

**DOCUMENT ISSUE**

01926 - [A1052027]

[Proper Disposition of Money Withheld by Federal Agency from Company Which Is Now in Bankruptcy]. B-187997. April 11, 1977. 7 pp.

Decision re: Cascade Reforestation, Inc.; by Robert P. Keller, Deputy Comptroller General.

Issue Area: Federal Procurement of Goods and Services: Reasonableness of Prices Under Negotiated Contracts and Subcontracts (1904).

Contact: Office of the General Counsel: Procurement Law I. Budget Function: General Government: Other General Government (906).

Organization Concerned: National Aeronautics and Space Administration; Internal Revenue Service; Department of Labor; Peerless Insurance Co.; Bank of Willamette Valley, Dallas, OR.

Authority: Assignment of Claims Act (31 U.S.C. 203; 41 U.S.C. 15). Bankruptcy Act, sec. 60(a) (11 U.S.C. 95(a)). Contract Work Hours and Safety Standards Act (40 U.S.C. 327 et seq.). Service Contract Act (41 U.S.C. 351 et. seq.). 26 U.S.C. 6321. 37 Comp. Gen. 318. B-170748 (1971). E-178198 (1973). D-185962 (1976). B-161460 (1967). B-170454 (1970).

The Director of Administrative Services of the Forest Service requested a decision concerning the proper disposition of \$14,706 withheld from Cascade Reforestation, Inc. The money was withheld pending the investigation of wage underpayments. GAO was asked to determine the priority of claims to the money from various claimants and whether the company was liable for the debts incurred by its director. All wage claims should be settled first, with any monies remaining being remitted to bankruptcy trustee. The company was not liable for the director's debts. (SS)

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F. Phillips  
Proc. I

**DECISION**



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

**FILE: B-187997**

**DATE: April 11, 1977**

**MATTER OF: Cascade Reforestation, Inc.**

**DIGEST:**

1. Workers underpaid under Contract Work Hours and Safety Standards Act, 40 U.S.C. § 327, et seq., and Service Contract Act, 41 U.S.C. § 351, et seq., would have priority over assignee to funds withheld from amount owing contractor since contract contained provision allowing Government to withhold funds pursuant to two acts to satisfy wage underpayment claims. Assignee can acquire no greater rights to funds than assignor has and since certain employees were underpaid and amount sufficient to cover underpayments was withheld, assignor has no right to funds to assign.
2. Claims by workers underpaid under Contract Work Hours and Safety Standards Act and Service Contract Act would prevail over IRS tax liens which matured subsequent to underpayments.
3. Courts, as well as this Office, recognize that unpaid laborers have equitable right to be paid from contract retainages and unpaid workers would have higher priority to funds withheld from amounts owing contractor than would trustee in bankruptcy.
4. While IRS is entitled to setoff against assignee-bank any of its claims against assignor-contractor which matured prior to assignment, agency may not set off claims which matured subsequent to assignment.
5. Where assignee has filed assignment with contracting agency in accordance with Assignment of Claims Act, 31 U.S.C. § 203, 41 U.S.C. § 15 (1970), it will have perfected assignment to extent that funds assigned under assignment cannot be attached by trustee in bankruptcy, unless trustee in bankruptcy can prove that there was preferential transfer.
6. Federal tax lien, unrecorded as of time of bankruptcy, is invalid against trustee in bankruptcy which would have priority to funds withheld from amount owed bankrupt contractor under contract.

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7. Where president of corporation leaves corporation and enters into several contracts with Government, as individual, claims against individual arising out of contracts may not be set off against funds withheld from amount owing corporation under contract which was signed by individual in his capacity as president of corporation.

The Director, Administrative Services, Forest Service, United States Department of Agriculture, has requested an advance decision concerning the proper disposition of \$14,706 withheld from Cascade Reforestation, Inc. (Cascade), which is currently in bankruptcy.

The \$14,706 was earned by Cascade for performance of Forest Service contract 13-1540, awarded on September 14, 1972, for tree planting in the Kaniksu National Forest. This amount was withheld pending the outcome of a Department of Labor (DOL) investigation of wage underpayments which, according to a letter dated October 25, 1972, from the DOL Regional Administrator, amounted to \$11,500.

There are several claimants and potential claimants to the funds and this Office has been requested to determine the priority of these claims. We have also been requested to answer the question of whether claims against Mr. Jerry M. Sullivan, who was president of Cascade until September 1, 1972, may be settled with funds owed Cascade.

The following have submitted claims for the money:

1. The Bank of Willamette Valley, Dallas, Oregon, on September 29, 1972, was assigned all monies due under contract 13-1540.
2. The trustee in bankruptcy for Cascade, by letter of December 29, 1972, requested that, after the wage claims were satisfied, the balance should be remitted to him.
3. By letter of June 21, 1976, DOL requested that the Forest Service transfer \$7,366.76 to them for disbursement. This amount represents \$6,427.73 finally determined due on contract 13-1540, plus \$939.03 due on region 3 contract 11-512 resulting from Service Contract Act (SCA) wage underpayments. Also, in connection with contract 13-1540, a total of \$230 was assessed for 23 violations of the Contract Work Hours and Safety Standards Act (CWHSSA), 40 U.S.C. § 327, et seq., and a total of \$108.07 is owed in CWHSSA overtime back wages. Included in the

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\$6,427.73 due under contract 13-1540 is an amount claimed by Klamath Reforestation, Inc. (Klamath), which did some of the tree planting as a subcontractor for Cascade. However, the contracting officer was not advised of the subcontract arrangement and, therefore, Klamath was not an approved subcontractor. Klamath's four underpaid employees were considered employees of Cascade.

4. Also, the DOL, San Francisco, in its letter of July 30, 1976, requested the transfer of \$2,075.36 due on contracts made by Mr. Jerry M. Sullivan as an individual. According to DOL, this amount covers \$702.13 wage underpayments under region 3 contract 14-1772 and \$1,373.23 wage underpayments under region 4 contract 15-1137. In connection with the latter contract, the Forest Service is claiming \$1,253.15 resulting from a default action against Mr. Sullivan. Also, the Forest Service claims an amount of \$4,489.89 for procurement costs resulting from a default by Mr. Sullivan as an individual on contract 02904.

5. The Internal Revenue Service (IRS) is claiming an amount of \$20,914.24 plus accrued interest and penalty covering Cascade's tax indebtedness.

6. The Peerless Insurance Company, the surety on the performance bond under contract 13-1540, has requested that the monies on hand be withheld until the period for filing claims has elapsed. However, since this was a performance bond, once work was completed the surety's obligation would cease. No payment bond was required on this contract.

Regarding the question of whether claims against Mr. Sullivan arising out of contracts between Mr. Sullivan as an individual and the Government may be settled with funds owed Cascade, we recognize that the Government has the same right as any other creditor to apply the unappropriated monies of its debtor, in its hands, to the extinguishment of debts due. United States v. Munsey Trust Company, 332 U.S. 234 (1947). However, this common law right of setoff would not be applicable in the present case since the evidence of record indicates that the contracts between the Government and Mr. Sullivan were entered into by Mr. Sullivan as an individual, many months subsequent to both the Cascade contract and Mr. Sullivan's departure from Cascade. It has been held that a duly organized business corporation enjoys an identity separate and apart from its stockholders, directors and officers. Gottlieb v. Sandia American Corporation, 452 F.2d 510 (1971). As a separate legal entity, a corporation

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cannot be required to pay legal obligations which are not its own. See Missouri Pacific Railroad Company v. Slayton, 407 F.2d 1078 (1969). We are of the view that the above rule can be extended to Mr. Sullivan in connection with the liabilities he incurred individually since there is no evidence that, after September 1, 1972, Cascade acquiesced or agreed to assume Mr. Sullivan's future liabilities or that Mr. Sullivan was in any way connected with Cascade. This being the case, the claims against Mr. Sullivan arising out of his contracts with the Government may not be settled with funds owed Cascade under contract 13-1540.

It is recognized that unpaid laborers have an equitable right to be paid from contract retainages. B-178198, August 30, 1973. Also, see Pearlman v. Reliance Insurance Company, 371 U.S. 132 (1962), where the court gave priority in withheld funds to a surety (who had paid laborers and materialmen) over the trustee in bankruptcy. In a similar case, Hadden v. United States, 132 Ct. Cl. 529 (1955), the court in giving priority to the claims of unpaid laborers over the claim of the trustee in bankruptcy stated:

"\* \* \* In the cases referred to above, the plaintiff was a surety company, asserting rights derived from its payment of laborers and materialmen. If this right is enforceable, the laborers and materialmen, in whose shoes the surety in those cases stood, must have had rights. \* \* \*"

Thus, we conclude that the request by DOL for \$7,366.76 covering wage underpayments would have priority over any claim by the trustee in bankruptcy. The trustee in bankruptcy apparently recognizes this priority since, as previously mentioned, only the balance of the funds has been requested after the wage claims have been satisfied.

Regarding the priority of claims as between unpaid workers and the assignee, the court in The National City Bank of Evansville v. United States, 143 Ct. Cl. 154, 163 F. Supp. 846 (1958), stated, in pertinent part:

"It is well established that \* \* \* by assignment the assignee could acquire no greater rights than its assignor. \* \* \*"

Contract 13-1540 contained a provision allowing the Government to withhold funds pursuant to the CWHSSA and the SCA to satisfy unpaid wage claims and CWHSSA liquidated damages.

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The DOL, pursuant to SCA, determined that the assignor had underpaid its employees in violation of this act and an amount sufficient to satisfy these unpaid wage claims was withheld from monies owing under the contract. Thus, the assignor had no right in the withheld fund, at least to the extent of the wage claims, to transfer to the assignee. Accordingly, it is our view that the claims for unpaid wages would have priority over the claim by Cascade's assignee. See B-178198, August 30, 1973. According to the record, the assignee had no objections to the wage claims being given priority over its claim.

Concerning the priority between the unpaid wage claims and IRS's tax lien, this Office has held that available funds should be applied first to the wage underpayments. B-170784, February 17, 1971, B-161460, May 25, 1967. Under the circumstances of the present case, we are of the view that priority should be given to the payment of unpaid wage claims in the amount requested for disbursement by DOL.

In regard to the priority between the IRS and the assignee, both the courts and this Office have held that in the absence of a no setoff provision in the contract, the Government, i.e., the IRS, is entitled to set off against the assignee-bank any of its claims against the assignor-contractor which had matured prior to the assignment. South Side Bank & Trust Co. v. United States, 221 F.2d 813 (1957), B-170454, August 12, 1970. Also, see Acme Electrical Supply, Inc., B-185962, April 7, 1976, 76-1 CPD 234. However, under the common law applicable to assignments, debts of the assignor which mature after an assignment is made may not be set off against payments otherwise due the assignee.

In this regard, in 37 Comp. Gen. 318 (1957), we stated:

"\* \* \* If the assignment of the contract proceeds was made before the tax became due, there would be no property or right to property owned by the taxpayer to which the lien could attach, at least to the extent of the assignee's entitlement to such proceeds."

In the present case the contract does not contain a "no set off" provision. However, we are advised that IRS sent out a tax assessment letter for \$6,894 on December 18, 1972, and another assessment letter for \$637.52 on June 18, 1973. It is on these

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two dates that IRS's claims matured. See 26 U.S.C. § 6321. Thus, since the assignment was effective as of September 29, 1972, the assignee would have a higher priority to the funds than would the IRS.

As to the priority between the assignee and the trustee in bankruptcy, generally, where, as in the present case, the assignee has filed its assignment with the Government agency involved in the contract to be performed by the bankrupt, in accordance with the Assignment of Claims Act, 31 U.S.C. § 203, 41 U.S.C. § 15 (1970), it will have perfected the assignment to the extent that the assignment cannot be attached by the trustee in bankruptcy. See Scarborough v. Berkshire Fine Spinning Associates, 128 F. Supp. 948 (1955). Thus, the assignee would have a higher priority to the funds than would the trustee in bankruptcy.

However, under section 60(a) of the Bankruptcy Act, 11 U.S.C. § 96(a), the assignment may be set aside or voided if the trustee in bankruptcy can prove that there was a preferential transfer. In order for there to be a preferential transfer, the following elements must be present: (1) a transfer of any of the property of a debtor; (2) for the benefit of a creditor; (3) for or on account of an antecedent debt; (4) made or suffered by such debtor while insolvent; (5) within 4 months before the filing of the petition initiating a proceeding under the Act, and (6) the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class. Diamond Door Co. v. Lane-Stanton Lumber Company, 505 F.2d 1199 (1974). In the present case we note that the notice of assignment was dated September 26, 1972, and acknowledged on September 29, 1972, while the letter from the trustee in bankruptcy requesting setoff against the withheld funds is dated December 29, 1972. This would indicate to us that element number (5) above, i.e., the assignment was made within 4 months of the date the bankruptcy petition was filed, is present. However, the evidence of record is insufficient to establish the presence of the other required elements. Of course, should it be established that all six elements did, in fact, exist in connection with the assignment, the trustee in bankruptcy would have a higher priority to the withheld funds than would the assignee. However, it should be kept in mind that the mere fact that the assignment was made within 4 months of bankruptcy does not mean that the assignment was preferential. See Cumberland Portland Cement Company v. Reconstruction Finance Corporation, 140 F. Supp. 739 (1953). Should

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the above-mentioned elements exist in the present case, we must consider whether the IRS or the trustee in bankruptcy would have a higher priority to the funds.

In United States v. Speers, Trustee in Bankruptcy, 382 U.S. 266 (1965), the court held that a Federal tax lien, unrecorded as of time of bankruptcy, was invalid against a trustee in bankruptcy. Thus, in the present case the trustee would have a higher priority to the funds than would the IRS since evidence of record indicates that the bankruptcy petition was filed prior to December 5, 1972, which predates both IRS tax liens.

Accordingly, the full amount of the wage claims under contracts Nos. 13-1540 and 11-512 should be satisfied from the withheld funds. Next, any CWSSA wage underpayments under contract 13-1540 and liquidated damages should also be paid from the withheld funds. However, the sum of \$337.07, representing the \$108.07 CWSSA underpayments under contract 13-1540 and \$230 CWSSA liquidated damages, should be retained by the Forest Service pending receipt of findings and recommendations which will presumably be contained in the DOL report promised by the Assistant Regional Administrator for Wages and Hours in a June 31, 1976, letter, after which these amounts may be disbursed in accordance with normal procedures. The balance of the funds should be remitted to the assignee, the Bank of Willamette Valley, provided that it is determined that the assignment was not a voidable preference. If it is determined that the assignment was a voidable preference, the balance should be remitted to the trustee in bankruptcy.

  
Deputy Comptroller General  
of the United States