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Jeffrey Murray

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Owner/Lender Liability to Unpaid Subcontractors

When subcontractors remain unpaid for labor or materials furnished at a construction site, where can they look for restitution? Since their contract is with the general or prime contractor, the most obvious answers include seeking recovery from the general contractor, proceeding under their right to file a mechanic’s lien, or seeking recovery as third party beneficiaries under a payment bond. However, the subcontractors may not be able to pursue their claims against a general contractor if the general contractor is destitute. Furthermore, lien rights may have been waived and a payment bond may not exist. Under these circumstances, may a subcontractor recover from the owner of the job site or the lender that is furnishing the funds to pay for the construction?

A subcontractor is limited in claiming restitution from an owner or lender because they are not in privity with any contracts to which the lender or owner is a party. However, Pennsylvania courts have developed a number of theories which may permit a subcontractor to recover payment from a lender or owner despite this lack of privity. Subcontractors have attempted to base owner or lender liability on theories of unjust enrichment, constructive trust, third party beneficiary, equitable obligations, reliance, agency, and tortious interference with contractual relations. This comment will examine the current state of law of owner/lender lia-

1. Most construction projects involve the successful interaction between the owner of the property, the lender supplying the funds, the general contractor, and subcontractors. The lender contracts with the owner to provide funds for the construction project. The owner will in turn contract with the general contractor to have the work done. The general contractor will then contract with subcontractors to complete specific phases of the project, i.e., plumbing, electrical wiring, and carpentry. The lender or owner has little, if any, contact with the subcontractors. If a subcontractor is not paid, their remedy is to bring an action against the general contractor for breach of contract.


3. The owner or lender may require the general contractor to post a performance bond for the protection of subcontractors supplying labor and material to the general contractor. If the general contractor then fails to pay subcontractors, the subcontractors can recover as third party beneficiaries from the surety. For example, when public works or improvements are involved, bonds are required to protect subcontractors. See 8 Pa Cons Stat Ann § 193 (Purdon Supp 1990). See also, 53 Pa Cons Stat Ann § 46406 (Purdon 1966 & Supp 1990)(bonds required for the protection of labor and materialmen when any person, copartnership, association, or corporation enters into a contract with boroughs).
bility to unpaid subcontractors with respect to the application and effectiveness of these theories.

I. RECOVERY BASED ON UNJUST ENRICHMENT

A subcontractor may assert that an owner/lender has been unjustly enriched when it would be inequitable for the owner or lender to retain the benefit of the subcontractor's labor and materials without providing payment to the subcontractor.

To assert recovery based on an unjust enrichment theory, the subcontractor must be able to prove at least two things. First, the subcontractor must prove that there has been a benefit bestowed upon the owner/lender. Second, the retention of the benefit must be "unjust." The question as to whether the owner/lender has been "unjustly enriched" by the efforts of a subcontractor will depend on the individual circumstances of each case. If the owner or lender has been unjustly enriched, the amount of recovery allowed will be based on the value of the benefit conferred and not on the amount of the subcontractor's loss.

As the cases in this section illustrate, the theory of unjust enrichment has been advanced when the owner or lender who is funding the project has stopped payment on the project and withheld project funds, while the subcontractors remain unpaid for labor and material. However, the fact that funds were withheld will not alone support a claim of unjust enrichment where the owner or lender has not retained the benefit of the subcontractor's work. For example, in *R.M. Shoemaker Co. v Southeastern Pennsylvania Development Corp.*, there was no "enrichment" to a lender that had not come into possession of, or acquired title to, the property, nor had profited from the transaction when it withheld advances to a contractor. Furthermore, even if the one who withholding the project funds has been enriched by receiving the benefit of the

7. *Meehan*, 189 A2d at 595. In *Meehan* a developer became insolvent prior to paying the subcontractor for material and labor expended in installing streets and sewers. The streets and sewers were subsequently dedicated to the township and the subcontractor sued the township on a theory of unjust enrichment, seeking restitution for the value of his material and labor. The court denied recovery, noting that the subcontractor "cannot merely allege its own loss as the measure of recovery - i.e., the value of labor and material expended - but instead must demonstrate that the [owner/lender] has in fact benefitted." Id at 595.
8. 275 Pa Super 504, 419 A2d 60 (1980).
subcontractor’s work, the enrichment is not “unjust” if, prior to the stopping of payments, advancements had been made to cover the cost of the subcontractor’s work. Consequently, the enrichment is not unjust if it would require the enriched owner to pay for the subcontractor’s labor or materials twice. However, when a lender or owner retains funds while enjoying the benefits of the subcontractor’s labor, restitution based on unjust enrichment may be maintained as the following two cases illustrate.

In *Gee v Eberle,* when the owner defaulted on its payments during construction of a shopping plaza, the lender foreclosed on the property, completed the project, and purchased the property at a sheriff’s sale. At the time of the owner’s default, a number of the subcontractors remained unpaid for work done. The property was later sold at a profit. The subcontractors argued that the owner/lender was enriched because the owner/lender had sold the property at a profit, and that the enrichment was unjust because

10. See *Myers-Macomber Engineers v M.L.W. Construction Corp. and HNC Mortgage and Realty Investors,* 271 Pa Super 484, 414 A2d 357 (1979). In *Myers-Macomber* the developer/owner defaulted on a mortgage commitment before the lender had advanced the total mortgage commitment of $5,850,00. *Myers-Macomber,* 414 A2d at 359. The lender took possession and subsequently purchased the property at a sheriff’s sale. One of the unpaid subcontractors sought to recover its costs from the lender for site preparation. *Id.* The court noted that, prior to the developers default, the lender had advanced the money budgeted for site preparation. *Id.* at 360. Any benefit the lender/owner had received from the subcontractor’s work was not unjust since the lender had already paid for the work. *Id.* The court further noted that it did not appear that the lender/owner was able to sell the property at a profit. *Id.* at 360-61. The court did not say if the outcome of the case would have been different if the lender had been able to sell the property at a profit. This issue was resolved in *Gee v Eberle,* 279 Pa Super 101, 420 A2d 195 (1980), which held that, even if the property was sold at a profit, the lender was not unjustly enriched if the funds had previously been advanced to cover the work. See notes 12 - 21 and accompanying text.

11. See *Meyers Plumbing & Heating v West End Federal Savings and Loan Ass’n.,* 345 Pa Super 559, 498 A2d 966 (1985). In *Meyers Plumbing & Heating* the subcontractors were suing the owner for materials ordered by, and sold to, the general contractor but not paid for. *Meyers Plumbing & Heating,* 498 A2d at 967. The court affirmed the lower court’s summary judgment in favor of the owner, holding that the owner was not unjustly enriched when the funds to pay the subcontractors had already been advanced by the lender and would be included in the mortgage loan owed by the owners to the lender. *Id.* at 969. Thus, to require the owners to pay the subcontractors would “require [the owners] to pay for the same items twice. As a result of the money having already been paid once, it can hardly be said that the owners’ ‘enrichment’ from the plumbing and heating materials is unjust.” *Id.* The subcontractors in *Meyers Plumbing & Heating* also argued for recovery based on a third party beneficiary theory (see notes 84 - 86 and accompanying text), and an agency theory (see notes 103 - 110 and accompanying text).

13. *Gee,* 420 A2d at 1053.
14. *Id* at 1054.
15. *Id* at 1062.
the owner/lender had retained funds for the project. The subcontractors further argued that their unsatisfied claims against the owner should be satisfied from the unexpended loan funds of the project. The court determined it would decide de novo the issue as to whether, under Pennsylvania law, an unpaid subcontractor could recover against a lender on the theory of unjust enrichment. The court held that the subcontractors could assert a theory of recovery based on unjust enrichment. Moreover, the court refused to impose any additional requirements on subcontractors, e.g., a showing (1) that the subcontractor had exhausted statutory or contractual remedies, or (2) that the owner/lender had engaged in some wrongdoing or misrepresentations, or (3) some direct contractual relationship existed between the subcontractor and lender or owner. In responding to the subcontractors' argument that they were entitled to recovery because the owner/lender had sold the property at a profit, the court stated:

If the lender has in fact made advances to pay for the work of a subcontractor, it has satisfied its obligation - so far as it is concerned, it has paid for the work - and the subcontractor may not claim part of the proceeds of the profit on an unjust enrichment theory. If, however, the lender has not made advances to pay for the work of the subcontractor, the subcontractor may be entitled to recover from the lender on a claim of unjust enrichment. On that claim, evidence of the resale may be relevant as tending to show the value to the lender of the subcontractor's work.

17. Gee, 420 A2d at 1050. The original loan agreement was for $1,350,000. The lender withheld funds after a total of $1,016,508.49 had been advanced. The subcontractors wanted the difference between these figures. Id at 1055.
18. The Gee court based its decision on the uncertainty as to the scope of Myers-Macomber, see note 10, stating “Myers-Macomber may be read as implicitly holding that such recovery will be allowed, denying it not as a matter of legal principle but rather because on the facts there was no unjust enrichment. However, Myers-Macomber may be read more narrowly, as going no further than assuming arguendo, without holding, that recovery will be allowed on proof of unjust enrichment, thus leaving undecided the issue of legal principle.” Id at 1057.
19. Id at 1058-59. The court recognized that this was the minority view, but rejected the imposition of these requirements, stating, “It is not apparent to us . . . why a subcontractor should have to satisfy any of these additional requirements to make out a case for unjust enrichment.” Id at 1059. The court further stated that its decision was “. . . sound and consistent with our decisions on the nature of a claim of unjust enrichment.” Id at 1060. However, the recent supreme court decision in D.A. Hill Co. v Clevertrust Realty Investors, 524 Pa 425, 573 A2d 1005 (1990), has revised the holding of Gee by deciding that if the one enriched had requested the benefit or misled anyone, the enrichment is not “unjust.” See notes 32 - 40 and accompanying text.
20. Gee, 420 A2d at 1062. The court's statement makes it clear that if funds have been advanced to pay the subcontractors, the owner has not been unjustly enriched just because a subcontractor has not been paid and the property is later sold at a profit. In this case the
Since it was unclear in Gee whether the lender had made advances to the subcontractors before withholding payments, the case was remanded for determination of this issue.\(^{21}\)

One year after the *Gee v Eberle* decision, the Third Circuit Court of Appeals in *In re Gebco Investment Corp.*\(^{22}\) held that subcontractors could recover from a trustee in bankruptcy, who stood in the shoes of the owner, under a theory of unjust enrichment.\(^{23}\)

The facts in *In re Gebco Investment Corp.* were similar to those in *Gee v Eberle*. The owner had defaulted on its mortgage obligation after the lender had advanced only part of the total loan obligation.\(^{24}\) The lender, invoking the terms of the loan agreement, refused to advance further funds and withheld the remaining project funds.\(^{25}\) However, some of the subcontractors continued to work after the lender had withheld payments.\(^{26}\) Subsequently, the owner filed a Chapter X petition for reorganization and, pursuant to a bankruptcy court order, the trustee sold the property.\(^{27}\) Thereafter, the lender received the full price of the mortgage and disclaimed any interest in the funds that had been withheld.\(^{28}\) The issue involved who was entitled to the money, the subcontractors or the trustee who stood in the shoes of the owner?

The court noted that both the lender and the owner were enriched because of the sale of the property.\(^{29}\) Furthermore, because no funds had been advanced by the lender or owner to the subcontractors the enrichment was unjust.\(^{30}\) Thus, the subcontractors were able to recover on their theory of unjust enrichment.\(^{31}\)

\(^{21}\) Id at 1061. The subcontractors also sought recovery based on a constructive trust theory (see notes 50 - 52 and accompanying text), third party beneficiary theory (see note 90 and accompanying text), and reliance theory (see notes 98 - 102 and accompanying text).

\(^{22}\) 641 F2d 143 (3d Cir 1981).

\(^{23}\) *Gebco*, 641 F2d at 149.

\(^{24}\) Id at 145.

\(^{25}\) Id.

\(^{26}\) Id.

\(^{27}\) Id.

\(^{28}\) Id.

\(^{29}\) The lender was enriched because it had received funds for the entire mortgage, even though $25,420 of the mortgage funds was undisbursed. The owner (trustee) was enriched because the building had cost approximately $86,000, but sold for $120,000. Id at 148-49.

\(^{30}\) The court noted that "[i]f that profit is increased by [the owners] failure to pay subcontractors who improved the property . . . [the] benefit would constitute unjust enrichment." Id at 149.

\(^{31}\) Id. The court also held that the subcontractor could recover on a third party beneficiary theory (see notes 67 to 73 and accompanying text), or equitable assignment theory
Recently, the Pennsylvania Supreme Court, in *D.A. Hill Co. v Clevetrust Realty Investors*,\(^3^2\) has imposed additional requirements on subcontractors seeking restitution based on unjust enrichment. Noting that even if an owner/lender was enriched, the court held that the enrichment would not be unjust if the owner/lender had not requested the benefit or mislead one of the parties.\(^3^3\) In *D.A. Hill Co.* the owner had defaulted after the lender had partially paid the amount agreed upon in the loan agreement.\(^3^4\) The lender foreclosed on the property, a mall, and later purchased it at a sheriff's sale.\(^3^5\) Relying on the decision in *Gee v Eberle*, the unpaid subcontractors filed a complaint alleging that the lender had been unjustly enriched.\(^3^6\) The trial court found that funds had been withheld from some of the subcontractors and that the owner/lender had been unjustly enriched.\(^3^7\) The superior court affirmed.\(^3^8\) The Pennsylvania Supreme Court reversed on two grounds, one being that the owner/lender was not enriched because the subcontractors failed to establish that the owner/lender had benefitted from their work.\(^3^9\) However, the court supplemented this holding by stating:

Further, even if the value of the benefit had been established, the subcontractors could not recover on an unjust enrichment theory because, assuming that [the lender] was enriched, it was not *unjustly* enriched. . . . [A] third party is not *unjustly* enriched when it receives a benefit from a contract between two other parties where the party benefitted has not requested the benefit or misled the other parties. There is no evidence of record that [the lender] either requested anything from the subcontractors or misled anyone; in fact, it did nothing more than exercise its rights under the construction loan agreement to discontinue construction installment payments and foreclose on the property. The subcontractors in this case voluntarily waived their rights to mechanics' liens and went forward without being protected by a performance bond. These decisions were a [calculated business risk]. It would be manifestly unfair for this Court to restructure these contractual arrangements in such a way as to place all of the risk on

(see notes 91 to 93 and accompanying text).

33. *D.A. Hill*, 573 A2d at 1010.
34. Id at 1007.
35. Id.
36. Id.
37. Id.
38. Id at 1008.
39. Id at 1010 (the court determined that the lender was not enriched, because the lender had advanced more money than the property was valued at — the lender had advanced approximately $1,903,000 but the court found the property to be worth an estimated $1,900,000).
[the lender], thus insulating the subcontractors from any responsibility for their own decisions and making [the lender] in effect the insurer of the subcontractors' interest.\(^4\)

\textit{D.A. Hill Co.} can be viewed as partially overruling \textit{Gee v Eberle}\(^4\) in that two of the three additional requirements, which had specifically been rejected in \textit{Gee v Eberle},\(^4\) are now fundamental in determining whether a subcontractor has a claim against the owner/lender based on an unjust enrichment theory. While there is still no requirement that there be a direct contractual relationship between the owner/lender and the subcontractor,\(^4\) the subcontractor now must show that the owner/lender has requested the benefit or has misled someone. Furthermore, the \textit{D.A. Hill} court has at least suggested that where the subcontractor has waived its statutory right to file a lien, or has failed to get a performance bond, restitution based on an unjust enrichment theory will be denied.\(^4\) (In light of this decision, subcontractors should be aware of these additional requirements if they attempt to recover for unpaid work and materials based on a theory of unjust enrichment).\(^4\)

40. Id at 1010 (footnote omitted).
41. \textit{Gee}, 420 A2d at 1050. See notes 12 to 21 and accompanying text.
42. \textit{Gee}, 420 A2d at 1060. See note 19 and accompanying text.
43. In fact, in Pennsylvania the law remains that "[t]he doctrine of unjust enrichment is clearly 'inapplicable when the relationship between the parties is founded on a written agreement or express contract.'" \textit{Gee v Eberle}, 279 Pa Super 119, 420 A2d 1060 (1980) (quoting \textit{Roman Mosaic and Tile Co., Inc. v Vollrath}, 226 Pa Super 215, 218, 313 A2d 305, 307 (1973)).
44. The court in \textit{D.A. Hill} seemed especially concerned about restructuring contractual arrangements as to place all the risk on the lender. \textit{D.A. Hill}, 573 A2d at 1010 ("If the right to file a mechanics' lien has been waved . . . a court should not rewrite the contract of the parties or legislate a right to receive payment from a mortgagee who has been compelled to go into possession to preserve its security."). Id at n. 5 (citing \textit{Myers-Macomber Engineers v M.L.W. Construction Corp.}, 271 Pa Super 484, 491, 414 A2d 357, 361 (1979)). However, no mention was made of the purpose of Pennsylvania's lien statute. See 49 Pa Cons Stat Ann § 1101 et seq (1965 & Supp 1990). At least one court has held that when the statute does not expressly state that its remedy is exclusive, and when the liberal purpose of the statute is to benefit subcontractors, it would be "illogical" to find that the legislature sought to expand the subcontractors' remedies by providing the vehicle of a mechanics' lien, while at the same time foreclosing a remedy based on a theory of unjust enrichment. \textit{Guarantee Elec. Co. v Big Rivers Electric Corp.}, 669 F Supp 1371 (W D Ky 1987).
45. One can imagine a situation where, due to the unequal bargaining positions between a subcontractor and the general contractor, the subcontractor has agreed to waive its statutory right to a mechanics' lien on the property and has failed to secure a performance bond from the contractor. It would seem that a strict application of the court's holding in \textit{D.A. Hill Co.} would deny the subcontractor any recover based on an unjust enrichment theory, even if the owner/lender had retained funds from which the subcontractor expected payment. The reason for this assumption is because, although the owner/lender may have been enriched, the enrichment would not be "unjust" simply because the subcontractor had not secured a performance bond and had waived its right to file a lien on the property.
Once these two factors are met, the amount of the subcontractor's recovery will be based on the value of the benefit that the owner/lender retains and not simply the value of the invoices submitted by the subcontractor. For example, in order to recover an amount of, lets say, $50,000 for labor and materials, the subcontractor will have to show that the owner/lender has benefited from the subcontractor's services to the sum of at least $50,000.

II. Recovery Based on a Constructive Trust

When the subcontractor cannot maintain an action under an unjust enrichment theory, the subcontractor might possibly obtain restitution based on a theory that the owner/lender retaining funds is holding the funds as a constructive trustee for the unpaid subcontractor. "[A] constructive trust . . . is not really a trust at all but rather an equitable remedy."47 "[It] is the formula through which the conscience of equity finds expression. When property has been acquired in such circumstances that the holder of legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee."48

If a constructive trust is sought to be imposed on property withheld for another, there must be some property that has been set aside for another's account by the one sought to be charged as a constructive trustee.49 Accordingly, in Gee v Eberle50 the court suggested that, if a fund were not in existence to pay the subcontractors at the time they performed the work, it would be difficult to find a res on which to base a constructive trust.51 However, if there

49. See for example, Philadelphia v Mancini, 431 Pa 355, 360, 246 A2d 320, 322 (1968). See also, In Re Penn Central Transportation Co., 323 F Supp 77 (E D Pa 1971) (an identifiable res is an essential requisite under a constructive trust theory).
50. 279 Pa Super 101, 420 A2d 1050 (1980).
51. Gee, 420 A2d at 1061, n.9. In Gee the lender (who later bought and became the owner of the property at a sheriff's sale) had set up a $1,350,000 account to fund the project. Id. The court noted that there were three possible outcomes upon remand and review of the record. First, the lower court could find that the original account still had sufficient funds remaining in the trust to pay the subcontractors. Should this be the case, there would be a res available consisting of the unexpended funds. The second possibility was that the original account initially had sufficient funds to pay the subcontractors, however it ran out of funds at the time of payment. Under these circumstances the court determined there would still be a res, because the owner/lender had held the fund at a point in time at which
were a fund being withheld from a general contractor until assurances were given that all subcontractors had been paid, then a sufficient res would exist from which the subcontractors could seek restitution directly under a theory that the fund was held in constructive trust.\textsuperscript{62}

Although the term "constructive trust" did not appear in the Pennsylvania Supreme Court's decision in Williard, Inc. v Powertherm Corp.,\textsuperscript{53} one commentator has suggested that the court used the constructive trust theory as a vehicle to reach undisbursed project funds retained by an owner for the benefit of subcontractors.\textsuperscript{54} In Williard, the owner retained the remaining balance of the project fund\textsuperscript{55} because the general contractor had failed to deliver satisfactory evidence that all subcontractors had been paid pursuant to the terms of the contract.\textsuperscript{56} The contract also provided that the owner could pay the unpaid subcontractors directly, and that the owner could terminate the contract upon failure of the general contractor to pay the subcontractors.\textsuperscript{57}

The appellees, a judgment creditor of the general contractor and an assignee of the general contractor's interest in the retainage, claimed priority over the subcontractors for the retained fund. Notwithstanding these collateral claims, the court held that, since the general contractor materially breached the contract by failing to provide the required assurances that the subcontractors had been paid, the appellees had no right to the fund.\textsuperscript{58} The court then went on to state:

It would be manifestly unjust for an owner to withhold final payment from the contractor out of concern for the subcontractors' interests by failing to distribute the retainage. In such a case there can be no doubt that equity

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the fund could be declared the subject of a constructive trust. Id (citing Kimball v Barr, 249 Pa Super 420, 378 A2d 366 (1977)). The third circumstance that could exist would be if "the original account was no longer in existence at the time the [subcontractors] performed their work and any further disbursements made on the project afterwards were in a separate account. . . . [This] final possibility would present the greatest obstacle to finding a res." Gee, 420 A2d at 1061, n.9.

52. See All State Industries, Inc. v H.E. Stoudt & Sons, Inc., 9 D & C 3d 552 (Common Pleas 1978)(constructive trust in favor of unpaid subcontractors imposed on funds withheld by the lender when the general contractor failed to develope a release of liens as required by contract).

53. 497 Pa 628, 444 A2d 93 (1982).


55. There remained a balance due in the fund of $ 147,396. Williard, 444 A2d at 95.

56. Id.

57. Id at 97.

58. Id.
and justice would recognize the subcontractors’ claims against the contract balance.\(^9\)

Accordingly, when the owner or lender shows the type of “concern for the subcontractors”\(^8\) that was present in Williard and there remains a res of an undisbursed project fund, subcontractors may recover directly from the fund on an equitable theory akin to the constructive trust.

III. RECOVERY AS THIRD PARTY BENEFICIARIES

When subcontractors have not been paid for their work because construction funds have been withheld, they may be entitled to the funds under the theory that they are third party beneficiaries. The Pennsylvania Supreme Court, in Guy v Liederbach,\(^6\) adopted the Restatement (Second) of Contracts § 302\(^5\) as a guide for ascertaining third party beneficiaries, concluding that:

There is thus a two part test for determining whether one is an intended third party beneficiary: (1) the recognition of the beneficiary’s right must be “appropriate to effectuate the intention of the parties,” and (2) the performance must “satisfy an obligation of the promisee to pay money to the beneficiary” or “the circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.”\(^3\)

59. Id at 97-8.
60. In Williard the “concern for the subcontractors” was evidenced by such things as reserving the right to: (1) withhold payment from the contractor until satisfactory evidence is provided that subcontractors have been paid, (2) pay unpaid subcontractors directly, and (3) terminate the contract upon failure of the general contractor to pay the subcontractors. Williard, 444 A2d at 97.
62. The Restatement (Second) of Contracts § 302 (1979) states:

§ 302 Intended and Incidental Beneficiaries
(1) Unless otherwise agreed between promisor and promisee, a beneficiary of a promise is an intended beneficiary if recognition of a right to performance in the beneficiary is appropriate to effectuate the intention of the parties and either
(a) the performance of the promise will satisfy an obligation of the promisee to pay money to the beneficiary; or
(b) The circumstances indicate that the promisee intends to give the beneficiary the benefit of the promised performance.
(2) An incidental beneficiary is a beneficiary who is not an intended beneficiary.
63. 501 Pa 47, 459 A2d 744 (1983) (citing the Restatement (Second) of Contracts § 302 (1979)). At the time of this writing only one reported case has been found that applies the Restatement guidelines in determining whether the subcontractors were third party beneficiaries. See Myers Plumbing & Heating v West End Federal Savings and Ass’n, 345 Pa Super 559, 498 A2d 966 (1984), and notes 84 to 86 and accompanying text. Prior to the adoption of the Restatement, courts facing a third party beneficiary claim by subcontractors used the Pennsylvania Supreme Court’s decision in Spries v Hanover Fire Ins. Co., 364 Pa 52, 70 A2d 828 (1950), as a guideline. See In the Matter of Gebeo Investment Corp., 641 F2d 143 (3d Cir 1981) and notes 67 to 73 and accompanying text; B. Bornstein & Son. Inc. v R. H. Macy & Co., 278 Pa Super 156, 420 A2d 477 (1980), rev’d on other grounds sub nom,
A third party beneficiary claim will probably succeed when the provisions of a contract between the owner/lender and the general contractor expressly give a subcontractor a direct interest as a third party beneficiary and when funds have been withheld for the purpose of paying the subcontractor.64

A more challenging situation is presented to subcontractors when the owner/lender does not expressly obligate itself to pay the subcontractor(s).65 In those situations, a court must determine whether the contracting parties intended to benefit the subcontractor(s) as a third party based on the terms of the contract and actions of the parties.66

Despite the fact that the construction agreement did not obligate the lender to pay subcontractors, the court in In the Matter of Gebco Investment Corp.,67 found that the subcontractors, as third party beneficiaries, had a right superior to the owner's bankruptcy trustee's in undisbursed construction loan funds.68 In Gebco the loan agreement between the lender and owner provided for the advancement of monies in stages as the building progressed with "[a]ll monies borrowed or advanced ... [to] be applied entirely and exclusively for the payment of labor and materials used in the construction . . . ."69 Furthermore, the final installment of the loan was not to be made until the owner produced a release of liens "evidencing payment for all labor done and materials delivered . . . ."70 The owner's general manager testified that undisbursed loan funds were earmarked for the payment of the subcontrac-

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64. See Kreimer v Second Federal Savings and Loan Association, 196 Pa Super 644, 176 A2d 132 (1961) (despite the fact that materialmen had a no lien contract, they were third party beneficiaries and entitled to recover from a fund held by lender, when the construction loan agreement contained the provision that "funds or security in [the lender's] possession . . . shall be held by the [lender] directly to those furnishing labor . . ."). Kreimer, 176 A2d at 132.

65. See Demharter v First Federal Savings & Loan Association, 412 Pa 142, 194 A2d 214 (1963) (bank having no obligation under loan agreement to pay materialmen, was not liable to materialmen when bank continued to advance funds to the owner after being notified by the materialmen that they were owed substantial amounts by the owner).


68. Gebco, 641 F2d at 143.

69. Id at 145.

70. Id.
The bank was also given the option of advancing sums directly to the subcontractors. The Gebco court concluded that the contract language and testimony evidenced an intent by the lender and owner that the withheld funds would be for the benefit of the subcontractors; based on that evidence, the subcontractors could recover on a third party beneficiary theory.

The subcontractors were not so successful in B. Bornstein & Son, Inc. v R.H. Macy & Co., where the court held that they were not entitled to withheld funds on the theory that they were third party beneficiaries. In Bornstein, the court first noted that the contract between the owner and general contractor contained no direct actionable promise which could be enforced by the subcontractors; in fact a clause in the contract denied any obligation on the part of the owner to pay, or see to the payment of, sums owed to the subcontractors.

The court then looked to the terms of the contract to determine if there was an intent to make the subcontractors third party beneficiaries. The contract between the owner and general contractor provided for the following: subcontractors were not to file liens; the owner could withhold payment to the general contractor if any liens were filed, but was not required to do so; and if the general contractor failed to pay subcontractors, the owner could terminate the general contractor’s status. The court determined that these provisions did not express an intent by the parties to benefit subcontractors, but rather an intent by the corporate owner to protect itself. At best, the status of the subcontractors was that of “incidental beneficiaries.” As a result of the court’s analysis, the subcontractors were precluded from recovering withheld funds based

71. Id at 147.
72. Id.
73. Id. The subcontractors were also entitled to recovery on an equitable assignment theory (see notes 91 to 93 and accompanying text), and an unjust enrichment theory (see notes 22 to 31 and accompanying text).
75. Bornstein, 420 A2d at 477.
76. Id at 482.
77. Id.
78. Id at 483.
79. Id. As an incidental beneficiary, the subcontractor would acquire no rights against the owner or lender. See Restatement (Second) of Contracts § 315 (1979); Meyers Plumbing & Heating v West End Federal Savings and Loan Ass’n., 345 Pa Super 559, 564-65, 498 A2d 966, 969 (1985).
on a third party beneficiary theory.\textsuperscript{80}

As noted above,\textsuperscript{81} the Gebco and Bornstein cases were decided before the Restatement § 302 two part test was adopted in Guy.\textsuperscript{82} Has the adoption of the two part Restatement test changed the position of subcontractors claiming restitution against owners or lenders on a third party beneficiary theory? The answer may be "yes" based on the decision of Meyers Plumbing \& Heating v West End Federal,\textsuperscript{83} wherein the court considered the question of subcontractors' rights under the Restatement.

In Meyers Plumbing \& Heating,\textsuperscript{84} the subcontractor attempted to hold the owners liable for unpaid materials - asserting that it was a third party beneficiary to either the contract between the owners and the lender, or the contract between the owners and the general contractor. The subcontractors based their status on the fact that the owners occasionally required their own endorsements on the construction loan checks, in addition to the endorsements of the subcontractor and general contractor.\textsuperscript{85} The court applied the two-part Restatement test and affirmed the lower court's summary judgment in favor of the owners, stating:

Applying [the Restatement (Second) of Contracts § 302] principles to the case at bar, we find that [the subcontractor] is not a third party beneficiary of either contract. Existence of the no-lien provision in the Contractor Warranty and of the Non-Lien Agreement itself manifests an obvious intent by the owners to protect themselves from the claims of any of [the general contractor's] subcontractors and to make the subcontractors the sole re-

\textsuperscript{80} Bornstein, 420 A2d at 483. See also, R.P. Russo Contractors \& Engineers, Inc. v C.J. Pettinato Realty \& Development Inc., 334 Pa Super 72, 482 A2d 1086 (1984) (There was no intent to make the subcontractors third party beneficiaries when they were aware that the general contractor had authority request that the lender withhold progress payments to the subcontractors if the general contractor believed that the subcontractors had breached portions of their contract). Russo, 482 A2d at 1086.

\textsuperscript{81} See note 63 and accompanying text.

\textsuperscript{82} See notes 61 to 63 and accompanying text. The court in Gebco based its decision on the guidelines set forth in Spires v Hanover Fire Insurance Co., 364 Pa 52, 70 A2d 828 (1950), which stated, "To be a third party beneficiary entitled to recover on a contract it is not enough that it be intended by one of the parties to the contract and the third person that the latter should be a beneficiary, but both parties to the contract must so intend and must indicate that intention in the contract; in other words, a promisor cannot be held liable to an alleged beneficiary of a contract unless the latter was within his contemplation at the time the contract was entered into and such liability was intentionally assumed by him in his undertaking; the obligation to the third party must be created, and must affirmatively appear in the contract itself. . . ."

Spires, 70 A2d at 830-31 (footnote and citations omitted).

\textsuperscript{83} 345 Pa Super 559, 498 A2d 966 (1984).

\textsuperscript{84} Meyers, 498 A2d at 966.

\textsuperscript{85} Id at 968.
sponsibility of [the general contractor].

Since the court in Meyers Plumbing & Heating could only sustain the lower court's summary judgment if the owners were entitled to a judgment as a matter of law,86 a broad reading of the decision would seem to indicate that the existence of a no-lien provision in the contract between the owner and the general contractor would preclude subcontractors from asserting a third party beneficiary claim against the owner. If such a broad reading was extended to agreements between a lender and an owner, the Gebco88 decision may be questionable, since the owner therein agreed that no liens would be filed by any of the subcontractors as one of the conditions of the loan.89

Finally, notwithstanding the fact that there may be language in the agreement which may be interpreted as expressing an intent to benefit the subcontractors, a provision in an agreement that expressly disclaims any intent to benefit third parties will be given effect to prevent subcontractors from advancing a claim as third party beneficiaries.90

86. Id at 969. The Non-Lien agreement was entered into between the owners and the general contractor and "stipulated that no claim for work or materials would be made against the owners except as provided in their building construction contract." Id at 967. The Contractor Warranty provided that the general contractor "would protect, defend and indemnify the owners from any claims for unpaid work, labor, or materials and that final payment would not be made until he delivered to the owners a complete release of all liens arising out of [his] performance." Id.


88. See notes 67 to 73 and accompanying text.

89. Gebco, 641 F2d at 143, 144.

90. See Gee v Eberle, 279 Pa Super 101, n.7, 420 A2d 1050, n.7 (1980). In Gee provisions in the loan agreement stated that the borrower would "keep the Premises and Improvements free of liens or claims for liens for material supplied and for labor or services performed . . . [and] will hold the right to receive [advances] as a trust fund for the purpose of paying the costs of construction . . . ." Gee, 420 A2d at 1050. The court stated that these provisions might be read as intending to confer a benefit on the subcontractors; however, against these provisions, the agreement provided that "[a]ll conditions of the obligations of Lender to make advances hereunder are imposed solely and exclusively for the benefit of Lender; . . . [t]he parties do not intend the benefits of this Agreement to inure to any third party." Id. The court held that by these last two provisions the owner and lender did not intend that the subcontractors should be third party beneficiaries. See also, R. M. Shoemaker v Southeastern Pa. Economic Development Corp., 275 Pa Super 504, 410 A2d 60 (1980) (general contractor could not maintain third party beneficiary status when agreement between owner and bank specifically provided that there would be no third party beneficiaries).
IV. Recovery Basen on Equitable Obligations Owed to the Subcontractor

If a subcontractor cannot recover under a third party beneficiary theory because both parties to the contract did not intend to benefit the subcontractor, then, under some limited circumstances, the subcontractor may be able to recover payment under the theory that the owner or lender owed him an equitable obligation under the terms of the agreement.

In In re Matter of Gebco Investment Corp., the subcontractor argued it was entitled to funds withheld by the lender as against the owner's bankruptcy trustee. The subcontractor based its argument on the theory that the owner assumed an implied obligation to the subcontractor. This implication arose out of two requirements in the construction loan agreement. First, the owner had to secure a no-lien stipulation from the general contractor. Second, the owner had to produce a release of liens before final payment was made. The court concluded that this arrangement constituted an equitable obligation by the owner:

By undertaking to provide a release of liens, [the owner] assumed an implied obligation to the subcontractors. The provision was written at the insistence of the [lender] for its benefit, and as a practical matter, it is unlikely that the loan would have been granted without that condition. Thus in return for assuming this obligation, [the owner] received substantial consideration in the form of a loan. The trustee, standing in [the owner's] shoes, is in no position to repudiate the equitable obligation undertaken at the time the loan was negotiated. The fact that the mortgage was later paid does not release the equitable charge attached to the funds in the bank's hands. That fund was encumbered in favor of the subcontractor who had a superior right to it over the owner or its trustee.

The decision in Gebco is notable, since almost one year earlier the court in Bornstein rejected the equitable obligation argument in the context of an owner/general contractor agreement, stating:

91. 641 F2d 143 (3d Cir 1981).
92. Gebco, 641 F2d at 143. The subcontractor also successfully argued recovery based on an unjust enrichment (See notes 22 to 31 and accompanying text) and third party beneficiary theory (See notes 67 to 73 and accompanying text).
93. Gebco, 641 F2d at 148. See also, Warrington v Mengel, 41 Pa Super 362 (1909) (similar loan arrangement to that in Gebco held to be an equitable assignment).
95. Except for the fact that the agreement in Bornstein was between the owner and general contractor, rather than the lender and owner as in Gebco, the agreements had substantially similar provisions. These provisions provided that certain project funds would be withheld until a release of liens was supplied which would evidence that the subcontractors
If we were to accept [the subcontractor's] contention [that the owner should be liable under an equitable obligation theory] the effect would be to re-write the owner's contract with the general contractor, thereby disabling the owner from protecting itself against 'harassing litigation by wronged subcontractors and materialmen.' We see no reason to put subcontractors in a position more advantageous than an owner's position.\[\text{96}\]

Although the \textit{Gebco} and \textit{Bornstein} courts reached different results, the two cases are distinguishable. \textit{Gebco} involved an agreement between the lender and the owner, which agreement required the owner to get a release of liens in return for which the owner would receive the benefit of a loan. The court perceived the owner as assuming an obligation that the subcontractors would be paid and, therefore, the retained funds were being withheld for the benefit of the unpaid subcontractors. However, the owner in \textit{Bornstein} was not required by any third party to put the release of liens clause in the agreement in order to receive some benefit; rather, the owner put the clause in the agreement for its own protection. The subcontractors were at best "incidental beneficiaries"\[\text{97}\] and the owner assumed no obligation to see that the subcontractors were paid.

In light of the decisions in \textit{Bornstein} and \textit{Gebco}, recovery on an equitable obligation theory has thus far been limited to owner liability to subcontractors. Applicability of this theory appears to be limited to situations similar to those in \textit{Gebco}.

\textbf{V. Recovery Based on a Reliance Theory}

In \textit{Gee v Eberle}\[\text{98}\] the court discussed the possibility of a subcontractor's recovery based on an equitable lien being imposed on unexpended loan funds. Such recovery would derive from the subcontractor's reliance on promises the owner gave it that there was adequate financing for the project.\[\text{99}\] When the subcontractors in \textit{Gee} were not paid for their work, they attempted to hold the

\[\text{had been paid, even though both agreements had "no lien provisions".}\]

\[\text{96. } \textit{Bornstein,} 420 \text{ A2d at 486 (citations omitted). The court went on to state that subcontractors could adequately protect themselves by requiring the general contractor to post a surety bond, or make sure that the contract between the owner and general contractor "... includes either an actionable promise on which they can rely, ... or a promise for their benefit ... ".} \textit{Id.}\]

\[\text{97. See notes 79 and accompanying text.}\]

\[\text{98. 276 Pa Super 101, 420 A2d 1050 (1980). See notes 12 to 21 accompanying text.}\]

\[\text{99. } \textit{Gee,} 420 \text{ A2d at 1050. The subcontractors also argued restitution based on an unjust enrichment theory (see notes 12 to 21 and accompanying text), a constructive trust theory (see notes 50 to 52 and accompanying text), and a third party beneficiary theory (see note 90).}\]
lender liable for supplying the original loan obligation based upon their reliance on the owner's promise that adequate funds where available. The court denied the subcontractor's recovery stating, "... to accept [their] argument would mean that parties to a loan would lose their freedom to alter its terms. Furthermore, to give effect to third party reliance on the existence of a loan fund might have unfortunate consequences for the construction industry." However, one of the subcontractors was allowed recovery based on a reliance theory, because he had received assurances directly from the lender (rather than the owner) that adequate funds were being withheld to pay him for work done.

VI. RECOVERY BASED ON AGENCY PRINCIPLES

In Meyers Plumbing & Heating v West End Federal Savings & Loan Ass'n, the court entertained a subcontractor's attempt to hold the owner liable based on agency principles. In Meyers Plumbing & Heating the lenders, to satisfy any misgivings of the subcontractor, sent a letter to the subcontractor stating that the lender would not make disbursements of funds "until the work was completed and [the lender] had in its possession a satisfactory inspection report." The owner eventually had the lender stop construction payments due to a dispute between the owner and the general contractor. The subcontractor was left unpaid for materials ordered by, and sold to, the general contractor.

The subcontractor sought recovery based on agency principles, asserting that the letter sent to him constituted a contract by the

100. Gee, 420 A2d at 1050. The original loan obligation was for $1,3500,00, but was later reduced to $1,100,000 due to the facts that one of the tenants had pulled out and not as much space was needed. Id at 1053.

101. Id at 1063. The court stated that the lender would be subjected to “unbargained for risk” if an unethical owner misrepresented to the subcontractors the extent of the lender's financing. Id. To avoid liability in such a case, the lender would have to disclose to each subcontractor at the outset of the project the actual funds available, and advise the subcontractors of any changes in the agreement during construction. “This obligation might discourage a lender from engaging in a project.” Id.

102. Id at 1054, 1064.

103. 345 Pa Super 559, 498 A2d 966 (1985). The subcontractors also attempted to assert claims against the owner under an unjust enrichment theory (see note 11) and as a third party beneficiary (see notes 83 to 86 and accompanying text).

104. Meyer, 498 A2d at 966.

105. Id at 967.

106. Id.

107. Id.
lender who was acting in its capacity as an agent of the owner.\textsuperscript{108} For summary judgment purposes, the court assumed that an agency relationship existed between the lender and owner, and that the letter was indeed a contract between the lender, acting as agent for the owner, and the subcontractor.\textsuperscript{109} However, since the record revealed no evidence that disbursements had been made before the work was completed or that the lender had in its possession a satisfactory inspection report, the terms of the contract were not breached.\textsuperscript{110}

VII. RECOVERY BASED ON TORTIOUS INTERFERENCE WITH CONTRACTUAL OBLIGATIONS

If an owner or lender interferes with the general contractor's contractual obligations to the subcontractor, a subcontractor may recover damages against an owner or lender for tortious interference if:

1) the acts complained of were willful and intentional; 2) that they were calculated to cause damage to the [subcontractor] in his business; 3) that these were done with the unlawful purpose of causing damage and loss to the [subcontractor] without right or justifiable cause on the part of the defendant; and 4) that actual damage and loss resulted.\textsuperscript{111}

In \textit{R.P. Russo Contractors & Engineers, Inc. v C.J. Pettinato Realty & Development Inc.},\textsuperscript{112} the subcontractor was appealing the lower court's order dismissing its claim against the lender, which claim alleged tortious interference with the contractual relationship between the subcontractor and the developer of the project.\textsuperscript{113} The reviewing court agreed with the lower court: when a lender is legally bound to disburse construction funds to the general contractor, a subcontractor will have no claim based on tortious interference against the lender simply for making payments to the general contractor, without regard to problems occurring between the general contractor and subcontractor.\textsuperscript{114} However, since the sub-

\begin{itemize}
\item \textsuperscript{108} Id at 968.
\item \textsuperscript{109} Id.
\item \textsuperscript{110} Id.
\item \textsuperscript{111} \textit{R.P. Russo Contractors & Engineers, Inc. v C.J. Pettinato Realty & Development Inc.}, 334 Pa Super 72, 77, 482 A2d 1086, 1090 (1984) (citing \textit{Glenn v Point Park College}, 441 Pa 474, 272 A2d 895 (1971)). The decision in \textit{R.P. Russo} was limited to a subcontractor claim against the lender. However, a tortious interference cause of action should also exist against an owner if these four elements are satisfied.
\item \textsuperscript{112} \textit{Russo}, 482 A2d at 1090.
\item \textsuperscript{113} Id at 1091.
\item \textsuperscript{114} Id. The subcontract provided that the subcontractor was to receive $224,295.00.
\end{itemize}
contractor's complaint had alleged that the lender conspired with the general contractor to oust the subcontractor for unlawful purposes, a cause of action for tortious interference was stated and the case remanded for a determination on the tortious interference claims.115

CONCLUSION

When a subcontractor is unable to recover from the general contractor for labor and material, subcontractors have argued a number of theories to hold owners or lenders liable to the subcontractor, despite the lack of privity between themselves and the owners or lenders. First, subcontractors have recovered under a theory of unjust enrichment. Under this theory, a subcontractor must first show that the owner/lender has been enriched by retaining a benefit from the labor and/or material that the subcontractor furnished. Once the subcontractor has shown that the owner has been enriched, the subcontractor must next show that it would be inequitable for the owner/lender to retain the benefit without compensating the subcontractor for the benefit conferred. Correspondingly, subcontractors have been successful in cases where the owner/lender has retained the benefit of the subcontractor's labor and/or materials, while withholding funds out of which the subcontractors were to be paid. However, the recent Pennsylvania Supreme Court decision in D.A. Hill Co.116 suggests that, even in these circumstances, there is no unjust enrichment if the owner/lender has not misled the general contractor or subcontractor and

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115. Id at 1091. The court also permitted the subcontractor to amend its complaint to assert that the lender and the developer conspired to oust appellant, in order to reduce the cost of constructing the project. However, the subcontractor's request to amend its complaint to assert a third party beneficiary cause of action was denied. Id at 1092. The court distinguished Gebco (see notes 67 to 73 and accompanying text) because, in the present case, no funds were being held strictly for the payment of subcontractors. Moreover, the agreement between the developer and the subcontractor stated that the developer had full authority not to request progress payments for the subcontractors, if it believed the subcontract had been breached. Russo, 482 A2d at 1092.

116. See notes 32 to 40 and accompanying text.
if the subcontractors have entered into the contract with the general contractor without securing a performance bond or mechanic's lien.

The second argument that has been successful for subcontractors is based on a constructive trust theory. Subcontractors have recovered under this theory when they have identified a res of funds in existence at the time of their performance, which fund had been set aside for their benefit by the owner or lender. In these cases, the owner or lender has been held to be a constructive trustee of the funds and found liable to the subcontractor for the funds.

A third theory available to subcontractors is the status of third party beneficiaries to a contract between the owner or lender and the general contractor. This status arises when there are provisions in the contract that indicate an intention by the parties to benefit the subcontractors. Subcontractors have successfully argued that the owner (or lender) and the general contractor intended to make them third party beneficiaries of construction funds when the contract language between the parties demonstrated an intent by the parties that the funds were withheld for the benefit of the subcontractors. Owners or lenders can easily protect themselves from third party beneficiary claims by expressly disclaiming any intent to benefit the subcontractors in the contract with the general contractor. In addition, the existence of a no-lien provision in the contract between an owner and the general contractor has been held to preclude subcontractors from asserting a third party beneficiary claim against the owner.

On a fourth theory, subcontractors may also recover when the owner has assumed an equitable obligation, namely obligating itself to see that the subcontractors get paid. This implied obligation may occur when the owner has conceded to the lender's demands to secure a release of liens and a no-lien stipulation from the general contractor in return for a loan.

Finally, subcontractors may be entitled to recovery from an owner or lender under reliance, agency, and tortious interference theories. Claims under these theories have not been as successful as those mentioned above.

Obviously, the best chance of recovery for an unpaid subcontractor is first to proceed against the general contractor. If the subcontractor cannot recover from the general contractor, then the above mentioned theories may provide relief by holding the owner or lender liable to the unpaid subcontractor.
To protect themselves from claims by unpaid subcontractors, owners and lenders may require the general contractor to post a bond that expressly guarantees payment of a subcontractor, in which case the subcontractor can recover against the surety as a third-party beneficiary of the bond. In addition, the lender and owner should make unequivocally clear in their contracts that they have no intention of making subcontractors third party beneficiaries to the contract.

Jeffrey Murray