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Pearlman v. Reliance Insurance Company, 371 U.S. 132 (1962)

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RECENT DECISIONS

MILLER ACT BOND SURETY IS SUBROGATED TO EQUITABLE RIGHT OF LABORERS AND MATERIALMEN TO PERCENTAGE FUND RETAINED BY THE UNITED STATES.—In April 1955, Dutcher Construction Corporation entered into a contract with the United States for work on the St. Lawrence Seaway Project. Reliance Insurance Company was the Miller Act bond surety for the contractor. By the terms of the contract the Government withheld a percentage of the estimated amounts due the contractor. This retained percentage fund was to be held until the completion and acceptance of the construction. Financial difficulty prevented completion by the contractor and by agreement the contract was terminated. A different contractor completed the construction and the work was ultimately accepted by the Government. The surety paid $350,000.00 to discharge debts of the original contractor for labor and materials. Thereafter, the original contractor was adjudicated a bankrupt. The percentage fund retained by the Government, totaling $87,737.35, was turned over to the contractor's trustee in bankruptcy. The trustee held the fund as part of the bankrupt's estate, claiming that it vested in him by operation of law under the Bankruptcy Act. The surety petitioned for the fund, arguing that it was entitled to the fund clear of the trustee's claim. The referee held that the surety was subrogated to the rights of the laborers and materialmen, but that they were only general creditors with no superior rights to the fund, and the fund was allowed to pass to the trustee.[1] The District Court vacated the order of the referee and held the surety entitled to the fund as against the trustee.[2] On appeal by the trustee, the Court of Appeals affirmed.[3] On certiorari to the Supreme Court of the United States, *held,* affirmed. The United States had a right to use the fund to pay laborers and materialmen. In addition, the laborers and materialmen had an equitable right to the fund held by the United States, which prevented it from becoming part of the bankrupt's estate. Upon payment of the laborers and materialmen the surety was subrogated to their rights to the fund. (Justices Clark, Douglas, and Brennan concurred in the result, but argued that the laborers and materialmen had no enforceable rights in the fund to which the surety could be subrogated. They would, nevertheless, permit the surety to recover on the basis of the contractor's assignment to the surety to recover to the fund. Mr. Justice White dissented, but wrote no opinion). *Pearlman v. Reliance Insurance Company,* 371 U.S. 132 (1962).

The Miller Act[4] requires that a contractor secure two bonds as a condition precedent to the award of a government construction contract. One, a performance bond, guarantees performance of the contract for the protection of the United States. The other, a payment bond, guarantees payment of the laborers and materialmen (hereinafter referred to as sup-

[1]35 J.N.A. Ref. Bankr. 81 (1961).
[2]In re Dutcher Construction Corp., 197 F. Supp. 441 (D.C.W.D.N.Y. 1961).
[3]298 F.2d 655 (2nd Cir. 1962).
[4]40 US.C. § 270 (1958).

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pliers).[5] For additional security, government contracts frequently provide for the retention of a percentage of the payments due the contractor as the work progresses.[6]

At the completion of the contract and after acceptance by the Government the contractor is entitled to the retained percentage fund. If the contractor defaults, the surety is liable on the bonds.[7] If the surety fulfills his obligation on the bonds he looks to the retained percentage for repayment.

If the contractor becomes bankrupt there is an issue as to whether the trustee in bankruptcy or the bond surety is entitled to the fund. Sureties have claimed rights to the fund through: 1) the contractor, 2) creditors paid (suppliers), and 3) the Government. Trustees in bankruptcy have claimed that the fund is part of the bankrupt contractor's estate. From the trustees point of view the surety stands in no better position than general creditors because: 1) any right of the contractor to the fund would become a right of the trustee; 2) the suppliers have a direct contractual right against the contractor only, not against the Government; and 3) the Government has no right to retain or use the fund as security for the payment of claims of the suppliers as it held the fund only for indemnification and to secure timely performance.

However, cases have recognized the surety's right of subrogation. The instant case is important because it recognizes a right of subrogation of the surety through the suppliers. The suppliers are held to have an "equitable lien"[8] on the fund through an assumed obligation of the Government to pay those who have contributed labor and materials to the structure. The surety, having paid them, is subrogated to their rights.

The court is careful to point out that priority of distribution in bankruptcy.[9] is not involved. The issue is whether the suppliers had an equitable lien on the fund superior to the title of the trustee.[10]

Prior to the instant case the landmark decision concerning the subrogative rights of sureties under Government contracts was *Henningsen v.*

[5]The bond protection extends to "any person having a direct contractual relationship with the sub-contractor. . . ." 40 U.S.C. § 270b(a) (1958). Coverage is, therefore, limited to sub-sub-contractors. Annot., 79 A.L.R.2d 855 (1961). Revised Codes of Montana, 1947, § 6-401 implies that "all" suppliers would be covered by the bond. The Supreme Court of Montana has not had occasion to construe the provision so it is not known whether coverage would be limited to sub-sub-contractors.

[6]The contract in the instant case, and almost all federal construction contracts, provides for a retained percentage. See Standard Form No. 23A, effective July 1, 1961, 26 Fed. Reg. 1050-51 (1961).

[7]On default by the contractor, the surety may choose to take over the contract, complete it and pay the laborers and materialmen. See, *e.g.*, Houston Fire & Cas. Ins. Co. v. E. E. Cloer Gen'l Contractor, Inc., 217 F.2d 906 (5th Cir. 1954). On the other hand, the surety may waive its right to take over the contract and may tender the penal sum on the bond to cover the losses. See, *e.g.*, Pennsylvania Fire Ins. Co. v. American Airlines, Ins., 180 F. Supp. 239 (E.D.N.Y. 1960).

[8]The obligation of the Government has been expressed as a "moral obligation" [Belknap Hardware & Mfg. Co. v. Ohio River Contract Co., 271 Fed. 144, 146 (6th Cir. 1921)], "equitable right" [Henningsen v. United States Fid. and Guar. Co., 208 U.S. 404, 409 (1908)], "equitable obligation" [California Bank v. United States Fid. and Guar. Co., 129 F.2d 751, 753 (9th Cir. 1942)], and "equitable lien" [Danais v. De Matteo Constr. Co., 102 F. Supp. 874, 877 (D.N.H. 1962)].

[9]Bankruptcy Act, 11 U.S.C. § 70 (1952).

[10]The bankruptcy Act provides that an equitable lien may be superior to the title of the bankruptcy trustee unless there were available means of perfecting a legal

United States Fidelity and Guaranty Co.[11] In that case the surety was required to perform the contract and to pay the suppliers in case of default by the contractor. The contractor completed performance of the contract, but did not make payment to the suppliers. The surety paid them, and was allowed recovery of the retained percentage of the contract price. The Court reasoned that the surety, upon payment to suppliers, had not only released the contractor from his obligations to them, but had also, to the same extent, released the Government from all "equitable obligations" to see that they were paid.[12] On this basis, the rights of the surety were superior to all other claims.

The Court relied heavily on the case of *Prairie State Bank v. United States,*[13] which involved a performance bond and not a payment bond. The surety completed the performance and claimed the withheld fund. The Court held that the fund was as much for the indemnification of the surety as it was for the Government. The surety, therefore, was subrogated to the security of the Government in the fund, and prevailed over the claim of a bank to whom the contractor had assigned his rights to the fund to secure a loan. The *Henningsen* case thus extended the *Prairie* principle to cases involving payment bonds. However, it did not specifically recognize an equity in the suppliers,[14] but held only that the surety had a superior claim to that of the assignee bank. It has been suggested that the Court was saying one of two things. First, that the surety, as in the case of default of the contractor, has an action for reimbursement against the Government as secondary principal. Second, that the Government in its discretion, though not legally bound, may satisfy an obligation which it in equity ought to recognize.[15] Under either of these views, the *Henningsen* case at least held that the Government had the right to retain the fund for the

lien. 11 U.S.C. § 96a (6) (1950). The Court recognizes the instant case as a proper case for allowance of an equitable lien since there would be no way in which a legal lien could be perfected against the Government. However, the court referred to the *Sexton* case, in which Mr. Justice Holmes recognized an equitable lien in a situation where there would have been an opportunity to have perfected a legal lien. Sexton v. Kessler, 225 U.S. 90 (1912). In that case, a lien on securities held in "escrow" was deemed an "equitable lien" and the lienholder was considered to have an equity in the securities superior to that of the trustee in bankruptcy. There really was not an escrow situation because the securities had merely been set to one side in the bankrupt's safe. The *Sexton* case would no longer be controlling in light of the 1950 Bankruptcy Act amendment. 11 U.S.C. § 96a (6) (1950).

[11]208 U.S. 404 (1908).

[12]The Court said: "[T]he Guaranty Company, was surety, was compelled to and did make payment. Is its equity superior to that of one who simply loaned money to the contractor to be by him used as he saw fit, either in the performance of his building contract or in any other way? We think it is. It paid the laborers and material-men and thus released the contractor from his obligations to them, and to the same extent released the Government from all equitable obligations to see that the laborers and supply men were paid." *Id.* at 410.

The Government does not want the suppliers left unpaid. This policy is so strong that the Government deems itself obligated to see that they are paid for their contributions to the construction. Other debts of the conractor are considered subordinate. See National Sur. Corp. v. United States, 133 F. Supp. 381, 384 (Ct. Cl. 1955).

[13]164 U.S. 227 (1896).

[14]*Supra* note 12.

[15]A discussion of these two possible interpretations, and an analysis of the subrogative rights of the Miller Act payment bond surety appears in Comment, *Reconsideration of Subrogative Rights of the Miller Act Payment Bond Surety,* 71 YALE L.J. 1274 (1962).

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benefit of the suppliers. Any theory giving the suppliers an equitable right in the fund would have to be predicated on a right in the Government to retain the fund for them.[16]

Subsequently, in *Munsey v. United States*,[17] the Court refused to recognize an equitable lien in the suppliers. There, however, the Government was itself asserting a claim against the fund in the nature of a "set-off." The Court held that in such situations the rights of the United States are paramount to all other claims. This distinction is recognized in the instant case,[18] but some of the lower federal courts have failed to recognize the importance of the "set-off" situation to the result in the *Munsey* case. Some courts have interpreted *Munsey* as denying the existence of any equitable claims to the fund by suppliers, regardless of whether the Government claimed a "set-off."

One such case where the court failed to distinguish *Munsey* is *American Surety Co. v. Hinds*.[19] The contractor defaulted just prior to completion of the construction leaving a large amount due the suppliers. The surety paid and then urged the court to limit the *Munsey* rule to the situation where the Government claims a "set-off" against the fund. The court refused, and denied subrogation of the surety through either a right of the Government or an equity of the suppliers. The Miller Act bond was deemed to be adequate protection for the suppliers.[20] The case of *Phoenix Indemnity Co. v. Earle*[21] arrived at a similar construction of *Munsey*. Curiously, the surety did not argue that the suppliers had any equity in the fund.

[16]Even where the contract expressly provides that the fund is to be payable at the completion of performance it has been held that the fund will still not be unconditionally payable at that time if the suppliers are unsatisfied. Such a contract was involved in California Bank v. United States Fid. and Guar. Co., 129 F.2d 751 (9th Cir. 1942). There the court stated, at page 754: "Though not legally obligated to pay these claims, the Unitned States had an equitable obligation to see that they were paid . . . It consequently had the right to retain, as security for their payment, the then unpaid part . . . of the contract price; . . . ."

[17]332 U.S. 234 (1947).

[18]"The point in issue in that case [Munsey] was whether the United States while holding a fund like the one in this case could offset against the contractor a claim bearing no relationship to the contractor's claim there at issue. We held that the Government could exercise the well-established common law right of debtors to offset claims of their own against their creditors. *This was all we held.*" Instant case at 135. (Emphasis added.)

[19]260 F.2d 366 (10th Cir. 1958).

[20]It has been argued that recognition of equitable rights in the laborers and materialmen is unnecessary and inconsistent with the intended protection of the payment bond. The contention is that the court is not warranted in extending an equitable right to the laborers and materialmen superior to claims of general creditors who do not have the protection of even a bond. See *In re* Flotation Systems, 65 F. Supp. 698, 702 (S.D. Cal. 1946).

[21]218 F.2d 645 (9th Cir. 1955). In that case the contractor did not pay the laborers and materialmen but the surety did. Thereafter, tax liens were filed against the contractor by the Internal Revenue Service. When the contractor became bankrupt, the surety claimed subrogation to the right of the Government to hold the fund. The court found that, though the surety is subrogated to this right and the right of the laborers and materialmen, it is to no avail because the laborers and materialmen have no right to the fund. The court in the ninth circuit again held that the surety has no advantage by claiming subrogation to the laborers and materialmen because the right is not enforceable. See Bank of Ariz. v. National Sur. Corp., 237 F.2d 90 (9th Cir. 1956).

On the other hand, courts in other circuits[22] have limited the *Munsey* decision to situations where the Government claims a "set-off." These courts have recognized an equitable right to the fund in the suppliers and have held this right superior to the rights of general creditors.

In the fourth circuit the court held, in *Greenville Savings Bank v. Lawrence*,[23] that an assignment of rights to the fund by the contractor to a bank as security for a loan could not create a claim in the bank superior to that of the unpaid suppliers. This is early[24] authority for an equitable right of suppliers in the fund. There was no bonding act in effect at the time the contract was entered into. The court was aware of the pressure on Congress for such legislation. The court said that such assignees generally do not have superior claims in such situations because:[25]

> This gives dishonest or reckless contractors the opportunity to underbid honest ones, and subjects congress to appeals to its generosity to make good the losses of those whose labor and materials have erected public buildings.

While this case was being litigated the first bonding act was enacted by Congress.[26] Later, the court in the seventh circuit said: "Under the authorities quoted [*Prairie* and *Henningsen*], the materialmen and the surety . . . have a prior right to the extent of their claims in the fund . . . in the nature of an equitable lien."[27]

The suppliers, therefore, were not limited solely to a legal right against the contractor, but were allowed to pierce the immunity of the Government to the extent of their claims. The method utilized is that of an equitable lien on the retained percentage fund held by the Government as stakeholder. When the surety paid the claims, it was subrogated to this right of the suppliers.

This right was strengthened by the sixth circuit in *Belknap Hardware & Mfg. Co. v. Ohio River Contract Co.*[28] The potential inadequacy of a payment bond is pointed out by this case. The contractor entered into a

[22]Cases are discussed in Annot., 45 A.L.R. 379 (1926) and Annot., 76 A.L.R.2d 792 (1961). The annotations consider the case where the surety completes the contract and the case where the surety, though not completing the contract, makes payment to the suppliers. Generally, the surety's rights might no longer vary between the two situations for the real concern of the Government has been said to encompass both the completion of the construction and payment. Whether the surety completes the building or is called upon only to make payment to the laborers and materialmen is immaterial so long as the building is completed by someone to the satisfaction of the Government. Royal Indem. Co. v. United States, 93 F. Supp. 891 (Ct. Cl. 1950).

[23]76 Fed. 545 (4th Cir. 1896).

[24]The Henningsen case, *supra* note 11, had not yet been decided.

[25]76 Fed. 545, 547 (4th Cir. 1896).

[26]The Heard Act, 28 Stat. 278 (1894), as amended, 33 Stat. 811 (1905), was the first bonding act, and was in effect until replaced by the Miller Act, 49 Stat. 794 (1935), 40 U.S.C. § 270 (1958). The Court in the instant case points out that there is no significance to be attached to the fact that the Heard Act required only one bond (payment and performance), but the Miller Act requires two bonds (one for payment and one for performance). The only real substantive distinction is that under the Miller Act payment bond the laborers and materialmen may bring their action on the bond after ninety days instead of the six months required by the Heard Act. Instant case at 134.

[27]In re P. McGarry & Son, 240 Fed. 400, 402 (7th Cir. 1917).

[28]271 Fed. 144 (6th Cir. 1921).

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contract for river improvements and the surety bonded his work and payment of suppliers. The contractor failed to complete the job and the surety became insolvent. The court held that the suppliers had rights to the fund which were superior to those of creditors of the contractor. Referring to *Henningsen,* the court said:[29]

> [W]e think the necessary effect of the decision is to hold that the laborers and materialmen, inspite of or in addition to the giving of the bond, had an original and continuing equitable priority in the fund. . . .

The court noted that the purpose of the bonding acts was to emphasize the protection the Government desired for the suppliers. The observation is not novel in light of the policy expressed in the *Greenville* case.[30] That policy was declared prior to the time that bonding requirements went into effect.

The "equitable lien" or "equitable right" of the suppliers is merged with the "equitable obligation" assumed by the Government for the protection of the suppliers. Each theory, however, is dependent on the other. Together the theories assure the suppliers that they will be paid.

The Supreme Court made a step toward express recognition of an equitable right in the suppliers in *American Surety Co. v. Westinghouse Electric Mfg. Co.*[31] In that case the contractor, who was later adjudged a bankrupt, completed the project for the Government but failed to pay the suppliers. The surety, in lieu of paying the suppliers, chose to pay the penal sum on the bond. The Court interpreted the *Henningsen* decision as giving an equity to the suppliers in such situations. The equitable rights were said to be based on an assumed "equitable obligation" of the Government to pay the suppliers. The Court said not only do the suppliers have rights to the fund, but that their rights are superior to any rights of the trustee in bankruptcy, assignees of the bankrupt, or, as in that case, a surety's claim to the fund by virtue of an indemnity assignment from the contractor. Since the suppliers had not been paid in full, the surety could not be subrogated to the benefit the Government extended to the suppliers.

The necessary effect of the *Belknap and Westinghouse* cases is to recognize underlying equities to the fund in the suppliers that extends beyond the protection afforded them by the Miller Act bond. In *Belknap,* the surety became insolvent and in *Westinghouse* it chose to pay the penal sum (which was not sufficient to satisfy the claims of the suppliers). Without a right of their own in the fund, the suppliers would have remained unpaid. In neither case did the court confine the suppliers to bond protection only, as was done in the *Hinds* and *Phoenix* cases.[32] When the surety does pay the suppliers, it can properly claim subrogation to their rights rather than to the inferior rights of the contractor. Even with an assignment from the contractor of all rights to the fund, the surety is in a stronger position by claiming through suppliers whom he was paid. This results from the Government's interest in assuring the payment of the suppliers.

[29]*Id.* at 149.
[30]*Supra* note 25.
[31]296 U.S. 133 (1935).
[32]*Supra* note 21.

The concurring Justices in the instant case refuse to recognize an equitable lien in the suppliers against the Government. Their view is that the *Munsey* decision ought not be distinguished, and that the only rights of the surety stem from its agreement with the contractor. The consideration for the assignment to the surety by the contractor of his rights to the fund is the execution of the bond.[33] The *Hinds* court hinted that the only equity of the surety through the United States would originate from the surety having performed on the performance bond rather than the payment bond.[34] As to the of the surety through the suppliers, the court said:[35]

> The rights of the surety are largely derivative in nature. Having paid the laborers and materialmen, appellant [surety] may claim subrogation to their rights. But since laborers and materialmen have no enforceable rights against the United States [citation to *Munsey*] the surety can rise to no higher position than the basis of subrogation.

By denying the suppliers any rights to the fund against the Government, the concurring opinion in the instant case forces the surety to rely on the assignment from the contractor.

If the surety is said to stand only in the shoes of the contractor a court may decide, as in *Philadelphia National Bank v. McKinlay*.[36] that the bankrupt contractor has no title[37] and no rights through which the surety can claim the fund. Hence, the surety would not be repaid out of the fund although he had paid the suppliers. The surety's claim through the contractor or by force of an assignment from the contractor is not as strong or satisfactory as the concurring opinion would indicate.

In the instant case, the holding that the Government has the right to retain the fund for the suppliers and that the suppliers have a right to be paid out of the fund clarifies the subrogative rights of the Miller Act pay-

[33]The concurring Justices rely on *Martin v. National Surety Co.*, 300 U.S. 588 (1937) and are of the opinion that the equities in favor of the suppliers grow out of the assignment between the contractor and the surety. In the *Westinghouse* case, *supra* note 31, the indemnity assignment to the surety gave the surety no superior claim to that of the laborers and materialmen. In other cases the assignment of rights to the fund by the contractor also has had no effect. In *Royal Indemnity Co. v. United States*, 93 F. Supp. 891 (Ct. Cl. 1950), the court specifically stated that the assignment by the contractor to the surety as part of the consideration for the bonds is null and void as to the United States, though it might be valid as between the parties. Reliance on the *Martin* case would seem to be very weak since by the terms of the assignment in that case the proceeds of the fund were to be devoted in the first instance to the laborers and materialmen. This fact seemed to be the basis of the Court's finding for the surety in that case on the strength of the assignment. Most cases, including the instant case, are not dealing with assignments which designate that the proceeds are to be used for the payment of the laborers and materialmen. Hence, equities in favor of the laborers and materialmen arising out of the agreement between the contractor and the surety will not always exist.

[34]260 F.2d 366, 368 n.5 (10th Cir. 1958).

[35]*Id.* at 368.

[36]72 F.2d 89 (D.C. Cir. 1934), *cert. denied*, 293 U.S. 583 (1934).

[37]Since the Court felt that the bankrupt had no title or claim to the fund, the trustee in bankruptcy did not prevail. Nor did the surety, who did not pay the laborers and materialmen, have superior claims by force of an assignment from the bankrupt contractor. The Court held for the laborers and materialmen: "In the view we take of this case, that sum /retained fund/ is earmarked with the claims of all persons furnishing supplies and labor on the contract, and this is true because, irrespective of the statutory bond, those persons who furnish labor and do work on a government project have an equitable lien on the fund, for the payment of their work and labor. . . ." *Id.* at 91.

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ment bond surety. An "equitable obligation" of the Government to pay the suppliers is not a new concept, and a corresponding "equitable lien" in the suppliers has long been hinted at. The instant case merges these two concepts to protect both the suppliers and the surety. It is actually nothing more than the utilization in equity of the law applicable to private construction contracts.

When the Government does not have an interest to preserve in the fund, there is no necessity to assert immunity to liens. Absent the "set-off" situation, the Government holds the fund as a mere "stakeholder." It risks no loss, and at most is a mere formal defendant. Should the risk of multiple liability appear, the Government may interplead the interested parties.[38]

In private construction contracts the retained percentage fund is held to indemnify the owner, secure timely performance, and protect the structure from liens of unpaid suppliers. In all states, legislation has created mechanic's liens which secure the payment of suppliers for private contracts.[39] Suppliers of labor and materials have a lien on a structure which is built by their efforts and with their materials. In public construction contracts the fund is held to indemnify the Government and secure timely performance, but not to protect the structure from liens since no lien can be asserted against the sovereign.[40] Congress has been concerned about the payment of suppliers to such an extent that it has seen fit to enact protective legislation. Even where the surety fails to fulfill its obligations under this legislative protection, the courts have favored the suppliers over other claimants to the fund. The decision in the instant case makes it more desirable for the surety to assure payment to the suppliers because the suppliers are recognized as having rights against the owner, the United States. If the surety pays the suppliers when the contractor defaults it has a subrogative right through the suppliers which is superior to the title of the contractor's trustee in bankruptcy.[41] Further, the application of the law of private construction contracts is especially appropriate in regard to the cost of surety bonds. As the District Court in the instant case pointed out:[42]

> [A]n extension of the Munsey decision would unwarrantably increase the risk to the surety, whose guarantee has played a direct part in the production of the bankrupt's income here at issue and would further increase expense to the government through in-

[38]Newark Ins. Co. v. United States, 169 F. Supp. 955 (Ct. Cl. 1959).

[39]In Montana, the laborers and materialmen on private construction contracts have a mechanic's lien on the property upon which the work or labor is done or material is furnished. The lien is given priority over any other lien or mortgage on the premises. Revised Codes of Montana, 1947, §§ 45-501 to -512.

[40]Hill v. American Sur. Co., 200 U.S. 197, 203 (1906); Equitable Sur. Co. v. McMillan, 234 U.S. 448, 455 (1914); Armstrong v. United States, 169 F. Supp. 259 (Ct. Cl. 1959).

[41]It has been argued that the majority of the decisions involving the Miller Act payment bond surety have left the surety at a disadvantage. The Miller Act is intended to assure the payment of the suppliers, but many decisions have not extended this policy to protect the surety who has made payment to the suppliers. See, Comment, *The Surety's Rights to Money Retained from Payments Made on a Public Contract*, 31 FORDHAM L. REV. 161, 164 (1962).

[42]*Supra* note 2 at 443.

creased bond premiums passed on by the contractor as the cost of doing business.

JOHN J. TONNSEN, JR.

A LANDOWNER HAS THE RIGHT TO INTERCEPT WATER PERCOLATING BENEATH HIS LAND EVEN THOUGH IT SUPPLIES A SPRING WHICH ANOTHER HAS APPROPRIATED.—Plaintiff owns eighty acres of farm land in the Helena valley. In 1920, his predecessor in interest validly appropriated eighty miners inches of water from several springs arising in the channel of Ten Mile Creek. In 1959 the Bureau of Reclamation commenced construction of an irrigation and drainage project in the valley, which included the construction of a drain ditch that generally parallels the channel of the stream in question. At its closest point, the ditch is about one/fourth mile from these springs. Plaintiff contended, and the trial court found, that the construction of the ditch caused the springs from which plaintiff appropriated his irrigation water to dry up. Ten Mile Creek, with the exception of the water supplied by these springs, is dry during the irrigation season. The drying up of these springs, therefore, eliminated plaintiff's only source of irrigation water. He brought suit against the United States under the Tucker Act,[1] alleging the taking of a property right in violation of the fifth amendment. *Held,* although the federal project caused plaintiff's springs to dry up, under applicable Montana law governing percolating water, that loss was *Damnum absque injuria. McGowan v. United States,* 206 F. Supp. 439 (D. Mont. 1962).

The Federal court in the instant case relies on the common law rule concerning percolating water, first set out in the English case of *Acton v. Blundell,*[2] which states that a landowner has the unqualified use of his land. Thus he can deprive a neighbor of his percolating water supply without liability for any injury, thereby sustained, regardless of the length of time the neighbor has beneficially used the water. At one time, this rule had been adopted in nearly all the western states.[3]

Surface water in all western states is capable of appropriation.[4] Once appropriated, the appropriator is protected from interference by any person except a prior appropriator. The question presented by the instant case is whether an appropriator should be protected from interference by a landowner who intercepts tributary water which percoluates beneath his land.

This paper will attempt to show that in concluding that the appropriator is not protected, the court has misinterpreted the applicable Mon-

[1]28 U.S.C. § 1346(a)(2). This statute simply gives the consent of the United States to be sued in all cases which involve constitutional issues.
[2]152 Eng. Rep. 1223 (Ex. 1843).
[3]Hutchins, SELECTED PROBLEMS IN THE LAW OF WATER RIGHTS IN THE WEST 156 (1942).
[4]*Id.* at 30.