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# Look Before You Lend: A Lender's Guide to Financing Government Contracts Pursuant to the Assignment of Claims Act

Heidi M. Schooner and Steven L. Schooner\*

## INTRODUCTION

Prior to 1940, government contractors, particularly thinly capitalized contractors, experienced difficulties obtaining financing.<sup>1</sup> Unlike contractors dealing with commercial concerns,<sup>2</sup> the government contractor was unable to grant its lender an interest in its most valuable asset—its accounts receivable. The Assignment of Claims Act of 1940 (Assignment of Claims Act or Act)<sup>3</sup> addressed this problem by allowing the government contractor to assign its government receivables as collateral for commercial loans.<sup>4</sup>

Much of the lending to government contractors takes the form of lines of credit secured by the assignment of the contractors' accounts receivable.<sup>5</sup> While the terms of the line of credit vary from lender to lender, the

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*Editor's note:* Christopher R. West, a partner of Weinberg and Green in Baltimore, Maryland, served as a reviewer for this Article.

1. See S. REP. NO. 217, 82d Cong., 1st Sess. (1951), reprinted in 1951 U.S.C.C.A.N. 1414.

2. For a general discussion of the assignment of rights to the payment of money to be earned by performance under contracts, see Grant Gilmore, *The Assignee of Contract Rights and His Precarious Security*, 74 YALE L.J. 217 (1964).

3. Ch. 779, 54 Stat. 1029 § 1 (1940) (codified as amended at 31 U.S.C. § 3727, 41 U.S.C. § 15 (1988)).

4. Various commentators encourage government contractors to seek such financing. See Raymond E. Vickery, Jr. & Andrew M. Paalborg, *Assignment of Claims Act*, 87-3 BRIEFING PAPERS (Federal Publications, Feb. 1987); John W. Chierichella et al., *Financing Government Contracts*, 86-7 BRIEFING PAPERS (Federal Publications, June 1986).

5. For a general discussion of accounts receivable financing, see JOHN F. DOLAN, UNIFORM COMMERCIAL CODE: TERMS AND TRANSACTIONS IN COMMERCIAL LAW § 15 (1991). This type of financing falls under the general category of "asset-based" financing. See generally MICHAEL D. RICE, ASSET FINANCING (1989).

loan often includes some type of monitoring device that enables the lender to match the outstanding loan amount to the collateral currently in the borrower's hands.<sup>6</sup>

One reason that lending against government receivables attracts lenders is that under the Prompt Payment Act,<sup>7</sup> the government is required to pay interest on invoices not paid within a specified period after payment is due.<sup>8</sup> This statute provides the government a strong incentive to pay invoices in a timely fashion. Therefore, financial institutions that lend against such receivables typically expect a continuous stream of payments, available in a relatively short period of time, to pay down the outstanding balance on the line of credit.

Although federal government contracts offer enticing opportunities for lenders, financial institutions should not rush blindly into the realm of government contracts.<sup>9</sup> Government contracts generally, and the financing of those contracts specifically, entail an extensive statutory and regulatory framework,<sup>10</sup> with attendant pitfalls and potentially grave consequences.<sup>11</sup>

This Article briefly summarizes the origin of the Assignment of Claims Act, discusses the lender's ability to obtain a valid assignment of moneys due or to become due under a government contract<sup>12</sup> (but not the numerous other assignment issues that a government contracts practitioner

6. For example, the line of credit may require the government contractor to submit a "borrowing base" certificate prior to drawing on its line of credit. The borrowing base is a calculation of a defined class of accounts receivable on hand. The borrowing base might be defined as 80% of the contractor's government accounts receivable less than 90 days old. Under this scenario, the loan agreement would provide that the current outstanding balance under the line of credit may not exceed the borrowing base.

7. Pub. L. No. 100-496, § 1, 102 Stat. 2455 (codified as amended at 31 U.S.C. §§ 3901-3907 (1988)).

8. 31 U.S.C. § 3902(a) (1988). If the invoice does not specify a payment date, it will be due 30 days after the invoice is received. *Id.* § 3903(a)(1)(B).

9. The government prefers that its contractors obtain private financing for their contracts. The Federal Acquisition Regulations (FAR) states the following order of preference for obtaining financing: (1) private financing on reasonable terms, (2) progress payments at customary rates, (3) guaranteed loans, (4) progress payments with unusual terms, and (5) advance payments. FAR 32.106, 48 C.F.R. § 32.106 (1991).

10. As one commentator explained:

If someone were asked to devise a contracting system for the federal government, it is inconceivable that one reasonable person or a committee of reasonable people could come up with our current system. . . . [The system] reflects the collision and collaboration of special interests, the impact of innumerable scandals and successes, and the tensions imposed by conflicting ideologies and personalities.

JAMES F. NAGLE, A HISTORY OF GOVERNMENT CONTRACTING 519 (1992).

11. The Supreme Court warned that contractors "must turn square corners when they deal with the Government." *Rock Island, Ark. & La. R.R. v. United States*, 254 U.S. 141, 143 (1920).

12. For a discussion of the Assignment of Claims Act from a different perspective—that of the contractor—see Vickery & Paalborg, *supra* note 4.

might confront), analyzes the priorities of competing claims against the government for payment of government receivables, and describes the procedure for asserting a claim against the government for payment.

### ***THE ORIGIN OF THE ASSIGNMENT OF CLAIMS ACT***

Two statutes address assignments by the federal government: The Anti-Claims Act<sup>13</sup> and the Anti-Assignment Act.<sup>14</sup> While the two statutes virtually are identical, the Anti-Claims Act pertains to the assignment of claims for work already completed,<sup>15</sup> and the Anti-Assignment Act pertains to the assignment of executory contracts.<sup>16</sup> The two statutes often are referred to collectively as the "Anti-Assignment Acts" because their general provisions invalidate transfers of claims against the government.<sup>17</sup> This Article refers to the relevant portions of the Anti-Assignment Act and the Anti-Claims Act collectively as the Anti-Assignments Acts, unless there is a specific reference to either or both.

The courts attribute Congress with recognizing two general purposes for the Anti-Assignment Acts. First, Congress sought to prevent fraud by prohibiting corrupt individuals from buying up claims against the United States and then using those claims to exert improper influence on gov-

13. 31 U.S.C. § 3727 (1988). For a discussion of the origin of the statute, see Vincent Belusko, Note, *Government Contracts—Assignments—Federal Contracting Officer Possesses the Requisite Authority to Waive the Requirements of the Anti-Assignment Act*, 41 U.S.C. § 15, and to Bind the Government to an Assignment of a Federal Contract—Tuftco Corp. v. United States, 614 F.2d 740 (Ct. Cl. 1980), 49 GEO. WASH. L. REV. 167, 170 n.23 (1980).

14. 41 U.S.C. § 15 (1988). This statute also is referred to as the Assignment of Contracts Act. See *Trust Co. Bank v. United States*, 24 Cl. Ct. 710 (1992). For a discussion of the origin of the statute, see Belusko, *supra* note 13, at 169 n.22.

15. The Anti-Claims Act, 31 U.S.C. § 3727(b) (1988), provides in pertinent part:

An assignment may be made only after a claim is allowed, the amount of the claim is decided, and a warrant for payment of the claim has been issued. The assignment shall specify the warrant, must be made freely, and must be attested to by 2 witnesses. The person making the assignment shall acknowledge it before an official who may acknowledge a deed, and the official shall certify the assignment. The certificate shall state that the official completely explained the assignment when it was acknowledged. An assignment under this subsection is valid for any purpose.

*Id.*

16. The Anti-Assignment Act, 41 U.S.C. § 15 (1988), provides in pertinent part:

No contract or order, or any interest therein, shall be transferred by the party to whom such contract or order is given to any other party, and any such transfer shall cause the annulment of the contract or order transferred, so far as the United States are concerned. All rights of action, however, for any breach of such contract by the contracting parties, are reserved to the United States.

*Id.*; see also *Tuftco Corp. v. United States*, 614 F.2d 740, 744 n.4 (Ct. Cl. 1980).

17. *United Cal. Discount Corp. v. United States*, 19 Cl. Ct. 504, 507 (1990).

ernment officials.<sup>18</sup> Second, Congress sought to allow the government to deal with only one claimant, thereby avoiding multiple payments, the investigation of assignments, and multiple party litigation.<sup>19</sup>

The Assignment of Claims Act amended the Anti-Assignment Acts to exempt from those Acts' general prohibition of assignments, certain assignments to financial institutions.<sup>20</sup> The purpose of the Assignment of

18. See *Webster Factors, Inc. v. United States*, 436 F.2d 425, 429 (Ct. Cl. 1971); *Patterson v. United States*, 354 F.2d 327, 329-30 (Ct. Cl. 1965) (Congress enabled the government "to deal exclusively with the original claimant . . . thus obviating the necessity of having to inquire into the validity of specific transfers or assignments of the claim, minimizing subjection to successive litigation upon the same claim, and eliminating the risk of double payment or multiple liability."); see also *United States v. Aetna Casualty & Sur. Co.*, 338 U.S. 366, 373 (1949), and cases cited therein.

19. See *supra* note 18.

20. The Assignment of Claims Act amended the Anti-Claims Act to provide that the general prohibition on assignments does not apply to:

[A]n assignment to a financing institution of money due or to become due under a contract providing for payments totaling at least \$1,000 when—

- (1) the contract does not forbid an assignment;
- (2) unless the contract expressly provides otherwise, the assignment—
  - (A) is for the entire amount not already paid;
  - (B) is made to only one party, except that it may be made to a party as agent or trustee for more than one party participating in the financing; and
  - (C) may not be reassigned; and
- (3) the assignee files a written notice of the assignment and a copy of the assignment with the contracting official or the head of the agency, the surety on a bond on the contract, and any disbursing official for the contract.

31 U.S.C. § 3727(c) (1988).

The Assignment of Claims Act amended the Anti-Assignment Act to provide that the general prohibition on assignments shall not apply:

[I]n any case in which the moneys due or to become due from the United States or from any agency or department thereof, under a contract providing for payments aggregating \$1,000 or more, are assigned to a bank, trust company, or other financial institution, including any Federal lender agency; *Provided*,

1. That in the case of any contract entered into prior to October 9, 1940, no claim shall be assigned without the consent of the head of the department or agency concerned;
2. That in the case of any contract entered into after October 9, 1940, no claim shall be assigned if it arises under a contract which forbids such assignment;
3. That unless otherwise expressly permitted by such contract any such assignment shall cover all amounts payable under such contract and not already paid, shall not be made to more than one party, and shall not be subject to further assignment, except that any such assignment may be made to one party as agent or trustee for two or more parties participating in such financing;
4. That in the event of any such assignment, the assignee thereof shall file written notice of the assignment together with a true copy of the instrument of assignment with (a) the contracting officer or the head of his department or agency; (b) the surety or sureties upon the bond or bonds, if any, in connection with such contract; and (c) the disbursing officer, if any, designated in such contract to make payment.

41 U.S.C. § 15 (1988).

Claims Act was “to encourage the participation of banks in the financing of Government contractors under the defense program of that time.”<sup>21</sup> Moreover, the Act “was intended to broaden the base of competitive bidders to include small companies which, because of their inability to finance the cost of contract performance and the statutory prohibition against assignment of the proceeds of the contract, were unable to undertake the performance of government contracts.”<sup>22</sup> Ultimately, however, the Assignment of Claims Act is for the protection of the government and does not govern the result in disputes between private parties.<sup>23</sup>

A caveat may be appropriate here. As already may be obvious, the Anti-Claims Act, the Anti-Assignment Act, and the Assignment of Claims Act have quite similar, and, therefore confusing, titles. Further, the title “Assignment of Claims Act” is a misnomer—the Act addresses the assignment of *payments* rather than the assignment of claims. Not surprisingly many courts and commentators refer to these three statutes interchangeably and somewhat inaccurately.

## ***COMPLIANCE WITH THE ASSIGNMENT OF CLAIMS ACT NUMEROUS REGULATORY REQUIREMENTS APPLY***

While the requirements of the financial institution exemption are set forth in the Assignment of Claims Act,<sup>24</sup> the policies and procedures governing the Act are contained in the Federal Acquisition Regulations (FAR).<sup>25</sup> The FAR sets forth the conditions, paralleling the Act's, for a valid assignment under the Act as follows:

Under the Assignment of Claims Act, a contractor may assign moneys due or to become due under a contract if all the following conditions are met:

- (a) The contract specifies payments aggregating \$1,000 or more.
- (b) The assignment is made to a bank, trust company, or other financing institution, including any Federal lending agency.

21. S. REP. NO. 217, 82d Cong., 1st Sess. (1951), *reprinted in* 1951 U.S.C.C.A.N. 1414.

22. *Continental Bank & Trust Co. v. United States*, 416 F.2d 1296, 1299 (Ct. Cl. 1969) (citing H.R. REP. NO. 2925, 76th Cong., 3d Sess. 2 (1940)).

23. *McKenzie v. Irving Trust*, 323 U.S. 365, 369 (1945) (citing *Martin v. National Sur. Co.*, 300 U.S. 588, 594-95 (1937)); *Lazere Fin. Corp. v. Palmetto & Irrigation, Inc. (In re Palmetto Pump & Irrigation, Inc.)*, 81 B.R. 109, 112 (Bankr. M.D. Fla. 1987) (citing *United Pac. Ins. Co. v. United States*, 358 F.2d 966 (Ct. Cl. 1966)).

24. *See supra* note 20.

25. The FAR is the primary document in the Federal Acquisition Regulations system, and contains uniform policies and procedures that govern the acquisition activity of all Federal executive agencies. The FAR is prepared, issued, and jointly maintained by the Department of Defense, the General Services Administration, and the National Aeronautics and Space Administration. The FAR is published in the Federal Register, in cumulative form in Title 48 of the Code of Federal Regulations, in looseleaf form available through the United States Government Printing Office, and in commercial versions.

- (c) The contract does not prohibit the assignment.
- (d) Unless otherwise expressly permitted in the contract, the assignment—
  - (1) Covers all unpaid amounts payable under the contract;
  - (2) Is made only to one party, except that any assignment may be made to one party as agent or trustee for two or more parties participating in the financing of the contract; and
  - (3) Is not subject to further assignment.
- (e) The assignee sends a written notice of assignment together with a true copy of the assignment instrument to the—
  - (1) Contracting officer or the agency head;
  - (2) Surety on any bond applicable to the contract; and
  - (3) Disbursing officer designated in the contract to make payment.<sup>26</sup>

The FAR and the FAR supplements<sup>27</sup> also prescribe procedures for the assignment. The assignment must be executed in accordance with the FAR provisions,<sup>28</sup> and the assignee must forward to each party receiving notice of the assignment an original and three copies of the notice of assignment plus one true copy of the assignment.<sup>29</sup> The regulations contain a suggested format for the notice of assignment.<sup>30</sup>

26. FAR 32.802, 48 C.F.R. § 32.802 (1991).

27. Individual agencies may supplement and implement the FAR with agency-specific guidance. See, for example, the Department of Defense FAR Supplement (DFARS) subpt. 232.8, 48 C.F.R. § 232.8 (1991); the General Services Acquisition Regulation (GSAR) subpt. 532.8, 48 C.F.R. § 532.8 (1991); and the Department of Energy Acquisition Regulation (DEAR) subpt. 932.8, 48 C.F.R. § 932.8 (1991), all implementing the Assignment of Claims Act. Note that the FAR numbering system maintains consistent identification of subject areas throughout the FAR and its supplements—for example, each of the supplementary references to FAR subpt. 32.8 use the same number and merely add a prefix identifying the subchapter.

28. FAR 32.805(a), 48 C.F.R. § 32.805(a) (1991), provides that:

- (1) Assignments by corporations should be (i) executed by an authorized representative, (ii) attested by the secretary or the assistant secretary of the corporation, and (iii) impressed with the corporate seal or accompanied by a certified copy of the resolution of the corporation's board of directors authorizing the signing representative to execute the assignment.
- (2) If the contractor is a partnership, the assignment may be signed by one partner, if it is accompanied by an acknowledged certification that the signer is a general partner of the partnership.
- (3) If the contractor is an individual, the assignment must be signed by that individual and the signature acknowledged before a notary public or other person authorized to administer oaths.

*Id.*

29. FAR 32.805(b), 48 C.F.R. § 32.805(b) (1991).

30. FAR 32.805(c), 48 C.F.R. § 32.805(c) (1991). This provision details various assignment requirements for corporations, partnerships, and individuals in addition to providing filing requirements and notice format.

The Department of Defense FAR Supplement (DFARS) explains in greater detail the mechanics or procedures entailed by the assignment.<sup>31</sup> The assignee must forward: (1) a true copy of the instrument of assignment, and an original and three copies of the notice of assignment to the administrative contracting officer,<sup>32</sup> (2) a true copy of the instrument of assignment and an original and three copies of the notice of assignment to the surety or sureties, if any,<sup>33</sup> and (3) a true copy of the instrument of assignment and an original and one copy of the notice of assignment to the disbursing officer.<sup>34</sup>

The administrative contracting officer acknowledges receipt of the assignment by signing and dating all copies of the notice of assignment.<sup>35</sup> The administrative contracting officer then: (1) files the true copy of the instrument of assignment and the original of the notice in the contract file, (2) forwards two copies of the notice to the appropriate disbursing officer, (3) returns one copy to the assignee, and (4) advises the designated contracting officer<sup>36</sup> of the assignment.<sup>37</sup> The disbursing officer: (1) acknowledges and returns a copy of the notice to the assignee and (2) files the true copy of the instrument and the original notice.<sup>38</sup> The FAR provides that, upon receipt of the notice, the administrative contracting officer must verify that the contract has been approved and executed properly, that the contract is one in which claims may be assigned, and that the assignment covers only money due or to become due under the contract.<sup>39</sup>

The last requirement is important in practice. Most assignment forms, typically drafted by lender's counsel, contain the broadest language pos-

31. DFARS 232.805, 48 C.F.R. § 232.805 (1991).

32. An administrative contracting officer (ACO) functions at and through a contract administration office and performs contract administrative functions involving, among other things, forward pricing rate agreements, allowable costs, disputes, progress payments, quality assurance, contractor purchasing system review, and consent to subcontracts. ACOs typically assume control over the contract after the procuring contracting officer (PCO) awards the contract. FAR 42.302, 48 C.F.R. § 42.302 (1991); DFARS 232.805(b)(i), 48 C.F.R. § 232.805(b)(i) (1991); *see also infra* note 36.

33. The surety then returns the acknowledged copies to the assignee. The assignee then forwards two of the three copies to the appropriate disbursing officer. DFARS 232.805(b)(ii), 48 C.F.R. § 232.805(b)(ii) (1991).

34. The disbursing officer is a government officer or employee designated to pay out monies and render accounts in accordance with laws and regulations governing the disbursement of public funds. *See* 31 U.S.C. §§ 3322(a), 3325(a) (1988).

35. DFARS 232.803(b)(i), 48 C.F.R. § 232.803(b)(i) (1991).

36. The contracting officer is an employee of the government with the authority to legally bind the government by signing a contractual instrument. A contracting officer may enjoy the authority to enter into, administer, and/or terminate contracts. FAR 2.101, 48 C.F.R. § 2.101 (1991). Contracting officers are appointed in writing, on a Standard Form (SF) 1402, Certificate of Appointment (or warrant). FAR 53.301-1402, 48 C.F.R. § 53.301-1402 (1991). *See generally* FAR subpt. 1.6, 48 C.F.R. § 1.6 (1991).

37. DFARS 232.803(b)(i)(A-B), 48 C.F.R. § 232.803(b)(i)(A-B) (1991).

38. DFARS 232.805(b)(iii), 48 C.F.R. § 232.805(b)(iii) (1991).

39. FAR 32.805(d), 48 C.F.R. § 32.805(d) (1991).



sible to cover any assignable right relating to the contract. The administrative contracting officer, however, may reject broadly drafted forms. The Assignment of Claims Act allows for the assignment of "moneys due or to become due" under the contract.<sup>40</sup> Therefore, contracting officers likely will not accept an assignment that contains broader language.<sup>41</sup> Moreover, the assignee must ensure that the assignment contains language granting the assignee ownership in the proceeds of the contract. Granting of a security interest is not sufficient.<sup>42</sup>

As a practical matter, the lender should maintain a file containing a complete copy of the government contract<sup>43</sup> and all modifications<sup>44</sup> to the contract. Lenders may be surprised to learn that, in certain circumstances, neither the government nor the contractor can provide the financial institution with a copy of the contract. For example, the regulations provide that an assignee may receive specific (but limited) information in lieu of the contract if the contract contains classified information.<sup>45</sup>

40. 31 U.S.C. § 3727(c) (1988); 41 U.S.C. § 15 (1988).

41. The Comptroller General indicated that the Assignment of Claims Act:

permit[s] the assignment of "moneys due or to become due" under a Government contract, not the assignment of any *claims* which might arise under such a contract. This . . . is a statutory limitation upon the character of the rights and the extent of the powers permitted to be conferred by the assignment . . .

[W]e do not believe that the act requires the Government to deal with a stranger to a contract during the course of regular administrative procedures established for the purpose of determining the amount of money due or to become due under the contract, at least not when the contractor is willing and able to act in the matter. The Government would be subject to considerable risk if it should attempt to settle a dispute between the contractor and the assignee over the right to prosecute claims under a contract.

Secretary of the Navy, B-124314, 35 Comp. Gen. 104, 109 (1955) (emphasis in original).

42. The Claims Court held that the grant of a security interest in accounts receivable did not constitute an assignment since the security agreement contained no language granting the lender ownership of or title to the proceeds of the government contract. *See American Nat'l Bank & Trust Co. v. United States*, 22 Cl. Ct. 7, 17 (1990); *see also* S. Thomas Shumate, B-195629, 79-2 CPD ¶ 182 (Sept. 7, 1979) (blanket assignment of all accounts receivable may not be recognized as valid assignment under the Assignment of Claims Act). *But see* General Servs. Admin., B-194945, 58 Comp. Gen. 619 (1979) (where bank received blanket lien on contractor's receivables which did not comply with Act's requirements, Comptroller advised agency to recognize assignment so long as bank agreed to indemnify agency of any claims).

43. Most government contracts comply with the Uniform Contract Format. *See generally* FAR 14.201-1, 15.406-1, 48 C.F.R. §§ 14.201-1, 15.406-1 (1991). The cover sheet on a government contract is typically a Standard Form (SF) 26, Award/Contract, or SF 33, Solicitation, Offer and Award. FAR 53.301-26, -33, 48 C.F.R. § 53.301-26, -33 (1991).

44. The Government uses the SF 30 for both unilateral and bilateral modifications to the contract. Amendment to Solicitation/Modification of Contract, FAR 53.301-30, 48 C.F.R. § 53.301-30 (1991). *See generally* FAR pt. 43, 48 C.F.R. pt. 43 (1991).

45. *See, e.g.*, DEAR 932.805, 48 C.F.R. § 932.805 (1991). For classified contracts, the Department of Energy provides the assignee with the following information: (1) name and address of the prime contractor; (2) contract number and date; (3) name, address, and phone

*ONLY FINANCIAL INSTITUTIONS ARE EXEMPT*

The Assignment of Claims Act exempts banks, trust companies, and other financial institutions from the general assignment prohibition contained in the Anti-Assignment Acts.<sup>46</sup> For the purposes of the Assignment of Claims Act, the Comptroller General defines a financing institution as one that:

deals in money as distinguished from other commodities as the primary function of its business activity. . . . A firm—be it a corporation, a partnership or a sole proprietorship—which as a primary function is regularly engaged in the financing business may be regarded as a financing institution. . . . However, a firm whose credit extension and lending operations, although carried on regularly, are merely incidental or subsidiary to another end, in the light of the firm's overall operations, and more important purpose, is not a financing institution.<sup>47</sup>

Frequently, subcontractors<sup>48</sup> attempt to obtain an assignment of a government contract. Subcontractors seek an assignment of the government contract when they are concerned that they may not receive payment from the prime contractor for subcontract work performed. The courts, however, consistently hold that a subcontractor is not a valid assignee under the Act, therefore making prospects of payment to the subcontractor uncertain.<sup>49</sup> Even where the subcontractor delivered goods on credit to the contractor, the subcontractor was rejected as a proper assignee under the

number of the DOE officials responsible for (a) receiving the material or service, and (b) making payment; (4) subcontract number; (5) date of subcontract; (6) date on which contract is to be completed; (7) total amount of contract; (8) dollar amount remaining to be delivered on contract; and (9) a statement as to the assignability of the contract.

46. See *supra* note 20 and accompanying text. The courts also have recognized various categories of assignments that are valid under operation of law. See *Keydata Corp. v. United States*, 504 F.2d 1115, 1118 (Ct. Cl. 1974); *Webster Factors, Inc. v. United States*, 436 F.2d 425, 429 (Ct. Cl. 1971) (quoting *Patterson v. United States*, 354 F.2d 327, 329-30 (Ct. Cl. 1965)). Discussion of such assignments is beyond the scope of this Article.

47. *Small Business Admin.*, B-152012, 43 Comp. Gen. 138, 139 (1963). See generally FAR subpt. 32.8, 48 C.F.R. § 32.8 (1991). See also RALPH NASH & STEVEN L. SCHOONER, *THE GOVERNMENT CONTRACT REFERENCE BOOK* 184-85 (1992).

48. A subcontractor is a supplier, distributor, vendor, or firm that furnishes supplies or services to a prime contractor or another subcontractor. FAR 44.101, 48 C.F.R. § 44.101 (1991). First-tier subcontractors hold a subcontract with the prime contractor. (The prime contractor holds a contract with the government and, therefore, enjoys privity of contract with the government). Second- (third-, etc.) tier subcontractors hold subcontracts with a subcontractor. As a general rule, subcontractors of any tier lack privity of contract with the government. FAR 3.502-1, 22.801, 48 C.F.R. §§ 3.502-1, 22.801 (1991).

49. See *Pan Arctic Corp. v. United States*, 8 Cl. Ct. 546, 547-48 (1985); *Diamond Mfg. Co. v. United States*, 3 Cl. Ct. 424, 427 (1983); *United States v. Russell Elec. Co.*, 250 F. Supp. 2, 22-23 (S.D.N.Y. 1965).

Act.<sup>50</sup> Moreover, the parent company of the contractor under a government contract is not a valid assignee.<sup>51</sup>

### **NOTICE OF THE ASSIGNMENT IS REQUIRED**

#### ***Compliance with the Notice Requirements Is a Prerequisite to a Valid Assignment***

As previously noted, one of the requirements for a valid assignment to a financial institution is that the assignee must send a written notice of assignment, together with a true copy of the assignment instrument to the contracting officer or agency head, the surety, and the disbursing officer.<sup>52</sup> Despite the apparent simplicity of this requirement, the courts often find that the assignee has failed to satisfy the notice requirements.<sup>53</sup>

Congress included the notice provisions in the Act to further one of the primary purposes of the Anti-Assignment Acts. Congress sought to allow the government to deal with only one claimant, thereby avoiding multiple payments, the investigation of assignments, and multiple party litigation.<sup>54</sup> In light of the notice provision's important role in the statutory scheme, the courts strictly construe notice provisions.<sup>55</sup> Failure to comply with the notice provisions, therefore, invalidates the assignment.<sup>56</sup>

Generally, the assignment is effective upon actual receipt of the notice of assignment.<sup>57</sup> The Court of Claims<sup>58</sup> has indicated, however, that the

50. *Uniroyal, Inc. v. United States*, 454 F.2d 1394, 1396 (Ct. Cl. 1972).

51. *Cross County Indus., Inc. v. United States*, 231 Ct. Cl. 899, 900 (1982).

52. *See supra* note 29 and accompanying text.

53. *See, e.g., Trust Co. Bank v. United States*, 24 Cl. Ct. 710 (1992) (assignee did not comply with notice provisions where notice of assignment, signed by assignee, was never filed); *American Fin. Assocs., Ltd. v. United States*, 5 Cl. Ct. 761, 769 (1984) (reliance upon contracting officer's representation that copy of notice was sent to disbursing officer was not sufficient to meet requirement to notify disbursing officer); *Bank Leumi Le-Israel, B.M., B-212599*, 63 Comp. Gen. 42 (1983) (assignment not valid where assignee notified contracting officer but not disbursing officer). *But see American Fin. Assocs., Ltd. v. United States*, 5 Cl. Ct. 761, 772 (1984) (with respect to contract No. 0795, inclusion on notice of code number and address that was designation for officer in charge of disbursements was sufficient to meet requirement to notify disbursing officer).

54. *American Fin. Assocs., Ltd. v. United States*, 5 Cl. Ct. 761, 768 (1984) (citing *United States v. Aetna Sur. Co.*, 338 U.S. 366, 373 (1949)).

55. *Id.*

56. *United Cal. Discount Corp. v. United States*, 19 Cl. Ct. 504, 507-08 (1990).

57. *Reliance Ins. Co. v. United States*, 15 Cl. Ct. 62, 66 (1988); *American Fin. Assocs., Ltd. v. United States*, 5 Cl. Ct. 761, 767 (1984); *Central Nat'l Bank v. United States*, 91 F. Supp. 738, 740 (Ct. Cl. 1950).

58. The Federal Court Improvement Act of 1982 (FCIA), Pub. L. No. 97-164, tit. I, pt. C, § 167, 96 Stat. 50 (1982) (codified as amended at 28 U.S.C. § 171 (1988)), bifurcated the Court of Claims and created the United States Claims Court and the United States Court of Appeals for the Federal Circuit). *See, e.g., Joseph A. Hrabik, Note, Federal Courts Improvement Act of 1982*, 24 DUQ. L. REV. 945 (1986); David V. Anthony & Gregory A. Smith, *The Federal Courts Improvement Act of 1982: Its Impact on the Resolution of Federal Contract Disputes*, 13 PUB. CONT. L.J. 201 (1983). More recently, the Federal Courts Administration Act of 1992, Pub. L. No. 102-572, § 901, 106 Stat. 4506 (1992), renamed the court as the United States Court of Federal Claims.

government has a reasonable time to determine the validity of the assignment.<sup>59</sup> After a reasonable time passes, the assignee is entitled to all amounts earned under the contract assigned.<sup>60</sup>

### ***The Government May Waive the Notice Requirements***

Despite the general bar of the Anti-Assignment Acts, the government may choose to recognize an assignment.<sup>61</sup> Nonetheless, the government rarely chooses to accept an assignment when it has no obligation to do so. In *Tuftco Corp. v. United States*,<sup>62</sup> however, the Court of Claims recognized the government's ability to waive the notice requirements under the Assignment of Claims Act.<sup>63</sup> To determine whether the government has waived the Act's requirements, the court must examine the totality of the circumstances, including the government's knowledge, assent, and any actions consistent with the terms of the assignment.<sup>64</sup>

With respect to the government's knowledge of the assignment, the Claims Court indicated that constructive knowledge on the part of the government is not enough and that even actual knowledge of an attempted assignment may not create a waiver.<sup>65</sup> For example, even where the contracting officer had knowledge of the assignment, a waiver of the notice provisions was not effective where the disbursing officer lacked knowledge of the assignment.<sup>66</sup> By the same token, the knowledge required may be more than just an awareness of the assignment. In *American National Bank & Trust Co. v. United States*,<sup>67</sup> the contracting officer had received a copy of an "assignment of security interest" claiming rights to proceeds under the government contract.<sup>68</sup> The Claims Court found that because the de-

59. *Produce Factors Corp. v. United States*, 467 F.2d 1343, 1349 (Ct. Cl. 1972) (citing *Central Nat'l Bank v. United States*, 91 F. Supp. 740, 741 (Ct. Cl. 1950)).

60. *Id.*

61. *Monchamp Corp. v. United States*, 19 Cl. Ct. 797, 801 (1990); *Tuftco Corp. v. United States*, 614 F.2d 740, 745 (Ct. Cl. 1980); *Maffia v. United States*, 163 F. Supp. 859, 862 (Ct. Cl. 1958).

62. 614 F.2d 740 (Ct. Cl. 1980).

63. *Id.* at 743. The *Tuftco* decision has been criticized by at least one commentator. See Belusko, *supra* note 13.

64. *American Nat'l Bank & Trust Co. v. United States*, 23 Cl. Ct. 542, 546 (1991) (citing *Tuftco Corp. v. United States*, 614 F.2d 740 (Ct. Cl. 1980)).

65. *United Cal. Discount Corp. v. United States*, 19 Cl. Ct. 504, 509-10 (1990). Here, the court rejected the plaintiff's waiver argument where the government had sent checks to the financial institution's address but was not aware the contract proceeds had been assigned and did not know that the address it was using was the financial institution's (rather than the contractor's) address. *Id.* at 508-10.

66. *Trust Co. Bank v. United States*, 24 Cl. Ct. 710, 712 (1992); *American Fin. Assocs., Ltd. v. United States*, 5 Cl. Ct. 761, 769 (1984).

67. 22 Cl. Ct. 7 (1990).

68. *Id.* at 10.

tails of a complex financing arrangement were not disclosed to the contracting officer, the notice provisions under the Act could not be waived.<sup>69</sup>

With respect to the government's assent to the assignment, the Claims Court has dismissed arguments of waiver where the contracting officer or disbursing officer have indicated any rejection of an attempted notice of assignment.<sup>70</sup> Finally, where the government admitted that the notice of assignment was received, acknowledged, and acted upon by a responsible officer, and where the government had delivered some payments under the contract to the contractor and some to the assignee, the court found the government's action consistent with the assignment, and bound the government to the assignment.<sup>71</sup>

### ***THE SOLE ASSIGNEE MUST PARTICIPATE IN THE FINANCING***

The Assignment of Claims Act provides that the contractor may assign moneys due or to become due under the contract to one party, or to an agent or trustee for multiple parties participating in the financing.<sup>72</sup>

#### ***The Assignment May Be Made to Only One Party or Trustee***

The Court of Claims has held that an assignment is not valid where an assignment to a previous assignee had not actually been released.<sup>73</sup> Failure to release the assignment violates the statutory requirement that the assignment be made to only one party. Presumably, the courts also would not allow an assignment to a financial institution acting as trustee for the benefit of a party other than a financial institution.<sup>74</sup>

69. *Id.* at 17-18.

70. *Trust Co. Bank*, 24 Cl. Ct. at 712; *American Fin. Assocs.*, 5 Cl. Ct. at 769.

71. *Maryland Small Business Dev. Fin. Auth. v. United States*, 4 Cl. Ct. 76, 80 (1983).

72. 31 U.S.C. § 3727(c) (1988); 41 U.S.C. § 15 (1988).

73. *First Nat'l City Bank v. United States*, 548 F.2d 928, 934 (Ct. Cl. 1977); *see also Webster Factors, Inc. v. United States*, 436 F.2d 425, 430 (Ct. Cl. 1971) (where various transfers had effect of assigning Government lease payments to two parties, second assignment was void).

74. A subcontractor seeking an assignment of contract proceeds might attempt to enlist a financial institution as trustee for the receipt of such proceeds in attempted compliance with the Act. Arguably, such an assignment should not be upheld. The assignment would circumvent the purpose of the financial institutions exception—to facilitate the financing of government contractors by the private sector. As discussed, *supra* notes 61-71 and accompanying text, the government could consent to the assignment, but only with full knowledge of the nature of the assignment. Therefore, the financial institution would have to disclose its capacity as trustee for the subcontractor to obtain the government's consent.

### ***The Financial Institution Must Participate in the Financing***

A financial institution is not an appropriate assignee under the Act unless it participates in the financing.<sup>75</sup> The Court of Claims has indicated that a financial institution “participating in such financing” under the Act is “a lender whose loan was used, or was available for use, in financing the particular government contract under which suit is brought.”<sup>76</sup> The court, however, explained that this definition does not mean that the loan must be tied to a particular contract, nor does it mean that revolving lines of credit cannot be secured by government receivables.<sup>77</sup> More recently, the Court of Claims stated that the financial institution must show that it loaned money or at least made money available for the performance of the contract.<sup>78</sup> A careful lender, therefore, will ensure that its records show that the assignment of government payments was used to finance the government contract.

### **WHAT ARE THE GOVERNMENT'S DUTIES?**

Upon receipt of a valid assignment, the government “can no longer discharge its payment obligation under the contract by paying the contractor.”<sup>79</sup> The government's obligations, however, do not extend far beyond this basic duty. In *Fairchild Industries, Inc. v. United States*,<sup>80</sup> the government delivered to the contractor checks made payable to the bank/assignee. The contractor then deposited the checks in its account at the bank. The bank argued that the government should have sent the checks to the bank. The court disagreed, concluding that the government could

75. See, e.g., *American Nat'l Bank & Trust Co. v. United States*, 22 Cl. Ct. 7, 16 (1990) (court found no valid assignment where no funds lent by lender were used to finance government contract); *Manufacturers Hanover Trust Co. v. United States*, 590 F.2d 893, 897-98 (Ct. Cl. 1978) (plaintiff could not avail itself of benefits of Act where assignments it received were not given to secure loans relating to present contracts or any other previously unsecured government contract loan).

76. *First Nat'l City Bank v. United States*, 548 F.2d 928, 934 (Ct. Cl. 1977).

77. *Id.* at 935 (citing *Continental Bank & Trust Co. v. United States*, 416 F.2d 1296 (Ct. Cl. 1969)). In *Peterman Lumber Co. v. Adams*, 128 F. Supp. 6 (W.D. Ark. 1955), the court explained:

[T]he purpose of the Act, as amended, is to assist Government contractors in financing their operations, and the Court is convinced that under the Act a contractor may assign his payments under a particular contract to the bank as security for the advances made in connection with said contract; or the contractor (when he is performing a number of Government contracts) may assign his payments under a particular contract as security for money advanced by the bank in connection with his whole operation of performing other Government contracts as well as that particular contract.

*Id.* at 13.

78. *American Nat'l Bank & Trust*, 22 Cl. Ct. at 16 (citing *Manufacturers Hanover Trust Co. v. United States*, 590 F.2d 893 (Ct. Cl. 1978)).

79. *Produce Factors Corp. v. United States*, 467 F.2d 1343, 1349 (Ct. Cl. 1972).

80. 620 F.2d 807 (Ct. Cl. 1980).

send the checks by any means so long as they ultimately were received by the bank.<sup>81</sup>

In *Produce Factors v. United States*,<sup>82</sup> the assignee made loans to the contractor on the basis of invoices submitted to the government. The contractor submitted invoices to the government and then retrieved the invoices from the government before they had been reviewed by government officials. The court held that the government did not violate any duty to the assignee in allowing the contractor to retrieve earlier submitted invoices.<sup>83</sup> In *Security Bank & Trust Co. v. United States*,<sup>84</sup> the court held that a bank/assignee was not entitled to recover from the government funds lent to a contractor based upon the government's failure to notify the bank that the assigned contract had been terminated.<sup>85</sup> The court denied the bank's recovery even though the government had sent a letter to the bank indicating that the government would notify the bank immediately of the termination date.<sup>86</sup>

The good news for the lenders is that the Court of Claims has imposed a duty on the government to notify the lender if, upon receipt of a notice of assignment, "the Government *knows* that the right of the contractor to receive payments is worthless because the contractor has already been paid."<sup>87</sup>

### ***COMPLIANCE WITH THE ASSIGNMENT OF CLAIMS ACT DOES NOT CREATE A PERFECTED SECURITY INTEREST***

The Assignment of Claims Act, as previously discussed, has no applicability to disputes between private parties.<sup>88</sup> Compliance with the Act will not perfect a creditor's security interest in the government receivable. To perfect a security interest in such collateral, a lender must comply with the Uniform Commercial Code.<sup>89</sup> Compliance with the Act is no substitute for proper perfection.<sup>90</sup>

81. *Id.* at 810.

82. 467 F.2d 1343 (Ct. Cl. 1972).

83. *Id.* at 1347.

84. 731 F.2d 861 (Fed. Cir. 1984).

85. *Id.* at 866.

86. *Id.* at 863.

87. *Mercantile Nat'l Bank v. United States*, 280 F.2d 832, 836 (Ct. Cl. 1960) (emphasis added).

88. *See supra* note 23 and accompanying text.

89. *See, e.g., General Cable Co. v. Altek Sys., Inc. (In re Altek Sys., Inc.)*, 14 B.R. 144, 147 (Bankr. N.D. Ill. 1981) (where first bank perfected its security interest in all contractor's account receivables under Uniform Commercial Code and second bank later received assignment of government contract, court held that first bank was entitled to proceeds of government contract); *see also Vickery & Paalborg, supra* note 4, at 6 (only way to perfect security interest in government contract against non-government third parties is by filing in accordance with U.C.C. Article 9).

90. *Altek*, 14 B.R. at 147.

## **PRIORITIES AMONG CREDITORS' COMPETING CLAIMS AGAINST THE GOVERNMENT FOR FUNDS ASSIGNED TO A FINANCIAL INSTITUTION**

### **THE ASSIGNEE RECEIVES NO GREATER RIGHTS THAN ITS ASSIGNOR**

Generally, the assignee "stands in the shoes" of the assignor and receives no greater rights than the assignor.<sup>91</sup> Except as discussed below regarding the recovery of payments made by the government and certain offsets,<sup>92</sup> the assignee's rights are subject to all of the same defenses that could be raised against the contractor.<sup>93</sup>

In assessing the value of the government accounts receivable as collateral, a prudent lender should consider the potential for competing claims against that collateral. The remainder of this section discusses the types of competing claims that the financial institution, as assignee, may face, and how the courts have treated the priority of these claims. Since the Assignment of Claims Act does not apply to disputes between private parties,<sup>94</sup> the cases discussed below concern claims that involve the government, as for example, claims for funds withheld or setoff by the government, or claims for the recovery of erroneous payments by the government.

## **DOES THE SURETY HAVE PRIORITY OVER THE FINANCIAL INSTITUTION?**

### **The Miller Act Requires Both Performance Bonds and Payment Bonds on Construction Contracts**

The Miller Act<sup>95</sup> applies to federal construction contracts and requires the execution of performance bonds<sup>96</sup> and payment bonds<sup>97</sup> in connection with such contracts. The Miller Act also allows certain classes of labor and materialmen to recover under the payment bond.<sup>98</sup> Financial institutions should be aware that the assignee of a government contract is imputed

91. *National City Bank v. United States*, 163 F. Supp. 846, 852 (Ct. Cl. 1958); *Hardin County Sav. Bank v. United States*, 65 F. Supp. 1017, 1022 (Ct. Cl. 1946).

92. See *infra* notes 124-34 and accompanying text.

93. *Produce Factors Corp. v. United States*, 467 F.2d 1343, 1349 (Ct. Cl. 1972); see *Modern Indus. Bank v. United States*, 101 Ct. Cl. 808, 821 (1944).

94. See *supra* note 23 and accompanying text.

95. Ch. 642, § 1, 49 Stat. 793 (1935) (codified as amended at 40 U.S.C. § 270(a)-(d) (1988)).

96. FAR 28.001 (Standard Form 35), 53.301-35 (Annual Performance Bond), 48 C.F.R. §§ 28.001, 53.301-35 (1991).

97. FAR 28.001 (Standard Form 34), 53.301-34 (Annual Bid Bond), 48 C.F.R. §§ 28.001, 53.301-34 (1991).

98. See JOHN CIBINIC, JR. ET AL., *CONSTRUCTION CONTRACTING* 1222-99 (1991).



with the knowledge of the Miller Act's payment and performance bond requirements.<sup>99</sup>

***What Is the Priority of the Surety's Claims Over the Lender with an Assignment of Contract Proceeds?***

Sureties often assert claims against the government and other parties for payments when the surety is called upon under a performance or payment bond.<sup>100</sup> This section discusses the surety's claim to funds assigned to a financial institution under the Act. In the event the contractor defaults,<sup>101</sup> the surety may have obligations under either a performance bond or a payment bond.<sup>102</sup> Once the surety has performed under either bond, it enjoys rights superior to the assignee to funds due or to become due under the contract.<sup>103</sup> The surety's priority status stems from its equitable right of subrogation.<sup>104</sup> As one court explained:

When a surety on a Government contractor's performance bond makes a payment thereunder to or for the United States, he is subrogated to the rights of the Government as to any funds due or to become due under the contract. This subrogation, sometimes called an equitable lien, relates back to the date of the bond, and is therefore superior to any conflicting claim thereafter asserted by another. In like manner, when a Government contractor's surety on a payment bond makes a payment thereunder to suppliers of labor or material, he is subrogated to the rights and preferences of such suppliers as to

99. *Royal Indem. Co. v. United States*, 93 F. Supp. 891, 894 (Ct. Cl. 1950).

100. See *CIBINIC ET AL.*, *supra* note 98, at 1334-51.

101. The government enjoys broad rights under the Default Termination clauses. FAR 52.249-8 to -10, 48 C.F.R. § 52.249-8 to -10 (1991). For example, the contractor is liable for excess costs of procurement—any excess costs incurred in acquiring supplies or services similar to those terminated for default—and for any other damages. FAR pt. 49, 48 C.F.R. pt. 49 (1991).

102. For a discussion of the differences between a performance and a payment bond, see *Morrison Assurance Co. v. United States*, 3 Cl. Ct. 626, 632 (1983); see also *NASH & SCHOONER*, *supra* note 47, at 293-94.

103. *National Sur. Corp. v. United States*, 133 F. Supp. 381, 384 (Ct. Cl. 1955); *American Fidelity Co. v. National City Bank*, 266 F.2d 910, 914 (D.C. Cir. 1959).

104. The Claims Court explained that:

Equitable subrogation has been allowed when a surety finances a project to completion after default of the prime contractor. By financing the government's project to completion, the surety is equitably allowed to maintain a claim when normally it would lack standing to sue the government. The recovery available under equitable subrogation, however, has been limited to funds held by the government, or funds improperly disbursed to a third party, only to the amount of the contract balance.

*Westech Corp. v. United States*, 20 Cl. Ct. 745, 749 (1990).

sums due or to become due under the contract; and again the subrogation relates back to the date of the bond.<sup>105</sup>

The surety has priority over the assignee<sup>106</sup> whether the funds claimed are progress payments,<sup>107</sup> final payments,<sup>108</sup> or retainages.<sup>109</sup>

The assignee receives one small concession. Once a payment has been made to the assignee, the surety cannot recover that payment unless the payment was induced by fraud.<sup>110</sup> The surety may recover from the government, however, for funds wrongfully paid to an assignee.<sup>111</sup>

### **DO THE CONTRACTOR'S EMPLOYEES HAVE SUPERIOR RIGHTS TO THE FINANCIAL INSTITUTION?**

Assignees should recognize that certain social and economic policies in public contracts may affect their rights to contract payments.<sup>112</sup> When the

105. *American Fidelity*, 266 F.2d at 914 (footnote omitted). Further, since the bond is the first step in obtaining a construction contract, the surety's rights generally predate the bank's. See CIBINIC ET AL., *supra* note 98, at 134.

106. *Reliance Ins. Co. v. United States*, 15 Cl. Ct. 62, 67 (1988); *Argonaut Ins. Co. v. United States*, 434 F.2d 1362, 1369-70 (Ct. Cl. 1970); *National Shawmut Bank v. New Amsterdam Casualty Co.*, 411 F.2d 843, 848-49 (1st Cir. 1969).

107. For an extensive discussion of progress payments in government contracts, see FAR subpt. 32.5, 48 C.F.R. § 32.5 (1991); and SEYFARTH, SHAW, FAIRWEATHER & GERALDSON, *THE GOVERNMENT CONTRACT COMPLIANCE HANDBOOK* ch. 13 (Federal Publications, 2d ed. 1991).

108. Final payment is the last payment the government makes on a contract when the parties believe that all of their obligations under the contract have been met. Various clauses in government contracts expressly bar claims not asserted by a contractor before final payment. See JOHN CIBINIC, JR. & RALPH C. NASH, JR., *ADMINISTRATION OF GOVERNMENT CONTRACTS* 923-25 (2d ed. 1985).

109. The retainage represents a percentage of the progress payments due under a construction contract withheld by the government, either routinely or due to the contractor's failure to make satisfactory progress. See FAR 32.103, 48 C.F.R. § 32.103 (1991); FAR 52.232-5, 48 C.F.R. § 52.232-5 (1991); CIBINIC & NASH, *supra* note 108, at 898-906.

110. *American Fidelity Co. v. National City Bank*, 266 F.2d 910, 916 (D.C. Cir. 1959); *Bank of Ariz. v. National Sur. Corp.*, 237 F.2d 90 (9th Cir. 1956); *United States Casualty Co. v. First Nat'l Bank*, 157 F. Supp. 789, 795 (M.D. Ga. 1957). The court in *American Fidelity* based its conclusion upon the fact that the 1951 amendments to the Assignment of Claims Act prohibit the government from recovering progress payments made to the assignee, except in the case of fraud. The court reasoned that the surety could not then recover such sums from an assignee, unless the payments had been induced by fraud. 266 F.2d at 916.

111. *Great Am. Ins. Co. v. United States*, 492 F.2d 821, 827 (Ct. Cl. 1974); *cf. Industrial Bank of Wash. v. United States*, 424 F.2d 932, 935 (D.C. Cir. 1970) (surety's right of subrogation gives it no rights against assignee for funds paid by government).

112. The FAR's coverage of Socioeconomic Programs, which is incorporated into the procurement process to foster the achievement of national goals, include: FAR pt. 19, Small Business and Small Disadvantaged Business Concerns; FAR pt. 20, Labor Surplus Area Concerns; FAR pt. 22, Application of Labor Laws to Government Acquisitions; FAR pt. 23, Environment, Conservation, Occupational Safety, and Drug-Free Workplace; FAR pt. 24, Protection of Privacy and Freedom of Information; and FAR pt. 25, Foreign Acquisition. 48 C.F.R. pts. 19, 20, 22, 23, 24, 25 (1991).

contractor fails to pay its employees in accordance with federal wage and hour statutes, the courts consistently have found that the government may withhold funds assigned to the financial institution.<sup>113</sup> Several statutes regulate the wages paid to and the hours worked by employees on federal contracts. For example, the Davis-Bacon Act<sup>114</sup> requires payment of not less than the prevailing wage rate for that locality to workers on federal or federally funded construction contracts of over \$2,000.<sup>115</sup> Similarly, the Service Contract Act<sup>116</sup> requires that contractors pay not less than the prevailing wages and fringe benefits for contracts for performance of services.<sup>117</sup>

In *United California Discount Corp. v. United States*,<sup>118</sup> the government withheld contract payments because of the contractor's violation of the Service Contract Act and the Contract Work Hours and Safety Standards Act.<sup>119</sup> The court held that even if the plaintiff were a proper assignee under the Anti-Assignment Acts, the contractor was entitled to nothing under the contract due to these violations.<sup>120</sup> The assignee, therefore, also was entitled to nothing.<sup>121</sup>

The Claims Court also has held that the Davis-Bacon Act gives employees' claims priority over the assignee's claims.<sup>122</sup> The Federal Circuit similarly has rejected the argument that the government has a duty to make regular inspections for compliance with the federal wage laws.<sup>123</sup> This means that a financial institution may continue to lend against government receivables over a period of time without knowing that the contractor is violating federal wage and hour laws. The financial institution, therefore, must have safeguards in place to ensure the contractor's compliance with these laws.

113. See *United Cal. Discount Corp. v. United States*, 19 Cl. Ct. 504, 510 (1990); *Unity Bank & Trust Co. v. United States*, 5 Cl. Ct. 380, 383 (1984), *aff'd*, 756 F.2d 870 (Fed. Cir. 1985).

114. 40 U.S.C. § 276a (1988); see also FAR subpt. 22.4, 48 C.F.R. § 22.4 (1991).

115. See *NASH & SCHOONER*, *supra* note 47, at 119; *CIBINIC & NASH*, *supra* note 108, at 225-30.

116. 41 U.S.C. §§ 351-357 (1988); see also FAR subpt. 22.10, 48 C.F.R. § 22.10 (1991).

117. The Act also requires that contractors provide safe conditions of work. See *NASH & SCHOONER*, *supra* note 47, at 335; Gilbert J. Ginsburg et al., *The Service Contract Act*, 90-7 BRIEFING PAPERS (Federal Publications, June 1990).

118. 19 Cl. Ct. 504 (1990).

119. 40 U.S.C. § 327 (1988).

120. *United Cal. Discount Corp.*, 19 Cl. Ct. at 510.

121. *Id.*

122. *Unity Bank & Trust Co. v. United States*, 5 Cl. Ct. 380, 383 (1984), *aff'd*, 756 F.2d 870 (Fed. Cir. 1985).

123. *Unity Bank & Trust Co. v. United States*, 756 F.2d 870, 873 (Fed. Cir. 1985).

## *CAN THE GOVERNMENT RECOVER PAYMENTS IMPROPERLY MADE TO AN ASSIGNEE?*

In 1951, Congress amended the Assignment of Claims Act to provide that the government may not recover payments made to an assignee because of any liability of the contractor, whether arising from the contract assigned or independently,<sup>124</sup> except when payments are induced by fraud.<sup>125</sup> With this amendment to the Assignment of Claims Act, the Senate sought to:

make it clear that a bank or other financing institution taking an assignment of claims pursuant to the act would not be subject to later recovery by the Government of amounts previously paid to the bank as assignee, except, of course, that it would not prevent the Government from obtaining restitution of amounts which may have been paid as a result of fraud.<sup>126</sup>

Further, the FAR provides that:

No payments made by the Government to the assignee under any contract assigned in accordance with the [Assignment of Claims] Act may be recovered on account of any liability of the contractor to the Government. This immunity of the assignee is effective whether the contractor's liability arises from or independently of the assigned contract.<sup>127</sup>

Although precedent bolsters the statutory provision,<sup>128</sup> the provision applies only if the assignee is a valid assignee under the Act. If not, then

124. The Anti-Assignment Act states:

In any case in which moneys due or to become due under any contract are or have been assigned pursuant to this section, no liability of any nature of the assignor to the United States or any department or agency thereof, whether arising from or independently of such contract, shall create or impose any liability on the part of the assignee to make restitution, refund, or repayment to the United States of any amount heretofore since July 1, 1950, or hereafter received under the assignment.

41 U.S.C. § 15 (1988).

The Anti-Claims Act states: "An assignee under this section does not have to make restitution of, refund, or repay the amount received because of the liability of the assignor to the Government that arises from or is independent of the contract." 31 U.S.C. § 3727(e)(1) (1988).

125. *American Fidelity Co. v. National City Bank*, 266 F.2d 910, 916 (D.C. Cir. 1959). The fraud exception derives from case law and is not found in the statute.

126. S. REP. NO. 217, 82d Cong., 1st Sess. (1951), *reprinted in* 1951 U.S.C.C.A.N. 1414, 1415.

127. FAR 32.804(a), 48 C.F.R. § 32.804(a) (1991).

128. In *Great Am. Ins. Co. v. United States*, 492 F.2d 821, 826 (Ct. Cl. 1974), the court found that the 1951 amendments to the Assignment of Claims Act barred the government's right to recover. "As a general rule, the Government has a right to recover funds which its agents have erroneously paid to another. However, this general rule does not apply when an Act of Congress expressly bars recovery." *Id.* (citations omitted).

the government may be able to recover funds previously paid to a purported assignee. In *American National Bank & Trust*,<sup>129</sup> the court resolved whether the government was entitled to recover \$764,897.76 paid to the bank under an invalid assignment.<sup>130</sup> The bank, acting under an agreement between several other creditors of the contractor, paid over ninety percent of the funds received from the government to one of the other creditors. Nevertheless, the court held that the government was entitled to recover the erroneous payments from the bank.<sup>131</sup>

As a general rule, the government possesses the same right as any other creditor to offset claims.<sup>132</sup> Both the Sixth Circuit<sup>133</sup> and the Court of Claims,<sup>134</sup> however, held that the government cannot achieve by offset a recovery of payments made to an assignee which is prohibited by the Act.

129. *American Nat'l Bank & Trust Co. v. United States*, 23 Cl. Ct. 542 (1991).

130. *Id.* at 546.

131. *Id.* The court opined "without the proper authority, . . . [the government's] payments to plaintiff were contrary to the law and clearly erroneous. Established law clearly provides that the Government may recover funds which its agents have wrongfully, erroneously, or illegally paid." *Id.* at 547.

132. *Centron Corp. v. United States*, 585 F.2d 982, 985 (Ct. Cl. 1979).

133. In *Sigmon Fuel Co. v. Tennessee Valley Auth.*, 709 F.2d 440 (6th Cir. 1983) (citing *Mercantile Nat'l Bank v. United States*, 280 F.2d 832, 837 (Ct. Cl. 1960)), the court stated:

We agree with the . . . [government] that the [Assignment of Claims] Act does not flatly prohibit set-offs. The Act does, however, clearly prohibit the . . . [government] from requiring an assignee . . . to repay amounts received under the assignment. Since the . . . [government] may not require . . . [the assignee] to repay funds received under the assignment, it also may not indirectly achieve the identical result by setting-off the amounts previously paid against amounts subsequently due.

*Id.* at 441.

134. In *Chelsea Factors v. United States*, 181 F. Supp. 685 (Ct. Cl. 1960), the government overpaid on one shipment of goods from a contractor, who was later convicted of fraud against the government. The court held that while the contractor forfeited its right to be paid for the goods delivered, accepted, and used, the assignee did not lose its security.

We see no reason why a banker, or those for whom he acts in financing a Government contract, should forfeit their security because of fraudulent acts of another person in which they did not participate. We cannot see why any prudent person would lend a dollar to finance a Government contract, if such a risk were added to those normally inherent in the lending of money.

*Id.* at 690; *cf.* *Franklin E. Penny Co. v. United States*, 524 F.2d 668 (Ct. Cl. 1975) (while assignee is not subject to offset, it can be subject to counterclaims).

## CAN THE FINANCIAL INSTITUTION OBTAIN A NO-SETOFF COMMITMENT?

The Assignment of Claims Act allows a no-setoff commitment<sup>135</sup> to be inserted in government contracts in certain instances.<sup>136</sup> The FAR imple-

135. A no-setoff commitment is a contractual agreement that, to the extent permitted by the Assignment of Claims Act, payments by the government to the assignee under an assignment of claims will not be reduced to liquidate the contractor's indebtedness to the government. *See* FAR 32.801, 48 C.F.R. § 32.801 (1991); NASH & SCHOONER, *supra* note 47, at 276.

136. The Anti-Claims Act provides:

During a war or national emergency proclaimed by the President or declared by law and ended by proclamation or law, a contract with the Department of Defense, the General Services Administration, the Department of Energy (when carrying out duties and powers formerly carried out by the Atomic Energy Commission), or other agency the President designates may provide, or may be changed without consideration to provide, that a future payment under the contract to an assignee is not subject to reduction or setoff. A payment subsequently due under the contract (even after the war or emergency is ended) shall be paid to the assignee without a reduction or setoff for liability of the assignor—

(1) to the Government independent of the contract; or

(2) because of renegotiation, fine, penalty (except an amount that may be collected or withheld under, or because the assignor does not comply with, the contract), taxes, social security contributions, or withholding or failing to withhold taxes or social security contributions, arising from, or independent of, the contract.

31 U.S.C. § 3727(d) (1988).

The Anti-Assignment Act provides:

Any contract of the Department of Defense, the General Services Administration, the Atomic Energy Commission, or any other department or agency of the United States designated by the President, except any such contract under which full payment has been made, may, in time of war or national emergency proclaimed by the President . . . or by Act or joint resolution of the Congress and until such war or national emergency has been terminated in such manner, provide or be amended without consideration to provide that payment to be made to the assignee of any moneys due or to become due under such contract shall not be subject to reduction or set-off, and if such provision or one to the same general effect has been at any time heretofore or is hereafter included or inserted in any such contract, payments to be made thereafter to an assignee of any moneys due or to become due under such contract, whether during or after such war or emergency, shall not be subject to reduction or set-off for any liability of any nature of the assignor to the United States or any department or agency thereof which arises independently of such contract, or hereafter for any liability of the assignor on account of (1) renegotiation under any renegotiation statute or under any statutory renegotiation article in the contract, (2) fines, (3) penalties (which term does not include amounts which may be collected or withheld from the assignor in accordance with or for failure to comply with the terms of the contract), or (4) taxes, social security contributions, or the withholding of taxes or social security contributions, whether arising from or independently of such contract.

41 U.S.C. § 15 (1988).

ment the statute<sup>137</sup> and permit use of the no-setoff clauses<sup>138</sup> during periods of war or national emergency.<sup>139</sup> The FAR provide that the no-setoff clause will not be enforceable in two instances. First, where the assignee has made neither a loan nor a commitment to lend under the assignment, the no-setoff clause is unenforceable.<sup>140</sup> Second, where the amount due on the contract exceeds the amount of any loans made or funds committed, the no-setoff will not apply to the extent of the excess.<sup>141</sup> The courts have upheld the use of the no-setoff clause where the assignee has complied

137. FAR 32.804, 48 C.F.R. § 32.804 (1991), provides:

(b) Except as provided in paragraph (c) below, the inclusion of a no-setoff commitment in an assigned contract entitles the assignee to receive contract payments free of reduction or setoff for—

(1) Any liability of the contractor to the Government arising independently of the contract; and

(2) Any of the following liabilities of the contractor to the Government arising from the assigned contract:

(i) Renegotiation under any statute or contract clause.

(ii) Fines.

(iii) Penalties, exclusive of amounts that may be collected or withheld from the contractor under, or for failure to comply with, the terms of the contract.

(iv) Taxes or social security contributions.

(v) Withholding or nonwithholding of taxes or social security contributions.

(c) In some circumstances, a setoff may be appropriate even though the assigned contract includes a no-setoff commitment, e.g.—

(1) When the assignee has neither made a loan under the assignment nor made a commitment to do so; or

(2) To the extent that the amount due on the contract exceeds the amount of any loans made or expected to be made under a firm commitment for financing.

*Id.*

138. See FAR 52.232-23, 48 C.F.R. § 52.232-23 (*Alternate 1*) (1991), which adds the following sentence to the Assignment of Claims clause: "Unless otherwise stated in this contract, payments to an assignee of any amounts due or to become due under this contract shall not, to the extent specified in the Act, be subject to reduction or setoff."

139. For Department of Defense contractors, however, a national emergency always exists. The defense procurement regulations state that under 50 U.S.C. § 1651(a)(4), (5) (1988), a national emergency exists for contract purposes. Nevertheless, if departments or agencies decide it is in the government's interest, they may exclude the no-setoff commitment. DFARS 232.803(d), 48 C.F.R. § 232.803(d) (1991).

140. FAR 32.804(c), 48 C.F.R. § 32.804(c) (1991).

141. FAR 32.804(c), 48 C.F.R. § 32.804(c) (1991); see *supra* note 137 for text of this provision.

with the requirements of the Act,<sup>142</sup> even where the contract was induced by fraud.<sup>143</sup>

## **CAN THE ASSIGNEE RECOVER AGAINST THE GOVERNMENT?**

### ***WHAT FORA AND WHAT WAIVER OF SOVEREIGN IMMUNITY ARE AVAILABLE?***

Financial institutions must recognize that, in the event that problems arise involving their financing of a government contract, their remedy likely lies in an unfamiliar forum, the United States Court of Federal Claims.<sup>144</sup> Sovereign immunity typically protects the government from suit, and a specific waiver of sovereign immunity is necessary for a financial institution to sue the government.<sup>145</sup> Further, to the extent that the government waives its sovereign immunity, the statutory scheme directs financial institutions to the Court of Federal Claims, rather than the United States District Courts or the agency boards of contract appeals.<sup>146</sup>

### ***The Assignee/Financial Institution Lacks an Apparent Remedy in Federal District Court***

The federal district courts do not welcome government contract disputes generally,<sup>147</sup> or assignment of claims disputes specifically.<sup>148</sup> For example,

142. See, e.g., *Central Bank v. United States*, 345 U.S. 639, 646 (1953) (IRS not permitted to setoff where government contract included no-setoff clause); *In re Set-off Auth. of Gov't*, 62 Comp. Gen. 683 (1983); *In re Priority Between Fed. Tax Lien & Assignment Under Gov't Contract*, 60 Comp. Gen. 510 (1981); *In re McNeely*, 37 Comp. Gen. 318 (1957); *Continental Bank & Trust Co. v. United States*, 416 F.2d 1296 (Ct. Cl. 1969) (where contractor had paid assignee all sums lent in performance of an assigned contract but still owed assignee on other loans, government was not entitled to setoff amounts due by contractor on other contracts against amounts due to contractor under the assigned contract). *But see* *South Side Bank & Trust Co. v. United States*, 221 F.2d 813, 814 (7th Cir. 1955) (IRS permitted to setoff where language of contract expressly negated applicability of no-setoff clause).

143. *United States v. Peoples Bank & Trust Co. (In re Gulf Apparel Corp.)*, 140 B.R. 593 (Bankr. M.D. Ga. 1992).

144. The Court of Federal Claims, although located in Washington, D.C., routinely schedules trials throughout the country, 28 U.S.C. § 2505 (1988), and conducts telephonic hearings, motions, and status conferences. The Rules of the United States Court of Federal Claims (RCFC) are published as an appendix to Title 28 of the United States Code. Practitioners unfamiliar with the Claims Court should obtain *THE UNITED STATES CLAIMS COURT: A DESK-BOOK FOR PRACTITIONERS*, most recently published by the United States Claims Court Bar Association in 1987.

145. 28 U.S.C. § 1346 (1988).

146. *Id.* §§ 2501-2522.

147. For a recent discussion, see Phillip M. Kannan, *Jurisdiction of District Courts in Cases Involving Government Contracts*, 21 PUB. CONT. L.J. 416 (1992). See also *Management Science Am., Inc. v. Pierce*, 598 F. Supp. 223, 225 (N.D. Ga. 1984), *aff'd*, 778 F.2d 792 (11th Cir. 1985).

148. *But see, e.g., California Bank v. United States Fidelity & Guar. Co.*, 129 F.2d 751, 752-53 (9th Cir. 1942); *Federal Sav. & Loan Ins. Corp. v. C & J Oil Co.*, 632 F. Supp. 1296 (W.D. Va. 1986) (cases where government was not party to litigation).



the courts have dismissed suits even if both the assignor and assignee are parties to the litigation.<sup>149</sup> The United States Supreme Court has stated:

[T]his theory that an assignee can avoid the Act by joining his assignor as a party defendant or an unwilling party plaintiff, would not only subvert the Act but flood the courts with litigation by permitting them to recognize assigned claims which the accounting officers of the Government would be obligated to reject.<sup>150</sup>

Quite simply, the courts have held that the "central purpose" of the Anti-Assignment statutes is that "the government might not be harassed by multiplying the number of persons with whom it has to deal."<sup>151</sup>

In *Sterling National Bank & Trust Co. v. Teletronics Services, Inc.*,<sup>152</sup> the court held that the Assignment of Claims Act does not contain a grant of jurisdiction.<sup>153</sup> The court determined, therefore, that "the only possible basis for jurisdiction is general federal question jurisdiction under 28 U.S.C. § 1331."<sup>154</sup> The assignee and the court conceded, however, that section 1331 was not a waiver of sovereign immunity.<sup>155</sup> The court concluded that section 1331 did not alter the exclusive jurisdiction enjoyed by the (then) Court of Claims<sup>156</sup> over cases sounding in contract, including those that involve federal laws or regulations.<sup>157</sup>

For smaller claims, however, financial institutions may indeed have a remedy in the district courts. Pursuant to the Little Tucker Act,<sup>158</sup> the district courts possess jurisdiction, in cases in which the amount claimed against the United States does not exceed \$10,000, concurrent with the

149. See *United States v. Shannon*, 342 U.S. 288, 291-93 (1952); *Naartex Consulting Corp. v. Watt*, 722 F.2d 779 (D.C. Cir. 1983). In *Naartex*, the district court described the disputed claims as "a classic violation of the federal anti-assignment laws." *Naartex Consulting Corp. v. Watt*, 542 F. Supp. 1196, 1203 (D.D.C. 1982).

150. *Shannon*, 342 U.S. at 293. The Court expressed concern that "the assignor knew of no damage and refused to bring suit, yet by their assignment the Government is forced to defend this suit through the courts and deal with persons who were strangers to the damage and are seeking to enforce a claim which their assignors have foresworn." *Id.*

151. *Naartex*, 722 F.2d at 794 (citing *Shannon*, 342 U.S. at 291-93; *Hobbs v. McLean*, 117 U.S. 567, 576 (1886); *Scanwell Labs., Inc. v. Thomas*, 521 F.2d 941, 944 n.3 (D.C. Cir. 1975), *cert. denied*, 425 U.S. 910 (1976) (plaintiff, in bankruptcy, assigned its claim to its counsel, which later transferred claim back to plaintiff so that government had to deal with only one claimant)).

152. 471 F. Supp. 182 (S.D.N.Y. 1979).

153. *Id.* at 184.

154. *Id.* at 185.

155. *Id.*

156. See *supra* note 58 for discussion of bifurcation of the Court of Claims.

157. *Sterling Nat'l Bank*, 471 F. Supp. at 185-86 (citing *Estate of Watson v. Blumenthal*, 586 F.2d 925, 929 (2d Cir. 1978)).

158. 28 U.S.C. § 1346(a)(2) (1988). The United States Court of Appeals for the Federal Circuit, which entertains appeals from the Court of Federal Claims, also entertains appeals from judgments of the district courts pursuant to the Little Tucker Act. *Id.* § 1295(a)(2).

United States Court of Federal Claims pursuant to the Tucker Act, discussed *infra*.<sup>159</sup>

***The Assignee/Financial Institution Is Not a Contractor for the Purposes of the Contract Disputes Act***

As a general rule, contract disputes are resolved pursuant to the Contract Disputes Act of 1978 (CDA).<sup>160</sup> The CDA requires that contracting officers consider claims as a jurisdictional prerequisite.<sup>161</sup> If the contracting officer fails to render a decision upon a contractor claim, or renders an adverse decision, the contractor must elect its forum. The contractor may "appeal" the decision to the appropriate agency board of contract appeals (Boards)<sup>162</sup> or file a direct access suit in the Court of Federal Claims.<sup>163</sup> Appeals from either forum proceed to the United States Court of Appeals for the Federal Circuit.<sup>164</sup>

The assignee/financial institution, however, is not a contractor and, as a result, cannot maintain an action against the government under the CDA.<sup>165</sup> "[T]he requirement of privity of contract must be shown for all parties attempting to maintain a suit as a contractor against the Government under the Contract Disputes Act of 1978."<sup>166</sup> The court explained:

[N]either the prime contract nor the contract of assignment was a tripartite agreement. To the contrary, both were separate and distinct subject matter contracts. That is to say, plaintiff was not a party to the former contract, and the government was not a party to the latter. Thus, under no hypothesis can it be said that plaintiff herein was in privity with the United States under either contract.<sup>167</sup>

This result proves consistent with the legislative history of the CDA, which attempted to "provide a single point of contact between the contracting officer and the *contractor*."<sup>168</sup>

159. See *infra* note 176 and accompanying text.

160. 41 U.S.C. §§ 601-613 (1988 & Supp. II 1990).

161. *Id.* § 605(a).

162. Boards of contract appeals are administrative boards established by procuring agencies to hear and decide disputes under the CDA. *Id.* §§ 606, 607.

163. *Id.* § 609.

164. 28 U.S.C. § 2522 (1988); 41 U.S.C. § 607(g) (1988 & Supp. II 1990).

165. *Thomas Funding Corp. v. United States*, 15 Cl. Ct. 495, 501-02 (1988).

166. *Id.* at 501 (citing *Erickson Air Crane Co. v. United States*, 731 F.2d 810, 813 (Fed. Cir. 1984)). See also *United States v. Johnson Controls, Inc.*, 713 F.2d 1541, 1548-52 (Fed. Cir. 1983) (privity of contract under agency theory requires three factors: (i) prime contractor acting as purchase agent, (ii) agency relationship established by clear contractual consent, and (iii) contract makes government directly liable to vendors).

167. *Thomas Funding*, 15 Cl. Ct. at 501.

168. *Id.* (emphasis in original) (citing S. REP. No. 1118, 95th Cong., 2d Sess. 16 (1978), reprinted in 1978 U.S.C.A.N. 5235, 5250).

Boards of contract appeals have found that by assenting to and recognizing an assignment of a contract, as opposed to mere payments, the government can waive the anti-assignment statutes, and permit an assignee to prosecute an appeal in its own name as a "contractor."<sup>169</sup> The Boards have assumed jurisdiction over a contractor's assertion that the government breached its contract when the government offset (against a payment due a bank) an overpayment on that contract,<sup>170</sup> and a demand for a payment allegedly made improperly to a financial institution.<sup>171</sup> In these disputes, however, the contractor, rather than the bank, commenced the suit against the government. Further, the Boards have held that an assignee lacked jurisdiction under the CDA to challenge the termination for default of a lease,<sup>172</sup> that a successor to an assignee could not intervene in a board proceeding,<sup>173</sup> and that an insurance company could not intervene in a board proceeding.<sup>174</sup>

169. *Rodgers Constr., Inc. & Fed. Ins. Co.*, IBCA Nos. 2777 *et al.*, 92-1 B.C.A. (CCH) ¶ 24,503, at 122,307-08 (Oct. 15, 1991). *See also* *In-Vest Corp.*, GSBCA No. 6365, 83-1 B.C.A. (CCH) ¶ 16,502, at 82,008-09 (Apr. 29, 1983) (government's recognition of responsible party indicated waiver of Anti-Assignment Act and implied consent to assignment); *Radiatronics, Inc.*, ASBCA No. 15,133, 75-2 B.C.A. (CCH) ¶ 11,349, at 54,069 (June 19, 1975) (Navy consented to assignment of contract by joining in amendments to the contract, by accepting deliveries, and by express admission in answer on appeal); *Vertical Aviation Trans. Systems, Inc.*, ASBCA No. 18,266, 74-1 B.C.A. (CCH) ¶ 10,617, at 50,363-66 (Apr. 19, 1974) (what constitutes government's recognition of successor in interest on contract was matter of substance, not form). *But see* *CBI Services, Inc.*, ASBCA No. 34,983, 88-1 B.C.A. (CCH) ¶ 20,430, at 103,334 (Dec. 8, 1987) (acquiescence of government in assignment of contract must be shown by affirmative steps).

170. *Cage Co. of Abilene*, ASBCA No. 25050, 84-2 B.C.A. (CCH) ¶ 17,293, at 86,136, 86,141 (Mar. 27, 1984). The contractor asserted that, as a result of the offset, an error that the government promptly remedied, the contractor's bank refused to continue funding the contract. Absent funding, the contractor ceased performance, and the government terminated the contract for default. The contractor failed to demonstrate that it sought financing elsewhere or that the offset was the primary or dominant cause of bank's decision to cease funding the contract. The board upheld the default termination.

171. *W.C. Shay*, HUD BCA No. 77-1A, 77-2 B.C.A. (CCH) ¶ 12,821, at 62,416 (Oct. 20, 1977). In determining the propriety of payment to a Savings and Trust Company, the contractor asserted that the board of contract appeals had jurisdiction to determine whether the government paid the wrong party and whether the contractor was justly due the proceeds claimed. In order to assume jurisdiction over the pre-CDA dispute, the board identified the contract's "payment clause" as the remedy-granting clause properly within the coverage of the "disputes clause."

172. *Broadlake Partners*, GSBCA No. 107,103, 92-1 B.C.A. (CCH) ¶ 24,699, at 123,266, 123,271 (Dec. 31, 1991) (assignment did not fall within one of recognized exceptions to contractual prohibition against assignment, nor did contracting officer waive prohibitions).

173. *Wyoming Nat'l Bank of Wilkes-Barre, Pa. v. United States*, 154 Ct. Cl. 590, 594-95 (1961) (affirming Armed Services Board decision).

174. *Zurn Engineers*, IBCA No. 1176-12-77, 78-2 B.C.A. (CCH) ¶ 13,335, at 65,188, 65,193-95 (July 20, 1978) ("the Board [of contract appeals] would be passing upon questions of law extrinsic to determining the rights of the parties to the contract and, therefore, acting outside the purview of its limited jurisdiction").

Because the assignee/financial institution cannot proceed pursuant to the CDA, therefore, the assignee cannot seek relief from a board of contract appeals. Nor can the assignee seek a CDA remedy from the United States Court of Federal Claims. Other avenues, however, may permit the assignee to seek relief in the Court of Federal Claims.

***The Tucker Act Alone Does Not Permit the Assignee to Litigate in the United States Claims Court***

The Tucker Act,<sup>175</sup> the Court of Federal Claims' primary jurisdictional statute, cannot alone provide a broader jurisdictional avenue to the Court of Federal Claims than that found in the CDA.<sup>176</sup> Assignees, for example, cannot maintain a breach action against the United States because they lack privity of contract with the government.<sup>177</sup> Moreover, a potential litigant must identify a statute providing a monetary remedy before the claimant can assert jurisdiction in the Court of Federal Claims. More specifically, the Tucker Act does no more than provide a forum for a claimant to pursue a proper remedy against the government.<sup>178</sup>

***The Anti-Assignment Statutes Entitle the Assignee to a Forum in which to Seek Relief***

Both of the United States Court of Federal Claims' predecessors, the Claims Court and the Court of Claims, have recognized that an assignee is entitled to sue the government to recover payments for work performed

175. Pub. L. No. 102-572, § 901, 106 Stat. 4506 (1992).

176. Pursuant to the Tucker Act, the Court of Federal Claims possesses jurisdiction to entertain any suit for money against the United States, which does not sound in tort, and which is founded upon: (1) the Constitution, (2) an act of Congress, (3) an Executive Order, (4) a regulation of an Executive Department, or (5) any express or implied-in-fact contract with the United States. *Id.*

177. *Thomas Funding Corp. v. United States*, 15 Cl. Ct. 495, 499-501 (1988) (citing *Produce Factors Corp. v. United States*, 467 F.2d 1343 (Ct. Cl. 1972)). The court also rejected the assignee's assertion that it was an intended third-party beneficiary with enforceable breach rights against the United States. *See also American Nat'l Bank & Trust Co. v. United States*, 22 Cl. Ct. 7, 13-14 (1990) and cases cited therein.

178. The Claims Court explained:

Nothing in . . . [the Tucker] Act . . . creates, in and of itself, a substantive right of recovery against the United States. Rather, the Act merely vests the Claims Court with jurisdiction when such a right independently exists. A claimant must look beyond the Tucker Act to discover and plead a money-mandating predicate upon which to complete jurisdiction.

*Westech Corp. v. United States*, 20 Cl. Ct. 745, 748 (1990) (citing *United States v. Testan*, 424 U.S. 392, 398 (1976); *United States v. Connolly*, 716 F.2d 882, 885 (Fed. Cir. 1983) (en banc), *cert. denied*, 465 U.S. 1065 (1984)).

by the contractor.<sup>179</sup> Nonetheless, the assignee (plaintiff), as the party asserting that the court possesses jurisdiction to entertain its claim, bears the burden of establishing subject matter jurisdiction.<sup>180</sup>

The Court of Federal Claims, again like the Claims Court and the Court of Claims, is a court of limited jurisdiction.<sup>181</sup> The Court of Federal Claims may entertain claims or grant relief only to the extent that the government has waived its sovereign immunity.<sup>182</sup> Further, waivers of sovereign immunity, or consent to be sued, must be expressed unequivocally and cannot be implied.<sup>183</sup> Jurisdiction based upon a statutory grant must be construed strictly, and all conditions placed upon such a grant must be satisfied before invoking the court's jurisdiction.<sup>184</sup>

The assignee, therefore, does not enjoy unfettered discretion in defining the parameters of its suit. An assignee "may only bring a suit against the government for *wrongful payment to a third party*, and may *not* maintain an action for breach of contract in [the Court of Federal Claims]." <sup>185</sup> The Claims Court has distinguished a claim for breach of contract—which requires privity of contract with the government<sup>186</sup>—from a claim for a remedy the assignee enjoys pursuant to the Anti-Assignment statutes as follows:

Under the Assignment of Claims Act, once notice of the assignment is duly given to the government, [the government] has a duty to make payments directly to the assignee for work performed by the assignor. In this case, the government received notice of the assignment . . . from which time it owed a duty . . . to make payments directly [to the financial institution]. As any failure to fulfill this duty is an actionable offense on the part of the government, this court has jurisdiction under the Assignment of Claims Act only for plaintiff's claim for

179. *Twin City Shipyard, Inc. v. United States*, 21 Cl. Ct. 582, 588 (1990); *Thomas Funding Corp. v. United States*, 15 Cl. Ct. 495, 502 (1988); *Florida Nat'l Bank v. United States*, 4 Cl. Ct. 396 (1984); *Merchants Nat'l Bank v. United States*, 689 F.2d 181 (Ct. Cl. 1982); *Tuftco Corp. v. United States*, 614 F.2d 740 (Ct. Cl. 1980); *Produce Factors Corp. v. United States*, 467 F.2d 1343 (Ct. Cl. 1972).

180. *National Sur. Corp. v. United States*, 20 Cl. Ct. 407, 409 (1990); *Pasco Enters. v. United States*, 13 Cl. Ct. 302, 305 (1987).

181. *Dynallectron Corp. v. United States*, 4 Cl. Ct. 424, 428, *aff'd mem.*, 758 F.2d 665 (Fed. Cir. 1984); *see also Soriano v. United States*, 352 U.S. 270, 273 (1957) (court noted it is settled that Congress restricted jurisdiction of Court of Claims).

182. *United States v. Testan*, 424 U.S. 392, 399 (1976); *United States v. Sherwood*, 312 U.S. 584, 586 (1941).

183. *Library of Congress v. Shaw*, 478 U.S. 310, 316 (1986); *Testan*, 424 U.S. at 399; *United States v. King*, 395 U.S. 1, 4 (1969).

184. *Cosmic Constr. Co. v. United States*, 697 F.2d 1389, 1390 (Fed. Cir. 1982). "In construing a statute waiving the sovereign immunity of the United States, great care must be taken not to expand liability beyond that which was explicitly consented to by Congress." *Fidelity Constr. Co. v. United States*, 700 F.2d 1379, 1387 (Fed. Cir.), *cert. denied*, 464 U.S. 826 (1983).

185. *Thomas Funding Corp. v. United States*, 15 Cl. Ct. 495, 502 (1988).

186. *Id.* at 499.

wrongful payment. The Act [,however,] did not give this court jurisdiction to entertain actions in breach of contract brought against the government by assignees.<sup>187</sup>

Quite simply, "a valid assignment of contract proceeds, standing alone, does not create privity of contract between the assignee and the United States."<sup>188</sup>

### ***HOW MUCH CAN THE ASSIGNEE RECOVER ONCE IT PREVAILS AGAINST THE GOVERNMENT?***

Although the financial institution may sue the government and recover payments due, the financial institution may find its recovery disappointing. First, the assignee cannot obtain a windfall recovery. "An assignee's recovery from the United States is limited to the extent of that assignor's outstanding debt to the assignee."<sup>189</sup>

Worse yet, the financial institution may not always find itself made whole. The lender's outstanding debt likely continued to accrue interest during the litigation against the government. If the assignee asserted a similar claim against a commercial entity, the assignee could claim interest upon the accounts receivable outstanding.<sup>190</sup> The assignee of government payments, however, should not expect to prevail upon a claim of interest based upon receivables owed by the government. As a general rule, a plaintiff cannot recover interest on a claim against the government absent a statutory or contractual right to that interest.<sup>191</sup> Interest on a claim against the United States shall be allowed in a judgment of the Court of Federal Claims only under a contract or act of Congress that expressly provides for payment.<sup>192</sup>

187. *Id.* at 502 (citing 31 U.S.C. § 3727 (1988); 41 U.S.C. § 15 (1988)).

188. *Twin City Shipyard, Inc. v. United States*, 21 Cl. Ct. 582, 588 (1990). *But see* *D&S Universal Mining Co. v. United States*, 10 Cl. Ct. 707, 710 (1986) (due to nature of 8(a) contract, government (through Small Business Administration) entered into "Agreement As To Special Numbered Account" with prime contractor, subcontractors, and financial institution).

189. *American Nat'l Bank & Trust Co. v. United States*, 22 Cl. Ct. 7, 13 (1990) (citing *Security Bank & Trust Co. v. United States*, 731 F.2d 861 (Fed. Cir. 1984); *Continental Bank & Trust Co. v. United States*, 416 F.2d 1296 (Ct. Cl. 1969)).

190. The invoice typically would include an interest provision.

191. 28 U.S.C. § 2516 (1988).

192. *Id.*; *see also* *Getty Oil Co. v. United States*, 767 F.2d 886 (Fed. Cir. 1985) (waivers of sovereign immunity will be strictly construed under § 2516); *J.F. Shea Co. v. United States*, 754 F.2d 338, 340 (Fed. Cir. 1985) (while sovereign immunity cannot be waived absent express consent by Congress, contract at issue expressly provides for interest payment); *First Nat'l City Bank v. United States*, 548 F.2d 928, 937 (Ct. Cl. 1977) (citing *United States v. Mescalero Apache Tribe*, 518 F.2d 1309, (Ct. Cl. 1975), *cert. denied*, 425 U.S. 911 (1976)) (plaintiff not entitled to recover interest on claim against government absent showing right to interest under statute or contract); *Florida Nat'l Bank of Miami v. United States*, 5 Cl. Ct. 396, 397 (1984) (plaintiff not entitled to interest on government's improper payment under valid

In most government contract disputes, however, prevailing contractors do recover interest upon their claims. The CDA specifically provides for the payment of interest from the date the contracting officer receives the contractor's claim until the government makes payment to the contractor.<sup>193</sup> An assignee, however, cannot be a "contractor" pursuant to the CDA. As previously discussed,<sup>194</sup> "the term 'contractor' means a party to a Government contract other than the Government"—a definition that excludes financial institutions.<sup>195</sup>

Nor should the assignee expect to recover interest based upon the "interest clause" typically found in government contracts. The interest clause aids neither contractors nor assignees. It benefits the government, and no other party. The government includes the interest clause in its contracts because, although the CDA provides for interest based upon contractor claims,<sup>196</sup> the statute does not provide for interest upon government claims. The government's right to interest, therefore, is contained in the contract clause.<sup>197</sup>

Finally, the Prompt Payment Act (PPA)<sup>198</sup> arguably could serve the assignee, although no precedent appears to support such a conclusion.<sup>199</sup> The PPA requires that the government pay interest for delayed payments

assignment absent express contract or statute); *Maryland Small Business Dev. Fin. Auth. v. United States*, 4 Cl. Ct. 76, 80 (1983) (government liable only for amount wrongfully paid under valid assignment); *Morrison Assurance Co. v. United States*, 3 Cl. Ct. 626, 638 (1983) (well established that interest not allowed on claim against government). *But see Chelsea Factors v. United States*, 181 F. Supp. 685, 693 (Ct. Cl. 1960) (assignee can collect sums due under contract from government even if such sums will be used to pay interest on contractor's loan from assignee).

193. The Contract Disputes Act (CDA) provides that:

Interest on amounts found due contractors on claims shall be paid to the contractor from the date the contracting officer receives the claim pursuant to section 605(a) of this title from the contractor until payment thereof. The interest provided for in this section shall be paid at the rate established by the Secretary of the Treasury pursuant to Public Law 92-41 (85 Stat. 97) for the Renegotiation Board.

41 U.S.C. § 611 (1988). The interest rate is set every six months. The government does not pay compound interest.

194. *See supra* note 20 and accompanying text.

195. 41 U.S.C. § 601(4) (1988).

196. 41 U.S.C. § 611 (1988).

197. *See FAR 33.208*, 48 C.F.R. § 33.208 (1991) (referencing FAR 32.614, 48 C.F.R. § 32.614). *See also* the interest clause which states, in pertinent part: "Notwithstanding any other clause of this contract, all amounts that become payable by the contractor to the Government under this contract . . . shall bear simple interest from the date due until paid unless paid within 30 days of becoming due." FAR 52.232-17(a), 48 C.F.R. § 52.232-17(a) (1991) (emphasis added).

198. 31 U.S.C. §§ 3901-3907 (1988).

199. The applicable contract clauses are found at FAR 52.232-25 to -27, 48 C.F.R. § 52.232-25 to -27 (1991). For a recent, extensive discussion of the PPA, see Michael J. Renner, *Prompt Payment Act: An Interest(ing) Remedy for Government Late Payment*, 21 PUB. CONT. L.J. 177 (1992).

under a government contract. The statute requires that interest be paid to a "business concern,"<sup>200</sup> but the Office of Management and Budget (OMB) Circular<sup>201</sup> uses the term *contractor*.<sup>202</sup> A financial institution, in order to recover PPA interest therefore, would face the same hurdles discussed with regard to the CDA. Unless the court found that the assignee was a contractor, the assignee could not recover interest pursuant to the PPA.

## **CONCLUSION**

In considering government receivables as a potential source of collateral, a financial institution may be tempted to view such receivables as a virtually guaranteed stream of payments. Unlike lending against commercial receivables, the lender need not worry whether the contractor's customer (the government) will be able to pay a valid invoice due to insolvency. Lenders unfamiliar with the special privileges of the government in the commercial area, however, should take heed. Lending against government receivables carries its own inherent risks.

Even assuming strict compliance with the Act, there are situations in which the government may be obligated to make contract payments to a party other than the assignee. In the event the contractor has violated certain federal wage statutes, the government may pay employees out of contract payments prior to paying the assignee. If a contractor defaults on a construction contract, the government may pay performing sureties over the assignee. In the absence of a no-setoff commitment in the contract, the government may setoff other claims, for example, IRS claims against the contractor, against amounts due under the contract. Moreover, in the event the lender does not receive the payments due under the contract, it may be forced to litigate its claims in an unfamiliar forum.

The assignment of moneys due or to become due under a government contract can be a valuable form of collateral. That collateral, however, requires special expertise and monitoring by the lender. The prudent lender will not embark on such financing without careful consideration of both its risks and rewards.

200. 31 U.S.C. § 3901(a)(2) (1988).

201. The Office of Management and Budget (OMB) is responsible for the promulgation of regulations pursuant to the Prompt Payment Act. As a result, the Prompt Payment Act is implemented by OMB Circular A-125 and FAR subpt. 32.9, 48 C.F.R. § 32.9 (1991).

202. See 54 Fed. Reg. 52,700 (1989); 52 Fed. Reg. 21,926 (1987); 50 Fed. Reg. 14,688 (1985); 49 Fed. Reg. 28,140 (1984); 48 Fed. Reg. 37,321 (1982).



