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DECISION

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

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FILE: B-181432 DATE: April 5, 1979

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MATTER OF: Bank of El Paso - Small Business Administration Guaranteed Loan

DIGEST: In accordance with B-181432, March 13, 1975, and subsequent opinions upholding that decision, determination by Small Business Administration ~~(SBA)~~ to terminate its guaranty on loan made by Bank of El Paso was correct since SBA has no authority to accept late payment of guaranty fee from lender if loan is already in default, as defined in SBA's regulations, or lender has reason to believe default is imminent. Although SBA might in certain circumstances be authorized to reinstate its guaranty if default was completely cured by borrower, within reasonable period of time and fee was paid prior to occurrence of any new default, this case is not appropriate one for such action since curing was inadequate.

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This is in response to a request from the President of the Bank of El Paso that we advise the Small Business Administration (SBA) to reverse its decision to withdraw its 90 percent guarantee of a $200,000 loan to Aritex, Inc. because the Bank had not paid the required guarantee fee prior to default by the borrower.

The Bank of El Paso 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 determination that a valid guarantee of this loan no longer exists, and its refusal to purchase the guaranteed portion of the loan, was based on our decision B-181432, March 13, 1975, we will consider the arguments set forth in the Bank's letter.

Based on the information provided by the Bank and the accompanying enclosures, including a letter from SBA dated December 15, 1977, in which SBA advised the Bank that the loan was no longer guaranteed, the facts concerning this matter appear to be as follows.

On January 4, 1977, the SBA office located in El Paso, Texas, approved a 90 percent guarantee of a $200,000 loan to be made by the Bank of El Paso to Aritex, Inc. The Bank disbursed the loan funds to the borrower on February 18, 1977, although the guarantee fee was not paid until June 10, 1977, at which time the borrower

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was already in default. In its letter of December 15, 1977, to the Bank, the Director of SBA's Office of Portfolio Management stated that SBA could not purchase the guaranteed portion of the loan. The legal basis for its decision was explained as follows:

> "By letter dated June 10, 1977, the Bank advised SBA that the borrower was in default for the payment due May 18, 1977, and forwarded the guaranty fee on the loan therewith. The SBA Form 750, Loan Guaranty Agreement, paragraph 2, executed between your Bank and SBA provides that 'An approved loan will not be covered by this Agreement until lender shall have paid the guaranty fee for said loan as provided in paragraph 5 of this Agreement.' Paragraph 5 provides in pertinent part, that 'within 5 days of the first disbursement on account of each loan, lender shall pay SBA a one-time guaranty fee amounting to 1 percent of the total amount guaranteed by SBA.'
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> "By Opinion No. B-181432, dated March 13, 1975, the Comptroller General has determined that SBA has no authority to purchase the guaranteed portion of any loan wherein the guaranty fee was not paid within 5 days of disbursement and the borrower is in default or the lender or SBA has knowledge of imminent default by the borrower. The opinion further provides 'With regard to SBA's accepting the guaranty fee after a loan is in default it is clear that such action would modify to the Government's detriment the terms of section 2 of the Guaranty Agreement requiring payment of the guaranty fee before the loan is covered by the guarantee. The stated rule in this regard is that no officer or agent of the Government has the authority to waive contractual rights which have accrued to the United States or to modify existing contracts to the detriment of the Government without adequate legal consideration or a compensating benefit flowing to the Government. See 46 Comp. Gen. 874 (1967); 45 Id. 224 (1965); 44 Id. 746 (1965); 41 Id. 169 (1961); and decisions cited therein.'
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> "The facts as presented by both your Bank and the El Paso SBA office clearly establish that no contract existed with regard to this loan, and SBA has no authority to purchase."

We should point out that the decision of March 13, 1975, upon which SBA relied in this matter, has been consistently and repeatedly upheld in subsequent opinions issued by our Office. B-181432, November 12, 1975; B-181432, August 15, 1977; B-181432, July 7, 1978; and most recently in B-181432, October 20, 1978. In our October 20, 1978, decision, which resulted from a request by SBA to reconsider our March 13, 1975, decision, we amplified and expanded upon that decision. We held that the provision in paragraph 2 of the Blanket Guaranty Agreement, which had been the primary basis for our original decision, was a material and unambiguous condition precedent to SBA's guarantee. Furthermore, we held that SBA had not waived that provision and could not be estopped from enforcing it. We believe that the rationale of our decision in that case, as well as the other cited decisions, is equally applicable to the loan in question here.

The Bank makes a variety of arguments to support its request that we advise SBA to reverse its decision to terminate the guarantee on this loan. First, it explains the reason the guarantee was not paid at the time the loan was disbursed. The Bank's letter states that the delay resulted from difficulty in obtaining SBA required life insurance on the Secretary-Treasurer of Aritex, which finally resulted in the Bank's determination, after approximately 4 months, that the insurance was not obtainable. It was not until then that the $1,800 check for the guarantee fee was submitted to SBA, together with certain other required documents. Subsequently, SBA agreed that the insurance coverage could not be obtained and a formal waiver of that requirement was made by SBA. Although our Office has no reason to dispute these allegations, we do not believe that they have any legal significance since it is clear under the terms of the Guaranty Agreement that until the fee was paid the loan was not covered by SBA's guaranty.

Second, it is maintained that "a gross misunderstanding of the facts" was demonstrated by SBA when it stated in its letter of December 15, 1977, that the Bank had advised it on June 10, 1977, of the default and at the same time, paid the guaranty fee on the loan. The Bank maintains that two separate letters were involved--one advising SBA of the default, and the other containing the check for the guaranty fee, together with several other documents. It states:

> "The two letters were sent by two different officers of the bank and were purely coincidental in timing of their origin and delivery to SBA. It is our contention that the lender (Mr. Clarke Harvey) was not aware of, or had any information

indicating imminent default at the time he wrote his letter because the letters originated in two separate departments with no prior knowledge of the existence of the other letter."

Again, we are not questioning the accuracy of this information. However, legally the Bank of El Paso, like any other private business institution, is bound by the knowledge and actions of its employees or agents as to its business affairs. The key factor in determining whether or not late payment of the fee can be accepted, thereby reviving SBA's guaranty, is whether or not a default has already occurred or the lender, as a single legal entity, has reason to believe default is imminent. It is clear that by the time the fee was paid on June 10, 1977, the Bank was aware that the borrower had defaulted by failing to make the payment due May 18, 1977.

It is also alleged that the Bank never requested SBA to purchase the guaranteed portion of the loan because the Bank was never convinced that true default ever existed. Although default is not specifically defined in the Guaranty Agreement, it is defined in SBA's regulations, which are incorporated by reference into the Guaranty Agreement by paragraph 1 thereof, to mean "non-payment of principal or interest on the due date." See 12 C.F.R. § 122.10(b) (1977). We note that not only did Aritex omit the May 18, 1977, payment, but as of April 1978, it was not current as to payments due by November 1977. It is clear that the loan was in default. Since the Bank had not paid the guaranty fee prior to default by the borrower, the loan was not covered by SBA's guaranty when the default occurred. In our view, it is immaterial whether the Bank formally requested SBA to purchase the loan. Once the loan is in default, SBA may not accept the guaranty fee and the loan may not be guaranteed.

You also contend that even if the guaranty did not exist prior to the payment of the fee, SBA did accept late payment of the required fee and then initiated action to purchase the loan from the Bank. As stated in SBA's letter of December 15, 1977, to the Bank, SBA has no authority to accept the guaranty fee from a bank after the borrower has defaulted. Therefore, SBA's acceptance of the guaranty fee in such circumstances is not legally binding on the Government.

Lastly, we have considered what in our view appears to be the most significant argument contained in the Bank's letter. After a detailed discussion concerning the reasons for the borrower's default

as well as the borrower's allegedly improved condition, as of April 11, 1978, the Bank maintains that the default has, in essence, been cured. It states:

> "* * * Since income from cattle operations is seasonal, usually once a year, we suggest restructuring of the payment program from monthly to annual payments in November of each year.
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> "The company is making arrangements to bring the original note current through November 1977, and would be able to make the next required payment in November 1978, and annual reductions thereafter. Additional collateral is available in the form of a second assignment on real estate and notes receivable from sale of land which were not pledged to our original loan.
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> "We request the reinstatement of this guaranty on what we believe to be more favorable circumstances than when the SBA's guaranty was originally approved. The loan was properly conceived, documented as SBA required and serviced as prudently as any in our bank that are not guaranteed.
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> "* * * We sincerely hope that your analysis of the facts will lead you to the conclusion that ours was an isolated instance in which we inadvertently forgot to pay the guaranty fee and that accepting the fee now and reinstating the guaranty on this loan would not result in the purchase of the guaranteed portion of a defaulted loan. The bank is firmly convinced that the 'default' situation is totally cured, and we are not now requesting purchase of the guaranteed portion by SBA. Furthermore, we are not aware now of any likelihood of an imminent default by our borrower."

In the line of cases that has developed pursuant to our original decision of March 13, 1975, our Office has addressed the question of the curing of a default by a borrower on only one occasion, and in that instance indirectly. In twin opinions to two Members of Congress--

B-181432, August 15, 1977 (copies of which were furnished to and apparently relied on by SBA)--we said the following with regard to the possible curing of a default:

> "* * * It is possible that the default by Cheops Construction Co., Inc., existing when the fee was paid on May 31, 1973, may have been cured subsequently and that NMSB's [the Bank's] demand for SBA to purchase the loan, which was made on March 11, 1977, may have resulted from another later default. If this is true, it is possible that when the actual uncured default which triggered the bank's demand that SBA purchase the loan occurred, the loan was covered by SBA's guaranty."

As suggested in that opinion, 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), supra, 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.

It is our view that the primary responsibility to determine the precise circumstances in which the borrower should be "allowed" to cure a default thereby resulting in a reinstatement of a previously terminated guarantee, should rest with SBA as the agency responsible for administering the guaranteed loan program. However, that is not to say that SBA's authority in this regard is without limitation. We believe that reinstatement should only be allowed in certain circumstances. First, it would be our view that before SBA reinstates

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its guaranty, the "curing" of the default must be total; that is, the borrower must have brought the loan into a fully paid, current status. The delinquent payments must in fact be paid rather than forgiven, rescheduled or otherwise corrected by means of a restructuring of the loan. Second, the amount of time a borrower may be allowed in which to cure the default should not be unlimited. In making this determination as to the maximum amount of time that should be permitted SBA might conclude that since a bank can only request it to purchase a loan after the loan has continued in default for at least 60 days (unless SBA agrees to a shorter period), a default should have to be cured within the period in order for SBA to reinstate its guaranty. Beyond that, it does appear to us that as an outside limit, a loan guaranty should probably not be reinstituted after SBA has specifically determined that its guaranty of that loan was no longer in effect because of the bank's failure to pay the fee before default, whether or not SBA's decision resulted from the bank's formal request that SBA purchase the loan.

Applying these standards to the instant matter, we do not believe that the guaranty of this loan should now be reinstated. First, it appears that the alleged curing of the loan resulted from a proposed loan restructuring and rescheduled loan payments, rather than the actual payment by the borrower of the delinquent installments. Second, the alleged curing of the default occurred after SBA formally denied the existence of a valid guaranty based on non-payment of the fee.

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). If there is any doubt concerning SBA's authority in this regard, the matter may be submitted here for further consideration.

R. F. Keller

Deputy Comptroller General
of the United States