GAO

United States
General Accounting Office
Washington, D.C. 20548

Office of the General Counsel

B-230871.4

June 19, 1996

Mr. Brad J. Hutchinson
18386 Carob Street
Hesperia, California 92345

Dear Mr. Hutchinson:

This responds to your request on behalf of Mark Steel Corporation, Fire Engineering Co., Inc., Insulated Building Products, Inc., J. W. Thompson Co., Peterson & Associates, Inc., and Data Air, Inc., that our Office consider referring their claims to the Congress under the Meritorious Claims Act, 31 U.S.C. § 3702(d).

These firms were subcontractors of Continental Construction Corporation (CCC) under National Aeronautics and Space Administration (NASA) contract No. NAS2-12863 for the construction of a 112,000 square foot aircraft testing facility at NASA's Dryden Flight Research Center in Edwards, California. The claimants are among a number of CCC's subcontractors who remained unpaid when NASA terminated the contract with CCC for default on March 2, 1989. Some weeks later, when CCC's performance and payment sureties also defaulted on their obligations, the subcontractors and NASA were left without recourse to recover their losses. A report issued on February 22, 1991, by NASA's Office of Inspector General (IG) recounted the many problems NASA experienced with the contract, highlighting in particular problems with the sureties. Citing the IG report and the Meritorious Claims Act you request that we recommend to the Congress that the firms be fully compensated. For the reasons set forth below, we cannot make such a recommendation.

Facts

At $16,184,800, CCC was the low bidder on the test facility construction contract. NASA conducted a preaward survey of CCC and found it to be responsible. The preaward survey uncovered the problems that later plagued the contract: CCC's inexperience and cash flow. However, in the judgment of the contracting officer,

these problems were not sufficient at the time of the survey to affect the firm's overall responsibility.[1]

The contract was awarded on October 23, 1987. CCC offered individual sureties for the performance and payment bonds mandated by the Miller Act, 40 U.S.C. § 270a. As required by the regulations in effect at the time, each surety submitted a sworn statement listing the property offered as security for the obligations. See Federal Acquisition Regulation (FAR) § 28.202-2 (1987). In addition, those statements were certified by bank officers who stated that they had personal knowledge of the individuals and the assets pledged. NASA reviewed the documentation evidencing the sureties' net worth, but the contracting officer did not independently verify the existence and value of the sureties' property.[2] The contracting officer accepted the sureties offered on the bonds and on November 2, issued CCC a notice to proceed.

Between November 1987 and February 1989, CCC completed about half of the project and was paid over $10 million in progress payments. In late February 1989, CCC abandoned the project and advised NASA that it was unable to complete the contract. NASA then terminated the contract for default. Thereafter, one of the performance sureties briefly and unsuccessfully attempted to complete the construction project, but that contract, too, was terminated for default on April 19, 1989. The other surety denied responsibility on June 12. NASA subsequently completed the construction of the test facility at considerable additional cost.

After the sureties' default, the government attempted to take possession of the assets they pledged as security for their performance and payment obligations. It was then that NASA learned that the assets were either nonexistent or otherwise unavailable to meet the sureties' obligations. As a result, no recovery was obtained for either the government or the unpaid subcontractors. The two individual sureties were later convicted on criminal charges relating to false statements in connection with the bonds.

There exist a number of unpaid subcontractors including the six claimants in this case. While it appears that they had causes of action against CCC, the letter to our Office does not indicate whether any of them pursued their rights under the

---

[1] Since CCC was a small business, had the contracting officer concluded that CCC was not responsible, the matter would have been referred to the Small Business Administration (SBA) for final determination under the SBA's certificate of competency procedures. See 15 U.S.C. § 673(b)(7).

[2] The regulations did not require the contracting officer to verify independently the information concerning the sureties' net worth. See FAR § 28.202-2 (1987).

contract. If they did, apparently, they did not recover any money. We are unaware of actions taken, if any, by those who did not join the request to our Office.

The six claimants in this case and amount of the claims they submitted to our Office are listed below:

Mark Steel	$506,221
Fire Engineering	$234,432
Peterson Associates	$264,477
Data Air	$ 49,713
J.W. Thompson	$ 69,800
Insulated Building Products	$250,612

Miller Act

The Miller Act requires contractors performing government construction contracts to post acceptable surety bonds to insure completion of the work and the payment of subcontractors. A performance bond protects the government's interest by providing a source of funds to complete the contract in the event of default. A payment bond assures payment to all persons supplying labor or materials. The bond is provided in lieu of mechanics' liens, which are not recognized on government contracts. For contracts valued over $5 million, the amount of the payment bond is set by the statute at $2,500,000. 40 U.S.C. § 270a(a)(2). While corporate sureties are more common, the regulations permit individuals to act as sureties for Miller Act performance and payment bonds. See FAR § 28.203.

In general, Miller Act payment bonds provide the sole fund available for the satisfaction of debts to subcontractors on government construction contracts. Thus, subcontractors under government contracts may not proceed against the government. Farmington Manufacturing Co., B-186817, Sept. 17, 1976, 76-2 CPD ¶ 255. The reasoning behind the rule is that a subcontractor's direct contractual relationship is with the prime contractor, not the government. In the absence of a direct contractual relationship, known as "privity of contract," a subcontractor may not attempt to enforce the prime contract for its benefit. Vern Willard, B-210544, March 14, 1983, 83-1 CPD ¶ 277. Therefore, our Office has no legal basis upon which to consider the claims. However, you request that we refer the claims to the Congress under the Meritorious Claims Act.

Meritorious Claims Act

Under the Meritorious Claims Act we may refer to the Congress a claim that deserves consideration because of substantial legal or equitable reasons but would otherwise not be payable. John H. Teele, 65 Comp. Gen. 679 (1986). The cases we have reported to Congress generally have involved equitable circumstances of an

unusual nature that are unlikely to constitute a recurring problem. See Major Gerald A. Lechliter, B-236008, May 7, 1991. The rationale for this practice is that recurring problems are best dealt with by general remedial legislation.

As you point out, we recently referred a claim concerning a similar situation to Congress under the Meritorious Claims Act. B-203871.3, August 19, 1993. That matter, like the one currently before us, concerned the nonpayment of subcontractors under a federal construction contract where both the prime contractor and the individual Miller Act sureties failed to honor their obligations. As in this case, the contracting agency's IG issued a report critical of the agency's acceptance of the sureties' affidavits, its award of the prime contract, and its reaction to poor performance by the prime contractor.

While it is indeed unfortunate that the claimants here are involved in a similar scenario, we do not believe that it would be appropriate for our Office to report these claims to the Congress as meritorious claims. As this case illustrates, such problems have occurred numerous times in the past and may well occur in the future. The continued referral to Congress of Miller Act bond claims such as these could create a de facto privity of contract between subcontractors and the government and result in liability on the part of the government where there currently is none. See Naval Facilities Engineering Command, 57 Comp. Gen. 176, 77-2 CPD ¶ 510 (1977), and Bob Bates, B-204165, Jan. 8, 1982, 82-1 CPD ¶ 25, reconsideration denied, B-205165.2, Mar. 8, 1982, 82-1 CPD ¶ 209, where our Office did not report to the Congress claims of subcontractors who were left without recourse because of faulty or nonexistent Miller Act bonds. If Congress believes as a matter of public policy that this long standing rule of law should be changed for federal construction contracts, it may of course enact legislation amending the Miller Act to do so. We do not think that it would be appropriate for our Office to assume a policy role by referring to the Congress repetitive Miller Act bond claims.

Accordingly, we decline to report the subcontractors' claims to the Congress under the Meritorious Claims Act.

Sincerely yours,

Robert P. Murphy
General Counsel

B-230871.4

June 19, 1996

DIGEST

Claimants, subcontractors on defaulted construction contract, suffered a loss when the prime contractor's individual sureties also defaulted on Miller Act payment bonds. Claimants' request referral of their claims to Congress for payment under the Meritorious Claims Act. We decline to refer the claims. Defaults by individual sureties will occur from time to time. Remedial legislation is the appropriate vehicle for correcting recurrent problems such as defaulted sureties. Repeated referrals of subcontractors' claims would establish a policy that contravenes the Miller Act, which provides that surety bonds are the sole source of funds for subcontractor payment claims. See statutes and decisions cited.