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JURISDICTION OF EQUITABLE SUBROGATION CLAIMS AGAINST THE FEDERAL GOVERNMENT-- HOW TO KEEP THE BLUE FOX OUT OF THE HEN HOUSE

John V. Burch, Esq.
BOVIS, KYLE & BURCH, LLC
53 Perimeter Center East
Third Floor
Atlanta, Georgia 30346-2298
(770) 391-9100

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INTRODUCTION

The United States Supreme Court's recent opinion in *Dept. of Army v. Blue Fox, Inc.*, 525 U.S. 255, 119 S.Ct. 687, 142 L.Ed.2d 718 (1999) has the potential of spawning some of the most significant litigation in the area of equitable suretyship in the last 100 years. This decision has been urged by Government lawyers (wrongly) as standing for the proposition that federal courts do not have jurisdiction over a claim of equitable subrogation which may be asserted by a surety against the Government. There is a case presently pending in the Federal Circuit of the Court of Appeals which deals with this important jurisdictional question and whatever the Court of Appeals decides, it would not be surprising to see the case go to the United States Supreme Court.

The beginning point of understanding the background in this argument is to recognize that Federal Government attorneys will assert jurisdictional defenses whenever they can. Government attorneys would vastly prefer to have a case kicked out on jurisdictional grounds to having to deal with the merits of the claim. Addressing the merits of a claim involves discovery, motions, trials and the possibility that the Government may have to pay the plaintiff. A successful jurisdictional defense ends the claim at a very early stage and insures that in spite of the merits of a claim, the Government pays nothing. No one can blame Federal Government attorneys for asserting jurisdictional defenses; they are simply doing the best job they can of winning the case. They have now come up with a new argument urging that the *Blue Fox* decision stands for the proposition that the surety is not entitled to enter the courthouse door in asserting a claim of equitable subrogation against Uncle Sam.

THE *BLUE FOX* DECISION

Given the significance of this case and what it says and does not say, it may be helpful to walk through the history of the litigation.

A. The Facts

Blue Fox was a subcontractor working on a project for a switching system at Umatilla Army Depot, Oregon. The SBA agreed to furnish supplies and services to the Army, and the SBA entered into an agreement with the Army under § 8A of the Small Business Act, 15 U.S.C. § 637(a). The SBA agreed to provide these items to the Army by a subcontract with Verdan Technology, Inc. The Army, SBA and Verdan then signed a tri-parte agreement. The SBA delegated responsibility for administering the contract to the Army, and Verdan was paid directly by the Army.

Somehow the Army deleted the bond requirements. The Army and the SBA conceded in litigation however that Verdan's contract for $432,392.00 was subject to the Miller Act, 40 U.S.C. §§ 270a - 270d. (The SBA never granted an exemption to Verdan from the Miller Act).

Blue Fox, Inc. entered into a subcontract with Verdan to construct a concrete block housing project for $186,347.00. Blue Fox did not know that Verdan had failed to provide payment and performance bonds. Verdan advised the Army on May 26, 1994 and June 15, 1999 that it had not been fully paid and that $46,586.00 remained unpaid. In spite of these notices, the Army disbursed over $86,000.00 to Verdan between July 5, 1994 and October 11, 1994.

In January, 1995 the Army ultimately terminated Verdan for default. One of the reasons identified by the Army in terminating them was their failure to pay Verdan. The Army then entered into a contract with another party to complete the project and the completion cost of $126,000.00 was partially funded by the undisturbed balance on the Verdan contract of $85,000.00.

Blue Fox obtained a default judgment against Verdan and its officers in the Tribal Court of the Yakima Indian Nation. Both are insolvent. These facts are set out in the opinion of the Circuit Court, *Blue Fox, Inc. v. Small Business Admin.*, 121 F.3d 1357 (9th Cir. 1997).

B. Blue Fox's Jurisdictional Argument

Since Blue Fox had no contract with the Army it had to come up with an imaginative basis for asserting jurisdiction. It is, of course, a basic proposition of Federal law that the United States may not be sued unless there is an express waiver of jurisdiction.

The Administrative Procedure Act, 5 U.S.C. § 702, provides that sovereign immunity against Federal agencies has been waived as to suits "seeking relief other than money damages". Blue Fox asserted an equitable lien against funds held by the Army as of the date of Blue Fox's demand against the Army. Blue Fox urged that these funds were subject to an equitable lien of the subcontractor and that an action for specific performance for the payment of money subject to this lien was not an action for money damages.

D. The District Court Decision

The order of the District Court is not published. The District Court decision holding that it did not have jurisdiction over Blue Fox's suit against the Army because of sovereign immunity went up on appeal. *Blue Fox, Inc. v. Small Business Admin.*, 121 F.3d 1357 at 1360 (9th Cir. 1997).

E. The Circuit Court Decision

The 9th Circuit reversed the decision of the trial court and its two to one decision held that the District Court did have jurisdiction over Blue Fox's claim. Basically the appeal court held that Blue Fox's claim was an equitable lien claim, i.e. a non-damage claim, and that because it did not seek money damages, the District Courts had jurisdiction under the Administrative Procedure Act.

Among the cases the 9th Circuit relied upon was *Aetna Cas. & Sur. Co. v. United States*, 731 F.3d 475 (2nd Cir. 1995). In this case Aetna had issued a surety bond to the Government guaranteeing Black Lung payments of LTV Steel Company to the extent of $5.5

million. LTV became bankrupt and the Dept. of Labor began to make Black Lung payments on its behalf and called on Aetna to pay its bond limits, which Aetna did. Aetna then asserted an equitable subrogation claim in the United States District Court. (Aetna did not assert a claim for equitable subrogation in the Court of Federal Claims - the forum which has repeatedly held that it has jurisdiction of such actions.) Aetna asserted that under the Administrative Procedure Act it was entitled to assert an equitable lien on the tax refund, and the Court of Appeals, noting cases such as *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962), treated a claim of equitable subrogation as a claim in equity, not in damages, and that the District Court should consider the claim of equitable subrogation under the Administrative Procedure Act, which provides that the District Court has jurisdiction of claims involving not asking for money damages.

The *Blue Fox* opinion jumped on this line of reasoning. The 9th Circuit cited cases such as *Henningsen v. United States Fid. & Guar. Co.*, 208 U.S. 404, 28 S.Ct. 389, 72 L.Ed. 547 (1908) and *Pearlman, supra.*, as standing for the proposition that the surety's claim of equitable subrogation is a creature of equity and that under the APA the District Court had jurisdiction against the Government for equitable subrogation claims. 121 F.3d at 1361-1362. The 9th Circuit recognized that Blue Fox did not have a right of subrogation against the Army, but it did have an equitable lien.

The dissent hammered the majority opinion and noted that never before has a court held that a subcontractor could sue an agency of the United States which had not agreed to be sued for contract monies that the prime should have paid to the sub. It pointed out that the law for decades has been that subs cannot afford a lien on Government property unless the Government has waived sovereign immunity.

The dissent then pointed out that "[N]o matter how you slice Blue Fox's claim, it seeks funds from the Treasury to compensate for the Army's failure to require Verdan to post a bond." 121 F.3d at 1364.

Finally, the dissent repeated that the sub's sole remedy for getting paid was under the Miller Act. It also noted that when the prime contractor fails to obtain a Miller Act payment bond and then defaults, it is the hapless subcontractor, not the United States, left holding the bag. 121 F.3d 1364, citing *Automatic Sprinkler Corp. v. Darla Envt'l. Specialists, Inc.*, 53 F.3d 181, 182 (7th Cir. 1995).

The final point is simply to note, as did the dissent, that *United States v. Munsey Trust*, 332 U.S. 234, 67 S.Ct. 1599, 1602, 91 L.Ed. 2022 (1947) states that, " [N]othing is more clear than that laborers and materialmen do not have enforceable rights against the United States for their compensation."

F. The Supreme Court Decision

Chief Justice Rhenquist delivered a unanimous opinion overturning the 9th Circuit and essentially adopting the dissent's view. It held in a nutshell that waiver of sovereign immunity must be strictly construed, and that the APA did not contain such a waiver.

The Court noted that § 702 of the APA does provide that District Courts have jurisdiction for claims seeking relief other than money damages against agency action or inaction. 5 U.S.C. § 702. However, the Court correctly recognized that the equitable lien sought by Blue Fox constituted a claim for money damages. Blue Fox's goal was to seize or attach money in the hands of the Government as compensation for a loss resulting from the default of the prime contractor. The contract balance had been paid out by the Army in spite of Blue Fox's demands, and the claim of an equitable lien was obviously a clear attempt to reach into the Federal Treasury and recover money damages. The Court restated the rule that sovereign immunity bars creditors from attaching or garnishing funds held in the hands of the Treasury or enforcing liens against property owned by the United States.

All of this is very straightforward and predictable. Indeed, it would have been far more surprising to find that a sub could assert a lien against property of the United States and a District Court would entertain jurisdiction of such a claim. Furthermore, Blue Fox did not involve a claim by a surety, and it did not involve a claim for equitable subrogation.

Government attorneys have seized on the last paragraph of the opinion, nevertheless, in asserting that *Blue Fox* stands for the proposition that Federal courts do not have jurisdiction over a surety's claim of equitable subrogation. The final paragraph of the opinion states:

> Respondent contends that in several cases examining a surety's right of equitable subrogation, this Court suggested that subcontractors and suppliers can seek compensation directly against the Government. See, *e.g., Prairie State Bank v. United States,* 164 U.S. 227, 32 Ct.Cl. 614, 17 S.Ct. 142, 41 L.Ed. 412 (1896); *Henningsen v. United States Fidelity & Guaranty Co., 208 U.S. 404, 410, 28 S.Ct. 389, 52 L.3d 547 (1908); Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 141, 83 S.Ct. 232, 9 L.Ed.2d 190 (1962) (stating that "the laborers and materialmen had a right to be paid out of the fund [retained by the Government]" and hence a surety was subrogated to this right); but see *Munsey Trust Co., supra,* at 241, 67 S.Ct. 1599 ("[N]othing is more clear than that laborers and materialmen do not have enforceable rights against the United States for their compensation"). None of the cases relied upon by respondent involved a question of sovereign immunity, and, in fact, none involved a subcontractor directly asserting a claim against the Government. Instead, these cases dealt with disputes between private parties over priority to funds which had been transferred out of the Treasury and as to which the Government had disclaimed any ownership. They do not in any way disturb the established rule that, unless waived by Congress, sovereign immunity bars subcontractors and other creditors from enforcing liens on Government property or funds to recoup their losses.

119 S. Ct. at 692.

THE GOVERNMENT'S ARGUMENT

Following the *Blue Fox* decision Government attorneys aggressively have asserted that *Blue Fox* stands for the proposition that the Court of Federal Claims does not have jurisdiction

over a surety's claim of equitable subrogation. Arguing that sovereign immunity cannot be implied but must be unequivocally expressed, they assert that there is no jurisdictional basis for claims of equitable subrogation. They contend that the claim of equitable subrogation is not found in a contract, but is a creature of equity. Since it is a creature of equity, they contend that without a specific grant of a waiver of immunity, there is no jurisdiction to hear such a claim.

There are of course a number of decisions standing for the proposition that the Court of Federal Claims does have jurisdiction over a surety's claim for equitable subrogation. The United States now takes the position that cases such as *Balboa Ins. Co. v. United States,* 775 F.2d 1159 (1985), which hold that there is jurisdiction of such claims, are incorrect, no longer valid and were overruled by *Blue Fox*. They are wrong.

There is a case presently pending in the Court of Appeals for the Federal Circuit directly addressing this question. In the case of *Ins. Co. of the West v. United States*, 2000 W.L. 123380 (Fed. Cir. Jan. 11, 2000), the Federal Circuit agreed to hear an appeal dealing directly with the issue of whether or not the Court of Federal Claims has jurisdiction over a surety's case of equitable subrogation.

THE COURT OF FEDERAL CLAIMS HAS JURISDICTION OVER EQUITABLE SUBROGATION CASES

A. The Tucker Act

The Tucker Act is the vehicle by which sureties have traditionally found jurisdiction in Federal Courts against the United States. The Tucker Act states that the Court of Federal Claims shall have jurisdiction over an action against the United States found upon one of any several grounds. First, it gives jurisdiction founded upon any Act of Congress, second it gives jurisdiction upon any express or implied contract with the United States. 28 U.S.C. § 1491(a)(1). The Tucker Act is a jurisdictional statute. It gives the Court of Federal Claims jurisdiction over certain causes of action. It does not create any cause of action. There are scores of cases which permit sureties to bring an action against the Federal Government using the Tucker Act as the jurisdictional basis upon which to assert equitable subrogation claims arising under Miller Act bonds.

For example, *Balboa Ins. Co. v. United States*, 775 F.2d 1158 (Fed. Cir. 1985), carefully analyzed the jurisdiction of the Federal Court of Claims on equitable subrogation actions. The court noted that a surety is *not* in the same position as that of a materialman. Suretyship is the result of a three-party agreement, and this agreement provides the traditional foundation of equitable subrogation. 775 F.2d at 1160-1161.

In *Balboa* the Government asserted a fall back argument that Federal courts had no jurisdiction over a claim by a surety for non-retained funds, as opposed to those not yet disbursed. The court found that this assertion was untenable. The court made it clear that the cases make no distinction between earned progress payments and retainage, and the surety has a right to assert its equitable subrogation claim against the total fund remaining in the Government's possession. 775 F.2d at 1163.

Government attorneys are now arguing that *Blue Fox* stands for the proposition that *Balboa* is no longer good law and that it impliedly overruled *Balboa. Balboa* of course does not stand alone, and there are quite a number of other cases finding that the Court of Federal Claim has jurisdiction over claims of equitable subrogation; the Government attorneys asset that all of these are now bad law. The Government attorneys are wrong.

This paper will not analyze in depth the basis of Court of Federal Claims jurisdiction over cases. It will only touch on some of the reasons for such a rule. The beginning point, of course, is to recognize that *Balboa* and similar cases soundly support such jurisdiction.

Moreover, the Tucker Act grants jurisdiction over any case on which there is an express or implied contract with the United States. 28 U.S.C. § 1491. There are several ways in which the surety is in privity with the United States. The surety has, of course, written Miller Act bonds and, as just cited from the *Balboa* case, bonds create a three-party agreement. 275 F.2d at 1160.

The obligee is just as much a party to the bond as are the principal and surety. While the Government attorneys may argue that the United States did not sign the bonds, there are a great many contracts by which one obtains rights even though a party does not sign a contract. For example: promissory notes run to a maker who does not execute the note, and deeds run to a grantor, who does not sign the deed. It has been recognized that as a result of this three-party agreement, the surety is as much as party to a Federal Government contract as is the contractor. *Federal Ins. v. United States*, 29 Fed.Cl. 302 (1993). Furthermore, the United States Supreme Court has taken the view that the terms of the contract are read into the bond. *Martin v. Nat'l. Surety Co.*, 300 U.S. 588 (1937).

In addition, the cases recognize that the Tucker Act gives jurisdiction over a third party beneficiary's action on a Federal contract. *Hebah v. United States*, 428 F.2d 1334 (Cl.Ct. 1970) and *Erikson v. United States*, 12 Cl.Ct. 754 (1987). Certainly the surety, which must complete the contact is an intend - and hence third party - beneficiary to the underlying construction agreement.

Another ground for Tucker Act jurisdiction is the fact that the Act includes jurisdiction for claims arising under a Federal statute. The surety's bond to the United States is written under the Miller Act, 40 U.S.C. § 270a-d. While the Miller Act does not expressly create the right of equitable subrogation, the Miller Act does create the suretyship relationship out of which equitable subrogation springs.

The truth of the matter is that *Blue Fox* simply does not say what Government attorneys hope it does. *Blue Fox* was merely a case in which a subcontractor endeavored to assert a lien on Federal Government property, something which cannot be done unless there is a waiver of immunity. *Blue Fox* does not involve a surety, it does not involve equitable subrogation, and it certainly does not repeal the long line of cases granting jurisdiction over equitable subrogation cases.

These issues, however, are now squarely before the Federal Circuit in the *Ins. Co. of the West v. United States*, 2000 W.L. 123380 (Fed. Cir. Jan. 11, 2000), and we will watch and

report.