DECISION

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

26405

FILE: B-210160 DATE: September 28, 1983

MATTER OF: Bureau of Prisons--Disposition of Funds Paid in Settlement of Breach of Contract Action

DIGEST:

Excess costs of reprocurement recovered from a breaching contractor by the Bureau of Prisons may be used to fund a replacement contract. It is illogical to hold a contractor legally responsible for excess reprocurement costs and then not permit the recovery of those costs to be used for the purpose for which they were recovered. As long as the Bureau receives only the goods and services for which it bargained under the original contract, there is no illegal augmentation of the Bureau's appropriation. Therefore these funds need not be deposited into the Treasury as miscellaneous receipts. Comptroller General decisions to the contrary are modified.

The Assistant Attorney General for Administration at the Department of Justice has requested our decision on whether certain funds, which were paid by a contractor in settlement of the Government's claim for breach of contract, may be used to replace defective work completed by the breaching contractor, without constituting an illegal augmentation of the appropriation from which the breached contract was initially funded. For the reasons given below, we conclude that the expenditure of those funds, as contemplated by the Department of Justice, would not constitute an illegal augmentation.

## BACKGROUND

In June 1974, the Bureau of Prisons awarded to the General Electric Company a contract (number GS 09B-C-9021 SF) in the amount of $152,850 for the design, manufacture, and installation of laminated polycarbonate LEXGARD security windows for the Federal Correctional Institution, Pleasanton, California. When General Electric allegedly breached the contract by providing defective materials, the United States initiated legal action against it. The lawsuit was settled when General Electric agreed to pay $406,111.30 into the registry of the District Court for the Northern District of California. This amount was in full satisfaction of any and all claims by the United States against General Electric arising from that contract. (We have been informally advised by the Department of Justice that the large difference ($253,261.30) between the amount awarded under the contract and the amount of the damages which General Electric agreed to pay is due to inflation and substantial underbidding on General Electric's part when it

026818/120515

originally obtained this contract. Justice also advised us that the $406,111.30 settlement amount was based upon the results of a new invitation for bids to secure a replacement contract.)

The District Court ruled that the money paid pursuant to the settlement agreement must be used to pay for the replacement of the faulty windows to the specifications required by the original Bureau of Prisons contract with General Electric. The court directed the Government to secure a replacement contractor whose bills for services and materials would be submitted to the court for payment from the amount paid by General Electric. The court also ruled that upon completion of the required work, the residue (if any) of the amount paid by General Electric would be turned over to the United States Bureau of Prisons. United States v. General Electric, Stipulation and Order Approving Compromise Settlement, Civ. No. 80-3485 TEH (N.D. Cal March 4, 1982). With regard to any residue which it may receive from the court upon completion of the replacement contract, Justice proposes to deposit such amounts into the Treasury as miscellaneous receipts. However, Justice is concerned that because the amount paid by General Electric greatly exceeds the amount paid under the breached contract, the balance of the court's order (requiring the use of the compromise settlement payment to fund a replacement contract) may result in an illegal augmentation of the Bureau of Prison's appropriation (number 15X1003) which was the funding source for the original contract.

Justice has reviewed our decisions in order to obtain guidance on this matter. Under those decisions, the "general rule," as prescribed by statute, is that all money received by and for the use of the Government must be deposited into the Treasury as miscellaneous receipts. See 31 U.S.C. § 3302 (formerly 31 U.S.C. § 484); 52 Comp. Gen. 45, 46 (1972). To the extent that such receipts are instead credited to a specific appropriation, they constitute an unlawful augmentation of that appropriation. Justice sees in our decisions two broad classes of exceptions. First, collections may be credited to a specific appropriation, rather than to miscellaneous receipts, when expressly authorized by statute. See, e.g. 57 Comp. Gen. 674, 685-86 (1978). Second, collections may be credited to an appropriation when they represent refunds or repayments of amounts which were improperly or erroneously paid from that appropriation. E.g. 61 Comp. Gen. 537 (1982); See 7 GAO Policy and Procedures Manual for Guidance of Federal Agencies §§ 13.2(2),13.3.

Justice proposes that the present case be resolved by the creation of a new exception to the general rule. Justice argues that to the extent that the funds paid by General Electric in settlement of the breach of contract litigation are used to complete the work originally contracted for, they should be credited entirely to the appropriation which originally funded the contract rather

than to miscellaneous receipts, and that such use for the replacement contract should not constitute an illegal augmentation of that appropriation.

PREVIOUS DECISIONS

We have on a number of occasions applied the exception for refunds of erroneous payments, described above by Justice, in the context of contractors who deliver defective work necessitating replacements. We have ruled that to the extent that a collection from the breaching contractor (or his surety) represents the recovery of payments which were in excess of the value of the goods or services that the agency actually received from the contractor, the collection is a repayment or refund, which may be credited to the agency's appropriation and used to pay for a replacement contract. See, e.g., 44 Comp. Gen. 623 (1965); 34 Comp. Gen. 577 (1955); 8 Comp. Gen. 103 (1928).

Application of this reasoning in the instant case would justify the use of only $152,850, the amount of the original contract payments to GE, for the costs of a replacement contract. This is the only amount which can be said to represent an erroneous payment because no value was received from the original contractor. This amount, as explained above, falls far short of the amount needed to replace the defective work. As Justice has observed, unless there is a basis to apply a third exception to the general rule of 31 U.S.C. § 3302(b), the balance of the settlement would have to be deposited in miscellaneous receipts. This means that unless the agency has another source of funds available to recover the rest of the expenses of the replacement contract, a critical need might have to go unmet.

An argument could be made that since in this case, the disposition of the entire settlement was ordered and controlled by a court, the usual rule does not apply. We have chosen not to consider the merits of that argument because the plight of Justice may be replicated many times by agencies who have reached agreements with the breaching contractor without instituting litigation. Resolution of contract disputes without resort to litigation is generally desired. We have therefore elected to reconsider a number of our old cases without reference to the presence or absence of a court-approved or ordered settlement.

The majority of GAO decisions which deal with excess reprocurement costs involve defaults by the original contractor rather than completion of the work in a defective manner. In both situations, the contract has been breached, and in both, the need for a replacement contract is attributable to the contractor's breach. We will therefore discuss our decisions on excess reprocurement costs with-

out reference to the event that gave rise to the need for the replacement contract--that is, whether occasioned by a default or by defective workmanship.

GAO has long held that excess reprocurement costs--i.e., costs incurred by the Government because of the breach of contract which exceed the amounts originally obligated for the procurement in question--should be charged to the account of the original contractor. However, any such amounts which the agency is able to recover must immediately be deposited in the Treasury as miscellaneous receipts. (See 14 Comp. Gen. 729, 730 (1935) for a clear statement of that principle.)

Moreover, we have held this to be the rule despite the possibility that the agency involved might not have enough unobligated funds in the balance of the applicable appropriation to fund a replacement contract. In one decision, for example, we quoted the General Counsel of the Office of Economic Opportunity who offered this analysis:

> "* * *It would seem that the controlling consideration in determining the disposition of recoveries from defaulting contractors should be whether such recoveries augment the agency's appropriation, in which case they should be deposited in the Treasury as miscellaneous receipts, or whether they merely offset additional government expenses resulting from the contractor's breach, in which case they should be considered in the nature of an adjustment and returned to the appropriation account. In this latter situation, the recoveries do no more than permit the agency to carry out the program contemplated by the Congress without having to return for an additional appropriation because of the failure of the contractor to perform * * *." 46 Comp. Gen. 554, 555 (1966).

While we acknowledged that those reasons "are not regarded as being without merit," we refused in that case to alter or deviate from the general rule that recovered excess reprocurement costs must be deposited into the Treasury as miscellaneous receipts. See also, 10 Comp. Gen. 510, 511 (1931).

More recently, we addressed the question of defaulting contractors and replacement contracts without dealing directly with how collections from the defaulting contractor should be handled. In 60 Comp. Gen. 591 (1981), we decided that when a contract is terminated because of default by the contractor, the amounts obligated to fund the original contract remain available to fund a replacement contract. With regard to reprocurement costs in excess of the amount of the original contract, we stated:

> "* * * Legally, the defaulting contractor is liable to the Government for the additional cost of the replacement contract. However, recovery of such funds by the Governnment may be subject to a great deal of uncertainty and delay * * *. Hence, the agency may utilize unobligated funds, if any, from its prior years' appropriations to increase the amount of obligations chargeable in that year for the original contract in order to pay the replacement contractor the full amount owed (while continuing to attempt collection from the defaulting contractor * * *)." Id. at 595.

We stopped short of explaining how the replacement contract was to be funded if there were no unobligated funds available to cover the excess reprocurement costs.

## DISCUSSION

After carefully reconsidering our earlier decisions in light of the arguments presented by the Department of Justice, we are convinced that our rule (requiring the entire amount of excess costs recovered from a defaulting contractor to be deposited into the Treasury as miscellaneous receipts) is wrong. The rule disrupts the procurement process and is not required by 31 U.S.C. § 3302.

The existing rule penalizes an agency for an event which lies beyond its control--a breach by the contractor. Because the agency may not use the excess reprocurement costs which it recovers from the contractor, even though the recovery is entirely adequate for that purpose, if it lacks adequate unobligated funds to pay such costs, it must either forgo an urgently needed procurement or else it must seek a supplemental appropriation from the Congress. Thus, our present rule places an added burden on the legislative process, as well as on the procurement process.

We do not think it is logical to insist that a breaching contractor is legally responsible for excess reprocurement costs and then, when the contractor fulfills that obligation, refuse to permit his payments to be used for that purpose. We regard the contractor's payments as being analogous to a contribution to a Government trust account, earmarked for a specific purpose. Just as the proceeds of a trust are considered to be appropriated for the purpose for which the funds were deposited, so too should excess reprocurement collections be considered to be available only for the purpose of funding a replacement contract.

This use of the recovered excess reprocurement costs does not, in our view, constitute an illegal augmentation of the agency's appropriation. The agency is being made whole at no additional expense to the taxpayer. It will merely be receiving the goods or services for which it bargained under the original contract.

We therefore decide that to the extent necessary to cover the full costs of a replacement contract, excess reprocurement costs recovered by an agency from a breaching contractor need not be deposited in the Treasury as miscellaneous receipts, but rather may be applied to the costs of the replacement contract. The replacement contract must be coextensive with the original contract; that is, it may procure only those goods or services which would have been provided under the breached contract. Any recovered excess reprocurement costs which are not necessary or used for such a replacement contract must still be deposited into the Treasury as miscellaneous receipts. To the extent that they are inconsistent with this decision, the following (and any other similar) decisions are hereby modified: 52 Comp. Gen. 45 (1972); 46 Comp. Gen. 554 (1966); 44 Comp. Gen. 623 (1965); 40 Comp. Gen. 590 (1961); 34 Comp. Gen. 577 (1955); 27 Comp. Gen. 117 (1947); 14 Comp. Gen. 729 (1935); 14 Comp. Gen. 106 (1934); 10 Comp. Gen. 510 (1931); 8 Comp. Gen. 284 (1928).

## CONCLUSION

We conclude that the use of General Electric's settlement payment to fund the replacement contract under the terms of the court's order will not result in an illegal augmentation of the Bureau of Prison's appropriation number 15X1003. Of couse, as Justice is aware, any residue from General Electric's payment which the agency may receive from the court upon completion of the replacement contract must be treated as damages and deposited into the Treasury as miscellaneous receipts.

for Milton J. Socolar
Comptroller General
of the United States