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DECISION

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

FILE: B-192884 DLG02438 DATE: July 31, 1979

MATTER OF: Chase Manhattan Bank - Small Business Administration Guaranteed Loan AGC00002

DIGEST:

1. SBA has discretion in appropriate case, subject to applicable statutory or regulatory provisions, to approve refinancing of existing non-guaranteed loan by new SBA guaranteed loan. Therefore, Bank's failure to pay guarantee fee prior to default on initial loan, thereby extinguishing guarantee on that loan pursuant to our decision B-181432, March 13, 1975, may not necessarily defeat otherwise valid guarantee of subsequent refinancing loan.

2. Where due to alleged clerical inadvertence date of note and date of disbursement of loan differ, it is not necessary to decide which date is controlling for purposes of determining whether guarantee fee was paid prior to default, because even assuming that default occurred prior to payment of guarantee fee, subsequent full payment by Borrower would have brought loan into fully paid, current status, thereby curing any existing default and enabling SBA to purchase guaranteed portion of loan.

The Chase Manhattan Bank, N.A. (Chase) has requested the General Accounting Office (GAO) to authorize the Small Business Administration (SBA) to purchase the guaranteed portion of a $250,000 term loan made by Chase to the Digital Lighting Corporation (Digital). SBA previously declined to purchase the guaranteed portion of the loan because Chase had not paid the required guarantee fee prior to default by Digital. DLG02439

A bank is not entitled, as a matter of law, to a formal decision from our Office. See 31 U.S.C. §§ 74, 82d (1976); and B-181432, November 12, 1975. However, since SBA's refusal to purchase the guaranteed portion of the loan was based on our decision B-181432, March 13, 1975, in which we held that SBA could not purchase the guaranteed portion of a loan if the guarantee fee had not been paid prior to the Borrower's default, we will consider the arguments presented by Chase. In accordance with our usual policy, we requested, and have received the views of the Administrator of SBA on this matter. SBA now takes the position that the Government should honor its guarantee on the $250,000 term loan.

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Based on the report submitted by SBA and the information provided by the Bank, the facts concerning the above-referenced loan appear to be as follows:

On April 5, 1976, Chase disbursed a $250,000, 90 percent SBA guaranteed loan (Loan 3) to Digital. This loan represented refinancing of two earlier loans made by chase to the same Borrower. The first loan (Loan 1) was a $100,000, 90 percent SBA guaranteed term loan made in 1973. The second loan (Loan 2), a $150,000 line of credit loan with an 80 percent SBA guarantee, was disbursed in 1975.

Before addressing the question of whether the guaranteed portion of Loan 3 may be purchased by SBA, we must first consider the timeliness of the guarantee fees paid to SBA on the two initial loans which were subsequently refinanced by Loan 3. Based on the certified loan transcript provided by the Bank, Loan 1 was disbursed to Digital on April 18, 1973. The guarantee fee on Loan 1 was also paid to SBA on April 18, 1973 and was therefore timely and paid in accordance with paragraph 5 of the Blanket Guaranty Agreement which requires payment of the fee within 5 days of first disbursement of a term loan. However, we are unable to reach that same conclusion concerning the $150,000 line of credit loan.

Loan 2, which was approved by SBA in writing on January 22, 1975, was disbursed by Chase on February 27, 1975. However, Chase did not pay the required guarantee fee on that loan until June 18, 1975. The relevant terms of the Blanket Line of Credit Guaranty Agreement, governing line of credit loans, are similar to the provisions of the Blanket Guaranty Agreement upon which our March 13, 1975, decision was based. Paragraph 2 of the Line of Credit Agreement provides that "Any approved line of credit will not be covered by this agreement until Lender shall have paid the guaranty fee for said line of credit as provided for in paragraph 5 of this agreement." Paragraph 5 provides that "Within 5 days of written notice of SBA's approval of the guarantee of each line of credit, Lender shall pay SBA a guarantee fee amounting to 1/4 of 15 of the total amount guaranteed by SBA."

Although it is clear that Chase did not pay the guarantee fee in accordance with paragraph 5 (which required payment by January 27, 1975), our decision of March 13, 1975, held that late payment of the guarantee fee did not necessarily preclude SBA from honoring the guarantee, provided the fee was paid prior to default by the Borrower. In the present case, the precise date on which Loan 2 first went into default is unclear. Digital apparently made interest payments on Loan 2 on March 1, and again on April 1, 1975. Following payment of the guarantee fee on June 18, only two additional payments are recorded for loan 2--$2,000 on August 26, 1975 and $3,600 on January 2, 1976. Unfortunately,

documents containing a record of the specific terms of the line of credit loan, including the schedule of interest and principal payments, are apparently missing from the SBA file. We do note that paragraph 3 of the Line of Credit Guaranty Agreement provides that:

> "The terms of the line of credit shall provide that non-payment of principal or interest on any note on any due date shall constitute a default. * * *"

Based on this provision as well as the actual repayment record (and in the absence of any information to the contrary) it is reasonable to assume that interest payments on the loan were due at some regular interval beginning immediately after disbursal. Therefore, although the matter is not entirely free from doubt due to the incomplete record, it appears that Chase did not pay the guarantee fee on Loan 2 prior to Digital's default on that loan. Accordingly, it is our view that pursuant to the terms of the Blanket Line of Credit Guaranty Agreement between SBA and Chase, SBA's guarantee on Loan 2 was not in effect when that loan went into default.

The next question is whether a loan that "lost" its SBA guarantee because the guarantee fee was not paid prior to default can be refinanced by a new loan that is covered by SBA's guarantee. Hypothetically, the requirement that the guarantee fee be paid prior to default as a condition precedent to SBA's obligation to purchase the guaranteed portion of a loan (B-181432, October 20, 1978) would be meaningless if a Bank could simply refinance a defaulted loan in order to obtain the SBA guarantee which it could not have secured on the initial loan.

However, in a related case where the guarantee on the refinanced loan was never secured, we considered the effect of a valid SBA guarantee on the initial loan. That decision is relevant here. In B-181432, July 7, 1978, the Lender contended that its rights under a valid guarantee agreement applicable to an initial loan had vested and therefore, were not extinguished when the initial loan was repaid by a refinancing loan. In that decision we responded to the Bank's argument as follows:

> "From a legal perspective as well as a practical one it is clear that when funds from Loan II were used to repay Loan I, Loan I as well as SBA's concomitant responsibility to guarantee that loan had in fact terminated."

Extension of that rationale suggests the parallel conclusion that a Bank's liability for failure to obtain a valid guarantee of the initial loan would also terminate when that loan was repaid with funds from the new loan.

Accordingly, it could be argued that any effect of Chase's failure to obtain a valid guarantee of Loan 2, should have terminated when Loan 2 was repaid by Loan 3.

Furthermore, in the only case in which we addressed the specific question of whether a loan with a lapsed guarantee could be refinanced by a new guaranteed loan, we recognized that SBA does have a considerable degree of discretion in determining whether or not to permit such a non-guaranteed loan to be refinanced and, in essence, reguaranteed. Thus, in B-181432, April 5, 1979, in which we first considered and rejected the Lender's contention that a defaulted loan, for which the guarantee fee had not been paid before default, had been cured by the Borrower, thereby reviving the extinguished guarantee, we went on to say the following:

> "However, as to the possibility of a refinancing of this loan, should the Bank wish to make a new loan to the borrower to repay the existing one and request SBA to issue a new guarantee on the second loan, we express no opinion since we believe that this determination can best be made by SBA in accordance with whatever regulatory provisions or internal SBA guidelines might be applicable to a situation in which an existing non-guaranteed loan is to be refinanced by an SBA guaranteed loan. This of course assumes that the Bank's allegations as to the borrower's improved circumstances could be substantiated so that repayment of the loan was reasonably assured as required by 15 U.S.C. § 636(a)(7) (1976)."

For these reasons, and because the record indicates that the refinancing of Digital's loans was primarily to assist the Borrower, we find that Chase's failure to pay the guarantee fee prior to default on Loan 2 does not necessarily defeat a valid guarantee of Loan 3, either in its entirety or for that portion of Loan 3 used to refinance Loan 2.

Turning now to the other major issue presented by this case, the relevant facts concerning the status of the guarantee on Loan 3 are as follows:

The note evidencing Loan 3 is dated March 24, 1976, the date originally scheduled for disbursement. However, because of delays by Digital in completing certain necessary forms, the loan was not

disbursed by Chase until April 5, 1976. Chase alleges that due to a clerical error, the date which appears on the face of the note itself was never changed from March 24, 1976, to April 5, 1976. However, the loan was entered in the Bank's records as of April 5, 1976, and interest began to accrue from that date. (Although the funds representing Loan 3 were apparently not disbursed to Digital in the usual sense, we believe that the date on which Loans 1 and 2 were closed out and interest began to accrue on Loan 3 is equivalent to the date of disbursement.) Chase paid the guarantee fee for the $250,000 term loan on April 30, 1976.

The note representing Loan 3 stipulated that only monthly interest payments were due for the first year, and on May 17, 1976, Digital paid the interest due on that date in full. Assuming Digital's first monthly interest payment was to be computed from the date of the note itself, payment was due on April 24, 1976. In that event, Chase's payment of the guarantee fee on April 30, 1976, occurred after default by Digital. By letters of May 12, 1977, and June 10, 1977, SBA refused purchase of the guaranteed portion of the $250,000 term loan because, according to the SBA, Chase failed to pay the guarantee fee prior to default as required by the Comptroller General.

This conclusion rests on the premise that the loan was in default on April 30, 1976. However, Chase contends, and SBA now agrees, that the date of disbursement is controlling. If this is true, then Digital's first interest payment would not have been due until May 5, 1976, and Chase's guarantee fee payment on April 30, 1976, would have been made prior to default.

We recognize that there may be some merit to this argument. The agreement covering Loan 3 is somewhat ambiguous in that it did not clearly indicate the day of the month on which each interest payment was due or whether the date of disbursement or the date of the note, assuming a difference between the two dates, was controlling. Also, it appears that except for the alleged clerical error by Chase, the date of disbursement and the date of the note would have been the same--April 5, 1976. This is somewhat analogous to the situation that was the subject of our decision B-191660, March 5, 1979, in which we held that a Bank's claim against the Government pursuant to Title I of the National Housing Act, as amended, was not barred even though the term of the note exceeded the statutory maximum, because the record indicated that due to inadvertence, the note as written did not reflect the intention of the parties at the time the loan was made. However, in our view it is not necessary to determine which date is controlling or whether our decision in B-191660, March 5, 1979, is applicable to these facts, since the question of the

validity of SBA's guarantee of Loan 3 can be resolved on an alternative basis.

Assuming the first payment was due on April 24, 1976, one month from the date of the note, the loan would have been in default prior to Chase's payment of the guarantee fee. However, in that case Digital's payment on May 17, 1976, would have brought the loan into a fully paid, current status, thereby curing the default that would have existed on April 30, 1976, the date the guarantee fee was paid. This issue was addressed at some length in B-181432, April 5, 1979, in which we said the following:

> "* * * [It] is our view that the failure of a bank to pay the guaranty fee prior to a default by a borrower does not necessarily preclude SBA in all circumstances from reinstating its guaranty and even purchasing the loan if subsequently, the original default is completely cured by the borrower and the required guaranty fee is paid in full prior to the occurrence of another separate default. We believe in those circumstances that SBA would have authority to purchase the loan in accordance with paragraph 2 of the Guaranty Agreement, which provides that a loan is covered after the guaranty fee has been paid. We also believe that such a result is both fair and reasonable, especially upon consideration of the definition of default set forth at 13 C.F.R. § 122.10(b), * * * which provides that default 'means non-payment of principal or interest on the due date.' Otherwise, there would be a technical default under this definition whenever the borrower was late in making a payment. For example, the guaranty of a loan might be forever terminated if the borrower was one day late in making his first payment, or any subsequent payment, and the bank had not yet paid the fee. This result would obviously be inequitable as well as inconsistent with the basic purpose of the guaranteed loan program."

Therefore, pursuant to that decision, even if we had concluded that there was no valid guarantee of Loan 3 on April 30, 1976, because of a prior default by the Borrower, a valid guarantee would have come into existence on May 17, 1976, when that default was cured.

Accordingly, we do not believe that SBA is precluded by any of our decisions from purchasing the guaranteed portion of the $250,000 loan Chase made to Digital (Loan 3). We note that Chase has also requested payment of the accrued unpaid interest on the two prior loans as well. Although we would not object to SBA's payment of the accrued interest

due on Loan I, if otherwise correct, we do not believe that SBA would be authorized to pay any of the accrued interest on Loan 2, since, as explained herein, it appears that Chase had not paid the guarantee fee for that loan prior to default by the Borrower.

Deputy Comptroller General
of the United States