DECISION | **THE COMPTROLLER GENERAL OF THE UNITED STATES** 25603
WASHINGTON, D.C. 20548

FILE: B-208515 **DATE:** June 28, 1983

MATTER OF: National Institutes of Health Funds Available to Pay Completing Performance Bond Surety

DIGEST:

1. Although a certifying officer at National Institutes of Health (NIH) made a computational error in certifying a voucher for payment, thus proximately causing an overpayment of $11,184, his accounts are settled by operation of law and he cannot be held liable for the loss where the Government did not raise a charge against the account within 3 years of receipt by the NIH of the substantially complete accounts of the certifying officer.

2. Under surety law surety has election to pay Government's excess cost of completing contract or undertaking to finish the job himself. Under latter election, surety, upon successful completion, is entitled to his costs, up to the unexpended balance of the contract. In considering amount of unexpended balance available to pay performance bond surety his costs for completion of a defaulted National Institutes of Health contract, Government must consider contract balance to include amount of the Government's previous mistaken overpayment to the contractor.

The Chief Certifying Officer, Operations and Accounting Branch, Division of Financial Management, National Institutes of Health, has requested a decision as to whether we will relieve Steven Metcalf, a certifying officer, from liability for an $11,184 overpayment to the general contractor on a contract with the National Institutes of Health (NIH). She has also requested an advance decision as to whether a voucher for $14,394, submitted by a performance bond surety for completion of the contract, may be certified for payment. We conclude that the voucher for $14,394 may be certified for payment from the unexpended balance of the contract plus funds available for construction at the NIH facilities in [illegible]

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certifying officer is free from liability by operation of law and that therefore we do not need to consider whether we should relieve him.

On August 30, 1977, NIH awarded T.G.C. Contracting Corporation of New York a contract for construction work on NIH buildings in Bethesda, Maryland. As required by the Miller Act, 40 U.S.C. § 270a (1976), T.G.C. secured a bond guaranteeing performance of the contract from National Bonding and Accident Insurance Company of Missouri.

Sometime after it began work, T.G.C. requested in invoice No. 1, dated September 11, 1978, a progress payment of $37,800. T.G.C. requested in invoice No. 2, dated September 22, 1978, a progress payment of $34,806. The certifying officer, Steven Metcalf, apparently adding the sum requested in invoice No. 1, $37,800 (a copy of which was included in the documentation submitted with invoice No. 2) to an $8,190 subtotal on the third page of invoice No. 2, certified payment for $45,990 on invoice No. 2. This was an overpayment of $11,184. Payment was made on December 11, 1978. The error was not discovered until March or April 1979.

In September 1979, NIH, citing T.G.C.'s failure to satisfactorily complete the construction work, declared the corporation in default. In order to secure performance of the contract, NIH entered into a subsequent agreement with National, the performance bond surety, on September 12, 1980. Under surety law, National elected to take over and fulfill T.G.C.'s obligations under the 1977 contract (as modified in October 1978). NIH released National from any liability on the overpayment and promised to pay National $14,394. National performed to the satisfaction of NIH and, on April 8, 1982, submitted an invoice for $14,394 for its completion costs.

Under the usual rules, applicable to surety take-over agreements, National would be entitled to its completion costs, up to the unexpended balance of the amounts obligated for the contract, without setoff by the Government of the contractor's debts. See FPR1-18.603-4(c). The question here is whether the negligence of a Government employee in making an overpayment to the defaulted contractor and thus depleting the unexpended contract balance affects the rights of the surety? We think it does not. The overpayment to T.G.C. was not within the scope of the risk which National had consented to undertake. The Government promised in the contract with T.G.C. to make progress payments to T.G.C. as the work proceeded. The contract provided, however, that, "there shall be retained 10 percent of the estimated amount [of progress payments] until final completion and acceptance of the contract work." Clause 7, March 8, 1978 Addendum to General Provisions. The contracting officer under this clause could release the retained progress funds only if he found satisfactory progress or if the work was substantially complete. In no case could he pay over the unearned contract balance. The certifying officer's erroneous calculation and his resulting overpayment contravened this provision. The result was a contract balance much lower than would otherwise have been the case.

The effect of premature or unauthorized payments on a performance bond surety was discussed at some length in a 1966 5th Circuit Court decision, National Union Indemnity Co. v. G. E. Bass and Co., Inc., 369 F. 2d 75, 77. The Court held that where there has been a material departure from the provisions of the contract, relating to the amount of payments and the security of retained funds, the surety is discharged from its obligations on the performance bond to the extent that the unauthorized payments prejudiced his interests. Calling this the "pro tanto release" rule, the Court explained:

> "The purpose of the pro tanto release of surety rule is that the material departure from the terms of the contract deprives the surety of the inducement to perform which the contractor would otherwise have, and destroys, diminishes, or impairs the value of the securities taken."

The surety in Reliance Insurance Co. of Philadelphia, Pa. v. Malcalum B. Colbert et al., 365 F. 2d 530, 534-5 (1966) was also given a "pro tanto" discharge by the court because the defaulting contractor had been overpaid. The court explained the theory succinctly in a footnote on page 535:

> "Sureties presumably rely on such payment provisions to provide a source of indemnity in case the contractor defaults. Apparently, the result of Church's failure to abide by [the payment schedule] was that more money was paid to the contractor than he should have received by the time he finally abandoned construction."

The total overpayments constituted the measure of the prejudice the surety suffered and he was therefore entitled to a discharge of his obligations to that extent.

In the present case, the surety did not seek a discharge of its obligations upon learning of the overpayment to T.G.C. Instead, it elected to complete the contract, but sought and received an assurance from NIH that it would not be made to suffer because of the Government's erroneous overpayments to the contractor. We think NIH was justified in giving National that assurance. In Trinity Universal Insurance Co. v. United States, 382 F.2d 317, 320 (1967), cert. denied 390 U.S. 906 (1968), the Court observed that the performance bond surety who elects to complete performance upon default of the contractor confers a benefit on the Government by relieving it of the task of completing performance itself. The Court then concluded:

> "The surety who undertakes to complete the project is entitled to the funds in the hands of the Government not as a creditor and subject to setoff but as a subrogee having the same rights to the funds as the Government."

See also Security Insurance Co. of Hartford v. United States, 428 F.2d 838, 844 (1970) in which the Court held that a performance bond surety who completed a contract upon the contractor's default was entitled to recover its costs free from any set-off because of taxes owed to the Government by the contractor. The Court explained that its decision "avoids the anomalous result whereby the performance bond surety, if set off were permitted, would frequently be worse off for having undertaken to complete performance."

While none of GAO's previous decisions deal with erroneous payments which deplete the contract balance, they all "recognize the right of a surety who completes a defaulted contract under a performance bond to reimbursement for the expenses it incurs in completing the contract free from set off by the Government of the debts of the contractor." B-192237, January 15, 1979. See also B-189137, May 19, 1978, and B-189679, September 7, 1977. We think the same reasoning applies in this case. The surety should not be made to suffer because of the debt owed by T.G.C. to the Government.

As to NIH's request to relieve the certifying officer from liability, our authority to settle the accounts of accountable officers, such as the certifying officer here, is limited to a 3-year period by 31 U.S.C. 3526(c), 96 Stat. 964 (formerly 31 U.S.C. § 82i), except when a loss is due to the fraud or criminality of the accountable officer. That statute, which was originally enacted when all accounts were physically transmitted to this Office for settlement, provides that such accounts shall be settled "within 3 years after the date the Comptroller General receives the account." As a result of changes in audit methods, however, accounts are now retained by the various agencies where they are subject to our audit and settlement. Accordingly, we consider the date of receipt by the agency of substantially complete accounts, or, where accounts are retained at the site, the end of the period covered by the account, as the point from which the 3-year period begins to run. B-206591, April 27, 1982; B-205587, June 1, 1982; B-181466, July 10, 1974; 3 GAO Policies and Procedures Manual for the Guidance of Federal Agencies sec. 69.1, fn. 1.

There is no indication of fraud or criminality by the certifying officer here. Since the 3-year statute of limitations began to run from March or April 1979, when the agency's records were complete, enabling it to discover the overpayment, the certifying officer's account with regard to the overpayment has been settled by operation of law. B-206591, supra; B-205587, supra. We thus need not consider the granting of relief. However, NIH should proceed with aggressive collection action to recover the overpayment from the contractor.

for Milton J. Socolar

Comptroller General
of the United States