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

B-168307

Small Bus Adm

RELEASED

FEB 6 1970

Dear Mr. Dellenback

Reference is made to several recent meetings of members of my staff with you concerning your request that we review the foreclosure action in connection with a Small Business Administration (SBA) loan to Mr. and Mrs. Stanley D. Mustoe (Rose Motel, Phoenix, Oregon). You informed us that correspondence received from your constituents, Mr. and Mrs. Stanley D. Mustoe, and their attorneys indicated possible improper conduct by SBA representatives in SBA's administration of the foreclosure action on the loan to the Mustoes. You also requested that we review SBA's investigation of your constituents' complaint since one of their attorneys charged that the investigation, which had been performed at your request, was biased.

Our review included an examination of records contained in the SBA loan file as furnished to us by SBA officials in Washington, D. C., and of the SBA investigation report and discussions with Mr. Stanley D. Mustoe, his two attorneys, Mrs. Jeanette T. Marshall and Mr. Cliff W. Brower, and SBA officials in Portland, Oregon, and Washington, D. C.

Our examination of the records and discussions did not result in identifying any improper conduct by SBA representatives in their administration of the Mustoe loan or any evidence that SBA's investigation of the matter was biased. The available information indicated that SBA's attempt to locate a buyer for the motel was prompted by the institution of a foreclosure suit by the seller of the motel, Mr. and Mrs. John J. Scupien, on their contract with the Mustoes for the purchase of the motel. It appears that SBA's primary concern in the matter was to protect the Government's financial investment in the motel and that SBA's action might have been misunderstood by your constituents. In retrospect, it seems that the misunderstanding which arose on the part of your constituents might have been avoided if SBA representatives had fully explained the actions they were taking and why they were being taken.

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In March 1968 SBA approved a $12,000 economic opportunity loan to Mr. and Mrs. Stanley D. Mustoe, doing business as the Rose Motel. Economic opportunity loans are authorized by title IV of the Economic Opportunity Act of 1964, as amended (42 U.S.C. 2901). Through the economic opportunity loan program, SBA places special emphasis on aid to small business concerns located in urban or rural areas of high unemployment or to small business concerns owned by individuals with low income.

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The proceeds of the loan were to be used primarily for remodeling the motel which had been purchased from Mr. and Mrs. John J. Scupien in June 1963 for a total purchase price of $35,000. The purchase contract provided that Mr. and Mrs. Scupien would retain title to the property until they had received full payment. A lien for the $12,000 loan was taken by SBA on the real and personal property, subject only to the prior lien of the Scupiens for the unpaid balance of about $21,000 on the purchase contract. It was hoped that the remodeling of the motel would attract additional customers to the motel which had been bypassed by a freeway that was opened to traffic in July 1963.

The terms of the SBA loan provided for repayment over a 10-year period with monthly payments of $135 at 5-½-percent interest beginning September 5, 1968. Even after remodeling, however, sufficient customers were not attracted to the motel, and the Mustoes, after making their September and October 1968 payments to SBA, made no further payments on the loan. Also, the Mustoes made no further payments on their contract for the purchase of the motel from the Scupiens after September 1968. Their unpaid balances at the time of the delinquencies amounted to $11,863 on the SBA loan and about $21,000 on the purchase contract with the Scupiens.

On January 8, 1969, the Scupiens provided SBA with a 90-day written notice of their intention to institute foreclosure proceedings on the contract for the purchase of the motel by the Mustoes. At that time, the Mustoes had not made four payments that were due on the Scupien contract and three payments that were due on the SBA loan. In view of the notice to foreclose, SBA officials considered the feasibility of purchasing the Scupiens' interest in the motel, but, on the basis of an SBA appraisal, they concluded that the motel was not an economically viable entity and that there would be insufficient equity in the property over and above the balance due the Scupiens to justify such purchase.

Therefore, in accordance with the terms of the loan which provided for acceleration of the entire indebtedness in the event of default, SBA advised the Mustoes on February 26, 1969, that the unpaid balance of the loan was immediately due. We have been advised by SBA officials in Washington, D. C., that acceleration of the payment on a loan is customary as a last effort to collect the loan before transferring it to the Liquidation and Disposal Section for whatever action is considered appropriate to protect the Government's investment. On March 3, 1969, SBA transferred the loan to SBA's Liquidation and Disposal Section in Seattle, Washington.

Based on the information developed during our review, the action which had been taken by SBA up to this point had caused no apparent concern to the Mustoes regarding improper conduct by any of the parties involved. The events which subsequently transpired, however, apparently led the Mustoes to believe that there was an arrangement between the Scupiens, SBA representatives, a realtor, and a potential buyer of the motel whereby the property would be sold at a sacrifice price to the buyer after the Mustoes were "squeezed out" of their interest by the foreclosure.

According to the SBA file, a possible alternative to foreclosure was to locate for the Mustoes a potential buyer of the motel who might be willing to assume the Mustoes' existing indebtedness on the motel. The SBA Liquidation and Disposal Officer requested a representative of Dean Vincent, Inc., a real estate firm in Eugene, Oregon, to look at the property with the intention of advising SBA of anyone the realtor knew who might be interested in purchasing the motel.

The realtor inspected the motel on March 26, 1969, at which time Mr. Mustoe declined to specify a sales price for the property. Shortly thereafter, Mr. Mustoe notified the realtor that about $57,000 would be needed to pay all of his debts.

On April 8, 1969, the SBA Liquidation and Disposal Officer and an SBA Appraiser inspected the motel to prepare a detailed listing of all furniture and equipment in connection with an appraisal of the motel's liquidation value. According to Mr. Cliff W. Brower (Mr. Mustoe's attorney), Mr. Mustoe asked the Liquidation and Disposal Officer whether an appointment should be made for a meeting between him and Mr. Brower but was advised by the Officer that a meeting with the Scupiens' attorney was preferred.

On April 8 or 9, 1969, the Scupiens' attorney offered the Mustoes $1,000 net of all obligations for their full interest in the motel. On April 9, 1969, a potential buyer located by the realtor inspected the property and left apparently without discussing price. According to Mr. Brower, Mr. Scupien visited the motel later that day and advised Mr. Mustoe that the buyer was to meet with the Scupiens' attorney.

Mr. Mustoe, seeking information on the possible sale of the motel, telephoned the realtor sometime after April 9. The realtor advised Mr. Mustoe that the buyer, who was interested in converting the motel into apartment units, had offered $41,000 for the property, that the buyer had estimated that $39,000 would be expended in conversion, and that $80,000 was the maximum amount he could invest in the property. The realtor also advised Mr. Mustoe that he had not accepted the offer in view of Mr. Mustoe's statement that $57,000 would be needed to pay all of his debts. Mr. Mustoe reaffirmed that $41,000 would not be enough.

The realtor, in an apparent attempt to salvage the sale and despite Mr. Mustoe's reaffirmation that $41,000 would not be enough, prepared an Earnest Money Agreement which was signed by the potential buyer and the realtor on April 15, 1969. The agreement provided for a total sale price of $41,436, assumption by the buyer of the $11,863 SBA loan and payment by the buyer of $29,573 to the Scupiens for their approximate $21,000 interest. Under the terms of the agreement, however, the Scupiens would be required to pay a $4,000 fee to the realtor and the motel's outstanding obligations. The financial statements for the motel as of December 31, 1968, showed outstanding obligations of $6,860 exclusive of the amounts due the Scupiens and SBA. Thus, the Scupiens would have received about $18,700 for their $21,000 interest.

The Scupiens did not sign the agreement and on April 23, 1969, commenced the foreclosure action against the Mustoes. SBA was named as a co-defendent. The court was scheduled to act on the foreclosure action on January 30, 1970.

CONCLUSIONS

Our examination of available records and discussions did not result in identifying any improper conduct by SBA representatives in their administration of the foreclosure action. We found no disagreement in the facts as they were stated by any of the parties, only disagreement as to what the facts implied. Mr. Mustoe's concern regarding impropriety of the parties involved apparently occurred because the prospective buyer, the realtor, and SBA representatives met with the Scupiens and their attorney to discuss the sale of the motel but would not meet with Mr. Mustoe's attorney even though they were requested to do so.

Available information indicates that SBA's actions were prompted by Mr. and Mrs. John J. Scupien's foreclosure on their contract with the Mustoes for the purchase of the motel. It appears that SBA's primary concern was to protect the Government's financial investment in the motel.

Since legal title to the property was retained by the Scupiens, it was necessary that the parties involved deal with them. SBA headquarters officials advised us, however, that, since the Mustoes had an interest in the property, a sale of the property could not have been accomplished without their approval unless, of course, the case was taken to court. We believe that the Mustoes' misunderstanding might have been avoided had SBA representatives kept the Mustoes fully informed of the negotiations being conducted for the sale of the motel and of other SBA actions being taken as a result of the Scupiens' foreclosure.

We did not find any evidence that would support a conclusion of bias in SBA's investigation of your constituents' complaint. The results of our review are consistent with the facts developed by SBA in its investigation as well as with its conclusion that no evidence was revealed of improper conduct by SBA representatives.

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Although formal written comments have not been obtained from SBA on the matters presented herein, the factual data contained herein has been discussed with SBA officials and they have been advised of the issuance of this report.

We trust that this information will serve the purpose of your request. Members of my staff will be available to discuss this matter with you further if you desire.

Sincerely yours,

Assistant Comptroller General
of the United States

The Honorable John R. Dellenback
House of Representatives