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

FILE: B-214905.2 **DATE:** July 10, 1984

MATTER OF: International Fidelity Insurance Co.--Reconsideration

DIGEST:

1. Prior decision is affirmed on reconsideration where the protester has not shown any error of law or fact which would warrant reversal of the decision.

2. Payment of withheld contract funds that are claimed by payment bond surety, the Department of Labor (DOL) for wage underpayments, and the Internal Revenue Service (IRS) for tax indebtedness may be made in the full amount of the DOL claim, then of the IRS claim, with the remaining balance payable to the surety.

3. Payment bond surety is not subrogated to the rights of unpaid or underpaid laborers.

4. The Federal Tax Lien Act of 1966 does not affect the government's separate remedial right of setoff.

International Fidelity Insurance Co. (Fidelity) requests that we reconsider our decision in the matter of Watervliet Arsenal, Department of the Army, B-214905, May 15, 1984. In that decision, we stated that payment of withheld contract funds that are claimed by a payment bond surety, the Department of Labor (DOL) for wage underpayments, and the Internal Revenue Service (IRS) for tax indebtedness may be made in the full amount of the DOL claim, then of the IRS claim, with the remaining balance payable to the surety. Fidelity, the surety in this case, asserts that we have overlooked certain court decisions which indicate that the surety should get priority over the DOL and the IRS.

We affirm our prior decision.

Fidelity cites the Supreme Court's decision in Pearlman v. Reliance Insurance Company, 371 U.S. 132,

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83 S. Ct. 232, 9 L. Ed. 2d. 190 (1962), to support its position that where the government is not itself the creditor, but is merely a "stakeholder" which will be passing the money on to some third party, the surety's claim has priority over the government's claim.

Fidelity's reliance on the Pearlman decision is misplaced. In Pearlman, the payment bond surety had been compelled to pay about $350,000 to discharge all of the debts to laborers and materialmen of the insolvent contractor. Since all of the laborers and materialmen had been paid by the surety, the retained funds in the government's hands clearly belonged to someone other than the laborers and materialmen. The court in Pearlman, following the rule stated in Henningsen v. United States Fidelity & Guaranty Company, 208 U.S. 404, 28 S. Ct. 389, 52 L. Ed. 547 (1908), commented that when a payment bond surety fully pays the debts owed to laborers and materialmen, the surety becomes subrogated to the contractor's and the laborers' and the materialmen's rights in the retained fund. The court, in stating that the surety had a priority to the retained money over the bankrupt contractor's trustee, concluded:

> ". . . the Government had a right to use the retained fund to pay laborers and materialmen; that the laborers and materialmen had a right to be paid out of the fund; that the contractor, had he completed his job and paid his laborers and materialmen, would have become entitled to the fund; and that the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it." (Emphasis added.) Pearlman v. Reliance Insurance Company, supra.

In Pearlman, the payment bond surety had priority to all the retained money only because all laborers and materialmen had already been paid. The court made it clear that "the laborers and materialmen had a right to be paid out of the fund" and that the surety gained its right to the retained fund "having paid the laborers and materialmen." Where, as here, however, the DOL is asserting a right of underpaid laborers not yet reimbursed by the contractor or the payment bond surety, it is clear that to the extent that the laborers have not been paid, the surety cannot be subrogated to the laborers' right to be paid from the retained fund. We conclude, as we did in our initial decision, that the claim of the DOL for the benefit of underpaid workers prevails over the surety's claim. Forest Service Request for Advance Decision, B-211539, September 26, 1983.

Fidelity cites a number of cases to support its argument that the rights of a surety making payment on a payment bond relate back to the date of the construction contract (not the date of payment on the bond) and, therefore, leave the contractor with no "property" in the unpaid contract balance held by the Army to which the IRS lien could attach. Fidelity, citing Aetna Insurance Co. v. United States, 197 Ct. Cl. 713, 456 F. 2d. 737 (1972), argues that the Federal Tax Lien Act of 1966 (the Act), 26 U.S.C. § 6321 et seq. (1982), provides that security interests arising from obligatory disbursement agreements such as payment bonds entered into before a tax lien is filed are protected against the tax lien even though funds are not advanced under the agreement until after the filing of the tax lien.

While we agree that the cases cited and the provisions of the Act in the Internal Revenue Code would give a payment bond surety priority over a subsequent tax lien in the circumstances outlined above by Fidelity, we believe that Fidelity is overlooking the distinction between the government's right in a tax lien and its separate remedial right to setoff. This distinction was recognized and clearly outlined by the Court of Claims in its Aetna decision cited by Fidelity. The court in Aetna, after a thorough examination of the legislative history of the Act, concluded that the Act in no way affects the government's right to setoff for taxes owed to the government by its contractor the unpaid contract balance claimed by the surety under its payment bond, as was held by the Supreme Court in United States v. Munsey Trust Co., 332 U.S. 234, 67 S. Ct. 1599, 91 L. Ed. 2022 (1947). The court found that the statutory collection procedures outlined in the Act and the government's right of setoff as outlined in Munsey are separate remedies available to the government, and that the former does not serve to limit the latter. See Morrison Assurance Co., Inc. v. United States, 3 Cl. Ct. 626, 632 (1983); United States Fidelity & Guaranty Co., et al. v.

United States, 201 Ct. Cl. 12, 475 F. 2d. 1377 (1973). As the Supreme Court stated in its Munsey decision, the government's right to setoff against payments withheld by it and due to the contractor on a construction contract as a result of a separate and independent transaction is superior to all claims of payment bond sureties, no matter when the claims of the sureties may have arisen.

We conclude that both the claim of the DOL for the benefit of unpaid or underpaid laborers and that of the IRS for the setoff from contract proceeds of monies to pay the contractor's tax liability take priority over the claim of Fidelity, the contractor's payment bond surety.

As Fidelity has not shown any error of fact or law in our initial decision, it is affirmed.

for Milton J. Socolar
Comptroller General
of the United States