

108647

Proc. - J  
J. Vickers

**DECISION**



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

9217

FILE: B-189901                      DATE: February 21, 1979

MATTER OF: C.G. Grant Construction Corp.

**DIGEST:**

Surety which completes defaulted contract pursuant to takeover agreement with Government is entitled to priority to contract retainages under performance bond over trustee in bankruptcy, assignee bank and Internal Revenue Service.

This case concerns the sum of \$80,923.12 which constitutes the final payment under Bureau of Mines (BOM) contract No. K0144080 and which is being withheld by BOM pending resolution of the conflicting demands for payment.

On March 21, 1974, the Bureau of Mines, Department of the Interior (BOM) entered into a contract with the C.G. Grant Construction Corp. (Grant) for construction of the Keyser Valley Strip Mine Area reclamation project in Lackawanna County, Pennsylvania. In accordance with the terms of the contract, Grant and the American Empire Insurance Company (Surety) executed performance and payment bonds.

On August 28, 1974, Grant filed a voluntary petition in bankruptcy and on September 8, 1974, Grant formally defaulted on the contract by notifying BOM that it was unable to fulfill contract obligations.

On July 25, 1974, Grant had assigned its rights under the contract to Hanover National Bank (Hanover), and on August 27, 1974, BOM reviewed the assignment and found it to be "proper and in order."

On August 21, 1974, the Surety sent a telegram to BOM stating that there were unpaid creditors and requesting that BOM make no further payments to Grant without the Surety's consent.

Shortly after Grant defaulted the Surety undertook completion of the remaining work under the contract. Although a formal takeover agreement between the Surety and the Government was not entered into until February 27, 1975, the Surety received regular progress payments beginning on September 15, 1974 (progress payment No. 9).

Work on the project was satisfactorily completed and on July 31, 1975, the Surety received the final progress payment (No. 23).

The unexpended funds, which are retained by BOM, are comprised of the following amounts:

1. Retainage (10 percent) of progress payments 1 through 6 amounting to \$10,665.77.
2. Withheld progress payments 7 and 8 in the full amounts totaling \$63,541.16.
3. Uncommitted contract balance of \$6,716.19.

Under the terms of the takeover agreement the unexpended funds are labeled the "contract fund" and are defined as "funds payable under the contract including all retained percentages and earned but unpaid progress estimates which are presently owing, but have not been paid to the defaulted contractor."

Claims to the contract fund have been filed by the Trustee in Bankruptcy, the assignee bank (Hanover), the Surety, and the Internal Revenue Service (IRS) for unpaid taxes.

The claim of the assignee is clearly inferior to the claim of the completing surety. National City Bank of Evansville v. United States, 143 Ct. Cl. 154 (1958). Likewise, a completing surety has priority over a trustee in bankruptcy. 8 Comp. Gen. 58 (1928); United States v. National Surety Co., 254 U.S. 73 (1920).

Regarding the priority as between the Surety and IRS, the Surety takes the position that since it spent more to complete the contract than is available from

the contract balance, it is entitled to the remainder of the contract fund. According to figures submitted by the Surety, it expended \$489,626.03 to complete the contract. That figure is composed of \$92,247.12 under the payment bond and \$397,378.91 under the performance bond. Since the Surety has received only \$224,266.33, payment of the entire amount remaining in the contract fund (\$80,923.12) would not fully reimburse the Surety for the cost of completing the contract.

IRS argues that because of the nature of the contract funds remaining, namely funds retained by BOM to assure that laborers and materialmen are paid and progress payments retained while the contractor was still performing, the Surety's claim is under the payment bond and not the performance bond. Therefore, since the Government may set off debts due it by a contractor from funds retained and due a Surety pursuant to payments under a payment bond, IRS is entitled to the contract fund. United States v. Munsey Trust Company, 332 U.S. 234 (1947). As of June 1, 1978, the outstanding tax liability of Grant, including interest, was \$92,388.38.


A performance bond Surety which undertakes to complete the remaining work left by a defaulted contractor is entitled to the funds in the hands of the Government without any setoff. Trinity Universal Insurance Co. v. United States, 382 F.2d 317 (5th Cir. 1967); United States Forest Service-Request for Advance Decision, B-192237, January 15, 1979. IRS's contention that the claim is actually under the payment bond rather than the performance bond has been round to be without merit by the courts. In Aetna Casualty and Surety Company v. United States, 435 F.2d 1082 (5th Cir. 1970), the Court of Appeals noted that to follow the above reasoning would make ineffective the rule enunciated in Trinity, supra.

The court made no distinction regarding the makeup of the contract retainage and stated:

" \* \* \* Here, however, the stipulation shows that Aetna expended in performance sums in excess of

receipts and in excess of the contract price. What defendant really wishes us to think is that a Surety who has issued both performance and payment bonds, and who completes a contract to avert a default, incurs expense under its payment bond, not under its performance bond, to the extent the costs are attributable to payments to labor and materialmen. The stipulation here fails to state that the costs of performance were for labor and material, but defendant wishes us to assume they were. Suppose they were, and in such cases no doubt usually they are, defendant's gloss would suck all the meaning out of the Trinity rule, and leave it an empty shell. \* \* \*

Accordingly, we find that the Surety is entitled to the entire contract fund free from setoff.

  
Deputy Comptroller General  
of the United States