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

FILE: B-181432 DATE: FEB 4 1977

MATTER OF: Commerce Bank of St. Charles, Missouri

DIGEST: Small Business Administration (SBA) is not liable to reimburse bank for $17,500 loss bank suffered on $25,000 loan it allegedly made to small business borrower on basis of SBA approval of $25,000 direct disaster loan to borrower. Under provision in Loan Authorization authorizing SBA to cancel loan upon learning of any adverse change in borrower's situation, SBA was justified in cancelling balance of loan upon learning of such adverse changes. Furthermore, facts do not support estoppel since SBA made no misrepresentations to bank and bank did not make loan in reliance on those representations SBA did make.

This decision to the Administrator of the Small Business Administration (SBA) is in response to a request from SBA's General Counsel for our opinion as to whether SBA is liable to the Commerce Bank of St. Charles in the amount of $17,500. The facts concerning this matter are set forth as follows in SBA's submission:

"An application was made by Midwestern Diversified Industries, Inc. (Midwest), for a $25,000 direct disaster loan July 31, 1973. The loan was officially approved by the SBA through the signing of an Authorization on October 9, 1973 * * *. The loan Authorization provided various conditions for payment including a requirement that the SBA receive a second deed of trust [on] property located at 433-513 Cape Rock Drive, Cape Girardeau, Missouri.

"Prior to the issuance of the above-mentioned Authorization, the Bank had agreed to loan $25,000 to Midwest. The SBA was aware of this prior to its Authorization. The loan was made by the Commerce Bank of St. Charles, St. Charles, Missouri (Bank) but the exact date of disbursement is not known.

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"After the issuance of the Authorization, Midwest directed SBA, by letter of October 11, 1973 * * * to pay the loan proceeds directly to Bank. SBA's Disaster Office Counsel, Francis B. Nolan, on October 12, 1973, wrote to the Bank advising it of the October 11 request by Midwest * * *. Nolan indicated that the SBA was willing to disburse 'checks' in the total amount of $25,000 as requested by the borrower with the provision that:

'All loan conditions precedent to disbursement are complied with and all lien positioning is as represented by borrower.'

"On January 15, 1974, the SBA advanced to the Bank $7,500 with a letter from Mr. Nolan * * * stating:

'The remainder of this money will be disbursed when we receive a Certificate of Title from (Midwest) as a check for the remainder of the money is being ordered today.'

"A copy of this letter was sent to Midwest. Also on January 15, 1974, Mr. Nolan wrote a letter * * * to the Midwest stating:

'Prior to further disbursement of loan, we must receive a Certificate of Title showing the SBA as holding a Deed of Trust on 433-513 Rock * * *'

"A copy of this letter was sent to the Bank. On the bottom of the file copy of this letter there is a note in handwriting which is, in essence, a reminder for our file, which states:

'No further disbursements until evidence of use of proceeds is received and Certificate of Title.'

"R. O. Browning of Cape Girardeau Abstract Company, wrote on February 1, 1974, a letter to Ed Broyle, a Disaster Branch Office employee of the SBA, indicating that the second deed of trust which the SBA had obtained did not cover all of the borrower's property * * *.

"On February 11, 1974, Mr. Nolan wrote to Mr. Carpenter of the Bank discussing the collateral and insurance situation of the loan, and requesting that a new deed of trust be signed, notarized, and sent to a named abstract and [illegible] company for filing * * *. This new deed of trust which covered the land not included in the prior deed of trust, was subsequently delivered as required.

"However, shortly thereafter the SBA became aware that Midwest was no longer in business. On February 27, 1974, Darrell Westbrook, the SBA Disaster Office Loan Officer, visited the Bank * * * and told Mr. Carpenter of the Bank that Midwest had closed.

"On February 28, 1974, the Disaster Office of the SBA requested the cancellation of the $17,500 check representing the balance of the loan * * *.

"On March 8, 1974, George E. Murray, the SBA Disaster Branch Manager and long-time SBA employee, signed an SBA Form 327 which indicated that there had been an 'adverse change' in the loan conditions and that the holders of the first Deed of Trust on the real estate which served as security for this loan had indicated that they would be instituting foreclosure proceedings * * *. On March [illegible] 1974, the attorney for the Bank made a demand on the SBA [illegible] for payment of the remaining $17,500 * * *.

"On March 19, 1974, the District Counsel for the SBA District Office in St. Louis, John Molloy, wrote the Bank's attorney, * * *, and stated:

> 'Further disbursement of the subject loan was terminated because of failure on the part of the borrower to fulfill the conditions of the Authorization of the subject loan.'

"Mr. Molloy's letter referred to the above-mentioned letter of October 12, 1973, from Disaster Counsel Nolan which informed the Bank that all conditions precedent to disbursement had to be complied with prior to disbursement. On October 16, 1974, the undisbursed loan balance of $17,500 was cancelled."

Subsequently, the Bank requested SBA to reconsider its conclusion that no further disbursements could be made to the Bank on this loan. Although SBA did review the entire matter and reaffirmed its original conclusion, the question has now been submitted to our Office for a definitive ruling. It continues to be SBA's position that it is not liable to the Bank for the remaining $17,500 balance of the loan by virtue of paragraph 13 of the Loan Authorization, which authorizes the Disaster Branch Manager to cancel the initial disbursement of the loan or any subsequent disbursements if there has been an "adverse change" in the borrower's situation since the date of the loan application. According to SBA's submission, an adverse change did occur when the holder of the first deed of trust indicated an intent to foreclose on the property which served as security for the SBA loan and when the borrower went out of business. SBA further supports its conclusion by reference to paragraph 5 of the Authorization, which provides that the purpose for the loan was to provide working capital, which is obviously only needed for a going concern. SBA's submission also emphasizes that not only were no representations, implied or actual, ever made to the Bank that it would be paid regardless of Midwest's activities, but the Bank was specifically informed that it would only be paid if certain conditions precedent set forth in the Loan Authorization were satisfied by Midwest. For the reasons set forth hereafter we agree with SBA's conclusion that it is in no way liable to the Bank in this case.

Paragraph 13 of the Loan Authorization, which is the primary basis set forth in SBA's submission for its decision to cancel any further disbursements of this loan, reads as follows:

> "Prior to the first disbursement, and to each subsequent disbursement on account of the Loan, Disaster Branch Manager shall be in receipt of evidence satisfactory to him in his sole discretion, that there has been no adverse change since the date of the Application, or since any of the preceding disbursements, or that since the date of such Application or of any such disbursement, no facts or circumstances have become known or have arisen with respect to the organization, operations, business prospects, fixed or other property, personnel, or in the financial or any other condition of Borrower, which would warrant withholding or not making any such disbursement or any further disbursement."

Under this provision it is clear that SBA was justified in refusing to make any further disbursements of the loan upon learning of the impending foreclosure on the real estate which was serving as security for the loan as well as the fact that Midwest had gone out of business. Clearly, either of these developments, occurring alone, would have constituted an "adverse change."

In this regard, the Bank claims in a letter to SBA dated July 24, 1975, requesting SBA to reconsider its position that there was no adverse change in Midwest's financial condition between October of 1973, when the Loan Authorization was approved and February of 1974. The Bank argues that if the borrower's credit had been investigated and the value of the real estate in question verified, the authorization might not have been issued in the first place. However, even if we assume, arguendo, that this is correct, the authority of SBA's District Branch Manager under paragraph 15 to cancel any further disbursement of the balance of the loan would not have been affected. Paragraph 15 authorizes such cancellations not only when there has been an "adverse change" in the borrower's situation since the date of the application but also when the District Branch Manager learns of facts or circumstances concerning the borrower's business prospects or financial condition, of which he may previously have been unaware, which would warrant withholding or cancelling further disbursements. In this regard see Romeo v. United States, 462 F.2d 1036 (8th Cir. 1972), in which the Court of Appeals upheld the authority of the Administrator of SBA under this provision to cancel a disaster loan that had already been approved upon learning of the applicant's continuing involvement in gambling activities.

The main thrust of the Bank's argument, although not specifically identified as such, is one of estoppel. Thus the Bank claims in its letter of July 24, 1975, to SBA that it is entitled to receive the balance of the money that was withheld by SBA since it disbursed the $25,000 loan to Midwest on the basis of SBA's loan authorization and the letter of October 12, 1973, in which SBA agreed to disburse its disaster loan directly to the Bank on behalf of Midwest. The essential elements of estoppel in a case such as this one involving the United States have been stated as follows:

> "In order to constitute an equitable estoppel there must exist a false representation or concealment of material facts, it must have been made with knowledge, actual or constructive, of the facts, the party to whom it was made must have been without knowledge or the means of knowledge of the real facts, it must have been made with the intention

> that it should be acted on; and the party to whom it was made must have relied on or acted on it to his prejudice." _United States_ v. _[illegible]_, 137 F. Supp. 24, 28 (D. N.D. 1956); also see B-181432, February 19, 1976.

As suggested in SBA's submission, it is clear that the instant factual situation does not support a successful estoppel argument since several, and possibly all, of the necessary elements of estoppel are absent. First, there never were any false representations made by SBA in this case. The record demonstrates that from SBA's first contact with the Bank in its letter of October 12, 1973, SBA consistently advised the Bank that the $25,000 loan could only be disbursed to the Bank if Midwest complied with all of the "conditions precedent to disbursement" which were set forth in the Loan Authorization. Also see 13 C.F.R. § 123.10 (1976). Paragraphs 3 and 14 of the Loan Authorization indicate that before disbursement, SBA had to receive Second Deeds of Trust on two pieces of real estate described therein as well as satisfactory title evidence concerning such real estate. In subsequent correspondence with the Bank, SBA restated that no further disbursement would be made until SBA was furnished a Certificate of Title showing that it held a Deed of Trust on the two properties. As stated above, on or before the date SBA received the required certificates SBA learned of the adverse change in Midwest's financial condition and refused to make any additional disbursements as it was authorized to do in the Loan Authorization. Thus it is apparent that no misrepresentations were ever made by SBA.

Moreover, the Bank cannot even establish that it made the loan to Midwest in reliance on whatever representations were made to it by SBA. As stated in SBA's submission, the Bank agreed to loan $25,000 to Midwest at some time prior to the issuance of the Loan Authorization by SBA, although the exact date of disbursement of the loan is not known. The letter dated October 11, 1973, from Midwest to SBA specifically requested SBA to issue its check jointly to Midwest and the Bank "so that the proceeds from the * * * loan authorization, can be used to repay this bank a ninety-day commercial demand note held by this bank in the amount of $25,000." This clearly implies that the Bank had already made its loan to Midwest before SBA conditionally agreed to disburse any funds to the Bank, thus indicating that the Bank's decision to make the loan could not have been based on any representations from SBA that the loan would be disbursed to the Bank. If the Bank disbursed its $25,000 loan to Midwest on the basis of the Loan Authorization alone, as may be the case, it of course did so at its own risk and subject to the conditions and general provisions contained in the Authorization.

On the basis of the foregoing, we concur with SBA's position that it is not in any way liable to the Commerce Bank of St. Charles in this case.

R.F.KELLER

Deputy Comptroller General
of the United States