



INTERIOR BOARD OF INDIAN APPEALS

United National Bank v. Acting Eastern Area Director, Bureau of Indian Affairs

30 IBIA 272 (04/14/1997)

Judicial review of this case:

Affirmed, *United National Bank v. U.S. Dept. of the Interior*, 54 F. Supp. 2d 1309
(S.D. Fla. 1998)



United States Department of the Interior

OFFICE OF HEARINGS AND APPEALS
INTERIOR BOARD OF INDIAN APPEALS
4015 WILSON BOULEVARD
ARLINGTON, VA 22203

UNITED NATIONAL BANK, Appellant	:	Order Affirming Decision
	:	
	:	
v.	:	
	:	Docket No. IBIA 96-62-A
ACTING EASTERN AREA DIRECTOR, BUREAU OF INDIAN AFFAIRS, Appellee	:	
	:	
	:	April 14, 1997

United National Bank (Bank) seeks review of a decision dated March 18, 1996, from the Acting Eastern Area Director, Bureau of Indian Affairs (Area Director; BIA), holding that the United States was not liable for a 90 percent guaranty of a \$150,000 loan. For the reasons discussed below, the Board of Indian Appeals (Board) affirms that decision.

On September 30, 1994, the Area Director approved the Bank's request for a 90 percent guaranty of a \$300,000 loan to T&M Builders, Inc., d.b.a. Broken Arrow Construction (T&M), which is 51 percent owned by Cecil Johns, a Seminole Indian. The loan was to provide funds for T&M to begin work on three school projects which had been awarded to it as a minority business enterprise by the Broward County, Florida, School Board.

The documents before the Board suggest that there were no problems with T&M's performance, although a question was raised and resolved about the sand T&M was using for exterior stucco. However, the documents indicate that there were delays in payments to T&M from the general contractor. A February 13, 1995, memorandum prepared by the Bank for itself and BIA suggests that because of the late payments, T&M experienced cashflow problems, and specifically had outstanding liabilities for payroll and unemployment tax, accrued interest, and accrued workers compensation (payroll tax obligations). The memorandum states that T&M verbally informed the Bank that all payroll tax obligations were current as of the date of the memorandum. The writer concluded that T&M continued to do well, despite the cashflow problems.

On March 31, 1995, the Bank requested that BIA guarantee a second \$150,000 loan to T&M. The credit memorandum prepared for the Bank's loan committee stated that T&M's need for an additional loan resulted from construction being behind schedule, and the general contractor placing an increased labor requirement on the subcontractors in order to ensure that the schools were completed on time. The memorandum stated that this had forced T&M to exhaust its available capital, which would be replaced through the second loan.

On May 9, 1995, the Area Director approved the second loan guaranty.

The Bank met with the principals of T&M several times after the second loan guaranty was approved. It was apparently during these meetings that the Bank concluded that T&M's financial problems were much more serious than it had believed. On July 12, 1995, the Bank made formal written demand to the Area Director for payment of the 90 percent guaranty on both loans. On July 14, 1995, the Bank notified T&M that T&M was in default and demanded immediate payment in full of the two loans.

On July 17, 1995, T&M filed a Chapter 11 bankruptcy proceeding.

In her March 18, 1996, decision, the Area Director stated that BIA would process the loss claim for the \$300,000 initial loan, but not for the \$150,000 second loan. The Area Director stated:

[A]rrearages [in payroll tax obligations] were significant when the \$150,000 guaranty was issued. [The Bank's] credit memorandum for the files indicates that verbal assurances were the only verification that all taxes were current. Regulations (25 CFR 103.49(c)) governing the loan guaranty program state very clearly that:

There shall be no liability on the part of the United States to reimburse a lender on a guaranteed loan for that amount of the guaranteed loan caused by (1) the lender's negligence in checking and verifying signatures, information in the loan application, supporting papers and documents; (2) the lender's furnishing false information to induce the issuance of a guaranty certificate by the Commissioner; or (3) the lender's willful or negligent action which permitted a fraud, forgery or misrepresentation.

Therefore, * * * it is our opinion that the United States is not liable for the guaranty of the \$150,000 guaranty.

Letter at 1.

On April 10, 1996, payment of \$297,047.85 was made to the Bank on the initial \$300,000 loan guaranty. This first loan guaranty is not at issue in this appeal.

The Bank filed an appeal from the Area Director's determination that BIA was not liable for any amount under the second loan guaranty. Both the Bank and the Area Director filed briefs on appeal.

The parties agree that the standard of care imposed on a lending institution participating in the BIA loan guaranty program is found in 25 C.F.R. § 103.49 (a), which provides: "Lenders shall use prudence in checking and verifying information contained in loan applications as well as supporting papers and documents in order to assure their accuracy and the validity of signatures."

The Bank contends that it did not fail to exercise ordinary prudence when it relied on T&M's verbal assurances that the payroll tax obligations had been paid. It states that it made no further inquiry about these overdue amounts in view of their relatively small size in comparison with T&M's total revenue. In an affidavit submitted with the Bank's Reply Brief, the servicing loan officer states that he received consistent verbal assurances from T&M that the outstanding payroll tax obligations had been paid, he had no reason to believe that T&M was being less than honest and truthful, and he would not have attempted to verify the status of those payments even if the loan were not guaranteed by BIA.

The Area Director argues that the Bank's actions did not evidence ordinary prudence, asserting that although the credit memorandum prepared by the Bank for the second loan guaranty request did not mention any outstanding debts for payroll tax obligations, those debts exceeded \$450,000 just 3½ months after BIA approved the second loan guaranty. The Area Director contends that the Bank's acceptance of T&M's verbal assurances of payment without further verification allowed either a fraud or a misrepresentation to be perpetrated on BIA.

The Bank's September 9, 1994, memorandum concerning the initial loan shows that T&M was a first-time customer, and that the Bank was interested in the possibility of obtaining other business from the Seminole Tribe because of its loan to T&M. This memorandum also shows that, although the Bank considered this to be a large loan request for a first-time borrower, it was well aware that, if a BIA guaranty was secured, its potential exposure on that loan would be only \$30,000. The memorandum ends: "Overall I feel this is credit is [sic] an acceptable risk to [the Bank], provided we have the BIA guarantee. Without the guarantee, I would not recommend or present this facility for approval." Memorandum at page 4.

As mentioned above, the Bank's February 13, 1995, memorandum discusses the fact that T&M's financial statement for December 31, 1994, showed several liabilities, including unpaid payroll tax obligations. The memorandum states at page 2: "I am informed that all payroll taxes and other taxes are current."

The Bank's May 3, 1995, memorandum accompanying the request for the second loan guaranty does not mention any outstanding obligations, but instead paints a very optimistic picture of T&M's financial situation and prospects.

In an October 30, 1995, memorandum to BIA, the Bank presents a chronology of the loan history. The memorandum states that, when T&M requested the second loan, it "represented that the [payroll tax obligations] were paid, and were current." Memorandum at page 1. The memorandum continues at page 2:

In June, [T&M] indicated they were considering filing bankruptcy. At month end, we met with the principals, who provided us with financial statements, indicating unpaid payroll taxes, unpaid unemployment taxes and unpaid workers compensation totaling \$353,983. When I inquired why this discrepancy surfaced now

and not during my previous conversations, the principals had no reply. They also stated that due to cost overruns at the job, they would not recover all the costs they incurred at the first job, and the second job would probably allow them to break even. I inquired why this information was contrary to the information presented to the bank at the time of the increase, and again there was no response.

The Bank admits that it accepted verbal assurances from T&M that the payroll tax obligations were current. Although the Board has difficulty imagining a situation in which a bank would accept verbal assurances from any borrower on a problem arising under a loan, it can accept the theoretical possibility that there might be instances in which a prudent lender would do so. For example, a prudent lender might take the verbal assurance of a borrower it had been dealing with for a period of time and with which it had established a basis for mutual trust. The Board cannot, however, conclude that a prudent lender dealing with a first-time customer and first-time borrower in regard to a sizeable loan would accept such verbal assurances, especially when past due obligations had surfaced within the first few months of operations under the initial loan and when the lender was contemplating a substantial second loan.

The Board concludes that the Bank did not exercise ordinary prudence in regard to the second loan under the circumstances of this case.

The Bank contends, in essence, that BIA acted imprudently in approving the second loan guaranty. It notes that BIA did not request additional information; characterizes the decision to approve the second loan as being made jointly by itself and BIA; cites two memoranda from the Director, Office of Economic Development, to the Area Director in support of what appears to be an estoppel argument; and contends that BIA's claim of negligence is barred by the doctrines of assumption of risk and contributory negligence.

The Board addressed similar arguments in Guardian Life Insurance Co. of America v. Acting Anadarko Area Director, 22 IBIA 104 (1992). *Inter alia*, the appellants in Guardian contended that, when it approved the loan guaranties they had requested, BIA made "a very stupid and irresponsible lending decision." 22 IBIA at 122 n.23. The Board held that "approval of the guaranties, while perhaps unwise, did not relieve [the lender] of its obligations under the regulations or the loan guaranty agreement." *Id.* at 123. The Board cited Citizens Marine National Bank v. U.S. Department of Commerce, 854 F.2d 223 (7th Cir. 1988), *cert. denied*, 489 U.S. 1053 (1989), in support of this holding. In Citizens Marine National Bank the Economic Development Administration (EDA) had refused to make good on a guaranty it had issued under the Trade Act of 1974. In a suit against the government by the lender bank, the district court held in favor of the bank, in part because of its conclusion that, as phrased by the court of appeals, "although the bank had behaved imprudently in administering the loan, so had the government." 854 F.2d at 225. The court of appeals reversed, stating:

The district court believed that in any event the bank's imprudence was somehow cancelled by the government's. Three ideas seem merged here: that the government broke its side of

the bargain; that by winking at the bank's carelessness the government in effect modified the guaranty agreement; that the government is in any event estopped by its conduct to complain of the bank's breach.

The government had received a copy of [the borrower's] financial statement before the loan closed, and could have withdrawn from the deal but didn't. And the employees of the [EDA] who supervised the transaction with the bank became aware of many of the bank's imprudent practices yet turned a blind eye. But nothing in the guaranty agreement enjoins the guarantor to vigilance--which scotches the suggestion that the government is guilty of a breach of contract too. Nor had these subordinate officials of the [EDA] who exercised inadequate oversight in this matter any actual or apparent authority to modify the terms of the guaranty. * * * The failure of the [EDA]'s regional staff to insist upon compliance with [a provision in the guaranty agreement concerning lender prudence] does not open the vaults of the Treasury to a bank that violated the provision.

The question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled, but it is at least clear that "however heavy the burden might be when an estoppel is asserted against the Government, the private party surely cannot prevail without at least demonstrating that the traditional elements of an estoppel are present." * * * That sinks the bank's estoppel argument, for there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank. * * * The government did not come down hard on the bank's imprudent practices, but neither did it direct or encourage them. [Citations omitted.]

854 F.2d at 228-29. See also United States v. First National Bank of Cicero, 957 F.2d 1362, 1370 (7th Cir. 1992) (citing Citizens Marine National Bank in holding that "the district court improperly accorded significant weight to its belief that the SBA's [Small Business Administration's] loss was in large part due to its own negligence ... in approving the * * * loan guaranty"); Valley National Bank v. Abdnor, 918 F.2d 128 (10th Cir. 1990) (holding that the lender's failure to service a guaranteed loan in a prudent manner, as required by SBA regulations and the loan guaranty agreement, excused fulfillment of the guaranty).

In Guardian the Board agreed with the appellants that Citizens Marine National Bank concerned a loan guaranty under an agreement which, unlike a BIA loan guaranty, permitted revocation for lender imprudence. However, it still found relevant the court's analysis of the effect of "government imprudence," stating that "[a]s in Citizens Marine National Bank, the duties at issue here are imposed upon [the lender], not BIA. The arguably imprudent BIA employees and officials had no authority to modify either the regulations or the loan guaranty agreement." 22 IBIA at 124. The Board also concluded that there was no basis for a finding of estoppel in Guardian.

In the decision at issue here, the Area Director quoted 25 C.F.R. § 103.49(c), which sets forth the circumstances under which the United States shall not be liable to reimburse a lender on a guaranteed loan. These regulations place a duty on the lender to verify information presented to BIA. Under 25 C.F.R. § 103.15(c), BIA may conduct an independent review of the application, but is not required to do so.

Furthermore, unlike the situation in Citizens Marine National Bank, the BIA employees here did not receive a copy of T&M's financial statement before the loan closed. Therefore, they had no opportunity to withdraw from the deal. Also, the BIA employees were not aware of any imprudent actions on the Bank's part, and therefore not only did not turn a blind eye to such practices, but had no reason to suspect that an independent investigation of T&M's financial situation was necessary.

The Board holds that, even if it were to find that BIA was imprudent in not conducting an independent investigation of T&M's financial situation--a finding it does not make--the Bank's imprudence cannot be excused because of any imprudence on the part of BIA employees. It also holds that there is no basis for a finding of estoppel for the same reasons as are set forth in the above quotation from Citizens Marine National Bank.

The Bank also argues that T&M's "failure to meet its payroll tax obligations was not the proximate cause of the loss sustained. The [BIA] was fully aware of the risks involved in approving a loan to a borrower with known cash flow difficulties, and voluntarily agreed to assume these risks in issuing its guaranty." Reply Brief at 2.

The Bank fails to state what it believed was the "proximate cause" of the loss here, or to provide any support for its suggestion that there must be a causal relationship between T&M's failure to meet its payroll tax obligations and, apparently, BIA's citing of that fact as a reason for declining to honor its loan guaranty. It is not possible for the Board to determine the exact cause of T&M's financial problems from the materials before it. It is quite evident, however, that those problems were substantial because, according to the Bank's July 14, 1995, notice of default, in less than ten months of operations, in addition to having unsatisfied judgments against it, T&M had unpaid payroll tax obligations exceeding the initial amounts of both loans. It is interesting that, whether or not the Bank now considers the unpaid payroll tax obligations to be the "proximate cause" of the loss, it considered them significant enough to list them as the first reason for declaring the loans to be in default. T&M's failure to meet its payroll tax obligations may have been only a symptom of a much larger problem. However, the fact remains that if the Bank had not relied solely on T&M's verbal assurances as to its financial condition prior to requesting the second loan guaranty, it would have discovered the extent of T&M's problems before additional funds had been loaned.

The Board finds the Bank's contention concerning BIA's alleged assumption of risk equally unpersuasive. As the court stated in Citizens Marine National Bank, 854 F.2d at 229,

[t]he Trade Act of 1974 authorizes the government to make risky loans (or loan guarantees) indeed, requires that they be risky,

since a condition precedent is that the borrower be unable to obtain financing on ordinary terms in the private capital markets. But the Act also requires that there be at least a reasonable assurance of payment, and this requirement was implemented by the altogether sensible provision in the guaranty agreement requiring the bank to act with the prudence of a normal commercial bank that had made a loan not guaranteed by the federal government.

Similarly, there is an element of risk in every loan guaranty made by BIA. Risk is, after all, the reason for the existence of the BIA guaranty program. However, in deciding to guaranty a loan, BIA does not assume the risk that the lender failed to verify information provided by the borrower, thereby violating the regulations requiring it to act prudently.

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 CFR 4.1, the Acting Eastern Area Director's March 18, 1996, decision is affirmed.

//original signed
Kathryn A. Lynn
Chief Administrative Judge

//original signed
Anita Vogt
Administrative Judge