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B-201388, Sep 23, 1981

Number: B-201388

Date: 1981-09-23

B-201388, SEP 23, 1981

DIGEST: TERMINATION BY SMALL BUSINESS ADMINISTRATION (SBA) OF ITS COMMITMENT TO GUARANTEE LOAN MADE BY BANK BECAUSE OF BANK'S FAILURE TO NOTIFY SBA OF DEFAULT BY BORROWER WITHIN 90 DAYS WAS CORRECT. ALTHOUGH REGULATIONS GOVERNING NOTIFICATION OF DEFAULT WERE CHANGED SEVERAL TIMES, WE HAVE HELD THAT THE REGULATIONS IN EFFECT WHEN DEFAULT OCCURRED ARE CONTROLLING IN THIS TYPE OF SITUATION. REGULATIONS IN EFFECT ON MAY 26, 1976, WHEN DEFAULT OCCURRED, SPECIFIED THAT GUARANTEE OF ANY LOAN WOULD BE TERMINATED IF SBA DID NOT RECEIVE NOTIFICATION OF DEFAULT WITHIN 90 DAYS.

CENTRAL STATE BANK - SBA GUARANTEED LOAN:

THIS DECISION IS IN RESPONSE TO A REQUEST FROM THE LAW FIRM REPRESENTING THE CENTRAL STATE BANK (BANK) FOR OUR OFFICE TO REVIEW THE DECISION OF THE SMALL BUSINESS ADMINISTRATION (SBA) TO TERMINATE ITS COMMITMENT TO GUARANTEE A $250,000 LOAN THE BANK MADE TO THE MODEL RAILROAD EQUIPMENT CORP. (BORROWER).

THE BANK IS NOT ENTITLED AS A MATTER OF LAW TO A FORMAL DECISION FROM OUR OFFICE. SEE 31 U.S.C. SECS. 74, 82D (1976); B-181432, NOVEMBER 12, 1975. HOWEVER, SINCE SBA'S DETERMINATION TO TERMINATE ITS GUARANTEE WAS BASED ON RULINGS OF OUR OFFICE, WE HAVE REVIEWED SBA'S DETERMINATION IN THIS CASE. FOR THE REASONS SET FORTH BELOW, WE AGREE WITH SBA'S DECISION DENYING ANY LIABILITY ON THE LOAN.

ON JANUARY 15, 1975, SBA APPROVED THE BANK'S REQUEST FOR SBA TO GUARANTEE 90 PERCENT OF A $250,000 LOAN TO BE MADE BY THE BANK TO THE BORROWER. THE BANK DISBURSED THE FULL AMOUNT OF THE LOAN TO THE BORROWER ON FEBRUARY 26, 1975. THE BORROWER DEFAULTED ON THE LOAN ON MAY 27, 1976, AND THE DEFAULT WAS NOT CURED WITHIN 90 DAYS OR ANY TIME THEREAFTER.

BASED ON THE INFORMATION SBA FURNISHED US, SBA WAS NOT NOTIFIED OF THE DEFAULT UNTIL MAY 26, 1977 - ONE YEAR AFTER THE DEFAULT OCCURRED. (IN THIS RESPECT, SBA STATES THAT IT HAS NO EVIDENCE THAT IT WAS NOTIFIED OF THE DEFAULT BEFORE MAY 26, 1977. FURTHERMORE, THE BANK WAS UNABLE, DESPITE NUMEROUS REQUESTS BY SBA, TO PROVIDE ANY PROOF THAT IT HAD NOTIFIED SBA OF THE BORROWER'S DEFAULT PRIOR TO THAT DATE.)

ON OCTOBER 20, 1980, SBA ADVISED THE BANK THAT IT WAS TERMINATING ITS GUARANTEE OF THE LOAN PURSUANT TO A RULING BY THE COMPTROLLER GENERAL THAT WHEN A DEFAULT ON A GUARANTEED LOAN OCCURRED DURING THE PERIOD BETWEEN FEBRUARY 19, 1976 AND AUGUST 10, 1976, SBA WAS REQUIRED TO TERMINATE THE GUARANTEE IF THE BANK HAD NOT NOTIFIED SBA OF THE DEFAULT WITHIN 90 DAYS.

THE QUESTION AS TO SBA'S AUTHORITY TO PURCHASE THE GUARANTEED PORTION OF A LOAN WHEN THE LENDER HAS NOT COMPLIED WITH THE NOTICE REQUIREMENTS SET FORTH IN SBA'S REGULATIONS AS WELL AS THE LOAN GUARANTY AGREEMENT WAS FIRST CONSIDERED IN OUR DECISION B-181432, FEBRUARY 19, 1976. IN THAT DECISION, WE HELD THAT SBA COULD NOT LEGALLY PURCHASE LOANS GUARANTEED PURSUANT TO SECTION 7 OF THE SMALL BUSINESS ACT, AS AMENDED, 15 U.S.C. SEC. 636 (A) (1976), UNLESS THE LENDING INSTITUTIONS INVOLVED HAD COMPLIED WITH THE REQUIREMENT THEN SET FORTH IN THE REGULATIONS AND THE GENERAL LOAN AGREEMENT THAT THEY NOTIFY SBA WITHIN 30 DAYS AFTER A DEFAULT BY THE BORROWER. SEE 13 C.F.R. SEC. 122.10(B)(1) (1975). WE FURTHER STATED THAT WITH RESPECT TO PAYMENTS ON DEFAULTS ARISING AFTER FEBRUARY 19, 1976, THE DATE OF OUR DECISION, WE WOULD TAKE EXCEPTION TO SUCH PAYMENTS IF THE NOTICE REQUIREMENTS WERE NOT STRICTLY COMPLIED WITH.

IN RESPONSE TO OUR DECISION, SBA AMENDED THE NOTICE PROVISION IN ITS REGULATIONS AND LOAN GUARANTY AGREEMENT ON MARCH 8, 1976 (EFFECTIVE FEBRUARY 19), AND AGAIN ON AUGUST 4, 1976 (EFFECTIVE AUGUST 10) TO INCREASE THE AMOUNT OF TIME IN WHICH BANKS COULD NOTIFY SBA OF A BORROWER'S DEFAULT AS WELL AS TO CHANGE THE LEGAL EFFECT OF A BANK'S FAILURE TO NOTIFY SBA WITHIN THE SPECIFIED TIME. ON MAY 26, 1976, WHEN THE BORROWER DEFAULTED ON THE INSTANT LOAN, THE APPLICABLE REGULATORY PROVISIONS, AS WELL AS THE PERTINENT PARAGRAPH IN THE LOAN GUARANTY AGREEMENT, READ AS FOLLOWS:

"*** THE GUARANTY OF ANY LOAN SHALL BE TERMINATED IF WRITTEN NOTIFICATION OF DEFAULT IS NOT RECEIVED BY SBA WITHIN 90 DAYS AFTER UNCURED DEFAULT BY THE BORROWER. LATE RECEIPT OR NONRECEIPT OF SUCH REQUIRED NOTICE WILL BE EXCUSED ONLY WHERE WRITTEN NOTIFICATION WAS SENT BY REGISTERED OR CERTIFIED MAIL NOT LATER THAN THE FIFTH DAY, OR BY MAIL GRAM NOT LATER THAN THE THIRD DAY, PRIOR TO THE NINETIETH DAY AFTER THE ORIGINAL DATE OF THE UNCURED DEFAULT. *** THE LENDER SHALL BE RESPONSIBLE TO ESTABLISH AND TO RETAIN EVIDENCE OF DELIVERY OF THE REQUIRED WRITTEN NOTIFICATION TO SBA."

41 FED.REG. 10415 (1976).

IN A LETTER DATED OCTOBER 29, 1976 FROM THE DIRECTOR, OF OUR COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION (CED), WHICH WAS BASED ON AN INTERNAL LEGAL OPINION PREPARED BY THE OFFICE OF GENERAL COUNSEL IN CONNECTION WITH THE DIFFERENT NOTICE REGULATIONS, SBA WAS ADVISED THAT THE REGULATIONS THAT WERE IN EFFECT WHEN A PARTICULAR LOAN WENT INTO DEFAULT WOULD BE CONTROLLING. WITH RESPECT TO THE SITUATION INVOLVED HERE, THAT LETTER READ AS FOLLOWS:

"2. WHERE DEFAULT OCCURRED ON OR AFTER FEBRUARY 19 BUT BEFORE AUGUST 10, 1976, PURCHASE IS PERMISSIBLE IF, BUT ONLY IF, NOTICE WAS RECEIVED BY SBA WITHIN 90 DAYS AFTER DEFAULT (OR NOTICE WAS GIVEN BY REGISTERED OR CERTIFIED MAIL WITHIN THE TIME PERIODS SPECIFIED IN THE THEN EXTANT REGULATIONS). THE PRESENCE OR ABSENCE OF SERIOUS HARM TO THE GOVERNMENT IS NOT A FACTOR FOR LOANS IN THIS CATEGORY."

IN SEVERAL CASES THEREAFTER, OUR OFFICE HAS REAFFIRMED OUR POSITION THAT THE REGULATIONS IN EFFECT WHEN A LOAN WENT INTO DEFAULT ARE CONTROLLING. SEE B-188741, JANUARY 25, 1978; AND B-181432, SEPTEMBER 4, 1979.

THUS, SINCE THE DEFAULT IN QUESTION OCCURRED DURING THE PERIOD BETWEEN FEBRUARY 19 AND AUGUST 10, 1976, AND SINCE SBA WAS NOT NOTIFIED OF THE DEFAULT WITHIN 90 DAYS, SBA'S DECISION TERMINATING THE GUARANTEE WAS CORRECT IN ACCORDANCE WITH THE REGULATIONS IN EFFECT AT THE TIME OF THE DEFAULT.

IN ITS LETTER REQUESTING OUR REVIEW OF SBA'S DECISION IN THIS CASE, THE LAW FIRM REPRESENTING THE BANK APPEARS TO SUGGEST THAT SBA'S ACTION AFTER THE DEFAULT OCCURRED MAY HAVE MISLED THE BANK. IN THIS RESPECT ITS LETTER READS AS FOLLOWS:

"*** THE SMALL BUSINESS ADMINISTRATION HAS BEEN WORKING WITH CENTRAL STATE BANK SINCE AT LEAST AS EARLY AS JULY, 1977 IN ATTEMPTING TO COLLECT THE OUTSTANDING INDEBTEDNESS ON THIS LOAN. MORE THAN THREE (3) YEARS LATER, IT ANNOUNCED THAT IT HAS TERMINATED ITS COMMITMENT TO GUARANTEE."

IT APPEARS THAT THE ARGUMENT BEING MADE ON BEHALF OF THE BANK IS ONE OF ESTOPPEL. IN EFFECT, IT IS SUGGESTED THAT AS A RESULT OF SBA'S NOT ADVISING THE BANK PROMPTLY THAT ITS FAILURE TO NOTIFY SBA OF THE DEFAULT WITHIN 90 DAYS HAD TERMINATED THE GUARANTEE, THE BANK WAS MISLED TO ITS DETRIMENT AND THAT SBA SHOULD THEREFORE BE ESTOPPED FROM DENYING LIABILITY.

SIMILAR ESTOPPEL ARGUMENTS HAVE BEEN MADE, CONSIDERED, AND REJECTED IN NUMEROUS OTHER CASES INVOLVING THE SBA GUARANTEED LOAN PROGRAM. SEE B-181432, NOVEMBER 12, 1975; B-181432, OCTOBER 20, 1978; AND B-181432 MAY 27, 1979. IN FACT, THE ORIGINAL DECISION OF FEBRUARY 19, 1976, DEALING WITH THE REQUIREMENT OF TIMELY NOTIFICATION OF DEFAULT SPECIFICALLY CONSIDERED AN ESTOPPEL ARGUMENT. WHAT WE SAID IN THAT CASE IS RELEVANT HERE AS WELL:

"HOWEVER, IT IS CLEAR THAT A LENDER WHO FAILED TO NOTIFY SBA WITHIN THE 30-DAY PERIOD PRESCRIBED IN BOTH THE REGULATIONS AND THE GUARANTY AGREEMENT COULD NOT SATISFACTORILY DEMONSTRATE THE PRESENCE OF ALL OR POSSIBLY ANY OF THE *** ELEMENTS THAT ARE NECESSARY, AT A MINIMUM, TO PRESENT A SUCCESSFUL ESTOPPEL ARGUMENT AGAINST THE UNITED STATES. SBA DOES NOT AND COULD NOT SERIOUSLY ARGUE THAT LENDERS WERE UNAWARE OF THE 30-DAY NOTICE REQUIREMENT, WHICH IS STATED, RESTATED, AND CONFIRMED ***. RATHER, THE ESTOPPEL ARGUMENT SEEMS TO BE, IN EFFECT, THAT CONTINUED AND PRESUMABLY KNOWING FAILURE BY LENDERS TO COMPLY WITH THIS REQUIREMENT MUST BE EXCUSED BECAUSE OF SBA'S FAILURE TO INSIST ON STRICT COMPLIANCE. IN OUR VIEW, SUCH AN APPROACH IS COMPLETELY UNTENABLE AS A MATTER OF LAW AND IS EQUALLY UNJUSTIFIABLE IN TERMS OF AVOIDING UNDUE 'HARDSHIP' TO THE LENDING INSTITUTIONS."

IN ADDITION, WE DO NOT BELIEVE THAT THE BANK HAS DEMONSTRATED THAT IT SUFFERED ANY INJURY AS A RESULT OF ITS ALLEGED RELIANCE ON SBA'S CONDUCT HERE - A NECESSARY ELEMENT OF A SUCCESSFUL ESTOPPEL ARGUMENT. FOR ONE THING, BY THE TIME SBA WAS ACTUALLY NOTIFIED OF THE DEFAULT - A YEAR AFTER IT OCCURRED - AND BEGAN THE ALLEGEDLY MISLEADING CONDUCT, THE GUARANTEE WAS ALREADY VOID UNDER THE APPLICABLE REGULATIONS. FURTHERMORE, THERE IS NOT EVIDENCE THAT THE AMOUNT OF THE LOSS SUFFERED BY THE BANK ON THIS LOAN WOULD HAVE BEEN SIGNIFICANTLY REDUCED IF IT HAD BEEN NOTIFIED ANY EARLIER THAT SBA'S GUARANTEE WAS TERMINATED. THEREFORE, ALTHOUGH WE MIGHT AGREE THAT SBA SHOULD HAVE NOTIFIED THE BANK MORE PROMPTLY THAT THE LOAN WAS NO LONGER GUARANTEED BECAUSE OF THE BANK'S FAILURE TO NOTIFY SBA OF THE DEFAULT WITHIN 90 DAYS, WE DO NOT BELIEVE THAT THE FACTS OF THIS CASE JUSTIFY THE APPLICATION OF ESTOPPEL AGAINST THE GOVERNMENT.

IN ACCORDANCE WITH THE FOREGOING, WE CONCUR IN SBA'S DECISION TO TERMINATE THE GUARANTEE IN QUESTION.