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

10,230

FILE: B-181432 DLGD1612 DATE: MAY 21 1979 AGC00002

MATTER OF: Community State Bank and Trust Company--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 guarantee on loan made by bank was correct since SBA has no authority under Loan Guaranty Agreement to accept payment of guarantee fee after default by borrower. Bank's arguments that it constructively complied with provisions of Loan Agreement or, in alternative, that SBA is estopped from enforcing those provisions are not legally or factually supportable.

This is in response to a request from the legal representatives of the Community State Bank and Trust Company (CSBT) concerning a $105,000 loan CSBT made to Leal Glass Company, ~~Inc. (Leal) that~~ DLG01613 was guaranteed by the Small Business Administration (SBA). SBA denied liability under the guaranty because CSBT had not paid the required guaranty fee prior to default by the borrower.

We were requested to review the facts concerning this matter and consider whether CSBT should be exempted from the effect of our March 13, 1975, decision. CSBT is not entitled as a matter of law to a formal decision from our Office. See 31 U.S.C. §§ 74, 82d (1976), as well as B-181432, November 12, 1975. However, since SBA's refusal to purchase this loan was based on our decision of March 13, 1975, B-181432, in which we held that SBA could not purchase the guaranteed portion of a loan if the guaranty fee had not been paid prior to the borrower's default, we will consider the arguments set forth in the letter from CSBT's legal representative.

Based on the information contained in that letter as well as the information we have obtained from SBA concerning this loan, the facts concerning this matter appear to be as follows. On May 6, 1976, SBA authorized CSBT to make an $85,000 loan to Leal with a 90 percent guaranty by SBA. Subsequently, on June 8, 1976, SBA authorized an increase in the amount of the loan to $105,000. The full $105,000 amount was disbursed on July 13, 1976. Although the borrower defaulted on this loan on November 13, 1976, when he failed to make the payment due on that date, the required guaranty fee totaling $945 (1 percent of the guaranteed portion of the loan) was not received by SBA until November 18, 1976. The loan settlement sheet was not received by SBA until November 29, 1976.

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The November default was never cured and the borrower's assets were sold at public auction on December 1, 1976. Shortly thereafter the bank requested SBA to purchase the guaranteed portion of the loan. SBA refused to do so, however, since the borrower had not paid the guaranty fee prior to default as required by paragraph 2 of the Blanket Guaranty Agreement.

The letter from CSBT's legal representative contains two legal arguments to support the request that we exempt CSBT from the effect of our March 13, 1975, decision. However, for the reasons set forth below we do not believe that a valid legal or factual basis for doing so exists here.

Before dealing with the specifics of this situation, 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. See 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 original decision, we amplified and expanded upon that decision. In that decision, we held that 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 guaranty. Furthermore, we held that, as a general proposition, SBA had not waived that provision and could not be estopped from enforcing it.

The rationale of the decision in that case, as well as the other cited decisions, is equally applicable to the loan in question here. However, the letter on behalf of CSBT does make two specific arguments to support its request for reconsideration, which deserve separate consideration. First, it is argued that the doctrine of detrimental reliance--estoppel--should excuse the bank's failure to pay the guaranty fee before the borrower's default. In this connection it is alleged that the guaranty fee check was dated July 16, 1976, and was drawn immediately after loan disbursement, thus indicating CSBT's intention to pay the guaranty fee at the time of disbursement. It is further alleged that when loan closing occurred on July 14, 1976, CSBT obtained all documents required by the SBA authorization with the exception of the settlement sheet. The borrower said he would complete and return the settlement sheet to the bank as soon as he had disbursed the loan funds in accordance with the terms of the loan. However, despite CSBT's efforts, the sheet was not returned to the bank. It is alleged that the check was not sent to SBA at that time because SBA personnel had informally advised the CSBT employee who presided at the settlement that SBA

would not accept payment of the guaranty fee unless submitted together with the loan settlement sheet and a copy of the promissory note. The guaranty fee check was apparently placed in the loan file and was not sent to SBA until a bank official learned of the problem in obtaining the settlement sheet, discovered the guaranty fee check in the file, and immediately directed that it be sent to SBA.

We do not believe that the bank has demonstrated detrimental reliance on SBA assurances which would estop SBA from enforcing the Guaranty Agreement as written. See especially B-181432, October 20, 1978, supra, for a discussion on estoppel. First, the bank chose to disburse the loan funds without requiring the borrower to provide it with the completed settlement sheet as a condition of loan disbursement. It then failed to obtain the sheet from the borrower in a timely fashion. In other words, even assuming it was relying on erroneous advice from SBA officials, whatever loss the bank may have suffered as a result of its failure promptly to submit to SBA the required guaranty fee or the other loan documents was due to its failure to obtain the necessary documents from the borrower. It was certainly aware of, and bound by, the requirement that the guaranty fee be paid. As stated in the letter from CSBT's legal representative, the bank was not in compliance with paragraphs 2 and 5 of the guaranty agreement. Secondly, since the letter states that the "superior officer" at the bank who learned that the guaranty fee check was still in the bank's possession immediately ordered the check to be sent to SBA without the settlement sheet, CSBT cannot demonstrate that it, as a legal entity, relied upon any advice by SBA personnel that the settlement sheet had to accompany the guaranty fee.

In addition to the estoppel claim, it is maintained that a bank making an SBA guaranty loan becomes a bailee or escrow agent for SBA since it retains, on behalf of SBA, the promissory note and other loan documentation, as well as the collateral for the loan, until such time, if ever, that the loan goes into default. Accordingly, it is argued that:

> "* * * when the employee of the Bank placed a check for the guarantee fee into the SBA file pending receipt of the settlement sheet, it was an act which clearly evidenced the intent on the part of the Bank to pay the guarantee fee, in that it earmarked the funds for the SBA and constituted constructive possession of such funds on behalf of the SBA."

It is further stated that "although there may not be strict compliance" with the provisions of the loan guaranty agreement, there was at least constructive compliance.

We do not believe that this argument is legally supportable. First, we agree with the position set forth by SBA concerning this theory in its response to our request for its views, which reads in pertinent part as follows:

> "* * * The Loan Guaranty Agreement provides expressly for the creation of a guaranty relationship between the two parties, and not for a bailment or an escrow, both of which are very different from the guaranty situation.
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> "A bailment is the delivery of personal property in trust for a specific purpose upon an express or implied contract that when the purpose is accomplished the property will be returned to the bailor or treated in accordance with his directions. The bailee has the right to exclusive possession of the property while the bailment exists and the bailor, who must have originally held title to the property, retains uninterrupted title. See 8 C.J.S. Bailments (1962) and 8 A.M. JUR. 2d § 2 Bailments (1963). Clearly, SBA never held title to any of the loan instruments or the check, never delivered any of the instruments to the Bank pursuant to a contract of bailment, and never intended to create a bailment for the instruments.
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> "An escrow is a written instrument containing terms creating a legal obligation which is deposited by the grantor, promisor, obligor or his/her agent with a third party who is not a party to the instrument. The instrument is kept by the depositary until the performance of a specified condition or the occurrence of a particular event, at which time the instrument is delivered over to the grantee, promisee or obligee. It must appear that the parties intended to create an escrow situation, and many authorities require a valid contract between the parties. See 30A C.J.S. Escrows § 1 (1965) and 28 AM. JUR. 2d Escrow §§ 1, 3, and 4 (1966). The elements necessary to create an escrow are obviously absent from the circumstances surrounding the Guaranty Agreement between SBA and the Bank."

Secondly, one of the reasons SBA adopted the one time fee payment requirement in 1973 as a condition precedent to its guaranty was to resolve the problems it had been having in collecting the fee. This was explained when SBA made the submission to us that resulted in the March 13, 1 75, decision. It wanted to make explicit the requirements of obtaining a valid guarantee and to avoid the kind of problem which has arisen here.

In our October 20, 1978, decision, supra, we said the following:

> "* * * we believe that under the Guaranty Agreement, it is the paym nt of the guaranty fee any time prior to default (or knowledge of impending default) which is material to the agreement. However, if payment of the guaranty fee was also permitted after a default had occurred, or an impending default became known, all participating lending institutions would be able, in effect, to receive the full benefit of SBA's guarantee without having to pay anything for it unti after the need for the guarantee became known. See B-181432, November 12, 1975. In many ways the guaranty fee requirement is analogous to the requirement in an insurance contract that the insured pay a premium prior to obtaining any insurance coverage. In the event the insured contingency occurred before the required premium was paid, no insurance coverage would exist. We believe the same rationale is applicable here."

Accordingly, pursuant to our decision, B-181432, March 13, 1975, and subsequent decisions as well, we believe that at the time the borrower defaulted on this loan, the loan was not covered by SBA's guaranty and SBA had no authority to purchase the loan.

R.F.KELLER
Deputy
Comptroller General
of the United States