INTERIOR BOARD OF INDIAN APPEALS

Wells Fargo Bank Minnesota v. Midwest Regional Director, Bureau of Indian Affairs

41 IBIA 226 (09/26/2005)
Appellant Wells Fargo Bank Minnesota (Bank) appeals from a May 15, 2003, decision of the Midwest Regional Director, Bureau of Indian Affairs (Regional Director; BIA), denying payment on BIA Loan Guaranty Certificate No. G972D1F5301, which had been issued to Northern National Bank 1/ under BIA's loan guaranty program, 25 U.S.C. §§ 1481-1512 and 25 C.F.R. Part 103 (1997). 2/ For the reasons discussed below, the Board affirms the Regional Director's decision.

1/ The Bank states that Northern National Bank was renamed Norwest Bank North Country on Oct. 22, 1997, and was merged into Norwest Bank Minnesota South on Sept. 12, 1998; that Norwest Bank Minnesota South was merged into Norwest Bank Minnesota on July 8, 2000; and that, on the same day, Norwest Bank Minnesota was renamed Wells Fargo Bank Minnesota. Bank's Opening Brief at 7.

In this decision, the term “Bank” is used to refer to the entity holding the loan guaranty at the time of the event under discussion, regardless of the name of the entity at that time.

2/ 25 C.F.R. Part 103 was revised in 2001, 66 Fed. Reg. 3861 (Jan. 17, 2001). As noted in the Federal Register preamble to the final rule, 66 Fed. Reg. at 3862, the revised regulations “do not govern pre-existing loan guarantees” unless “a lender [elects] to have its pre-existing loan guarantees governed by the new regulations * * * by entering into a new loan guaranty agreement with BIA.”

No such election was made in this case. Therefore, the loan guaranty at issue here is governed by the regulations which were in effect prior to the present regulations. In this decision, the Board cites from the 1997 edition of 25 C.F.R. because the loan guaranty at issue here was approved in 1997. However, the relevant provisions of Part 103 remained the same from 1997 until the present regulations were promulgated in 2001.
Background

On November 19, 1996, the Bank submitted a request for a 90% guaranty of a $71,000 loan to Sandra Nichols, a member of the Minnesota Chippewa Tribe, who sought funding for a new business in Cass Lake, Minnesota, to be known as The Flower Basket and Little Bear’s Art Gallery and Antiques. The Regional Director approved the request on February 26, 1997, and sent the Bank a copy of BIA’s standard Loan Guaranty Agreement for signature.

On March 7, 1997, the Bank issued a loan to Nichols, securing it with a mortgage on the real property upon which she had located her business. On March 11, 1997, the Bank notified BIA that it had increased the loan amount by $4,561.29 to cover life insurance for Nichols, stating that it did not intend to ask BIA to guarantee this additional amount. Following further discussions, the Regional Director approved a modified Loan Guaranty Request and prepared an addendum to the request, noting that the loan total was now $76,839.29, including a loan guaranty premium and an insurance premium, but that BIA would guarantee only 90% of $71,000. The Bank accepted the addendum on March 20, 1997.

During the course of the loan, the Bank submitted status reports to BIA on a quarterly basis and a report titled “Annual Rating of Guaranteed Loans” on an annual basis. In the status report for the quarter ending September 30, 2000, the Bank stated that the loan was current and had a principal balance of $67,694.77 and an interest balance of $393.00. In the “Annual Rating” for the year ending September 30, 2000, the Bank rated the loan as “problemless,” the highest of five possible ratings, and one which the rating form defines thus: “A loan that is performing as expected. Payments are current, the borrower is in general compliance with the terms of the loan, and projected receipts and expenses indicate the likelihood of repayment in full is very good. The loan does not pose an abnormal credit risk to the Government.”

On October 26, 2000, less than a month after rating Nichols’ loan as “problemless,” the Bank wrote to the Midwest Regional Credit Officer, stating that the loan was in default and that Nichols had notified the Bank that she had closed the doors of her business, was unable to pay off the loan, and had scheduled an auction of her business assets for October 29, 2000. The Bank requested that BIA provide instructions and forms for filing a claim on the loan guaranty.

The Regional Director responded on November 13, 2000, sending the Bank copies of BIA Form 5-4760, “Notice of Default/Claim for Loss” and Form 5-4759, “Assignment of Interest,” and stating in part: “If you suffer a net loss after all security interests have been liquidated, you may submit the enclosed Form 5-4760 to this office.”

3/ At the time of approval, the Midwest Regional Director was known as the Minneapolis Area Director.
On December 1, 2000, the Bank’s attorney wrote to Nichols, stating that she was in default for the following reasons:

1) Failure to make payments to the Bank on October 7, 2000 and November 7, 2000, in the amount of $820.83 each, for total defaulted payments of $1,641.66.

2) Failure to maintain insurance on the mortgaged property as required by the terms of the mortgage.

3) Failure to pay 1999 real estate taxes when due currently in the amount of $3,042.90, which includes penalties and interest through November 30, 2000.

4) Failure to pay 2000 real estate taxes when due, currently in the amount of $2,306.00.

Bank’s Attorney’s Dec. 1, 2000, Letter to Nichols at 2. There is no indication that either the attorney or the Bank sent BIA a copy of this letter in December 2000. 4/

In its status reports for the quarters ending December 31, 2000, and March 31, 2001, the Bank informed the Regional Office that Nichols’ auction of her business assets had netted $5,985.60, which the Bank had applied as a reduction of principal; that Nichols had abandoned the property on which the Bank held a mortgage; that the Bank had commenced foreclosure proceedings; and that there was a party who might be interested in purchasing the Bank’s “Sheriff’s Certificate of Sale” following foreclosure. In its status report for the quarter ending June 30, 2001, the Bank reported that the Sheriff’s Sale was scheduled for August 8, 2001.

On October 23, 2001, the Bank wrote to the Regional Credit Officer, stating that it had completed the foreclosure process and that the redemption period had expired. The Bank summarized the steps it had taken in connection with the foreclosure. It stated that, after learning in March 2001 that Nichols had abandoned the property, the Bank entered and inspected it, discovering extensive damage. The Bank stated further that it had been unable to sell the property at the price on the Sheriff’s Certificate, $66,039.02. Because of the cost of making repairs, the Bank said that it believed the property should be sold “as is” as soon as possible to keep costs down. It therefore sought BIA’s concurrence “to extend, review and accept any offers for a reduced price of the building.” Bank’s Oct. 23, 2001, Letter at 2. By

4/ The record copy of the attorney’s Dec. 1, 2000, letter is attached to the Bank’s Nov. 26, 2002, Notice of Default/Claim for Loss. The letter shows that a copy was sent to the Bank’s Commercial Loan Officer but does not show that a copy was sent to BIA.
The Regional Director’s statement that Nichols’ tax defaults were disclosed to BIA in October 2000 is puzzling because, as far as the administrative record shows, the first mention of the tax defaults was made in the Dec. 1, 2000, letter from the Bank’s attorney to Nichols, and the first notice to BIA was given in the Bank’s Mar. 5, 2002, letter to the Regional Credit Officer.

On March 5, 2002, the Bank wrote to the Regional Credit Officer, stating that a purchase offer for the property had been made but then withdrawn because of the costs of repairing the property. The Bank also stated that there were delinquent taxes on the property, totalling $8,618.13 through March 31, 2002.

On November 26, 2002, the Bank submitted a Notice of Default/Claim for Loss, seeking to recover $69,250.76 on its loan guaranty. Attached to the claim were documents showing that the Bank had sold the real property for $2,500; had paid $11,059.34 in closing costs, primarily to cover the delinquent property taxes; and had thus incurred a net loss of $8,559.34 on the sale.

On May 15, 2003, the Regional Director denied the Bank’s claim, giving several reasons for denial.

He first held that the guaranty was void because the loan and guaranty had been transferred from Northern National Bank to Norwest Bank and ultimately to Wells Fargo Bank Minnesota, without notice to BIA as required by 25 C.F.R. § 103.51 and paragraph 18 of the Loan Guaranty Agreement.

He then held that the guaranty had ceased being in force and effect under 25 C.F.R. § 103.36 because the Bank had failed to notify BIA within 45 days of several instances of default by Nichols and had failed to take action within 60 days of those defaults. In particular, the Regional Director stated that Nichols had failed to pay real property taxes during 1999 and 2000 and had failed to maintain insurance on her property, and that both failures constituted violations of her mortgage and were therefore defaults under 25 C.F.R. § 103.1. He stated in part:

Upon inquiry with the Cass County Auditor’s Office, we discovered that [Nichols] had stopped paying real estate taxes in May 1999 and was nearly a year late in paying the real estate taxes for 1998. Even disregarding [Nichols’] late payment of taxes in 1998, [Nichols] was undeniably in default for non-payment of real estate taxes when they became due in May 1999, October 1999, May 2000 and October 2000 — defaults which should have been discovered with reasonable inquiry by a prudent lender, and which were not disclosed to the BIA until October 2000. [5/]

To the contrary, the [Bank’s]

5/ The Regional Director’s statement that Nichols’ tax defaults were disclosed to BIA in October 2000 is puzzling because, as far as the administrative record shows, the first mention of the tax defaults was made in the Dec. 1, 2000, letter from the Bank’s attorney to Nichols, and the first notice to BIA was given in the Bank’s Mar. 5, 2002, letter to the Regional Credit Officer.
annual report to the BIA for the period ending September 30, 2000 characterized the loan as “PROBLEM LESS.” The [Bank’s] failure to notify the BIA of [Nichols’] default within 45 days and to take appropriate action in accordance with 25 C.F.R. § 103.36 within 60 calendar days of the default date of May 1999 caused the guaranty to cease being in force and effect.

* * * Based on information we obtained from the insurer Northway Insurance Services, [Nichols’] insurance policy was cancelled for non-payment on December 15, 1999. The insurance company stated that it routinely provides a copy of the cancellation notice to lenders to allow lenders to protect their interest in the collateral. * * * [T]he lack of oversight in allowing the insurance policy to be cancelled arguably contributed to the [Bank’s] inability to recover the cost of repairing the extensive structural damages which the [Bank] contends drastically reduced the value of the collateral. Failure to proceed in accordance with 25 C.F.R. § 103.36 within 45 calendar days of the default date of December 15, 1999, caused the guaranty to cease being in force and effect.

The Bank appealed the Regional Director’s decision to the Board. The Bank and the Regional Director filed briefs.

Discussion and Conclusions

The Board first considers the Bank’s arguments as they concern the Regional Director’s second holding — that is, his holding that the loan guaranty had ceased to be in force and effect under 25 C.F.R. § 103.36(a) because of the Bank’s failure to notify BIA of Nichols’ tax and insurance defaults within 45 days of their occurrence and its failure to take one of the required actions with 60 days of those defaults.
“Default” is defined in 25 C.F.R. § 103.1 to include the “failure of a borrower to:
(1) Make scheduled payments on a loan when due * * * or (3) Comply with the covenants,
obligations, or other provisions of a loan agreement.”

25 C.F.R. § 103.36 provides:

(a) Within 45 calendar days after the occurrence of a default, the lender shall notify the Commissioner [6/] by certified or registered mail showing the name of borrower, guaranty certificate number, amount of unpaid principal, amount of principal delinquent, amount of interest accrued and unpaid to date of notice, amount of interest delinquent at time of notice, and other failure of the borrower to comply with provisions of the loan agreement. Within 60 calendar days after default on a loan, the lender shall proceed as prescribed in either paragraph (b), (c), or (d) of this section, unless an extension of time is requested by the lender and approved by the Commissioner. The request for an extension shall explain the reason why a delay is necessary and the estimated date on which action will be initiated. Failure of the lender to proceed with action within 60 calendar days or the date to which an extension is approved by the Commissioner shall cause the guaranty certificate to cease being in force or effect. If the Commissioner is not notified of the failure of a borrower to make a scheduled payment or of other default within the required 45 calendar days, the Commissioner will proceed on the assumption that the scheduled payment was made and that the loan agreement is current and in good standing. The Commissioner will then decrease the amount of the guaranty pro rata by the amount of the due installment and the lender will have no further claim for guaranty as it applied to the installment, except for the interest subsidy on guaranteed loans which may be due.

(b) The lender may make written request that payment be made pursuant to the provisions of the guaranty certificate or guaranty agreement. If the Commissioner finds that a loss has been suffered, the lender may be paid the pro rata portion of the amount guaranteed including unpaid interest.

(c) The borrower and the lender may agree upon an extension of the repayment terms or other forbearance for the benefit of the borrower. The lender may extend all reasonable forbearance if the borrower becomes unable to meet the terms of a loan. However, such forbearance will not be extended if it will increase the likelihood of a loss on the loan. Agreements between a lender

6/ “Commissioner” is defined to mean “the Commissioner of Indian Affairs or his authorized representative.” 25 C.F.R. § 103.1.
and a borrower shall be in writing and will require approval by the Commissioner.

(d) The lender may advise the Commissioner in writing that suit or foreclosure is considered necessary and proceed to foreclosure and liquidation of all security interests. * * *

The Bank first argues that it complied with 25 C.F.R. § 103.36(a) because it notified BIA within 45 days of determining that Nichols was in default and took one or more of the required actions within 60 days. Bank's Opening Brief at 8. This argument evidently refers to Nichols' default in making payments to the Bank, a default which was not at issue in the portion of the Regional Director's decision now under review. 7/ To the extent the Bank suggests in this argument that it was not required to comply with 25 C.F.R. § 103.36(a) until it made a determination of default, the Board rejects the argument for the reasons stated in connection with the argument discussed next.

The Bank argues that it was unaware of Nichols' failure to pay insurance premiums and failure to pay real property taxes at the time the defaults occurred. The essence of this argument seems to be that the Bank should not have been required to comply with 25 C.F.R. § 103.36(a) with respect to defaults of which it was unaware.

In his answer brief, the Regional Director argues that "default," as defined in 25 C.F.R. § 103.1, "is expressly defined as [the] Borrower's failure to take certain actions — not the Lender's discovery thereof" and that, "[i]n order to reap the protections of the 90% guaranty provided by the BIA, lenders must undertake whatever steps are reasonably necessary to ensure that they detect occurrences of default, notify the BIA of such occurrences of default, and take action within 60 days." Regional Director's Brief at 13-14.

In reply to the Regional Director's argument, the Bank contends:

The operative event causing a guaranty certificate to become unenforceable is the failure of a lender to proceed with action after declaring a borrower in default. * * * Contrary to the suggestion made by the BIA in its brief, a guaranty certificate may only be deemed invalid upon a lender's failure to proceed with action within 60 days of declaring a borrower in default; a guaranty certificate

7/ At another point in its opening brief, the Bank claims that, “when it discovered the [tax and insurance defaults, it] provided notice to BIA of such events of default.” Id. at 11.

The Bank does not provide any evidence of this claimed notice. From the record, it is clear that the Bank was aware of these defaults by Dec. 1, 2000. However, as noted above, 41 IBIA at 229-30 n.5, it does not appear that the Bank provided any notice of the defaults to BIA until it mentioned the tax defaults in its Mar. 5, 2002, letter.

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does not become unenforceable due to a lender’s failure to notify the Commissioner of a default within 45 days after the occurrence of a default.

Bank’s Reply Brief at 2 (emphasis in original).

The Bank’s argument, as expressed in its reply brief, is plainly at odds with the language of 25 C.F.R. § 103.36(a). Contrary to the Bank’s contention, the regulation explicitly provides that it is the occurrence of a default that sets the provisions of the regulation in motion, not the lender’s declaration of default.

The Bank’s ultimate aim in making this argument seems to be the same as that pursued by appellants in earlier loan guaranty appeals, who contended that no default occurred until a lender declared a default or took some action against a borrower. That is, both the Bank in this case and the appellants in the earlier cases have sought to have the time periods in subsection 103.36(a) counted from some event defined by the lender, rather than from the time of the actual default.

The Board has consistently rejected arguments that default does not occur until a lender declares a default or takes some action against a borrower. See, e.g., First National Bank of Gordon, Nebraska v. Acting Deputy Commissioner of Indian Affairs, 37 IBIA 101, 105-06 (2002); Marquette Bank, N.A. v. Acting Director, Office of Economic Development, 35 IBIA 161, 170 (2000); Security State Bank, Dunseith, North Dakota v. Director, Office of Economic Development, 33 IBIA 225, 234 (1999). The Board also rejects the argument made by the Bank in this case, not only under the principles of the earlier cases, but because it ignores the plain language of subsection 103.36(a).

The Bank does not dispute that Nichols was in default under her mortgage when she allowed her insurance to lapse and when she failed to pay real property taxes. Indeed, Nichols’ mortgage required her to “keep the Property insured for its full value against all hazards including loss or damage caused by fire, collision, theft, flood and hail (if applicable) or other casualty,” ¶ 13, and to “pay all taxes and assessments relating to Property when due.” ¶ 18. The mortgage further provided that Nichols would be in default if she “fail[ed] to perform any Obligation or breach[ed] any warranty or covenant to Lender contained in this Mortgage.” ¶ 21(b).

While acknowledging that the defaults occurred, the Bank contends, as noted above, that it should be excused from complying with the requirements of 25 C.F.R. § 103.36(a) with respect to those defaults because it was not aware of them when they occurred. The Bank contends that it did not receive notice of insurance cancellation and that “[a] prudent lender relies on a cancellation notice from an insurance company, and does not have an obligation to predict that a borrower will not make premium payments when due.” Bank’s Opening Brief at 10.
At the time of loan closing, Northern National Bank was shown on Nichols' insurance policy as a party with a secured interest. Nothing in the record shows that the Bank updated its information with the insurance company following the mergers and name changes affecting it. Nor does the Bank claim in this appeal that it kept the insurance company informed of the changes. Thus it appears possible that the Bank's asserted failure to receive notice of cancellation may have resulted from the Bank's failure to update its information with the insurance company. However, it cannot be determined from the present record whether the Bank's failure to receive notice was the fault of the insurance company or the fault of the Bank.

The Bank does not claim that it was entitled to sit back and await notice that Nichols' real property tax payments were in arrears. In effect, then, the Bank concedes that it had an affirmative responsibility to keep itself informed of Nichols' tax payments, or lack thereof.

Under paragraph 18 of Nichols' mortgage, the Bank had the option of requiring Nichols to "deposit with [the Bank] each month one-twelfth (1/12) of the estimated annual insurance premium, taxes and assessments pertaining to the Property," so that the Bank could make the payments itself. By exercising this option, the Bank could have ensured that the tax and insurance payments were made in a timely manner. The Bank does not explain why it did not exercise this option. Nor does it describe the method it usually employs to ensure timely tax payments by its borrowers, or state whether it followed its usual practice in this case.

As the Bank presents no reason for its failure to discover Nichols' tax defaults, its argument must be construed as one for the proposition that a lender should be excused from the requirements of 25 C.F.R. § 103.36(a) in any case where the lender fails to learn of a borrower's defaults, regardless of the lender's culpability for its failure.

The Board cannot accept such a proposition. Accordingly, it rejects the Bank's contention that it was not required to comply with 25 C.F.R. § 103.36(a) with respect to defaults of which it was unaware.

Next, the Bank argues:

[Nichols] in theory complied with covenants, obligations and provisions of the Note; the BIA relies upon covenant defaults in the Mortgage relating to real estate taxes and insurance coverage. BIA relies upon several covenant defaults by [Nichols] as a basis for denying [the Bank's] claim. The covenant defaults which the BIA relies upon are covenant defaults set forth in the mortgage.

Bank's Opening Brief at 9. Although this argument is not entirely clear, the Bank may be contending that only the obligations in the promissory note signed by Nichols, and not the
obligations in her mortgage, were covenants or obligations of a loan agreement within the meaning of 25 C.F.R. § 103.1.

The Bank does not develop this argument, perhaps because it understands that the promissory note and mortgage are integrated documents, i.e., that together they constitute the Bank’s “loan agreement” with Nichols. 8/ Indeed, the Bank recognized the integrated nature of the documents in its December 1, 2000, default notice to Nichols, which makes no distinction between default under the promissory note (failure to make payments when due) and default under the mortgage (failure to maintain insurance and pay real property taxes).

The Bank has failed to show that Nichols’ failure to maintain insurance and failure to pay real property taxes are not defaults within the meaning of 25 C.F.R. § 103.1.

The Bank next argues that Nichols’ insurance and tax defaults did not prejudice the position of BIA because, under Minnesota law, the delinquent real property taxes would not have taken priority over the Bank’s mortgage and because “the damage to the property was not damage that would be an insured loss.” Bank’s Opening Brief at 11.

25 C.F.R. § 103.36(a) does not require that BIA show that it has been prejudiced by a borrower’s default or by a lender’s failure to comply with the time requirements of the regulatory provision. See Marquette Bank, N.A., supra, 35 IBIA at 173:

[T]here is no requirement that BIA prove prejudice. 25 C.F.R. § 103.36(a) establishes the procedures that a lender must follow after default in order to maintain the guaranty certificate in full force and effect. A lender’s failure to follow those procedures results in the guaranty certificate ceasing to be in full force and effect. Nothing more is required.

The Board finds that BIA was not required to show that it was prejudiced by Nichols’ defaults in order to hold the Bank responsible for complying with 25 C.F.R. § 103.36(a).

Next, the Bank contends that, as to Nichols’ tax and insurance defaults, BIA was limited to the remedy specified in 25 C.F.R. § 103.28(b).

8/ The 1997 regulations do not define the term “loan agreement.” Even without the benefit of a definition, however, it is evident that a loan agreement necessarily encompasses all documents upon which a loan depends.

The present regulations define “loan agreement” as “the collective terms and conditions under which the lender extends a loan to a borrower, as reflected by the documents that evidence the loan.” 25 C.F.R. § 103.44 (2005).
Subsection 103.28(b) sets out certain filing requirements and then provides:

Lenders must also see that:

* * * * *

(2) Taxes on the property included in the securing instruments are paid promptly to prevent such taxes from becoming a lien taking priority over a mortgage; and

(3) Hazard and liability insurance is obtained and maintained in an amount sufficient to protect the security against the risks or hazards to which it may be subjected, to the extent customary in the locality.

Failure of a lender to discharge any of these responsibilities will diminish the amount of the guaranty or insurance to the extent of any loss caused by the lender’s failure, unless there are extenuating circumstances which in the judgment of the Commissioner do not justify a reduction of the amount guaranteed or insured.

The Bank contends that there are extenuating circumstances here because it “had no basis upon which to conclude that [Nichols] was not paying real estate taxes.” Bank’s Opening Brief at 12. Further, it contends that there was no loss attributable to the delinquent taxes. Therefore, it reasons, the amount of the loan guaranty should not be diminished at all.

Nothing in 25 C.F.R. § 103.28(b) states that the remedy provided therein is the exclusive remedy for a lender’s failure to ensure that real property taxes are paid and insurance is maintained. The Bank was clearly in violation of subsection 103.28(b), and BIA could have chosen to invoke its remedy. However, the Bank had included tax and insurance requirements in its loan agreement with Nichols, and thus her failure to comply with those requirements constituted defaults which imposed obligations on the Bank under 25 C.F.R. § 103.36(a). Therefore, BIA was not limited to the remedy in 25 C.F.R. § 103.28(b) but was entitled to hold the Bank responsible for its failure to follow the procedures in 25 C.F.R. § 103.36(a).

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9/ Despite this assertion, it is clear that the loss incurred by the Bank in selling the foreclosed property was attributable in part to the delinquent taxes.
Nichols was first in default in May 1999 when she failed to pay real property taxes. She was subsequently in default in October 1999 and May 2000. The Bank failed to notify BIA of these defaults within 45 days of the defaults and failed to take action within 60 days. The Bank's failure to take action within 60 days of the defaults caused the loan guaranty to cease being in force and effect.

Because the Regional Director's decision can be affirmed on this basis alone, the Board finds it unnecessary to address the Regional Director's other holdings or the Bank's arguments concerning those holdings.

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 Board affirms the Regional Director's May 15, 2003, decision.

I concur:

________________________________________________________________________
Anita Vogt
Senior Administrative Judge

________________________________________________________________________
Steven K. Linscheid
Chief Administrative Judge

10/ Like the Regional Director, the Board disregards Nichols' apparent default in paying her 1998 taxes late. Further, in light of the Regional Director's statement that BIA received notice of Nichols's tax defaults in October 2000, the Board disregards her October 2000 tax default and, in light of the possibility that the Bank's failure to learn of Nichols' insurance default may have been the fault of the insurance company, it also disregards that default.