

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
M & S GRADING, INC.,) CASE NO. BK02-81632-TJM
)
Debtor(s).) CH. 7

MEMORANDUM

Hearing was held in Omaha, Nebraska, on May 18, 2009, on Anderson Excavating Company's request for payment of administrative expense (Fil. #865) and objections by the Contractors, Laborers, Teamsters & Engineers Health, Welfare and Pension Plans (Fil. #871) and James Killips, the Chapter 7 Trustee (Fil. #872). T. Randall Wright appeared for the Trustee, Ken Wentz appeared for Anderson Excavating Company, and M. H. Weinberg appeared for the Plans. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(B).

In 2004 – post-petition – Anderson Excavating Company subcontracted the debtor, M & S Grading, Inc., to perform some of the work on Anderson's contract with the Metropolitan Utilities District ("MUD") of Omaha for Phase I of the Platte West water treatment plant construction project. Because this was a public construction project, Anderson was required by state law to provide a bond to insure payment of all labor and material costs of the project. At the time, M & S was party to and had assumed the responsibilities of certain collective bargaining agreements with the International Union of Operating Engineers Local 571 to pay administrative dues to the union and contribute to training, pension, and health and welfare plans on behalf of M & S's employees. During the project, M & S became delinquent on those contributions and was ordered to comply with its statutory and contractual duty to make timely contributions. M & S was unable to meet those obligations, so in February or March 2005, Anderson paid a total of \$134,277.62 to the Plans and the training fund to settle their claim against its bond. This sum was in addition to the payments due from Anderson to M & S under the parties' contract. Anderson now seeks repayment of this amount as an administrative expense under 11 U.S.C. § 503(b) as an actual, necessary cost of preserving the bankruptcy estate. The parties concede that Anderson's payment reduced the amount of the Plans' claim against the bankruptcy estate.

The Plans and the Trustee object to the administrative expense request. The Trustee questions whether Anderson's payment provided a direct benefit to the estate, pointing out that the payment was made after M & S ceased business operations in January 2005. The Plans join in this argument.

In addition, the Plans argue that Anderson cannot be subrogated to the Plans' claim because

Anderson has not met the requirements of 11 U.S.C. § 509.¹ Specifically, the Plans argue that Anderson cannot meet the five elements necessary to support a § 509 claim:

- 1) Payment must have been made by the subrogee to protect his own interest.
- 2) The subrogee must not have acted as a volunteer.
- 3) The debt paid must be one for which the subrogee was not primarily liable.
- 4) The entire debt must have been paid.
- 5) Subrogation must not work any injustice to the rights of others.

Feldhahn v. Feldhahn, 929 F.2d 1351, 1353-54 (8th Cir. 1991) (citing In re Leedy Mortgage Co., 111 B.R. 488, 492 (Bankr. E.D. Pa.1990)).² While § 509 requires a claimant to establish that it is liable with the debtor on a claim of a creditor against the debtor and has paid that claim, some courts

¹§ 509. Claims of codebtors

(a) Except as provided in subsection (b) or (c) of this section, an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, is subrogated to the rights of such creditor to the extent of such payment.

(b) Such entity is not subrogated to the rights of such creditor to the extent that —

(1) a claim of such entity for reimbursement or contribution on account of such payment of such creditor's claim is —

(A) allowed under section 502 of this title;

(B) disallowed other than under section 502 (e) of this title;

or

(C) subordinated under section 510 of this title; or

(2) as between the debtor and such entity, such entity received the consideration for the claim held by such creditor.

(c) The court shall subordinate to the claim of a creditor and for the benefit of such creditor an allowed claim, by way of subrogation under this section, or for reimbursement or contribution, of an entity that is liable with the debtor on, or that has secured, such creditor's claim, until such creditor's claim is paid in full, either through payments under this title or otherwise.

²It should be noted that the Eighth Circuit Court of Appeals made clear that its application of these factors in Feldhahn “does not mean that we believe it is the only proper analysis for a § 509(a) claim.” 929 F.2d at 1354 n.4. “We note that the Leedy factors do not strictly follow the language of § 509(a). We also note that the Leedy test has its origins in equitable subrogation cases, not § 509 cases, and that some courts consider these distinct forms of subrogation.” Id. (citations omitted).

also apply the equitable subrogation factors set out in Feldhahn. See Photo Mech. Servs., Inc. v. E.I. DuPont de Nemours & Co., Inc. (In re Photo Mech. Servs., Inc.), 179 B.R. 604, 618-20 (Bankr. D. Minn. 1995) and cases cited therein.

Regardless of whether equitable subrogation is appropriate, it is clear from the statutory language of § 509 that Anderson is a co-debtor entitled to subrogation, although its claim ultimately should be subordinated to the Plans' claim. Moreover, as explained below, Anderson's claim is not entitled to administrative priority.

In § 509(a), "the term 'liable with' means that 'the parties are liable to the same creditor at the same time on the same debt. The word 'with' has been defined as sometimes equivalent to the words 'in addition to.'" Photo Mech. Servs., Inc., 179 B.R. at 619 (quoting Sun Co. v. Slamans (In re Slamans), 148 B.R. 623, 625 (Bankr. N.D. Okla. 1992), aff'd, 175 B.R. 762, 764 (N.D. Okla. 1994)).

As the employer, M & S obviously was primarily responsible for payment of its employees' wages and benefits. Because M & S was a subcontractor on a public project, state law required the prime contractor to obtain a bond for the cost of labor and material for the project. Neb. Rev. Stat. § 52-118.³ That payment bond protects the employees of a subcontractor, even though they do not

³ 52-118. Public building construction; bond required for benefit of laborers, mechanics, and suppliers; exception

(1) Except as provided in subsection (2) of this section, it shall be the duty of the State of Nebraska or any department or agency thereof, the county boards, the contracting board of all cities, villages, and school districts, all public boards empowered by law to enter into a contract for the erecting, furnishing, or repairing of any public building, bridge, highway, or other public structure or improvement, and any officer or officers so empowered by law to enter into such contract, to which the general provisions of the mechanics' lien laws do not apply and when the mechanics and laborers have no lien to secure the payment of their wages and suppliers who furnish material and who lease equipment for such work have no lien to secure payment therefor, to take from the person as defined in section 49-801 to whom the contract is awarded a payment bond or bonds in a sum not less than the contract price with a corporate surety company and agent selected by such person, conditioned for the payment of all laborers and mechanics for labor that is performed and for the payment for material and equipment rental which is actually used or rented in the erecting, furnishing, or repairing of the public structure or improvement or in performing the contract.

(2) The labor and material payment bond or bonds referred to in subsection (1) of this section shall not be required for (a) any project bid or proposed by the State of Nebraska or any department or agency thereof which has a total cost of fifteen thousand dollars or less or (b) any project bid or proposed by any county board, contracting board of any city, village, or school district, public board, or

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have a direct contractual relationship with the prime contractor. Neb. Rev. Stat. § 52-118.01.⁴ Here,

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officer referred to in subsection (1) of this section which has a total cost of ten thousand dollars or less unless the state, department, agency, board, or officer includes a bond requirement in the specifications for the project.

(3) The bond or bonds referred to in subsection (1) of this section shall be to, filed with, approved by, and safely kept by the State of Nebraska, department or agency thereof, officer or officers, or board awarding the contract. No contract referred to in subsection (1) of this section shall be entered into by the State of Nebraska, department or agency thereof, officer or officers, or board referred to in subsection (1) of this section until the bond or bonds referred to in subsection (1) of this section has been so made, filed, and approved.

(4) The bond or bonds referred to in subsection (1) of this section may be taken from the person to whom the contract is awarded by the owner and owner's representative jointly as determined by the owner. The corporate surety company referred to in subsection (1) of this section shall have a rating acceptable to the owner as the owner may require.

⁴52-118.01. Public building construction; bond; claim for unpaid labor or material; action; procedure

Every person who has furnished labor or material in the prosecution of the work provided for in the contract set out in subsection (1) of section 52-118, in respect of which a bond is or bonds are furnished under such section, and who has not been paid in full therefor before the expiration of a period of ninety days after the day on which the last of the labor was done or performed by him or her or material was furnished or supplied by him or her for which such claim is made shall have the right to sue on such bond or bonds for the amount or the balance thereof unpaid at the time of the institution of such suit and to prosecute the action to final execution and judgment for the sum or sums justly due him or her. Any person having a direct contractual relationship with a subcontractor but no contractual relationship, express or implied, with the contractor furnishing such bond or bonds shall have a right of action upon the bond or bonds upon giving written notice to the contractor within four months from the date on which such person did or performed the last of the labor or furnished or supplied the last of the material for which such claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied or for whom the labor was done or performed. Such notice shall be served by mailing the same by registered or certified mail, postage prepaid, in an envelope addressed to the contractor at any place he or she maintains an office or conducts his or her business or his or her residence or in any other manner in which a notice may be served.

This provision adopts the language in the federal Miller Act, 40 U.S.C. § 3133(b)(2), which has been
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the Plans gave timely notice to Anderson and its surety company that the Plans claimed \$197,008.80 in unpaid contributions related to the MUD project. Accordingly, Anderson is liable on the debt with M & S and has met the first element of § 509(a).

The second element of § 509(a) requires that Anderson have paid the claim, which it did. As noted, the Plans claimed \$197,008.80 from Anderson and/or its surety. Anderson paid \$134,277.62 in full settlement of the claim(s), which resulted in releases of any and all claims by the Plans against Anderson, the surety company, and MUD. Therefore, unless subsections (b) or (c) of § 509 provide otherwise, Anderson is subrogated to the rights of the Plans to the extent of Anderson's \$134,277.62 payment.

Section 509(b)(1) establishes that Anderson would not be subrogated to the Plans' rights to the extent Anderson's claim was allowed under § 502, disallowed under § 502(e), or subordinated under § 510. It has not been. Section 509(b)(2) does not allow the subrogation of a claim if the claimant received the consideration for its payment of the claim. This provision excludes those who are primarily liable on the debt from obtaining subrogation because they received consideration for paying the debt. Fibreboard Corp. v. Celotex Corp. (In re Celotex Corp.), 472 F.3d 1318, 1321-22 (11th Cir. 2006). When Anderson paid the Plans' claim, it had already paid M & S in full for its work on the MUD project. The payment of the Plans' claim was over and above the amount due to M & S on the subcontract and was made to prevent litigation on the bond. Therefore, § 509(b) does not preclude subrogation.

However, § 509(c) requires that a subrogated claim is nevertheless subordinated to the primary creditor's claim until the primary creditor is paid in full. Aetna Cas. & Sur. Co. v. LTV Steel Co. (In re Chateaugay Corp.), 94 F.3d 772, 779 (2d Cir. 1996). Therefore, under the plain language of the statute, Anderson will not receive anything on its claim unless and until the Plans' claim is paid in full.

⁴(...continued)
interpreted by the United States Supreme Court as clarifying that

the right to bring suit on a payment bond is limited to (1) those materialmen, laborers and subcontractors who deal directly with the prime contractor and (2) those materialmen, laborers and subcontractors who, lacking express or implied contractual relationship with the prime contractor, have direct contractual relationship with a subcontractor and who give the statutory notice of their claims to the prime contractor.

Clifford F. MacEvoy Co. v. United States ex rel. Calvin Tomkins Co., 322 U.S. 102, 107-08 (1944), *quoted in* McElhose v. Universal Sur. Co., 158 N.W.2d 228, 234 (Neb. 1968)). Moreover, Nebraska Revised Statutes sections 52-118, -118.01, and -118.02 "should be given a liberal construction and application in order to give effect to the intention of the Legislature to protect those whose labor and materials become a part of public projects." McElhose, 158 N.W.2d at 235.

To better its position in the repayment scheme, Anderson argues that its claim should have administrative priority under § 503(b)(1)(A), which requires a showing that the claim arose from a transaction with the estate and tangibly benefitted the estate. AgriProcessors, Inc. v. Iowa Quality Beef Supply Network (In re Tama Beef Packing, Inc.), 290 B.R. 90, 96 (B.A.P. 8th Cir. 2003). Because the allowance of administrative claims often diminishes the recovery of other creditors and claimants, § 503(b) is narrowly construed. Id. (citing Manufacturers Hanover Trust Co. v. Bartsh (In re Flight Transp. Corp. Sec. Litig.), 874 F.2d 576, 581 (8th Cir. 1989)). The party seeking an administrative expense must show that the expenditures benefit the estate as a whole rather than the individual creditor. Fruehauf Corp. v. Jartran, Inc. (In re Jartran, Inc.), 886 F.2d 859, 871 (7th Cir. 1989). “Benefit to the estate” can include “the larger objective . . . of operating the debtor’s business with a view to rehabilitating it.” Reading Co. v. Brown, 391 U.S. 471, 475 (1968).

Here, Anderson made the payments at issue in February or March 2005. M & S had ceased business operations in January 2005, and was no longer involved in the MUD project. Anderson had previously paid M & S in full under the subcontract; the payments to the Plans were simply to forestall litigation on the bond. Anderson did not make the payment in an effort to help M & S stay in business. The payment merely reduced the amount of the Plans’ ultimate claim against the bankruptcy estate, substituting Anderson for a portion of that claim, but did not preserve the estate in the sense contemplated by § 503(b). Therefore, Anderson is not entitled to an administrative expense priority. It shall be treated as a general unsecured claimant for distribution purposes.

A separate order will be entered denying Anderson’s motion.

DATED: June 25, 2009

BY THE COURT:

/s/ Timothy J. Mahoney
United States Bankruptcy Judge

Notice given by the Court to:

*Ken Wentz
T. Randall Wright
M. H. Weinberg
United States Trustee

Movant (*) is responsible for giving notice to other parties if required by rule or statute.

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ORDER

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IT IS ORDERED: For the reasons stated in the Memorandum of today's date, Anderson Excavating Company's request for payment of administrative expense (Fil. #865) is denied.

DATED: June 25, 2009

BY THE COURT:

/s/ Timothy J. Mahoney
United States Bankruptcy Judge

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