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DECISION

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

[Request for SBA Purchase of Guaranteed Loan] 79879
DLG 02326

FILE: B-193134 DATE: July 27, 1979

MATTER OF: Herget National Bank of Pekin, Illinois - Small Business Administration Guaranteed Loan

DIGEST: Bank's alleged modification of terms of loan guaranteed by Small Business Administration (SBA), whereby bank agreed to grant borrower additional time to begin repaying principal and interest on loan, was not legally effective with respect to SBA, since bank neither requested nor received SBA's prior written approval of such modification as required by Authorization and Guaranty Agreement between SBA and bank. Therefore, in accordance with B-181432, March 13, 1975 and subsequent opinions upholding that decision, SBA's refusal to purchase the loan was correct, since SBA has no authority to accept payment of guarantee fee after default by borrower.

This is in response to a request from the counsel for the Herget National Bank (HNB) of Pekin, Illinois, for our Office to review the decision of the Small Business Administration (SBA) not to purchase an SBA-guaranteed loan made by HNB. In denying any liability under the terms of the Guaranty Agreement, SBA relied on our decision, B-181432, March 13, 1975, in which we held that SBA could not purchase a guaranteed loan if the required guaranty fee had not been paid by the lender before the loan went into default or if the lender had reason to believe a default was imminent. For the reasons set forth hereafter, we agree with SBA's determination.

As recognized in the request, HNB is not entitled as a matter of law to a formal decision from our Office. See 31 U.S.C. § 74, 82d (1976); B-181432, November 12, 1975; B-181432, April 5, 1979. However since SBA's refusal to purchase this loan was based on our decision of March 13, 1975, we will consider the arguments set forth on behalf of HNB.

Based on the information contained in the letter from HNB's counsel, as well as the information we were provided by SBA, the facts concerning this matter appear to be as follows. On July 5, 1973, SBA issued an Authorization approving HNB's request for an SBA guarantee of a proposed loan in the amount of $53,000 to Mr. and Mrs. John Vagen to open the Pekin Electronic Store.

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The note given by the borrowers to HNB was dated July 21, 1973. The SBA Authorization provided that monthly interest installments of $375.00 would commence one month from the date of the note. It further provided that monthly installments of $1133.00 each, representing combined principal and interest payments would commence 4 months from the date of the note. The note contained identical terms.

The loan, most of which was to be used to purchase inventory was disbursed as follows:

| | |
|---|---|
| September 12, 1973 - | $25,000 |
| September 20, 1973 - | 6,000 |
| September 21, 1973 - | 4,800 |
| October 18, 1973 - | 4,000 |
| January 22, 1974 - | 7,000 |
| October 10, 1974 - | 4,000 |
| December 5, 1975 - | 2,200 |

(The last two disbursements were not made in accordance with the terms of the Authorization, which required that no disbursement could be made later than 12 months from the date of the Authorization unless with prior written consent of SBA.)

It appears that HNB formally notified SBA of each disbursement as it was made on the SBA form provided for this purpose. HNB alleges that the funds were disbursed in this manner because the borrower did not receive all the inventory (which was to have been delivered within 3 months of the date of the note) until March 1974, approximately 8 months from the date of the note.

The bank further alleges that since the inventory did not arrive until March, the borrower's cash flow did not warrant payments prior to April. Accordingly, HNB agreed to give the borrowers until April 4, 1974, to make the first payment on the loan.

On April 4, 1974, the borrower paid HNB all interest that had accrued on the monies disbursed by the bank up to that point ($46,800). Then, beginning on April 19, 1974, and continuing through March 21, 1978, the borrower made regular monthly payments - principal and interest- "with precision." HNB did not pay SBA the required guarantee fee on this loan until March 25, 1975. In April 1978, HNB advised SBA that the borrower had filed for bankruptcy, leaving an unpaid balance on the loan of $12,850.30. SBA denied HNB's claim on the grounds that it had not paid the guarantee fee on this loan

prior to the borrower's default which occurred when the borrower failed to make the payments due from December 21, 1973 to March 21, 1974. (In making this determination SBA apparently misread the terms of the note, which actually provided that the first combined principal and interest payment was to become due 4 months from the date of the note on November 21, 1973.)

The decision of March 13, 1975, upon which SBA relied 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; B-181432, October 20, 1978; B-181432, April 5, 1979; and B-181432, May 21, 1979. In the October 20, 1978 decision, which resulted from a request by SBA that we reconsider our original decision, we instead expanded upon that decision. Specifically, we held that paragraph 2 of SBA's Blanket Guarantee 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, as a general proposition, SBA had not waived that provision and could not be estopped from enforcing it. Our view of the basic legal issues involved here is no different.

HNB did not pay the guarantee fee on this loan in accordance with the provisions of the guarantee agreement, which provides that the fee should be paid within 5 days of first disbursement of the loan. The fee which should have been paid by September 17, 1973--5 days after the date of the first $25,000 disbursement--was not paid until March 25, 1975. In our decision, B-181432, March 13, 1975, we held that lenders could make late payments of the fee--after the 5 day period--and thereby revive SBA's guarantee, provided the loan was not yet in default or likely to be in default.

The primary argument made on behalf of HNB, however, is that our earlier decisions are not applicable because this borrower was not in default or likely to be in default at the time the guarantee fee was paid to SBA on March 24, 1975, since HNB had agreed to "postpone" the disbursements to, as well as the repayments from, the borrower. The bank contends that these actions were justified in light of SBA's requirement that lenders insure that loan proceeds only be used by the borrower for the purposes specified in the Authorization. Thus, since the loan funds were to be used primarily to pay for inventory, which was not delivered until March 1974, HNB argues that it was justified in withholding funds until the inventory arrived. HNB further maintains that even though HNB did not require the borrower to make any payments

before April 1974, and so did not consider the borrower's "failure" to make payments before that date as a default, any such default that did occur was cured when the borrower made the April 4, 1974, payment of all accrued unpaid interest on the monies received up to that point.

In the present case, the record, including all of the correspondence of SBA with HNB and the actual repayment record, tends to support HNB's contention that it did not consider this loan to be in default until April 1978, when the borrower filed for bankruptcy. However, even assuming that to be the case, the matter is not resolved. Since HNB was clearly delinquent in paying the fee, SBA was without authority to accept the fee and honor its guarantee if, in fact, the loan was in default when the fee was paid, whether or not HNB believed that to be the case.

There is no written evidence in the record to substantiate HNB's claim that the terms of the loan, specifically the repayment schedule, had been changed by mutual agreement between it and the borrower. Moreover, HNB neither requested nor received SBA's prior written approval of any changes in the terms of this loan. SBA's Authorization, which sets forth SBA's approval of HNB's request for a guarantee says that:

> "No provision stated herein shall be waived without prior written consent of SBA. The loan shall be administered as provided in the guaranty agreement."

The guarantee agreement, the terms of which are specifically incorporated by reference into the Authorization, is even more specific when it states:

> "SBA shall either authorize the guaranty or decline it, by written notice to the Lender. Any change in the terms or condition stated in the loan authorization shall be subject to prior written approval by SBA. 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." (Emphasis added.)

In accordance with a separate provision in the Guaranty Agreement, HNB did notify SBA in writing of all disbursements on the loan as soon as they were made. Arguably, even though the note required interest payments to begin August 21, 1973, 1 month from the date of the note, SBA must have known at least constructively that the

borrower could not have been considered in default until after the first disbursement was made on September 12, 1973, since the borrower was not legally obligated to pay interest on money that had not yet been received.

In this connection, the provision in the note requiring the borrower to commence interest payments 1 month from the date of the note would only make sense if at least the initial disbursement was to be made no later than 1 month from the date of the note. There is, however, no such requirement. The language of the Authorization gives HNB up to 6 months from the date of the Authorization, or until January 5, 1973, to make the first disbursement, and does not prescribe a particular time for execution of the note. Similarly, the amounts to be paid monthly, specified in the Authorization and the note, are apparently based on the assumption that the full $53,000 would have been disbursed on the date of the note, even though the Authorization expressly acknowledges that there may be multiple disbursements over a 1-year period.

SBA apparently assumed, in its June 27, 1978, letter to HNB, that interest and principal payments were due in the amounts and at the times specified in the note, regardless of the fact that disbursement of the full amount had not been made when the payments were first due. HNB disputes this. We find it unnecessary to resolve this dispute because, even assuming that payments were due based not on the date and amounts in the note but on the dates and amounts of the disbursements, the borrower was in default before the guarantee fee was paid.

We would agree that, with respect to the interest any default that might have occurred before April 4, 1974, was cured by the payment on that date of all accrued unpaid interest. However, the same cannot be said of the borrower's default in failing to make the required principal payments. The borrower's failure to make principal payments cannot be "excused" or explained on the same grounds as his failure to commence interest payments as specified.

As suggested above, construing any ambiguity as to when payments were to begin in favor of the borrower, the terms of the note as written would at the very least have required the borrower to commence monthly payments of principal (and interest) on January 12, 1974, no later than 4 months from the date of the first disbursement. Thus, the borrower was in default on the principal amount of the loan, since he did not make the first principal payment until more than 3 months later--on April 19, 1974. Although the borrower continued to make all principal and interest payments on a regular

monthly basis from April 19, 1973, until March 21, 1978, the default was a continuing one since the "missed" payments (which, at a minimum included those due for the months of January, February, and March), were never made up by the borrower. Moreover, whatever modification of the basic loan agreement may have been attempted between HNB and the borrower to "postpone" the borrower's obligation to make the combined principal and interest payments, it is our view that any such modification was not legally effective, at least so far as SBA was concerned, since SBA did not give prior written consent as required by the Authorization.

Therefore, the borrower's failure to make principal payments as required did constitute a default, for the purpose of determining SBA's obligation on its guarantee. Moreover, this default was never cured by the borrower and continued until HNB requested SBA to purchase the loan in 1978. Accordingly, we agree with SBA's determination that this loan was not covered by the guarantee when the borrower defaulted and should not have been purchased by SBA.

Deputy Comptroller General
of the United States