Transportation

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-195351.2 April 30, 1980

The Honorable A. Vernon Weaver
Administrator, Small Business Administration AGC00002

Dear Mr. Weaver:

This is our response to your General Counsel's request for reconsideration of our decision, B-195351, dated January 21, 1980, on the claim of the Security DLG03677 Bank & Trust Company, Lawton, Oklahoma (Bank), against the Small Business Administration (SBA) arising from an "8(a)" contract arrangement involving Bluford Service Company (Bluford) for food services at Fort Sill, DLG03678 Oklahoma. The factual basis for that decision was provided by documented reports from the SBA and the Department of the Army, and there we considered the positions of all parties. After considering the additional points presented by the SBA and the Bank, we affirm our earlier conclusion that the Government is not liable to the Bank.

The facts are undisputed. Under the provisions AGC00020 of section 8(a) of the Small Business Act, the SBA DLG03067 entered into a prime contract with the Army and the SBA entered into a subcontract with Bluford. Bluford was to provide services at Fort Sill. Based upon a valid assignment of contract proceeds, the Bank granted a line of credit to Bluford in the amount of $80,000 to be repaid from the semimonthly contract payments each of which exceeded $80,000. The assignment authorized and directed that contract payments be made directly to the Bank. Originally, the prime contract covered the period from October 1, 1976, through September 30, 1977, but the contract period was extended by contract modifications through September 30, 1978. A February 25, 1978, modification provided that the contract could be terminated for the convenience of the Government in the event that a contract was awarded under a then pending solicitation at any time prior to September 30, 1978.

[REQUEST for RECONSIDERATION] 010182

By letter of March 10, 1978, to the Bank, SBA forwarded a copy of the modification, explained the circumstances of its issuance, and advised, in effect, that 30 days' notice would be given prior to any termination. SBA further stated that "[i]t is our opinion that an award will not be made on this within the remaining period." The contract was terminated for convenience by modification dated August 24, 1978, effective August 31, 1978; however, neither the SBA nor Fort Sill expressly informed the Bank of the termination of Bluford's contract. Fort Sill directly awarded another contract dated August 30, 1978, under the then pending solicitation to Bluford for the 1-month period covering September 1978.

Prior to the direct Fort Sill-Bluford contract, the Bank issued $80,000 notes semimonthly which would be repaid by checks sent directly to the Bank from Fort Sill and made payable to the Bank. Routinely, on September 8, 1978, Bluford borrowed $80,000, but on September 22, 1978, Bluford paid its note with a Fort Sill check made payable to it and the check was personally delivered to the Bank. At Bluford's request that same day, the Bank issued a new note--the subject of the claim--for $80,000 to become due on or before October 22, 1978. On October 10, 1978, Bluford received final payment on the second contract for $85,378.84. None of this money was used to repay the Bank and the Bank demanded payment of the money due on the note plus interest and attorneys fees from the SBA.

The January 21, 1980, decision noted that any theory of Government liability advanced by the parties hinged upon the Bank's absence of notice of termination of the first contract. In the circumstances then in the record, we concluded that the Bank knew or should have known that the Army's contractual relationship with Bluford substantially and materially changed to the Bank's detriment prior to the last loan to Bluford.

The prior decision noted that (1) from the outset, the Bank took prudent measures to insure Bluford's payment of any loan by requiring that the Army make Bluford's payments under the contract payable only to the Bank so that Bluford received contract proceeds from the Bank only after the Bank was repaid in full;

(2) over 6 months prior to the last loan, the Bank was advised that the first contract was modified expressly to include the termination for convenience of the Government clause permitting the Army to terminate at any time, which would clearly foreclose the possibility of 30 days' notice in some cases despite SBA's assurances to the contrary; and (3) the Bank was notified by SBA that the Army, under a pending solicitation, was attempting to make another award for the services provided by Bluford.

The prior decision concluded that the above circumstances effectively placed the Bank on notice that it was to rely on Bluford's ability and willingness to honor any future notes. Rather than diligently following the status of the contract following receipt of the March 10 letter and after the drastic disruption of the payment pattern, the Bank knowingly elected to loan Bluford additional monies without any Government involvement. In our view, the paramount and proximate cause of the Bank's failure to receive final payment was its tacit agreement to assume the risk of default, permit the Government to pay Bluford directly, and permit Bluford, in turn, to pay the Bank.

On reconsideration, the General Counsel states the following. The Bank clearly did not have actual knowledge that the contract had been terminated. The concept of imputed notice is not applicable here because the Bank's actual knowledge of the facts would not have led a reasonably cautious person to make inquiry as to the ultimate facts. The only fact which could have alerted the Bank of a change of circumstances in this case was that a teller in the Bank deposited a check which was written and sent to Bluford rather than the Bank. Otherwise, the circumstances were unchanged. The check was in the usual amount and form; it was deposited on the usual day; and Bluford was still performing in the manner in which it had in the past. Further, no notice of termination was given by the Army; no notice had been received from SBA as promised; and Bluford had not advised the Bank of any change. The General Counsel concludes that, at most, the above facts would lead a reasonably prudent lender to assume a harmless mistake by the Army or a change in procedures,

whereas the type of act which would have put the Bank on inquiry regarding the continued existence of the contract serving as security would have been nonpayment when due. Further, the General Counsel notes that the cases dealing with imputed notice are decided upon the unique facts in each case, and no case on all fours with the facts in the instant matter was found.

In an effort to learn more about the circumstances surrounding the September 22, 1978, loan, we requested relevant information from the counsel for the Bank. Counsel confirmed that the check in payment for the services for Bluford for the first half of September was made directly to Bluford instead of the Bank; "The Vice President who handled the loan was not made aware of this until the check was presented to him on September 22, 1978." Counsel also reports that at that time, the check was deposited in Bluford's account, the Bank's loan was repaid and the advance in question was made to cover the payroll for Bluford for the last half of September.

In the Bank's view, "the simple fact that the Government check from Fort Sill was made payable to Bluford instead of the Bank was insufficient notice to alert the Bank to anything" since it is not unusual that mistakes in the issuance of Government checks come to the attention of the Bank. The significance of a changed payee on the check was, in the Bank's opinion, totally insufficient for the Bank to assume, first, that the Army would fail to give notice to the Bank of the termination or cancellation of the contract, and, second, that the assurance of SBA of any material change which might prejudice the Bank's position in the matter would not immediately be given by SBA.

The only matter not of record in the prior decision is the Bank counsel's statement regarding the circumstances of the September 22, 1978, loan repayment and new loan. The new information that a Bank vice president (rather than a teller) was the official who handled the transaction for the Bank tends to reinforce our earlier conclusion.

We recognize that applicable regulations require notice of termination be given to an assignee in

certain circumstances and the record does not contain any evidence that either the Army or SBA gave the Bank express notice of termination of the first Bluford contract. Further, it appears that Bluford did not tell the Bank of the termination. The lack of express notice from the Government to the Bank, however, is not determinative here. As indicated in the earlier decision, we believe that the above-listed circumstances were enough to place the Bank on notice that its security interest had been detrimentally affected.

Although it is important, as pointed out by the Bank, that the Government observe its duty of notifying the assignee of contract termination, we believe that it is equally important that, in these circumstances, the assignee be alert to significant and drastic changes in payment practices and procedures.

Thus, after reviewing the comments of the General Counsel in the light most favorable to the Bank, and after noting in SBA's report that there is no controlling judicial precedent, at best the matter is a doubtful claim. Pursuant to longstanding precedent, the courts should decide the matter if the claimant elected to pursue that course. See Longwill v. United States, 17 Ct. Cl. 288 (1881); Charles v. United States, 19 Ct. Cl. 316 (1884); 33 Comp. Gen. 394 (1954) ("When a case arises with respect to which there is no controlling judicial precedent and as to which substantial doubt exists as to the action which a court of competent jurisdiction might take, it is regarded as the duty of the accounting officers to deny the claim and leave the claimant to his remedy in the courts.").

Accordingly, no basis has been presented to modify or reverse the January 21, 1980, decision.

Sincerely yours,

Milton J. Socolar

For the Comptroller General
of the United States