INTERIOR BOARD OF INDIAN APPEALS

First National Bank of Pawhuska v. Director, Office of Economic Development,
Bureau of Indian Affairs

35 IBIA 63 (05/22/2000)

United States Department of the Interior

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

FIRST NATIONAL BANK OF PAWHUSKA
v.
DIRECTOR, OFFICE OF ECONOMIC DEVELOPMENT,
BUREAU OF INDIAN AFFAIRS

IBIA 99-35-A Decided May 22, 2000

Appeal from a decision partially denying a Claim for Loss on a loan guaranty.

Affirmed.

1. Indians: Financial Matters: Financial Assistance

Under the Bureau of Indian Affairs' loan guaranty program, any amounts disbursed for purposes other than those provided in the loan agreement must, unless approved by the Commissioner of Indian Affairs, be excluded in computing the amount for which the lender may be reimbursed in the event of a loss on a loan. 25 C.F.R. § 103.46(a).

2. Indians: Financial Matters: Financial Assistance

Under the Bureau of Indian Affairs' loan guaranty program, there is no liability on the part of the United States to reimburse a lender on a guaranteed loan for that amount of the guaranteed loss caused by the lender's willful or negligent action which permitted a fraud, forgery or misrepresentation. 25 C.F.R. § 103.49(c)(3).

APPEARANCES: Geoffrey M. Standing Bear, Esq., Pawhuska, Oklahoma, for Appellant; David B. Johnson, Esq., Office of the Solicitor, U.S. Department of the Interior, Washington, D.C., for the Director, Office of Economic Development.

OPINION BY ADMINISTRATIVE JUDGE VOGT

Appellant First National Bank of Pawhuska seeks review of a November 24, 1998, decision of the Director, Office of Economic Development, Bureau of Indian Affairs (Director; BIA), partially denying a Claim for Loss under a loan guaranty. For the reasons discussed below, the Board affirms the Director's decision.

Background

In 1990, BIA guaranteed a $197,960 loan made by Appellant to Charles Clark d.b.a. Pawnee Tee's (Clark), a T-shirt manufacturer in Pawnee, Oklahoma. By late 1993, the loan had been paid down to $71,364.

In January 1994, Clark sought a new loan from Appellant in the amount of $500,000. On February 2, 1994, Appellant applied to BIA for an 80% guaranty of a $500,000 loan to Clark. BIA approved the request and issued Loan Guaranty Certificate G944D1B057 on April 29, 1994.

The loan closed on May 2, 1994. On that date, Clark signed a number of documents, including a Use of Funds Agreement, which stated in part:

> 2. Said funds [$500,000] shall be used for the expansion costs involving equipment, machinery, supplies, and inventory as indicated on the Use of Proceeds breakdown, in the amounts as follows more or less.
>
> | Item | Bureau of Indian Affairs Guarantee 1/ |
> |---|---|
> | Renovation | $ 40,000.00 |
> | Furniture and Fixtures | 10,000.00 |
> | Machinery and Equipment | 180,000.00 |
> | Inventory | 144,000.00 |
> | Operating Capital | 48,000.00 |
> | Payment of existing loan | 78,000.00 |
> | | $500,000.00 |
>
> 3. The proceeds of $500,000 shall be deposited in a business account. Any deviation from the above must be approved firstly by the Area Director in concurrence, Anadarko Area Office, Bureau of Indian Affairs.
>
> Conditions accepted by:
>
> Participant: /s/ 5-2-94
> Charles Clark Date

1/ This breakdown is the same as that shown in the "Itemized Use of Proceeds" included in Clark's loan application.

By July 1995, Clark had begun to have financial problems. At that time, and again in March and April 1996, Appellant sought BIA approval for loan modifications to assist Clark in meeting his obligations under the loan. In both cases, BIA approved the modifications. See Area Director's Letters dated July 18, 1995, and April 9, 1996.

On April 29, 1996, Appellant made five new loans to Clark. 2/ Appellant did not inform BIA of these loans at the time they were made, and BIA did not learn of them until two years later.

On August 26, 1996, Appellant informed BIA that the Internal Revenue Service (IRS) had served a levy on Appellant for any assets belonging to Clark. IRS closed down Clark's business in September 1996. The business remained closed until early January 1997. During that time, Appellant granted Clark forbearance on its loan payments. BIA concurred in the forbearance. In March 1997 and June 1997, Appellant requested that BIA concur in further forbearance, and BIA did so. 3/

On August 14, 1997, Appellant submitted a formal Notice of Default to BIA. On September 24, 1997, Appellant filed suit against Clark in the District Court of Osage County, Oklahoma. On November 13, 1997, Clark filed for protection under Chapter 7 of the Bankruptcy Code.

Appellant obtained a release of collateral from the Bankruptcy Court and hired an auctioneer to help dispose of the collateral. On April 30, 1998, BIA officials met with Appellant's officials at Appellant's office. At that meeting, BIA learned of the 1996 loans and learned that some collateral might not have been maintained for the BIA-guaranteed loan. Among other things, BIA expressed concern about whether Clark had purchased new equipment with $180,000 of the loan proceeds, as he had promised to do. Appellant agreed to search for documentation concerning Clark's use of the loan proceeds.

On June 19, 1998, Appellant submitted its formal Claim for Loss, in which it sought reimbursement from BIA in the amount of $392,182.58.

2/ The loans were in the amounts of $35,711.00, $11,157.74, $37,852.94, $30,100.00, and $490,143.12.

3/ In his brief in this appeal, the Director states that BIA probably erred in doing so because Clark was in default on his loan. The Director observes that 25 C.F.R. § 103.36(a) required Appellant to give formal notice of default and states that nothing in the loan guaranty regulations permits a lender to delay a formal default by granting forbearance. Director's Brief at 4-5 n.6.

In connection with its review of Appellant's claim, BIA again sought information from Appellant concerning Clark's use of the loan proceeds. See, e.g., Area Director's July 10, 1998, Letter to Appellant. Although Appellant furnished no direct evidence on this point, it supplied BIA with a copy of its Proof of Claim in Clark's bankruptcy case and copies of the auctioneer's sales records. After studying these documents and finding no evidence of the equipment Clark was supposed to have purchased with the loan proceeds, BIA came to believe that the loan proceeds might not have been used as intended, particularly as to equipment purchases. BIA asked for assistance from the Department's Office of Inspector General (OIG). Appellant gave OIG personnel access to its records, and both OIG and BIA continued to review the matter. They learned, inter alia, that $426,990.26 of the loan proceeds had been placed in Clark's general account in Appellant's bank on May 5, 1994 (BIA Note to File, July 9, 1998; Area Director Sept. 4, 1998, Memorandum at 4, ¶ 4); that large checks had been drawn on that account and made payable to Clark's payroll account at a different bank (Area Director's Sept. 4, 1998, Memorandum at 4, ¶ 5); and that "[t]he total loan was gone in approximately eight (8) months" (BIA Note to File, July 17, 1998). Neither OIG nor BIA was able to find any evidence that Appellant knew what Clark had done with the loan proceeds.

On November 24, 1998, the Director issued a decision authorizing reimbursement to Appellant in the amount of $187,312.22 and denying the remainder of Appelant's claim. The decision stated in part:

> Claim Offset: Our guaranteed lenders are required by Federal Regulation (25 CFR 103.46(a)) and by their loan guaranty agreements to use prudence in disbursing loan funds to assure use of loan funds for purposes for which the loans are made. In the event of default, amounts disbursed for purposes other than provided in the loan agreement are excluded from the lender's reimbursement (25 CFR 103.46(a) and 25 CFR 103.49(c)(3)).
>
> In a letter dated July 10, 1998, [the] BIA Anadarko Area Director requested documentation to substantiate loan disbursements. To date, that documentation has not been received. To the contrary, a site visit to [Clark's] place of business and a review of the record of the property liquidated in foreclosure have indicated that little expansion of the business occurred as a result of the latest loan. We are offsetting the Claim for Loss by loan categories for the following reasons:
>
> 1. Some minimal Renovation of Facilities was done, but none worth more than about $1,000, which we will concede.
>
> 2. There is no indication that any Furniture and Fixtures ($10,000), nor

3. Machinery and Equipment ($180,000) were purchased and we are denying the total amounts allocated to those expenses.

4. We will pay the $144,000 allocated to Inventory, although evidence does not suggest, one way or the other, if this sum was properly spent.

5. We are offsetting the $48,000 allocated to Operating Capital by $41,825, which is the amount of checks issued to Mr. and Mrs. Clark and their son Wayne for no apparent business related reason. We will pay $6,175 for Operating Capital.

6. The Bank made Payment of the Existing Loan out of the $500,000 new loan. Bank statements show a deposit of $426,990.26 on May 5, 1994, so we assume the existing loan plus accrued interest totaled the difference between those amounts, or $73,009.74, which we will pay.

Our calculation of the amount to be paid is as follows:

Unpaid Principal:	
Prior Loan	$ 73,009.74
Inventory	144,000.00
Operating Capital	6,175.00
Total Principal	$223,184.74
Unpaid Interest Computed to 04/30/98 @ 8.5%	$ 74,837.26
Total Amount Delinquent:	298,022.00
Net Deduction (Liquidation minus liquidation charges)	63,881.72
Net Delinquent Balance:	$234,140.28
80% Guarantee of Net Delinquent Balance:	$187,312.22.

We are authorizing payment of $187,312.22 under our guaranty.

The difference is $204,870.36 less than the bank's claim for loss. The basis for this reduction is 25 CFR 103.49(c)(3) * * * and 25 CFR 103.46(a).

Director's Nov. 24, 1998, Decision at 1-3.

Appellant appealed to the Board, attaching to its notice of appeal copies of Clark's "Accountant's Compilation Reports" for the years 1993-1996 and contending that BIA had issued its decision without the benefit of these documents. Appellant stated that it had furnished the documents to OIG but believed that OIG had not shared them with BIA.

The Board asked the Director to review Appellant's statement and documents and determine whether the documents would have assisted him in his decision making. The Director replied that he had reviewed Appellant's documents and that an Area Office official had reviewed the OIG files and that nothing in Appellant's documents or in the OIG files would have changed his decision. The Board therefore proceeded to docket the appeal.

Briefs were filed by Appellant and the Director.

Discussion and Conclusions

Central to this appeal are the two regulations relied upon by the Director. 25 C.F.R. § 103.46(a) provides:

> The guaranty or insurance of a loan by the Commissioner * * * will be based on the requirement that adequate loan servicing will be performed by the lender. * * * Lenders are expected to follow accepted standards employed by prudent lenders in the area in servicing similar type loans. In servicing loans, lenders will make every effort to prevent and minimize potential losses. Lenders will use prudence in disbursing loan funds to borrowers to assure, to the extent feasible, that loan funds are used only for the purposes for which the loan is made. Unless approved by the Commissioner, any amounts disbursed for purposes other than those provided in the loan agreement shall be excluded in the [sic] computing the amount for which the lender may be reimbursed in the event of a loss on a loan.

25 C.F.R. § 103.49(c) provides:

> 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 loss caused by: * * * (3) The lender's willful or negligent action which permitted a fraud, forgery or misrepresentation.

Appellant ignores these regulations in its first argument before the Board. In that argument, Appellant contends that BIA was precluded by statute))specifically, by 25 U.S.C. § 1493))from reducing the amount of Appellant's reimbursement on the loan guaranty.

25 U.S.C. § 1493 provides:

> Whenever the Secretary finds that any lender or holder of a guaranty certificate fails to maintain adequate accounting records, or to demonstrate proper ability to service adequately loans guaranteed or insured, or to exercise proper credit judgment, or has willfully or negligently engaged in practices

> otherwise detrimental to the interests of a borrower or of the United States, he may refuse, either temporarily or permanently, to guarantee or insure any further loans made by such lender or holder, and may bar such lender or holder from acquiring additional loans guaranteed or insured hereunder: Provided, That the Secretary shall not refuse to pay a valid guaranty or insurance claim on loans previously made in good faith.

Appellant bases its argument on the last sentence of 25 U.S.C. § 1493. It does not mention 25 U.S.C. § 1494, which provides:

> Any evidence of guaranty or insurance issued by the Secretary shall be conclusive evidence of the eligibility of the loan for guaranty or insurance under the provisions of this chapter and the amount of such guaranty or insurance: Provided, That nothing in this section shall preclude the Secretary from establishing, as against the original lender, defenses based on fraud or material misrepresentation or bar him from establishing, by regulations in force at the date of such issuance or disbursement, whichever is the earlier, partial defenses to the amount payable on the guaranty or insurance.

The Board has previously noted that these two provisions must be read together. Guardian Life Insurance Company v. Acting Anadarko Area Director, 22 IBIA 104, 115 (1992). So too has the United States District Court for the Southern District of Florida, in a case where the plaintiff challenged the validity of 25 C.F.R. § 103.49(c) on the grounds that it was in conflict with 25 U.S.C. § 1493. United National Bank v. United States Department of the Interior, Civ. No. 97-1912 (S.D.Fla. Jan. 29, 1998). 4/ The court rejected the plaintiff's challenge, observing that "§ 1493 and 25 C.F.R. § 103.49(c)(3) are only in conflict if one ignores § 1494" and declining to "construe § 1493 in isolation and ignore the existence of § 1494." Slip op. at 12. The court held that "25 C.F.R. § 103.49(c) is a valid regulation," id., and that BIA "may assert the defense of negligence to void a guaranty." Id. at 10.

Not having addressed 25 C.F.R. §§ 103.46(a) and 103.49(c) at all in this part of its argument, Appellant has not explicitly challenged their validity. However, if Appellant's statutory argument is sound, the validity of both regulations is necessarily called into question.

The Board has no authority to declare a duly promulgated regulation invalid. E.g., Edwards v. Portland Area Director, 29 IBIA 12 (1995). Even if it had that authority, however, the Board would not exercise it here, because Appellant's statutory argument is plainly

4/ This decision affirmed the Board's decision in United National Bank v. Acting Eastern Area Director, 30 IBIA 272 (1997).

unsound. Like the plaintiff in United National Bank, Appellant disregards 25 U.S.C. § 1494. The Board cannot and will not do so.

The Board rejects Appellant's contention that BIA was precluded by statute from reducing the amount of Appellant's recovery.

Next, Appellant argues that "25 CFR 103.46(a) is not applicable here as the loan funds were disbursed with both the tacit and express approval of [BIA]." Appellant's Opening Brief at 2.

BIA clearly agreed to the disbursement of funds for the purposes stated in the Use of Funds Agreement. There is no evidence, however, that BIA agreed, either expressly or tacitly, to the disbursement of funds for any other purpose.

Appellant also contends that BIA closely monitored the loan transactions and expressed approval of Appellant's actions. Further, Appellant contends that BIA should have been aware that the loan proceeds had not been used in accordance with the loan agreement.

The Director acknowledges that "BIA made an effort to stay informed about the circumstances of the loan." Director's Opening Brief at 11. He contends, however, that "most of BIA's information concerning this loan was supplied by [Appellant]," id. at 11-12, and that BIA cannot be faulted for failing to discover information which Appellant did not furnish.

The record shows that BIA had frequent contacts with Appellant beginning in July 1995, when Appellant first informed BIA of Clark's financial difficulties. The record also shows that BIA agreed to Appellant's attempts to assist Clark and that BIA then believed Appellant was taking appropriate actions. However, it is apparent that BIA was unaware at that time that Clark had not used the loan proceeds in accordance with the loan agreement. Accordingly, BIA's favorable view of actions taken by Appellant in July 1995 and later was clearly based upon an incomplete understanding of the facts. 5/

There is no evidence that Appellant made any contact with BIA between April 1994, when the Loan Guaranty Certificate was signed, and July 1995. By July 1995, the loan proceeds had all been disbursed and, as far as the record shows, Appellant had lost track of them. Thus, as the Director notes (Director's Brief at 15 n.27), the damage had already been done. Appellant does not explain what BIA could have done to rescue Appellant from its predicament at that point, even if BIA had been made aware of the misuse of loan proceeds.

5/ The Director argues in this appeal that "[h]ad BIA known that [Clark] never purchased the equipment, machinery, fixtures, furniture, and building renovations the loan was intended to fund, it certainly would not have stuck so tenaciously to its hopes for [Clark's] business." Director's Brief at 16 n.29.

The greatest fallacy in Appellant's argument is its failure to recognize that proper servicing and documentation of the loan was Appellant's responsibility, not BIA's. With respect to the task at issue here, 25 C.F.R. § 103.46(a) places responsibility squarely on the lender: "In servicing loans, lenders will make every effort to prevent and minimize potential losses. Lenders will use prudence in disbursing loan funds to borrowers to assure, to the extent feasible, that loan funds are used only for the purposes for which the loan is made." No corresponding responsibility is placed on BIA. Even in a case where BIA has been imprudent, a lender is not relieved of its responsibilities under the regulations. United National Bank, 30 IBIA at 275; Guardian Life Insurance Company, 22 IBIA at 123-124. Appellant has not shown that BIA was imprudent in this case.

The Board concludes that nothing that BIA did or failed to do relieved Appellant of its obligations under the regulations.

Appellant contends that it is "[o]f great significance" that BIA required in the Loan Guaranty Certificate "that all of the funds be disbursed to [Clark] no later than 6 (six) months from the date of the loan Authorization of April 29, 1994." Appellant's Opening Brief at 2. Appellant mentions the requirement at least two more times (on pages 3 and 5 of its opening brief) but never explains why it considers the requirement to be relevant to the issue here.

In his response, the Director speculates as to Appellant's point: "Apparently, [Appellant] would argue that by including that requirement, BIA essentially pre-approved any disbursement made within that time period." Director's Brief at 11 n.19. The Director also suggests that Appellant might be contending that the time deadline prevented adequate monitoring by Appellant.

The "pre-approval" theory is in direct conflict with the Use of Funds Agreement. In fact, there is nothing in any of the loan documents which lends credence to this theory. Moreover, as the Director points out, the loan guaranty authorization provides for disbursement within six months "unless such time is extended pursuant to prior written consent by BIA." 6/ Thus, the time deadline was not inflexible, and Appellant could have sought an extension if it found that its planned schedule of disbursements was no longer prudent. In any event, as noted above, Appellant had disbursed the entire loan proceeds by May 5, 1994, six days after the Loan Guaranty Authorization was signed. Thus, it would be hard put to argue that the six-month deadline was a problem.

6/ The authorization states: "This authorization is subject to * * * (b) First disbursement of the loan being made not later than 1 months (sic), and no disbursement being made later than 6 months from the date of this Authorization, unless such time is extended pursuant to prior written consent by BIA."

The Board concludes that Appellant was not relieved of its obligations under the regulations by the six-month deadline for disbursements in the Loan Guaranty Certificate.

Next, Appellant contends that, in order to reduce Appellant's loan guaranty payment, BIA must show more than negligence on Appellant's part. Rather, Appellant asserts, BIA must show that Appellant actually intended to deceive BIA. For this assertion, Appellant cites First Interstate Bank of Billings, N.A. v. United States, 27 Fed. Cl. 348 (1992), a case concerning a Farmer's Home Administration (FmHA) loan guaranty which included an "incontestability clause." 7/ The Court of Federal Claims found that, under the language of that clause, an intent to deceive must be shown before FmHA could contest the guaranty.

As the Director points out, there are two reasons why this case does not help Appellant. First, the decision was vacated by the Court of Appeals for the Federal Circuit, which found the lower court's "intent to deceive" standard more rigorous than justified by the language of the FmHA "incontestability clause." First Interstate Bank of Billings, N.A. v. United States, 61 F.3d 876 (Fed.Cir. 1995).

Second, there is no language comparable to the FmHA "incontestability clause" in BIA's loan guaranty regulations or documents. BIA's loan guaranty regulations explicitly allow for the reduction of a loan guaranty payment on the basis of a "lender's * * * negligent action which permitted a fraud, forgery or misrepresentation."

The Board rejects Appellant's contention that BIA was precluded from reducing Appellant's guaranty payment on the basis of negligence.

Finally, Appellant offhandedly contends that the "principles * * * of laches and estoppel apply throughout the case presently before the Board." Appellant's Opening Brief at 9. Appellant fails to make any argument whatsoever in support of those contentions.

Appellant's bare allegations are insufficient to show that the principles of laches and estoppel apply in this case. Appellant has failed to carry its burden of proof in this regard.

In his answer brief, the Director argues that BIA's action was justified under both 25 C.F.R. §§ 103.46(a) and 103.49(c).

7/ The clause was based on a FmHA regulation which provides:

"The Loan Note Guarantee constitutes obligations supported by the full faith and credit of the United States and are [sic] incontestable except for fraud or misrepresentation of which the lender or holder has actual knowledge at the time it becomes such lender or holder or which lender or holder participates in or condones."
7 C.F.R. § 1980.11.

[1] The last sentence of 25 C.F.R. § 103.46(a) provides: "Unless approved by the Commissioner, any amounts disbursed for purposes other than those provided in the loan agreement shall be excluded in the [sic] computing the amount for which the lender may be reimbursed in the event of a loss on a loan."

The Director contends: "It is apparent that [Clark] spent nothing, or very little, on several categories of expense as required in the Use of Funds Agreement, yet all the funds were spent. It follows that the funds were spent improperly, at least to the extend of required expenditures that were not made." Director's Brief at 14.

BIA may well have been more generous to Appellant than Appellant deserved. For instance, BIA paid $144,000 for inventory even though the Director found that "evidence does not suggest, one way or the other, if this sum was properly spent." Director's Decision at 2. BIA excluded only those amounts which it could determine with reasonable certainty had not been spent as required. Appellant has not refuted any of BIA's determinations in this regard.

The Board finds that BIA's exclusion of $204,870.36 from Appellant's reimbursement was justified under 25 C.F.R. § 103.46(a).

[2] As noted above, 25 C.F.R. § 103.49(c) provides:

> 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 loss caused by: * * * (3) The lender's willful or negligent action which permitted a fraud, forgery or misrepresentation.

The Director contends that Appellant's "failure to establish any spending safeguards whatsoever, when the Use of Funds Agreement required Clark to confine his spending in a very specified manner, * * * amounts to a violation of 25 C.F.R. § 103.49(c)." Director's Brief at 14. He continues:

> The Use of Funds Agreement constituted [Clark's] representation that he would spend the loan proceeds in accordance with its terms. Despite having at its disposal reasonable means to monitor [Clark's] spending, however, [Appellant] simply allowed [Clark] to spend the funds as he chose. [Clark] did not spend the funds as agreed, resulting (among other things) in a diminished level of collateral when [Clark] defaulted. [8/] Nothing in the administrative record

8/ According to the loan documents, the $180,000 worth of equipment which was to have been purchased with the loan proceeds was to serve as collateral for the loan.

> indicates if or when [Appellant] realized that [Clark] had misused loan funds, and nothing indicates that [Appellant] ever called the misuse to BIA's attention. At a minimum, then, it seems clear that [Appellant's] negligence permitted [Clark's] misrepresentation to go undetected." [Footnotes omitted.]

Id. at 14-15.

The Board agrees that Appellant's failure to monitor Clark's use of the loan proceeds was negligent and that Appellant's negligence permitted a misrepresentation. The Board therefore finds that BIA's exclusion of $204,870.36 from Appellant's reimbursement was justified under 25 C.F.R. § 103.49(c) as well as 25 C.F.R. § 103.46(a).

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the Director's November 24, 1998, decision is affirmed.

//original signed
Anita Vogt
Administrative Judge

I concur:

//original signed
Kathryn A. Lynn
Chief Administrative Judge