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Client Alert

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Treasury's Contracts Under New Emergency Economic Stabilization Act Raise Risks and Uncertainties

The US Department of Treasury (Treasury) recently began awarding contracts to private companies to provide services in support of the recently enacted Emergency Economic Stabilization Act of 2008 (EESA). On October 6, 2008—a mere three days after EESA's enactment—Treasury issued notices inviting financial institutions to bid on contracts related to the management of Treasury's anticipated "portfolio of troubled mortgage-related assets." Bids had to be submitted within two days on October 8 for three categories of services: (1) "custodian, accounting, auction management, and other infrastructure services," (2) "securities asset management services," and (3) "whole loan asset management services." More recently, Treasury has issued another notice inviting financial institutions to bid on "equity, debt, warrants asset management services." Although there is an expectation of multiple awards for each category of services, Treasury has publicly announced only one award to date (to Bank of New York Mellon).[1]

In addition, Treasury has awarded contracts to law firms, accountants and consultants to provide professional services in support of the EESA effort. These include contracts for legal services to three firms, contracts to the accounting firms of PricewaterhouseCoopers and Ernst & Young and to the investment advisor EnnisKnupp & Associates. Treasury also issued a solicitation to procure additional legal services from other sources with bids due on November 6, 2008.

Like the EESA itself, these contracts raise issues and risks that are virtually unprecedented. The financial institutions and firms receiving awards from Treasury may well discover that they are subject to a variety of challenging "government contract" requirements as a result of these contracts.

> "Notwithstanding their characterization by Treasury as 'financial agency agreements,' the contracts awarded by Treasury to financial institutions to support the EESA may be subject to the FAR and other 'government contract' requirements."

"Government Contract" Requirements

When a US federal agency like Treasury procures services from a private party, the procurement is generally subject to a broad range of statutes (including the Competition in Contracting Act or CICA, Procurement Integrity Act and Truth in Negotiations Act) and regulations (most significantly, the Federal Acquisition Regulation or FAR). Many of those government contract rules and regulations implement socio-economic policies on such matters as affirmative action employment

requirements, drug-free workplace policies, environmental practices, domestic preferences, small business subcontracting goals, safety and labor laws, and a variety of other issues that have little or nothing to do with the reasonableness of the contractor's prices or the quality of its services. In addition, government contractors are subject to various record-keeping requirements and to burdensome government audits. These requirements and risks go far beyond those that companies are exposed to in the commercial marketplace.

The biggest surprise for an inexperienced government contractor is that practices common in the commercial marketplace can result in suspension, debarment or even criminal prosecution in the context of a government contract. For example, taking a customer to lunch may be construed as an illegal gratuity or bribe; merely obtaining information not available to other offerors may violate the Procurement Integrity Act; and exaggerating or "puffing" the capabilities of the company or its products may be a criminal false statement. These are but a few examples of conduct for which government contractors and their employees can be—and often are—severely punished.

Thus, unless these requirements are waived or otherwise deemed inapplicable, the financial institutions and firms awarded contracts under the EESA (many of whom may not be experienced government contractors) could be exposed to significant and unexpected risks and requirements.

Treasury's Decision Not to Waive "Government Contract" Requirements

Significantly, Section 107(a) of the EESA provides that Treasury may "waive specific provisions of the Federal Acquisition Regulation upon a determination that urgent and compelling circumstances make compliance with such provisions contrary to the public interest." This section further provides: "Any such determination, and the justification for such determination, shall be submitted to the Committees on Oversight and Government Reform and Financial Services of the House of Representatives and the Committees on Homeland Security and Governmental Affairs and Banking, Housing, and Urban Affairs of the Senate within 7 days."

Despite the Act's plain terms, Treasury apparently has not sought to waive any of the FAR's requirements in connection with the EESA contracts. None of the Treasury's public notices indicate that it either has waived, or intends to waive, these requirements. Nor, to date, has any public record been found of notices to Congress regarding any waiver. While Treasury may try to make waivers in the future, the current state of affairs is that Treasury apparently has not taken advantage of the EESA's provision regarding waiver.

Treasury's Contracts with Law Firms, Accountants and Consultants

Far from waiving the FAR's requirements, Treasury has indicated that the FAR will apply to contracts awarded to lawyers, accountants and other non-financial institutions in support of the EESA. Indeed, based on a limited review of the available portions of these contracts, it appears that they provide expressly for the FAR's application. In at least one contract, Treasury characterized it as "a procurement contract under the Federal Acquisition Regulation."

Moreover, the solicitation recently issued by Treasury to procure legal services in support of the EESA specifically provides for the application of a wide range of "government contract" requirements. It, in fact, lists about 50

separate FAR clauses applicable to the lawyers and law firms awarded contracts by Treasury.

The lawyers, accountants and consultants who accept these contracts will find themselves in the highly regulated and risky world of government contracting. While there is some uncertainty whether the FAR and other "government contract" requirements apply to the contracts awarded to financial institutions (as explained below), Treasury has made clear that the FAR applies itself to the support contracts awarded to lawyers, accountants and consultants.

Treasury's Position on Agreements with Financial Institutions

While Treasury acknowledges the FAR's application to the professional services contracts described above, it has taken a very different and somewhat questionable position regarding the awards to financial institutions. Treasury characterizes those contracts as "financial agency agreements," and has taken the position that such financial agency agreements are "not a Federal procurement contract and [are] therefore not subject to the provisions of the Federal Property and Administrative Services Act (41 U.S.C. §§ 251-260), the Federal Acquisition Regulations (48 CFR Chapter 1), or any other Federal procurement law."[2] According to Treasury, it "has long had the statutory authority to retain financial agents to provide services on its behalf."[3]

Significantly, the EESA itself contains language supporting a distinction between a financial agency agreement and other types of contracts. Section 101(c)(3) of the Act authorizes Treasury to "[d]esignat[e] financial institutions as financial agents of the Federal Government, and such institutions shall perform all such reasonable duties related to this Act as financial agents of the Federal Government as may be required." In Section 101(c)(2), the Act separately addresses "contracts, including contracts for services authorized by section 3109 of title 5, United States Code," which provides for "temporary (not in excess of 1 year) or intermittent services of experts or consultants."

Case Law on "Financial Agency" Agreements

There is nonetheless considerable ambiguity on the application of the FAR and other "government contracts" requirements to Treasury's agreements with financial institutions. The two leading cases addressing "financial agency" agreements are *United States v. Citizens & Southern National Bank*, 889 F.2d 1067 (Fed. Cir. 1989), and *Transactive Corp. v. United States*, 91 F.3d 232 (DC Cir. 1996). As the courts have observed, "[n]o statutory provision, however, clearly establishes when Treasury may choose to [designate a financial agent] to obtain financial services instead of relying on the procurement procedures of the CICA, further described in the Federal Acquisition Regulations."[4]

While the governing legal standard is not precisely defined, it appears to turn on whether "the government as principal and in its sovereign capacity delegates to its financial agents some of the sovereign functions that the government itself would otherwise perform."[5] In short, if a financial institution is providing services **for** the benefit of the government, then the FAR and similar requirements apply. However, if it is acting **as** the government in its provision of services, then the "financial agent" designation applies and the arrangement is arguably not to be subject to these "government contracts" requirements. Highlighting the difficulty in applying these general principles, the two leading cases came to opposite conclusions—one upholding

and the other rejecting Treasury's characterization of a contract—as summarized below.

The *Citizens & Southern National Bank* Case

In *United States v. Citizens & Southern National Bank*, Treasury conducted a competitive procurement using procedures only "loosely modeled on the Federal Acquisition Regulations" for a private party to establish a system to track the collection of monies owed to the United States.[6] Treasury's contract award was challenged, before the General Services Board of Contract Appeals, on grounds that it was not conducted in accordance with the FAR.[7] While the Board dismissed the protest, it held that the process was a "procurement" and, accordingly, held that Treasury had to follow the FAR's normal procedures.[8]

The Federal Circuit reversed on grounds the process was not a "procurement."[9] Specifically, the court held that the relationship at issue was one where the government was delegating "to its financial agents some of the sovereign functions that the government itself would otherwise perform."[10] As such, the ultimate award was not a procurement contract and, therefore, outside the jurisdiction of the Board as defined by the Brooks Act.[11]

In so holding, the court found persuasive the fact that Treasury "would not receive title to either the computer hardware or software necessary to run the system." Thus, the court held:

> What Treasury did here was designate or authorize, in the exercise of its discretion, a financial institution to act in its stead for the stated purposes. Regardless of appearances, this was akin to appointment of public employees, which is not a matter of contract even when terms and conditions guide the employment relationship. Just as public employment results from the conferral of a status, so does Riggs' financial agency: Treasury conferred a status on Riggs, whose undertaking was set out in return. This was not a procurement contract . . .[12]

The *Transactive Corp.* Case

In contrast, the DC Circuit rejected the Treasury's position in *Transactive Corp. v. United States*. In that case, the court found that Treasury improperly bypassed the FAR and CICA in attempting to designate a "financial agent" instead of entering into a contract.[13] At issue was Treasury's implementation of an "Electronic Benefits Transfer" or "EBT" system, which would permit the electronic transfer of funds held by the Treasury Department to private individuals and for those individuals to withdraw that money using a debit card.[14] Rather than using the procurement procedures governed by the FAR and CICA, Treasury elected to use an "Invitation for Expressions of Interest" or "IEI," which is "a method of solicitation for banking services that emerges from the authority of Treasury to name certain financial institutions as 'depositaries of public money' and 'financial agents' of the federal government."[15]

The IEI process was challenged by Transactive because, while it had experience administering an EBT system, it was not associated with any financial institution and, therefore, could not be designated a "financial agent."[16] Specifically, Transactive argued that Treasury was, in fact, attempting to procure services rather than appoint a financial agent. The DC Circuit agreed, and held that the IEI process was improper because the "Treasury neither acts as a principal to the institution it selects to administer the EBT program nor delegates to this institution some of the sovereign functions that the government itself would otherwise perform."[17] In so holding, the court

noted that Treasury was attempting to "designate a party a financial agent even though it has expressly declined to name as financial agents others that perform similar tasks."[18]

The Resulting Uncertainties and Risks

As these cases illustrate, Treasury does not have *carte blanche* to designate financial institutions as "financial agents" to avoid the FAR's application to its contracts. Whether a particular agreement is properly designated as involving a financial agency will depend upon the specific tasks contemplated.

Looking at the agreements entered into thus far by Treasury under the EESA, it is not clear how a court would rule. One financial agency agreement provides explicitly that the contractor is to "release assets and disburse cash, in accordance with the Treasury's instructions."[19] This activity appears to be a sovereign function that the DC Circuit recognized as indicative of a financial agent.[20]

However, this same agreement also requires performance of numerous other financial services that may not be "sovereign functions." These include providing accounting and reporting services, such as cash flow analysis, providing pricing, valuation and market information services, and setting up a system to receive and store loan and legal documents. Notably, Treasury has contracted with accounting firms to do similar work and these contracts are expressly subject to the FAR.[21]

The bottom line is that, notwithstanding their characterization by Treasury as "financial agency agreements," the contracts awarded by Treasury to financial institutions to support the EESA may be subject to the FAR and other "government contract" requirements. While the application of these requirements to its contracts with financial institutions is debatable, it is clear—based on Treasury's own statements—that the FAR does apply to the EESA contracts awarded to lawyers, accountants and consultants. Perhaps most importantly, all of these contracts like the EESA itself are likely to be subject to scrutiny for years to come.

Endnotes

[1] *See* Financial Agency Agreement, as attached to Press Release, US Department of Treasury, Treasury Hires Custodian Under the Emergency Stabilization Act, HP-1211 (Oct. 14, 2008).

[2] *See* Financial Agency Agreement, Section 27(A), as attached to Press Release, US Department of the Treasury, Treasury Hires Custodian Under the Emergency Economic Stabilization Act, HP-1211 (October 14, 2008).

[3] *Id.*

[4] *Transactive Corp.*, 91 F.3d at 235.

[5] *Citizens & Southern National Bank*, 889 F.2d at 1069.

[6] 889 F.2d at 1068.

[7] *Id.* at 1069.

[8] *Id.*

[9] *Id.* at 1070.

[10] *Id.* at 1069.

[11] *Id.* at 1070.

[12] *Id.* at 1070 (internal citations omitted).

[13] 91 F.3d at 241.

[14] *Id.* at 233.

[15] *Id.*

[16] *Id.*

[17] *Id.* at 240 (internal quotation marks omitted).

[18] *Id.* at 241.

[19] *See* Custodian Contract, Exhibit A as attached to Press Release, US Department of the Treasury, Treasury Hires Custodian Under the Emergency Economic Stabilization Act, HP-1211 (October 14, 2008).

[20] *Transactive Corp.*, 91 F.3d at 238.

[21] *Compare* Custodian Contract, Exhibit A as attached to Press Release, US Department of the Treasury, Treasury Hires Custodian Under the Emergency Economic Stabilization Act, HP-1211 (October 14, 2008) *with* Ernst & Young Purchase Agreement, Attachment 3 at 2-3 as attached to Press Release, US Department of the Treasury, Treasury Hires Accounting Firms Under the Emergency Economic Stabilization Act, HP-1225 (October 21, 2008).

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