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The Financing Advisor

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ASSIGNMENT OF CLAIMS ACT DOCUMENTATION

We are often asked, by lenders and borrowers alike, what the current market trend is with respect to Federal Assignment of Claims Act (the "Assignment of Claims Act" or "FACA") instruments of assignment and notices of assignment. Are lenders still requiring these documents? What are the risks of not obtaining them? Is there something short of full compliance with the Assignment of Claims Act that can be done to adequately protect a lender and not unduly burden a borrower?

Anyone who has been involved in the process of obtaining FACA assignments knows that it is frequently a tedious and sometimes difficult process, especially if a borrower has many smaller contracts with a number of different government agencies. As a result, we have found that the vast majority of lenders are not requiring borrowers to provide FACA assignments at the closing of a loan, but instead reserve the right to require them to be provided at a later date – typically upon the occurrence of an event of default under the loan documents.

The question then becomes, if FACA assignments are not being required at loan closing, how is a lender protected, and what are the potential risks of not having FACA assignments in place?

Before describing some of the specific benefits afforded by the Assignment of Claims Act, we will point out a common misunderstanding with respect to FACA assignments. Many people believe that FACA assignments perfect a lender's security interest in government accounts receivable. That is simply not the case. Perfection of a lender's security interest in government accounts receivable, like any other account receivable, is accomplished by filing a properly completed UCC-1 financing statement among the state records of the jurisdiction of organization, jurisdiction of incorporation or state of residence of the borrower. What then are the benefits of having FACA assignments in effect? There are 4 primary benefits.

First, a properly processed FACA assignment obligates the government to make contract payments directly to the bank or financial institution identified in the FACA assignment. Put another way, the government is prohibited from sending government contract payments to any other person or entity while the FACA assignment is in effect. Just to be clear though, the actual obligation of the government to make payments under a government contract is set forth in the contract itself (or by reference to a particular Federal Acquisition Regulation set forth in the government contract). However, once the obligation to pay ripens (pursuant to the terms of the applicable government contract), the payment direction of the FACA

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assignment then governs and (as further described below) not even the contractor/borrower can change that payment direction without the lender's consent.

Second, a properly processed FACA assignment puts the government "on notice" that a lender is relying on the payment direction afforded by the FACA assignment – typically for purposes of collateralizing a loan, credit facility or some other financial accommodation made by the lender to the borrower. And if the government is "on notice" of the FACA assignment, then the government is prohibited from clawing back from the lender any government contract payment received by the lender that may have been made in error (or that could have been retained by the government as an offset to some other liability that the contractor/borrower may owe to the government). Of course, the government would still have recourse against the contractor/borrower for the return of any such payment, but it would not have any such recourse against the lender.

Third (albeit similar to the first point), a properly processed FACA assignment protects a lender from borrower-fraud. When a FACA assignment has been accepted by the government, the borrower is unable to redirect the government to make contract payments elsewhere. The government can only act pursuant to the written instructions of the lender (as to where payments should be sent) while the FACA assignment is in effect. A few years back, one of our lender clients shut down a revolving line of credit of one of its customers (simply because the customer failed to provide requested financial information to renew the line). And, while suspending the customer's line of credit quickly got the customer's attention, the customer was also quick to re-direct future payments under its government contracts to a different financial institution. Had FACA assignments been in effect, the customer would not have been able to redirect the payment on its government accounts receivable elsewhere.

And fourth, a properly processed FACA assignment provides the lender with the right to pursue collection of a government contract receivable against the government. If, for example, the government was obligated to make a government contract payment pursuant to the terms of the applicable government contract, but simply failed to do so, then the lender can pursue a collection action directly against the government for the payment of the assigned government contract receivable (which, unlike commercial account debtors, the lender would not be able to do in the absence of a FACA assignment). Obviously, to the extent that the government had a valid defense against the borrower as to the payment of the government contract receivable, the lender would likewise be subject to that defense.

So, notwithstanding the benefits afforded by FACA assignments, why aren't lenders insisting on them and what are lenders doing to otherwise minimize the risk that their government contract receivable collateral will not disappear? There are a number of reasons, but we will only highlight the most common ones in this article. First and foremost, many lenders find comfort in having a perfected security interest in the government account receivable by virtue of simply filing a UCC-1 financing statement. Second, government contracts are awarded, expire, terminate and are renewed all the time, and many lenders cannot keep up with processing FACA assignments for every government contract of their borrowers. Instead, some lenders obligate their borrower to periodically provide FACA assignments for only those government contracts which meet certain criteria, such as having a remaining value of $500,000 or more and a remaining term (including renewal options) of 6 months or longer. The dollar threshold is intended to quantify a certain credit risk tolerance while the “6 months or longer” criteria is appropriate from a practical perspective because sometimes it could take a few months just to get the government to acknowledge receipt of a properly filed FACA assignment. And while there is certainly the “inconvenience” factor that borrowers oftentimes claim, the fact is that the task of completing FACA assignments is ministerial in nature and not very time consuming to accomplish. Nevertheless, for our lender clients who elect not to require FACA assignments either at loan closing and/or periodically thereafter, we include a provision in our loan documents which grants the lender the right to require them at any time after the occurrence of an event of default. The savvy lender knows, however, that it cannot count on a borrower performing a post-event of default obligation if that borrower is presumably already in default for failing to perform some other obligation. For that reason, our loan documents also include a corresponding right of the lender to obtain injunctive or other equitable relief to compel the borrower to deliver FACA assignments to the lender (if requested) after the occurrence of an event of default. This adds an extra level of protection to the lender in the event that a borrower, who is already in default, fails to timely comply with the lender’s request.

There are many nuances to properly completing and processing FACA assignments, as well as details with respect to the mechanics of complying with the Assignment of Claims Act, which we have not fully vetted in this article. If you would like further information, or would like to discuss government contract financing generally, please do not hesitate to contact us.

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