No. 103018-5

SUPREME COURT
OF THE STATE OF WASHINGTON

In the Receivership of:
CASTLE WALLS LLC:

JOHANSEN CONSTRUCTION COMPANY, LLC,

Petitioner,

v.

REVITALIZATION PARTNERS, LLC,

Respondent/Receiver.

MEMORANDUM OF *AMICI CURIAE* ASSOCIATED GENERAL CONTRACTORS OF WASHINGTON AND NATIONAL UTILITY CONTRACTORS ASSOCIATION OF WASHINGTON IN SUPPORT OF PETITION FOR REVIEW

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I. IDENTITY AND INTERESTS OF *AMICI*

Amici Curiae are the Associated General Contractors of Washington ("AGC") and National Utility Contractors Association of Washington ("NUCA"), further identified in their motion for leave to participate as *amici*. They have a keen interest in cases affecting their thousands of members in Washington's construction industry. The industry relies on contract terms to keep projects on track and allocate risk. These include detailed payment provisions which include conditions precedent to avoid double payment and project delays, and to ensure that those doing the work get paid as agreed. The ability to rely on those contract provisions is critical to operation of the construction industry.

Amici appear herein because the Court of Appeals affirmed a trial court decision giving those contract payment provisions no effect. *In re Receivership of Castle Walls, LLC*, __ Wn. App. __, 545 P.3d 816 (2024) ("Decision"). As a published decision, it makes such contract provisions

meaningless for future construction projects. The key issue for *Amici* is whether receivers and their supervising courts may disregard express contractual conditions precedent governing an insolvent subcontractor's right to payment and thereby fundamentally change parties' agreed economic relationships.

The Decision ruled that courts and receivers may ignore the contract rights between contractors and insolvents. To reach that result it not only relied on federal bankruptcy law, it expressly disregarded this Court's cases holding a receiver "stands in the shoes" of its insolvent. Instead, the Decision holds trial courts may "do equity" in favor of a receiver even though it rewards inequitable conduct, here the breach of express contract terms *and* the fraudulent negotiation of joint checks.

II. ISSUES ADDRESSED BY *AMICI CURIAE*

A. Does a receiver still stand in the shoes of its insolvent? **Yes.**

B. Did the Receivership Act Abrogate Washington Contract Law? **No.**

C. Do equitable principles supersede express contract terms? **No.**

D. Are receiverships defined, governed by, and conducted pursuant to Washington law rather than federal bankruptcy law? **Yes.**

III. STATEMENT OF THE CASE

AGC and NUCA agree with Johansen's Statement of the Case and add the following summary relevant to their concerns.

The subcontractor and insolvent herein, Castle Walls, LLC ("Castle Walls"), breached its contract with the contractor, Johansen Construction Co., LLC ("Johansen"), by among other things failing to pay its supplier when Johansen issued it joint checks, resulting in the job being liened and stopped. Johansen terminated Castle Walls before it assigned its interests to the receiver, and had to pay the supplier to restart the job. When the receiver was appointed Castle Walls had lost its contract right to payments from Johansen. Its fraudulent negotiation of the joint checks also meant Castle Walls never had any legal right to that money under Washington law. After the receiver was appointed, Castle Walls' bank belatedly sent the same amount of money as the joint checks to Johansen's bank to cure its improper

negotiation of joint checks, and "debited" Castle Walls' overdrawn account. The receiver then demanded from Johansen the money sent by the bank under the peremptory turnover statute, RCW 7.60.070.

Despite Castle Walls' undisputed breaches of contract and fraudulent acquisition of funds, the trial court ruled without analysis the money must be turned over to the receiver under RCW 7.60.070, even though the statute precludes "turnover" of alleged estate property where there is a "bona fide dispute" over the right to the property. The dispute was over Castle Walls' breaches negating any contract right to payment and its fraudulent negotiation of joint checks. The turnover order ignored the express contract provisions barring Castle Walls from contract relief and gave the receiver the benefit of Castle Walls' fraudulent negotiation of the checks.

Under this ruling, the consequence of a subcontractor's breaches and fraud is that the contractor has to pay the supplier twice and pay the receiver for the subcontractor's "work" despite

its breaches which preclude such payment under the contract. This was untenable to *Amici's* members. They filed an *amicus* brief below in support of Johansen.

Division I's Decision affirmed. It ignored the express contract provisions which precluded relief for Castle Walls and for the receiver who heretofore stood "in the shoes" of the insolvent, disregarding this Court's "stand in the shoes" decisions. The Decision also relied on federal bankruptcy cases to side-step controlling Washington law governing banking practice on fraudulently obtained funds. The Decision conflicts with multiple decisions of this Court, basic principles of equity, and Ch. 7.60 RCW, as Johansen's petition points out.

Most importantly to AGC and NUCA, if those decisions and basic principles no longer apply in receiverships, none of *Amici's* thousands of members can rely on their contracts with subcontractors and suppliers when one goes insolvent. *Amici's* members face the prospect of paying twice for the same work or materials when a sub goes insolvent as well as paying –

rewarding – the breaching insolvent's receiver.[1] *Amici* cannot believe that is equitable or lawful under Washington law.

IV. ARGUMENT

A. Since the Assignment of Rights Means the Receiver Stands in the Shoes of its Insolvent, Its "Right" to Payment is Based on its Insolvent's Contract Rights and Must Remain Subject To The Contract's Terms, Or Construction Contracts Are Nullities.

As is common in the construction industry, whether Johansen was obligated to pay its subcontractor Castle Walls is defined by express contract terms and conditions precedent in their subcontract. Conditions precedent are facts and events "that must exist or occur before there is a right to immediate performance" and "a breach by a plaintiff of a material condition precedent relieves a defendant of liability under a contract." *Ross v. Harding*, 64 Wn.2d 231, 236, 241, 391 P.2d 526 (1964).

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[1] This disregard for contract rights in receiverships is seen in another Division I decision. *In re Receivership of Applied Restoration*, 28 Wn.App.2d 881, 539 P.3d 837 (2023) ("*Applied Restoration*"), *petition for review pending*, No. 102883-1.

The Decision concluded that the insolvent Castle Walls' "performance of work" when it submitted invoices to Johansen entitled the receiver (which was assigned such rights, assets and liabilities as Castle Walls had on the date of assignment) to payment for that work, regardless of its breach of the contract's payment terms. *See* Decision, 545 P.3d at 826 (when "Johansen made the progress payments to Castle Walls…Johansen *owed* those funds to Castle Walls") (emphasis added).

But submission of an invoice by a subcontractor does not automatically entitle the subcontractor to payment. The legal obligation to pay and the legal right to receive payment is governed by the terms of each contract. Or has been, until now.

The Decision sidestepped Castle Walls' breach of the express contract requirements (and the thefts) as though they did not exist to find a right to payment of Castle Walls that the

receiver possessed based on unspecified "broad equitable powers of the trial court as to remedies." Decision, 545 P.3d at 826.[2]

This analysis begs the question of what remedies the assignee-receiver of Castle Walls' rights is entitled to, when balancing Castle Walls' contract breaches against the contract and equitable rights of the innocent contractor scrambling to complete the job. This scenario of breaches and inequitable conduct occurs all too regularly to *Amici's* members. They need to know their contract rights are respected. They were not here.

Johansen's petition sets out this Court's cases holding a receiver stands in the shoes of its insolvent and therefore cannot exercise authority over property in which its insolvent had no

[2] The Decision also sidestepped the fact that the initial "crediting" to Castle Walls' account of the joint check amounts by Castle Walls' bank was void since without the second endorsement, no title passed. *See Johansen's Petition for Review* at pp. 4, 7-8, 20-21. No equitable principle is identified that gives the receiver rights to funds where Castle Walls had none.

lawful interest on the date of assignment[3] that the Decision effectively overruled by asserting the 2004 codification of the Receivership Act and unspecified equitable principles. *See* Decision, 545 P.3d at 823: "the blind application of [the stands in the shoes] rule would require this court to ignore the specific circumstances of the case, the equitable powers of the court, and the relevant provisions of the current receivership statute."

Amici do not exaggerate when they advise the Court this material change to the long-standing law of insolvents' assignments and contract rights will make operation of the construction industry dramatically uncertain. This is so because the Decision tells contractors that if a sub becomes insolvent and assigns its rights to a receiver, the contractor cannot rely on the express contract requirements for payment they had negotiated – they are in uncertain, uncharted territory. That is the opposite of

[3] *See Petition for Review* at 2 (Issue 1); 14-18, citing *Morse Electro Products Corp. v. Beneficial Industrial Loan Co.*, 90 Wn.2d 195, 579 P.2d 1341 (1978), and three earlier decisions.

what contract law is supposed to do – it is supposed to provide a measure of certainty by its agreed provisions that guide the parties' actions and payments, especially when one becomes unable to perform or insolvent.

The carefully-structured contract provisions which are ubiquitous in the industry are pre-planned back-stops for the problems no one wants but regularly occur when a subcontractor becomes insolvent. Enforceable contract terms that bind the assignee-receiver give the contractor and others on the job a measure of certainty so they can minimize the disruption and costs imposed by the insolvency and complete the job. This matters to *Amici's* members. Because the Decision upsets this carefully planned contractual safety net upon which the entire industry relies, this Court should grant review.

B. The Receivership Act Did Not Abrogate Washington Contract Law

The Decision asserts the 2004 codification of the Receivership Act by SSB 6189 abrogated Washington's settled receivership law that receivers "step into the shoes of

insolvents." While the legislature may supersede, modify, or abrogate the common law, "[i]t is a well-established principle of statutory construction that '[t]he common law...ought not to be deemed repealed, unless the language of a statute be clear and explicit for this purpose.'" *Potter v. Washington State Patrol*, 165 Wn.2d 67, 77, 196 P.3d 691 (2008). There is no such clear, explicit language in the Act.

Neither the legislation nor the legislative reports suggest a major change was made. Rather, the legislature enacted SSB 6189 after a ten-year WSBA effort to make receiverships more accessible to practitioners. The Final Senate Bill Report notes that "[t]he limitations and restrictions applicable to receiverships specifically provided for under current law are ***preserved***." F. S.B. Report on SSB 6189 at 1, 58th Leg. Reg. Sess. (Wash. 2004) (emphasis added).[4]

[4] Bill reports are at https://app.leg.wa.gov/billsummary?BillNumber=6189&Year=2003&Initiative=false (visited 6/3/24).

By enacting the Receivership Act the legislature intended to consolidate "the rules generally governing receivership proceedings … into a single chapter…." *Id*. There is no discussion in the Act nor any report of granting receivers new rights, power, or authority exceeding those of the insolvent and contrary to settled law. Had the legislature shown an intent to make such a change, AGC and NUCA would have participated fully in the legislative process to protect their members' right to contract. There was no need as there was no such intent in 2004.

C. Equitable Principles Do Not Supersede Express Contract Terms; They Preclude Granting Equity To Receivers Of Insolvents With Unclean Hands.

The Decision's conclusion that the insolvent Castle Walls was equitably entitled to payment for "work performed" was apparently because it would be unfair or unjust to withhold payment, regardless of the express provisions in the contract with Johansen. This relief sounds in the doctrine of unjust enrichment which "is the method of recovery for the value of the benefit retained absent any contractual relationship because notions of

fairness and justice require it." *Young v. Young*, 164 Wn.2d 477, 484, 191 P.3d 1258 (2008). But here there was a contract, the subcontract that precludes payment to Castle Walls due to the breaches. Further, "[a] party to a valid express contract is bound by the provisions of that contract, and may not disregard the same and bring an action on an implied contract relating to the same matter, in contravention of the express contract," *Chandler v. Washington Toll Bridge Authority*, 17 Wn.2d 591, 604, 137 P.2d 97 (1943). Finally, "[t]he courts will not allow a claim for unjust enrichment in contravention of a provision in a valid express contract." *MacDonald v. Hayner*, 43 Wn. App. 81, 86, 715 P.2d 519 (1986).

All this means that, even if Castle Walls "performed work", that did not create an equitable right to payment when the subcontract's express terms provided that payment was *not* owed under the circumstances of the multiple breaches. Indeed, if such an equitable right was created here, *Amici's* members' contract payment provisions are worthless.

The subcontract here required certifications for payment. Castle Walls certified falsely that it had satisfied all contractual conditions precedent to payment including paying its supplier, and discharged and released its general contractor and owner from liability arising out its scope of work under the subcontract, satisfying the conditions precedent to progress payments. *See, e.g.,* CP 100, 114, 150 (certifications, releases).

But Castle Walls had not satisfied those conditions, meaning Johansen had no contractual obligation to pay Castle Walls. This is the kind of situation that AGC's and NUCA's members see far too often and for which they craft their contracts to protect themselves and their projects. They need the Court to confirm their contract rights will not be eliminated by some unspecified, after-the-fact equitable relief to the breaching party.

Finally, it is black letter law that a party with unclean hands cannot receive equitable relief. *Kramarevcky v. Department of Social & Health Services*, 122 Wn.2d 738, 743 n.1, 863 P.2d 535 (1993) (courts may not grant equitable relief

to a party at fault in the transaction at issue). And yet, contrary to these principles, the Decision affirmed the trial court's "equitable choice" to ignore the conditions precedent requirements to payment and Castle Walls' breaches, and disregarded the most basic principle that the receivers have only the rights of their insolvents at the time of assignment.

V. CONCLUSION

If not changed the Decision will wreak disruption and damage to Washington's construction industry by the uncertainties and inequities it creates. *Amici* AGC and NUCA ask the Court to grant review to clarify that receivers do stand in the shoes of their insolvent, and that the equitable authority of trial courts in receiverships is governed by Washington law, cannot override the parties' express contract provisions, and that innocent contractors cannot be required to pay twice for the insolvent's breach.

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RESPECTFULLY SUBMITTED this 9th day of July, 2024.

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CERTIFICATE OF SERVICE

On July 9, 2024, I caused to be served a true and correct copy of the foregoing document to be served on counsel of record stated below, via the Washington Courts E-Portal:

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 9th day of July, 2024, at Seattle, Washington.

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