UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of: PARTNERSHIP FOR URBAN HOUSING DEVELOPMENT, INC., A PENNSYLVANIA NON-PROFIT CORP., ANTHONY L. MERRIETT, BOARD CHAIRMAN, INDIVIDUALLY, AND GREGORY H. WHEELER, BOARD PRESIDENT, INDIVIDUALLY, Respondents.	14-AF-0102-CM-001 April 28, 2016

Appearances

Julia Murray, Attorney
Henry Schoenfeld, Attorney
United States Department of Housing and Urban Development, Washington, D.C.
For Petitioner

Gregory H. Wheeler, *Pro Se*
For Respondents

INITIAL DECISION AND ORDER

BEFORE: Alexander FERNÁNDEZ, Administrative Law Judge

On December 20, 2013, the U.S. Department of Housing and Urban Development ("HUD" or the "Government") served Partnership for Urban Housing Development, Inc., ("Respondent PUHD"), Anthony L. Merriett ("Respondent Merriett"), and Gregory H. Wheeler ("Respondent Wheeler") (collectively, "Respondents") with Pre-penalty Notices advising them that HUD was considering levying civil money penalties against them for alleged violations of 12 U.S.C. § 1735f-15(c) and its implementing regulations. HUD filed the *Complaint* on May 30, 2014, alleging violations of 12 U.S.C. § 1735f-15(c)(1)(B)(ii) and (xi). Specifically, HUD contends that Respondents used restricted funds for unauthorized purposes, and refused to comply with HUD's request that they submit Previous Participation Certifications ("PPCs") for each member of Respondent PUHD's Board of Directors. The *Complaint* seeks joint and several civil money penalties of $37,500 for the unauthorized use of funds, and $42,500 for the failure to submit a PPC. Respondents filed an *Answer* on July 24, 2015.

A hearing in this matter was conducted on January 12-13, 2016, in Philadelphia, Pennsylvania. Testimony was heard from Paul Aprigliano, Satellite Office Director for HUD's Departmental Enforcement Center; and Respondents Merriett and Wheeler.[1] Respondents submitted their closing arguments in writing on February 8, 2016. The Government submitted its *Post-Hearing Brief* on February 26, 2016; Respondent's submitted theirs on March 11, 2016. The Government filed its *Reply to Respondent's Post-Hearing Brief* on March 28, 2016. Respondents did not reply to HUD's *Brief*. Accordingly, the record is now closed and this proceeding is ripe for initial decision.

STATUTORY AND REGULATORY BACKGROUND

Under specific circumstances, the Government may impose civil money penalties on the mortgagor of a property that includes five or more living units and that has a mortgage insured, co-insured, or held pursuant to the National Housing Act of 1937. 12 U.S.C. § 1735f-15(c)(1)(A)(i); 24 C.F.R. § 30.45. The same penalties may also be assessed against an officer or director of such a mortgagor. 12 U.S.C. § 1735f-15(c)(1)(A)(iii); 24 C.F.R. § 30.45(c)(3). Violations of 12 U.S.C. § 1735f-15(c)(1)(B) that occurred on or after March 8, 2007, are subject to a maximum civil penalty of $37,500. Violations occurring on or after February 19, 2013, are subject to a maximum penalty of $42,500.

Section 1735f-15(c) identifies several actions that would render a mortgagor liable for civil money penalties. Among these violations are the knowing and material:

1. Assignment, transfer, disposition, or encumbrance of any personal property of the Project, including rents, other revenues, or contract rights, or paying out any funds, except for reasonable operating expenses and necessary repairs, without the prior written approval of the Secretary. 12 U.S.C. § 1735f-15(c)(1)(B)(ii).

2. Failure to provide specific answers to questions upon which information is sought relative to income, assets, liabilities, contracts, the operation and condition of the property, or the status of the mortgage. 12 U.S.C. § 1735f-15(c)(1)(B)(xi).

FINDINGS OF FACT

The Court has considered all matters presented by the parties, including the *Complaint*, the *Answer*, the exhibits, the testimony at hearing, and both parties' post-hearing submissions. Based on a thorough and careful analysis of the entire record, the

[1] As a sanction for their repeated failures to comply with Court orders, Respondents were barred from calling any direct witnesses or entering any evidence. However, they were given an opportunity to provide testimony themselves, and were allowed to cross-examine Mr. Aprigliano.

Court finds the facts as described below and further finds and takes cognizance of facts as described elsewhere in this *Initial Decision and Order*.

1. Respondent PUHD is a non-profit 501(c)(3) corporation created on May 31, 1978, under the laws of the Commonwealth of Pennsylvania.

2. Respondent Merriett is Chairman of PUHD's Board of Directors. Respondent Wheeler is President of the Board.

3. Respondent PUHD owns Diamond Park Apartments ("the Project") and is the mortgagor for the apartment complex, which provides 48 housing units for elderly and disabled residents.

4. Respondent PUHD received a direct loan under Section 202 of the National Housing Act in approximately 1985 to fund the construction of the Project. It signed a Housing Assistant Payments ("HAP") contract on June 27, 1986, authorizing HUD to make rental assistant payments on behalf of the Project's residents.

5. On January 16, 2009, Respondent PUHD refinanced its HUD loan under Section 223(f) of the National Housing Act.

6. The new loan, for $3,289,300, was financed by Wells Fargo and insured against default by HUD.

7. In exchange for HUD's promise to insure the Wells Fargo loan, Respondents entered into a Regulatory Agreement with HUD on January 16, 2009.

8. Respondent Merriett, in his capacity as Board Treasurer, signed the Regulatory Agreement on behalf of Respondent PUHD.

9. Respondents filed an Incumbency Certificate with HUD on January 12, 2009, days before signing the Regulatory Agreement

10. Paragraph 6(b) of the Regulatory Agreement repeats the statutory language of 12 U.S.C. § 1735f-15(c)(1)(B)(ii), which prohibits Respondents from encumbering Project property, or paying out Project funds for non-Project purposes without first receiving written permission from HUD.

11. Paragraph 9(f) of the Regulatory Agreement repeats the statutory language of 12 U.S.C. § 1735f-15(c)(1)(B)(xi), which requires Respondents to give specific answers to HUD questions regarding the status of the Project.

12. Paragraph 9(e) of the Regulatory Agreement requires Respondents to submit a signed and certified "complete annual financial report" within 60 days of the end of each fiscal year.

13. All of Diamond Park's residents are participants in HUD's Section 8 Program, whereby HUD pays approximately 70% of the residents' monthly rental payments.

14. As a HAP Program participant, Respondent PUHD receives approximately $700,000 per year in rental subsidies through the Section 8 Program.

15. From June 19, 1986, until January 31, 2009, Diamond Park was managed by Presbyterian Homes/Presby's Inspired Life ("Presby"). Presby controlled a checking account at Wachovia Bank, account number 2100010536815 ("the Wachovia Account").

16. The Wachovia Account was Respondent PUHD's primary Project account. Project revenues, including rental payments, were deposited in that account, and Project expenses were paid from that account.

17. Presby also managed five of Respondent PUHD's Wachovia savings accounts, which were for operating cash, tenant security deposits, residual receipts, replacement reserves, and escrow deposits.

18. Respondents grew dissatisfied with Presby's management of the property, and, on February 1, 2009, hired Interstate Realty Management Company ("Interstate") to replace Presby.

19. During the management transition, Presby transferred the balances in three savings accounts — operating cash, tenant security deposits, and escrow deposits — into the Wachovia Account. It then transferred most of the new balance into an account controlled by Interstate. After the transfer, the Wachovia Account's balance was $10,479.12.

20. As of December 31, 2010, the balance in the Wachovia Account was zero.

21. The residual receipts and replacement reserves savings accounts were not included in the transfer and remained at Wachovia.

22. After the mortgage was refinanced in 2009, Respondents placed $850,461 in a repair escrow account at Wells Fargo. The account was to be used to fund non-critical repairs.

23. Respondent Merriett instructed Interstate to transfer $93,520 from the repair escrow account into a Liberty Bell Bank account controlled by Respondent Merriett.

24. The Liberty Bell account was created to allow Respondents to pay construction costs while awaiting HUD approval to expend funds from the repair escrow account.

25. Respondents wrote one check from the Liberty Bell account, to Olde City Craftsman, Inc. On July 6, 2009, Interstate wrote Respondent PUHD a check for $65,815; the remaining balance in the Liberty Bell account.

26. Respondent Merriett deposited Interstate's check in a City National Bank account ("the CNB Account") ending in 2539.

27. The CNB Account is an entity account in the name of Respondent PUHD. The mailing address for the account is Respondent Merriett's home address. He is the only person authorized to issue checks from the account.

28. On March 4, 2010, Respondent PUHD deposited a check for $22,230 from the repair escrow account into the CNB Account. On May 17, 2010, it deposited a check for $4,000 from the replacement reserve account into the CNB Account. On September 17, 2010, it deposited a check for $5,170 from the residual receipts account into the CNB Account. HUD authorized the release of these funds from their respective Project accounts.

29. As of December 31, 2010, Respondents had deposited a total of $31,400.09 into the CNB Account.

30. During 2010, Respondent Merriett received $16,900 in payments from the CNB Account. Respondent Wheeler received $2,950 in payments from the CNB Account. The checks were written by Respondent Merriett.

31. The payments to Respondents Merriett and Wheeler were for PUHD-related business.

32. On August 24, 2011, Respondent filed its annual audited financial statement for fiscal year 2010.

33. The audit was performed by Asher & Co., an independent public accounting firm.[2]

34. The audit indicated "[d]uring 2010, entity expenses were paid in the amount of $39,479 by a Board member who solely controlled the funds. The payment of entity expenses was not approved by HUD."

35. The $39,479 in allegedly unauthorized disbursements represented the $10,479 from the Wachovia Account and $29,000 in disbursements from the CNB Account, including the payments made to Respondents Merriett and Wheeler.

[2] Respondents have called the Court's attention to the fact that Asher was at one point a wholly owned subsidiary of Interstate. This information appears intended to imply collusion between Asher and Interstate. However, Respondent never explicitly raised a conspiracy argument, nor provided any evidence to support it. Moreover, they do not deny that disbursements were made from the accounts identified and in the amounts identified in the audit. They question only whether those accounts were entity or project accounts.

36. Respondent Merriett was the Board member in control of both the Wachovia and CNB Accounts during 2010.

37. The audit further stated that "[e]ntity expenses were paid from [Respondent PUHD's] operating cash account ... and that the expenses "should be reimbursed in the amount of $39,479 to the Development's operating account."

38. The audit showed that Respondent PUHD did not have any entity revenue in 2010.

39. Prior to releasing the audit, Asher asked Respondents for information regarding how the funds from the Wachovia and CNB Accounts had been spent.

40. In response, Respondent Merriett provided Asher with bank statements that identified the amount of the disbursements but did not explain how the funds were spent.

41. Respondents never gave Asher a full explanation of how the funds were spent.

42. Unable to confirm that the disbursed funds were used for Project-related purposes, Asher categorized them as entity expenses and deemed them to be unauthorized.

43. Respondent Merriett signed the audit on August 11, 2011. He did not challenge its findings, and did not fully read the audit before he signed it.

44. On June 4, 2013, HUD's Departmental Enforcement Center issued Respondent PUHD a Notice of Violation of the Regulatory Agreement and a Notice of Default of the Housing Assistant Payments Contract ("Notice of Violation"), based on the allegedly unauthorized disbursements.

45. The Notice of Violation ordered each current Board member to submit an updated Previous Participation Certification to HUD.

46. Respondents 2009 Incumbency Certificate identified Respondent Merriett as a PUHD Board member, secretary and treasurer. It identified Respondent Wheeler only as a Board member.

47. Respondents never filed an updated PPC.

DISCUSSION

I. <u>Respondents Are Liable for Civil Money Penalties</u>

The Government's *Complaint* seeks a total civil money penalty of $80,000 against all three Respondents, and alleges two violations of federal statutes and contractual obligations. To review, HUD seeks a civil money penalty of $37,500 for Respondents' allegedly unauthorized use of Project funds for non-Project purposes, in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(ii). It also seeks a civil money penalty of $42,500 for Respondents' alleged refusal to provide an updated PPC when requested, in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(xi). Both penalties represent the maximum allowable penalties at the time the alleged misconduct occurred.

A. Unauthorized Use of Project Funds

Count I of the *Complaint* alleges that Respondents' disbursement of $39,479 from the Wachovia Account and the CNB Account in 2010 violated the Regulatory Agreement because those monies were classified as Project funds. The Regulatory Agreement and the relevant statutory language prohibit the use of Project funds without HUD's prior, written approval, unless the funds are being used for reasonable operating expenses and necessary repairs. 12 U.S.C. § 1735f-15(c)(1)(B)(ii).

Respondents' defense is two-fold. First, they assert that the accounts in question were entity accounts. The funds were therefore entity funds, which do not require HUD approval prior to disbursement. Alternatively, even if the funds were Project funds, Respondent's argue that they were used for purely Project-related purposes.

The first question before the Court is whether the $39,479 represents Project or entity funds. The term "project funds" is not defined anywhere in the National Housing Act, its implementing regulations, or the Regulatory Agreement. Neither party has ever explicitly defined the term. However, it is generally understood that "project funds" are those funds either directly allocated to the Project or generated by Project revenue, such as rental payments or security deposits.[3] An examination of the evidence reveals that these funds were indeed Project funds.

The Wachovia Account

First, the Wachovia Account was indisputably a Project account during the time it was under Presby's control. Presby's Director of Accounting stated via affidavit that Presby managed Diamond Park's Project accounts, not Respondent PUHD's entity accounts. Respondents confirm as much, stating that they have never controlled Project accounts. Rent payments by the tenants went into this account, as did Section 8 HAP payments by HUD. The Wachovia Account was also used to pay Project-related expenses. This is the very definition of a Project account.

Prior to transferring the majority of the Wachovia Account balance to Interstate, Presby merged the account with three other accounts: the Diamond Park savings account,

[3] See Indian Motocycle Associates III Ltd. P'ship, 161 B.R. 865, 867 (Bankr. D. Mass.), rev'd, 174 B.R. 351 (D. Mass. 1994), vacated sub nom. Indian Motocycle Associates III Ltd. P'ship v. Massachusetts Hous. Fin. Agency, 66 F.3d 1246 (1st Cir. 1995) (Regulatory Agreement defined "project funds" as "all revenues from operations and earnings on deposits of project funds and, unless otherwise provided, earnings on escrows.")

the escrow deposit account, and the tenant security deposit account.[4] All three of these accounts were also Project-related accounts, and their funds were also Project funds. Accordingly, 100% of the monies in the Wachovia Account immediately prior to the handover were Project funds.

Respondents contend, however, that the Wachovia Account ceased to operate as a Project account after the handover, thus converting the funds within it into entity funds. Specifically, Respondent Merriett testified that he received a call from Interstate Controller Ralph Massaro that the funds in the Wachovia Account were "no longer a part of operations, that we could use them in a miscellaneous category."[5] According to Respondent Merriett, he then used the funds in the account to pay miscellaneous expenses, completely depleting the account by the end of 2010.

Respondents' emphasis on the nature of the accounts, rather than the funds themselves, is misplaced. Even if Respondents took over the Wachovia Account after the

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[4] Respondent Merriett also testified that, prior to the handover, the Wachovia Account already contained tenant security deposits "that had been in this fund for over 20 years." It is unclear whether these deposits predated the creation of the separate security deposits account.

[5] An affidavit by Mr. Massaro directly contradicts Respondent Merriett's claim that Mr. Massaro told him the Wachovia Account contained miscellaneous funds. In the affidavit, Mr. Massaro states that "at no time did I or [Interstate] advise Mr. Merriett or Mr. Wheeler that the funds remaining in the Wachovia Account were anything other than operating funds. At no time did I or IRM advise Mr. Merriett or Mr. Wheeler that these funds were entity funds, or funds belonging to PUHD." The Court is inclined to believe Mr. Massaro's version of events for one reason: Respondents' apparent confusion as to whether Mr. Massaro's statement was referring to the CNB Account or the remains of the Wachovia Account. Respondent's *Post-Hearing Brief* offers perhaps the clearest accounting of the sequence of events, from Respondents' point of view. The *Post-Hearing Brief* states that Mr. Massaro:

> claimed he had received a certain amount of funds that were neither Project or Project operational funds and requesting that the Entity take these funds as they, [Interstate], did not want to manage these undesignated funds. Subsequently, two checks were turned over to [Respondent Merriett], on two separate occasions to account for the discovery of undesignated funds and said funds were deposited in the Respondents' Entity ... accounts identified as such."

The *Post-Hearing Brief* goes on to assert that the "undesignated" funds were then used "to make expenditures that were 100% project related including the purchase of computers which were synced to new security cameras..."

The conversation, and the events that occurred as a result of it, could not have been related to the Wachovia Account. Interstate never "received" the $10,479; it remained in the Wachovia Account after the transition from Presby to Interstate. Mr. Massaro could therefore never write a check turning over that amount to Respondent's control. Interstate had, however, received the $850,000 revenue from the refinance, which had been slated for rehabilitation work. Both parties agree that Interstate was not contracted to manage those monies. The checks written by Interstate were the $93,520 from the escrow account into the Liberty Bell account, and the $65,815 from the Liberty Bell account into the CNB Account. These could not be the same funds from the Wachovia Account, which had always been in the Wachovia Account and were left untouched after the management transfer to Interstate.

transition to Interstate, the funds within the account still belonged to the Project.[6] Their nature remains unchanged, regardless of their location.[7] Accordingly, the $10,479 that remained in the account after the handover remained Project funds. Absent HUD permission, they could only be spent on reasonable expenses and repairs.

Although Respondents contend that the disbursements from the CNB Account were related to the management and upkeep of Diamond Park, they make no such assertions with regard to the $10,479 in the Wachovia Account. Indeed, Respondents have offered no explanation of how those funds were spent, beyond the opaque reference to "miscellaneous expenses." When asked at the hearing why Respondents refused to provide Asher and HUD with details about these expenditures, Respondent Merriett testified that he "didn't think they ... needed to know that."

The Government insists that "failing to provide an explanation for how Project funds are expended constitutes an unauthorized distribution of Project funds." The law is not quite so clear cut. The lone case cited by HUD is United States v. Giordano, 898 F. Supp. 2d 440 (D.R.I. 2012). That case does indeed support HUD's proposition. However, it is distinguishable from the present matter in one crucial respect. Giordano was a civil penalty case brought pursuant to 12 U.S.C. § 1715z-4a, under Subchapter II: Mortgage Insurance. This proceeding arises pursuant to 12 U.S.C. § 1735f-15, under Subchapter V: Miscellaneous.

The two sections are not interchangeable. Cases brought under Section 1715z-4a are argued in federal court by the United States Attorney General, in the name of the United States itself. Cases under Section 1735f-15 are heard by administrative law judges pursuant to the Administrative Procedures Act. Additionally, Section 1715z-4a allows for double damages for unauthorized use of multifamily housing project assets and income while Section 1735f-15 currently caps the maximum penalty at $42,500. Most importantly, Section 1715z-4a states that "[F]or purposes of this section, a use of assets or income in violation of the regulatory agreement ... shall include any use for which the documentation in the books and accounts does not establish that the use was made for a reasonable operating expense or necessary repair of the property." 12 U.S.C. § 1715z-4a(a)(1) (emphasis added). There is no similar language in Section 1735f-15. Giordano was thus based on a statute that expressly placed the burden on the respondent to prove that expenditures were reasonable or necessary. Section 1735f-15 has no express burden-shifting language. HUD is therefore required to prove its case by a preponderance of the evidence, as mandated in 24 C.F.R. § 26.45(e).

[6] This tenet operates in both directions. In a 2009 case, for example, $10,000 was inadvertently deposited into a project account. The return of those funds to their rightful owner did not violate the Regulatory Agreement because the funds were never "project funds" despite being in the project account. Sundial Care Ctr., Inc., & Teresa Wong, 2009 WL 7228512, *21 (Mar. 25, 2009) ("funds inadvertently transferred to the project account do not lose their character as property of their rightful owner, and so do not qualify as project funds for the purposes of 12 U.S.C. § 1735f-15(c)(1)(B)(ii).")

[7] The Court notes that Respondents' theory — that moving monies from one account to another fundamentally changes the "source" of those monies — is a simplified version of a tactic criminal enterprises have used with great success from time immemorial. The common term for it is "money laundering." Of course, there is no suggestion whatsoever that Respondents have engaged in any illegal or immoral activity here. The Court merely remarks that money cannot so easily be liberated from its past.

Respondent's refusal to offer any information about how it spent the $10,479 in the Wachovia Account renders it impossible for the Court to conclude that the funds were used for reasonable expenses or repairs. HUD, meanwhile, provides an audit, signed by Respondent Merriett, stating that the expenditures were unauthorized. Moreover, Respondents knew the bank statements they had provided were insufficient, based on an e-mail received by Respondent Merriett on March 11, 2011. Respondents did nothing to rectify the situation. This is circumstantial evidence that Respondents recognized that their use of the Wachovia Account was inappropriate. HUD's evidence — in the face of no contrary evidence — nudges it just over the preponderance threshold. The Court therefore finds that Respondents did not use the funds in the Wachovia Account for reasonable expenses or repairs. They were thus required to obtain written approval from HUD before disbursing those funds. Their failure to do so violated the Regulatory Agreement and HUD regulations.

The CNB Account

Unlike the Wachovia Account, the CNB Account was never a Project account. It was created by Respondents to pay time-sensitive construction costs out of Project operating accounts while awaiting HUD's permission to use funds from the Project's escrow accounts.[8] Those payments were largely reimbursed from the Project's accounts once permission was granted. HUD agrees that Respondents' use of the CNB Account in this way was appropriate.

Again, however, an entity account may contain Project funds. During 2010, Respondents transferred $31,400 into the CNB Account from the Project's repair escrow account, the replacement reserve account, and the residual receipts account. All of those accounts are Project accounts, and the transfers were made with HUD's express permission. Asher's audit concluded that Respondents had spent $29,000 of the $31,400 on unauthorized expenses, consisting of $16,900 in payments to Respondent Merriett; $2,950 in payments to Respondent Wheeler; and $9,150 in payments for other items and services. Respondents readily acknowledge these payments, and provided invoices substantiating them. According to the invoices, and to a check from Respondent PUHD to Respondent Merriett, the payments to Respondent Merriett were meant to reimburse him for:

- Services rendered in pursuit of the refinancing of Diamond Park Apartments; negotiating with banks and financial institutions ($8,000);
- Redesign of architectural work related to Respondent PUHD's attempt to become "developer of record" for the 1800 block of N. 31st Street ($3,000);

[8] Respondents also make reference to an entity account that has existed for several decades, funded by entity revenue such as board membership fees and donations. According to Respondents, that entity account has been used to pay for quarterly board dinners and social events for Diamond Park residents, including trips to Atlantic City and picnics. Respondent did not, however, provide any documentation regarding that account. More importantly, they do not claim that the expenditures in question came from that account. The audit confirms the existence of entity accounts, but it also shows that the entity earned no revenue in 2010 and the accounts had no positive balances from which funds could be drawn.

- Purchase of two laptop computers; time spent meeting with various business groups to develop a strategic plan for the community ($3,000);
- Time spent preparing documents for meetings with city officials regarding the redevelopment of the 1800 block of N. 31st Street ($500);
- Time spent working on affordable housing proposals ($2,000);
- Travel-related expenses ($250);
- Cost of business cards ($150)

Invoices from Respondent Wheeler show that he billed Respondent PUHD for legal services, at a rate of $250 per hour, for:

- Correspondence with HUD and Wells Fargo ($700);
- Correspondence with HUD and Wells Fargo ($2,000);
- Correspondence with HUD and Wells Fargo ($250)

Respondents argue that these expenditures constitute reasonable expenses. The Court disagrees. In general, a reasonable operating expense is one "arising from the everyday operation and maintenance of the project" and "should be limited to expenses paid or incurred in connection with the actual operation of the project as a going concern." U.S. v. Schlesinger, 88 F. Supp. 2d 431, 451 (D. Md. 2000); U.S. v. Harvey, 68 F. Supp. 2d 1010, 1017-18 (S.D. Ind. 1998); Giordano, 898 F. Supp. 2d at 459. Further, for an expense to be reasonable, it must benefit the project, not the owners. Schlesinger, 88 F. Supp. 2d at 451. Ample case law has held that reimbursements to owners benefit the recipient, at the expense of the project itself. See, e.g., U.S. v. Frank, 587 F.2d 924 (8th Cir. 1978); U.S. v. Coleman, 200 F. Supp. 2d 561 (E.D.N.C. 2002). Such reimbursements are therefore unreasonable. Payments for legal fees are similarly inappropriate, unless the fees are related to everyday operation of the project. For example, legal fees may be reasonable and necessary if they were incurred "to collect rent, evict tenants, or defend lawsuits growing out of the operation of the Project." U.S. v. Berk & Berk, 767 F.Supp. 593, 599 (D.N.J. 1991).

Here, Respondents Merriett and Wheeler received compensation and/or legal fees for their work shepherding Diamond Park through the mortgage refinance process. The work had nothing to do with the normal, day-to-day operation of the Project. Compensation for that work was therefore not a reasonable operating expense. Notably, had the compensation come from Respondent PUHD's entity funds, it would not have run afoul of the Regulatory Agreement. Respondents apparently genuinely believed that the funds were entity funds because they were in the CNB Account, which is an entity account. That belief was erroneous. Accordingly, Respondents have violated the Regulatory Agreement and HUD regulations.

B. Failure to Provide Previous Participation Certificate

Count II of the *Complaint* alleges that Respondents refused to submit a PPC for each Board member after being instructed to do so by HUD. This failure allegedly violated section 9(f) of the Regulatory Agreement, which commands Respondents to "give specific answers to questions upon which information is desired from time to time."

The parties agree that Respondents never complied with HUD's request to file an updated PPC. Instead, Respondents contend that the request was unwarranted because HUD already had all relevant information regarding Respondents Merriett and Wheeler. Additionally, they argue that a new PPC is only required when an entity is created or when there is a substantial change in the entity or its principles, neither of which were present in this case.

Central to Respondents' argument is an Incumbency Certificate filed with HUD on January 12, 2009. That document listed Respondent Merriett as "Board Member, Secretary and Treasurer," and identified Respondent Wheeler as "Board Member." It also listed Moses Williams as the Board chairman and included five other Board members. One of those members was Crawford Wilson, whose presence on the Board initially prompted HUD to seek more information about the Project's leadership.[9]

Respondents' own description of the Board's current makeup confirms that the 2009 Incumbency Certificate is out of date. Respondents now claim the titles of Board chairman and Board president, respectively, and state that they are the only principles of Respondent PUHD. Moreover, they assert that Mr. Wilson has resigned from the Board.

HUD regulations state that a new PPC is required "[a]t least 30 days prior to the date of any proposed substitution or addition of a new principal in an existing Project ... *or proposed participation in a different capacity* from that previously approved for the same Project." 24 C.F.R. § 200.217(a)(12) (emphasis added). If the structure and makeup of the Board of Directors has indeed changed, as reflected in Respondents' changed roles, HUD should have been made aware of those changes. After learning of the new management structure, HUD was well within its rights under the Regulatory Agreement to seek updated information reflecting those changes. Respondents agreed to respect the terms of the Regulatory Agreement. They therefore cannot choose to ignore HUD's request. Doing so violated the Regulatory Agreement and HUD regulations.

C. Respondents' Violations were Knowing and Material

A violation of the Regulatory Agreement does not automatically result in the imposition of civil money penalties. First, the Government must prove that those violations were both knowing and material. 12 U.S.C. § 1735f-15(c)(1)(B). The term "knowing" or "knowingly" is defined at 24 C.F.R. § 30.10 as "having actual knowledge of or acting with deliberate ignorance of or reckless disregard" for prohibitions that give rise to civil money penalty liability. The term "material" or "materially" is defined to mean "having the natural tendency or potential to influence," or "in some significant respect or to some significant degree." 24 C.F.R. § 30.10.

[9] Mr. Wilson owns Olde City Craftsman, Inc., which had been contracted to do maintenance and repair work at the Project. HUD questioned whether Mr. Wilson had obtained the contract while serving as a Board member, which would have constituted a conflict of interest.

Respondents have never denied that their actions were deliberate. Indeed, they have consistently maintained that they did not violate the Regulatory Agreement, not that they did not know what the Regulatory Agreement required. Respondent Merriett signed the Regulatory Agreement, and thus is presumed to have read and understood its terms. The same presumption applies to Respondent Wheeler, who, as a member of the Board of Directors, was obligated to familiarize himself with the Regulatory Agreement. Accordingly, both men knew, or should have known, that the Regulatory Agreement forbade the use of Project funds for non-Project-related purposes and that they were required to provide necessary information to HUD upon request. Their actions in the face of that knowledge were reckless.

Respondents have also never challenged HUD's assertion that the violations were material. There would be little merit to such a challenge. It goes almost without saying that the use of Project funds for miscellaneous or non-Project purposes puts those funds at risk. This is particularly true with regard to the Wachovia Account, which saw its balance completely depleted during the course of 2010. How those funds were spent remains a mystery. The misuse of Project funds puts HUD at enhanced risk of paying an insurance claim on the mortgage loan. Additionally, by refusing to apprise HUD of the composition of the Project's leadership, Respondents deprived HUD of the ability to identify conflicts of interest or foresee potential management hazards. These concerns undoubtedly have a significant impact on HUD's interests. The Court thus finds that Respondents' violations were both knowing and material.

II. Determining Penalty Amount

Having concluded that Respondents' actions subject them to civil money penalties, the Court must consider whether the requested penalty amounts are appropriate. HUD regulations specify that the Court weigh the following aggravating and mitigating factors in determining the penalty amount:

- Gravity of the Offense
- History of Prior Offenses
- Respondents' Ability to Pay
- Injury to the Public
- Benefits Received by Respondents
- Benefits Received by Others
- Deterrence
- Degree of Respondents' Culpability
- Injury to Tenants
- Other Matters as Justice May Require

24 C.F.R. § 30.80.

Each factor must be considered, although not every factor will apply directly to every charge. Sundial Care Center, Inc. and Teresa Wong, HUDALJ 08-055-CMP, 2009 WL 6869730 (March 25, 2009). Each factor is assessed independently, and given approximately equal weight. In analyzing each factor, the Court must determine whether the respondent's conduct, as related to that factor, warrants increasing or decreasing the penalty amount. The presence or absence of any particular factor is not determinative. South Texas Mortg. Corp., HUDALJ 04-003-MR, 2005 WL 6521927 (April 12, 2005). However, a particularly compelling factor may be enough, on its own, to support the imposition of a maximum penalty. In re Yetiv, HUDALJ 02-001-CMP, 2003 WL 2596134, *11 (Sept. 2, 2003). For example, a particularly grave offense, or an offense with severe injury to the public, may demand the harshest possible penalties. As a general rule, a factor will justify a maximum sanction if the respondent's conduct was particularly egregious.

A. Count 1 — Unauthorized Use of Project Funds

The Government seeks the maximum civil money penalty of $37,500 against Respondents, jointly and severally.

Gravity of the Offense: Misuse of Project funds is a serious concern because it constitutes a direct threat to the Project's limited resources. By expending Project funds for non-Project or unauthorized purposes, Respondents made it more difficult for the Project to pay its bills or otherwise cover its operating expenses. This inherently undermines the Project's financial stability. If allowed to continue unchecked, this conduct could cause Diamond Park to default on its loan. The consequences for the Project's residents — most of whom are low-income senior citizens in this case — would be catastrophic. The consequences for HUD itself would be substantial, as it is responsible for ensuring the $3.2 million loan.

Full consideration of this factor requires some discussion of why and how the funds were misspent. The CNB Account was intended as a waystation to allow Respondents to pay contractors while awaiting permission to utilize funds from the Project's escrow accounts. As Respondents observe, it could take months or years for those funds to become available. Meanwhile, contractors could not be paid. The result would be a Project in limbo, unable to begin or continue its physical rehabilitation efforts. Respondents used the CNB Account to alleviate this bureaucratic pressure. They were not wrong to do so. HUD acknowledges that the account was generally used appropriately, even though it was an entity account utilizing Project funds. Respondents' error was in failing to recognize the difference between paying contractors for rehabilitation work and paying themselves for their work as members of the Board.[10]

The same does not hold true for the Wachovia Account, however. According to Respondents, those funds were spent on "miscellaneous" expenses, a term that is vague enough to include almost anything. There is no indication that a "miscellaneous" expense is "Project-related," much less that it is a "reasonable" expense. HUD approval for non-operating expenses is required specifically to prevent this kind of undocumented

[10] Respondent Merriett testified that the Board authorized him to receive $50,000 as payment for his efforts to negotiate the refinance of Respondent PUHD's mortgage. Although project board members are traditionally prohibited from receiving compensation, HUD has expressed no opinion here about the propriety of the payments to Respondents Merriett and Wheeler.

use of Project resources. As a result of Respondents' actions, an account that contained more than $10,000 was drained to exhaustion in less than one year. This conduct must be met with a strong sanction.

History of Prior Offenses: Respondent PUHD has been in existence since 1978, and has had a contractual relationship with HUD since at least 1986. Respondent Merriett has been associated with the Project since its inception; Respondent Wheeler joined the Board in 2002. None of the Respondents have previously been adjudged to have violated any HUD regulations. One offense in 30 years supports the imposition of a minimum sanction.

Respondents' Ability to Pay: Respondents did not raise their ability to pay as an affirmative defense, as is required by 24 C.F.R. § 30.80(c). Accordingly, they are presumed to be able to pay any penalty assessed. This factor has no impact on the amount of penalty to be assessed.

Injury to the Public: HUD claims that Respondents' actions harmed the public by forcing HUD to expend time and resources investigating and litigating this matter. The Court notes that HUD's Departmental Enforcement Center exists specifically to investigate and prosecute cases of this sort. Every such case requires the expenditure of time and resources, and every minute or dollar invested in one case means it cannot be invested elsewhere. This is inescapably a cost to the agency, and thus an injury to the public that the agency serves. It does not support a maximum penalty, however. The cost, though real, is applicable to every case pursued by HUD, whether successful or not. Every case therefore includes an injury to the public, making this factor an automatic add-on every time liability is found. HUD's theory would go one step farther, requiring a maximum penalty for every violation. Such an approach would make any analysis of this factor pointless, thereby defeating its purpose.

There is, however, a separate public injury. Respondents, as the custodians of the Project Funds have a duty to safeguard them. Respondents failed in this duty. By using Project Funds on unauthorized expenditures and refusing to produce any evidence that such unauthorized expenditures were used on reasonable expenses, Respondents caused injury to the public. As such, the Court finds such injury to the public to be an aggravating factor.

Benefits to the Respondents: Respondent Merriett received $16,900 in Project funds from the CNB Account. Respondent Wheeler received $2,950. Neither Respondent denies receiving these payments. They have thus both benefitted from the violation of the Regulatory Agreement, and enriched themselves at the expense of Diamond Park. The fate of the $10,479 from the Wachovia Account is unknown, making it impossible to determine whether one or both Respondents directly benefitted from the misuse of that account. Regardless, there is no doubt that both Respondents enjoyed economic advantages from their conduct. The Court therefore views this as an aggravating factor in the penalty determination.

That said, this is not a factor that demands a maximum penalty because Respondents' conduct was not particularly egregious. Their actions were not motivated by greed. To the contrary, Respondents actually did the work for which they received payment, submitted the proper invoices for that work, and did not pay themselves any more than they thought they had legitimately earned. This is not a case of owners gone rogue. The Court therefore concludes that this factor warrants only a moderate increase in the penalty amount.

Benefits to Others: HUD does not allege that anyone other than Respondents benefitted from the unauthorized use of Project funds. This factor is therefore not relevant to this Count.

Deterrence: HUD argues that assessing a maximum penalty against Respondents will send a strong message to others with HUD-insured mortgages and/or HAP contracts that it is unwise to ignore or circumvent their contractual obligations. The Court agrees with that general principle. It also agrees with HUD that "the penalties assessed must be greater than the benefits enjoyed."

The Court is not convinced, however, that a maximum penalty will have the desired deterrent effect here because the factual circumstances in this case are fairly unique. Respondents were in the process of changing management companies while almost simultaneously managing the proceeds of the refinanced mortgage loan. The misuse of funds is partially attributable to miscommunications and misunderstandings during the transition period. There is no reason to suspect that other housing project owners are likely to find themselves ensnared in similar scenarios. If they do, their awareness of the significant penalty assessed in this *Order* should spur them to devote heightened attention to the source of the funds they wish to utilize. A maximum penalty is not necessary to achieve that goal.

Degree of Respondents' Culpability: Respondents Merriett and Wheeler are culpable for their actions. Respondent Merriett, in particular, directly controlled both the Wachovia and CNB Accounts. If, as they claim, they are the only two principles for Respondent PUHD, it is entirely their responsibility to ensure that the Regulatory Agreement and HUD regulations are complied with. They did not fulfill that responsibility here.

Had Respondents acted out of personal greed or intent to defraud HUD, this factor would likely demand imposition of a maximum penalty, irrespective of any other factor. That is not the case here. The Court has found no nefarious motive, and HUD does not allege one. Rather, Respondents' misconduct appears to have been the product of considerable confusion regarding which funds were available for use without HUD authorization. Recklessness, arrogance, obstinacy, and more than a touch of frustration with HUD bureaucracy certainly played roles as well.

Another recent Philadelphia civil money penalty case stands in sharp contrast to the present matter. In Mantua Gardens East, Inc., the board president deliberately encumbered a housing project's property, both real and personal, in an attempt to extricate the project from its Regulatory Agreement.[11] Knowing HUD would not approve, he actively sought to hide his actions from the agency. He then repurposed those funds for his personal use, reaping a payday of approximately $200,000.[12] Based upon the brazen and calculating nature of his actions, this Court found reason to assess the maximum penalty under nearly every factor, including culpability.

There is no similar brazenness here. Throughout this proceeding, Respondents have consistently insisted that the funds in question were entity funds because they were in entity accounts. This premise is the foundation for much of their defense. As discussed *supra*, the name on an account has no bearing on the nature of the funds within it. Respondents were confident that transferring Project funds into the CNB Account removed the Regulatory Agreement's restrictions as to those funds. They were wrong. Accordingly, they must pay a civil money penalty. The Court thus finds this to be a minor aggravating factor.

Injury to Tenants: The Court finds no significant actual injury to Diamond Park's tenants. It is true, of course, that Respondents' misuse of Project funds threatened the long-term financial stability of the Project, but there is no indication of any impending collapse. It is worth noting that the funds in question were generated from the refinance of the mortgage, not from the general operating account. Had Respondents endangered their primary account, it would be far more likely to result in a maximum sanction, as the threat of default would thus have been a more distinct possibility.

Other Matters as Justice May Require: HUD has not identified any other matters that would aggravate or mitigate the penalty assessment. No such matters are readily apparent to the Court. Accordingly, this factor is not relevant to this Count.

Conclusion: Detailed consideration of each factor enumerated in 24 C.F.R. § 30.80 reveals compelling aggravating and mitigating arguments.[13] Accordingly, the Court finds it appropriate to assess a civil money penalty of **$28,125** for Count I.

B. Count 2 — Failure to Answer Questions About the Operation of the Project

The Government seeks a civil money penalty of $42,500 against Respondents, jointly and severally. This represents the maximum penalty allowable under the statute.

[11] In re Mantua Gardens East, Inc., HUDALJ 12-F-043-CMP-3, 2013 WL 663168 (Feb. 1, 2013); (penalty determination reversed upon Secretarial review); Grier v. U.S. Dep't of Hous. & Urban Dev., 797 F.3d 1049 (D.C. Cir. 2015) (denying petition for review) (rehearing en banc denied August 3, 2015).

[12] Rather than explain what he had done with the project's money, the respondent asserted his constitutional right under the 5thAmendment to avoid self-incrimination.

[13] Specifically, Gravity of the Offense is a strong aggravating factor. Injury to the Public, Benefit to Respondents, Deterrence, and Culpability are all minor aggravating factors. History of Prior Offenses is a strong mitigating factor. The other three factors are either irrelevant or neutral.

Gravity of the Offense: Respondents are obligated to comply with the terms of the Regulatory Agreement. Compliance is not voluntary. The Regulatory Agreement stated that owners "shall give specific answers to questions upon which information is desired from time to time relative to income, assets, liabilities, contracts, operation, and condition of the property and the status of the insured mortgage." The reason for this requirement is readily apparent. It is in HUD's interest to ensure that the Project does not default on its loan. HUD therefore has a strong incentive to know who is making the management decisions in the Project. Here, HUD had reason to believe a conflict of interest existed with one of Respondent PUHD's board members. The request for an updated PPC was intended to resolve that concern. By refusing to comply with the request, Respondents left HUD in the dark about a potentially crucial weakness in the management structure. This is a significant, and deliberate, violation of the Regulatory Agreement. A severe sanction is therefore warranted.

History of Prior Offenses: As discussed previously, this is Respondents' first offense. This factor supports imposition of a minimum sanction.

Respondents' Ability to Pay: Respondents have not raised inability to pay as an affirmative defense. It is therefore presumed that they can pay any penalty assessed.

Injury to the Public: The Court is deeply troubled not just by Respondent's complete refusal to file a PPC, but with the utter dismissiveness with which they handled HUD's request. Their compliance would have cost nothing, and could have been accomplished with little inconvenience. Compiling the necessary information would take mere moments. Transmitting that information to HUD could be accomplished with a keystroke. They did not even have to search for the proper HUD form; it was included in the Notice of Violation. Their decision to ignore a legitimate HUD request is therefore baffling.

The failure to file the PPC is far from inconsequential. Without a current PPC, HUD cannot determine who is managing Diamond Park. This increases the likelihood of misconduct, which in turn increases the likelihood of a default on Diamond Park's mortgage. This would directly harm HUD, as the mortgage's insurer. The money HUD would be required to pay out upon default is taxpayer money. HUD therefore has a duty to the public to protect its investments. If HUD cannot exercise the oversight necessary to do so, it would be unwilling to insure mortgages at all. The potential ramifications would be devastating given the central role HUD-backed mortgages play in the American housing market.

More broadly, government agencies cannot function if their contract partners refuse to comply with the terms of their contracts. Housing projects like Diamond Park need HUD to provide critical funding, and HUD needs responsible partners to ensure that those funds are put to their best use. It is a collaborate endeavor. Respondents' cavalier disregard threatens to undermine that relationship. This not only harms HUD, but the general public at large. A strong sanction is therefore warranted.

Benefits Received by the Respondents: HUD contends that the refusal to supply a PPC benefitted Respondents by allowing them to avoid further scrutiny, avoid their contractual obligations, and protect other guilty parties by withholding their identities. The Court believes that Respondents' conduct was very much to their detriment. If their goal had been to hide their actions, they could have easily produced an inaccurate PPC and hoped HUD would look no deeper into the matter. Instead, they ignored the request entirely, in essence challenging HUD's right to demand this information. The refusal was an act of outright rebellion. As such, it placed Respondents directly on HUD's radar, thus ensuring further investigation. Respondents' conduct illustrates the truth of the Japanese proverb "*deru kugi wa utareru*" — "the nail that sticks up feels the hammer first." This could not have benefitted Respondents. Accordingly, this factor does not alter the penalty determination.

Benefits Received by Others: HUD does not identify what others may have benefitted from Respondents' actions, or how. This factor is therefore not relevant to this Count.

Deterrence: Unlike Count 1, Respondents here are not the victims of a genuine mistake, recklessness, or confusion. Here, they made a conscious decision to violate the Regulatory Agreement. Quite simply, Respondents did not file an updated PPC because they did not want to. Statutory, regulatory, and contractual rules are not susceptible to the whims of the moment. A severe sanction will reinforce this lesson and potentially deter others from engaging in similar behavior.

Degree of Respondents' Culpability: Respondents are fully culpable for their actions. They knew HUD had the right to request an updated PPC, and knew they were obligated to provide such a document if asked. They deliberately refused to comply with the request. Respondents suggest that they viewed the request as unnecessarily redundant, and perhaps intended as harassment. They also make vague insinuations of racism, paternalism, and conspiracy, but provide no elaboration. If Respondents indeed suspected the PPC request was demanded for malicious purposes, the proper recourse would be to address those concerns with HUD, and file a complaint with HUD's Office of Inspector General if need be. Instead, they chose to ignore the request.[14] They must accept the consequences of that decision. This factor supports a maximum sanction.

Injury to Tenants: Separate and apart from injuries to the public, of which Diamond Park's tenants are a part, the failure to file an updated PPC did not cause any identifiable injury to Diamond Park's tenants. Respondents' refusal to apprise HUD of the makeup of its Board may theoretically have increased the potential for misconduct to occur, thus threatening the stability of the Project. However, any conclusion based on such a theory would be an exercise in fortune-telling. This factor has no impact on the penalty assessment.

[14] The Court notes that Respondents' refusal to comply with legitimate requests has surfaced during the course of this proceeding as well. They refused, without explanation, to produce discovery documents requested by HUD Counsel. They also failed to respond to multiple orders from the Court, including an *Order to Show Cause* why sanctions should not be granted. Respondents surely do not question HUD Counsel's right to request such documents, or the Court's right to demand compliance with its rules.

Other Matters as Justice May Require: No such matters have been raised or are apparent. This factor is not relevant to this Count.

Conclusion: Respondents' culpability, the gravity of this offense, and the goal of deterrence strongly support imposition of a maximum penalty. This is weighed against Respondents' 30-year history as reliable providers of critical housing for low-income elderly and disabled residents. There is no justification for the outright refusal to comply with a valid request for information. However, a \$42,500 penalty for a single rebellious act over the course of 30 years appears out of proportion, particularly when that act constitutes only a theoretical threat to the Project or its insured mortgage. As three factors support a maximum sanction, and one supports a minimum sanction, the Court finds it appropriate to assess a civil money penalty in the amount of **\$31,875** for Count 2.

CONCLUSION

Respondents knowingly and materially breached the Regulatory Agreement when they used Project funds without authorization and when they failed to provide an updated PPC upon request. These acts constitute violations of 12 U.S.C. § 1735f-15(c)(1)(B)(ii) and 12 U.S.C. § 1735f-15(c)(1)(B)(xi), respectively. They therefore warrant the imposition of civil money penalties. After an independent consideration of the mandated factors, the Court finds Respondents PUHD, Anthony Merriett, and Gregory Wheeler jointly and severally liable for a total of \$60,000 in civil penalties.

These penalties are immediately due and payable by Respondents without further proceedings, except as described below. Respondents are prohibited from using Project income to pay these penalties. 12 U.S.C. § 1735f-15(d)(5); 24 C.F.R. § 30.45(h); 24 C.F.R. § 30.68(d).

So **ORDERED**,

Alexander Fernández
Administrative Law Judge