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# LIQUIDATION OF A FEDERALLY FUNDED AGENCY: THE LESSONS TO BE LEARNED FROM THE GREATER LOS ANGELES COMMUNITY ACTION AGENCY

*June Carbone\**

Under the best of circumstances, the liquidation of a publicly funded agency poses a host of difficult legal and policy questions. The Greater Los Angeles Community Action Agency (GLACAA) was liquidated under the worst of circumstances. The City and County of Los Angeles revoked GLACAA's charter, and the Community Services Administration (CSA) terminated funding because of extensive, longstanding corruption and mismanagement.<sup>1</sup> At termination, GLACAA held approximately \$3,000,000 in grant funds and faced scores of pending actions, with judgments for hundreds of thousands of dollars mounting rapidly.<sup>2</sup> At the same time, the grantor agencies, who provided the bulk of GLACAA's assets, pressed their own claims against GLACAA's remaining funds.<sup>3</sup>

Responsibility for the closedown, though nominally entrusted to the City of Los Angeles, was in fact divided among the city, the county, CSA, and a contract administrator under contract with the city. There was no clear chain of command, no clear authority for any party to represent GLACAA's interests, and no mechanism to resolve the competing claims to GLACAA's assets.<sup>4</sup>

Four years after GLACAA's demise, the litigation continues.<sup>5</sup> Individ-

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1. THE DEMISE OF THE GREATER LOS ANGELES COMMUNITY ACTION AGENCY, TWENTY-SIXTH REPORT OF THE COMM. ON GOV'T OPERATIONS, H.R. REP. NO. 1441, 96th Cong., 2d Sess. 1 (1980) [hereinafter cited as HOUSE REPORT].

2. *Id.*

3. *Id.*

4. See *infra* notes 43-45 and accompanying text.

5. See *infra* notes 56, 72-73 and accompanying text.

ual actions may finally resolve the claims to GLACAA's funds, if only by default, but the multiplicity of actions offers no model for the resolution of future disputes and the inarticulate, poorly reasoned legal decisions rendered to date offer no guidance for the development of the law.<sup>6</sup>

To highlight the difficulties attending the dissolution of a publicly funded agency, this article reviews the litigation surrounding GLACAA's demise. It examines existing provisions regulating such dissolutions, compares them to the provisions governing corporate liquidation and bankruptcy, and proposes reforms that assign responsibility for future closedowns, define liability, and provide a mechanism for resolving the claims of competing creditors.

Finally, the article discusses the federal interest in grant funds both before and after termination of a grantee. A series of recent decisions has held that grantor agencies retain a continuing interest in grant funds, an interest protected by sovereign immunity and sufficient, at least in theory, to defeat the interests of all other creditors. The implications of these decisions have yet to be explored, and federal regulations were written without acknowledging their existence. Yet, these rulings potentially render federally funded agencies like GLACAA judgment proof, and give the grantor agencies final authority over claims against grant funds upon termination of the grantee. The article concludes with a discussion of the regulations necessary to define the doctrine and limit the injustices inherent in such a far-reaching extension of sovereign immunity.

### I. CLOSING DOWN GLACAA: THE LEGAL NIGHTMARE REALIZED

GLACAA was the second largest Community Action Agency (CAA) in the United States.<sup>7</sup> An independent public agency established by a Joint Powers Agreement between the City and County of Los Angeles,<sup>8</sup> GLACAA was created to receive federal, state, and local antipoverty funds and distribute them to eligible agencies conducting health, education, and social service programs.<sup>9</sup> During 1977 and 1978, it administered more than

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6. See *infra* notes 29, 32, 158, 193 and accompanying text.

7. HOUSE REPORT, *supra* note 1, at 2.

8. The California Joint Powers Act, CAL. GOV'T CODE §§ 6500-6507 (West 1980) authorizes political subdivisions to join together to perform functions common to them, including the creation of an independent agency. See *id.* § 6507. Pursuant to a 1965 Joint Powers Agreement, the City and County of Los Angeles designated the Economic and Youth Opportunities Agency (EYOA) as a community action agency empowered to receive and distribute antipoverty funds. See *infra* note 9. The city and county executed a new joint powers agreement in 1972 designating GLACAA as EYOA's successor.

9. The Community Services Administration (CSA), the successor to the Office of Economic Opportunity (OEO), provided the bulk of federal funding pursuant to the Economic

\$30,000,000 annually to ninety delegate agencies in the Los Angeles area.<sup>10</sup>

GLACAA experienced financial and administrative difficulties almost from its inception.<sup>11</sup> By January 1976, a combined Los Angeles City and County audit team found the mismanagement to be so great that it recommended the dissolution of the agency.<sup>12</sup> CSA, the city, and the county struggled to rescue GLACAA, securing the appointment of a new executive director in January 1979.<sup>13</sup> The new director compounded rather than alleviated GLACAA's difficulties and, in December 1977, the city voted to withdraw from the Joint Powers Agreement.<sup>14</sup> Even then, the city did not finally terminate the agreement until November 24, 1978.<sup>15</sup> CSA moved to end funding in August and gave formal notice on October 6, 1978.<sup>16</sup> Finally, on December 31, 1978, GLACAA transferred all of its property and assets to the City of Los Angeles to be held in trust for CSA, the city, and

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Opportunity Act of 1964 (codified as amended at 42 U.S.C. §§ 2781-2837 (1976)). Section 2790 permitted "a State or political subdivision of a State . . . or a combination of such political subdivisions, or a public or private nonprofit agency or organization which has been designated by a State or such a political subdivision or combination of such subdivisions, or an Indian tribal government" to be designated as a community action agency. Section 2785 provided that CAAs were to receive federal, state and local funds, distribute the funds to community action programs (CAPs), and monitor the CAPs. The "delegate agencies" to which GLACAA awarded funds were "community action programs" within the meaning of § 2790(a). The Department of Health, Education and Welfare (now the Department of Health and Human Services (HHS)) also provided funding under the "Headstart" program. *See* Headstart-Follow Through Act, 42 U.S.C. § 2928 (1976).

10. HOUSE REPORT, *supra* note 1, at 3; REPORT BY THE COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE, DECISIVE GOVERNMENT ACTION NEEDED TO RESOLVE PROBLEMS OF COMMUNITY ACTION PROGRAMS IN LOS ANGELES I (1979) [hereinafter cited as GAO REPORT].

11. These difficulties are discussed at length in the HOUSE REPORT, *supra* note 1, the GAO REPORT, *supra* note 10, and were highlighted in a "60 Minutes" expose broadcast on October 8, 1978. The House report summarized abuses which included "unwarranted dismissal of employees, replacement of key figures who provided financial control within the agency, easily documentable travel and telephone abuses, ghost employees, kickbacks, and open refusals to comply with legitimate requests of Board members or follow the regulations of the Community Services Administration." HOUSE REPORT, *supra* note 1, at 3.

12. GAO REPORT, *supra* note 10, at 3.

13. *Id.*

14. During the tenure of the new executive director, GLACAA was found to have fired a number of GLACAA employees without cause and in violation of their union contracts giving rise to back pay awards that eventually exceeded a million dollars. *See infra* note 18. In addition, although the executive director was not implicated, other high GLACAA officials were convicted for kickbacks and other fraudulent activities. *See* United States v. Mena, No. 80-720 (C.D. Cal. Aug. 1980).

15. Letter from Los Angeles Mayor Thomas Bradley to County Board of Supervisors (Nov. 24, 1978). The termination was to take effect on Dec. 31, 1978. *Id.*

16. Letter from Alphonse Rodriguez, Director, Region IX CSA, to Otilio Barron, Chairman, GLACAA Board of Directors (Oct. 6, 1978).

the county.<sup>17</sup> GLACAA then ceased to exist.

GLACAA did not go quietly, however. By December 30, 1981, twenty former employees had obtained arbitration awards or judgments for wrongful discharge approaching a million dollars in damages.<sup>18</sup> The discharged employees were represented by a former Economic and Youth Opportunities Agency counsel who obtained the awards over token GLACAA opposition.<sup>19</sup> The awards and judgments generally provided back pay and fringe benefits from the date of termination to the date of reinstatement with no requirement that the discharged employees seek other employment,<sup>20</sup> and with sick leave calculated at 57½ days per year.<sup>21</sup>

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17. GLACAA's assets at termination consisted of approximately three million dollars in unspent grant funds, office equipment, furniture and similar property purchased with grant funds. See GLACAA Closedown Plan, app. E (Aug. 31, 1979), submitted in *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. Dec. 8, 1978).

The city authorized the general manager of the City Development Department to contract for professional services, and he executed a contract with Arthur Young and Company and Moultrie and Simpson, a joint venture, to administer the closeout. See Los Angeles City Council Resolutions Nos. 79-1209, S-30, and 72-1209, S-22. Michael J. Donohoe, a partner with Arthur Young and Company, was named contract administrator.

The city, however, never clearly recognized itself or anyone else as a "trustee and successor in interest" to GLACAA because of fear of assuming GLACAA's liabilities. See GAO REPORT, *supra* note 10, at 42-47.

18. The employees had been fired in 1976 and 1977, and they challenged the dismissals for failure to conform to the termination procedures of their union contract, obtaining arbitration awards which they confirmed as state court judgments. See *Block v. GLACAA*, No. C 206478 (L.A. Super. Ct. Nov. 14, 1977), *aff'd*, (Cal. App. Aug. 21, 1979); *Macias v. GLACAA*, No. C 264866 (L.A. Super. Ct. Mar. 12, 1979); *Britton v. GLACAA*, No. C 263723 (L.A. Super. Ct. Feb. 13, 1979); *Abelson v. GLACAA*, No. C 218512 (L.A. Super. Ct. Jan. 30, 1979); *Phillips v. GLACAA*, No. C 214489 (L.A. Super. Ct. Jan. 24, 1979); *Al-Essahki v. GLACAA*, No. C 258318 (L.A. Super. Ct. Dec. 12, 1978); *O'Connell v. GLACAA*, No. C 243148 (L.A. Super. Ct. Nov. 28, 1978); *Manos v. GLACAA*, No. C 23543 (L.A. Super. Ct. Sept. 28, 1978); *Coats v. GLACAA*, No. C 246264 (L.A. Super. Ct. Sept. 27, 1978). Cf. *Wormack v. GLACAA*, No. C 265872 (L.A. Super. Ct. July 25, 1979); *Lockhart v. GLACAA*, No. C 218425 (L.A. Super. Ct. Oct. 17, 1979). See also CAL. CIV. PROC. CODE § 1285 (West 1982) (authorizing confirmation of arbitration awards as state court judgments).

Two employees had claims pending at the time of GLACAA's termination and those cases were handled by the firm of Watson and Gantz, the counsel retained by the contract administrator. In *Lockhart*, No. C 218425, the arbitrator held that Lockhart had been discharged for cause but that the termination became effective prematurely, and awarded \$6,318.98 plus costs to cover the period. In *Wormack*, No. C 265872, Wormack prevailed, but the court reduced the judgment by \$20,000 to account for mitigation of damages. Both claims were eventually satisfied from grant funds with CSA approval. *But see infra* note 61.

19. The counsel for the discharged employees was a former EYOA (GLACAA's predecessor) counsel who allegedly negotiated the union contract under which the employees sued. GLACAA attempted to disqualify plaintiffs' counsel on at least one occasion, but raised the issue only on appeal and the appellate court rejected the argument because it had not been raised below. See *Block v. GLACAA*, Nos. 54221, 54773 (Cal. App. June 20, 1979).

20. For the six employees in *Abelson*, No. C 218512 and *O'Connell*, No. C 243148, the

When the discharged employees levied on the judgments, they calculated back pay for periods in which GLACAA did not exist, and in some cases, double pay for periods in which the employees had been reinstated and paid.<sup>22</sup> Corrected calculations would have reduced the levies by over \$200,000.

GLACAA largely ignored the awards and judgments and with GLACAA's termination imminent, the discharged employees filed suit against GLACAA, its board of directors and executive director, the City and County of Los Angeles, and CSA alleging that the defendants could not terminate GLACAA or establish a new CAA without a "transition" or a "closedown" plan that would settle all of GLACAA's debts.<sup>23</sup> The United States District Court for the Central District of California agreed and issued a preliminary injunction in March 1979, enjoining the disposal, sale, transfer or waste of any GLACAA property "without submitting to the Court and plaintiffs a plan, approved by the Community Services Admin-

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judgment amounts made no provision for mitigation of damages. In *Al-Essahki*, No. C 258318 and *Phillips*, No. C 214489, the arbitrator reduced the back pay awards to six months, finding that six months was sufficient time to find new employment. In the other cases, the court deducted interim earnings from the back pay awards but permitted the awards to run indefinitely. See *supra* note 18 (collecting cases). There is no indication that GLACAA pursued the issue of mitigation of damages in any of the proceedings. See, e.g., Reporter's Transcript at 3, 8 (Sept. 7, 1979); *Abelson*, No. C 218512.

21. GLACAA employees who worked through December 31, 1978, were compensated for unused sick leave at a rate of 7 1/2 days per year as provided under the union contract.

22. Back pay was calculated to include periods in 1979 in *Abelson*, No. C 218512, *Britton*, No. C 263723, *Phillips*, No. C 214489, *Macias*, No. C 264866, and *Block*, No. C 206478, and to include periods in which the employees were reinstated and paid in *Britton*, No. C 263723, *Macias*, C 264866, and *O'Connell*, No. C 243148. In contrast, in the cases handled by the counsel retained by the contract administrator, the judgments were specifically limited to December 31, 1978. See, e.g., *Womack*, No. C 265872.

23. *Abelson v. Olivarez*, C.A. No. 78-4665 (C.D. Cal. filed Dec. 8, 1978). See 45 C.F.R. § 1060.200 (1981), Office of Economic Opportunity (OEO) Instruction 6302-2, app. B.8, (transition plan required "as part of an application for recognition of a new CAA which will replace one or more existing CAAs" or a closedown plan "as part of a report to OEO of the revocation or opt-out of the designation of an existing CAA where no new (or other existing) CAA is designated to replace it"). See *infra* note 24.

Both revocation of an existing CAA and designation of a new one required compliance with procedures set forth in 45 C.F.R. § 1060.200 (1981). The City and County of Los Angeles did not comply with those procedures because they feared liability for GLACAA's affairs. Instead, they terminated GLACAA in accordance with the provisions of the CAL. GOV'T CODE §§ 6500-6507 (West 1980), and the Joint Powers Agreement governing GLACAA, and CSA revoked GLACAA's funding following the "closeout" procedures for terminating a grant. See CSA Instruction 6800-12. The *Abelson* court found the distinction disingenuous, particularly since CSA attached a memorandum construing the city and county's actions in terminating GLACAA "as a revocation of GLACAA's designation as a CAA." Federal Defendants' Points and Authorities in Opposition to Plaintiffs' Motion for Preliminary Injunction, Exhibit B, *Abelson*, No. C 218512.

istration on or before July 1, 1979, in compliance with the provisions of OEO [Office of Economic Opportunity] Instruction 6302-2."<sup>24</sup>

At the same time the former employees were moving to freeze the assets, they pressed their own claims by levying on GLACAA bank accounts. Between December 1978 and April 1979, writs of execution exceeding

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24. Order of Mar. 8, 1979, *Abelson*, No. C 218512. OEO Instruction 6302-2 (currently codified at 45 C.F.R. § 1060.200 (1981)) requires submission of a transition plan to CSA with an application for designation of a new CAA or CSA approval of a closedown plan before revocation of an existing CAA. Closedown plans must include provisions for:

(1) The phase-out of program operations.

.....

(3) Determination of the balance of funds required to cover closedown costs and the liquidation of liabilities, and the preparation if necessary, of funding requests to extend operations into the next program year and/or apply for additional funds to complete close down.

(4) Protection of all employment rights of employees of the CAA.

.....

(9) An inventory of all property purchased with OEO grant funds.

.....

(11) A final audit, with the report available within 90 days of termination.

45 C.F.R. § 1060.200, app. B.8.

In August 1979, defendants filed a closedown plan with the court, proposing to settle GLACAA's liabilities through an administrative claims procedure and the continuation of existing litigation. Plaintiffs, arguing that the City and/or the County of Los Angeles were in fact acting as CAAs, moved to reject the closedown plan and order the submission of a transition plan in which the city and/or the county would be required to assume GLACAA's liabilities.

CSA opposed the motion arguing that the city and county had not applied for recognition as CAAs and that under the Economic Opportunity Act of 1964, it had no authority to compel any political subdivision to become a CAA. CSA Memorandum in Opposition to Motion to Reject Closedown Plan and Order Submission of Transition Plan, *Abelson*, No. C 218512.

The city and county agreed that they had never applied for recognition and stated that they would not so long as there was any possibility of assuming liability for GLACAA's affairs. *See, e.g.*, County Opposition to Motion to Reject Closedown Plan and Order Submission of Transition Plan, and County Supplement Opposition to Motion to Reject Closedown Plan, *Abelson*, No. C 218512. At the time the parameters of that liability were undefined and estimates ranged as high as ten million dollars.

Nonetheless, without recognizing a new CAA, CSA funded the City of Los Angeles as a limited purpose agency pursuant to 42 U.S.C. § 2808(b) (1976) in order to maintain GLACAA's delegate agencies on an interim basis. The discharged employees argued that such funding required a transition plan. *See* Plaintiffs' Motion to Reject Closedown Plan and Order Submission of Transition Plan, *Abelson*, No. C 218512; 42 U.S.C. § 2808(b) (1976). The court never ruled on the motion. Even adopting the discharged employees' analysis, however, the court's authority to order a transition plan was limited and an injunction against further funding in the absence of a transition plan would have been the more appropriate course. The city and county maintained that they would forego funding rather than submit to a transition plan so that such an order would not have ensured satisfaction of discharged employees' judgments.

\$800,000 were served on Union Bank.<sup>25</sup> Faced with these levies and the competing claims of the federal agencies and the City and County of Los Angeles, Union Bank filed an action in interpleader in March 1979.<sup>26</sup> The interpleader action temporarily stayed satisfaction of the writs and offered a forum for resolution of GLACAA's affairs. But the discharged employees' counsel convinced the bank that it lacked the diversity necessary to maintain the action in federal court.<sup>27</sup> On March 14, 1979, the bank voluntarily dismissed the action without refiling in state court.

To prevent distribution of the funds, the United States Attorney filed third party claims in state court asserting CSA's interest in the funds.<sup>28</sup> The Superior Court for the County of Los Angeles denied the claims, but on June 13, 1979, the United States obtained a stay pending appeal.<sup>29</sup>

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25. The writs are set forth in the First Amended Complaint, *United States v. Abelson*, No. 79-1359 (C.D. Cal. April 12, 1979), and in the Complaint in Interpleader, *Union Bank v. GLACAA*, No. 79-0693 (C.D. Cal. Feb. 20, 1979). The sum does not include levies by the California Board of Equalization for back taxes. *Id.* at ¶ 12.1. *See also supra* note 18.

26. *Union Bank*, No. 79-0693 at 7-8. The Union Bank complaint included, among the competing claims, those of: GLACAA, *id.* at ¶ 12.1; of the former employees who had levied on the account, *id.* at ¶¶ 12.g-k, m; of the California Board of Equalization which had also levied against the account to satisfy back taxes, *id.* at ¶ 12.1; of the City of Los Angeles on the basis of its claim to any remainder, *id.* at ¶ 12.f; of CSA pursuant to 45 C.F.R. § 1410.10, *id.* at ¶ 12.b; of the Department of Health, Education, and Welfare on the basis of its loan to GLACAA and lien on the outstanding balance, *id.* at ¶ 12.c; and of the United States through the claims of its agencies, *id.* at ¶ 12.d.

The bank satisfied the claims of two employees, however, before filing the interpleader action. Manos received \$32,459.17 on January 11, 1979, and Coats received \$47,017.14 on January 12, 1979. First Amended Complaint in *United States v. Abelson*, No. 79-1359 (C.D. Cal. April 12, 1979).

27. *See* 28 U.S.C. § 1335 (1976); *United States v. Drydock Sav. Inst.*, 149 F.2d 917 (2d Cir. 1945); *St. Louis Union Trust Co. v. Stone*, 428 F. Supp. 988 (E.D. Mo. 1977).

28. *Phillips v. GLACAA*, Nos. C 263723, C 264866, C 214489, C 243148, C 258318, C 218512 (L.A. Super. Ct. Mar. 16, 1979). *See supra* note 18.

Under the California Code of Civil Procedure, third party claims automatically stay satisfaction of writs until the claims are decided. CAL. CIV. PROC. CODE § 689 (West 1980). The summary procedure is one designed to permit third parties to contest title to property subject to levies. CSA claimed the funds on the basis of its reversionary interest in the funds under 45 C.F.R. § 1050.112(b) (1979), and the immunity of federal funds from state process. *Phillips*, No. C 214489. The parties stipulated that all funds subject to the levies were CSA grant funds even though a major portion of the funds originated with HHS and the County of Los Angeles. *See* Closedown Plan, Exhibit E, *supra* note 24.

29. The court, in a minute order, reasoned that under 45 C.F.R. § 1050.112(b) (1979), only "unobligated" funds reverted to CSA and that the writs of execution constituted "obligations." *Phillips*, No. C 214489. The reversion, however, occurred on January 1, 1979, and all but two of the writs were issued after the first of the year. The court did not address the issue of whether the writs could attach to grant funds which had reverted to CSA, and it did not address CSA's sovereign immunity claim other than to find that GLACAA was the "owner" of the funds. *See infra* note 68.

The superior court granted a stay pending appeal subject to a \$150,000 bond. *Phillips*,



Shortly after filing the state court action, the United States also asserted a claim to the funds in federal court. Although the United States asserted the interests of both CSA and the Department of Health and Human Services (HHS) in the federal action and raised claims that went beyond those raised in state court, the federal court stayed the action, pending final determination of the state court appeal.<sup>30</sup> When another former employee levied against the grant funds in September 1979, the United States filed a new action seeking to enjoin the levy.<sup>31</sup> In the only federal decision to touch on the merits of the federal claim, the court denied the government's motion for a preliminary injunction commenting only that the United States was "unlikely to prevail on the merits."<sup>32</sup> The United States filed a motion for summary judgment, but the court never ruled on the motion.<sup>33</sup>

While pursuing this litigation, CSA also attempted to settle the claims. Although CSA had originally argued that federal funds should not be used to satisfy judgments against GLACAA, on June 1, 1979, CSA offered to permit grant funds to be used to pay back pay and fringe benefits through January 1, 1979, if the amounts were mitigated and did not include sick

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No. C 214489. The United States obtained a writ of *supersedas* from the appellate court without bond as the United States and its agencies are exempt from such requirements under 28 U.S.C. § 2408 (1976). See *Phillips*, Nos. C 56537, 56604 (Cal. Ct. App. June 30, 1981).

30. *United States v. Abelson*, No. 79-1359 (C.D. Cal. April 12, 1979). The action was stayed on November 19, 1979. In this action, the United States advanced the interests of HHS as well as CSA. The government argued that the United States held an equitable lien in the funds, that the funds had reverted to the United States in accordance with federal grant regulations, that the funds were protected from unconsented state process in accordance with the doctrine of sovereign immunity, and that because the funds were owed to the United States, under 31 U.S.C. § 191 (1976), such debts must be satisfied before the debts of any other creditor. *Id.*

31. *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979). See *Block v. GLACAA*, No. C 206478 (L.A. Super. Ct. Mar. 12, 1979). *Block* obtained a judgment on Nov. 14, 1977. GLACAA appealed, the court of appeal affirmed and remitted the case to superior court on August 21, 1979. On September 27, 1979, *Block* caused a writ of execution to be served on Union Bank for \$82,622.97. *Block* calculated the writ of execution to include back pay through August 31, 1979, including eight months in which GLACAA did not exist.

32. Motion for Summary Judgment, *Block*, C.A. No. 79-04487. The court denied the preliminary injunction on February 21, 1980, and *Block* received approximately \$30,000—the funds remaining in the Union Bank account—satisfying less than half of the amount of the writ. *Block*, No. 79-04487.

33. The United States moved for summary judgment on the grounds of sovereign immunity, the equitable lien held by the United States, the reversionary interest of the grantor agencies, and the federal priority statute. Motion for Summary Judgment, *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979). The case was settled in June 1981 when *Block* agreed to reduce his back pay award to January 1, 1979.

leave.<sup>34</sup> The lawyer for the former employees rejected the offer on behalf of fourteen of his clients.<sup>35</sup> He never responded on behalf of the others, and he never proposed a counteroffer.<sup>36</sup> A year later the contract administrator for the GLACAA closedown again offered to settle, setting forth specific amounts for ten of the former employees.<sup>37</sup> The former employees insisted, however, that they would settle only for the full amounts of their writs of execution.<sup>38</sup>

With federal efforts to claim the funds stymied and negotiations stalled, one other avenue remained open—moving to quash the writs of execution. This course was an obvious one. The grantor agencies objected to the levies because the levies were inflated. Back pay beyond the date of GLACAA's termination and double payment for employees who were reinstated and paid were possible grounds to quash the writs, even if they did not permit correction of other miscalculations.<sup>39</sup> Identifying the proper parties and securing adequate representation made this course difficult, however.

At the time the writs were issued, GLACAA was in its death throes.<sup>40</sup> Severo and Severo, GLACAA's counsel, ceased to represent the agency

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34. Letter from Frank N. Jones, CSA, to Michael M. Hachigian, attorney for former employees (June 1, 1979).

35. Letter from Michael M. Hachigian to Frank N. Jones (July 11, 1979). Apparently a major reason for the refusal was a failure to pay sick leave. *Id.* The judgments miscalculated sick leave at 57 1/2 days a year, almost 20% of the judgment award. *See supra* note 21. CSA originally refused to pay sick leave but later offered to pay 7 1/2 days per year, the amount paid employees who had worked through December 31, 1978. *See supra* note 34.

36. In December 1979 and January 1980, the federal court scheduled settlement conferences between the parties. Information was exchanged, and CSA reiterated that its June 1, 1980 offer was still open, but no further offers were exchanged.

37. Letter from Michael J. Donohoe, contract administrator, to Michael M. Hachigian, attorney for discharged employees (June 5, 1980). *See supra* note 17.

The offer included salary, vacation leave, 7 1/2 days of sick leave per year, retirement benefits through December 31, 1978, and interest less any identifiable substitute earnings. Donohoe lacked sufficient information to calculate mitigation of damages for the other discharged employees.

38. Letter from Michael M. Hachigian to Michael J. Donohoe (July 11, 1980).

39. CAL. CIV. PROC. CODE § 473 (West 1979) authorizes the court to "relieve a party or his legal representative from a judgement . . . taken against him through his mistake, inadvertance, surprise or excusable neglect." The motion for relief, however, be made within six months of the judgment. *Id.* The court's equitable powers also include the power to grant relief at any time on grounds of extrinsic fraud. *Beresh v. Sovereign Life Insurance Co.*, 92 Cal. 3d 547, 155 Cal. Rptr. 74 (1979). Motions for relief because of intrinsic fraud, that is fraud occurring during the adversary proceeding, come within the scope of the statute and must be made within six months. *Id.*

40. The judgments were entered between September 27, 1978 and March 12, 1979; the writs were issued between December 4, 1978 and April 2, 1979. *See supra* note 18 and Complaint in Interpleader, ¶¶ 12.g-k, m, *Union Bank v. GLACAA*, No. 79-0693.

after its termination on January 1, 1979.<sup>41</sup> Months before the contract administrator retained new counsel, Watson and Gantz, to represent GLACAA.<sup>42</sup> Even then, the extent of the lawyers' authority remained uncertain.<sup>43</sup> To initiate affirmative litigation, including any action to quash the writs, Watson and Gantz requested authority from the contract administrator.<sup>44</sup> The contract administrator forwarded the request to the Los Angeles City Development Department which sent it to CSA for approval.<sup>45</sup> Two months passed before final approval.

Even when authority was secured, the litigation proceeded slowly. Watson and Gantz noted that two of the judgments contained the language "less any legal offsets."<sup>46</sup> They noticed depositions for July 23, 1979 to determine the extent of possible offsets. When the discharged employees refused to appear, Watson and Gantz filed motions to compel their attendance.<sup>47</sup> The court<sup>48</sup> indicated that it included the language "less any legal offsets" to provide for mitigation of damages,<sup>49</sup> that the judgments were interlocutory, not final,<sup>50</sup> that writs of execution should not have been issued,<sup>51</sup> and that the court retained jurisdiction.<sup>52</sup> The court declined to quash the writs *sua sponte*, but held that if the discharged employees did not cooperate with efforts to take their depositions, the court would entertain a motion to quash the writs.<sup>53</sup> Such a motion was never filed, because

41. *See supra* note 17.

42. *See supra* note 16.

43. *See* letter from Malbour Watson to contract administrator Donohoe (July 2, 1979). Watson noted he had asked Donohoe on at least three occasions to request the city council to delineate the authority lines he would have to follow.

44. *Id.* Emmett J. Gantz, Watson's partner, also wrote to Donohoe requesting authority. Letter from Emmett Gantz to Michael Donohoe (July 16, 1979).

45. The City of Los Angeles wrote to CSA requesting approval of such authority. Letter from Parker C. Anderson, Director, Demonstration Projects Division of the Community Development Department of the City of Los Angeles, to Alphonse Rodriguez, CSA Regional Director (Aug. 1, 1979). Rodriguez granted such approval on Sept. 12. Letter from Alphonse Rodriguez to Parker Anderson (Sept. 12, 1979).

46. *Abelson v. GLACAA*, No. C 218512 (L.A. Super. Ct. Jan. 30, 1979); *O'Connell v. GLACAA*, No. C 243148 (L.A. Super Ct. Nov. 28, 1978).

47. Motion for Order Compelling Attendance at Deposition or in the Alternative to Set Aside All Judgments, *Abelson*, No. C 218512.

48. Gantz appeared before Judge Dell, the superior court judge who issued the *Abelson* and *O'Connell* judgments.

49. Reporter's Transcript, at 2-4, 9 (Sept. 7, 1979); Reporter's Transcript at 3 (March 14, 1979), *Abelson*, No. C 218512.

50. *Id.* at 23, 27-28 (Nov. 17, 1979); *id.* at 2 (Jan. 2, 1980); *id.* at 13, 14, 15, 21 (Mar. 14, 1979).

51. *Id.* at 18, 23, 27-28 (Nov. 9, 1979).

52. *Id.* at 3, 10 (Sept. 7, 1979); *id.* at 23 (Nov. 9, 1979).

53. *Id.* at 18 (Nov. 9, 1979); *id.* at 14, 20, 22 (Mar. 14, 1980).

of a dispute over Gantz's standing to represent GLACAA<sup>54</sup> and because of delay in filing the necessary papers.<sup>55</sup>

By the fall of 1980, GLACAA's affairs were still far from settled.<sup>56</sup> CSA

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54. See, e.g., *id.* at 1 (Sept. 7, 1979); 17, 23, 26 (Nov. 9, 1979); 2, 3 (Jan. 25, 1980); 4, 12-15 (Mar. 14, 1980). The discharged employees challenged Gantz's authority to represent GLACAA's interests because Gantz represented the contract administrator and the contract administrator had not assumed responsibility for GLACAA's liabilities. See *id.* at 3-5 (Mar. 14, 1980). Although the court indicated that a city council resolution or city attorney's opinion designating a successor in interest would have clarified matters, the court concluded "that the City actually is the legal successor in interest to GLACAA, at least the de facto successor in interest to GLACAA." *Id.* at 12-13 (Mar. 14, 1980). The court further stated that:

I will certainly make a finding that the City is the legal successor in interest to GLACAA. That is a finding. I am not ordering them to substitute in as a party, but I think it is clear from all of the documentation that has been filed that the City has assumed that particular position. I am not in a position to order that the judgment be defrayed out of city funds which I suspect would make your clients very happy and it would make me happy, too, but I don't see how I possibly have that jurisdiction.

I am certainly not representing that the City has any responsibilities that go above and beyond attempting to terminate this litigation and to make recommendations to the appropriate federal agency.

*Id.* at 18-19 (Mar. 14, 1980).

55. At the beginning of the March 14th hearing, the court required the six employees subject to the *Abelson* and *O'Connell* judgments to appear for depositions no later than May 1, 1980. *Id.* at 23. Only three employees appeared, and they were unwilling to answer substantial portions of the questions asked. Reporter's Transcript at 11 (Sept. 7, 1979), *Abelson*, No. C 218512. Gantz, however, did not prepare a motion to quash the writs of execution until August 19, 1980. By that time, Judge Dell had been transferred from the Los Angeles Superior Court to the Santa Monica Superior Court, and he indicated reluctance, though not refusal, to hear the motion. Letter from George M. Dell to Emmett J. Gantz (Sept. 15, 1980). Because of a change in counsel, a decision to pursue settlement negotiations and a dispute over whether to continue funding GLACAA counsel, such a motion was never filed.

56. In addition to the cases involving the employee discharges, GLACAA was embroiled in 90 other cases at the time of its termination. HOUSE REPORT, *supra* note 1 at 31-32. Only a few of the cases were active and fewer still went to judgment. The more important cases were: *Camara v. GLACAA*, No. C 218515 (L.A. Super. Ct. filed Oct. 31, 1977) and *Bolte v. GLACAA*, No. C 225240 (L.A. Super. Ct. filed Dec. 30, 1977) (employee discharge claims decided in GLACAA's favor and affirmed on appeal, Oct. 1980); *Ferguson v. Kedren*, No. CV-75-3167 (C.D. Cal. filed Sept. 1975) (sex discrimination class action brought against GLACAA delegate agency); *Kraus v. Samaniego*, No. C 233687 (L.A. Super. Ct. filed Mar. 16, 1978) (action by GLACAA's former insurance broker alleging defamation, intentional breach of contract, intentional interference with business relationships and negligence); *Samaniego v. GLACAA*, No. C 267224 (L.A. Super. Ct. filed Dec. 29, 1978) (breach of contract action by former GLACAA executive director, voluntarily dismissed in 1981); *Wells Fargo Bank v. GLACAA*, No. C 257958 (L.A. Super. Ct. filed Oct. 12, 1978) (interpleader action to resolve claims to GLACAA's trust fund containing over \$400,000); *Abelson v. Donohoe*, No. C 336371 (L.A. Super. Ct. filed Sept. 2, 1980) (seeking an accounting of GLACAA's pension trust fund); *Abelson v. Donohoe*, No. C 351568 (L.A. Super. Ct. filed Jan. 8, 1981).

grants to the city to manage the closedown and the city's contract with contract administrator expired during the summer of 1980. CSA assumed closer supervision of the closedown efforts,<sup>57</sup> arranging for new counsel to represent GLACAA.<sup>58</sup> By the time the new counsel, Parra and Putnam, became familiar with the case, the prospects for quashing the writs appeared remote<sup>59</sup> and renewed settlement efforts began.<sup>60</sup>

The settlement negotiations were protracted because of the mutual distrust between the parties,<sup>61</sup> the complexity of the issues,<sup>62</sup> and the intervention of other parties.<sup>63</sup> Nonetheless, by the spring of 1981, Parra and Putnam recommended settlement terms that would have terminated the discharged employees' back pay claims on the earlier of January 1, 1979 or the date of reinstatement, and deducted their earnings from the back pay awards. The discharged employees would have kept their inflated sick

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57. Arthur Young's contract lapsed and the Rural Development Corp. (RDC) completed the closedown. RDC, however, never acted as "trustee," "contract administrator," or "successor" to GLACAA or in any other role involving risk of liability for GLACAA's affairs.

58. The firm of Parra and Putnam replaced Watson and Gantz. The attorneys were paid from CSA grant funds awarded RDC to administer portions of the closedown.

59. By that time, two years had passed since issuance of the writs and eight months since Judge Dell's invitation to file a motion to quash.

60. See letter from James E. Gonzales, II, CSA regional counsel, to Michael M. Hachigian (Dec. 4, 1980) (referring to Mr. Hachigian's offer to Parra and Putnam). In September 1980, the discharged employees' counsel indicated that he would consider settlement for something less than the full amount of the writs of execution for at least some of the employees. Letter from Michael M. Hachigian to James E. Gonzales, II (Sept. 8, 1980).

61. Government counsel did not trust the discharged employees' counsel because of their earlier dealings with him. In 1979, Watson and Gantz succeeded in reducing the *Lockhart* judgment to \$6,000. The discharged employees' counsel demanded payment, and the CSA regional counsel informed him that there were funds available to cover Lockhart's judgment and that if Lockhart levied on the funds, CSA would not oppose the levy. Letter from James E. Gonzales, II to Michael J. Donohoe (Nov. 9, 1979). The discharged employees' counsel levied on the account on behalf of Block instead of Lockhart and then came back to CSA asking why Lockhart had not been paid. Letter from Michael M. Hachigian to Michael J. Donohoe (Nov. 27, 1979). See *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979). The discharged employees' counsel, in turn, continually questioned government counsel's authority to enter into a settlement. See *supra* note 66.

62. Recalculation of back pay alone was complex because of the varying rates used for the different time periods, and the need to account for fringe benefits, the deduction of other earnings, interest, and taxes.

63. The Internal Revenue Service (IRS) notified the contract administrator that it held GLACAA responsible for both the employer's and the employees' shares of the tax obligations arising from the back pay awards, and that, if necessary, it intended to proceed against Arthur Young and Company to satisfy the obligations. The discharged employees at first refused to agree to tax deductions, making a settlement impossible, but later agreed to provide for withholding taxes. Later the county, as stakeholder of the funds, indicated that it would not pay the full amount of interest it had received from the funds, but the matter was resolved within a few weeks.

leave awards and any other claims pending against GLACAA and its successors.<sup>64</sup>

While the settlement recommendation was under consideration, the California Court of Appeal scheduled oral argument on CSA's appeal of its third party claims.<sup>65</sup> CSA offered to postpone the hearing to permit settlement negotiations to be concluded, but the attorney for the discharged employees refused.<sup>66</sup> Seven days after oral argument, the court ruled in CSA's favor in cases affecting eleven of the thirteen individuals.<sup>67</sup> After the ruling, CSA offered to renew settlement negotiations, but refused to pay the inflated sick leave awards and insisted on a dismissal of all claims against GLACAA.<sup>68</sup>

At this point the federal court brought renewed pressure on the government to settle.<sup>69</sup> It ordered the parties to appear for trial in seven days, even though potentially dispositive motions were pending in *Abelson v.*

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64. The principal claims were those raised in *Wells Fargo Bank*, No. C 257958 (L.A. Super. Ct. filed Oct. 12, 1978); *Abelson v. Donohoe*, No. C 336371 (pension issues); *Abelson v. Donohoe*, No. C 351568 (cost of living increase).

65. The argument was scheduled for June 23, 1981.

66. To settle the case, the government required review by CSA, HHS, the trial and appellate staffs of the Department of Justice, and the Assistant Attorney General for the Civil Division and the approval of the Associate Attorney General and the Solicitor General. See 28 C.F.R. § 0.160 (1980) and 45 C.F.R. § 1069 (1979). Final approval of the settlement could not be secured before the scheduled hearing. See Status Report, *United States v. Abelson*, C.A. No. 79-1359 (C.D. Cal. April 12, 1979).

67. *Phillips v. GLACAA*, Nos. 56537, 56604 (Cal. Ct. App. June 30, 1981). The court recognized CSA's reversionary interest in the funds, effective December 31, 1978, and ruled that only execution liens, not judgments could obligate the grant funds. Accordingly, the court concluded that any writs of execution levied after December 31, 1978, were invalid. Slip op. at 11-13. The court rejected CSA's executory lien because it was not raised below. *Id.* at 7. The effect of the ruling was to invalidate the *Abelson*, *Britton*, and *Macias* writs affecting 11 of the 13 employees. The *O'Connell* and *Al-Essahki* writs were affirmed. *Id.* at 13-14.

68. See Reporter's Transcript of Proceedings, July 20, 1981, *United States v. Abelson*, No. 79-1359; *Abelson v. Olivarez*, No. 78-4665.

69. The federal court with responsibility for *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. filed Dec. 8, 1978); *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979); *United States v. Abelson*, No. 79-1359 (C.D. Cal. April 12, 1979), had urged the government to settle throughout the proceedings. See, e.g., Reporter's Transcript of Proceedings, June 30, 1980; *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979).

In May 1981, the court ordered the cases settled by June 8, 1981, and ordered Washington counsel to appear personally on that date. When counsel reported that only two of the cases had been settled, the court ordered Washington counsel, the Assistant United States Attorney, and Mr. Putnam, (but not the counsel for the discharged employees), to appear personally every day at 1:30 p.m. until all of the remaining cases were settled. See Reporter's Transcript of Proceedings, June 8, 1981, *Block*, No. 79-04487. The court relented the next day after government counsel filed an Ex Parte Motion to Vacate Order or in the alternative, for Stay Pending Appellate Review, but ordered government counsel to appear again in two weeks. See Reporter's Transcript of Proceedings, June 9, 1981, *Block*, No. 79-04487.

*Olivarez*, and a stay was in effect in *United States v. Abelson*.<sup>70</sup> It also ordered the General Counsel of CSA to appear personally.<sup>71</sup> At 4:30 p.m. on the day set for trial, the court called the parties into chambers and urged revival of settlement efforts.

The settlement negotiations resumed. CSA's authorization had not been renewed and the new General Counsel was determined to conclude the matter before CSA went out of existence on October 1, 1981. On September 24, 1981, a new agreement was reached. The terms were substantially the same as those proposed by Parra and Putnam in the spring, except that the discharged employees agreed to drop two other lawsuits in return for an additional \$23,000. *Abelson v. Olivarez* was finally dismissed on September 24, 1981,<sup>72</sup> and *United States v. Abelson* on October 20, 1981. Even with the settlements and CSA's termination, however, several additional lawsuits and a final accounting remained before GLACAA's affairs could be concluded.<sup>73</sup>

## II. THE NECESSARY ELEMENTS FOR MORE EFFECTIVE CLOSEDOWNS

### A. Better Implementation of Existing Regulations

The difficulties associated with GLACAA's demise are so manifest that any proposals for improvement must begin with better implementation of existing laws. The first suggestion, on which virtually every GLACAA critic has commented,<sup>74</sup> is the need for faster action to close down a trou-

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70. Bench Order of July 20, 1981, *United States v. Abelson*, No. 79-1359; *Abelson v. Olivarez*, No. 78-4665. See also Government's Ex Parte Motion to Vacate Trial Date, July 21, 1981; *United States v. Abelson*, No. 79-1359; *Abelson v. Olivarez*, No. 78-4665.

71. The new CSA General Counsel, Frederic Freilicher, had been identified as the CSA official who recommended different settlement terms after the June 30, 1981 state court decision noted *supra* note 67. See Reporter's Transcript of Proceedings, July 20, 1981, *United States v. Abelson*, No. 79-1359; *Abelson v. Olivarez*, No. 78-4665.

72. Counsel for plaintiffs in *Kraus v. Samaniego*, No. C 233687 (L.A. Super. Ct. filed Mar. 16, 1978) moved to intervene in *Abelson*, No. 78-4665 on April 27, 1979, in order to protect Kraus' claim against GLACAA. The court denied the motion without prejudice. Kraus was notified of the settlement conference on September 22, 1981, but his counsel was not invited into chambers during the session in which the court was informed the case had been settled. After the case was dismissed on September 24, 1981, Kraus again moved to intervene but the motion was denied because the case had been dismissed. See Order Denying Motion to Intervene, *Abelson*, No. 78-4665.

73. In addition to *Kraus*, the most important case still pending after the settlement was *Wells Fargo Bank v. GLACAA*, No. C 257958 (L.A. Super. Ct. filed Oct. 12, 1978). The discharged employees refused to relinquish their claims, but the federal government was named as a party to the suit and intended to press its own claim to the funds. See *supra* note 56. In addition, although this settlement disposed of the largest part of GLACAA's remaining assets, final disposition of the remaining funds had yet to be determined.

74. See GAO REPORT, *supra* note 10, at 24-26.

bled agency. GLACAA's financial and administrative difficulties were identified as early as 1976.<sup>75</sup> The decision to terminate the agency was not made until two years later, and even then, termination appears to have been accelerated only by the "60 Minutes" expose.<sup>76</sup> Yet, every month GLACAA remained in existence, its assets were being dissipated by waste, mismanagement, and fraud, and its legal difficulties compounded by defiance and malpractice.<sup>77</sup>

Second, a closedown plan providing for the disposition of the agency's assets and liabilities must be devised and approved before termination, not afterwards. CSA regulations required such approval,<sup>78</sup> and even if they did not, effective management would.<sup>79</sup> Obtaining the necessary information should not pose insurmountable difficulties; CAAs, like most grantees, are subject to periodic audits and are required to make their books and records available to the grantor agencies.<sup>80</sup> Moreover, "settling" liabilities may mean only authorization of litigation,<sup>81</sup> and the "disposition" of assets may be the designation of a recipient for any remaining funds from the litigation. Nonetheless, adoption of such a plan before termination

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75. See *supra* note 12 and accompanying text.

76. See *supra* note 11. See generally GAO REPORT, *supra* note 10; HOUSE REPORT, *supra* note 1; United States v. Mena, No. 80-720 (C.D. Cal. Aug. 1980).

77. In discharging employees, for example, GLACAA violated the procedures required by its union contract, failed to challenge the inflated calculation of damages presented by the discharged employees, and then ignored the court orders requiring reinstatement, permitting the damage claims to mount indefinitely. See *supra* note 18. Even when GLACAA offered reinstatement to seven employees, it took no action to notify the court or to reduce the judgments. *Id.*

78. 45 C.F.R. § 1060.200, part G.1.3. app. B.8 (1979). CSA argued in *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. filed Dec. 8, 1978) that a closedown plan was unnecessary because CSA terminated funding in accordance with 45 C.F.R. § 1050.122 (1979), and CSA "closeout" procedures were all that were required. A closedown plan is required, however, whenever "a state or local government revokes the designation or opts out of an existing CAA without making a new designation," 45 C.F.R. § 1060.200, part G.1 (1979), and the court ordered submission of a plan for GLACAA meeting those requirements. See *supra* note 24.

79. See, e.g., the municipal bankruptcy provisions of ch. IX of the Bankruptcy Act, 11 U.S.C. §§ 901-946 (Supp. III 1979), requiring formulation of a plan to meet the liabilities of the insolvent municipality and the National Credit Union Administration Act, 12 U.S.C. § 1766 (1976), authorizing the dissolution of insolvent credit unions by a liquidating agent with authority to take possession of the books, records and property of the credit union and distribute the assets to the creditors and members.

80. 45 C.F.R. § 1067.5, app. A, ¶ 12 (1979).

81. *E.g.*, the GLACAA closedown plan provided for (1) the processing of routine obligations; (2) establishment of a claims procedure to dispose of other claims; and (3) continuation of existing litigation and settlement efforts to resolve the claims of the discharged employees. Sec. VI, Closedown Plan, *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. filed Dec. 8, 1978).



should provide the means to resolve competing claims, offer greater protection from legal challenges,<sup>82</sup> and speed implementation of a closedown.<sup>83</sup>

Third, from the date of termination, some entity should be authorized to act legally on behalf of the defunct grantee. A major portion of the difficulties with the GLACAA closedown arose because of the fragmentation of authority. The contract administrator would not act without approval from the City of Los Angeles; the city could not or would not act without approval from CSA.<sup>84</sup> Emmett Gantz, attorney for GLACAA, lost six months seeking to establish the contract administrator's authority to represent GLACAA's interests.<sup>85</sup> The absence of a designated entity with legal authority to act and the absence of a clear chain of command made an efficient GLACAA closedown impossible from the outset.

There is no question that with or without new regulations the GLACAA closedown could have been more efficient. But one difficulty overshadowed the others: the lack of a mechanism to define responsibility for GLACAA's liabilities. The City and County of Los Angeles, which created GLACAA, were the logical entities to supervise the closedown. Indeed, to the extent anyone assumed that responsibility, the city acted as trustee and hired the contract administrator to carry out the administrative duties.<sup>86</sup> But because of concern over potential liability, the city never formalized the arrangement, undercutting the ability of the contract administrator to act as GLACAA's successor.<sup>87</sup> Because of that concern, neither the city nor the county would propose a closedown plan or accept the responsibilities associated with a transition plan.<sup>88</sup> For GLACAA, the issue was never resolved. The discharged employees' Motion to Reject Closedown Plan and Order Submission of a Transition Plan purported to

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82. Even if closedown plans are not required by law, in the absence of such a plan, legal challenges are more likely to focus on the entire closedown. *See, e.g., Abelson*, No. 78-4665 at 6. With a properly promulgated plan, the challenge is likely to be limited to a particular provision, permitting the rest of the closedown to proceed on course.

83. One drawback is that the process of devising and approving such a plan may slow termination. Conversely, the pressure to terminate the agency, which may aid in agreement to a closedown plan, dissipates once the agency is no longer in existence.

84. *See supra* notes 43-45.

85. *See supra* note 50.

86. *See supra* note 17.

87. *See supra* note 54. Judge Dell indicated that a city council resolution or opinion of the city attorney recognizing the city as GLACAA's trustee and successor in interest would resolve the matter, but the city provided neither. *Id.*

88. A transition plan would have required the new CAA to assume the liabilities of the old one. 45 C.F.R. § 1060.200, app. B.8 (1979). *See supra* note 24.

assign responsibility,<sup>89</sup> but granting the motion would have solved nothing,<sup>90</sup> and approval of the closedown plan would not have settled all questions concerning GLACAA's liabilities.<sup>91</sup> For GLACAA, the end will come only with final distribution of its assets.<sup>92</sup> For other publicly funded agencies, new regulations are required.

### *B. New Regulations to Assign Responsibility and Define Liability*

To avoid the difficulties attending the GLACAA closedown, it is essential to assign responsibility and define liability from the outset. Existing regulations fail to perform that function and bankruptcy provisions are unavailable to CAAs. New regulations tailored to the particular needs of publicly funded agencies are needed.

Current regulations are limited to the closedown procedures described above. CSA required the development and approval of a closedown plan, settling all liabilities before termination of a CAA,<sup>93</sup> but the parties submitting the plan were left to their own devices. The GLACAA closedown plan, for example, established a claims procedure that purported to resolve all but "routine obligations."<sup>94</sup> But the City of Los Angeles could not require judgment creditors to use the claims procedure nor did it insist on "exhaustion" of the claims procedure as a precondition to litigation.<sup>95</sup>

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89. *Id.*

90. The discharged employees argued that a transition plan would require the new CAA (either the city or the county) to reinstate them, pay back pay awards, and satisfy all claims remaining against GLACAA. Ordering a transition plan, however, would not in itself have resolved the competing claims to GLACAA's funds nor would it have necessarily made city, county or federal assets available to satisfy GLACAA's liabilities. *See United States v. Orleans*, 425 U.S. 807 (1976) (federal agencies cannot be held liable for the acts of CAAs). Moreover, any such order would have been appealed and the new CAA could have sought modification of the judgments.

91. For example, the closedown plan provided for the continuation of litigation to resolve the former employees' claims. *See supra* note 77. *See also* GAO REPORT, *supra* note 10, at 46-47 (noting CSA proposal to amend regulations to clarify liability of joint powers).

92. Presumably further litigation would be pointless once agency assets are exhausted. Existing litigation, however, includes disputes over GLACAA trust funds which could result in the return of over \$400,000 to GLACAA. *See supra* note 56.

93. *See supra* note 24. If a new CAA were designated at the same time, a transition plan requiring the new CAA to assume the liabilities of the old one would have been required. *Id.* The regulations applied only to CAAs. If CSA or other federal grantors discontinued funding of other organizations, no closedown plan was required, even if federal funding was the sole source of the organization's income. *But see* 45 C.F.R. §§ 74.111, 1050.112 (1979) (limited procedures attending closeout of the grant). HHS, which funds conducting Headstart activities, for example, has no regulations comparable to CSA's closedown and transition provisions.

94. *See supra* note 24. "Routine obligations" were to be paid from the appropriate grants.

95. *Cf. infra* note 115.

More importantly, the plan contained no bar to new claims,<sup>96</sup> and no method to distribute GLACAA's assets among its competing creditors.<sup>97</sup>

In comparison, a substantial body of law defines the obligations and liabilities of private corporations. At common law, a corporation ended its existence for all purposes upon dissolution.<sup>98</sup> It lost the ability to sue and be sued.<sup>99</sup> Pending actions were abated, and judgments issued after dissolution were void.<sup>100</sup> Creditors had two remedies: they could proceed against the trustee or anyone else other than a good faith purchaser for value in possession of the corporate assets<sup>101</sup> or they could pursue an action in equity to liquidate the corporation for the benefit of creditors.<sup>102</sup>

Modern statutes generally extend the life of the corporation beyond dissolution for the purpose of winding up its affairs,<sup>103</sup> though most states limit the period in which the defunct corporation can sue and be sued to two or three years.<sup>104</sup> These statutes also require corporations entering into voluntary liquidation to provide for the payment of all debts and liabilities<sup>105</sup> and to reserve a portion of the assets to pay the claims of un-

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96. See, e.g., *supra* note 56.

97. The determination of the priority of GLACAA creditors was complicated by the fact that GLACAA's assets consisted almost exclusively of grant funds which should have reverted to the grantor agencies on January 1, 1979. All of the agencies asserted that use of their funds to pay the discharged employees' judgments was unauthorized. If the grantor agencies' claims were added to those of GLACAA's other creditors, GLACAA liabilities would have exceeded substantially its assets. See Declaration of Michael E. Donohoe, Nov. 15, 1979; *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979).

98. *Johnson v. Helicopter & Airplane Serv. Corp.*, 404 F. Supp. 726 (D. Md. 1975). See also *Canadian Ace Brewing Co. v. Anheuser-Busch, Inc.*, 448 F. Supp. 769 (N.D. Ill. 1978), *aff'd*, 602 F.2d 593 (7th Cir.), *cert. denied*, 444 U.S. 884 (1979); *Stone v. Gibson Refrigerator Sales Corp.*, 366 F. Supp. 733 (E.D. Pa. 1973).

99. 366 F. Supp. at 734.

100. *Id.* See also *Katz v. Aspinwall*, 342 F. Supp. 286 (N.D. Ala.), *aff'd*, 459 F.2d 1045 (5th Cir.), *cert. denied*, 409 U.S. 1000 (1971); *Sharp v. Eagle Lake Lumber Co.*, 60 Cal. App. 386, 212 P. 933 (1923); *California Nat'l Supply Co. v. Flack*, 183 Cal. 124, 190 P. 634 (1920) (the judgment could be impeached by any interested party including creditors and shareholders liable for the debts of the corporation).

101. See *Stewart v. United States*, 327 F.2d 201 (10th Cir. 1964); *Drew v. United States*, 367 F.2d 828 (Ct. Cl. 1966); *Koch v. United States*, 138 F.2d 850 (10th Cir. 1943); 16A *Fletcher Cyclopedic Corporations* § 8161 (1979).

102. Courts of equity have the inherent power to appoint a receiver to liquidate the assets of a dissolved corporation. *United States v. American Tobacco Co.*, 221 U.S. 106, 186 (1911); *Bellevue Gardens, Inc. v. Hill*, 297 F.2d 185 (D.C. Cir. 1961); 16A *Fletcher Cyclopedic Corporations* §§ 8157, 8198. The rights of creditors and the power of equity are particularly strong where there is evidence of fraud to avoid satisfying creditors' claims. *Cf.* MODEL BUSINESS CORP. ACT § 97 (1979).

103. See MODEL BUSINESS CORP. ACT § 105 (1979).

104. *Id.* But see CAL. CORP. CODE § 2010 (West 1977) (extending the life of the corporation for purposes of winding up without limit).

105. See MODEL BUSINESS CORP. ACT § 92(c) (1979) (requiring that "all debts, obliga-

known or disabled creditors or shareholders.<sup>106</sup> Where the dissolution is involuntary or where a creditor invokes the intervention of the court, a trustee may be appointed to liquidate the corporation.<sup>107</sup> The trustee assumes possession of the corporate assets and generally the ability to sue and be sued on behalf of the dissolved corporation.<sup>108</sup> A claims procedure may be established providing notice to the corporation's creditors and requiring submission of all claims within a limited period of time.<sup>109</sup> At the conclusion of the liquidation the trustee completes distribution of the corporation's assets to the creditors, bondholders, and stockholders in accordance with the priority of their claims.<sup>110</sup>

Where the corporation is insolvent, it also has recourse to bankruptcy.<sup>111</sup> Once a bankruptcy petition is filed,<sup>112</sup> all proceedings against the debtor are automatically stayed,<sup>113</sup> the court obtains jurisdiction to recover preferences made within the preceding ninety days<sup>114</sup> and to establish a claims

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tions and liabilities of the corporation have been paid and discharged or that adequate provision has been made therefor" as a condition of voluntary dissolution). *See also id.* § 102 governing involuntary dissolution.

106. MODEL BUSINESS CORP. ACT § 104.

107. *See id.* §§ 97-103.

108. *Id.* § 98. *See, e.g.,* *Burroughs v. Fields*, 546 F.2d 215 (7th Cir. 1976); DEL. CODE ANN. tit. 8, § 279 (1980); NEV. REV. STAT. § 78.600 (1981).

109. MODEL BUSINESS CORP. ACT § 100 (1979). *See generally id.* § 98; 16A Fletcher's *Cyclopedia Corporations* §§ 8179-8189.

110. *See* MODEL BUSINESS CORP. ACT §§ 98, 102 (1979); 16A Fletcher's *Cyclopedia Corporations* §§ 8180-8186; *Macneale v. Lalance & Grosjean Mfg. Co.*, 276 F. 491 (6th Cir. 1921).

When the corporation is insolvent, the assets are distributed as far as they go. MODEL BUSINESS CORP. ACT § 102 (1979). The corporation or the trustee may file bankruptcy, but the corporation may also be liquidated under state law without federal bankruptcy proceedings. *Id.*

111. *See* 11 U.S.C. §§ 1-151326 (Supp. IV 1980).

112. Bankruptcy proceedings may be initiated either by a petition filed voluntarily by the debtor, 11 U.S.C. § 301 (Supp. IV 1980), or involuntarily upon a petition by the requisite number of creditors. *Id.* § 303. Involuntary proceedings, however, may be brought only under Chapters 7 and 11 of the Code and not under the provisions of chapters 9 and 13 which govern municipal bankruptcy and the adjustment of debt of small businesses and persons with regular income, respectively.

113. The stay is automatic once the petition is filed and it applies to legal process or proceedings against the debtor, enforcement of existing judgments, efforts to obtain the debtor's property or to perfect a lien against it, and other actions to pursue or enforce claims arising before commencement of the bankruptcy action against the debtor or his estate. 11 U.S.C. § 362(a) (Supp. IV 1980). *See also id.* § 1301. Exceptions to the automatic stay are set forth in 11 U.S.C. § 362(b) (Supp. IV 1980).

114. 11 U.S.C. § 547(b) (Supp. IV 1980) provides that:

procedure with a limited period for the submission of claims.<sup>115</sup> The bankruptcy trustee may also sue to recover assets owed to the debtor.<sup>116</sup> At the conclusion of the proceedings, the debtor's assets are distributed in accordance with the priorities established by the Code<sup>117</sup> and the debtor's liabilities are discharged by court order.<sup>118</sup>

GLACAA fit comfortably into none of these provisions. Neither California law nor the Joint Powers Agreement extended GLACAA's existence for the purpose of suing or being sued beyond the date of its termination, so that under state law, the writs and judgments entered after January 1, 1979 should have been void.<sup>119</sup> But GLACAA's termination was of questionable validity because of the failure to comply with federal law,<sup>120</sup> and

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[T]he trustee may avoid any transfer of property of the debtor —

. . . .

(4) made —

(A) on or within 90 days before the date of the filing of the petition, or

(B) between 90 days and one year before the date of the filing of the petition,

if such creditor, at the time of such transfer —

(i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

(5) that enables such creditor to receive more than such creditor would receive if —

(A) the case were a case under chapter 7 of this title [11 U.S.C. §§ 701-766];

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title [11 U.S.C. §§ 1-151326].

115. *Id.* § 501. The 1978 revision of the Bankruptcy Code eliminated the six-month period for filing claims, *see id.*, but Rule 302(e), Rules of Bankruptcy Procedure, continues to limit claims to a six-month period following the first meeting of creditors in chapter 7 proceedings. Claims that are timely filed are deemed allowed unless there is an objection. 11 U.S.C. § 502(a). If there is an objection, the court determines the amount of the claim. *Id.* § 502(b). Damages resulting from the termination of employment contracts are limited to compensation for one year from the date of termination or the filing of the petition, whichever is earlier. *Id.* § 502(b)(8). The debtor is also required to file a list of creditors. *Id.* § 521.

116. The trustee has the capacity to sue and be sued. 11 U.S.C. § 323(b) (Supp. IV 1980).

117. *Id.* §§ 507, 726. The debtor is required, unless the court orders otherwise, to file a schedule of assets and liabilities, and a statement of the debtor's financial assets. *Id.* § 521(a).

118. *Id.* § 727.

119. *See CAL. GOV'T CODE* §§ 6500-6585 (West 1980). Under California law, a defunct entity has no authority to sue or be sued, all actions pending against it abate at the time of liquidation, and any subsequent judgments entered against it are void unless the life of the entity has been extended by statute. *Compare* *Defense Supplies Corp. v. Lawrence Warehouse Co.*, 336 U.S. 631 (1949), and *A B C Brewing Corp. v. Commissioner*, 224 F.2d 483 (9th Cir. 1955) with *Sharp v. Eagle Lake Lumber Co.*, 60 Cal. App. 386, 212 P. 933 (Dist. Ct. App. 1923), and *California Nat'l Supply Co. v. Flack*, 183 Cal. 124, 190 P. 634 (1920).

120. *See supra* notes 23-24. The preliminary injunction in *Abelson v. Olivarez*, No. 78-

the judgments and levies issued after January 1, 1979 were never challenged as void under state law.<sup>121</sup> Similarly, although the discharged employees asked the court to order submission of a closedown or transition plan,<sup>122</sup> the court never assumed the powers of a court in equity to administer the assets for the benefit of creditors.<sup>123</sup> More important, the failure of the court to rule on the motion to reject the closedown plan limited the effectiveness of the plan while precluding other efforts to resolve GLACAA liabilities.<sup>124</sup> The contract administrator, who might otherwise have been able to resolve some claims, was never formally vested with the authority of a trustee,<sup>125</sup> and GLACAA would have had difficulty initiating bankruptcy proceedings.<sup>126</sup>

No ready model existed for the dissolution of GLACAA, and none exists now for the dissolution of other publicly funded agencies. The CSA recognized the need for federal regulations governing the dissolution of CAAs.<sup>127</sup> Drawing on experience with corporate liquidation and dissatisfaction with the procedures employed to closedown GLACAA, other fed-

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4665 (C.D. Cal. filed Dec. 8, 1978), did not purport, however, to extend GLACAA's existence beyond January 1, 1979.

121. The writs and judgments were challenged by the federal creditors on other grounds. *See supra* notes 28-33, 68. If GLACAA had successfully challenged the writs and judgments as void, the discharged employees could have attempted to substitute the contract administrator or the City of Los Angeles as parties or to persuade the federal court in *Abelson* to require payment of their claims as part of the GLACAA closedown plan, subject to the claims of other creditors. *Cf. supra* notes 101-02.

122. *Supra* notes 23-24 and accompanying text. They also moved to reject the submitted closedown plan and to order submission of a transition plan. *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. filed Dec. 8, 1978).

123. Given the existence of federal regulations governing the GLACAA closedown, a separate proceeding in equity may not have been appropriate, but there was nothing to prevent the court from taking a more active role in the GLACAA liquidation. In issuing the preliminary injunction enjoining the transfer of GLACAA's assets, for example, the court exercised its powers to protect the interests of the discharged employees but it did so without regard to the effect on GLACAA's other creditors. *See supra* notes 23-26. The federal agencies attempted to resolve their claims before the same court, but the court never ruled on the substance of the claims. *See supra* notes 30-32.

124. *See supra* note 23 and accompanying text. For example, the City and County of Los Angeles were reluctant to clarify the authority of the trustee or to play a greater role in closing down GLACAA so long as the issue of liability was unresolved. *See supra* note 54.

125. *See supra* note 124. *See also* notes 43-45.

126. As a joint powers entity, GLACAA was a public agency and a "municipality" under the Bankruptcy Code. 11 U.S.C. § 101(29) (Supp. IV 1980). The municipal bankruptcy provisions of chapter 9 would have been of no use because they provide for debt adjustments, not liquidation. *Id.* §§ 901-946. GLACAA could not invoke the liquidation procedures under chapter 7, *id.* §§ 701-766, because it was not a "person" within the meaning of the Code. *Id.* § 109(b). "Person" includes "individual, partnership, and corporation," but does not include "governmental unit." *Id.* § 101(30).

127. *See* 45 C.F.R. § 1062.200, app. B.8 (1979) and *supra* note 24.

eral agencies should review their regulations to insure that they provide for the effective and orderly dissolution of public agencies.<sup>128</sup> At a minimum, such regulations should provide for:

1. *The termination of the entity and its capacity to sue and be sued.* Virtually all grantees are organized with some provision for their termination, whether as a matter of federal or state law; it is their status upon termination which needs to be clarified. The common law rule that all actions abate upon the dissolution of the entity, while no longer applicable to most corporations, may apply to CAAs, and federal regulations should require that the rule be made explicit.<sup>129</sup>

Litigation should then be permitted to proceed against a responsible party, not the defunct organization.<sup>130</sup> A trustee or a creditor would have a greater incentive to contest liability vigorously with less danger of default.<sup>131</sup> Moreover, where the agency's assets consist primarily of federal funds which revert to the grantor agency upon termination, the grantor agency has the greatest interest in opposing the claim.<sup>132</sup> The affairs of

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128. Revised federal regulations could make effective liquidation procedures a condition of funding. Consistent with principles of federalism, the liquidation procedures themselves would be governed by state law. Alternatively, the federal Bankruptcy Code could be amended to add a new section providing for the liquidation of federally funded entities.

129. GLACAA's termination was governed by the CAL. GOV'T CODE §§ 6500-6585 (West 1980) and the Joint Powers Agreement between the City and County of Los Angeles. See *supra* note 8. CSA regulations governed termination of the grant, and required CSA approval of the closedown plan. See 45 C.F.R. §§ 1050.112, 1062.200, app. B.8 (1979). Neither state law nor federal regulations, however, purported to deal with GLACAA's status upon termination.

Ordinarily, the common law rule governs in the absence of a provision extending the life of the agency. See, e.g., *supra* note 117. Grantor agencies could make application of the common law rule—or at least some provision setting a limit to the legal life of the grantee—a condition of funding where appropriate to protect their interest in grant funds.

130. The responsible entity could be a trustee, a designated government unit, the grantor agency or any other interested creditor. See *supra* notes 101-02. To insure notice to the responsible entity, substitution should occur upon motion of either party.

Continuing litigation should be limited to claims against the trustees, judicial review of the claims procedure and general challenges to the closedown. Litigation against the trustee and judicial review of the claims procedure should be limited to the liquidation period, i.e., until the final distribution of assets. After that time, litigation should be permitted only against the grantor agencies or other creditors receiving the defunct agency's assets. See *infra* notes 134-53 and accompanying text discussing trustee and claims procedures.

131. A defunct corporation usually has an interest in preserving assets for the benefit of its shareholders and, in many cases, the officers or directors. A defunct public or nonprofit agency whose funding has been involuntarily revoked may have little incentive to protect federal grant funds. Even if default judgments are avoided, half-hearted defenses may be unavoidable, and collusion with the claimants, particularly where they are former colleagues or clients, is possible.

132. Federal grant funds are made for specific periods with the grantee losing all authority to expend or "obligate" remaining funds at the end of the grant period. The unobligated

public agencies tend to be less complex than those of corporations and there is no reason to prolong the legal life of the grantee pending the outcome of what may be protracted litigation.<sup>133</sup>

2. *Designation of the entity to conduct the closedown.* The presence of a person or entity ready to take charge of the agency's affairs on the date of termination is essential to the efficient dissolution of any agency. Where the agency has been terminated because of corruption or mismanagement, speed may be essential to prevent the further dissipation of assets. Even where termination is the result of a routine funding cutback, an entity authorized to act on the date of termination is necessary for the smooth operation of the closedown.<sup>134</sup>

The entities with the greatest interest in the preservation of assets are the grantor agencies which have a reversionary interest in the funds and the state and local units in which the agency is organized. Although the Economic Opportunity Act of 1964 required the creation of CAAs under state law,<sup>135</sup> federal regulations could limit grant awards to entities with a designated trustee or liquidator responsible for the dissolution of the grantee.<sup>136</sup> Such a designation should be made at the time the grantee is created and no later than the date of the grant award. The designation should define

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funds revert to the grantor. *See, e.g.*, 45 C.F.R. §§ 74.111(b), 1050.112(b), and 1067.5 app. A.3 (1979). *See generally* OMB Circular A-110, 41 Fed. Reg. 32,015 (1976).

133. Corporate reorganizations in the Southern District of New York, for example, take an average of eight years to resolve. Even GLACAA's tangled affairs should be resolved substantially within three years, and the dissolution of other agencies should take far less time. Rather than extending the legal life of the agency, revised regulations should permit litigation to continue only against the responsible parties with specific assets reserved to cover appropriate liabilities.

134. A legal gap in authority between termination and the assumption of authority by the liquidator invites default and confusion. Even if there is no legal gap, a practical gap between termination and the time the liquidator can effectively assume control permits the dissipation of assets and a fragmentation of authority that may be difficult to correct. In GLACAA's case, final judgments were entered and writs of execution levied in the first few months after GLACAA's termination, a period in which GLACAA had no effective legal representation. *See supra* note 17.

135. 42 U.S.C. § 2790(a) (1976), *repealed by*, Act of Aug. 13, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981).

136. CSA regulations required that the entities effecting termination of a CAA prepare a closedown plan, but did not require any single entity to assume responsibility once termination occurred. *See* 45 C.F.R. § 1062.200, app. B.8 (1979). In GLACAA's case, the City of Los Angeles was supposed to act as liquidator, but when the city failed to formalize the arrangement, there was no way to define or enforce the city's responsibilities. *See supra* notes 23-24 and accompanying text. Federal regulations should require designation of a single governmental entity responsible for the closedown and define its responsibilities in advance of termination. While other federal grantors do not always have the same relationship with their grantees as CSA did with GLACAA, they could limit funding to organizations with effective liquidation procedures.



the obligations and authority of the liquidator,<sup>137</sup> its capacity to sue and be sued in the name of the defunct agency,<sup>138</sup> and its liability for the defunct agency's affairs.<sup>139</sup> The liquidator should automatically assume such responsibility on the effective date of termination.

Where the grantee's assets consist largely of federal funds, and/or where there is evidence of fraud and/or widespread mismanagement, the federal grantor may wish to retain authority to act as liquidator.<sup>140</sup> In either case, the grantor should require approval of a closedown plan before termination of a grantee.<sup>141</sup>

3. *Establishment of a claims procedure.* Federal regulations<sup>142</sup> should also establish a claims procedure for distributing the defunct grantee's remaining assets and resolving its liabilities. With litigation against the defunct grantee abated, closedown procedures could require claims to be filed administratively.<sup>143</sup> The liquidator would then allow or disallow the claims,<sup>144</sup> and the allowed claims would be divided into three groups: (1) authorized obligations,<sup>145</sup> (2) unauthorized obligations,<sup>146</sup> and (3) the

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137. The liquidator should take possession of the grantee's assets and records and assume the right to assert the grantee's claims and defenses, and to initiate suit either to recover the assets of the defunct agency or to reopen judgments and otherwise contest prior orders.

138. *See supra* note 137 and proposed limits on litigation *supra* note 130. *Cf.* 11 U.S.C. § 323 (Supp. IV 1980).

139. Liability should be clearly limited to the defunct agency's remaining assets with the liquidator responsible only for its conduct of the closedown. *Cf.* 11 U.S.C. § 233 (Supp. IV 1980) (requiring the posting of a bond, exempting the trustee in bankruptcy from the debtor's liability and imposing a two-year statute of limitations on suits against the trustee).

140. For example, the grantor agency might retain authority to act as liquidator upon notice to the designated liquidator 30 days before termination if the grantor claims 75% of the defunct agency's assets, *or* if it claims 40% and there is evidence of fraud and/or widespread mismanagement, *or* in any case in which the designated liquidator consents.

141. *Cf.* 45 C.F.R. § 1062.200 (1979).

142. The regulations should be federal rather than state to the extent they would govern federal claims to unexpended grant funds.

143. The grantee should be required to list any known creditors at the time of termination, and notice should be provided both specifically to those creditors and generally through newspaper announcements. *Cf.* 11 U.S.C. §§ 501-502, 521 (Supp. IV 1980). Claimants would be required to file claims within a prescribed period not to exceed six months. *Cf.* Rule 302(e), Rules of Bankruptcy Procedure. Failure to file such claims would bar any right of action arising from the claim against the estate, the liquidator, or the grantor agency.

144. The liquidator could not look behind final judgments, but he could seek to reopen them and to pursue any other remedies that would normally be available to the defunct agency.

A method should also be devised for determining contingent and unliquidated claims. Either the liquidator could determine the amount or he could set aside an appropriate amount in accordance with the priority of the claimant until the amount is resolved in another forum. *Cf.* 11 U.S.C. § 502(c) (Supp. IV 1980).

145. "Authorized obligations" would include any obligation incurred before termination

claims of the grantor agencies.<sup>147</sup> Authorized obligations would be satisfied first in accordance with the priorities otherwise established by law.<sup>148</sup> Unauthorized obligations would then be charged against the particular grant from which they would be paid<sup>149</sup> with the grantor agency allowing or disallowing the obligation. Disallowed obligations could be recovered against any existing general assets of the grantee.<sup>150</sup> Disappointed claimants could challenge the disallowance by the liquidator or the grantor agency as arbitrary and capricious.<sup>151</sup> At the conclusion of the claims process, the liquidator should distribute any remaining assets to the appropriate claimants<sup>152</sup> and file a certificate of liquidation completing the closedown and providing for the disposition of any future recovery of assets.<sup>153</sup>

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and provided for by a specific grant. For example, GLACAA employee salaries were authorized obligations to the extent the CSA grant authorized the particular positions at the salary claimed.

146. "Unauthorized obligations" would include any obligations of the grantee not provided for by a particular grant. *E.g.*, the discharged employees' judgments, while obligations of GLACAA, were not provided for in any of the grants awarded GLACAA since the funds awarded for employee salaries had already been spent. Obligations incurred after expiration of the grant are by definition unauthorized. *See supra* note 123. The liquidator's expenses should be handled separately from an additional grant, if necessary, or from a portion of the defunct agency's assets reserved for that purpose. *Cf.* 11 U.S.C. § 507(a)(1) (Supp. IV 1980) (granting the highest priority to satisfaction of the administrative expenses incurred in bankruptcy).

147. The claims of the grantor agencies would include their reversionary interest in unexpended or unobligated grant funds, *see supra* note 132, and claims arising from disallowed expenditures under prior grants. *See generally* OMB Circular A-110, 41 Fed. Reg. 32,015 (1976).

148. *See, e.g.*, 11 U.S.C. §§ 507, 726 (Supp. IV 1980).

149. *E.g.*, the discharged employees' judgments against GLACAA would be charged against the CSA grant because CSA funded the positions from which they were discharged as well as GLACAA central administration. The HHS grant, in contrast, funded only Headstart related activities.

150. The grantor agency is in effect a secured creditor, holding a lien in unexpended grant funds sufficient to defeat the interest of any other creditor.

151. Judicial review would be limited to the type of review of final agency actions provided by the Administrative Procedure Act, 5 U.S.C. § 702 (1976). Any such action against the liquidator, however, should abate at the time the certificate of liquidation is filed although the claimant might still proceed against the grantor agency.

152. Dispersals to satisfy authorized obligations or other uncontested claims could be made before final liquidation subject to the availability of assets.

153. GLACAA could, for example, eventually recover \$400,000 deposited in a trust fund. *See supra* note 56. The certificate of liquidation should provide that such funds would be paid to CSA if CSA were deemed the appropriate claimant. A general right of recovery should also be assigned to the claimant given highest priority to returning unsecured assets.

The effect of the certificate of liquidation would be to discharge all liability for the defunct agency's affairs. Any party wishing to contest the provision for future disposition of assets

### III. THE FEDERAL INTEREST IN GRANT FUNDS

Whatever method is adopted for liquidating federally funded agencies, determination of the priority of federal claims, both before and after termination, requires a thorough examination of the nature of the federal interest in grant funds. A growing body of law holds that the federal nature of grant funds is "immutable,"<sup>154</sup> that the grantor agency retains a substantial interest in grant funds in the possession of a grantee,<sup>155</sup> and that such funds cannot be used for any purpose other than those specified in the grant.<sup>156</sup> The implication of these rulings, if carried to its logical conclusion, is to render entities like GLACAA judgment proof.<sup>157</sup> At the same time, grantor agencies often have difficulty protecting their interest in the funds because of judicial reluctance to deny judgment creditors a remedy.<sup>158</sup> Federal agencies have an obligation to review the results of these rulings and to define clearly the remedies available to those wronged by publicly funded agencies.

#### A. *The Regulatory Structure*

The federal interest in grant funds is defined by the regulatory scheme under which they are administered. While regulations vary from agency to agency, virtually all provide that grants are to be awarded for specific purposes, over a limited period of time, with a reversionary interest in the

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should be required to do so at the time the certificate is filed. *Cf.* 11 U.S.C. § 727 (Supp. IV 1980).

154. *National Ass'n of Farmworker Orgs. v. Marshall*, 628 F.2d 23, 26 (D.C. Cir. 1979).

155. *Id.* See also *United States v. Maxwell*, 588 F.2d 568 (7th Cir. 1978).

156. See, e.g., 45 C.F.R. § 1050.61(a)(3) (1981). The grantees, however remain independent, nonfederal entities whatever the character of their assets. See *United States v. Orleans*, 425 U.S. 807 (1976); Mason, *Current Trends in Federal Grant Law—Fiscal Year 1976*, 35 FED. BAR J. 163, 180-81 (1976).

157. Although most programs require a nonfederal share, the non-federal share may be insufficient to cover the liabilities of the grantee or it may be protected by regulations restricting use of the non-federal funds. A major part of GLACAA's non-federal share consisted of funds under the Comprehensive Education and Training Act (CETA), originally awarded by the Department of Labor to the County of Los Angeles, and from the county to GLACAA. See *Closedown Plan*, at app. 3, *Abelson v. Olivarez*, No. 78-4665 (C.D. Cal. filed Dec. 8, 1978).

158. In *United States v. Block*, No. 79-04487 (C.D. Cal. Nov. 19, 1979), for example, the court denied the government's motion for a preliminary injunction without discussing the federal nature of the funds after the court had made clear on numerous occasions that it felt the government's position was inequitable. See also *infra* note 195. Similarly, the court in *Flint v. Point Coupee Community Advancement, Inc.*, No. 77-193 (M.D. La. July 30, 1979) rejected the government intervenor's claim on the basis of a factual finding that the grantor agencies failed to sustain their burden of tracing the attached funds to federal grants without reference to the underlying legal issue.

United States.<sup>159</sup> For convenience, only CSA regulations will be discussed at length.

CSA awarded funds to community action agencies as part of the effort "to eliminate the paradox of poverty in the midst of plenty . . . ." <sup>160</sup> Congress authorized the director of CSA to "provide financial assistance to community action agencies for the planning, conduct, administration and evaluation of community action programs and components."<sup>161</sup>

As a condition of funding, CAAs were required to establish an accounting system with internal controls to provide reliable data, "safeguard their assets," and "promote operating efficiency and encourage compliance with prescribed management policies . . . ." <sup>162</sup> CSA regulations further required grantees to "safeguard all such assets and . . . assure that they are used solely for authorized purposes."<sup>163</sup> Authorized purposes are specified in the grant award.

In applying for a grant, the CAA was required to submit a detailed budget for approval.<sup>164</sup> The Grant Statement announcing the award approved the proposed program, obligated the grant funds, specified the grant terms, and incorporated the general conditions which apply to all grants.<sup>165</sup> The general conditions limited expenditures, providing that:

Expenses charged against program funds may not be incurred

159. The Office of Management and Budget promulgates general guidelines as part of its regulations. See OMB Circular A-110, 41 Fed. Reg. 32,015 (1976) (establishing uniform administrative requirements governing grants to institutions of higher education, hospitals and other nonprofit organizations). Such grants exceed 18 billion dollars a year. See Mason, *supra* note 156, at 164; Wallick and Montalto, *How Naked at the Day of Judgment: Improving the Remedies Systems for Grant-Type Assistance*, 10 PUB. CONT. L.J. 177, 182 n.12 (1978).

160. 42 U.S.C. § 2701 (Supp. IV 1980), *repealed by* Act of Aug. 12, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981).

161. *Id.* § 2808(a) (Supp. IV 1980), *repealed by* Act of Aug. 12, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981).

162. *Id.* § 2835(a) (1976) *repealed by* Act of Aug. 12, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981).

163. 45 C.F.R. § 1050.61(a)(3) (1981). "The acceptance of a grant fund from the United States creates a legal duty on the part of the grantee to use the funds or property made available in accordance with the conditions of the grant." See *King v. Smith*, 392 U.S. 309 (1968); *Williford v. Laupheimer*, 311 F. Supp. 720 (E.D. Pa. 1969). See also 45 C.F.R. § 1050.10 (1981) (requiring grant funds to be segregated from other funds); 45 C.F.R. § 1050.15-.17 (1981) (requiring nongovernmental grantees to be insured and bonded); OMB Circular A-110, attachment B, 41 Fed. Reg. 32,015, 32,016 (1976).

164. See 45 C.F.R. § 1067.40 (1981). See also OMB Circular A-110, attachment M, 41 Fed. Reg. 32,015, 32,030 (1976).

165. See CSA Instruction 6710-1. The general conditions are set forth at 45 C.F.R. § 1067.5 (1981).

prior to the effective date of the grant or subsequent to the termination date unless written prior approval has been received from the CSA funding official and may be incurred only as necessary to carry out the purposes and activities of the approved program. . . . Expenses charged against program funds must also be incurred in accordance with CSA directives.<sup>166</sup>

At the end of the grant period, CAAs lost all authority to obligate the funds and any remaining funds reverted to CSA.<sup>167</sup>

In addition to limiting the purposes and duration of the grant, CSA exercised continuing supervision after the award had been made. The statute required annual audits with a provision for the recovery of "disallowed" costs.<sup>168</sup> CSA directives further required that "the grantee and its delegate agencies shall submit financial program progress, evaluation, and other reports as required by CSA directives, and shall maintain such property, personnel, financial and other records and accounts as are deemed necessary by CSA to assure proper accounting for all program funds."<sup>169</sup> CSA also reserved the right to suspend or terminate the grant for cause,<sup>170</sup> to super-

166. 45 C.F.R. § 1067.5 app. A, ¶ 3 (1981).

167. *Id.* See also 45 C.F.R. § 1050.112(b) (1981).

168. 42 U.S.C. § 2835(c) (Supp. IV 1980), *repealed by* Act of Aug. 13, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981). See also 45 C.F.R. § 1068.42 (1981). The Act further provided that costs disallowed by the audits may be recovered "by appropriate means, including court action or a commensurate increase in the required non-Federal share" if the grant continued in effect. 42 U.S.C. § 2835(c) (Supp. IV 1980).

169. 45 C.F.R. § 1067.5, app. A, ¶ 12 (1981). See also OMB Circular A-110, attachments C, G & H, 41 Fed. Reg. 32,015, 32,017, 32,018, 32,029 (1976); Mason, *supra* note 156, at 176 n.79. Grantees were required to maintain and retain financial records, 45 C.F.R. §§ 1050.21-.23 (1981), grant access by authorized federal officials, *id.* § 1050.25, maintain a financial reporting system, *id.* §§ 1050.70-.73 and monitor and report program performance. *Id.* § 1050.80-1 to .80-3.

The regulations also provided extensive controls on property purchased with grant funds, 45 C.F.R. §§ 1971.1-.91 (1979), with the grantor agency retaining a property interest in real and personal property as well as grant funds. See also OMB Circular A-110, attachment N, 41 Fed. Reg. 32,015, 32,035 (1976). *Cf.* 42 U.S.C. § 2982c(b) (Supp. IV 1980), *repealed by* Act of Aug. 13, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981) providing that:

[p]roperty acquired as a result of capital investments made by any community development corporation with funds granted as its Federal share of the cost of programs carried out under this subchapter, and the proceeds from such property, shall become the property of the community development corporation and shall not be considered to be Federal property. The Federal Government retains the right to direct that on severance of the grant relationship the assets purchased with grant funds shall continue to be used for the original purpose for which they were granted.

170. 45 C.F.R. § 1067.5 app. A, ¶ 14 (1981). See also OMB Circular A-110, attachment

wise closeout and termination procedures,<sup>171</sup> and to recover any remaining grant funds.<sup>172</sup>

### B. Legal Developments

A growing body of case law holds that the continuing supervision and control exercised by grantor agencies gives rise to a property interest in grant funds in favor of the United States. The United States Court of Appeals for the District of Columbia Circuit discussed the nature of the federal interest in a series of cases holding that attorneys' fees could not be paid from grant funds.<sup>173</sup> In *National Council of Community Mental Health Centers v. Weinberger*,<sup>174</sup> plaintiffs prevailed on behalf of a nationwide class contesting the impoundment of funds for community mental health centers. The district court later awarded attorneys' fees from unexpended grant funds.<sup>175</sup> The court of appeals reversed in *National Council of Community Mental Health Centers v. Matthews*,<sup>176</sup> holding:

[t]he manner of disposition of these unexpended funds is conclusive evidence of their true ownership. As noted previously, these unexpended funds are one factor taken into account in determining the amount of future grants which each grantee will receive. These funds do not remain at the grantee's disposal if they have not been "expended" by the end of the fiscal year. It is only through a subsequent continuation grant approved by HEW that a grantee can again reach these unexpended funds which it failed to use the previous year. These unexpended funds are thus in the

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L, 41 Fed. Reg. 32,015, 32,030 (1976); 45 C.F.R. §§ 1050.115-1 to .115-8 (1981). *But see* Mason, *supra* note 156, at 178.

171. 45 C.F.R. §§ 1050.115-1 to .115-8. *See also* OMB Circular A-110, attachment K, 41 Fed. Reg. 32,015, 32,030 (1976).

172. 45 C.F.R. § 1050.112(b) (1981).

173. At the time these cases were decided, 28 U.S.C. § 2412 (1976) provided:

Except as otherwise specifically provided by statute, a judgment for costs, as enumerated in section 1920 of this title but not including the fees and expenses of the attorneys may be awarded to the prevailing party in any civil action brought by or against the United States or any agency or any official of the United States acting in his official capacity, in any court having jurisdiction of such action.

Accordingly, attorneys' fees could not be awarded against the United States or its agencies or from federal funds unless specifically authorized by statute. *See National Council of Community Mental Health Centers v. Matthews*, 546 F.2d 1003, 1006-07 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977). The statute has since been amended to permit attorneys' fees awards against the United States. *See Equal Access to Justice Act*, Pub. L. No. 96-481, § 204(a), 94 Stat. 2327 (1980) (codified at 28 U.S.C. § 2412 (Supp. IV 1980)).

174. 361 F. Supp. 897 (D.D.C. 1973).

175. *National Council of Community Mental Health Centers, Inc. v. Weinberger*, 387 F. Supp. 991 (D.D.C. 1974).

176. 546 F.2d 1003 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

safekeeping of the public treasury until their use is once again authorized. . . . An award of attorney's fees from these funds therefore would be an award against the United States and contrary to 28 U.S.C. § 2412, unless another statute specifically authorizes this award.<sup>177</sup>

To circumvent the ruling, plaintiffs in a subsequent impoundment case, *National Association of Farmworker Organizations v. Marshall*, suggested that the government dispense 99.5% of the impounded funds to the grantees and release the withheld .5% as payment of attorneys' fees after the grantees had spent the money.<sup>178</sup> Plaintiff's argued that once the grantee had spent the funds and reversion to the Treasury was impossible, the funds lost their federal character. The court of appeals emphatically rejected this argument, holding:

[W]e underscored the reversion of unexpended funds to illustrate that grant money is federal, hence incapable of use for payment of attorneys' fees under § 2412 . . . . Federal grant money does not lose its federal character. The .5% which plaintiffs desire continues to be United States money.

This common sense characterization is bolstered by the government's pinpointing of factors further evidencing the immutable federal nature of the grant funds at issue here. The congressional purpose of the funds is to alleviate unemployment among migrant and seasonal farmworkers. In order to ensure the effectuation of this purpose, the Secretary has continuing control over the funds, even while they are in the grantee's hands, and can audit the grantee's accounts or recall the funds. In *Community* we emphasized similarly clear federal purposes and control in rejecting plaintiffs' counsel's application for attorneys' fees.<sup>179</sup>

While the District of Columbia Circuit relied on the award of grant funds to promote specific statutorily defined purposes, the continuing supervision and control of the grantor agency, and the government's reversionary interest in such funds, the court emphasized that no element in the formula was indispensable, that "[w]hether unexpended funds revert to the Treasury or to the farmworkers program, or whether they are fully spent, these funds cannot shed their federal character."<sup>180</sup>

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177. 546 F.2d at 1007 (citations omitted). See also *National Ass'n of Regional Medical Programs, Inc. v. Matthews*, 551 F.2d 340 (D.C. Cir. 1976), cert. denied, 431 U.S. 954 (1977) (reversing district court ruling that the Secretary of HEW was a "mere stakeholder" of grant funds obligated to the grantee).

178. *National Ass'n of Farmworker Orgs. v. Marshall*, 628 F.2d 23 (D.C. Cir. 1979).

179. *Id.* at 26.

180. *Id.* See also *American Ass'n of Marriage & Family Counselors, Inc. v. Brown*, 440

The Fifth Circuit relied on a different theory to reach the same result. In *Henry v. First National Bank*,<sup>181</sup> white Mississippi businessmen, seeking to recover damages arising from a civil rights boycott caused writs of attachment to be issued against the bank accounts of Mississippi Action for Progress (MAP), a nonprofit corporation whose assets consisted almost entirely of Headstart funds.<sup>182</sup> The businessmen prevailed in state court,<sup>183</sup> and judgments under Mississippi law are immediately executory.<sup>184</sup> After the state court refused to grant a stay without bond pending appeal,<sup>185</sup> the state court defendants together with the United States as intervenor<sup>186</sup> applied to the federal court for a preliminary injunction.

The court granted the injunction, and the Fifth Circuit affirmed, both finding that the United States had an equitable lien against grant funds held by MAP. The Fifth Circuit explained that criteria for the lien were met because the United States retained a reversionary interest in the funds which is triggered when funds are used for purposes other than those delineated in the grant.<sup>187</sup> The court added that the "equitable as well as the

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F. Supp. 1114 (D.D.C. 1977). *Cf.* *United States v. Farmers State Bank*, 249 F. Supp. 579 (D.S.D. 1966).

The court distinguished *National Treasury Employees Union v. Nixon*, 521 F.2d 317 (D.C. Cir. 1975), which permitted the payment of attorneys' fees from employees' salaries in the possession of the United States on the grounds that the government had no continuing interest in such salaries once they were paid to the employees, while the United States retained continuing interest and control over grant funds in the hands of the grantee.

181. 595 F.2d 291 (5th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980).

182. *See* 42 U.S.C. §§ 2928a-n (1976). The court in *Henry* ruled that virtually all of MAP's assets derived from Headstart grants. 595 F.2d at 308. The writs were issued by the Mississippi Chancery Court, the court in which the damage actions were pending. *See* MISS. CODE ANN. § 11-21-77 (1972).

183. *Claiborne Hardware, Inc. v. NAACP*, No. 78-353 (Miss. Ch. Ct. Aug. 9, 1976).

184. MISS. CODE ANN. § 11-51-31 (Supp. 1982).

185. *See Henry*, 595 F.2d at 296.

186. The United States intervened on the ground, *inter alia*, that it:

claimed a full and complete equitable lien interest in all of MAP's funds and property derived from federal grants made exclusively to it for the purpose of operating the Headstart Program in Mississippi. The United States argued that no property interest of the United States can be subjected to judicial process without its consent and that injunctive relief was necessary to prevent the impending loss of United States property in MAP's hands to the state court plaintiffs.

*Id.* at 297.

187. *Id.* at 308-09. The essential elements of an equitable lien are "(1) a debt, duty or obligation owing by one person to another . . . and (2) a res to which that obligation fastens, which can be identified or described with reasonable certainty." *Avco Delta Corp. Canada Ltd. v. United States*, 484 F.2d 692, 703 (7th Cir. 1973), *cert. denied*, 415 U.S. 931 (1974). An equitable lien "may be created by express contract which shows an intention to charge some particular property with a debt or obligation, or it may arise by implication from the relations and dealing of the parties whose interests are involved." *Morrison Flying Servs. v. National Bank*, 404 F.2d 856, 861 (6th Cir. 1968), *cert. denied*, 393 U.S. 1020 (1969). *Accord*



legal property interests of the United States enjoy immunity from unconsented judicial process,"<sup>188</sup> and upheld the preliminary injunction enjoining state process.

Relying on similar theories, other courts also have ruled that the theft of grant funds is a federal crime. In *United States v. Maxwell*,<sup>189</sup> the Seventh Circuit explained that the grantee "held the funds as a trustee, the United States retained a beneficial interest in them, and this was sufficient to bring them within the phrase 'money, or thing of value of the United States.'" <sup>190</sup> Similarly, the Ninth Circuit in *United States v. Johnson*,<sup>191</sup> held that the continuing supervision and control of the grantor agency gave rise to a federal property interest whether or not the funds reverted to the United States.

Virtually all grants are awarded for specific purposes, subject to the continuing supervision and control of the grantor agency, with a reversionary interest in the United States.<sup>192</sup> Under the doctrine described above, the conclusion that such statutes and regulations give rise to a federal property interest is inescapable,<sup>193</sup> and federal property interests are by definition

*Citizens Co-op Gin v. United States*, 427 F.2d 692, 695 (5th Cir. 1979); *Caldwell v. Armstrong*, 342 F.2d 485, 490 (10th Cir. 1956).

188. 595 F.2d at 309. See *Black Constr. Co. v. American Vocational Ass'n*, 419 F.2d 308 (D.C. Cir. 1969).

189. 588 F.2d 568 (7th Cir. 1978).

190. *Id.* at 572. 18 U.S.C. § 641 (1976) makes it a federal offense to steal, purloin or otherwise convert "money, or a thing of value of the United States." Eighty-eight and four tenths percent of the stolen funds had originated from HEW grants. The court noted that the authorizing statute referred to the "financial interest of the United States," 20 U.S.C. § 1070b-2(b)(6) (1976), and concluded that HEW had sought to protect that interest in its agreement with the grantee and in the regulations by which it retained a reversionary interest in the funds. 588 F.2d at 572.

191. 596 F.2d 842 (9th Cir. 1979). The funds involved had been transferred from the Department of Housing and Urban Development (HUD) to a public agency of the City and County of San Francisco.

192. See OMB Circular A-110, 41 Fed. Reg. 32,015 (1976). Moreover, some grantor agencies rely on contractual agreements with the grantee to safeguard their interest in grant funds. HUD, for example, awards funds to housing authorities subject to a Declaration of Trust executed and recorded by the housing authority, which provides that the authority holds the project and all property associated with it in trust for the benefit of the government and the holders of the bonds. See *Union Bank v. Rosien*, No. 67-1332-R (C.D. Cal. Dec. 12, 1969) (barring levy to satisfy back pay claims against such funds). See also *New Jersey v. Housing Auth.*, No. 1206-70 (D.N.J. 1972).

193. The sole adverse decision to discuss the merits was reversed on appeal. In the Los Angeles Superior Court judgment in *Phillips v. GLACAA*, No. C 263723 (L.A. Super. Ct. Mar. 16, 1979), the minute order demonstrates that the court failed to comprehend the nature of the grant relationship. The court held:

The United States claims that because in its judgment the expenditures to pay the various judgments are for obligations in breach of its contract with GLACAA . . . the funds are not 'obligated.' This cannot be; GLACAA is the 'owner' of the

protected by sovereign immunity. The courts have yet to discuss when the grantor agencies can be deemed to have waived immunity, but as a general matter, waivers of sovereign immunity must be explicit and narrowly construed.<sup>194</sup> Under existing regulations, few exist.<sup>195</sup> The courts have also failed to address the parameters of sovereign immunity to determine whether the federal interest diminishes at any point during which the funds remain in the possession of the grantee.<sup>196</sup> Congress and the federal agencies have been similarly silent, yet this issue raises potentially far-reaching implications for the administration of federal grants.<sup>197</sup>

### C. Implications

Recognition of the federal interest in grant funds, carried to its logical conclusion, could render federally funded entities judgment proof. There are many organizations like GLACAA and MAP whose primary if not

funds, and the execution liens are 'obligations' against the funds. If GLACAA is in breach of its contract with the U.S., the funds are nevertheless 'obligated' and the U.S. will have to look elsewhere for its recovery.

*Id.* The breach of contract language the court employed was inappropriate to the grant relationship, and the court's conclusion that "GLACAA is the 'owner' of the funds" ignored the substantial body of law noted above. *See* National Ass'n of Farmworker Orgs. v. Marshall, 628 F.2d 23 (D.C. Cir. 1979) (describing the government as the "owner" of grant funds). Moreover, the *Phillips* court confused the question of what is necessary to "obligate" GLACAA under state law with the question of what is necessary to "obligate" grant funds under federal law. *See* OMB Circular A-110, attachment K.3.b., 41 Fed. Reg. 32,015, 32030 (1976), and 45 C.F.R. § 1050.112(b) (1981). The California Court of Appeals reversed on the ground that reversion of the funds to CSA barred any subsequent levy against the funds. The court did not reach the rest of the government's argument because it had not been raised below. *See supra* note 68.

194. *Santa Clara Pueblo v. Martinez*, 436 U.S. 49, 58 (1978); *United States v. Testan*, 424 U.S. 392, 400 (1976). The award of funds for a particular purpose does not in itself waive immunity from state process, even process designed to effectuate that purpose. *Cf. infra* note 196.

195. Few federal regulations explicitly permit grant funds to be subject to judicial process against the grantee. An exception is 45 C.F.R. § 101.30-4 (1981) (permitting use of CSA grant funds to satisfy back pay awards in discrimination cases).

196. The federal character of grant funds is largely an all or nothing proposition. Either the funds are federal, and therefore protected by sovereign immunity, or they are not. The exceptions are those specifically provided by statute or regulation, *see, e.g.*, 42 U.S.C. § 2982c(b) (Supp. IV 1980), *repealed by* Act of Aug. 13, 1981, Pub. L. No. 97-35, § 683(a), 95 Stat. 519 (codified at 42 U.S.C.A. § 9912(a) (West 1981)) (effective Oct. 1, 1981), and those where the interests of the grantor and the judgment creditor are identical. For example, a federal agency presumably could not intervene to prevent satisfaction of an obligation authorized by the grant because the interests of the creditor and the federal agency would be identical, and therefore there could be no federal interest served by intervention. *But see supra* note 194.

197. The Supreme Court has yet to consider the matter, however, and while it is difficult to distinguish or limit the cases described above, reversal is possible.

exclusive source of assets is federal grant funds. Damages are rarely assessed against such organizations for activities authorized and approved by the grantor agencies, and grant applications rarely include satisfaction of damage judgments in the proposed budget. Accordingly, the grantor agencies, under the holdings described above, could seek to block virtually every significant levy against these organizations as unconsented judicial process against federal property.

In practice, the results have not been so harsh. The grantor agencies have not sought to intervene in every case in which they might theoretically block such levies.<sup>198</sup> Even where the United States has intervened, courts are often reluctant to leave the judgment creditor without a remedy despite the apparent requirements of prior holdings.<sup>199</sup> Further, regulations usually require grantees to carry some form of insurance covering the most common damage actions.<sup>200</sup>

Nevertheless, there is no guarantee that insurance will cover every award,<sup>201</sup> and the United States can and has intervened.<sup>202</sup> So long as

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198. The grantor agencies have two possible means of recovery: intervening to block the levy or permitting the levy, "disallowing" the cost, and then seeking recovery from the grantee. *See supra* note 168. The grantor agencies often choose not to intervene either because the amounts are de minimis or because they are notified after the levy occurs. In other cases, the failure to intervene is the result of deliberate policy. *See, e.g.*, 45 C.F.R. § 1010.30-4 (1981) (permitting use of CSA funds to satisfy back pay claims in discrimination cases). HHS regulations define "unallowable" costs to include costs "resulting from violations of, or failure of the institution to comply with Federal, State and local laws and regulations and costs for liabilities to third persons not compensated by insurance or otherwise." 45 C.F.R. § 74, app. C, pt. D, ¶ 5 (1978). HHS policy, however, at least as expressed in *Flint v. Point Coupee Community Advancement, Inc.*, No. 77-193 (M.D. La. July 30, 1979), is to disallow the costs, but permit the levies where the judgment is related to the HHS program, (e.g., back pay awards for HHS funded positions) and to intervene to protect HHS funds where the levies are unrelated to the program (e.g., back pay awards for CSA funded positions).

199. *See supra* note 158.

200. *See, e.g.*, OMB Circular A-110, attachment B, 41 Fed. Reg. 32,015, 32,016 (1976); 45 C.F.R. § 1050.15-71 (1980); 45 C.F.R. § 74, app. C, part II, ¶ C (1978). HHS Headstart regulations provide that: "Actual losses which could have been covered by permissible insurance . . . are unallowable unless expressly provided for in the grant agreement." *Id.* ¶ C(4)(d). The most common insurance policies are those covering tort liability, e.g., damages arising from an automobile accident involving a vehicle driven by a grantee's employee in the course of business.

201. GLACAA carried at least three insurance policies covering contractual as well as tort liability, but it never reported the claims of the discharged employees. By the time the contract administrator brought the matter to the attention of the insurance carriers, the period for reporting such claims had expired and the carriers declined to provide coverage. *See* Letter from Michael J. Donohoe to Chapman and Associates Insurance Agency, insurer for GLACAA (Nov. 2, 1979).

202. *See Henry v. First Nat'l Bank*, 595 F.2d 291 (5th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980); *Flint v. Point Coupee Community Advancement, Inc.*, C.A. No. 77-193 (M.D.

federal funds constitute the grantee's sole assets, the dilemma presented is a cruel one: the more deplorable the acts of the grantee, the more the victim deserves to be compensated and the less justification there is for using federal funds to do so.<sup>203</sup>

The grantor agencies have yet to acknowledge that a dilemma exists. Federal regulations are largely silent on the matter,<sup>204</sup> and policy guidelines virtually nonexistent.<sup>205</sup> The grantor agencies have responded on a case-by-case basis, intervening haphazardly to block substantial judgments only when execution of the judgment is imminent.

Failure to address the issue systematically compounds the uncertainties and injustices inherent in the law. First, the grantor agencies' failure to draft appropriate regulations deprives those who deal with the grantee of notice at the same time it weakens the federal claims.<sup>206</sup> Second, federal intervention at the stage where execution is imminent may deprive plaintiffs of a remedy while foreclosing other avenues that may have been available earlier.<sup>207</sup> Third, the federal decision to intervene may vary without principle from case to case.<sup>208</sup> Satisfaction of judgments against federally funded agencies could become a complicated and expensive game of roulette.

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La. July 30, 1979); *United States v. Block*, No. 79-1359 (C.D. Cal. April 12, 1979); *United States v. Abelson*, No. 79-04487 (C.D. Cal. Mar. 19, 1979).

203. *See supra* notes 196, 198.

204. The exception appears to be 45 C.F.R. § 1010.30-4 (1980) and explicit trust arrangements such as those employed by HUD. *See supra* note 192. Grant regulations are drafted in terms of "allowable" and "disallowable" costs, not in terms of the propriety of unconsented levies against the funds. *See supra* note 198.

205. *But see* HHS policy, *supra* note 198.

206. The HUD trust arrangements, for example, are much clearer. *See supra* note 192. In cases brought without such specific provisions, success has been less predictable. *See supra* note 158.

207. *E.g.*, plaintiffs bringing a wrongful discharge action may have sought damages rather than injunctive relief or proceeded against the grantee rather than the responsible individuals in the mistaken belief that a judgment for damages could be satisfied.

The grantor agencies intervene after final judgment because, they argue, that the dispute between the plaintiff and the grantee does not concern them. *See United States v. Orleans*, 425 U.S. 807 (1976). It is only when liens are issued against federal funds that the interest of the grantor agencies becomes "ripe."

208. CSA did not intervene in the *Manos* and *Coats* cases solely because it learned of them too late to prevent execution of their judgments. *See supra* note 18. Moreover, while CSA claimed to have intervened in the GLACAA cases because it viewed the judgments as unreasonable, it has also intervened in cases where it did not dispute the amount of the judgments. *See, e.g.*, *Flint v. Point Coupee Community Advancement*, No. 77-193 (M.D. La. July 30, 1979).

#### D. Proposals

The competing interests are sharply drawn. On the one hand, federal agencies ought to be able to insure that federal funds are spent only for the purposes for which they have been appropriated, and that the illegal, unauthorized actions of grantees not be allowed to dissipate funds intended to serve the poor or to advance some other statutorily defined purpose. On the other hand, the victims of the grantees' illegal, unauthorized actions should not be without a remedy. Community action and similar publicly funded agencies exist only because of the availability of federal funding.<sup>209</sup> They act under the supervision and direction of the Federal Government,<sup>210</sup> and their major, if not only, source of property is federal grants.<sup>211</sup> The Federal Government cannot abdicate its responsibility for the liabilities of these agencies.

The doctrine of sovereign immunity developed to prevent the disruption of public activities inherent in unconsented levies against federal funds.<sup>212</sup> Yet, Congress has enacted comprehensive waivers of sovereign immunity to provide remedies for those injured in the course of governmental activities.<sup>213</sup> Congress passed these waivers both to promote fairness and equal treatment, and less altruistically, to encourage others to do business with the United States. The same considerations apply to federal grants, and grantor agencies ought to be willing to accept the same tradeoff: surrender of immunity in return for the ability to define the conditions of surrender. The alternative may be judicial emasculation of the doctrine.<sup>214</sup>

In reviewing the regulations which govern the expenditure of grant funds, the grantor agencies should, as an absolute minimum, define the circumstances under which they would and would not permit federal funds to be used to satisfy the liabilities of the grantee.<sup>215</sup> Doing so would remedy the inequities which stem from lack of notice and it would strengthen

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209. See *supra* note 9 (discussing the federal law requiring the establishing of CAAs).

210. See *supra* notes 173-97 and accompanying text.

211. Federal regulations even govern the percentage of required nonfederal funding. See, e.g., 45 C.F.R. §§ 1050.50, 1068.20-1 to .20-5 and OMB Circular A-110, attachment E, 41 Fed. Reg. 32,015, 32,017 (1976). See also *supra* note 182.

212. *E.g.*, *Larson v. Domestic & Foreign Corp.*, 337 U.S. 682, 704 (1949) ("[t]he Government, as a representative of the community as a whole, cannot be stopped in its tracks by any plaintiff who represents a disputed question of property or a contract right.")

213. See Contract Disputes Act of 1978, 41 U.S.C. §§ 601-613 (Supp. IV 1980) and the Federal Tort Claims Act, 28 U.S.C.A. §§ 2671-2680 (West 1965 & Supp. 1982). See also 28 U.S.C. §§ 1491-1505 (1976 & Supp. IV 1980) (as amended by Act of April 2, 1982, Pub. L. No. 97-164, 96 Stat. 39 (effective Oct. 1, 1982)) & 2401-2415 (1976 & Supp. IV 1980).

214. See *supra* note 197.

215. OMB should draft uniform grant regulations which could then be incorporated into agency regulations.

agency claims in individual cases.<sup>216</sup> New regulations should specify the classes of creditors and types of claims that would not be permitted to recover from grant funds,<sup>217</sup> require recording the federal interest in the grantee's assets wherever feasible,<sup>218</sup> and require the grantor agency to assert its interest before, not after, final judgment.<sup>219</sup>

In drawing the line between recoverable and unrecoverable claims,<sup>220</sup> the grantor agencies should go beyond existing law and permit grant funds to be used to satisfy claims arising from the operation of the funded program, whether or not the specific action was authorized or the expense budgeted. For example, if the grantor agency provides funds for the employee salaries and benefits necessary to administer a particular program, it should permit back pay awards from grant funds.<sup>221</sup> The grantor agency may require that the grantee's nonfederal assets be taken first; it may seek to recover any such awards from the grantee;<sup>222</sup> and it may wish to exclude recovery for punitive damages, attorneys' fees,<sup>223</sup> fines, penalties,<sup>224</sup> or amounts beyond those provided in the approved program for such activi-

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216. See *supra* notes 206-08.

217. The regulations should distinguish among unliquidated or unsecured claims, the claims of judgment creditors, and claims remaining upon the dissolution of the agency. As a general rule, grantees should deal with unliquidated or unsecured claims as they do under current law, with the proposed regulations primarily affecting levies by judgment creditors. The grantor agencies may wish to limit prejudgment attachments even if they permit post-judgment levies since the former may have a more disruptive effect on grant programs.

Treatment of claims remaining upon the dissolution of the grantee may differ depending on the grantor agency's degree of responsibility for the affairs of the grantee. Where the grantor agency provides only one of several sources of the grantee's assets and has no particular responsibility for the conduct of the grantee's affairs, (e.g., HUD grants to the City of New York) a creditor's right to recover from grant funds should be no greater upon insolvency or liquidation than otherwise. Where, as with CAAs, the grantor agency plays a major role in the creation, termination or overall management of the grantee, and particularly where the grantor promulgates regulations requiring the liquidation of the grantee's liabilities, see *supra* note 24, the grantor agency should permit greater use of grant funds to resolve the grantee's liabilities upon insolvency or liquidation.

218. Recording an interest in cash or in bank accounts would pose obvious difficulties, but the grantor agencies could record interests in property purchased with grant funds. See, e.g., U.C.C. § 9-401 (1978).

219. See *infra* notes 233-35.

220. "Recoverable" and "unrecoverable" are used to mean "recoverable" and "unrecoverable" against grant funds. A creditor's right of recovery against other assets of the grantee would be unaffected.

221. This is the policy HHS followed in *Flint v. Point Coupee Community Advancement, Inc.*, C.A. No. 77-193 (M.D. La. July 30, 1979). See *supra* note 198.

222. See *supra* note 198 (provisions for the recovery of disallowed costs).

223. Punitive damages and attorneys' fees are rarely permitted against federal agencies. *But see* 28 U.S.C. § 2412 (Supp. IV 1980).

224. The deterrent value of fines and penalties would be weakened if the grantee could simply pay such amounts from grant funds.

ties.<sup>225</sup> It should not, however, prevent compensation for actual injury.

With respect to tort actions, existing regulations require grantees to carry insurance,<sup>226</sup> and the grantor agency may wish to broaden coverage,<sup>227</sup> police the requirement more vigorously,<sup>228</sup> and require grantees to report on insurance provisions with notice of the lawsuit.<sup>229</sup> If the grantee is uninsured in violation of agency regulations, recovery against federal funds should still be permitted with sanctions against the grantee. The grantor may, however, wish to exclude recovery for certain intentional, willful or malicious torts, requiring plaintiffs to proceed against the responsible individuals.<sup>230</sup>

After defining clear areas where recovery against grant funds will be permitted, the grantor agency may wish to bar all recovery for actions clearly exceeding the grantee's authority<sup>231</sup> or unrelated to the grant program.<sup>232</sup> The grantor agency may still require the grantee to carry insurance to cover such liability, however, and may impose sanctions for incurring liability.

Wherever the line is drawn between recoverable and unrecoverable

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225. For example, the regulations could limit back pay awards to be satisfied from grant funds to the salary levels approved by the grantor agency for the positions at issue. The grantor agencies should not preclude recovery, however, because the money allotted for salaries had been spent and only other program funds remained. In the GLACAA cases, such a rule would have meant that the discharged employees could have recovered back pay from CSA funds, but the amount of back pay recoverable from grant funds would have been limited to the salaries and benefits CSA had approved for those positions. *See supra* notes 21-22. In drafting such regulations, the grantor agencies may also wish to adopt the provisions in 42 U.S.C. § 200e-16 (1976 & Supp. 1980) and similar legislation, limiting employment awards to back pay.

226. *See supra* note 200.

227. *Id.*

228. The grantor agencies should specify stricter penalties for the failure to carry insurance and require regular reports about the existence of coverage.

229. The grantee should report whether its insurance will cover the situation, and whether it has reported the lawsuit to the insurance carrier. In most cases, if the insurance carrier will cover damages, it will also defend the lawsuit.

230. *Cf.* the limitations on recovery under the Federal Tort Claims Act, 28 U.S.C.A. § 2680(h) (West 1965 & Supp. 1982) and the provision for suit against individuals in *Bivens v. Six Unknown Named Agents*, 403 U.S. 388 (1971).

231. The grantor should permit recovery of a claim arising from the discharge of an employee hired to work on the grant program, even though the grantee only had authority to hire ten employees, and the discharged employee was the eleventh. A claim arising from the discharge of an employee hired to bribe public officials, on the other hand, would be non-recoverable even if related to the grant program. The concept is similar to that of apparent authority under the law of agency. *See, e.g., Lux Art Van Service, Inc. v. Pollard*, 344 F.2d 883 (9th Cir.), *cert. denied*, 382 U.S. 837 (1965).

232. *See supra* note 198. The grantor agencies, however, should also consider setting a *de minimus* amount below which they will not interfere in the effort to enforce any judgment.

claims, the grantor agencies should be required to assert their interests before final judgment. Federal regulations should require the grantee to notify the grantor agency of any litigation which might affect grant funds,<sup>233</sup> and the grantor agency could then decide whether to intervene or otherwise assert its interest in the normal course of the lawsuit.<sup>234</sup> Any interest not asserted before final judgment should be barred.<sup>235</sup>

Regulations incorporating these proposals would still leave areas where recovery against the grantee would be uncertain, but those areas would be more closely in line with the provisions for recovery against federal agencies.<sup>236</sup> Moreover, potential plaintiffs would be on notice as to their chances of recovery and could proceed accordingly.

Failure to regulate the void created by the far-reaching decisions examining the federal interest in grant funds would invite closer judicial scrutiny. The courts have considered the federal interest only in the relatively favorable context of attorneys' fee awards and a million dollar judgment by white businesses against civil rights organizations.<sup>237</sup> The courts have yet to define the limits of that interest or the circumstances in which it can be waived. The courts in more mundane cases have already denied the United States relief while sidestepping the underlying legal issues.<sup>238</sup> Future courts, facing the spectre of federally created judgment proof entities, may restrict the doctrine even if they must stretch the limits of existing law to do so.<sup>239</sup> The grantor agencies have an opportunity to take advantage of favorable precedents to define the limits of liability that grant funds can

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233. Regulations might require that the grantee notify the grantor agency within 30 days of service of the complaint, with a report specifying the nature of the charges, the possibility of recovery against grant funds, an outline of the grantee's defenses, and the applicable insurance provisions.

234. See FED. R. CIV. P. 20 (intervention). The United States may also file, pursuant to 28 U.S.C. § 517 (1976), a "suggestion of interest" setting forth the interests of the United States without formal intervention.

The grantor agencies may wish to consider, however, reserving the option to defend the grantee, in the manner of an insurance carrier, where a successful claim would be recoverable against grant funds.

235. The regulations should be drafted so that sovereign immunity is waived with respect to any claim not asserted before final judgment. The grantor agency may wish to provide an exception, however, where the agency has not received notice or for summary proceedings where a final judgment may occur within a short time after service of the complaint.

236. See *supra* notes 213, 231.

237. See *National Ass'n of Farmworker Orgs. v. Marshall*, 628 F.2d 23 (D.C. Cir. 1979); *Henry v. First Nat'l Bank*, 595 F.2d 291 (5th Cir. 1979), *cert. denied*, 444 U.S. 1074 (1980).

238. See *supra* note 158.

239. See *supra* note 198. The courts could also attempt to circumvent the doctrine simply by requiring a greater factual showing to demonstrate the origin of the funds. See, e.g., *Flint v. Point Coupee Community Advancement, Inc.*, C.A. No. 77-193 (M.D. La. July 30, 1979). Alternatively, they could expand possible claims against the grantor agencies for failure to



be used to satisfy, and in the interests of justice, have an obligation to do so.

#### IV. CONCLUSION

The problems which beset GLACAA's liquidation are not limited to CAAs. Similar difficulties could attend termination of any publicly funded agency where the lines of responsibility and the limits of liability are not clearly drawn. Federal and state regulations should be reviewed to insure the existence of efficient and orderly procedures for the termination of public agencies.

In addition, the Office of Management and Budget should lead the way in reviewing the federal interest in grant funds, devising new regulations which define the limits of that interest and clarify the remedies available to those wrongfully injured by federal grantees. Grant law has been too long an undeveloped area ruled by confusion and default.

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supervise. See *Gautreaux v. Romney*, 448 F.2d 731 (7th Cir. 1971), *aff'd sub nom. Hills v. Gautreaux*, 425 U.S. 284 (1976).