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

B-177648

August 10, 1973

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Spitz & Grossman
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Corpus Christi, Texas 78401

Attention: Oscar Spitz, Esq.

Gentlemen:

This is in reply to your letter of May 21, 1973, and earlier correspondence, relative to the claim of Centron Corporation (Centron) for royalty payments in connection with Value Engineering Change Proposal (VECP) EG-01, submitted under Contract No. DAAA09-69-F-0046, between the Small Business Administration (SBA) and the United States Army Ammunition Procurement and Supply Agency (APSA).

This contract, entered into on September 4, 1968, pursuant to section 8(a)(1) of the Small Business Act, 15 U.S.C. 637(a)(1), called for the furnishing of 310,000 bandoleers for 40mm cartridges at a price of $201,500. SBA awarded subcontract No. SBA-0022-8(a) on September 13, 1968, to Elegant Garments, Inc.. (Elegant), for the performance of the prime contract. Since Elegant, an ethnic minority-owned company, was unable to obtain conventional financing, SBA authorized advance payments in accordance with its policy of aiding such concerns to become competitive, self-sustaining businesses.

On August 19, 1969, SBA and APSA entered into Contract No. DAAA09-70-C-0006, for an additional 200,000 of the same bandoleers at the same unit price. This additional quantity was added to the original subcontract between SBA and Elegant by Modification No. 1 to that subcontract, raising the total contract price to $331,500.

Centron, an unsuccessful bidder for the bandoleer contract, had previously submitted a Value Engineering Change Proposal (VECP) to APSA on August 13, 1969, which suggested that a cost saving could be

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realized if uncapped snap fasteners were substituted for capped fasteners specified in the 40mm cartridge bandoleer IFB. By agreement dated September 24, 1969, Centron assigned all its right, title, and interest in the VECP to Elegant and agreed to furnish all necessary documents, drawings, and specifications connected therewith in return for Elegant's promise to submit said VECP immediately to AP&A and turn over to Centron 85 percent of the resulting monies received under the Value Engineering Incentive Clause in its subcontract with SBA. In order to implement this latter provision, paragraph 8 of their September 24th agreement provided that a joint escrow arrangement would be set up to apportion the proceeds.

When Elegant refused to cooperate in establishing the joint escrow arrangement after the VECP was accepted by AP&A, Centron brought an action in the United States District Court for the Northern District of Illinois (Civil Action No. 70 C 1919) seeking a preliminary injunction restraining Elegant from disposing of funds already received under the VECP and requiring SBA, also named as a party defendant, to deposit into the Court all future royalties pending a determination of Elegant's and Centron's respective contract rights. On August 8, 1970, the Court entered a judgment order whereby the parties (except SBA) consented to stipulations that the September 24, 1969, agreement was valid and binding between said parties; that a joint escrow account would be established with the American National Bank and Trust Company of Chicago as escrow agent; and that Elegant would deliver written instructions to SBA directing that all royalties on the VECP be paid to the bank.

SBA was represented at the hearing but refused to enter into the stipulations; because, as Centron's counsel explained to the Court, the Government did not want to waive any rights to the proceeds it might otherwise possess, particularly since the money going into escrow might be subject to an offset by SBA against a prior indebtedness owed to it by Elegant. Centron offered no objection to the exclusion of SBA from the judgment.

In October 1970, SBA acknowledged receipt of a notice of assignment of VECP royalties from Elegant to the bank. On February 10, 1971, Centron sent to SBA a guaranty agreement executed by Elegant, Centron, and the First National Bank of Mineral Wells, Texas, covering royalties that may become repayable to the United

States due to cancellation or termination of orders. This guaranty agreement was acknowledged by SBA on February 24, 1971. On December 1, 1970, and March 11, 1971, SBA paid the bank the sums of $9,078.56 and $69,[illegible]5.97, respectively, less certain deductions due SBA by Elegant.

VECP EG-01 was subsequently approved for use with the bandoleer M7 f/Mine, APERS, MlBAl. Elegant, without consulting Centron, decided to negotiate a lump-sum settlement with the Government in lieu of royalty payments. Thereafter, the Government agreed to pay Elegant $4,000 in "full and final settlement of all claims of the contractor for monies earned as a result of Government acceptance of VECP EG-01 for use with the Bandoleer, M7 f/Mine, APERS, MlBAl." This settlement was incorporated as Modification No. 5, executed in April 1971, to the SBA prime contract and the Elegant subcontract. Centron was not a party to the modification and the $4,000 was paid directly to Elegant.

Elegant subsequently defaulted on a total of $40,000 owed to SBA in connection with the initial advance payments under its subcontract with SBA. Centron has been informed that it is SBA's intention to set off all royalty payments due Elegant and received by SBA under its contract with APSA against Elegant's indebtedness.

SBA's position, as expressed in its report to our Office, is that the judgment order issued by the District Court excepted SBA and thus is not binding. SBA believes that there is no privity of contract between SBA and Centron. Moreover, SBA contends that the purported assignment by Elegant to Centron of 85 percent of the VECP is not enforceable since it is contrary to the "anti-assignment" statutes, 31 U.S.C. 203; 41 U.S.C. 15.

On the other hand, Centron contends that the withholding of royalties by SBA for set-off purposes is in disregard of the court order. It is Centron's position that SBA is a mere stakeholder without a proprietary interest in the proceeds of VECP EG-01 in which Centron has always had an 85 percent beneficial ownership. Centron asserts that the assignment of these royalties did not violate the "anti-assignment" statutes. Centron further alleges that the lump-sum settlement in lieu of royalties on the M7 bandoleer, which was reached by the Government and Elegant without the participation or consent of Centron, was an arbitrary and unauthorized action for which SBA is obliged to make Centron whole.

A threshold issue is the contention that SBA is bound by the consent order of the District Court to recognize the validity of the assignment of 85 percent of the proceeds of the VECP to Centron. However, it is well settled that a person not a party to a stipulation is not bound thereby, especially where the judgment or stipulation expressly excepts a person from its operation. See C.J.S., Stipulations, section 14.

Since the Court's order is not dispositive of the rights of SBA and Centron to the royalties accrued under the VECP, it is necessary to determine the priority of their respective claims. As mentioned above, Elegant received advance payments under its subcontract. The advance payment provision reads, in part:

> (10) Prohibition Against Assignment. Notwithstanding any other provision of this contract, the Subcontractor shall not transfer, pledge, or otherwise assign this contract, or any interest therein, or any claim arising thereunder, to any party or parties, bank, trust company, or other financing institution.

The subcontract further provided, in pertinent part:

> (14) Representations and Warranties. To induce the making of advance payments, the Subcontractor represents and warrants that--
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> * * * * *
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> (e) None of the assets of the Subcontractor is subject to any lien or encumbrance of any character except for current taxes not delinquent, and except as shown in the financial statements furnished by the Subcontractor to the Contracting Officer. There has been no assignment of claims under any contract affected by these advance payment provisions, or if there has been any assignment, such assignments have been terminated.
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> * * * * *
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> (g) These representations and warranties shall be continuing and shall be deemed to have been repeated by the submission of each request for advance payments.

The clear intent of the preceding provisions is to secure the repayment of the original advance payment which SBA made to Elegant to enable it to perform the bandoleer contract. In consideration thereof, Elegant agreed not to assign any claim arising under its subcontract. VECP EA-01 was incorporated into the above subcontract by Modification No. 2 on January 13, 1970; thus, Elegant's claim or interest in the monies flowing from this VECP constitutes a claim arising under the contract which falls squarely within the purview of the quoted contractual prohibition against assignment of such claims. Accordingly, Elegant's purported assignment of 85 percent of the royalties of VECP EG-01 to Centron was ineffectual and in derogation of the rights of the Government under the subcontract.

While you characterize the arrangement between Centron and Elegant as "a joint venture to secure and perform a public contract," we do not believe that the purported set-off is adversely affected thereby. The debt SBA seeks to set off arose under the same contract which gave rise to the VECP royalties and, for that reason, it may not be said that the set-off involves a prior unrelated debt of Elegant that a joint venturer might be protected against.

Respecting the initial recognition of the assignment and the payment of royalties to the assignee bank, we adopt with approval the SBA legal rationale as stated in its report to our Office:

> "* * * The 'anti-assignment' statutes have been construed to exist solely for the benefit of the Government and thus permit the Government to assent to and recognize an assignment where it deems it appropriate. * * * Therefore, it is our opinion that it was legally unobjectionable for SBA to, as it did, elect to honor the assignment as to some payments and then decline, as it did, to recognize the assignment as to further payments. [Cases and authorities cited.]"

Accordingly, we conclude that no valid objection may be raised by our Office to the set-off action contemplated by SBA.

Sincerely yours,

Paul G. Dembling

For the Comptroller General
of the United States