

declined to adopt it because it is based on a faulty legal premise, and because it would unduly burden the Agency's enforcement authority. Contrary to the assertion that misrepresentation is "tantamount to civil fraud or deceit", as several comments contended, the concept of negligent misrepresentation is well established in the law. *See, e.g., First National Bank, Henrietta v. SBA*, 429 F.2d 280 (5th Cir. 1970).

SBA emphasizes that the regulation authorizes enforcement action only if a CDC misrepresents or fails to disclose "material" information, which would include important information that the CDC would have reason to know the Agency was relying upon in making a decision about a loan or the CDC's participation in the Program. An example of such information would include a CDC's misrepresentation of or failure to disclose information in its annual report to SBA that, if accurately disclosed, would show that the CDC was in violation of SBA rules or regulations. Similarly, a CDC that was seeking authority from SBA to issue a 504 debenture and failed to disclose a significant adverse change in the borrower's financial condition that was known to the CDC would have failed to disclose a material fact.

As to such critical facts, the Agency believes that CDCs have an obligation to exercise diligence to ensure that they provide accurate information to SBA that the CDC knows, or should know, that the Agency is relying upon. Under egregious circumstances, enforcement action may be appropriate if a CDC negligently fails to do so, and SBA needs the flexibility to be able to undertake enforcement action without the unwarranted burden of having to prove that the CDC intended to deceive the Agency. If a CDC's misrepresentation or failure to disclose material was a result of inadvertence, the CDC will have the opportunity to explain this in responding to any proposed enforcement action. In doing so, however, SBA expects that the CDC would discuss the quality control measures it had implemented to prevent transmission of inaccurate or less than thorough information to the Agency. SBA will, thus, consider the "intent" of the CDC as part of its determination of whether to proceed with a proposed enforcement action.

A concern was raised regarding the use of the word "material" in § 120.854(c) because this term was considered to be too subjective and would "open the likelihood for abuse and retaliation by the Agency." SBA has considered this comment but believes that the term should be retained in the

final rule for several reasons. First, use of the word "material" is important in that SBA is making it clear that trivial infractions will not trigger an enforcement action under § 120.854(c). Thus, contrary to the comment's suggestion that the word "material" could increase the risk of unfounded enforcement actions against a CDC, the intent of the Agency in using this word is just the opposite. At the same time, SBA believes that needed flexibility in applying its 504 Program enforcement procedures is retained through the word "material". SBA notes that this term has been employed as longstanding policy with respect to denials of loan guarantees under the 7(a) Program under § 120.524. Thus, SBA believes it is appropriate to retain this word in the final rule.

Several comments were received regarding language in proposed § 120.854(d) that evidence of CDC improper actions could include the CDC's failure to meet one or more of the portfolio benchmarks established by SBA to measure a CDC's portfolio performance. Many of these comments raised similar concerns regarding the accuracy or lack of public adoption of the benchmarks that were discussed above, which SBA has considered and rejected.

Moreover, these comments appear to be based on the erroneous belief that an SBA enforcement action could proceed solely upon a CDC's failure to meet a portfolio benchmark. The regulation provides that benchmark performance is merely supporting evidence that a "CDC is not performing underwriting, closing, servicing, liquidation, litigation, or other actions with respect to 504 loans in a commercially unreasonable or imprudent manner." SBA has made a minor revision to the second sentence of § 120.854(d) to emphasize this regulatory interpretation.

The need to show that a CDC's actions were imprudent or commercially unreasonable would also preclude SBA from being able to bring an enforcement action using the CDC's benchmark performance if the CDC could show that the performance score was directly related to SBA's approval or liquidation of 504 loans, and not the CDC's actions. Thus, SBA disagrees with those comments which asserted that the provision could be used to bring an enforcement action against a CDC for actions that were beyond its control.

In the context of a specific enforcement action that was relying on a CDC's benchmark score as evidence of that CDC's imprudence or commercial unreasonableness, the CDC, having access to the score, as discussed above,

and having its own information about the performance of its loan portfolio, would be able to present SBA with arguments that the benchmark score was inaccurate in its opposition to the enforcement action. SBA would carefully consider those comments before proceeding with any enforcement action.

Other comments requested that SBA modify § 120.854(e) to clarify that an agency notification of deficiency to a CDC include a request to take corrective action if appropriate. SBA considered this concern, agrees with the comments, and is modifying the rule accordingly so that an agency notice of deficiency also include a request for corrective action if appropriate. SBA also agrees with, and has modified § 120.854(e) to address, those comments that stated that it would be fair to provide the CDC with a reasonable period of time to cure the deficiency. The Agency disagrees, however, with comments that a specified time for a cure should be provided because SBA needs flexibility in determining the appropriate cure period depending upon the facts of each situation. SBA further disagrees with comments suggesting that a notice of deficiency must describe with specificity the corrective action that is needed rather than simply requiring it to be corrected. Although SBA may suggest the type of corrective action that is needed, it will generally be the CDC, with the knowledge of its own operations and portfolio, that will be in the best position to make the judgment as to how best to correct a deficiency.

Comments objected to proposed language in § 120.854(f) that would permit SBA to initiate enforcement action based upon a CDC's "pattern of uncooperative behavior or an action that SBA determines is "deleterious to the 504 program" or that "undermines SBA's administration of the 504 program" or that was "not consistent with standards of good conduct." Generally, the comments expressed concern that these provisions were ambiguous and subject to subjective interpretation. The terms are so broad, one comment opined, so "as to render it useless in determining what the SBA means and what is expected of the CDC" and allows SBA "to decertify a CDC simply for convenience," and without just cause or due process.

SBA has considered these comments but believes that the provisions should be retained in order to preserve needed and justifiable flexibility in administering the 504 program, as discussed above. It has been the Agency's experience in dealing with enforcement actions in the past that it