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

In the Matter of:

KEITH R. HELLER,

Respondent.

and

UNIVERSITY COMMUNITY PROPERTIES, INC., CEDAR RIVERSIDE ASSOCIATES, CEDAR RIVERSIDE PROPERTIES, INC., STAGE I LAND COMPANY AND F BUILDING LAND COMPANY,

Affiliates.

HUDALJ 91-1575-DB
Decision Issued: March 27, 1991

Lisa K. Wright, Esquire
For the Department

Robert W. Junghans, Esquire
For the Respondent

Before: William C. Cregar
Administrative Law Judge

INITIAL DETERMINATION AND ORDER

Respondent, Keith R. Heller, and affiliates, University Community Properties, Inc., Cedar Riverside Associates, Cedar-Riverside Properties, Inc., Stage I Land Company and F Building Land Company, appeal a proposed debarment dated September 26, 1990, and signed by Arthur J. Hill, Acting Assistant Secretary for Housing of the U.S. Department of Housing and Urban Development ("HUD" or "the Department"). HUD proposes that Respondent and his affiliates be debarred from further participation in primary covered transaction and lower-tier covered transactions (see 24 C.F.R. Sec. 24.110(a)(1)) as either a participant or principal throughout the Executive Branch of the Federal Government, and from participating in procurement contracts with HUD for a period of five years from the date of the final determination of this matter.

The proposed debarment is based upon a civil judgment in the U.S. District Court for the District of Minnesota which was affirmed by the U.S. Court of appeals for the Eighth Circuit. *National Corporation for Housing Partnership v. Liberty State Bank, State I Land Company, F Building Land Company and Keith Heller*, 3-84-1097 and 3-85-421 (8th Cir. 1988). Respondent's appeal is dated October 18, 1990. Section 24.313(b)(2)(ii) of the Department's regulations (24 C.F.R. 24.313(b)(2)(ii)) provides that where, as here, the action is based on a civil judgment, the hearing shall be limited to the opportunity to submit documentary evidence and written briefs. The parties timely filed documentary evidence and briefs on January 14, 1991.

The Department alleges that the civil judgment establishes that Respondent and his affiliates commingled tenant security deposits with project operating funds in violation of HUD regulatory agreements. These agreements require the segregation of security deposit funds in separate trust accounts and forbid the transfer or encumbrance of these funds without prior written HUD approval. The Department alleges that by violating regulatory agreements, Respondent has committed an offense "indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a person." 24 C.F.R. Sec. 24.305(a)(4).

Respondent contends that 1) this action, based as it is upon the application of present regulations, is time-barred by regulations in effect at the time of the alleged misconduct; 2) since Respondent no longer does business with HUD he cannot be held to lack "present responsibility;" 3) his actions were reasonable and were permitted by a good faith interpretation of the HUD regulatory agreements; and 4) the Department's action is contrary to its own regulations and is the result of a long standing vendetta against him.

Findings of Fact

Respondent's relationship with HUD, which began in the early 1970's, has not been a happy one. At that time a large scale mixed use project in the Cedar-Riverside area of Minneapolis was included within HUD's New Town program. The first phase of what was to be a ten stage development, Cedar Square West, was completed in 1973. HUD issued mortgage insurance covering this project under FHA project numbers [redacted], [redacted], [redacted]4, [redacted]5, and [redacted] in February 1972.

A Regulatory agreement was entered into for each of the project mortgages. The agreements are identical except for typed information on the first page, specific to the project number under which each mortgage insurance policy was issued. Paragraph 6 of the agreement contains two clauses, 6(b) and 6(g), germane to this case:

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

(b) Assign, transfer, dispose of, or encumber any personal

> property *owned by the owner*[1] of the project, including rents, or pay out any funds except for reasonable operating expenses and necessary repairs.
>
> (g) Require, as condition of the occupancy or leasing of any unit in the project, any consideration or deposit other than the prepayment of the first months' rent plus a security deposit not in excess of one month's rent to guarantee the performance of the covenants of the lease. Any fund 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.

From the project's inception, a sum of money equal to the security deposit owed to the tenants was set aside and invested in certificates of deposit. Repayment to tenants was made from the project's general operating fund. In 1973 some of the certificates were pledged to secure a loan for project purposes. This loan was repaid in 1974. This loan was reported to HUD. No objection was raised by any HUD official. Affidavit.

In early 1981, Stage I and F Building placed tenant security deposits in a bank account and commingled these deposits with other funds. In October 1981, these accounts were moved to Liberty State Bank and invested in certificates of deposit. In August 1982, Stage I borrowed the amount of the certificates of deposit from Liberty pledging the certificates as security for the loan.

The project defaulted in 1984.[2] By 1986, all legal and contractual obligations between HUD and Respondents were terminated.

The litigation which resulted in the decision by the Circuit Court was initiated by the Cedar Square West receiver against Liberty to recover the tenants' deposits. On April 18, 1986, the District Court for the District of Minnesota granted partial summary judgment against Liberty. It determined that under Minnesota law, a landlord receives residential security deposits as a bailment. Having no interest in the fund other than as a bailee, it could not grant a security interest to Liberty. After a trial on the issue of damages, Mr. Heller, Stage I, and F Building were held liable for $340,107.18. Res. Brief, p. 4; Govt. Ex. A p. 5. The decision of the District Court was affirmed by the

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[1]The italized language was inserted by Mr. Heller. Affidavit of Keith R. Heller ("Affidavit").

[2]Respondent blames HUD for the default. HUD's alleged failures include a failure to file a timely environmental impact statement. An earlier filing would allegedly have prevented the change in zoning because more stages would have been completed. In addition, HUD is alleged to have caused the second default by insisting on reporting contributions to working capital as income, and because a healthier financial picture was presented than was warranted by the circumstances, thereby preventing Respondent from increasing the rent. Affidavit.

Court of Appeals on January 7, 1988.

The Circuit Court for the Eighth Circuit, affirming the decision of the U.S. District Court, found that 1) in order to obtain HUD financing Stage I and F Building entered into regulatory agreements with HUD governing the operation of the financed properties; 2) the regulatory agreements contained requirements that security deposits be segregated from all other funds in a trust account; 3) Stage I and F Building collected security deposits and placed the funds in a bank account commingling the security deposits with other funds so that it was not possible to trace accounts directly from the tenants to the security deposit account; 4) on August 3, 1981, Respondent Heller wrote to the Chairman of Liberty State Bank offering to deposit these funds with Liberty; 5) in October 1981, the security deposit accounts were moved to Liberty and invested in certificates of deposit; 6) in August 1982, Stage I borrowed the amount of the CD's from Liberty and pledged the CD's as security for the loan, and; 7) after Cedar Square West went into receivership, Liberty applied the CD proceeds against Stage I's defaulted loan, except for $5,587.82. Govt. Ex. A pp. 2-4.

When the District Court decision was appealed, Respondent deposited with the court sufficient funds to pay the judgment in lieu of a bond. These funds were released and the judgment paid after the U.S. Court of Appeals rendered its decision.[3] Despite the commingling of the security deposits with other funds, all tenants received refunds of their security deposits. Affidavit.

Respondent and his affiliates are related as follows: Stage I, a Minnesota limited partnership, and F Building, a partnership, owned the Cedar Square West Apartments, a multifamily housing project located in Minneapolis, Minnesota. Cedar Associates, a corporation, and Cedar Properties, a Minnesota limited partnership, are the general partners in both Stage I and F Building. Respondent, Keith Heller, is the president of Cedar Associates and a general partner of Cedar Properties. Respondent also owns University Community Properties, Inc., which managed the project.

Discussion

The Department contends that Respondent and his affiliates are subject to debarment based upon the cause set forth at 24 C.F.R. Secs. 24.305(a)(4), since the commingling of security deposits with general funds and the use of commingled deposits as loan collateral violate the regulatory agreements and, therefore, demonstrates a lack of responsibility. The Department further contends that the seriousness of these actions, combined with the lack of mitigation, are sufficiently serious to warrant the imposition of a debarment for five years.

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[3]The Department questions Respondent's statement that forms the basis for this finding. It states, "Respondent has asserted but failed to present any evidence to the Government proving its claim." Govt. Brief, p. 9. Because Respondent's statement is in an affidavit under oath, and because the Department has presented no evidence to the contrary, I find that Respondent and his affiliates satisfied the judgment.

Respondent and his affiliates raise the following defenses: 1) The action is barred by a three year limitation set forth in the predecessor to the current regulation, 24 C.F.R. Sec. 24.4(b) (1988); 2) since Respondent's relationship with HUD ceased in 1986, "there is no 'present responsibility' within the meaning of 24 C.F.R. Sec. 24.305(a)(4) which the conduct alleged...can 'seriously and directly affect'"; 3) Respondent reasonably interpreted the regulatory agreement to permit commingling and pledging the tenant deposits; 4) the sanction is contrary to 24 C.F.R. Sec. 24.200(e)(2) which prohibits sanctions against ultimate beneficiaries, including subsidized mortgagors unless there is evidence of fraud, 5) any sanction is contrary to HUD regulations since it would be punitive. 24 C.F.R. Sec. 24.115(b).

The Action is not Time Barred

The regulations in effect at the time this action was brought became effective on October 1, 1988. Respondent asserts that its activities were discovered by HUD at least by April 17, 1986, when the U.S. District Court issued its decision on liability, and certainly no later than January 22, 1987, when the final District Court Judgment was entered. It contends that the regulations previously in effect barred actions brought more than three years after the discovery of the cause upon which the action is based. Since present regulations remove this time limitation, Respondent contends that the regulation as applied to it involves retroactive application of regulations. Respondent argues that the retroactive application of regulations is looked upon with disfavor by the courts and certainly cannot be used to resurrect a claim which has previously been barred.

As Respondent correctly points out, the regulations in effect immediately prior to the current regulations contained a three year limitation on the bringing of actions. Thus, 24 C.F.R. Sec. 24.5(b) stated:

> Time limitations on decision to debar. The notice of proposed debarment shall be issued within three years of - (1) A criminal conviction; (2) completion of an investigation or audit which is a basis for the debarment action; or (3) discovery of the cause on which the debarment is based, which ever event is later.

The present regulations contain no similar time bar and also provide that "[t]his part [Part 24] shall apply to actions initiated after the effective date of these regulations regardless of the date of the cause giving rise to the sanction." 24 C.F.R. Sec. 24.110(e).

Although Respondent's argument is, at first glance, an attractive one, Respondent fails to note that the regulation it cites only became effective on October 2, 1987. 52 Fed. Reg. 37116 (Oct. 2, 1987). The regulations in effect when, according to Respondent, the cause was discovered contained no similar time limitation. Accordingly, Respondent has failed to demonstrate that the present regulation "resurrect[s] a claim which has previously been barred."

Respondent's Past Actions can Affect his Present Responsibility

Respondent contends that, since all relationships between him, his affiliates and HUD ceased in 1986, regulations authorizing his debarment based on his lack of "present responsibility" are inapplicable. This contention lacks merit.

Debarment is a sanction which may be invoked by HUD as a measure for protecting the public by ensuring that only those qualified as "responsible" are allowed to participate in HUD programs; *Stanko Packing Co. v. Bergland,* 489 (D.D.C. 1980); *Roemer v. Hoffman,* 419 F. Supp. 130, 131 (D.D.C. 1976). "Responsibility" is a term of art used in government contract law. It encompasses the projected business risk of a person doing business with HUD. This includes his integrity, honesty, and ability to perform. The primary test for debarment is present responsibility. However, a finding of present lack of responsibility can be based upon past acts. *Schlesinger v. Gates,* 249 F. 2nd 111 (D.C. Cir. 1957); *Roemer, supra.*

That HUD's regulations apply to past actions of Respondents, even those who have no present business dealings with HUD, is further demonstrated by the regulatory definition of "participant." A participant is defined as any person who "submits a proposal for, enters into, or *reasonably may be expected to enter* into a covered transaction." 24 C.F.R. Sec. 24.105(m) (emphasis added). The language of this regulation clearly contemplates that those not presently doing business with the government may be subject to sanctions, including debarment.

The Regulatory Agreements Cannot be Reasonably Interpreted to Permit the Pledging of Tenant Security Deposits

Respondent contends that his insertion of the phrase, "owned by the Owner," in paragraph 6(b) of the contract caused him to form the belief that security deposits were taken out of the scope of that paragraph of the Regulatory Agreement since, under Minnesota law, security deposits do not become the property of the landlord. Thus, he contends that the addition of the phrase permitted him to form a reasonable belief that he could, without Secretarial approval, encumber personal property, i.e., tenant security deposits, so long as the property was not his own. He also contends that his interpretation was reasonable because he complied with Minnesota law by maintaining sufficient amounts in general operating funds to meet his obligation to repay tenant security deposits, and because HUD raised no objection to his previous pledge in 1974.

These contentions are without merit for the following reasons: 1) Paragraph 6(g), which was not modified by the Respondent, contains a specific requirement applicable to tenant security deposits. It requires that tenant security deposits be kept "separate and apart" from all other funds in a trust account; 2) the specific language regarding tenant security deposits in 6(g) governs the more general language in paragraph 6(b), *Restatement (Second) of Contracts*, Sec. 203(c)(1979); 3) Respondent's interpretation of the agreement would lead to an absurd result; there would be no Secretarial scrutiny over any disposition or encumbrance of the limited resources belonging to low income tenants, those in most need of protection, while the Secretary would continue to require

prior approval to "assign, transfer, or encumber" the property belonging to the owner of the multifamily project;[4] 4) regardless of whether Respondent maintained sufficient reserves in general operating funds to satisfy the tenant security deposits, the words "separate and apart" in paragraph 6(g) clearly preclude commingling; 5) the record does not establish that HUD had actual knowledge or approved of the commingling of funds in 1982.

HUD Regulations Requiring a Showing of Fraud when Respondents are "Ultimate Beneficiaries" do not Apply to Respondents *qua* Property Managers

Respondent claims that 24 C.F.R. Sec. 24.200(e)(2) bars the Department's claim. This regulation provides:

> Sanctions against participants whose only involvement in HUD programs is as ultimate beneficiaries, such as..*subsidized mortgagors*, may be taken only upon evidence of fraud unless the participant has otherwise been debarred or suspended by another Federal agency. (emphasis added)

Since Respondent is a subsidized mortgagor, and there has been no showing of fraud in the civil judgment relied upon by the Department, Respondent asserts that the claim against it is barred. However, Respondent, through his affiliates, also managed the property. In fact, it was as property manager that the tenant security deposits were collected. Accordingly, Respondent is not an "ultimate beneficiary" and this regulation does not bar the Department's action.

Grounds for Debarment Exist under 24 C.F.R. Sec. 24.305(a)(4)

Respondent and his affiliates commingled tenant security deposits and used them as security for a loan. Both of these acts are prohibited by the regulatory agreements and indicate a present lack of business integrity. Even the risk of subjecting tenant security deposits to the risk of seizure has been held to warrant the imposition of sanctions since, once they lose their separate identity, they may be attached for owner debts. *In the Matter of Housing Resources Management, Inc. and Affiliates*, HUDBCA No. 90-1438-DB (October 18, 1990). In this case, that risk was realized. Tenant security deposits were seized and, only after extensive litigation, were they recouped. As stated by the Circuit Court, "As a result of this failure, the receiver had no trust fund from which to pay Cedar Square West's obligation to its tenants." Decision, p. 9.

Accordingly, the record establishes adequate grounds for the imposition of the

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[4]As the Department states in its brief, "It is entirely possible that the money in the security deposit account can be the difference between a family having a home and being homeless. For instance, if a tenant were to vacate his unit, but not have his deposit promptly refunded, he may not have the funds necessary to pay the security deposit on his next residence." Govt. Brief, p. 7.

sanction of debarment under 24 C.F.R. Sec. 24.305(a)(4).[5]

The Government has Failed to Demonstrate that a Debarment for Five Years is Warranted Under these Circumstances

HUD regulations provide that "the seriousness of the person's acts or omissions and any mitigating factors shall be considered in making any debarment decision." 24 C.F.R. Sec. 24.300. Although grounds exist for the debarment of Respondent and his affiliates, mitigating circumstances militate against imposition of a debarment for the five year period as was requested by the Department. See 24 C.F.R. 24.300. Those mitigating circumstances include the lack of criminal intent, including an intent to defraud the government. This militates against a period of debarment of more than three years.[6] The other mitigating factors applicable in this proceeding, include the following:

1) Respondent provided sufficient funds to pay the judgment and, following the adverse decision by the Court of Appeals, he instructed that the judgment be paid;

2) Respondent did not personally benefit from these acts. All of the security deposits either went into the project or were expended for its benefit;

3) Much time has passed since Respondent's wrongful acts. Use of the tenant security deposits as collateral occurred in August 1982. There has been a lengthy period between Respondent's acts and the decision to impose a debarment. The passage of a significant period of time is a factor to be taken into account in mitigation. *In the Matter of Robert Gordon Darby*, HUDALJ 89-1373-DB(LDP), 89-1387-DB (April 13, 1990), appeal pending, No. 2:90 CV 01184-18 (D.S.C. filed May 31, 1990);

4) Other than the time the tenants were deprived of their security deposits, there is no record evidence of harm[7] resulting from Respondent's conduct.

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[5]Other than the allegations in Mr. Heller's affidavit, there is no record evidence that the action is the result of a vendetta against him. These bare allegations are insufficient to establish that improper considerations motivated HUD officials to propose Mr. Heller's debarment.

[6]The Department's debarment regulations provide that the period of debarment for causes other than those related to a violation of the requirements concerning a drug-free workplace "generally should not exceed three years." See 24 CFR 24.320(a)(1). The regulations further provide that "[w]here circumstances warrant, a longer period of debarment may be imposed." *ID.* Examples of such circumstances include but are not limited to evidence of criminal intent, an intent to defraud the government, and acts which are wilful or egregious, combined with the lack of significant mitigating factors. Although the evidence presented in this proceeding supports a finding that Respondent's conduct was wilful, not only is there is no evidence of criminal intent, including an intent to defraud, but significant mitigating factors are also present.

[7]There has been no evidence of actual harm to tenants resulting from delays in refunding the tenant security deposits.

These factors warrant the imposition of debarment for less than a three year period.

CONCLUSION AND ORDER

Under the circumstances presented, I conclude that the debarment of Respondent, Keith R. Heller and his affiliates, University Community Properties, Inc., Cedar Riverside Associates, Cedar-Riverside Properties, Inc., Stage I Land Company and F Building Land Company, is based on adequate cause and is in the public interest. I conclude that a debarment for a meaningful period is necessary to deter Respondent, his affiliates, and other from acting similarly in the future.[8] Upon consideration of the public interest and the entire record in this matter, I conclude that good cause exists to debar Respondent and his affiliates from further participation in primary covered transactions 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 eighteen months, to run from the date this Order becomes final.

William C. Cregar

WILLIAM C. CREGAR
Administrative Law Judge

Dated: March 27, 1991.

[8]For cases supporting the proposition that the sanction of debarment serves the goals of individual and general deterrence, *see, e.g., L. P. Steuart & Bro., Inc. v. Bowles,* 322 U.S. 398 (1944); *Janik Paving & Constr., Inc. v. Brock, 828 F. 2d 84 (2d Cir. 1987); Copper Plumbing & Heating Co. v. Campbell, 290 F.2d 368 (D.C. Cir. 1961).*