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An Unpaid Subcontractor Is Entitled to an Equitable Lien on the Retainage When There Is No Bond.

Martha I. Macartney

CASE NOTES

EQUITABLE LIEN—Miller Act Bond—An Unpaid Subcontractor Is Entitled to an Equitable Lien on the Retainage When There is no Bond

Kennedy Electric Co. v. United States Postal Service, 508 F.2d 954 (10th Cir. 1974).

On December 30, 1969 the United States Post Office Department[1] awarded a contract to J. C. Corrigan Company for the construction of a mail facility at Milwaukee, Wisconsin. Because the project was federally sponsored, Corregan was required to supply performance and payment bonds pursuant to the Miller Act.[2] Corrigan was unable to obtain the bonds and did not notify the Department of its failure to file them. Corrigan Construction Company,[3] defendant, subcontracted part of the contract to Kennedy Electric Company, plaintiff, who furnished labor and materials that were incorporated into the bulk mail handling facilities.

Both the contract and Department Regulations limited progress payments to 70 percent of the costs incurred by the contractor up to a maximum of

1. The defendant-appellee is the United States Postal Service which, under the Postal Reorganization Act, 39 U.S.C. § 101 (1970), succeeded to the interests of the former United States Post Office Department on July 1, 1971. The assets and liabilities of the Post Office Department were transferred to the Postal Service and constituted its initial capital. 39 U.S.C. § 2002 (1970).

2. 40 U.S.C. § 270(a)-(e) (1970). The Miller Act required the Department to obtain the bonds from Corrigan "before" awarding the contract. According to the contract, however, Corrigan had 10 days "after" the award within which to file the bonds.
The Miller Act provides in pertinent part:

> (a) Before any contract, exceeding $2,000 in amount, for the construction, alteration, or repair of any public building or public work of the United States is awarded to any person, such person shall furnish to the United States the following bonds, which shall become binding upon the award of the contract to such person, who is hereinafter designated as contractor:
> (1) A performance bond with a surety or sureties satisfactory to the officer awarding such contract, and in such amount as he shall deem adequate, for the protection of the United States.
> (2) A payment bond with a surety or sureties satisfactory to such officer for the protection of all persons supplying labor and material in the prosecution of the work provided for in said contract for the use of each such person.

3. J.C. Corrigan Company had subcontracted a portion of the contract to Corrigan Construction Company. Both J.C. Corrigan Company and Corrigan Construction Company were joined in the first suit as third party defendants. At trial, the Federal District Court for Colorado held that the two Corrigan companies were "for all practical purposes a single entity." Kennedy Elec. Co. v. United States Postal Serv., 367 F. Supp. 828, 829 (D. Colo. 1973).

70 percent of the contract price.[4] Nevertheless, the Department made progress payments to Corrigan far in excess of the stipulated amount.[5] Despite Corrigan's unsatisfactory progress under the contract and the repeated inquiries made by Kennedy into the status of the project, the Department failed to investigate Corrigan's financial position as required under Department Regulations.[6]

Not until April 1971, well over a year after awarding the contract, did the Department discover Corrigan's failure to file the bonds. The following month, upon determination that Corrigan's failure to file the bonds was willful, the Department terminated the contract. Corrigan thereafter declared bankruptcy, and Corrigan Construction Co., the second company, became insolvent. Both companies failed to pay Kennedy as a result of their financial situations. Kennedy instituted suit against the United States Postal Service[7] to recover the unpaid amount from the retainage it held.[8] The Postal Service asserted its own claims against the retainage which, if allowed, would have exhausted the fund.[9] In rejecting the Postal Service's claims the Federal District Court for Colorado ruled that Kennedy held an equitable lien both on funds which the Postal Service had retained and on funds that the Postal Service had wrongfully disbursed in a March 24, 1971 progress payment.[10] The Postal Service appealed. Held—*Affirmed.* When the protection provided under the Miller Act to insure payment of a federal government subcontractor fails due to the noncompliance of either the prime contractor or the government with the Act's requirements, such subcontractor is subrogated to

4. 41 C.F.R. § 1-30.510-1 (1971).

5. The Department made subsequent progress payments including the March 24, 1971 progress payment of $190,747.00 to Corrigan's assignee, First National Bank of Boston which brought the total progress payments to $889,311.00. Even though the Department concluded the contract was 95 percent completed, this payment brought the total progress payments made in excess of the 70 percent maximum allowable payments to $225,072.78. Kennedy Elec. Co. v. United States Postal Serv., 367 F. Supp. 828, 830-31 (D. Colo. 1973).

6. According to 41 C.F.R. § 1-30.521 (1971), the Department was required to obtain full information concerning both the progress payments under the contracts involved (including status of the subcontract) and concerning the contractor's other operations and financial condition. The Department violated the requirements of 41 C.F.R. § 1-30.521-1 (1971), providing "that particular care must be taken to assure that the unpaid balance of the contract will be adequate to cover the anticipated cost of completion, or that the contractor has adequate resources to complete the contract . . . ."

7. The United States Postal Service succeeded to the interests of the United States Post Office Department on July 1, 1971 under the Postal Reorganization Act, 39 U.S.C. § 101 (1970).

8. The court in *Kennedy* refers to the funds retained by the Postal Service under the contract including the March 24, 1971 progress payment as "retainage." Kennedy Elec. Co. v. United States Postal Serv., 508 F.2d 954, 958 (10th Cir. 1974).

9. *See* Brief for Appellee at 18, Kennedy Elec. Co. v. United States Postal Serv., 508 F.2d 954 (10th Cir. 1974).

10. Kennedy Elec. Co. v. United States Postal Serv., 367 F. Supp. 828, 841 (D. Colo. 1973), *aff'd*, 508 F.2d 954 (10th Cir. 1974).

the equities of a surety and holds an equitable lien on all funds retained, and on those funds which should have been retained by the government.[11]

A contractor engaged in public building or construction work is ordinarily required to post a bond conditioned both on the faithful performance of the contract as indemnification of the obligee government, and on the payment of the claims of laborers, materialmen, and subcontractors in the prosecution of the work.[12] In 1894 Congress enacted the Heard Act, which required government contractors to execute penal bonds for the benefit of all persons supplying labor and materials on the contract.[13] Although the Miller Act repealed the Heard Act, it incorporated the Heard Act's basic provisions, and was designed primarily to eliminate certain of the Act's procedural limitations[14] on the statutory beneficiaries in favor of facilitating an unpaid creditor's realization of benefits under the payment bond.[15] Current provisions of the Miller Act require that before any contract in excess of $2,000 is awarded, every government contractor is required to furnish to the United States a performance bond for the protection of the government and a payment bond to protect all persons supplying labor and material for the project.[16]

The underlying purpose of the Miller Act is to afford laborers, materialmen and subcontractors protection and security against irresponsible contractors who fail to pay for the labor and materials incorporated into the construction project.[17] This protection is in lieu of traditional mechanic's liens estab-

11. Kennedy Elec. Co. v. United States Postal Serv., 508 F.2d 954, 960 (10th Cir. 1974).

12. Standard Accident Ins. Co. v. United States, 302 U.S. 442, 443 (1938) (Heard Act); Equitable Sur. Co. v. United States, 234 U.S. 448, 454 (1914) (D.C. statute modeled after Heard Act); Hardaway v. National Sur. Co., 211 U.S. 552, 554 (1909) (Heard Act); Price v. H.L. Coble Constr. Co., 317 F.2d 312, 315, 321 (5th Cir. 1963) (Alabama statute); Boka Elec. Constr. Co. v. W. M. Chappell, Inc., 262 F.2d 718, 720 (D.C. Cir. 1958) (D.C. statute).

13. Act of August 13, 1894, ch. 280, 28 Stat. 278 (1894), *as amended*, Act of February 24, 1905, ch. 778, 33 Stat. 811.

14. Under the Heard Act, Act of February 24, 1905, ch. 778, 33 Stat. 811, a single bond was required to protect both the government and the suppliers of labor and materials. The government was given the sole right to sue on the bond for 6 months after completion of the work and final settlement. Other claimants were allowed to bring suit only after the expiration of 6 months and had to join in a single action. Serious inconveniences and delays resulted where claimants, often in need of immediate funds, were compelled to settle meritorious claims for less than the full amount. *Id.* The Miller Act, 40 U.S.C. § 270(a) (1970), was designed to meet these difficulties by requiring that the prime contractor execute two bonds—a performance bond to protect the government and a payment bond to protect the creditors. *Id.* Creditors can sue on the latter bond without waiting for the government and even waiting for completion of the project. Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 105-106 n.4 (1943).

15. *Hearings on H.R. 2068 Before the House Comm. on the Judiciary*, 74th Cong., 1st Sess. (1935).

16. 40 U.S.C. § 270(a) (1970). The amount of the performance bond is not specifically set by statute but is left to the judgment of the governmental officer letting the contract. The amount of the payment bond, however, is defined in the Act depending on the total contract price. *Id.*

17. United States *ex rel.* Sherman v. Carter, 353 U.S. 210, 216 (1957); Equitable

lished for laborers and materialmen of private building and construction contractors.[18] Such protection is necessary in view of the uniform rule of sovereign immunity exempting government property from liens.[19] The Miller Act limits recovery on the payment bond to laborers, materialmen, and subcontractors who deal directly with the prime contractor, or who have a direct contractual relationship with the subcontractor.[20]

Recovery under the act is secured by a surety who guarantees the completion of the contract and the payment of the suppliers involved. The surety on the bond of a public contractor becomes obligated to perform when a contractor has defaulted either in performance of the contract or in payment of his subcontractors, according to the provisions of the suretyship.[21] Because the surety has a contractual agreement with the prime contractor regarding his obligations and compensation, he cannot be compelled to assume any liability not originally contemplated nor can the terms of the suretyship be altered without his consent.[22] If a surety's position has been prejudiced by the contractor's or the obligee's actions, the surety may be released from any liability.[23]

Sur. Co. v. United States, 234 U.S. 448, 456 (1914); United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 471, 474 (1910); United States *ex rel.* Hill v. American Sur. Co., 200 U.S. 107, 204 (1906).

18. United States *ex rel.* Sherman v. Carter, 353 U.S. 210, 216 (1957); Illinois Sur. Co. v. John Davis Co., 244 U.S. 376, 380 (1917); United States *ex rel.* Hill v. American Sur. Co., 200 U.S. 197, 203 (1906); Continental Cas. Co. v. United States, 305 F.2d 794, 797 (8th Cir.), *cert. denied*, 371 U.S. 922 (1962).

19. United States v. Munsey Trust Co., 332 U.S. 234, 241 (1947); Equitable Sur. Co. v. United States, 234 U.S. 448, 455 (1914); Title Guar. & Trust Co. v. Crane Co., 219 U S. 24, 32 (1910); United States v. Ansonia Brass & Copper Co., 218 U.S. 452, 471, 474 (1910); United States *ex rel.* Hill v. American Sur. Co., 200 U.S. 197, 203 (1906).

20. Although the Miller Act does not specifically define "subcontractor," it has been considered in its technical sense as one "who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract," thus excluding ordinary laborers and materialmen. Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 109 (1944). It would be impossible for the prime contractor to protect himself if the class sought to be protected under the payment bond were not thus defined. *Id.* at 110

21. *See* A. STEARNS, THE LAW OF SURETYSHIP § 1.4, at 3 (5th ed. 1951).

22. Wilkinson v. McKimmie, 229 U.S. 590, 593 (1913); Prairie State Bank v. United States, 164 U.S. 227, 233-37 (1896); Cross v. Allen, 141 U.S. 528, 537 (1891); Reese v. United States, 76 U.S. (9 Wall.) 13, 21 (1869); Miller v. Stewart, 22 U.S. (9 Wheat.) 680, 702 (1824); St. Petersburg Bank & Trust Co. v. Boutin, 445 F.2d 1028, 1031 (5th Cir. 1971); Trinity Universal Ins. Co. v. Gould, 258 F.2d 883, 887 (10th Cir. 1958); United States v. Stephanidis, 46 F.2d 691 (E.D.N.Y. 1930); Bopst v. Columbia Cas. Co., 37 F. Supp. 32, 34 (D. Md. 1940).

23. Prairie State Bank v. United States, 164 U.S. 227, 233-34 (1896). The surety has been released from liability in several situations: where the government has made premature or unauthorized payments; where the government has failed to withhold monies sufficient to meet the claims or liens of laborers and materialmen; and where the government has failed to comply with the contractual stipulation for withholding a percentage of the contract price. *Id.* at 233-34. It has been generally recognized that in order for a surety to be discharged the action by the government must have resulted in

Under the Miller Act a surety may present a claim against the fund which the government retains until completion of the contract and acceptance of the project. The surety predicates his claim on the equitable doctrine of subrogation.[24] He must fulfill the contractor's obligation in a manner other than as a mere volunteer, however, in order to be subrogated to the right of the contractor in the unpaid contract amount.[25] The surety, as assignee of the obligee, may also bring an action at law against the principal-contractor.[26] As against the obligee, however, the surety's right is an equitable one.[27] The courts have established the priority of the surety's equities to the retained percentages of the contract price over an assignee of the contractor[28] and over a trustee in bankruptcy when the surety had discharged his obligation prior to the contractor's adjudication as bankrupt.[29] In certain situations, however, the surety's rights have been subordinated to the government's claims against the contractor[30] and to the claims of laborers and materialmen.[31]

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substantial injury, loss, or prejudice to the surety. Pickens County v. National Sur. Co., 13 F.2d 758, 762 (4th Cir. 1926).

24. Subrogation, as a matter of right, arises in favor of a surety who has paid the debt which ought, in whole or in part to have been met by another. Aetna Life Ins. Co. v. Middleport, 124 U.S. 534, 548-49 (1888); *see* Stickells, *Bonds of Contractors on Federal Public Works: The Miller Act*, 36 B.U.L. REV. 499, 541 (1956).

25. United States v. National Sur. Co., 254 U.S. 73, 76 (1920); Aetna Life Ins. Co. v. Middleport, 124 U.S. 534 (1888). In *Aetna*, the Supreme Court elaborated on the prerequisites to asserting the equitable doctrine of subrogation stating,

> 1. that the person seeking its benefits must have paid a debt due to a third party before he can be substituted to that party's rights; and, 2. that in doing this he must not act as a mere volunteer, but on compulsion, to save himself from loss by reason of a superior lien or claim on the part of the person to whom he pays the debt, as in cases of sureties . . . .

Aetna Life Ins. Co. v. Middleport, 124 U.S. 534, 547-49 (1888); A. STEARNS, THE LAW OF SURETYSHIP, § 11.15, at 474 (5th ed. 1951); *see* II J. APPLEMAN, INSURANCE LAW AND PRACTICE § 6618, at 445-46, § 6601, at 425-26 (1944). "The surety on the bond of a prime contractor has been held entitled to all the equities of the principal and also those of the creditor, under the doctrine of subrogation." *Id.* § 6601, at 425-26.

26. Generally the government is the obligee in the bonding situation—the prime contractor is the principal. *See* A. STEARNS, THE LAW OF SURETYSHIP § 1.4, at 3 (5th ed. 1951).

27. *See* II J. APPLEMAN, INSURANCE LAW AND PRACTICE, § 6618, at 445-46 (1944).

28. *Id.* § —, at 561; Prairie State Bank v. United States, 164 U.S. 227, 240 (1896); Seaboard Sur. Co. v. First Nat'l Bank & Trust Co., 121 F.2d 288, 292-93 (8th Cir. 1941); National Sur. Co. v. County Bd. of Education, 15 F.2d 993, 996 (4th Cir. 1926); Maryland Cas. Co. v. Pittsburgh, 51 F. Supp. 459, 461 (W.D. Pa. 1943).

29. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 133, 141 (1962); Cox v. New England Equitable Ins. Co., 247 F. 955, 957 (8th Cir. 1917).

30. United States v. Munsey Trust Co., 332 U.S. 234, 239 (1947). In *Munsey* the government was allowed a set-off against funds in its possession as damages arising out of a debt incurred by the contractor under a separate and independent transaction despite the claims to the funds of the surety who had paid the laborers and materialmen. The Supreme Court later in Pearlman v. Reliance Ins. Co., 371 U.S. 132 (1962) emphasized that their decision in *Munsey* was only that the government could exercise the well-established common law right of debtors to offset claims of their own against their creditors. *Id.* at 140.

31. American Sur. Co. v. Westinghouse Elec. Mfg. Co., 296 U.S. 133, 137-38 (1935). In *American Sur. Co.* a surety on a Miller Act bond was not, by right of sub-

The subcontractor who has contributed labor or materials has traditionally been entitled to a lien in order to insure that he will not go unpaid.[32] In addition to the mechanic's lien, there is presently a morass of liens conferred by state statutes to protect the various classes of producers and suppliers.[33]

A subcontractor may bring suit under the Miller Act on the payment bond for the amount owed him on the contract, provided that he give written notice to the contractor within 90 days from the date on which he performed the last of the labor or furnished the last of the material for which he is making his claim.[34] A government subcontractor's remedies are not defined, however, when there has been a failure to exact the required bonds.[35]

The concept that upaid laborers and materialmen possess an equitable lien on the retainage of a government contract has emerged from a long line of cases.[36] The earliest of these cases, *Greenville Savings Bank v. Lawrence*,[37]

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rogation, entitled to priority over the claims of laborers and materialmen who were beneficiaries of the bond and who were not fully satisfied out of the bond upon the insolvency of the contractor with respect to the unpaid portion of the contract price retained by the government. Maryland Cas. Co. v. Board of Water Comm'rs, 66 F.2d 730, 736-37 (2d Cir.), *cert. denied*, 290 U.S. 702 (1933). In *Maryland Cas. Co.* the surety who completed the abandoned city contract was subrogated to the city's right to retain the stipulated percentages and had priority to them over laborers and materialmen, in the absence of a contrary contractual obligation. The payment bond is created for the security of laborers and materialmen and the surety is not entitled to priority over those it has contractually agreed to protect.

32. *E.g.*, Smith v. Wilcox, 74 P. 708, 709 (Ore. 1903); Collins v. Board of Trustees of Davis & Elkins College, 79 S.E. 10, 12, 14 (W. Va. 1913). For a discussion of the history of liens see Note, *Government Subcontractors' Remedies in Rem*, 30 GEO. WASH. L. REV. 994, 994-95 (1962).

33. *See, e.g.*, GA. CODE ANN. § 67-2204 (1967); MICH. STAT. ANN. § 26.281 (Supp. 1974); OREGON REV. STAT. § 87,085 (Supp. 1961).

34. 40 U.S.C. § 270(b) (1970).

35. There is a split in authority among state court decisions as to the liability to laborers and materialmen of a public body and its officers who have failed to exact the bonds required by state statutes similar to the Miller Act. The majority view holds that when a contract for public work has been let without obtaining from the contractor the statutory bonds conditioned on payment of claims for labor and material furnished to the contractor, the public body is not liable to laborers and materialmen for work done and material furnished in the absence of a statutory requirement that a public body either pay these claims or withhold funds to insure their payment. E.I. Dupont De Nemours & Co. v. Glenwood Springs, 19 F.2d 225, 229 (8th Cir. 1927) (municipal corporation); Newt Olson Lumber Co. v. School Dist., 263 P. 723, 724 (Colo. 1928) (school district); Woodward Lumber Co. v. Grantville, 79 S.E. 221, 222 (Ga. Ct. App. 1913) (municipal corporation); J.E. Moss Iron Works v. Jackson County Court, 109 S.E. 343, 348 (W. Va. 1921) (county court). The minority view holds the public body liable because it is through their negligence to exact the required bond that the laborers and materialmen have lost the protection afforded by statute as a substitute for unavailable lien rights on the property. Stephenson v. Monmouth Min. Mfg. Co., 84 F. 114, 117 (6th Cir. 1897); Warren *ex rel.* Hughes Supply Co. v. Glens Falls Indem. Co., 66 So. 2d 54, 58 (Fla. 1953); C.A. Burton Mach. Co. v. Ruth, 186 S.W. 737, 737-38 (Mo. Ct. App. 1916).

36. American Sur. Co. v. Westinghouse Elec. Mfg. Co., 296 U.S. 133, 138-39 (1935); Philadelphia Nat'l Bank v. McKinlay, 72 F.2d 89, 91 (D.C. App.), *cert. denied*, 293 U.S. 583 (1934); Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271

established the right of the governement to pay laborers and materialmen out of the retained fund in preference to general creditors and assignees of the contractor.[38] Shortly thereafter in *Prairie State Bank v. United States,*[39] the Supreme Court expanded the equitable lien concept by recognizing that a portion of the retained contract price was for the benefit not only of the obligee, but also of the one who was guaranteeing the performance of the work, thereby raising an equitable right in the surety.[40] The surety in *Prairie,* who had completed construction of the Galveston Customs House after the contractor's default, was subrogated to the rights of the United States in the retainage and granted priority over a general creditor and an assignee of the contractor.[41] Although *Prairie* did not involve laborers' and materialmen's claims, it demonstrates that parties other than the prime contractor or the government might hold a claim to the retained funds.

In *Henningsen v. United States Fidelity & Guaranty Co.,*[42] a surety who had paid the laborers and materialmen prevailed over an assignee in a suit to recover funds held by the United States.[43] The Supreme Court based its decision on the "respective equities of the parties," mentioning for the first time the government's "equitable obligations to see that the laborers and supply men were paid."[44] Subsequent cases have interpreted *Henningsen* to hold that an equitable lien exists in favor of the surety who has discharged the contractor's obligation to pay the suppliers, even though the decision did not suggest that laborers and materialmen could hold such an equitable lien.[45] This lien came into existence while the retained percentages of the contract price were still in the hands of the government[46] and it continued to exist after distribution.[47]

F. 144, 148-49 (6th Cir. 1921); Cox v. New England Equitable Ins. Co., 247 F. 955, 957 (8th Cir. 1917); *In re* McGarry & Son, 240 F. 400, 402 (7th Cir. 1917); Greenville Sav. Bank v. Lawrence, 76 F. 545, 548 (4th Cir. 1896).

37. 76 F. 545 (4th Cir. 1896).

38. *Id.* at 547.

39. 164 U.S. 227 (1896).

40. *Id.* at 233.

41. *Id.* at 232-33.

42. 208 U.S. 404 (1908).

43. *Id.* at 411.

44. *Id.* at 409-10.

45. Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271 F. 144, 148 (6th Cir. 1921); Cox v. New England Equitable Ins. Co., 247 F. 955, 957 (8th Cir. 1917); *In re* McGarry & Son, 240 F. 400, 402 (7th Cir. 1917); *In re* Scofield Co., 215 F. 45, 48-50 (2d Cir. 1914).

46. In *In re* McGarry & Son, 240 F. 400 (7th Cir. 1917), the court found an equitable lien for the surety in funds which had already been paid over to the trustee in bankruptcy of the contractor, stating that "the $2,000 fund in the hands of the trustee stands charged with the same equities . . . as when it was undistributed in the hands of the United States." *Id.* at 402.

47. In Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271 F. 144, 149 (6th Cir. 1921), the court described the lien as "an original and continuing equitable priority in the fund."

The Supreme Court in *United States v. Munsey Trust Co.,*[48] granted the government a set-off against retained funds in its possession as damages arising out of a debt incurred by the contractor under a separate transaction. Because the government was not only a stakeholder but was also asserting a claim against the funds, *Munsey* is distinguishable from previous cases in which the United States was a mere stakeholder.[49]

During this period of interpretation of the Miller Act many courts began to recognize the existence of an equitable lien of the unpaid laborers and materialmen on the retainage held on a contract by the United States.[50] Such a lien was specifically recognized by the Federal District Court for the Eastern District of Missouri in *United States ex rel. Reuter v. MacDonald Construction Co.*:[51]

> [A]n unpaid laborer or materialman has an equitable lien upon funds in the hands of the United States which were retained from the prime contractor . . . . The passage of the Miller Act did not destroy this equitable lien.[52]

In *National Surety Corp. v. United States*[53] the Court of Claims acknowledged the equitable obligations of the United States to insure the payment of laborers and materialmen and reciprocally, the equitable right of laborers and materialmen to assert their claim to monies held by the government which are due the contractor.[54] Subsequently, in *United States Fidelity & Guaranty Co. v. United States*[55] the Court of Claims held that unpaid subcontractors who had received the total amount of the payment bond had no standing to enforce an equitable lien on amounts that were retained or should have been retained by the United States.[56]

A government subcontractor's remedies are not delineated, however, when the payment bond has not been filed. Such an absence of remedy coupled with the bankruptcy of the prime contractor was the factual basis on which the court granted an equitable lien to the unpaid subcontractor in

48. 332 U.S. 234 (1947).

49. *See, e.g.*, American Sur. Co. v. Sampsell, 327 U.S. 269, 273 (1946); Henningsen v. United States Fidelity & Guar. Co., 208 U.S. 404, 405 (1908); Prairie State Bank v. United States, 164 U.S. 227, 233 (1896); Home Indem. Co. v. United States, 376 F.2d 890, 893 (Ct. Cl. 1967).

50. United States *ex rel.* Reuter v. MacDonald Constr. Co., 295 F. Supp. 1363, 1366 (E.D. Mo. 1968); National Sur. Corp. v. United States, 133 F. Supp. 381, 384 (Ct. Cl.), *cert. denied*, 350 U.S. 902 (1955). *But see* United Pacific Ins. Co. v. United States, 319 F.2d 893, 896, n.1 (Ct. Cl. 1963). *See also* J.V. Gleason Co. v. Aetna Cas. & Sur. Co., 452 F.2d 1219, 1225 (8th Cir. 1971); Continental Cas. Co. v. United States, 169 F. Supp. 945, 946-47 (Ct. Cl. 1959).

51. 295 F. Supp. 1363 (E.D. Mo. 1968).

52. *Id.* at 1366.

53. 133 F. Supp. 381 (Ct. Cl.), *cert. denied*, 350 U.S. 902 (1955).

54. *Id.* at 384.

55. 475 F.2d 1377 (Ct. Cl. 1973).

56. *Id.* at 1382.

Kennedy Electric Co. v. United States Postal Service.[57] The Postal Service cited *United States v. Munsey Trust Co.*[58] as dispositive of Kennedy's claims because in *Munsey* the Court had stated that "laborers and materialmen do not have enforceable rights against the United States for their compensation."[59] The court in *Kennedy* found this argument inapplicable, however, emphasizing that the statement in *Munsey* was based on the premise that laborers and materialmen were protected by the statutorily required payment bond.[60] Such a premise is absent in *Kennedy* because there was no Miller Act surety to provide this security. The court in *Kennedy* also subordinated the Postal Service's claim for liquidated damages to Kennedy's claims because of equitable considerations,[61] thus reducing the status of the Postal Service to that of a stakeholder. The rule announced in *Munsey* is clearly inapplicable in a situation such as *Kennedy* because in *Munsey* the Court expressly excluded such a factual situation from the scope of its decision: "We need not decide whether laborers and materialmen would have any claim to the retained percentages if both contractor and surety failed to pay them."[62]

Fifteen years later the Supreme Court in *Pearlman v. Reliance Insurance Co.*[63] finally settled a conflict among the circuit courts over the interpretation

57. 508 F.2d 954, 960 (10th Cir. 1974). The Tenth Circuit has previously held that a lien becomes effective when the right to a fund materializes or when the fund comes into existence. Caldwell v. Armstrong, 342 F.2d 485, 490 (10th Cir. 1965). An equitable lien is a right, not recognized by law, to have a fund or specific property applied in whole or in part to the payment of a particular debt or obligation, but it is not a property right in the thing itself nor a right to obtain possession of the fund or property. Jamison Coal & Coke Co. v. Goltra, 143 F.2d 889, 893 (8th Cir. 1944).

58. 332 U.S. 234 (1947).

59. *Id.* at 241.

60. *Id.* at 243-44.

61. The court in *Kennedy* determined that Kennedy's equitable rights outweighed those of the Postal Service in several aspects. The Department, the Postal Service's predecessor, precipitated this controversy by awarding a contract to Corrigan, before Corrigan filed the payment and performance bond, in violation of the Miller Act. The Department subsequently failed to exercise the supervision prescribed by the Department Regulations and made illegal progress payments to Corrigan's assignee, First National Bank of Boston. The Postal Service had received the benefit of Kennedy's labor and material which had been incorporated into the mail facility. It has an obligation to pay and Kennedy has the right to be paid for the labor and material. The retainage from which Kennedy seeks recovery was originally created to pay for the construction of the mail facility, thus although the Postal Service is not affirmatively recovering its liquidated damages it is not being forced to pay Kennedy out of monies not appropriated for this project. The Postal Service would have been unjustly enriched for its negligence and illegal conduct if the court had not granted an equitable lien in favor of Kennedy. For cases supporting subordination of claims because of equitable considerations see, Pepper v. Litton, 308 U.S. 295, 306 (1939); International Tel. & Tel. Corp. v. Holton, 247 F.2d 178, 182 (4th Cir. 1957); Wheeling Valley Coal Corp. v. Meade, 171 F.2d 916, 919 (4th Cir. 1949); Hanssen v. Wingren, 121 F.2d 1011, 1013 (10th Cir. 1941).

62. United States v. Munsey Trust Co., 332 U.S. 234, 242 (1947).

63. 371 U.S. 132 (1962).

and effect of *Munsey*.[64] *Munsey*, it was held, "left the rule in *Prairie Bank* and *Henningsen* undisturbed."[65] The *Pearlman* decision further strengthened Kennedy's argument that an unpaid subcontractor had an equitalble lien on the retainage in stating that "the Government had a right to use the retained fund to pay laborers and materialmen; that the laborers and materialmen had a right to be paid out of the fund . . . ."[66] The government's relationship toward laborers and materialmen had thus developed from an equitable obligation in *Henningsen*, into a right of both the government and laborers and materialmen to satisfy the suppliers' unpaid claims out of the retainage. The Postal Service nevertheless urges that the decision in *United States Fidelity & Guaranty Co. v. United States*[67] is the correct analysis and application of the *Munsey* and *Pearlman* decisions.[68] *Guaranty Co.* is distinguishable from *Kennedy* in two important factual aspects. First, the defendant in the instant case is the United States Postal Service, with the statutory power to sue and be sued.[69] In *Guaranty Co.* the defendant was the United States government—protected under the doctrine of sovereign immunity. Second, in *Guaranty Co.* the surety had fulfilled his obligation by paying to the extent of his bond, while in *Kennedy*, because of the Department's failure to exact the payment bond, there was no surety from whom the subcontractors could recover.

Several courts have recognized a distinction between the position of the *Guaranty Co.* subcontractor, who is protected by a bond, and the *Kennedy* subcontractor who is not.[70] The court in *United Pacific Insurance Co. v. United States*[71] declared the Miller Act to be the sole remedy of an unpaid subcontractor, noting that "there is no question in this case of the solvency of the surety."[72] Such a qualifying statment suggests that there is another remedy when, as in *Kennedy*, the surety is insolvent or nonexistent.[73] So

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64. Some Circuit Courts of Appeals held that the surety was not entitled to subrogation. *See* American Sur. Co. v. Hinds, 260 F.2d 366, 368 (10th Cir. 1958); Phoenix Indem. Co. v. Earle, 218 F.2d 645, 649 (9th Cir. 1955). The conflict was resolved in *In re* Dutcher Constr. Corp., 298 F.2d 655, 659 (2d Cir.), *aff'd sub nom.*, Pearlman v. Reliance Ins. Co., 371 U.S. 132, 141 (1962), where the Supreme Court concluded that the surety was entitled to the fund by subrogation.

65. Pearlman v. Reliance Ins. Co., 371 U.S. 132, 141 (1962).

66. *Id.* at 141.

67. 475 F.2d 1377 (Ct. Cl. 1973).

68. Kennedy Elec. Co. v. United States Postal Serv., 508 F.2d 954, 959 (10th Cir. 1974).

69. 39 U.S.C. § 401(1) (1970).

70. United Pac. Ins. Co. v. United States, 319 F.2d 893, 896, n.1 (Ct. Cl. 1963); United States *ex rel.* Brown Bros. Grading Co. v. F. D. Rich Co., 285 F. Supp. 572, 577 (D.S.C. 1968); United States *ex rel.* Reuter v. MacDonald Constr. Co., 295 F. Supp. 1363, 1366 (E.D. Mo. 1968).

71. 319 F.2d 893 (Ct. Cl. 1963).

72. *Id.* at 896 n.1.

73. United States *ex rel.* Brown Bros. Grading Co. v. F.D. Rich Co., 285 F. Supp. 572, 577 (D.S.C. 1968).

too, in *United States ex rel. Reuter v. MacDonald Construction Co.*,[74] the court said that the materialmen or laborers could not pursue the remedy of an equitable lien on the retainage unless the Miller Act surety was insolvent and therefore unable to pay the amounts to which they were entitled.[75] In order for Kennedy to fully satisfy its claim to this remedy it must recover not only from the funds retained but also from the funds which should have been withheld.[76] The courts have consistently held that the government cannot escape liability to a Miller Act surety by making a wrongful payment.[77] The trial court in *Kennedy* cited *National Surety Corp. v. United States*,[78] reiterating the right of materialmen to assert a claim against funds in the hands of the United States or funds which, under its regulations, *should* be in its hands.[79] This had the effect of increasing an unpaid subcontractor's sources of recovery while further patterning a subcontractor's rights after those of a surety.

In *Kennedy* the court has interpreted the Miller Act not as the exclusive remedy of an unpaid subcontractor but as an additional protection. Although the Miller Act affords the ordinary and primary protection for laborers, materialmen, and subcontractors, the retainage becomes available when such statutory security proves insufficient.[80] The decision poses the question whether the extension of the surety's equities to an unpaid, unbonded subcontractor reach further than to the subcontractor. Since suppliers of subcontractors, as well as the subcontractors themselves, can recover on a Miller Act bond,[81] these suppliers should logically be able to assert an equitable lien on the retainage as well. Implicit in this argument is the problem of determining priority to the fund between an unpaid subcontractor and the unpaid supplier when the prime contractor is bankrupt and there is no surety.

74. 295 F. Supp. 1363 (E.D. Mo. 1963).

75. *Id.* at 1366.

76. At the time of trial, the Postal Service held a fund of only $35,739.47; therefore, the court extended Kennedy's equitable lien to the March 24, 1971 progress payment of $190,747.00 in order to fully satisfy Kennedy's claim of $61,281.31 plus interest. Kennedy Elec. Co. v. United States Postal Serv., 508 F.2d 954, 960 (10th Cir. 1974).

77. Fireman's Fund Ins. Co. v. United States, 421 F.2d 706, 709 (Ct. Cl. 1970); Home Indem. Co. v. United States, 376 F.2d 890, 892 (Ct. Cl. 1967); Hanover Ins. Co. v. United States, 279 F. Supp. 851, 853 (S.D.N.Y. 1967).

78. 133 F. Supp. 381 (Ct. Cl.), *cert. denied*, 350 U.S. 902 (1955).

79. Kennedy Elec. Co. v. United States Postal Serv., 367 F. Supp. 828, 843 (D. Colo. 1973) (emphasis added).

80. *See* Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271 F. 144, 148 (6th Cir. 1921).

81. Illinois Sur. Co. v. John Davis Co., 244 U.S. 376, 380 (1917); Mankin v. United States, 215 U.S. 533, 539-40 (1910); United States *ex rel.* Hill v. American Sur. Co., 200 U.S. 197, 205 (1906). In Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 105 (1944) the Supreme Court held that the phrase in the Miller Act, 40 U.S.C. § 270(a) (1970), that "'all persons supplying [the contractor] . . . with labor and materials' included not only those furnishing labor and materials directly to the prime contractor but also covered those who contributed labor and materials to subcontractors."

Faced with this situation again, the courts should probably recognize an equitable lien for both classes of claimants and make a pro rata distribution of the fund.[82]

Several options exist by which to avoid the recurrence of this situation. The Miller Act could be amended to create a statutory cause of action and remedy for the unpaid subcontractor when there has been a failure to exact the required bond.[83] Congress could also increase the burden on the subcontractor by requiring him to be certain that the bonds have been filed before he furnishes any labor or material to the contractor. A third choice is to facilitate the method by which the successful claimant may execute on his judgment. Presently, a party must present his judgment to the General Accounting Office to be paid from a general appropriation provided by Congress in order to settle judgments against the United States.[84]

The position of a federal government subcontractor is a precarious one. He does not have the statutory mechanic's liens available in the private construction industry; nor does he have the same bargaining power dealing with the federal government as he might have with a private individual or business. The Miller Act provides adequate protection for subcontractors so long as it is viewed as an additional protection and not an exclusive remedy. If the Miller Act were deemed the sole remedy, a subcontractor's freedom to contract would be further limited because he would be forced to assume the risk of not being paid while being virtually powerless to shift the burden to the prime contractor and the federal government—the principal parties to the main contract. Such a mandatory assumption of risk might persuade the subcontractor not to engage in federal government contracts thus producing more difficulties in the construction industry.

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82. By extending an equitable lien to both the unpaid subcontractor and the unpaid supplier of the subcontractor the courts would create a remedy for the claimants when there is no surety that parallels their remedy when the Miller Act surety exists. As in past decisions where the source of recovery has been insufficient to satisfy all the claims, the courts would distribute the monies proportionate to the different interests of the parties.

83. In a minority of state decisions the public body has been held liable for failure to exact the bonds required by the state statute. Such liability has been based on the fact that the particular statute involved included a specific cause of action and remedy for unpaid laborers and materialmen in this type of situation. Stephenson v. Monmouth Min. Mfg. Co., 84 F. 114, 117 (6th Cir. 1897); Warren *ex rel.* Hughes Supply Co. v. Glens Falls Indem. Co., 66 So. 2d 54, 58 (Fla. 1953); C.A. Burton Mach. Co. v. Ruth, 186 S.W. 737, 737-38 (Mo. Ct. App. 1916). If the Miller Act were amended to include such a change, holding the government liable for such non-compliance would be easier.

84. 28 U.S.C. §§ 2414, 2517-2519 (1970); 31 U.S.C. § 724(a) (1970). Under these provisions, claimants are subject to delays in payment which could injure them financially and which could partially be avoided by the creation of a more direct method of execution.