

## Memorandum

TO: The IBCS Group, Inc.

FROM: Laurence Schor  
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RE: Summary of COFC and GAO *Tip Top* Decisions, and Meaning and Impact of Same

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### I. GAO Decision

Digest Section Summary of GAO Opinion: The GAO found that the CO “reasonably determined that the assets pledged by the surety, which were incapable of being placed in escrow, were unacceptable.”

Conclusion reached by GAO: “Thus, to be an acceptable personal property asset under the FAR, an asset must be capable of being placed in an escrow account” (citing FAR 28.203-1(b)(1)), and the FAR gives the right to request a substitution of assets.

-Also, agencies may not automatically reject a bidder for unacceptable individual sureties because the SF 28 and supporting documents contain minor defects that might easily be remedied.

Surety’s Position on Effect of Decision: The GAO misread the FAR to mean that all assets must be placed in escrow, versus certain specific/defined assets (mostly financial instruments) which the FAR mentions in its discussion of escrow account. In addition to the FAR mentioning only financial documents in its escrow discussion, it makes no sense to expect every conceivable asset to be placed in an escrow account, and one must apply a common sense reading of the regulation. It is illogical to expect a bank to physically hold, in one of its branches, a mountain of coal or other commodity. However, even if an escrow account is required for all personal property assets, Scarborough meets this requirement in that a signed bill of sale (which is the legal indicia of ownership and control) is or will be placed in escrow in an escrow account maintained with an FDIC insured institution.

### II. U.S. Court of Federal Claims Decision Upon *De Novo* Protest

The contractor, Tip Top, upon receiving the GAO opinion, filed a *de novo* protest at the United States Court of Federal Claims (“COFC”), which made a much more detailed and legally significant analysis than the GAO. It is this analysis by the COFC, and not GAO’s administrative decision, that should be considered.

Although the COFC ultimately found that the CO did not act irrationally, it is well known that this is a very low threshold for a CO to clear. Judge Bush hints that, if the Court had been able to determine the escrow account question from scratch, it would have reached a contrary

decision (*i.e.*, that the bond and asset met the requirements of the FAR). But, under the existing standards of review, it could not do that.

Also, Judge Bush purposely declined to get into the issue of whether the lists of acceptable and unacceptable assets in the FAR are all-inclusive such that other valuable assets not listed can be pledged in support of a bond (which clearly they can, if one considers the “include” and “include but are not limited to” language of FAR 28.203-2(b) and (c), respectively. Also, that gold bullion is not listed by the FAR but is clearly acceptable.

The spurious Government argument that coal was a “speculative” asset was, essentially, completely ignored by Judge Bush, as it should have been. The surety was/is offering already mined, extracted, stockpiled, valuable and saleable coal and not “mineral rights” (*i.e.*, the speculative right to dig/mine in the hopes of finding a valuable mineral – *see* FAR 28.203-2(c)(7)).

Further, she expresses her dismay at the poorly drafted language of FAR Part 28.2 which created an opening for the CO to reach such an impractical and overly-technical conclusion. Below we have summarized some of the statements, findings and conclusions by Judge Bush, with the surety’s position on the impact/effect (if any) added.

What COFC says was the basis of the CO’s rejection decision:

-(p. 5) “In short, Tip Top was eliminated from the competition because the agency did not consider “marketable coal” as an acceptable asset for a bid bond. In the agency’s view, marketable or mined coal was a “speculative asset” excluded by section 28.203-2(c)(7).”

-(p. 16) The CO rejected the coal asset on 2 grounds:

- 1) The coal asset does not meet the requirements of FAR 28.203 – this ground will be addressed below.
- 2) The coal asset is a “speculative asset” excluded by FAR 28.203-2(c)(7) – as shown above, per the terms of the far and the legal definitions of “mining rights” (which this is not), this is a non-issue, and the COFC properly treated it as such. **[As this ground for rejection is invalid, that leaves #1 above as the sole remaining ground on which the CO *could* have rejected the asset, and we will show that the asset does meet the FAR and can be rationally accepted under the COFC’s decision.]**

COFC’s statement of the “primary issue” in this case

-COFC’s statement of primary issue: (p. 17) COFC says the primary issue is “**whether the CO had a rational basis** for determining that Tip Top’s pledged coal was not an acceptable asset to cover the bond obligation and rejecting its proposal on that basis.” **[Note – not whether the CO was correct, or made the best decision, or even whether the coal is an acceptable asset under the FAR; the test is only if the decision reached by the CO can be said to be rational, which is a low hurdle to clear and does *not* prevent any other CO from accepting coal as an asset. Stated differently, another CO reviewing the same exact bond with coal as the asset could/can rationally conclude that it *is* acceptable.]**

-(p. 18) COFC later concludes that the CO's reasoning was rational and not arbitrary or capricious; again, a low threshold. **[More importantly the fact that the COFC upheld the Tip Top CO's decision as rational and not arbitrary or capricious is not a blanket prohibition on coal as an asset under the FAR.]**

COFC limits its review to only certain documents in the Administrative Record

-(p. 17) The difference between a GAO decision and a COFC decision is that COFC "lacks authority to uphold an agency action on grounds not considered by the agency." Also, that a COFC decision, a decision by a federal court of national jurisdiction, generally carries more weight than a GAO decision.

-(p. 18) COFC refused to consider any documents submitted after 2/19/08, the date of the CO's decision rejecting the bond; if it had considered them, it would have found the additional evidence provided by the contractor and surety was favorable to the contractor and surety, and further undermined the Government's argument.

COFC summarizes the parties' main arguments:

-Tip Top's arguments:

(pp. 21-23) Tip Top argues coal is an acceptable asset and readily marketable under FAR 28.203(a):

- 1) Coal is an acceptable asset under FAR 28.203-2 because the list of acceptable and unacceptable assets are not exclusive
- 2) The CO erred in categorizing previously mined, extracted, stockpiled, and marketable coal as a "speculative asset" under FAR 28.203(c)(7); it is not a "mineral right" by definition, legally, or in practice; the value is readily determinable by DOE-published "spot prices" and industry indices
- 3) It was sufficient for Scarborough to provide a security interest in the mined coal, and that an escrow account is not required **[however, if it is ultimately determined to be required, Scarborough's bond program has since been revised to specifically include an escrow account with an FDIC insured bank];**
- 4) The Gov't is confused about the escrow requirements in the FAR; an escrow account is not required for all assets

-Gov't's arguments:

- 1) (pp. 23-25) Coal is speculative **[Which, the surety argues, it clearly is not, by definition, at law and by practice]**
- 2) the only acceptable assets, or personal property, other than real property contemplated by the FAR drafters under FAR 28.203-2(b) are "cash, CDs, and certain other cash equivalents and stocks and bonds." **[A proper reading of the FAR shows that other personal assets can clearly be pledged; otherwise, the FAR would have listed the above and stated only these are allowed. Instead, the FAR purposely leaves the list open. Gold bullion is a personal asset and a commodity, and the CO would not refuse to accept that.]**

- 3) FAR 28.203-1(b) requires acceptable assets to be physically placed in an escrow account; **[This is an impossibility for most assets, which is why the FAR only discusses an escrow account in conjunction with “securities”. The surety would argue that it is a reasonable interpretation that only “securities” must be held in escrow; even if all other assets must be held in escrow, as noted above, the Scarborough bond program includes an escrow so this is no longer an issue, and is a key point on which *Tip Top* can be distinguished – e.g., the decision predates the changes to the bond program and documentation.]**

COFC says the 2 main areas of dispute between the parties are:

The Court rejects or ignores two (2) of the Gov’t’s arguments, and defines the dispute as:

- 1) (p. 25) whether the list of acceptable assets under FAR 28.203-2(b) is exclusive, or merely provides examples
- 2) whether FAR 28.203-1(b) requires all acceptable personal property to be placed into an escrow account

- COFC notes that regulations are “convoluted” and **“open to different interpretations”**

COFC weighs-in on the above issues:

-(p. 27) COFC notes that the CO has “wide degree of discretion and business judgment” **[which discretion the surety here does not dispute]** in determining the acceptability of an individual surety,” and COFC will not question such a determination so long as it is reasonable. **[Note that this implies that a CO may just as easily apply her/his discretion and business judgment to find that the individual surety and his bond are acceptable, and this would be consistent with the FAR, *Tip Top*, and other law.]**

-(p. 31) COFC refuses to reach the issue of whether the list of acceptable and unacceptable assets in FAR 28.203-2(b) are exclusive or inclusive (i.e., merely set out examples); the “undertaking of such an endeavor [would be] daunting.” **[In the absence of such a ruling, normal rules of statutory and regulatory construction require that express language be given a reasonable reading to achieve the plain meaning; here, the FAR language clearly leaves the list of acceptable assets open.]**

-“Instead, the focus of this decision is on the interpretation of the provisions of FAR 28.203 and related sections as they prescribe the particular security interest required for personal property pledge as an asset.” **[The surety takes the position that the FAR requires a first priority UCC Article 9 security interest, which is what he is providing to the Government.]**

-**[The COFC, unfortunately, confuses security interest with an escrow, citing to FAR 28.203-1(b); COFC states that the FAR provisions give “a clear indication that the security interest called for when individual sureties pledge assets is either an escrow account for personal property or a lien on real property.” An escrow account is separate from a security interest, so the COFC was clearly wrong on this point as a matter of law.]**

-While acknowledging ambiguity in the FAR language, and that FAR 28.203-1(b) says “may be provided”, it finds that “when read as a whole, [the FAR sections] require the submission of an escrow account in order for personal property to be received as an acceptable asset.” (Emphasis added.) **[It does not say that the asset must physically be placed in escrow, which would be illogical for valuable commodities such as gold, silver, oil and coal. The Scarborough bond documents have since been revised to include an escrow account, as stated above, so the “submission of an escrow account” requirement is met.]**

-(p. 32) COFC cites also to the following as support for its conclusion:

- 1) SF 28, Block 7(b) – requires that the escrow account be described
- 2) FAR 52.228-11, “again setting forth a requirement for an escrow account for personal property.”

--**[The surety argues that both observations miss the point that an escrow account is not the same as a security interest; the COFC is confounding the two legal concepts.]**

-COFC Conclusion: “The foregoing provision requires that the pledges of assets must be either in the form of a recorded lien on real estate or an escrow account for all other proffered assets (i.e., personal property).” (Emphasis added.) **[Again, the requirement for an escrow for all personal assets is subject to debate, and the surety believes the better argument is that it is only required for securities; however, even if it were ultimately determined to be required for commodities, his program now has the required escrow account in an FDIC financial institution.]**

-Therefore, the COFC finds the CO’s decision was reasonable **[although COFC acknowledges that other interpretations (i.e., the contractor’s and surety’s) are reasonable, too, but that is not the test in a bid protest action, so the COFC could not consider this].**

-(p. 33-34) COFC says that both parties’ arguments had strong and weak sides, based in large part on the ambiguities in the FAR, and *both parties’ arguments were reasonable, “with the CO’s position being victorious only because the standard of review dictates such an outcome when both sides have reasonable positions.”*

#### Conclusions and Summary of Implications for Scarborough Bonds:

-**First**, it must be recognized that an escrow account with a federally insured institution and in the name of the contracting agency *is* provided with the bond package, and that a valid, negotiable/transferable (by the CO) Bill of Sale is placed in escrow. The surety has placed (or will place) a Bill of Sale to the proper amount of coal into the FAR specified escrow account, **so the escrow account requirement** (to the extent the COFC holding is correct, and we note that it is on appeal to the Court of Appeals for the Federal Circuit), **is met**.

-**Second**, the COFC ignored the Government’s silly argument that mined/extracted/stockpiled coal is speculative; it is not, and the FAR distinguishes the legal right to mine coal in the future from underground (which is speculative) from actual, above-ground, mined, stockpiled and saleable coal (which is not speculative – as shown, *inter alia*, by the Department of Energy’s

purchases of coal and publishing of coal spot prices, which are applicable as of the stated time and not in the future, on its own website).

**-Third**, all the COFC says is that the contracting officer's decision, while perhaps not the one it would have reached, met the rationality test, which any Government attorney recognizes is a low hurdle; also, the COFC did so in the context of its finding that the FAR regulations on individuals sureties are very vague and ambiguous. It is equally as rational (if not more, the surety argues) for the CO to find that the bond is acceptable, and other agencies have so found. This extends to the CO being able to rationally accept coal as an asset, and to accept the Scarborough bonds.

**-Fourth**, the COFC left open the issue of whether the list of acceptable and unacceptable assets is inclusive or exclusive; we argue that, by the very language of the section, the FAR list of acceptable assets is not exclusive, and other valid but non-listed assets may be considered. To conclude otherwise would mean that gold bullion could not be pledged in support of a bond.

**-Fifth**, nowhere in the decision does the COFC rule that coal cannot be used as an asset to back a bond.