

DL-1  
Mr. Boyle

12620



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

B-195351

January 21, 1980

The Honorable A. Vernon Weaver  
Administrator, Small Business  
Administration

*Doc 2*

*DLB-03677*

Dear Mr. Weaver:

*DLB-03678*

*SBA]*

This is our decision on the claim of the Security 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, Oklahoma. The factual basis for the decision was provided by documented reports from the SBA and the Department of the Army, and we have considered the positions of all parties. We conclude that the Government is not liable to the Bank.

I. Factual Summary

*4A*

Under the provisions of section 8(a) of the Small Business Act, the SBA entered into prime contract No. DABT39-76-C-3164, dated September 20, 1976, with the Army. The SBA subcontracted the performance of this 1-year contract to provide cooks and dining facility attendants at Fort Sill by entering into subcontract No. SB6328(a) 77C-700, dated October 1, 1976, with Bluford.

*Prime Contractors  
Subcontractors  
Contractor payments  
Government liability  
Bank loans  
Delinquent loans  
Debt Collection*

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 bimonthly 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

*008385*

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. 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 contract No. DABT39-78-C-3202 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 bimonthly which would be repaid by checks sent directly 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 has demanded payment of the money due on the note plus interest and attorneys fees from the SBA.

The sole basis of the Bank's claim is that it continued to loan Bluford money in reliance on the SBA's March 10 written promise to notify it 30 days prior to termination of Bluford's first contract, which the SBA did not do. In addition, the SBA also questions (1) whether the Army was required to notify the Bank of the termination, and (2) whether the Government's failure to notify the Bank of the first contract termination makes the Government liable for Bluford's subsequent default on the last bank payment.

## II. The Bank's Actual or Constructive Notice

Any theory of Government liability advanced by the parties hinges upon the Bank's absence of actual or constructive notice of termination of the first contract. Union National Bank of Austin, Texas, B-187445, January 27, 1977, and cases cited therein. In the circumstances of this case, we believe that the Bank did know 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.

First, from the outset, the Bank took prudent measures to insure Bluford's payment of any loan since the valid assignment of contract required that the Army make Bluford's payments under the contract payable only to the Bank. Procedurally, Bluford received contract proceeds from the Bank only after the Bank was repaid in full directly by the Army. That procedure reasonably protected the Bank's interests and provided an effective measure of security for the Bank. That procedure was in effect continuously for almost 2 years.

In contrast, prior to the last loan, a sudden and significantly different payment procedure occurred. Bluford repaid the loan with an Army check payable to it, not the Bank. Moreover, Bluford was in possession of the check instead of it being sent directly to the Bank by the Army. The Bank was or should have been aware that its past security for future loans no longer existed.

Second, 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. Further, 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.

From these facts, we believe that the Bank was alerted months in advance that Bluford's contract was near an end and the possibility that the end would be sudden. With that notice, it would have been reasonably prudent for the Bank to have been especially watchful concerning the existence of the security for future loans to Bluford, namely, the continued existence of the Bluford subcontract.

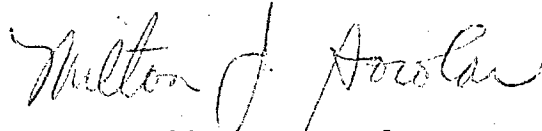
In sum, the above circumstances effectively placed the Bank on actual or constructive notice that it was to rely on Bluford's ability and willingness to honor any future notes. Rather than diligently following the status of the contract following receipt of the March 10 letter and after the drastic disruption 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.

### III. Recommendation

We recommend that the Government (SBA and the Army) deny liability for the reasons stated and disallow the Bank's claim.

By letter of today, we are notifying the Secretary of the Army of our decision.

Sincerely yours,



For The Comptroller General  
of the United States