat in circumstances from the instant action, see generally In re U.S. Electric, Inc., 123 B.R. 262 (Bankr. S.D. Ohio 1990) (supplier did not violate stay by informing debtor-contractor's customers that they could pay supplier directly and then deduct payments from sums owing to debtor on construction project); In re Alliance Properties, Inc., 104 B.R. 306 (Bankr. S.D. Cal. 1989) (government contractor's surety held equitable interest in contract proceeds, which was superior to that of creditor granted priority interest in proceeds postpetition, to extent surety discharged debtor-contractor's prepetition debts to subcontractors); Builders Alliance, Inc. v. C. & J. Clark Retail, Inc. (In re Builders Alliance, Inc.), 100 B.R. 203 (Bankr. E.D. Pa. 1989) (debtor general contractor's breach of contract in failing to pay subcontractors or to obtain release (continued...))



payments to Diehl, Zions had not notified Christiansen that payments on the debtor's accounts, under the circumstances presented in this case, should only be made directly to Davidson or Zions. Cf. In re Alliance Properties, Inc., 104 B.R. 306, 312 (Bankr. S.D. Cal. 1989) (government contractor's surety held interest in contract proceeds superior to that of creditor granted priority interest in proceeds postpetition, to extent surety discharged debtor-contractor's debts to subcontractors; surety issued bonds prior to creditor's secured financing and had no prior notice of the cash collateral order); (Dewhirst v. Citibank (In re Contractors Equipment Supply Co.)), 861 F.2d 241 (9th Cir.

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<sup>1</sup>(...continued)

of liens, allowed property owner to withhold payment to debtor); In re Inca Materials, Inc., 81 B.R. 728 (Bankr. N.D. Ga. 1988) (debtor's supplier's payment under general contractor's payment bond, after debtor subcontractor failed to pay supplier, was impressed with constructive trust, and thus was not account receivable of debtor subject to creditor's perfected security interest), aff'd by First Bulloch Bank & Trust Co. v. Inca Materials, Inc. (In re Inca Materials, Inc.), 880 F.2d 1307 (11th Cir. 1989); In re Dunwell Heating & Air Conditioning Contractors Corp., 78 B.R. 667 (Bankr. E.D.N.Y. 1987) (accounts receivable traceable to services performed for improvement of real property constitute trust assets and are not property of the estate); Shaw Industries, Inc. v. Gill (In re Flooring Concepts, Inc.), 37 B.R. 957 (Bankr. 9th Cir. 1984) (general contractor's postpetition payments made directly to subcontractor-debtor's materialman in exchange for materialman's forbearance to further pursue its lien remedy was not voidable by the trustee); Dickenson v. Hacker Bros., Inc. (In re LaFollette Sheet Metal, Inc.), 35 B.R. 634 (Bankr. E.D. Tenn. 1983) (where general contractor enjoyed setoff right against retainage fund which was created when general contractor, pursuant to its subcontract with debtor, retained 10% from each progress payment for performance of debtor as subcontractor on school construction project, trustee could not avoid general contractor's postpetition payments to suppliers of debtor); Tonyan Construction Co. v. McHenry State Bank (In re Tonyan Construction Co.), 28 B.R. 714 (Bankr. N.D. Ill. 1983) (subcontractors were beneficial owners of funds deposited into debtor's general account in bank where funds were released to debtor for specific purpose of paying the subcontractors to whom they were due).

1988) (security interest in debtor's account receivable did not attach when secured creditor notified account debtor, where account was not in existence).

Zions claims that Christiansen violated § 363(c)(2)<sup>2</sup> by paying Diehl the amount necessary to release the lien. Assuming that the amounts owing to Davidson are cash collateral subject to Zions' security interest, the court does not believe that § 363(c)(2), which limits the trustee's use of cash collateral, precludes the actions taken by Christiansen. Additionally, with respect to the Anderson Lumber payment, the questioned propriety of Davidson's endorsement does not change the fact that Christiansen paid monies to Davidson through joint payment on the account.

Zions also claims that Christiansen was required to make payment to Davidson, despite any interest claimed by Diehl, citing Georgia Pacific Corp. v. Sigma Service Corp., 712 F.2d 962 (5th Cir. 1983). Georgia Pacific, however, is inapposite to the present action. The court in that case was faced with the issue of whether funds held by an owner of property at the time of the debtor-contractor's bankruptcy filing, for work performed prepetition on the property, should be turned over to the debtor-contractor or

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<sup>2</sup>11 U.S.C. § 363(c)(2) provides:

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless--

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

to materialmen who claimed an interest in the funds. The court simply determined that the funds to be paid by the owner were property of the estate and thus should be paid over to the estate. It is clear from the court's discussion that the result would have been different had the unpaid materialmen taken the appropriate steps prepetition to protect their interest by obtaining the benefits of a statutory lien or trust on the prepetition funds. Id. at 970. The materialmen took the steps necessary to obtain lien or trust rights to the funds, but those steps to lien property of the estate were taken postpetition and were thus voidable. The legal posture of Georgia Pacific, which involves the assertion of a prepetition claim to property of the estate, is discernibly quite different from that present in this action.


Zions further contends that Diehl violated the automatic stay by filing the mechanic's lien on the Project. The court disagrees. As permitted under state law, Diehl liened the Project, which was not property of the estate. Nothing in § 362 precludes Diehl's action. And contrary to Zions' assertions, the court does not view Christiansen's direct payment to Diehl to obtain release of the mechanic's lien, as a violation of the stay in this instance.

Accordingly,

IT IS HEREBY ORDERED that Zions' Motion for Summary Judgment Against Christiansen is DENIED. IT IS FURTHER ORDERED that Christiansen's Motion for Summary Judgment is GRANTED.

DATED this 17 day of April, 1992.

BY THE COURT:



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GLEN E. CLARK, CHIEF JUDGE  
UNITED STATES BANKRUPTCY COURT