IN THE UNITED STATES BANKRUPTCY COURT

(71)

FOR THE DISTRICT OF UTAH

COUNTER COPY - DO NOT REMOVE - [redacted]

In re SOUTH VILLAGE, INC., Debtor. GENERAL ELECTRIC MORTGAGE CORPORATION, previously known as AMFAC MORTGAGE CORPORATION, Plaintiff. -vs- SOUTH VILLAGE, INC., a Utah corporation, et. al., Defendants.	)	Bankruptcy Case No. 82C-00040 Civil Proceeding No. 82PC-0127 FINDINGS AND CONCLUSIONS ON MOTION OF JOSEPH SMITH PLUMBING FOR SUMMARY JUDGMENT AGAINST BUD BAILEY CONSTRUCTION COMPANY

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This is a mortgage foreclosure action initiated in a Utah State Court and removed to the United States Bankruptcy Court for the District of Utah. Bud Bailey Construction Company (Bailey) and Joseph Smith Plumbing (Smith) are two of the defendants. Smith cross claims against Bailey.

Bailey and Smith agree that Bailey was the general contractor on a construction project, that Smith was a plumbing subcontractor, that Smith has earned and has not been paid $6,663.20, and that neither the owner nor the construction lender has paid Bailey the final construction loan payment. The owner

is the debtor in the bankruptcy case. Bailey argues that Smith must wait for payment until Bailey is paid because of the following term of the subcontract:

> ARTICLE VI: Payment by the Contractor to the Subcontractor shall be made as the work progresses pursuant to requests for payment received from the Subcontractor at the end of each month. Said application shall be accompanied by properly executed lien waivers or other evidence satisfactory to the Contractor that all labor and materials furnished by the Subcontractor to that date have been paid for. Payment shall then be made for the work covered in said application and as it is approved by the Contractor within ten (10) days after receipt of payment for said work from the Owner. The Subcontractor's application for payment shall be submitted on the last day of each month. The payments made pursuant to said requests shall be deemed partial payments, but shall not include _____% which shall be retained out of each payment until final completion, acceptance, and payment by the Owner. Until such final payment by the Owner, the work and contract of the Subcontractor shall not be deemed completed. (Blank in original).

Smith performed all of its subcontract work on or before December 31, 1980. Smith argues that the provisions of Article VI of the subcontract do not make payment to Bailey by the Owner a condition of Bailey's duty to pay Smith but instead are intended only to measure the passage of time.

Section 227 of the Restatement (Second) of Contracts (1979), provides for resolving doubts as to whether an event is made a condition of an obligor's duty and as to the nature of such an event: "an interpretation is preferred that will reduce the

obligee's risk of forfeiture, unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk." Comment b to Section 227 explains that "[t]he non-occurrence of a condition of an obligor's duty may cause the obligee to lose his right to the agreed exchange after he has relied substantially on the expectation of that exchange, as by preparation or performance. The word 'forfeiture' is used in this Restatement to refer to the denial of compensation that results in such a case. The policy favoring freedom of contract requires that, within broad limits . . . , the agreement of the parties should be honored even though forfeiture results. When, however, it is doubtful whether or not the agreement makes an event a condition of an obligor's duty, an interpretation is preferred that will reduce the risk of forfeiture." Comment b then gives an example

> For example, under a provision that a duty is to be performed 'when' an event occurs, it may be doubtful whether it is to be performed only if that event occurs, in which case the event is a condition, or at such time as it would ordinarily occur, in which the event is referred to merely to measure the passage of time.
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> In the latter case, if the event does not occur some alternative means will be found to measure the passage of time, and the non-occurrence of the event will not prevent the obligor's duty from becoming one of performance. If the event is a condition, however, the obligee takes the risk that its non-occurrence will discharge the obligor's duty.
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> . . .

> When . . . the nature of the condition is such that the uncertainty [as to the occurrence of the event] is not likely to be resolved until after the obligee has relied by preparing to perform or by performing at least in part, he risks forfeiture. If the event is within his control, he will often assume this risk. If it is not within his control, it is sufficiently unusual for him to assume the risk that, in case of doubt, an interpretation is preferred under which the event is a condition. The rule is, of course, subject to a showing of a contrary intention, and even without clear language, circumstances may show that he assumed the risk of its non-occurrence.

Next, comment b gives an illustration of the operation of the rule it discusses, an illustration which is strikingly similar to the Bailey/Smith dispute:

> A, a general contractor, contracts with B, a sub-contractor, for the plumbing work on a construction project. B is to receive $100,000, "no part of which shall be due until five days after Owner shall have paid Contractor therefor." B does the plumbing work, but the owner becomes insolvent and fails to pay A. A is under a duty to pay B after a reasonable time.

This illustration, according to the Reporter's Note, is based on Thos. J. Dyer Co. v. Bishop Int'l Engr. Co., 303 F. 2d 655 (6th Cir. 1962).

Dyer involved a contract with language identical to that used in the illustration. The court stated the issue in the case as being "whether . . . [the contract language quoted in the illustration above] is to be construed as a conditional promise to pay, enforceable only when and if the condition precedent has

taken place, which in the present case has not occurred, or . . . it is to be construed as an unconditional promise to pay with the time of payment being postponed until the happening of a certain event, or for a reasonable period of time if it develops that such event does not take place." 303 F. 2d at 659. In holding that the contract did not create a condition, the court explained that

> It is, of course, basic in the construction business for the general contractor on a construction project of any magnitude to expect to be paid in full by the owner for the labor and material he puts into the project. He would not remain long in business unless such was his intention and such intention was accomplished. That is a fundamental concept of doing business with another. The solvency of the owner is a credit risk necessarily incurred by the general contractor, but various legal and contractual provisions, such as mechanics' liens and installment payments, are used to reduce this to a minimum. These evidence the intention of the parties that the contractor be paid even though the owner may ultimately become insolvent. This expectation and intention of being paid is even more pronounced in the case of a subcontractor whose contract is with the general contractor, not with the owner. In addition to his mechanic's lien, he is primarily interested in the solvency of the general contractor with whom he has contracted. He looks to him for payment. Normally and legally, the insolvency of the owner will not defeat the claim of the subcontractor against the general contractor. Accordingly, in order to transfer this normal credit risk incurred by the general contractor from the general contractor to the subcontractor, the contract between the general contractor and subcontractor should contain an express condition clearly showing that to be the intention of the parties.

. . .

> In the case before us we see no reason why the usual credit risk of the owner's insolvency assumed by the general contractor should be transferred from the general contractor to the subcontractor. It seems clear to us under the facts of this case that it was the intention of the parties that the subcontractor would be paid by the general contractor for the labor and materials put into the project. We believe that to be the normal construction of the relationship between the parties. If such was not the intention of the parties it could have been so expressed in unequivocal terms dealing with the possible insolvency of the owner. North American Graphite Corp. v. Allan, 87 U.S. App. D.C. 154, 184 F. 2d 387, 390. Paragraph 3 of the subcontract does not refer to the possible insolvency of the owner. On the other hand, it deals with the amount, time and method of payment, which are essential provisions in every construction contract, without regard to possible insolvency. In our opinion, paragraph 3 of the subcontract is a reasonable provision designed to postpone payment for a reasonable period of time after the work was completed, during which the general contractor would be afforded the opportunity of procuring from the owner the funds necessary to pay the subcontractor. Stewart v. Herron, 77 Ohio St. 130, 149, 82 N.E. 956. To construe it as requiring the subcontractor to wait to be paid for an indefinite period of time until the general contractor has been paid by the owner, which may never occur, is to give to it an unreasonable construction which the parties did not intend at the time the subcontract was entered into.

303 F. 2d at 660-661

The contract provision between Bailey and Smith in this case is substantially similar to the contract in Dyer and the

reasoning of Dyer applies. Although it appears that the Utah Supreme Court has not ruled on the precise issue before the court in this case, the reasoning and result in Dyer are consistent with the Utah court's reluctance to give effect to conditions precedent. In Cheever v. Schramm, 577 P. 2d 951, 953 (Utah 1978), the Utah Supreme Court said that "[a] simple statement or stipulation in a contract is not necessarily a condition to a party's duty of performance. The intention to create a condition in a contract must appear expressly or by clear implication." The contract in this case says nothing about assumption of the risk of the owner's insolvency. Thus, it is this court's view that on these facts the Utah Supreme Court would follow Dyer. The Dyer rule is not only the rule adopted by the Restatement of Contracts, but it is the rule adopted by the majority of courts which have considered the issue. See Watson Construction Company v. Reppel Steel & Supply Co., 598 P. 2d 116 (Ariz. App. 1979), and cases cited therein. The Tenth Circuit Court of Appeals, applying Oklahoma law, has expressly endorsed the reasoning and result in Dyer. Byler v. Great American Insurance Co., 395 F. 2d 273 (10th Cir. 1968).

Bailey argues that Dyer is not applicable here because Smith assumed the risk of payment from the owner. In support of this assertion Bailey relies on the affidavit of a former employee who assisted in negotiating the subcontract with Smith. Assuming for the purposes of this ruling that the affidavit is admissible

evidence, the affidavit, although it indicates that Smith had opportunity to read and ask questions about the contract, and although it indicates that Bailey's intent was that payment would not be made to subcontractors except as provided in the contract and that Bailey "routinely informed subcontractors that Bud Bailey Construction was not in a position to finance the project without payment from the owner," the affidavit does not say that Bailey's employee and Smith discussed the terms of Article VI or whether Smith would assume the risk of the owner's nonpayment. No other circumstances have been shown which indicate that Smith assumed that risk.

In the alternative, Bailey argues that if the court finds that the contract with Smith does not condition its duty to pay on the receipt by Bailey of payment from the owner, the court should find that the contract means that Bailey must pay Smith within a reasonable time and that a reasonable time has not yet expired. Bailey argues that a reasonable time is "equal to the amount of time necessary in exhausting the remedies against the owner (or lending institution)." While this argument might have some persuasive force in other circumstances, Smith has gone unpaid for more than two years. Although it appears that Bailey has diligently pursued its remedies against both the owner and the construction lender, a reasonable time, as a matter of law in this case, has expired. Requiring Smith to wait longer than two years would, in the words of the Dyer court, give the subcontract

"an unreasonable construction which the parties did not intend at the time the subcontract was entered into." 303 F. 2d at 661.

DATED this 29 day of March, 1983.

BY THE COURT:

Glen E Clark

GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE