UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of:

Jack W. Blumenfeld, Alan Feingold,
Executive House Associates,
Executive House Management
Corporation,

Respondents

And Jack W. Blumenfeld &
Company, And Deptford
Investment Corporation,
Affiliates.

HUDALJ 90-1550-DB
HUDALJ 90-1551-DB
Decision issued: August 28, 1992

Dane M. Narode, Esq.
Robin E. McMillan, Esq.
For the Department

Thomas S. McNamara, Esq.
For the Respondents

Before: WILLIAM C. CREGAR
Administrative Law Judge

INITIAL DETERMINATION AND ORDER

Statement of the Case

This proceeding arose pursuant to 24 C.F.R. § 24.300 *et seq.* On August 13, 1990, the Assistant Secretary of Housing/Federal Housing Commissioner, U.S. Department of Housing and Urban Development ("HUD" or "the Department"), in two separate actions which were subsequently consolidated, proposed the debarment of Respondents, Jack W. Blumenfeld, Alan Feingold, Executive House Associates, Executive House Management Corporation and their affiliates, Jack W. Blumenfeld & Company, and Deptford Investment Corporation. The debarment would prohibit their participation in primary and lower-tier covered transactions as either participants or principals at HUD and throughout the Executive Branch of the Federal Government, and from participating in procurement contracts with HUD for a period of three years. These actions claim that Respondents, owners and managers of Executive House, a HUD insured multi-family project, violated the regulatory agreement governing the

financial administration of the project. Respondents appealed both actions and requested oral hearings. After the parties filed responsive pleadings and the cases were consolidated, an oral hearing took place on March 24 and 25, 1992, in Norristown, Pennsylvania.[1] Post-hearing briefs were filed on May 8, 1992. Respondents filed a reply brief on May 15, 1992; the Department filed a reply brief on May 29, 1992.[2]

The Department alleges Respondents violated HUD regulations by the following conduct:

1. Making disbursements of project funds for improper purposes when the project was in default in violation of Section 6 (b) of a regulatory agreement entered into by Respondents as a condition of obtaining a HUD mortgage insurance commitment ("Regulatory Agreement");

2. Improperly transferring tenant security deposit funds from a fiduciary account to the project's operating account in violation of Section 6 (g) of the Regulatory Agreement;

3. Making unauthorized disbursements of project funds and unauthorized distributions of project funds when the project was in default in violation, of Sections 6 (b) and (e) of the Regulatory Agreement; and,

4. Failing to repay the improperly disbursed and distributed funds after being ordered to do so by HUD.

The Department asserts that this conduct constitutes cause for debarment under 24 C.F.R. Sections 24.305 (b) (3),[3] (d), and (f).

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[1]The cases were scheduled for hearing in December, 1990. The hearings were continued at Respondents' request to await a decision of the United States District Court for the District of Pennsylvania on cross motions for summary judgment. The parties believed that a decision by the District Court on these motions would simplify the issues before this tribunal. However, after several months passed without a decision, I again scheduled hearings to commence in June, 1991. On June 7, 1991, I granted a second continuance because an involuntary bankruptcy petition was filed against Respondents Blumenfeld and Feingold. Because of the automatic stay provision of the Bankruptcy Code, the imposition of debarments was precluded absent permission from the Bankruptcy Court. Permission for this proceeding to continue was granted on November 14, 1991.

[2]The parties did not request the opportunity to file reply briefs at the conclusion of the hearing, and Respondents' reply brief was not authorized by this tribunal's order setting dates for the filing of post-hearing briefs. Rather than oppose this unauthorized filing, the Department moved to file its own reply brief which is attached to its Motion. There being no objection to the filing of either reply brief, both are accepted.

[3]In its post-hearing brief the Department alleges that causes for debarment have also been established under 24 C.F.R. Sections 24.305 (b) (1) and (2). Govt. Post-hearing Brief at 21. These subsections were not relied upon in either the Complaint or in the hearing of this matter. Accordingly, I have

Respondents admit to having made disbursements for payments on a construction loan, for certain attorney fees, and for a political contribution after the project defaulted under the note and mortgage. However, Respondents assert that the transfer of the tenant security deposit funds was made in the mistaken belief that a bond had been obtained; and, after learning that the bond had not been issued, they immediately replaced the money. Respondent Blumenfeld admits to having repaid himself for advances to the project after a default occurred under the note. But, Respondents assert that the Regulatory Agreement allowed these repayments even after the project defaulted under the note by virtue of language permitting withdrawals for "reasonable operating expenses" and "payment for reasonable expenses incident to the operation and maintenance of the project." Govt. Ex. 1, (Regulatory Agreement), ¶¶ 6 (b), 13 (g).[4] They further assert that, by its conduct, HUD led them to believe that the disbursements were permissible and, for approximately two years, it took no action to inform Respondents that it viewed these disbursements as improper. Finally, Respondents assert that HUD acted vindictively throughout its handling of this matter and seeks improperly to penalize them through use of the debarment process.

Findings of Fact

The Parties

1. Respondent Executive House Associates ("EHA") is a Pennsylvania limited partnership and the developer and owner of an apartment building located at 6100 City Avenue, Philadelphia, Pennsylvania ("Executive House" or "the Project"). At all times relevant to this action (before December 31, 1988) Respondents Jack W. Blumenfeld and Alan Feingold were the general partners of EHA. Stip. 1.

2. Respondent Executive House Management Corporation ("EHMC"), at all times relevant to this action, acted as the managing agent for EHA, received project rental income and paid certain operating expenses of the project (rather than EHA receiving such rent revenues and paying project expenses directly.) Stip. 16.

3. Jack W. Blumenfeld and Company ("JWB & Co.") is a sole proprietorship owned by Mr. Blumenfeld. Stip. 2.

4. Mr. Blumenfeld and Mr. Feingold were general partners in Deptford Investment Corporation. Govt. Ex. 37, p. 4; Tr. pp. 167-168.

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not considered these additional causes.

[4]The following reference abbreviations as used in this decision: "Govt. Ex." for Government's or Department's Exhibit; "Res. Ex." for Respondents' Exhibit; "Tr." for transcript; and "Stip." for the Stipulation of Facts admitted as "Joint Exhibit 1."

5. Respondent Jack W. Blumenfeld is an experienced real estate developer with prior experience with HUD-insured projects. Mr. Blumenfeld was, at all times relevant to this proceeding, the principal general partner of EHA, as well as the owner of JWB & Co. and part owner of EHMC. Tr. pp. 150-152, 154-155.

6. Respondent Alan Feingold, also a real estate developer, was Mr. Blumenfeld's partner for over 15 years. He was a general partner of EHA until December 31, 1988, and a part owner of EHMC. Govt. Ex. 40, p. 5-6; Tr. p. 152-155. On March 12, 1985, Alan Feingold, on behalf of EHMC, signed a document entitled, "Executive House Management Plan" that states that "Executive House Management Corp. is under the control of the General Partners of Executive House Limited Partnership, Jack W. Blumenfeld and Alan Feingold." Govt. Ex. 5. Mr. Feingold played a significant managerial role in EHA, being responsible for management and administration. Govt. Ex. 45 (Deposition of Alan Feingold), p. 20.

The Project

7. On August 3, 1982, EHA borrowed $18,634,500 from VNB Mortgage Corp. ("VNB"), a private mortgage lender, as part of the financing for the development of Executive House. EHA executed a mortgage ("the Mortgage") and a mortgage note ("the Note") to VNB to evidence and secure its obligation to repay the loan. Stip. 3; Res. Exs., 1, 2.

8. VNB assigned the note and mortgage to the Pennsylvania Housing Finance Agency, which then assigned the note and mortgage to Sovran Mortgage Corp. Sovran sold the note and mortgage to the Government National Mortgage Association ("GNMA"). Stip. 7.

9. Under the terms of the note, commencing May 1, 1985, EHA was obligated to make 60 monthly payments of $166,350.55 in principal and interest on the first of each month. Thereafter, monthly payments of principal and interest in the amount of $146,975.39 were due and payable to the mortgagee on the first day of each subsequent month until the entire indebtedness was paid. Stip. 9.

10. Pursuant to Section 221 of the National Housing Act, 12 U.S.C. § 17151, the Secretary of HUD endorsed the Note for insurance on January 9, 1985. Stip. 4.

11. At all relevant times, the project was subject to a Regulatory Agreement for Multifamily Housing Projects, dated August 3, 1982, which was signed by Mr. Blumenfeld in his capacity as general partner of EHA. Mr. Feingold did not sign this agreement. Stip. 5; Res. Ex. 3.

12. Section 11 of the mortgage incorporates the provisions of the Regulatory Agreement. Stip. 6.

13. The project first became available for occupancy in April, 1984. Stip. 8.

14. By 1985, the project was experiencing a negative cash flow resulting from poor occupancy rates. The rental income of the project did not generate sufficient funds to enable EHA to pay the operating costs and service of the project's debt. Tr. pp. 218, 244-245.

Respondents' Disbursements and Advances

15. After the project defaulted, EHA paid $112,183 out of project funds for construction costs, $68,275 for legal fees unrelated to day-to-day project operations, including $50,000 to pursue a Chapter 11 bankruptcy action and to prevent a foreclosure by HUD, $15,725 to prepare a letter to solicit capital contributions from the limited partners, $25,500 to review and interpret the partnership agreement, and $250 for a political contribution. Govt. Exs. 11, 25, 31, 32, 33, 35, 37, pp. 7-9, 23-24; Res. Corrected Memorandum of Law, p. 5; Tr. pp. 103, 104, 128-130, 134.

16. Prior to June 18, 1987, Mr. Blumenfeld authorized EHMC to transfer $118,000 from its security deposit escrow account to EHA. EHA deposited these funds into its general operating account and later used them to repay a portion of the advances made by Mr. Blumenfeld to the Project. The funds were used by Mr. Blumenfeld to fund "his other business interests." Six checks drawn on EHMC between June 18, 1987, to September 28, 1987, completely exhausted the tenant security deposit funds. Tr. pp. 108, 231-232; Govt. Ex. 36.

17. When Mr. Blumenfeld authorized this transfer, he acted in the belief that EHA had obtained a commitment over the telephone from a bonding agent for the issuance of a bond to secure the guarantee by EHA of the repayment of the tenant security deposits. Tr. pp. 230-231, 262-263, 266-267. He did not wait to assure that the bond had been issued before he authorized the transfer and, in fact, the bond was never issued. Approximately nine months after he authorized the transfer, he learned that a bond had not, in fact, been issued. In March 1988 he restored the full amount necessary to fund the tenant security escrow account. Govt. Exs. 4, p. 17, 37 p. 14..

18. During the course of a later audit of the Project, the HUD Office of Inspector General ("OIG") learned of these withdrawals from a 1987 Financial Statement and Auditors Report, dated May 12, 1988, prepared by EHA's own accounting firm. This report disclosed that the security deposit liability was unfunded as of December 31, 1987, but was subsequently funded in March 1988. Tr. p. 138, Govt. Ex. 4, p. 17.

19. From January 1985, through December 1987, JWB & Co. paid the monthly payroll and other costs for Project personnel by loaning its own funds. Stip. 18. In other words, Mr. Blumenfeld, through JWB & Co., regularly financed the cash requirements of the Project. The Project, in turn, regularly repaid his loans through payments to JWB &

Co., and Deptford Investment Corp. to the extent permitted by Project rental income. Stip. 17-21; Sec. Ex. 9; Res. Exs. 7, 27; Tr. pp. 233-234, 244-245.

20. During the period from October 1, 1985, through December 1987, JWB & Co. loaned the Project $720,100 for "operating expenses other than payroll." During the same period, loans for payroll totaled $1,034,961. Repayments to Mr. Blumenfeld totaled $2,542,000. Stips. 19, 20; Res. Ex. 27.

Regulatory Agreement and Handbook Requirements[5]

21. The Regulatory Agreement precludes the pay-out of project funds to an owner, or the receipt or retention of project funds by an owner except from "surplus cash." The one exception to this rule permits a pay-out for "reasonable operating expenses." Govt. Ex. 1 (Regulatory Agreement), § 6 (b), (e). The term "reasonable operating expenses" is not defined in the Regulatory Agreement.

22. Section 6 (e) prohibits "distributions" to the owners after a default under a regulatory agreement, note, or mortgage. Distributions are defined as the withdrawal or taking of project cash or assets. Like Section 6 (b), this definition also excepts payments for "reasonable expenses incident to the operation and maintenance of the project." Govt. Ex. 1, § 13 (g).

23. Section 6 (g) of the Regulatory Agreement requires that funds collected as security deposits be kept separate and apart from other funds of the project in a trust account that is at all times required to equal or exceed the aggregate of all outstanding obligations under that account. Govt. Ex. 1 (Regulatory Agreement). The Pennsylvania Landlord and Tenant Act of 1951, P.S. Section 250.101, *et. seq.*, permits Pennsylvania landlords subject to the Act to obtain a guarantee bond to secure the return of such funds. 68 P.S. § 250.511c.

24. Section 12 of the Regulatory Agreement grants HUD a security interest in the rents, profits, income, and charges of the project. Permission is granted to the owner to collect and retain these rents, profits, income, and charges until a default is declared "under this agreement," after which this permission is terminated as to all rents due or collected after the default is declared. Govt. Ex. 1, § 12.

25. The term "default" is specifically defined in the Regulatory Agreement. It is a default declared by the Secretary when a violation of the Agreement is not corrected to

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[5]Relevant portions of the Regulations, Regulatory Agreement and Handbook are set out in the Appendix.

his satisfaction within the time allowed by the Agreement or within such further time as the Secretary permits after written notice. Govt. Ex. 1, § 13 (h).[6]

26. Section 11 of the Regulatory Agreement sets forth the procedure by which the Secretary gives written notice of a violation of the agreement prior to declaring a default. It further provides that, upon the declaration of a default, the Secretary may collect all rents and charges of the project and use them to pay the owner's obligations under the Agreement, Note and Mortgage. Govt. Ex. 1, § 11.

27. HUD Handbook 4370.2 is dated April 1, 1981. It replaces earlier "instructions"; "applies to multifamily rental projects under a . . . regulatory agreement permitting HUD to exercise control over project administration"; and is "for the use of mortgagors and their employees." It does not purport to supersede existing regulatory agreements or govern their terms in case of a conflict. Res. Ex. 5.

28. Section 8 of the Handbook provides that if a project is delinquent under the mortgage, loans and advances made by the owner to meet reasonable and necessary operating expenses may not be repaid from project funds without written approval from HUD. However, it also states that such loans and advances are not "distributions" if they are "authorized." Res. Ex. 5.

HUD's Involvement

29. Responsibility for oversight of HUD insured multi-family projects, including the enforcement of regulatory agreements, rests with the Multi-family Loan Management Branch of HUD's Philadelphia Regional Office. Tr. p. 36. The Multi-family Loan Management Branch is a component of the Loan Management Branch which, in turn, is a component of the Housing Management Division of the Office of Housing.

30. The Branch oversees compliance by reviewing certified annual financial statements submitted by project owners, monthly accounting reports submitted by project owners when required by HUD, and audits conducted by the Office of Inspector General ("OIG"). It also conducts on-site physical inspections of the property. Tr. pp. 36-37.

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[6]Because "default" is specifically defined in the agreement in this limited way, it does not have the same meaning as "default" under the note or mortgage for failure to make payments when due. This reading is clearly manifested by comparing Sections 6 (e)(2) and Section 12. The former section speaks to defaults under this "Agreement, or under the note or mortgage." This language specifically recognizes multiple types of defaults and makes them all subject to its requirements. The latter section speaks to a uniquely defined default declared by the Secretary under the agreement (pursuant to Sections 11 and 13 (h)). The Secretary declared such a default in November 1987. Govt. Ex. 7.

31. The persons in the Multi-family Loan Management Branch responsible for insuring compliance with HUD regulations are the Branch Chief and the loan servicers under his or her supervision. Loan servicers are responsible for monitoring the operation, management, and financial condition of the HUD insured multi-family projects. Their duties include analyzing monthly accounting reports, and communicating problems arising from their analyses to project owners. At any given time only one loan servicer is assigned to a project. Each loan servicer has approximately 50-80 loans in his or her portfolio. Tr. pp. 37-38.[7]

32. Monthly accounting reports from a project are required by HUD if the project is experiencing financial difficulties, or if the project has not attained full occupancy. Stip. 24. Because EHA had not attained full occupancy, HUD began requiring these reports in April 1984. Stip. 25.

33. Monthly reports from EHA for the period April 1984 through December 1984 were not received by HUD until some time after January 1985. Stip. 28.

34. By letter dated June 18, 1985, [redacted] Russell, Chief, Loan Management Branch, HUD acknowledged receipt of the monthly accounting reports for the period April 1984 to December 1984, and requested Mr. Blumenfeld to provide certain additional information and clarification. Specifically, he was asked to explain and/or correct a disbursement labeled "Return to Owner." The letter was prepared for Mr. Russell's signature by loan servicers, Johnson and Walsh. Stip. 29.

35. Sometime in June 1985, Ms. Johnson met with [redacted] McAleer, the Controller for EHA, and [redacted] Rabinowitz, Financial Vice President and Chief Financial Officer of EHA. The purpose of the meeting was to discuss Ms. Johnson's questions regarding EHA's monthly accounting reports. They all agreed on a format to be used by EHA in reporting advances and other activity in the owner's account. EHA thereafter used this format for its monthly reports. Tr. pp. 196-197, 206, 215-217.

36. The monthly accounting reports submitted by EHA for the period January 1985 through July 1985 are all dated August 15, 1985, and were sent to HUD by letter dated August 22, 1985. The monthly accounting report for August 1985 is dated September 24, 1985. Stips. 31, 32.

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[7] [redacted] Johnson was the loan servicer assigned to the Project until July 1985, when she was succeeded by [redacted] Walsh. Stip. 27. From 1985 to 1987, the Chief of the Multi-family Loan Management Branch was [redacted] Peruto. Tr. pp. 296-297. [redacted] Russell was Chief of the Loan Management Branch until January 1988. Res. Ex. 37 (Deposition of [redacted] Russell), p. 5. He was succeeded by [redacted] Langston in April 1988. Res. Ex. 39 (Deposition of [redacted] Langston), p. 7. Since 1985 J[redacted] Wolf has been the Director of Housing Management. Tr. p. 332.

EHA's Default

37. EHA failed to make the September 1, 1985, payment on the Note before 30 days after the due date. GNMA mailed a "Notice of Default Status" to EHA dated October 15, 1985. Stip. 11, 12.

38. Under the terms of the Mortgage, the failure of EHA to pay any installment of principal and interest within thirty days after the due date constitutes a default. Under the Note, such a default automatically entitles the mortgagee to declare the entire unpaid principal due and payable. Stip. 10.

39. Beginning in October 1985, Representatives of EHA, including Mr. Feingold and Mr. Rabinowitz attended meetings with HUD representatives in an effort to negotiate a workout agreement. Tr. pp. 219-223, 306-307, 314-316, 337-338; Res. Ex. 18.

40. EHA made payments totalling approximately $600,000 on its mortgage debt during 1985 and 1986. It made no payments on its debt in 1987 or 1988. Stip. 13.

41. The monthly accounting reports for the period January 1986, through June 1986, were sent to HUD by letter dated July 24, 1986.

42. EHA submitted its reports for the period August 1986 through February 1987 to HUD sometime between December 1986 and May 26, 1987. The monthly report for March 1987 was sent to HUD by letter dated November 30, 1987. It submitted monthly reports for the period April 1987 through October 1987 to HUD by letter dated November 30, 1987. Stips. 38, 39.

43. The purpose of HUD's review of the reports is to insure that no improper expenditures are made. If a loan servicer had questions about an owner's practices, the standard practice in the Philadelphia Regional Office was to write a letter, over the signature of Mr. Russell or Mr. Langston, to the project owner inquiring about the questionable item and requesting an explanation. If not satisfied with the explanation the project owner would be notified and requested to furnish additional information. If HUD were satisfied with the explanation, there normally would be no further correspondence. If not satisfied, HUD would request additional information or would request repayment. HUD normally would take these actions within two to three weeks after it was indicated. Tr. pp. 67-70, 277-279, 280.

44. EHA disclosed the advances made to the project and the repayment of such advances in its monthly reports. Res. Ex. 7 As a result, upon receipt of these reports, HUD was aware of the existence of both advances and repayments. Tr. pp. 313, 317-318, 323-325, 327, 333.

45. A default was declared by the Secretary pursuant to Section 11 of the Regulatory Agreement on November 4, 1987. Govt. Ex. 7. At no time prior to the issuance of draft audit findings ("Draft Findings") by the HUD OIG on September 28, 1988, did HUD give any written notice to EHA that the reimbursement of advances to the owners constituted a violation of the Regulatory Agreement. Tr. pp. 170-171, 327-329; Res. Ex. 28. A copy of HUD's Draft Findings was sent to EHA on or about September 28, 1988. Not until October 1988, when the OIG issued its Final Findings, did HUD seek repayment of prior advances for operating expenses from EHA. Govt. Ex. 37, Tr. p. 314.

46. Mr. McAleer and Mr. Rabinowitz had a copy of Handbook 4370.2 in 1985 when they changed their format for monthly reports. Because they had jointly developed their reports with the Loan Management Branch, they believed their monthly reporting format was in accordance with the Handbook. Tr. pp. 205-206.

47. It is HUD policy to encourage owner advances to HUD-insured projects. Such advances benefit HUD by protecting the HUD insurance fund. Tr. pp. 317-318; Res. Ex. 34 (Deposition of [redacted]. Shick), pp. 11-14, 18.

The OIG Audit

48. HUD's OIG initiated an audit of the Project in 1987. The OIG Draft Findings conclude that, in violation of the Regulatory Agreement, the Project owners withdrew $1,507,939 from the project while the project was in default, and recommended that the owners reimburse the project in this amount. OIG calculated that a gross amount of $2,542,900 was withdrawn from the project from October 1, 1985, (the date of EHA's default on the note) through January 31, 1988, but gave credit for $1,034,961 paid by JWB & Co. for project payroll. Although $720,000 in partner advances were also made during this period, the Draft Findings do not credit the owners for these advances in determining the amount to be reimbursed. Tr. pp. 96-97, 118, 122-124; Res. Ex. 28.

49. In its October 28, 1988, final report ("Final Findings") the OIG reversed its finding that credited the owners for the $1,034,961 for payroll expenses, stating that "the owners withdrew $2,542,900 from the project while the mortgage was in default, contrary to the regulatory agreement." Govt. Ex. 37. (Finding 1)

50. The Final Findings further conclude that the owners used project funds to pay unnecessary and unsupported costs in the amount of $209,047 and violated the Regulatory Agreement by removing tenant security deposits. Govt. Ex. 37 (Findings 2, 4).

51. The OIG recommended that the improper disbursements be repaid. By letters dated September 30, 1988, and October 24, 1988, EHA offered to pay $708,938 in order to resolve findings 1 and 2 of the Draft Findings. HUD rejected this offer. Govt.

Ex. 37, Atch. C; Tr. pp. 171-173.

EHA's Bankruptcy

52. On January 22, 1988, EHA filed a voluntary petition for reorganization under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Pennsylvania. On May 16, 1988, the Secretary of HUD filed a proof of claim for $23,177,215.57. The actual amount of HUD's adjusted secured claim was $22,564,947.64. Among the documents attached to the Proof of Claim were the Note, Mortgage, and the Regulatory Agreement. Stips. 40, 41.

53. The Bankruptcy Court ultimately valued the Project at $12,900,000 and "crammed down" the value of the Secretary's secured claim to $13,800,000, representing the sum of the value of the Project plus $900,000 in project rents. Stip. 42.

54. On January 17, 1990, the bankruptcy judge approved a Plan of Reorganization ("the Plan") filed by EHA. The Plan requires EHA to pay HUD $128,105 per month until HUD receives the full amount of its allowed secured claim. EHA has paid these monthly installments since April 1990. Stips. 43-45.

Mitigating Factors

55. Mr. Blumenfeld is an experienced developer who has successfully developed 25 to 30 real estate projects including numerous single-family houses financed with FHA insurance, and three multi-family insured projects. One of these, the 1500 Locust Project, was completed in 1973 and was paid off early. Tr. pp. 150-152, 239. There is no evidence of any impropriety in his prior dealings with HUD.

56. Mr. Blumenfeld is no longer personally involved in the management of Executive House. He is no longer a shareholder, officer, or director of Deptford. Tr. pp. 167-169.

57. EHA presently owes Mr. Blumenfeld in excess of $6 million for unpaid loans and deferred management fees. Mr. Blumenfeld is involved in a personal bankruptcy proceeding. Tr. pp. 173-174.

58. Mr. Blumenfeld attempted to keep Executive House going by refinancing the 1500 Locust Project. A previous participation clearance from HUD is required before the refinancing can occur. *See* 24 C.F.R. § 200.210 *et seq.* As of July 3, 1990, HUD had not acted upon on the requested clearance. Res. Ex. 8.

59. Upon learning that no guarantee bond had been issued, Mr. Blumenfeld ordered the tenant security fund replaced.

60. Mr. Feingold never had a controlling interest as a general partner of EHA, nor was he an officer of Deptford. He did not authorize or approve any of the disbursements of project funds or the transfer of tenant security deposits. None of the disbursements made by EHA were paid to or received by him. He relinquished his partnership in EHA effective December 31, 1988. Tr. p. 16.

61. The Project is now operating successfully at a sustaining level of occupancy. EHA has made all payments to HUD required by the bankruptcy plan.

Discussion

I. Principals, Participants, and Affiliates

HUD's debarment regulations "apply to all persons who have participated, are currently participating or may reasonably be expected to participate in transactions under Federal nonprocurement programs." 24 C.F. R. § 24.110 (a).

As Mr. Blumenfeld and Mr. Feingold were owners, officers and partners of EHA and EHMC, they were also "principals"[8] during the key events which transpired in this case. Respondents do not dispute Mr. Blumenfeld's status as a principal; however, they claim that Mr. Feingold's role in these events was too limited to make him subject to debarment. I disagree. Mr. Feingold not only shared in the ownership, but he also served as a key employee of both EHA and EHMC. He stated during a deposition that he was responsible for the "administrative management functions" of EHMC. These included the "entire scope of the management process, rentals, advertising, marketing, management, [and] personnel." Govt. Ex. 45 (Deposition of Alan Feingold), p. 20. Correspondence and billings from the law firm relating to the improper use of Project funds for the preparation of a solicitation for additional capital were addressed to him. Sec. Exs. 15-17. After the default, he participated in the workout negotiations and, in this capacity, became aware of HUD's belated concerns about project funds being improperly diverted. Govt. Ex. 45 (Deposition of Alan Feingold), p. 7, 15, 20; Tr. p. 313, 317-318, 322, 325, 327, 333, 346. 24 C.F.R. § 24.105 (p).

The record establishes that EHA, EHMC, Mr. Blumenfeld, and Mr. Feingold also fall within the definition of "participant." EHA and Mr. Blumenfeld entered into a "primary covered transaction" by executing the Regulatory Agreement. As a general partner of EHA and Vice-President of EHMC, Mr. Feingold entered into a "lower tier covered transaction" when he executed the Executive House Management Plan and Housing Management Agreement on March 12, 1985. Govt. Exs. 5, 6. The Management Agreement is a procurement contract for services between a "participant"

[8]Definitions of "principal," "participant," "covered transaction," and "affiliate" are set forth in the appendix.

(EHA) and persons who are also project owners (Mr. Blumenfeld and Mr. Feingold); hence, it is a "lower tier covered transaction." 24 C.F.R. Sec. 24.110 (a) (ii) (c). The Executive House Management Plan signed by Mr. Feingold on behalf of EHMC also reflects that he could "reasonably be expected to enter into a covered transaction." 24 C.F.R. § 24.105 (m). It states that "Executive House Management Corp. is under the control of the General Partners of Executive House Limited Partnership, Jack W. Blumenfeld and Alan Feingold." Govt. Ex. 5. Finally, he is a "participant" because he was "authorized to commit a participant (EHA) in a covered transaction as an agent or representative of another participant (EHMC)." 24 C.F.R. § 24.105 (m); Govt. Ex. 6.

Because Mr. Blumenfeld controlled JWB & Co., it is his affiliate. 24 C.F.R. § 105 (b). However, the record is insufficient to establish what persons or entities actually controlled Deptford at the time of these events. Accordingly, the record fails to establish that Deptford is an affiliate of any of the Respondents.

II. Regulatory Agreement and Program Violations

A. Use of Project Funds for Other than Ordinary Expenses After Default

The record establishes that after a default had occurred under the Note and Mortgage, EHA paid: 1) $112,183 out of project funds for construction costs; 2) $68,275 for legal fees unrelated to day-to-day project operations, including $50,000 to pursue the Chapter 11 bankruptcy action and to prevent a foreclosure by HUD, $15,725 to prepare a letter to solicit capital contributions from the limited partners, and $2,550 to review and interpret the partnership agreement; and 3) $250 for a political contribution.[9] These expenditures violate Section 6 (b) of the Regulatory Agreement which prohibits the pay-out of any funds after a default *except for reasonable operating expenses and necessary repairs.* Respondent has failed to demonstrate that these expenditures were for reasonable operating expenses.

"Operating expenses" are "expenses paid or incurred in connection with the actual operation. . .as a going concern." They are to be distinguished from "capital expenditures" which promote the interests and expectations of the partners. *United States v. Thompson*, 272 F. Supp. 774, 787 (E.D. Ark. 1967), *aff'd.* 408 F.2d 1075 (8th Cir. 1969).

Construction costs are capital expenditures, not "operating expenses." *Id*; *In re EES Lambert Associates*, 43 B.R. 689, 691 (Bkrtcy. N.D. Ill. 1984), *aff'd.*, 63 B.R. 174 (N.D. Ill. 1986). Similarly, legal fees not associated with the day-to-day operation of the project are not "operating expenses." Respondents' legal expenses related to instituting

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[9]The Department waived its claim to other expenditures by EHA which were deemed to be improper by OIG. These were funds expended for marketing services ($26,758), interest costs ($1,581), small appliances ($1,726), and tenant parties ($4,139). Govt. Ex. 37 pp. 8-9; Tr. p. 133.

a bankruptcy action and preventing foreclosure. They did not arise from day-to-day operations and they were incurred to benefit the partners rather than to protect the Government's security interest. *United States v. Frank,* 587 F. 2d 924 (8th Cir. 1978); *In re Garden Associates, supra; In re EES Lambert, supra.* The legal expenses which Respondents incurred for the review of the partnership agreement were also unrelated to the day-to-day operations of Executive House and were undertaken for the benefit of the partners, not the Government. Finally, political contributions do not relate to the day-to-day operating expenses of a project, nor are they made to protect the Government's security interest.

B. Withdrawal of Tenant Security Deposits

The record establishes that Mr. Blumenfeld authorized the withdrawal of funds from the tenant security account. Funds were withdrawn on six occasions, beginning on June 18, 1987, and ending on September 28, 1987. The proceeds funded Mr. Blumenfeld's "other business interests." Tr. p. 232. Mr. Blumenfeld believed that he was permitted to withdraw the funds secured by a bond, and that such a withdrawal is authorized by Pennsylvania law.[10] After learning that the bond had not been issued, he ordered the replacement of the funds. The funds were replaced prior to the initiation of the OIG investigation.

Having observed his demeanor, I credit Mr. Blumenfeld's testimony that, 1) following a telephone conversation with a bonding company agent, he thought he had received a commitment to issue a bond, and 2) upon learning that the bond had not been issued, he ordered the funds to be replaced. Although the withdrawals began in June 1987, and the funds were not replaced until "very early in 1988," there is no evidence that Mr. Blumenfeld knew that the bond had not been issued until the latter date. His testimony is supported by his undisputed claim that he previously obtained HUD's permission to remove the tenant funds after obtaining a guarantee bond in connection with another HUD-insured project. Tr. pp. 230-231, 262-263.

Mr. Blumenfeld's testimony does not excuse Respondents' removal of the funds in the tenant security escrow account. Mr. Blumenfeld acted improperly when he

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[10]The applicable Pennsylvania statute provides:

> Every landlord subject to the provisions of this act may, in lieu of depositing escrow funds, guarantee that any escrow funds, less cost of necessary repairs, including interest thereon, shall be returned to the tenant upon termination of the lease, or on surrender and acceptance of the leasehold premises. The guarantee of repayment of said escrow funds shall be secured by a good and sufficient guarantee bond issued by bonding company authorized to do business in Pennsylvania.

68 P.S. § 250.511c.

authorized the removal of funds from the Project trust account without first assuring himself that a bond had been, in fact, obtained. Respondents' responsibility to maintain and protect the tenant security account is fiduciary. This is made clear by the language of Section 6 (g) of the Regulatory Agreement which requires that the deposits be kept separate from other funds and that they shall *at all times* equal or exceed the aggregate of all outstanding obligations. Removal of $118,000 from the trust account, even for a limited period, risked the safety of those funds by exposing them to attachment to satisfy debts of the Project owners. *Housing Resources Management, Inc.*, HUDBCA No. 90-5241-D19 (October 18, 1990). Mr. Blumenfeld's belief that a security bond had been obtained at the time he authorized release of the funds does not relieve him or the other Respondents of their fiduciary responsibility to protect the funds. Accordingly, even though the funds were subsequently replaced, Respondents' removal of the tenant security deposits violated Section 6 (g) of the Regulatory Agreement.[11]

C. Recoupment of Owner Advances

The parties have stipulated that Mr. Blumenfeld's contributions were for payroll ($1,034,961) and operating expenses other than payroll ($720,000). Stip. No. 20. In the interest of economy, Respondents paid the operating expenses for this and other projects through JWB & Co. After funds were loaned by Mr. Blumenfeld through JWB & Co., operating expenses were reimbursed by EHA and returned by JWB & Co. to Mr. Blumenfeld. This was done on an ongoing basis. There is no evidence that these pay-outs to Mr. Blumenfeld were for anything other than reimbursements of operating expenses, or that these operating expenses were unreasonable.

The Department grounds its claim that the owners improperly recouped advances upon two theories: first, that without the written consent of HUD, Sections 6 (b) and (e) of the Regulatory Agreement prohibit the disbursement of any project funds while the mortgage is in default; and second, that project funds were disbursed in derogation of HUD's security interest, in violation of Section 12 of the Regulatory Agreement.

Respondents contend that Section 6 (b) and (e) of the Regulatory Agreement permits repayments to the owners because the repayments constitute a reimbursement for loans made to finance ordinary Project operating expenses on an ongoing basis. They also assert that the Regulatory Agreement does not prohibit EHA's practice of paying the operating expenses of the project "indirectly" by reimbursing the owner who advanced the funds in the first instance. Corrected Memorandum of Law, p. 9. They further assert that Section 12 of the Regulatory Agreement does not apply since no default was ever declared by the Secretary as required by Sections 11 and 12.

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[11]Respondents acknowledge that Mr. Blumenfeld's authorization and the subsequent transfer of funds resulted in a "temporary" violation of the Regulatory Agreement. They contend that the violation was not willful or sufficiently serious to affect the integrity of HUD programs. Res. Reply Memorandum, pp. 9-10.

Section 6 (b) of the Regulatory Agreement prohibits payments to owners without the written permission of the Secretary unless there is "surplus cash"[12] or the money is for operating expenses or necessary repairs. Section 6 (e) prohibits the making of any "distribution" of assets without the written permission of the Secretary except from surplus cash. A "distribution" includes payments to the owners. However, payments for operating expenses and necessary repairs are not distributions. Read together, these provisions prohibit the removal of funds by the owners without the written permission of the HUD Secretary for any purpose other than the ongoing operation of the project. Since the Project was in default, and the owners removed funds without written permission of the Secretary of HUD, the only question presented is whether the Regulatory Agreement permitted the repayments to the owners because they were originally for operating expenses and necessary repairs. I conclude that, despite the fact that the funds withdrawn were repayments of loans made by the owner to the project for ongoing expenses, the owner repayments were not transformed into payments for ordinary expenses or necessary repairs. Accordingly, their removal violated Section 6 of the Regulatory Agreement.

Project income belongs to the United States after a default. *United States v. American Nat. Bank & Trust Co.*, 573 F. Supp. 1319, 1323 (1983). It is "[t]he federal policy to protect the treasury and to promote the security of federal investment which in turn promotes the prime purpose of the [National Housing] Act - to facilitate the building of homes by the use of federal credit." *United States v. Stadium Apts., Inc.*, 425 F.2d 358, 363 (9th Cir. 1970), *cert. den.*, 400 U.S. 926 (1970) *quoting United States v. View Crest Garden Apts., Inc*, 268 F.2d 380, 383, (9th Cir. 1959). Owner-creditors are uniquely able to use their position to remove project funds belonging to the United States. Section 6 of the Regulatory Agreement is intended to prevent the depletion of these project funds by project owners. Construing the same provisions as are found in the instant Regulatory Agreement, the United States Court of Appeals for the Eighth Circuit, stated:

> Neither the payment for attorneys' fees incurred in the acquisition of the project nor the repayment of the bank loan, the proceeds of which were used to equip and furnish part of the premises for a private club, *nor the withdrawal of funds to reimburse any of the partners for prior advances to the operating account constituted payment of reasonable expenses incidental to the operation and maintenance of the project.* To interpret the language of the regulatory agreement to validate these withdrawals would deny the claim of the party having security in the assets of the project in favor of defaulting entrepreneurs who happened to have immediate control over the checkbook.

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[12]A project in default has no "surplus cash." *In re Garden Manor Associates*, 70 B.R. 477, 480 (Bkrtcy. N.D. Cal. 1987).

United States v. Thompson, 408 F.2d 1075, 1080-1081 (8th Cir. 1969) (emphasis added).

Respondents' contend that the ongoing nature of these payments and repayments is distinguishable from the situation in *Thompson*, where owners took their repayment in a lump sum in order to prevent personal loss. That distinction is meritless. It makes no difference whether removal of project funds occurs all at once or over a period of time, since both methods result in the depletion of funds belonging to the United States. Also without merit is Respondents' second contention that the Regulatory Agreement, while prohibiting direct payments to the owner, permits the indirect method of reimbursing the owner through an intermediary corporation. Whether direct or indirect, both repayment methods result in the owner obtaining money belonging to the United States out of project funds without the approval of the Secretary of HUD.

The Department failed to establish a violation under its theory that project funds were disbursed in derogation of HUD's security interest. While HUD has a security interest in the property irrespective of default, Section 12 grants project owners permission to continue collecting and retaining rents until a default is declared. Sections 11, 12 and 13 (h) of the Regulatory Agreement require that the Secretary affirmatively declare a default for failure to adhere the terms of the Regulatory Agreement before this permission is terminated. The term "default" under these sections does not have the same meaning as a failure to make a timely installment payment, its meaning under the Note and Mortgage.[13] HUD did not terminate this permission until November 4, 1987,[14] when it declared a default under this Section. Accordingly, the Department has failed to demonstrate that Respondents removal of accumulated rentals to repay advances for operating expenses before November 4, 1987, violated Section 12 of the Regulatory Agreement.

III. Grounds for Debarment

Respondents' use of project funds after default for repayment of construction loans, attorneys' fees unrelated to day-to-day-operations, and political contributions was negligent, if not wilful. The case law cited above interpreting the same regulatory agreement language clearly establishes the impropriety of such payments. Accordingly,

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[13]HUD also argues that a default as defined in Section 13 (h) of the Regulatory Agreement is incorporated within the meaning of the terms of the Note and the Mortgage. While HUD points to the language of Section 6 (e) (2) of the Regulatory Agreement as incorporating the meaning of default in all three documents, that is, the Note, the Mortgage, and the Regulatory Agreement, the Department has not identified language in either the Note or the Mortgage that incorporates the default definition set forth in Section 13 (h) of the Regulatory Agreement.

[14]*Cf. In the Matter of Steve Vogds, Robert J. Werra, Westgreen Associates LTD., and American Republic Realty Corporation, a/k/a Amrecorp*, HUDALJ 90-1484-DB(LDP), February 8, 1991, holding that removal of owner advances violated Section 12 of the regulatory agreement. However, the issue of whether a default was declared under that section was not litigated.

these disbursements were made in disregard of clearly articulated requirements set forth in the case law cited above or, viewed in the most favorable light, without research or inquiry. The large amounts expended for these improper purposes seriously depleted the funds available to the project and, ultimately, increased the amount of HUD's loss. Respondents' 1) disregard of the requirements of the Regulatory Agreement; and 2) the effect of these actions to increase HUD's potential financial loss; are sufficiently serious to affect Respondents' present responsibility. 24 C.F.R. § 24.305 (d).

Mr. Blumenfeld's reliance on a bonding company agent's verbal commitment in a phone conversation exposed $180,000 belonging to others to the risk of attachment by creditors. A fiduciary responsibility for the money of other people is synonymous with a high duty of care. His authorization of the removal of funds without waiting for the issuance of the bond was either grossly negligent or reckless, and thereby constituted a wilful violation of a public agreement or transaction so serious as to affect the integrity of a HUD program. 24 C.F.R. § 24.305 (b) (3). The disregard of the requirements of the Regulatory Agreement, is also sufficiently serious to affect Respondents' present responsibility. 24 C.F.R. § 24.305 (d).

Both the improper use of project funds and the removal of the tenant security account constitute material violations of two program requirements applicable to a public agreement or transaction involving insurance. 24 C.F.R. § 24.305 (f).[15] These program requirements are found in the Regulatory Agreement itself. They are: 1) the preclusion by Section 6 (b) of the Regulatory agreement of the improper expenditure of project funds after a default, and 2) the Section 6 (g) fiduciary responsibility of the owners to protect the tenant security account.

The transfer to the owners of approximately $2.5 million out of the project for other than ordinary expenses, constituted a material violation of a program requirement applicable to a public agreement or transaction. 24 C.F.R. § 24.305 (f). Section 6 of the Regulatory Agreement sets forth a requirement that, after a default, project funds belonging to HUD may not be recouped without HUD's written authorization. Respondent violated this requirement and, accordingly, the transfer to the owners is cause for debarment under 24 C.F.R. § 24.305 (f).

HUD has not demonstrated that Respondents' refusal to repay the improper disbursements and advances is a wilful violation under 24 C.F.R. § 305 (b) (3). HUD's demand that Respondents repay the disbursements was made well after Respondents filed for bankruptcy. In October 1988 Respondents offered to pay HUD $708,938 to resolve Audit Findings 1 and 2. This offer was rejected by HUD. Implicit in Respondent's offer of a lesser amount than that demanded by HUD, is a refusal to

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[15]Cause for debarment under this section depends upon the existence of a program requirement because there is no charge that statutory or regulatory prohibitions were violated.

replace the amount improperly taken out of the project. The record is insufficient to establish whether Respondents had sufficient assets to satisfy HUD's demand at the time it was made. However, Respondents' refusal to satisfy HUD's repayment demand, whether or not wilful, constitutes an additional violation of the Regulatory Agreement and cause for debarment under 24 C.F.R. Sections 24.305 (d) and (f).

Mitigation

The events which gave rise to this case took place between four and seven years ago. Mr. Blumenfeld is no longer involved in the management of EHA and is in a personal bankruptcy proceeding. He has no history of prior problems in his past dealings with HUD. The record reflects that he strove to keep Executive House going despite its occupancy problems. The Project is currently operating successfully with EHA making the payments required of it by the approved bankruptcy plan.

Although Respondents violated Sections 6 (b) and (e) of the Regulatory Agreement by repaying owner project loans out of project funds, this violation is mitigated by the actions of HUD. The record establishes that after the project's default the HUD Philadelphia Regional Office was aware that Mr. Blumenfeld was loaning funds to the project for operating expenses and that EHA was repaying him. Despite having this knowledge, the responsible HUD office took no action to curtail the repayments to Mr. Blumenfeld following the Project's default in October 1985. As a result of HUD's actions, Respondents were led to believe that HUD had given its permission for the practice to continue.

In June 1985 employees of both HUD and Respondents met and agreed upon the contents of EHA's monthly reports.[16] In accordance with their agreement, Respondents' monthly accounting reports showed total monthly and cumulative amounts

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[16]In its Post-hearing Brief HUD claims for the first time Respondents "attempted to conceal" the owner repayments from HUD in June and July of 1985. The unstated inference to be drawn from this claim is that Respondents thereby caused HUD to remain in ignorance that Mr. Blumenfeld was being reimbursed. Govt. Post-hearing Brief, p. 10. On July 25, 1985, Mr. McAleer responding to Ms. Johnson's June 18, 1985, inquiry concerning the designation "Return to Owner," wrote: "As discussed, the Return to Owner designation was to transfer funds from one account to another for the project." Res. Ex. 14. The record does not support HUD's belated claim that this letter was intended to mislead and its inference that it succeeded in doing so. First, Respondents' letter indicates that the designation was part of the understanding Respondents reached with HUD concerning the monthly reports. HUD never subsequently claimed that the designation "Return to Owner" had not been discussed at these June 1985 meetings. Second, the name of the account states exactly what it is. Respondents could not have reasonably believed they could conceal this obvious entry nor could HUD have been mislead by a letter which merely states that the account reflects the transfer of funds from one account to another. It was unnecessary for Respondents also to state the obvious by including the information that an account named "Return to Owner" was the designation given funds that were being returned to the Project owners. In addition, as discussed below, the record reflects that HUD had actual knowledge that repayments were being made to Mr. Blumenfeld and, accordingly, that it was not mislead by Respondents' letter.

designated as "Returns to Owner" in "Schedule C" (Schedule of Accounts Payable - Owner). EHA also modified Item No. 8 (b) of the cover/summary sheet of the monthly accounting reports entitled "Accounts Payable," which originally included categories (a) "Routine" and (b) "Flexible Subsidy/MIO Plan Items," to reflect instead the following categories: (a) "Routine," (b) "Owner," and (c) "Advance/Rents." Stip. 31; Res. Ex. 7.

These reports reflected that repayments to owners were being made by specifically describing these amounts as an item entitled "Return to owner."[17] HUD questioned these payments on August 26, 1986, when HUD first received the monthly reports reflecting the Project's condition after the default in October 1985.[18] HUD's letter, dated August 26, 1986, requested an explanation of a "variance" described as "Returns to Owner." Stips. 32-34, Res. Ex. 23. Respondents' September 16, 1986, reply to that letter clearly sets forth that the owner was making advances and taking repayment. Explaining the "variance" this letter states:

> [P]lease understand that the returns to owner as shown in our report simply represent transfers of cash from the managing agent to the owner. Please be advised that the payroll expense is incurred by the general partner. This amount is not shown as a cash disbursement but is brought into the report through the reconciliation of the accounts payable to the general partner. While you indicate that there was an excess of returns over advances of some $332,000 please be advised that in July, as you will notice in the report, the amount was reduced by over $164,000. In addition, during the first seven months of the year, (1986) the general partner contributed total payroll of $207,952.29.

Res. Ex 24.

Eight months passed. HUD sent a second letter, dated May 27, 1987, requesting further information from EHA. This letter inquired about the checks identified by the designation "Return to Owner" in the payee column of "Schedule B." HUD also requested a "separate list of all funds paid to the owner from the project, and a corresponding column of all advances made to the project from the owner," further

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[17]Schedule "C" of these reports lists the cash withdrawn either by the entry "Returns to Owner" or "Return to J.W.B." (Jack W. Blumenfeld).

[18]EHA did not submit its monthly reports covering the period August 1985 through November, 1985 until July or August 1986. Respondents are responsible for timely submitting these reports and are at fault for their unexplained failure to submit timely monthly reports. In April 1987, Mr. Wolf wrote Respondents stating, "As you are aware, you have not submitted any monthly accounting reports despite repeated requests." Govt. Ex. 45, (Deposition of Alan Feingold), pp. 42-44. I have concluded that the failure timely to submit these reports constitutes an additional ground for my conclusion that Respondents are not presently responsible. As discussed below, even after they were received, the reports did not cause HUD to change its practice of permitting the loans and repayments to continue.

stating that, "[t]his letter will enable our office to reconcile the correct status of advances." EHA did not submit a written response to this letter.[19] Stip. 37.

During the period from October 1985 to September 1988 when the HUD OIG issued its draft findings, HUD never directed Respondents to change their practice of making advances and taking repayments. Govt. Ex. 45 (Deposition of Alan Feingold), p. 65.[20]

Accordingly, the record establishes that Respondents' repayments to Mr. Blumenfeld were made in reliance upon an understanding that the loans for operating expenses made after the default for Project operating expenses could later lawfully be recouped. This understanding arose from HUD's inaction. Each time Mr. Blumenfeld made a loan to the project, he did so with the understanding, based on HUD's inactivity, that he could recapture his money. Had he been informed by HUD that withdrawal of these payments was improper, it is possible that he would have discontinued making both the loans and the repayments. There has been no showing why he would not have ceased making the withdrawals immediately.

Respondents' reliance on HUD's apparent approval was not unreasonable because they could believe, with some justification, that HUD was applying the Regulatory Agreement and the Handbook. Section 6 of the Regulatory Agreement does not explicitly state that repayments of owner loans for ordinary expenses made after a default may not be recouped. My conclusion that owners may not recapture their project loans after a default results from an interpretation of the language of the agreement in light of applicable case law. *Cf. In the Matter of Steve Vogds, Robert J. Werra, Westgreen Associates, LTD., and American Republic Realty Corporation, a/k/a Amrecorp*, HUDALJ 90-1483-DB(LDP), HUDALJ 90-1484-DB(LDP), February 8, 1991, p. 7. ("A reasonable expense does not become unreasonable simply by the passage of time.") Handbook 4370.2 is also ambiguous when applied to this situation. The Handbook goes further than Section 6 of the Regulatory Agreement because it requires

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[19]Like the failure to submit timely monthly reports, Respondents' unexplained failure to respond this letter constitutes an additional basis for my conclusion that Respondents are not presently responsible.

[20]Mr. [redacted] Peruto, the Chief of the Multi-family Loan Management Branch, and Mr. [redacted] Wolf, Director of Housing Management testified that during the course of at least two meetings, they told Mr. Rabinowitz, EHA's Chief Financial Officer and Mr. Feingold to tell Mr. Blumenfeld that the repayment of advances violated HUD requirements. Tr. pp. 313, 317-318, 323-325, 327, 333. Both Mr. Rabinowitz and Mr. Feingold deny that this topic came up at their various meetings. Mr. Feingold recalls having discussed the matter with Mr. Blumenfeld, but does not remember when. Govt. Ex. 45 (Deposition of Alan Feingold), pp. 32-33; Tr. p. 235. No record apparently exists of these conversations, nor is there evidence that HUD communicated its position directly to Mr. Blumenfeld. In view of this conflicting testimony, the lack of a memorandum or any record establishing if and when these purported conversations occurred, I conclude that a preponderance of evidence fails to establish that HUD informed Respondents that their course of conduct was in violation of the Regulatory Agreement prior to the issuance of the Draft OIG findings.

that written permission from HUD be obtained for the repayment owner advances made for operating expenses after a default. Govt. Ex. 5, ¶ 8 (c). The ambiguity results from Paragraph 8 (a) which declares that repayments of advances for ordinary expenses, *if authorized*, are not "distributions" and are not subject to the "surplus cash rules set forth in the regulatory agreement. . . ." In other words, according to the Handbook, "authorized" repayments are not prohibited by either Section 6 (b) or (e) of the Regulatory Agreement. The Handbook does not define the term "authorized." Nothing states that it means "written approval of the Secretary," nor does any language compel that particular reading. The term may also be construed broadly to include approval of the ongoing advances and repayments which Respondents made in this case and which HUD approved by virtue of it acceptance of Respondents' practices.

Conclusion and Order

The Department proved that Respondents violated Sections 6 (b) and (g) of the Regulatory Agreement by making improper disbursements and removing tenant security deposits. These actions constitute cause for debarment under 24 C.F.R. Section 24.305, (d) and (f). The removal of the tenant security deposits is also cause for debarment under Section 24.305 (b) (3). HUD proved that Respondents violated Sections 6 (b) and (e) of the Regulatory Agreement by repaying themselves for advances made for ordinary expenses. Accordingly, the repayments are cause for debarment under Section 24.305 (f). Finally, HUD demonstrated that Respondents' failure to repay the amount improperly dispersed constitutes an additional violation of the Regulatory Agreement and cause for debarment under 24 C.F.R. Sections 24.305 (d) and (f).

The existence of a cause for debarment does not necessarily require that a respondent be debarred. HUD must also determine whether debarment is necessary to protect the public interest. *See* 24 C.F.R. §§ 24.115 (a), (b) and (d). The debarment process is not intended as a punishment, rather, it protects governmental interests not safeguarded by other laws. *Joseph Constr. Co. v. Veterans Admin.*, 595 F. Supp. 448, 452 (N.D. Ill. 1984). These governmental and public interests are safeguarded by precluding persons who are not "responsible" from conducting business with the Federal Government. *See* 24 C.F.R. § 24.115 (a). *See also Agan v. Pierce*, 576 F. Supp. 257 (N.D. Ga. 1983); *Stanko Packing Co., Inc. v. Bergland*, 489 F. Supp. 947, 948-49 (D.D.C. 1980).

"Responsibility" is a term of art which encompasses business integrity and honesty. *See* 24 C.F.R. § 24.305; *Gonzalez v. Freeman*, 334 F.2d 570, 573 & n.4, 576-77 (D.C. Cir. 1964). Determining "responsibility" requires an assessment of the current risk that the government will be injured in the future by doing business with a respondent. *See Shane Meat Co., Inc. v. U.S. Dep't of Defense*, 800 F.2d 334, 338 (3d Cir. 1986).

That assessment may be based on past acts. *See Agan v. Pierce*, 576 F. Supp. at 261; *Delta Rocky Mountain Petroleum, Inc. v. U.S. Dep't of Defense*, 726 F. Supp. 278 (D.Colo. 1989).

This case presents significant mitigating factors. While the owner repayments constitute cause for debarment under 24 C.F.R. Section 24.305 (f), Respondents' recapture of its loans to the project is mitigated by HUD's tacit permission. Also significant are the lengthy passage of time since these events; the current successful operation of the Project, Respondents' successful past course of dealings with HUD; their willingness to work out a settlement; and the nature of these acts evidencing carelessness, inattention, and inefficiency rather than flagrant and intentional disregard of HUD's rules. Despite these mitigating factors, I conclude that Respondents' continued dealings with HUD pose a present risk to the Federal Government. Because of their improper disbursements Respondents were solely responsible for the loss of $180,708 belonging to the United States. Respondents' conduct also indicates a degree of corporate carelessness or inefficiency incompatible with that degree of care and efficiency necessary for those responsible for public funds. I conclude that a debarment of one year will afford Respondents an opportunity to demonstrate to HUD that they have instituted sufficient corrective actions to preclude a recurrence of similar violations. *Robinson v. Cheney*, 876 F.2d 152, 160 (D.C. Cir. 1989). In view of the mitigating factors described above, I further conclude that a debarment for the three year period proposed by the Department would be punitive. 24 C.F.R. §. 115 (b).

Accordingly, upon consideration of the public interest and the entire record in this matter, I conclude and determine that good cause exists to debar Respondents Jack W. Blumenfeld, Executive House Associates, Executive House Management Corp., and affiliate Jack W. Blumenfeld from further participation in primary and lower tier covered transactions as either a participant or principal at HUD and throughout the Executive Branch of the Federal government, and from participating in procurement contracts with HUD for a period of one year, until August 28, 1993.

Although Mr. Feingold did not authorize the withdrawals of advances, did not receive repayments of the advances, and did not play a role in the removal of the tenant security funds, the record establishes that he was directly involved in the management of EHMC and, in that capacity, in the authorization of the improper payment of legal fees. Accordingly, I conclude that he also poses a present risk to the public. Thus, I conclude that it is also necessary for him to demonstrate that he has taken steps to insure that any wrongful conduct on his part will not recur. Accordingly, I conclude and determine that good cause exists to debar Respondent Alan Feingold

from further participation in primary and lower tier covered transactions as either a participant or principal at HUD and throughout the Executive Branch of the Federal government, and from participating in procurement contracts with HUD for a period of one year, until August 28, 1993.

For the reasons set forth above, the Complaint is dismissed as to Deptford Investment Corp.

WILLIAM C. CREGAR
Administrative Law Judge

Issued: August 28, 1992

APPENDIX

Relevant Agreement, Handbook and Regulatory Provisions

Regulatory Agreement Provisions

Section 6 of the Regulatory Agreement provides:

Owners shall not without the prior written approval of the Secretary:

(b) Assign, transfer, dispose of, or encumber any personal property of the project, including rents, or pay out any funds except from surplus cash, *except for reasonable operating expenses and necessary repairs.*

* * * * *

(e) Make or receive and retain, any distribution of assets or any income of the project except on the following conditions:

(1) All distributions shall be made only as of and after the end of a semiannual or annual fiscal period, and only as permitted by the law of the applicable jurisdiction:

(2) *No distribution* shall be made from borrowed funds, prior to the completion of the project *or when there is any default under this agreement or under the note or mortgage*;

(3) Any distribution of any funds of the project, which the party receiving such funds is not entitled to retain hereunder, shall be held in trust separate and apart from other funds.

* * * * *

(g) ". . .Any funds collected as security deposits shall be kept separate and apart from all other funds of the project in a trust account the amount of which shall, *at all times* equal or exceed the aggregate of all outstanding obligations under said account."

Section 13 (g) of the Regulatory agreement defines "distribution" as:

[a]ny withdrawal or taking of cash or any assets of the project, including segregation of cash or assets for subsequent withdrawal within the limitations of

Paragraph 6 (e) hereof, and *excluding payment for reasonable expenses incident to the operation and maintenance of the project.*

Section 11 of the Regulatory Agreement provides:

> Upon a violation of any of the above provisions of the Agreement by Owners, the Secretary may give written notice, thereof to Owners, by registered or certified mail, addressed to the addresses stated in this Agreement. . . .If such violation is not corrected to the satisfaction of the Secretary within thirty (30) days after the notice is mailed or within such further time as the Secretary determines is necessary to correct the violation, without further notice the Secretary *may declare a default under this Agreement* effective as of the date of such declaration of default and upon such default the Secretary may:
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> * * * * *
>
> (b) Collect all rents and charges in connection with the operation of the project and use such collections to pay the Owner's obligations under this Agreement and under the note and mortgage and the necessary expenses of preserving the property and operating the project . . . .

Section 12 of the Regulatory Agreement sets forth HUD's right to a security interest in the rental income of the project as follows:

> "As security for the payment due under this Agreement to the reserve fund for replacement, and to secure the Secretary because of his liability under the endorsement of the note for insurance, and as security for the other obligations under this Agreement, the Owners respectively assign, pledge, and mortgage to the Secretary their rights to the rents, profits, income and charges of whatsoever sort which they may receive or be entitled to receive from the operation of the mortgage property, subject, however, to any assignment of rents in the insured mortgage referred to herein. Until a default is declared *under this Agreement*, however, permission is granted to Owners to collect and retain under the provisions of this Agreement, such rents, profit, income, and charges, but upon default this permission is terminated as to all rents due or collected thereafter."

Section 13 (h) of the Regulatory Agreement defines a default "under the Regulatory Agreement":

> (h) "Default" means a default *declared by the Secretary when a violation of this Agreement is not corrected* to his satisfaction within the time allowed by this Agreement or such further time as may be allowed by the Secretary *after written notice.*

Govt. Ex. 1. (emphasis added)

Handbook Provisions

Paragraph 1. of HUD Handbook 4370.2 dated April 1, 1981, states that it "replaces earlier instructions,. . . applies to multifamily rental projects under a charter or regulatory agreement permitting HUD to exercise control over project administration and operation," and is "for the use of mortgagors and their employees."

Paragraph 8 states:

> (a) *Authorized* repayment of advances made for necessary and reasonable operating expenses *are not considered distributions* and, hence, *are not subject to the surplus cash rules set forth in the project regulatory agreement.* . . .
>
> * * * * *
>
> (c) If the project is delinquent under the mortgage, loans and advances made by the owner to meet necessary and reasonable operating expenses *may not be repaid from project income unless written approval has been given by HUD.* . . .

Res. Ex. 5. (emphasis added)

Regulatory Definitions of Principals and Participants

Title 24 C.F.R. Section 24.110 defines a "primary covered transaction" and "lower tier covered transactions" as including:

> (a) (i) . . .any nonprocurement transaction between an agency and a person, regardless of type, including . . . loan guarantees.
>
> (a) (ii) (c). . .any procurement contract for goods or services between a participant and a person under a covered transaction, regardless of amount, under which that person will have critical influence on or substantive control over that covered transaction. Such persons are:
>
> (17) Project owners. . .

Title 24 C.F.R. Section 24.105 defines "Affiliate," "Participant" and "Principal":

> (b) *Affiliate.* Persons are affiliates of each another if, directly or indirectly, either one controls or has the power to control the other, or, a third person has the power to control both.

(m) *Participant.* Any person who submits a proposal for, enters into, or reasonably may be expected to enter into a covered transaction. This term also includes any person who acts on behalf of or is authorized to commit a participant in a covered transaction as an agent or representative of another participant.

(p) *Principal.* Officer, director, owner, partner, key employee, or other person within a participant with primary management or supervisory responsibilities. . . .

Regulatory Causes for Debarment

Title 24 C.F.R. Section 24.305 provides that debarment may be imposed, *inter alia,* for :

(b) (3) A willful violation of a statutory or regulatory provision or requirement applicable to a public agreement or transaction.

* * * * *

(d) Any other cause so serious or compelling a nature that it affects the present responsibility of a person.

* * * * *

(f) In addition to the causes set forth above, HUD may debar a person from participating in any activities or programs of the Department for material violation of a statutory or regulatory provision or program requirement applicable to a public agreement or transaction including applications for grants, financial assistance, insurance or guarantees, or to the performance of requirements under a grant, assistance award, or conditional or final commitment to insure or grantee.