DECISION

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

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98587

FILE: B-181432

DATE: FEB 19 1976

MATTER OF: SBA section 7(a) business loans

DIGEST:

Under Small Business Administration (SBA) "section 7(a) business loan program," authorized by 15 U.S.C. § 636, requirement in statutory regulations and Loan Guaranty Agreement that lender notify SBA within 30 days of borrower's default in order to demand SBA purchase of guaranteed loan constitutes a material and legally binding element in contractual relationship between SBA and lending institution. Therefore, SBA cannot waive noncompliance with such requirement and lacks authority to purchase loan for which required 30-day notice has not been given.

This decision to the Administrator of the Small Business Administration (SBA) concerns a problem which has arisen in the implementation of SBA's so-called "section 7(a) business loan program." The program, consisting of direct loans, immediate participation loans, and guarantees of loans to small business concerns, is conducted pursuant to section 7 of the Small Business Act, as amended, 15 U.S.C. § 636(1970), which provides in pertinent part:

> "(a) The Administration is empowered to make loans to enable small-business concerns to finance plant construction, conversion, or expansion, including the acquisition of land; or to finance the acquisition of equipment, facilities, machinery, supplies, or materials; or to supply such concerns with working capital to be used in the manufacture of articles, equipment, supplies, or materials for war, defense, or civilian production or as may be necessary to insure a well-balanced national economy; and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis. * * *"

Specifically, the instant problem relates to SBA's treatment of the requirement for notification of defaults under "simplified blanket guaranteed loans," provided for in SBA regulations, 13 C.F.R. § 122.10(b)(1) (1975), as follows:

> "Simplified blanket guaranteed loans are loans made by financial institutions under a Guaranty Agreement between SBA and the lending institution which is applicable to future loans to small business concerns as authorized by SBA. Under such a Guaranty Agreement, SBA is obligated to purchase not more than 90 percent of the outstanding balance of each loan thereunder together with accrued interest in the event the borrower has defaulted for not less than 60 days. Any eligible loan which the lending institution would make only with the guaranty of SBA may be authorized by SBA under said Guaranty Agreement. Notification to SBA within 30 days of any default is a condition precedent to the lending institution's demand for purchase by SBA. Default means nonpayment of principal or interest on the due date, or the breach by the borrower of any loan covenant which the lending institution determines to be an adverse change in the borrower's ability to repay the loan." (Emphasis added.)

Paragraph 7 of the current Loan Guaranty Agreement (SBA form 750)--which apparently covers most of the guarantees now in effect--provides as follows with respect to default notices:

> "Lender shall notify SBA in writing within 30 days of any uncured default by a borrower in making payment when due of any installment of principal or interest on any note. If such default continues uncured for 60 days (or less, if SBA agrees), and if Lender shall have duly notified SBA of the default, Lender may demand in writing that SBA purchase the guaranteed percentage of the loan."

During a full-scale audit of SBA by our Office,* it was discovered that in most cases participating banks have not complied with the required 30-day notice of default. Late notices ranged from 31 days to over 300 days, and were received, on the average, about 4 months after borrowers became delinquent. Moreover, it appears that at least some participating banks have adopted a policy of reporting delinquencies to SBA on some basis other than 30 days, i.e., quarterly, semiannually, or other time ranges. However, SBA's stated policy is not to enforce strict compliance with the 30-day notice requirement by refusing to purchase loans for which such timely notice was not given. Rather, an SBA procedural issuance--paragraph 52 of SOP 50-50-1, effective October 10, 1975--states in this regard:

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*This audit was specifically mandated by section 13 of the Small Business Amendments of 1974, approved August 23, 1974, Pub. L. No. 93-386, 88 Stat. 750, 15 U.S.C.A. § 633 note.

"Lender must notify SBA in writing (preferably by using SBA Form 1071) of default in payment of principal or interest on any loan, within 30 days following the date due. In the event the Agency receives a request to purchase the guaranteed portion of a loan in default on which an SBA Form 1071 (or other written notice) has not been submitted, a determination must be made as to whether or not that failure resulted in any substantial loss to the Agency and/or the borrower. If the Agency and/or the borrower did suffer any substantial loss, consideration should be given to denial of liability. If there was no substantial loss to either the Agency or the borrower, the Agency may, upon the first instance of failure to submit the SBA Form 1071 (or other written notice), honor the guaranty (if no substantial interest has accrued) but remind the lender of its obligation under the guaranty agreement to advise SBA of uncured 30-day defaults. Also advise the participant in writing that upon their next failure to provide written notice of uncured 30-day default in payment, that the interest accrued from date of default to date of purchase will not be paid. On the second occasion of failure to submit a 1071 (or other written notice), interest accrued from the date of default to date of purchase will not be paid. Should the participant continue to fail and/or refuse to submit 1071's (or other written notice) as required, consideration should be given to refusing to participate with that lender. (Paragraph 14 of SBA Form 750 may be invoked.) Failures on the part of the lender to submit the SBA Form 1071 (or other written notice) as required should be noted on the SBA Form 916, 'Bank Record Card.'"

In view of the foregoing, we requested, and have recently received, a report from SBA concerning its legal authority to purchase loans despite a bank's failure to comply with the 30-day notice requirement as set forth in SBA's regulations and the Loan Guaranty Agreement. The SBA report advances several theories to support such authority. However, after careful consideration of the SBA arguments and for the reasons stated hereafter, we conclude that the agency is legally bound to comply with this requirement as written. Accordingly, it is our opinion that SBA lacks authority to purchase a guaranteed loan where the bank has not given the required 30-day notice of default.

- I -

As noted previously, the relevant SBA regulation specifically states that "Notification to SBA within 30 days of any default is a condition precedent to the lending institution's demand for purchase by SBA."

Black's Law Dictionary 366 (Rev. 4th ed. 1968) contains the following definition of the term "condition precedent:"

> "* * * A condition precedent * * * is one which is to be performed before some right dependent thereon accrues, or some act dependent thereon is performed. Federal Land Bank of Louisville v. Luckenbill, 213 Ind. 616, 13 N.E. 2d 531, 533. A 'condition precedent' is one that is to be performed before the agreement becomes effective, and which calls for the happening of some event or the performance of some act after the terms of the contract have been agreed on, before the contract shall be binding on the parties. Rogers v. Maloney, 85 Or. 61, 165 P. 357, 358; Harper-Lincoln Pine Lock Oil Co. v. Pruitt, 191 Ky. 207, 229 S. W. 374. "

Accordingly, the regulation clearly means that unless a participating lending institution notifies SBA of any uncured default by a borrower within 30 days of such default, the lending institution involved would lose any legal right it might otherwise have had to demand that SBA purchase the guaranteed percentage of the defaulted loan.

SBA argues, among other things, that the "condition precedent" language set forth in the regulations has not been carried over to paragraph 7 of the current Guaranty Agreement, supra, which restates the 30-day notice requirement and authorizes a lender to demand purchase by SBA, inter alia, * * * if Lender shall have duly notified SBA of the default * * *." Moreover, SBA states that while it has intended to revise the 30 day notification provision in the next overall amendment of Part 122, title 13, of the regulations, it has construed the promises and obligations of the lender and SBA under the guaranteed loan program as being subject to the existing provisions of the Guaranty Agreement. We disagree with these assertions for two reasons. First, we do not believe that there is any substantive legal difference between use of the term "condition precedent" in the regulation and use of the word "if" in the agreement. Both provisions have the same legal effect, namely, establishment of the requirement of due notice by the lender within 30 days of default, before SBA's reciprocal obligation to honor its guaranty comes into being. Second, even if it is

assumed, arguendo, that paragraph 7 of the Agreement has a different meaning or is in fact less stringent than the corresponding provision in the regulations, the existing regulatory provision, which has the force and effect of law, would be legally controlling. See 36 Comp. Gen. 507 (1957), in which we concluded that there was no legal basis to pay participants in a soil-bank program, administered by the Department of Agriculture, an amount in excess of the maximum permitted under the applicable regulations even though payment of such an amount would have been in accordance with the terms of the contract.

Thus the instant situation is very similar to the situation considered in our decision to SBA, B-181432, March 13, 1975, wherein we concluded that a provision contained in the Guaranty Agreement which stated that until the guaranty fee was paid, an approved loan was not covered by SBA's guaranty, legally prohibited SBA from purchasing the guaranteed loan whenever a default occurred prior to payment of the required fee by the lender. Adherence to the precedent established in that decision requires that a similar result be reached in the instant case, namely, that SBA has no authority to honor its guaranty when the lending institution involved fails to notify SBA of any uncured default within the specified 30 day period, as required by both the regulation and the Agreement.

- II -

The primary basis set forth in SBA's report for its conclusion that it has the authority to purchase these loans is that Government agents possess the legal authority and discretion to waive procedural requirements or conditions that are published in a regulation or contained in a contractual agreement. For reasons that will be set forth later in this opinion we do not agree with SBA's position in this regard.

SBA also attempts to justify its position by making the assumption that the issue involved here "relates solely to the case where the lender's only failure under the Guaranty Agreement has been the failure to give the 30 days default notice, i.e., the loan has been otherwise properly disbursed and serviced * * * and the failure to receive the 30 days default notice has not caused any loss or damage to SBA." In such cases SBA acknowledges that it has not refused to honor its guaranty. However, we find it difficult to accept this assumption entirely for several reasons. First of all, it is our understanding that SBA does not attempt to determine if a lender's failure to give notice within the prescribed period resulted in any loss or damage to the agency and that SBA has not refused to honor its loan guarantees on such ground. Secondly, the relevant language of SBA's internal procedures, SOP 50-50-1, supra, indicates that only in instances where there is substantial loss to SBA (rather than "any loss or injury" as stated in the SBA report) should SBA even consider whether or not to deny liability.

Furthermore, as suggested above, it is our view that regardless of whether it can be determined that SBA suffered a substantial loss as a result of the lack of timely notice, SBA has no inherent authority or discretion to waive or otherwise disregard statutory regulations or vested contractual rights.

SBA asserts that under general contract law principles it has authority to waive the 30-day notice requirement and may be estopped by such waiver in the same manner as a private contractor. This attempt to apply general contract waiver principles to a Federal agency goes against the great weight of authority reflected both in our own rulings and judicial decisions.

Thus, for example, in 35 Comp. Gen. 56 (1955), we considered a request from a Government agency to revise certain contracts under which the United States guaranteed the foreign investment of American businessmen by reducing the total guarantee fee payments due the United States. In our decision we said the following:

> "It is also urged that, since private insurance companies can lower premiums or make refunds to policyholders, the Government should be able to do the same, but this argument overlooks the fact that private parties can give away their property and contractual rights whereas an agent of the Government has no such authority."

The general rule set forth in B-181432, March 13, 1975, supra, concerning a related question involving SBA, would be controlling here:

> "* * * 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. 189 (1961); and decisions cited therein."

Also see Bausch & Lomb Optical Company v. United States, 78 Ct. Cl. 584, 607,(1934), cert. denied 292 U.S. 645 (1934); Pacific Hardware & Steel Co. v. United States, 49 Ct. Cl. 327, 335 (1914). It follows that if the officers or agents of the Government do not have the authority to waive the contractual rights of the Government directly, they cannot do so indirectly by following a particular course of conduct.

The leading judicial precedent in this regard is Federal Crop Insurance Corporation v. Merrill, 332 U.S. 380 (1947), wherein the Supreme Court held that statutory regulations limiting crop insurance provided by a Government Corporation were binding, even though a Corporation agent had advised claimants that they had insurance coverage beyond the scope of the regulations. In reaching this conclusion, the Court stated, 332 U.S. at 383-85:

"The case no doubt presents phases of hardship. We take for granted that, on the basis of what they were told by the Corporation's local agent, the respondents reasonably believed that their entire crop was covered by petitioner's insurance. And so we assume that recovery could be had against a private insurance company. But the Corporation is not a private insurance company. It is too late in the day to urge that the Government is just another private litigant, for purposes of charging it with liability, whenever it takes over a business theretofore conducted by private enterprise or engages in competition with private ventures. Government is not partly public or partly private, depending upon the governmental pedigree of the type of a particular activity or the manner in which the Government conducts it. * * * Whatever the form in which the Government functions, anyone entering into an arrangement with the Government takes the risk of having accurately ascertained that he who purports to act for the Government stays within the bounds of his authority. The scope of this authority may be explicitly defined by Congress or be limited by delegated legislation, properly exercised through the rule-making power. * * *

"* * * Just as everyone is charged with knowledge of the United States Statutes at Large, Congress has provided that the appearance of rules and regulations in the Federal Register gives legal notice of their contents. 49 Stat. 502, 44 U.S.C. § 307.

"Accordingly, the Wheat Crop Insurance Regulations were binding on all who sought to come within the Federal Crop Insurance Act, regardless of actual knowledge of what is in the Regulations or of the hardship resulting from innocent ignorance. The oft-quoted observation in Rock Island, Arkansas & Louisiana Railroad Co. v. United States, 254 U.S. 141, 143, that 'Men must turn square corners when they deal with the Government,' does not reflect a callous outlook. It merely expresses the duty of all courts to observe the conditions defined by Congress for charging the public treasury. The 'terms and conditions' defined by the Corporation, under authority of Congress, for creating liability on the part of the Government preclude recovery for the loss of the reseeded wheat no matter with what good reason the respondents thought they had obtained insurance from the Government.

> Indeed, not only do the Wheat Regulations limit the liability of the Government as if they had been enacted by Congress directly, but they were in fact incorporated by reference in the application, as specifically required by the Regulations."

With respect to the possibility of estoppel directed against the Federal Government, we would point out that as illustrated in Merrill, the courts have traditionally been very reluctant to apply the doctrine of estoppel against the Federal Government or one of its agencies, and have generally held that the Government is not subject to the same rules of estoppel as are private parties. See also United States v. California, 332 U.S. 19, 39-40 (1947); Shotwell v. United States, 163 F. Supp. 907, 915 (E.D. Wash. 1958). This judicial reluctance is based largely on the rule set forth in Utah Power & Light Co. v. United States, 243 U.S. 389, 409 (1917) to the effect that:

> "* * * the United States is neither bound nor estopped by acts of its officers or agents in entering into an arrangement or agreement to do or cause to be done what the law does not sanction or permit * * *."

It is true that in certain limited circumstances an estoppel argument has been successfully employed against the United States. See for example United States v. Georgia Pacific Company, 421 F. 2d 92 (9th Cir. 1970). The essential elements of estoppel have been set forth as follows in cases involving the United States:

> "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. Shaw, 137 F. Supp. 24, 28 (D. N.D. 1956); and see United States v. Georgia Pacific Company, supra., at 96."

However, it is clear that a lender who failed to notify SBA within the 30-day period prescribed in both the regulations and the Guaranty Agreement could not satisfactorily demonstrate the presence of all or possibly any of the foregoing elements that are necessary, at a minimum, to present a successful estoppel argument against the United States. SBA does not and could

not seriously argue that lenders were unaware of the 30-day notice requirement, which is stated, restated, and confirmed in the various agency issuances described previously. Rather, the estoppel argument seems to be, in effect, that continued and presumably knowing failure by lenders to comply with this requirement must be excused because of SBA's failure to insist on strict compliance. In our view, such an approach is completely untenable as a matter of law and is equally unjustifiable in terms of avoiding undue "hardship" to the lending institutions.

- III -

SBA's report to us advances several variations on the foregoing theme in terms of purported general administrative discretion to waive regulatory requirements. Essentially the same arguments have been consistently rejected by our Office. See in addition to the decisions cited previously, 53 Comp. Gen. 664 (1973); 51 id. 162 (1971); 43 id. 31 (1963); 37 id. 820 (1958); B-168300, December 4, 1969; B-138127, December 31, 1958. However, one of these variations does warrant additional consideration here.

SBA stresses that waiver authority exists in this case, claiming in essence that the 30-day notice requirement is a relatively minor and subordinate procedural condition. Merely categorizing a regulatory requirement as "procedural" rather than "substantive" in the abstract is not persuasive with respect to the waiver issue. See Note, Violations by Agencies of Their Own Regulations, 87 Harv. L. Rev. 629, fn. 2 (1974). In any event, even if the 30-day notice requirement is considered "procedural" in nature, we cannot accept SBA's attempt to downplay its significance. This requirement clearly represents more than a convenience for the agency. Rather, it affects the basic contractual relationship between SBA and the lending institutions and was obviously intended to protect the legitimate interests of the Government as well as the small business borrowers.

The importance of this requirement and the consequences resulting from lack of strict compliance became evident in the course of our audit review. SBA's ability to provide borrowers with timely assistance depends upon an early awareness of the borrower's problems. Timely information is particularly vital when the borrower's problems have caused him to become delinquent on his loan. On guaranteed loans, SBA must depend on the lending institutions for information on the borrower's payment status, and the 30-day notice requirement serves this purpose.

Our review indicated that lack of timely notices of default deprived SBA of information vital to its servicing responsibility and contributed to the agency's failure to provide prompt assistance to borrowers. Our statistical sample in one district showed that by the time SBA was notified of delinquency, borrowers had

missed an average of three monthly payments. SBA loan specialists at this district office advised us that by this time the borrower usually has too many financial problems for SBA to be of any help.

In a memorandum dated October 3, 1974, to Regional and District Directors, SBA's Associate Administrator for Finance and Investment described the damage done to SBA's loan servicing efforts by late delinquency notification as follows:

> "There is considerable evidence that the current [notification] procedures are too informal and have allowed the banks to become lax in fulfilling the requirement of notice of 30 day default. This has resulted in numerous instances where the servicing office knows little or nothing about the account until we are called upon to purchase. It follows that many purchased guarantees are beyond effective assistance and immediately become liquidation cases."

The fact that the 30-day notice requirement is described in SBA regulations as a "condition precedent" to purchase of loans, our audit findings as discussed above, and the above-quoted memorandum by a high SBA official clearly belie SBA's present characterization of the notice requirement as a minor procedural matter. They also cast doubt upon the assertion in SBA's report to us that compliance with the notice requirement is waived only where it is determined that failure to comply did not result in loss to the Government. The SBA report gives no indication as to how this determination is made, although the need for such a determination would presumably arise only after the situation is considered beyond cure.

Thus, contrary to the assertions in SBA's report, we believe that the 30-day notice requirement is a significant and material device to protect the Government's interests. Moreover, this requirement is at least equally important, in our view, to the interests of the small business borrowers in terms of providing a mechanism to make SBA assistance available in time to do some good. It must also be emphasized that, contrary to an assertion in SBA's report, we do not seek "to question the judgment of SBA in developing, refining, modifying, and executing the statutory program delegated by Congress * * *." Rather, our concern is with SBA's disregard of a requirement promulgated in mandatory terms by the agency itself, the importance of which is clearly confirmed by the agency's own program experts.

In summary, we conclude that SBA's failure to insist on strict adherence to the 30-day notice requirement is legally impermissible. The notice requirement and the effect of noncompliance are unambiguously stated in the SBA regulations. Such requirement is a significant and material element in SBA's contractual relationship with the lending institutions; and the agency's failure to enforce it is prejudicial to the interests of the Government as well as the small businesses for whose benefit the program exists.

Accordingly, it is our opinion that SBA lacks authority to purchase guaranteed loans in the case of noncompliance with the 30-day notice requirement. However, in view of the large number of loans in this category that have already been purchased by SBA and considering SBA's longstanding practice of honoring the guarantee despite the failure of the lending institutions to submit timely notice of default, we will not take exception to payments already made. With respect to defaults which have already occurred, but concerning which SBA has not yet purchased the underlying loan, we will not question payment provided that SBA is able to make the determination on a specific case-by-case basis that the United States has not been seriously harmed by the failure to give timely notice. Our Office will take exception to any future payments on defaults which arise after the date of this decision if the notice requirements are not strictly complied with. We strongly recommend that all lending institutions be immediately notified of the import of this decision.

R.F.KELLER

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