

Barker

DECISION



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

FILE: B-221506

DATE: July 14, 1986

MATTER OF: Entitlement to Contract Payment-Department of
the Air Force

DIGEST: A surety called upon to answer for its principal's default is subrogated to any funds due or to become due under the contract and this subrogation right relates back to the date of the bond. Therefore, a performance bond surety which completed contract performance after the contractor's default, has priority to proceeds of Armed Services Board of Contract Appeals award over the prime contractor and the contractor's assignee bank.

On September 15, 1985, the Armed Services Board of Contract Appeals (ASBCA) ruled that Western Mechanical Contractors, Inc., and Ben Matto (joint venture) (Western Mechanical or contractor) was entitled to payments totaling \$15,915, plus interest, under contract number F38601-79-C-0010 with the Department of the Air Force. The contracting officer at Shaw Air Force Base requested our decision on whether the award should be paid to the contractor, to the contractor's surety, or to an assignee bank. In our opinion, the surety should receive the payment.

FACTS

Western Mechanical was awarded the above-referenced contract in June 1977 for housing renovation at Shaw Air Force Base. On May 8, 1981, its rights to proceed were terminated under the authority of General Provision Number 5 of the contract entitled "Termination for Default-Damages for Delay-Time Extension." Nearly a year after its default and termination, on May 2, 1982, Western Mechanical executed an assignment of the monies due it under the contract to the Allied Lakewood Bank of Dallas.

Following termination, the surety on the contractor's performance bond, the Aetna Insurance Company, completed the project. However, for reasons not clear from the record, Aetna would not enter into the customary "takeover" agreement

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with the Air Force.^{1/} For this reason, the Air Force decided to make no payments to Aetna during the time the contract work was being completed, although Aetna had sent in several invoices during that time. The Air Force accepted the last unit of work in September 1982. The contracting officer, uncertain as to who was entitled to the contract funds, refused to release the final contract payment until Western Mechanical, Aetna, and the Allied Lakewood Bank came to an agreement as to its disbursement.

Eventually, the Air Force paid most of the remaining contract funds to Aetna pursuant to a joint letter to the Air Force Contracting Division at Shaw AFB, dated January 12, 1984. The amount of this payment was far less than the actual expenses Aetna's follow-on contractor incurred in completing the project. The Air Force withheld \$5,515 from the payment because of defective lighting work which Western Mechanical had performed prior to its termination. It also withheld an amount assessed for liquidated damages because of late completion of project units. The letter, which was signed by representatives of the contractor, Aetna, and the assignee bank, stated:

"Each of us does hereby request and direct that all remaining contract funds * * * should be paid to Aetna Insurance Company * * *.

"Each of the undersigned parties does concur in this request and does assure you that it will make no claim against the Department of the Air Force or any other government entity or representative for misapplication or failure to pay these particular contract funds."

After Aetna took over performance of the contract, Western Mechanical appealed its default termination to the ASBCA. The Board denied Western Mechanical's appeal of termination for default. The Board did rule, however, that the contractor was entitled to recover \$15,915, plus interest as provided in section 12 of the Contract Disputes Act of 1978, 41 U.S.C. § 611 (1982). A portion of the award, \$5,515,

^{1/} While the presence or absence of a formal takeover agreement may be important in certain situations--see, e.g., 65 Comp. Gen. 29 (1985)--it is not relevant to this decision.

represented the amount which the Air Force had withheld from the final contract payment because of the defective lighting work. The Government conceded before the Board that the withheld amount was due because the follow-on contractor had corrected the lighting defects when it took over performance of the contract. The remaining \$10,400 represented liquidated damages which the contracting officer assessed and withheld from the final contract payment but which exceeded the amount of liquidated damages to which the Government was entitled under the contract.

Apparently, all of the signatories of the joint letter of January 12, 1984, claim the ASBCA award. The contracting officer has attempted to have them agree on the payment of the award, but has been unable to do so. Consequently, he requested this decision on which of them--the contractor, the surety, or the assignee--is entitled to payment.

DISCUSSION

Aetna is entitled to the proceeds of the Board's award because, as performance surety, it has priority over the prime contractor and over the assignee bank. Also, as explained below, the joint letter agreement authorizes the Government to distribute the award proceeds to Aetna.

The courts have held consistently that a surety called upon to answer for its principal's default is subrogated to any funds due or to become due under the contract, and this subrogation right relates back to the date of the bond. American Fidelity Co. v. National Bank of Evansville, 105 U.S. App. D.C. 312, 266 F.2d 910 (1959). The courts have specifically applied this principle so as to allow a surety to collect contract funds over a defaulted prime contractor. National Surety Corp. v. United States, 319 F. Supp. 45 (N.D. Ala. 1970). Numerous court decisions have held under this rule that the rights of a surety to contract funds are also superior to those of the contractor's assignee. E.g., Royal Indemnity Company v. United States and Jersey State Bank, 371 F.2d 462, 464 (Ct. Cl. 1967) and cases cited therein; National Surety Corp. v. United States, 133 F. Supp. 381, 383; 132 Ct. Cl. 724, 727 (1955), cert. denied sub. nom. First National Bank in Houston v. United States, 350 U.S. 902. This principle has been applied where, similar to this case, the funds in dispute are derived from an award by an agency board of contract appeals made to a prime contractor on its claim for a rebate of liquidated damages assessed by the Government. In re Cummins Const. Corp., 81 F. Supp. 193 (D.Md. 1948).

Furthermore, the decisions of this Office consistently apply the rule, in accord with the court decisions cited above, that a surety answering for a defaulted contractor has priority over the contractor and assignee bank to retained contract funds. E.g., 64 Comp. Gen. 763 (1985); 58 Comp. Gen. 295 (1979). This rule clearly applies in this case so as to entitle Aetna to recover the ASBCA award proceeds over Western Mechanical and the Allied Lakewood Bank since as surety it was called upon to perform under its performance bond in the manner discussed above.

Moreover, this conclusion is reinforced by the jointly-signed January 1984 letter which provides that "all remaining contract funds * * * should be paid to Aetna Insurance Company * * *." As discussed above, both items which comprise the award--excess liquidated damages assessed and the Air Force's claim amount for corrections for defective lighting--would have been included in those "remaining contract funds" if the Government had not erroneously withheld them at the time it made the final contract payment. Accordingly, we see no reason why these funds should not be viewed as encompassed by the January 1984 agreement.


for Comptroller General
of the United States