

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
BOARD OF CONTRACT APPEALS
WASHINGTON, D.C.

In the Matter of:

PAUL A. KNIGHT,

Respondent.

HUDBCA No. 92-G-7560-D40
Docket No. 92-1826-DB

For the Respondent:

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For the Government:

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DETERMINATION BY ADMINISTRATIVE JUDGE TIMOTHY J. GRESZKO

April 6, 1993

Statement of the Case

Paul A. Knight ("Respondent") requested a hearing on a proposed debarment issued on February 7, 1992 by Arthur Hill, Assistant Secretary of the U.S. Department of Housing and Urban Development ("Department," Government or "HUD"). The Department proposes to debar Respondent 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 three years. Respondent was temporarily suspended on February 7, 1992, pending a final determination of the debarment action. HUD alleges that Respondent

participated in a scheme to circumvent HUD's regulations, and that Respondent knowingly permitted parties to certain Form HUD-1 Settlement Statements and Mortgagor's Certificates to falsely certify that the sources of the down payment and closing costs were true and correct in that all of the monies were paid from the buyers' funds, when in fact, they were not paid from buyers' funds. HUD further alleges that Respondent knew or should have known that these false documents would be submitted to HUD for the purpose of influencing the Department to insure these loans. Respondent admits that the statements at issue were false, but asserts that he did not know of, cause, or induce the making of the false statements at issue.

A hearing was held in Austin, Texas, and both parties subsequently submitted post-hearing briefs. This determination is based upon a consideration of the entire record in this case.

Findings of Fact

1. Respondent is a licensed attorney in the State of Texas who has conducted real estate settlements for thirty-six years. (Tr. 13, 158-59). As an attorney whose principal area of practice is real estate, Respondent has prepared thousands of Form HUD-1 settlement statements ("settlement statement" or "HUD-1"), and is familiar with HUD's minimum investment requirements. (Tr. 13-14). Respondent has conducted numerous settlements involving FHA-insured mortgages, and is aware that the settlement statement and its addendum are relied upon by the lender and HUD in making insurance eligibility determinations. (Tr. 14-15).

2. At all times relevant to this matter, Respondent had a business relationship with ██████ Moshref ("Moshref" or "seller"), the seller in the two transactions at issue. (Tr. 17-23, 61, 147-48). This professional relationship began in 1980. (Tr. 147-48). In 1984, Respondent and Moshref entered into a formal Partnership Agreement creating Knight-Moshref Associates. (Govt. Exh. 1; Tr. 17-18). The purpose of this joint venture was to engage generally in the real estate business, and to invest, purchase, sell, exchange, and lease real estate in the Austin, Texas area. (Govt. Exh. 1). This partnership was in existence during 1986. (Tr. 18-20). In addition to buying and selling real estate with Moshref, Respondent acted as the settlement agent on approximately 30 to 40 properties that were sold by Moshref during the early and mid-1980s. (Tr. 20-22). Moshref was also Respondent's tenant during 1985 and 1986. (Tr. 22). Moshref was a "major client" of Respondent's, and approximately ten percent of Respondent's legal work was for Moshref. (Tr. 22-23). Moshref was a trusted friend and client of Respondent. (Tr. 61).

3. At all times relevant to this matter, Respondent also had a business relationship with ██████ Meyers and his spouse, ██████ Meyers ("buyers"), the buyers in the two transactions. (Tr. 23-26, 53-54, 65-68). Respondent was on a first-name basis with the buyers (Tr. 26), and acted as their lawyer in preparing a joint venture agreement in a matter and with parties not related to this case. (Tr. 26, 97-101).

4. In mid-1986, Moshref informed the Meyerses that he wished to sell them two additional investment properties, the "Meadgreen" and "Charolais" properties. (Tr. 68-69, 102). Moshref advised the Meyerses that he would pay all down-payment and closing costs, that they would pay nothing down, and that they would only need to provide the credit to obtain FHA financing. (Tr. 74, 91-92, 102). Moshref would manage the properties and, if they appreciated, resell them and share any profits with the Meyerses. (Tr. 68-69, 102). The buyers did not tell Respondent about the terms of the deal they had struck with Moshref, and there is no evidence in this record that Moshref told him. (Tr. 92-93).

5. The Meyerses agreed with this plan and, on August 22, 1986, they entered into contracts to purchase the two properties from Moshref. (Govt. Exh. 2, 3). Each contract identifies Respondent as the escrow agent and indicated that \$500 "is herewith tendered by Buyer and is to be deposited as Earnest Money" with Respondent. (Govt. Exh. 2, 3). On the last page of each contract, Respondent signed an "Earnest Money Receipt" acknowledging receipt of \$500 in the form of a personal check from Moshref on September 8, 1986. (Govt. Exh. 2, 3).

6. Respondent assumed that the \$1000 in earnest money had been previously paid by the Meyerses to Moshref, and that Moshref was providing him with the Meyerses's funds for deposit into the escrow account. (Tr. 29-30, 149-50). Respondent did not verify this assumption with Moshref because, in his experience, it was a common practice in real estate transactions where no broker was involved for buyers to initially pay earnest money directly to sellers. (Tr. 29-30, 149-50).

7. On October 23, 1986, ██████ Meyers and Moshref opened a checking account at the Bank of the West, in Odessa, Texas, and Moshref deposited \$█████ of his own money into this account. (Govt. Exh. 16; Tr. 109-10, 116-17, 124-26). Signatory authority on this checking account was in Moshref's name. (Govt. Exh. 16; Tr. 125). On October 31, 1986, the Bank of the West received a Request for Verification of Deposit ("VOD") from the lender, United Austin Mortgage Company. (Govt. Exh. 19; Tr. 126-27). Attached to the VOD was a statement, signed by ██████ Meyers, which advised the lender that the \$█████ to be used for the down-payment on the two properties was in the Bank of the West account. (Govt. Exh. 19). The Bank of the West returned the VOD to United Austin Mortgage Company on or about November 19, 1989, with a notation indicating that the account's current balance was \$█████ (Govt. Exh. 19; Tr. 127). Shortly thereafter, the \$█████ deposited by Moshref was drawn out of the account and returned to Moshref. (Govt. Exh. 20, 21; Tr. 111, 127-29).

8. On November 24, 1986, United Austin Mortgage Company issued a Certificate of Commitment for each property. (Govt. Exh. 14, 15). The FHA-insured loan amount for the Meadgreen property was \$82,350. (Govt. Exh. 14). The FHA-insured loan amount for the Charolais property was \$89,600. (Govt. Exh. 15). The expiration date for each commitment was March 3, 1987. (Govt. Exh. 14, 15).

9. Respondent sent a letter to the Meyerses dated December 10, 1986. A number of documents related to the transaction were enclosed with the letter for the Meyers's signatures. The letter made no mention of either a closing date or closing costs. (Govt. Exh. 5). Respondent's file contained a similar unsigned letter containing the same instructions as the letter set forth above, and also indicated that the Meyerses should be prepared to pay the balance of the down payment and closing costs at the time of closing. The letter also stated that the Meyerses could pay these costs directly to Moshref, and that Moshref could verify payment at closing. (Govt. Exh. 5A).

10. The Meyerses and Moshref entered into a "Management Agreement and Option" on each property. (Govt. Exh. 13; Tr. 71-75, 92, 107-08). These agreements, each dated December 21, 1986, were signed by the Meyerses and Moshref at Moshref's home. The agreements gave the Meyerses an option to reconvey the property to Moshref after six months but within ten years from the date of purchase. (Govt. Exh. 13). During the term of these agreements, Moshref agreed to manage the property. Further, each agreement provided that, "as part of the consideration for the agreements and options herein granted, Moshref has agreed to pay to Owner the total amount of Owners down-payment and closing costs to be paid by Owner on purchase of the subject property." (Govt. Exh. 13; Tr. 71-75, 92, 107-08). These agreements were not executed in Respondent's office or in his presence, and there is no evidence that Respondent was aware of the existence of the agreements at the time of the closing. (Tr. 107-08).

11. The Meyerses travelled from their home in the [REDACTED] Texas area, on or before December 22, 1986, in order to attend the closing on the Meadgreen and Charolais properties. (Tr. 69-70, 106-07). The Meyerses did not bring any certified checks with them, because they knew of their private agreement with Moshref. (Tr. 70-71). Respondent's normal practice when conducting settlements was to "require the buyer to bring to closing a cashier's check" rather than a personal check for deposit into his escrow account. (Tr. 16). This was true on "almost every occasion." (Tr. 16, 52). The reason for requiring a certified check from the buyer was to ensure that his escrow account balance would be sufficient to make disbursements on the same day. (Tr. 16, 49-50, 52). Although it was "abnormal" for Respondent to allow a buyer to give personal checks in payment of closing costs, there were times when Respondent would accept a personal check because he knew that the writer of the check was responsible and that there would be sufficient funds to cover the check. (Tr. 16). The Meyerses, Moshref, and Respondent were present at the closing which occurred at Respondent's office on December 22, 1986. (Tr. 31, 80, 107-09). [REDACTED] Meyers testified at the hearing that he assumed Respondent knew that Moshref was paying the down-payment and closing costs because of Respondent's business relationship with Moshref, but he also admitted that he did not actually know if Respondent was aware of the Meyers's agreement with Moshref. (Tr. 92). He stated that he made the false statements at issue on the basis of "ignorant trust and being led to believe that this is all just routine." (Tr. 93).

12. Respondent testified at the hearing that he observed [REDACTED] Meyers at the closing in Respondent's office, produce "one of these little things like you can carry in your hip pocket, in a billfold size check," like "temporary checks that you might get when you open a new account." (Tr. 155). Respondent testified that when [REDACTED] Meyers began to write him a personal check for the amounts due the seller, Respondent told Meyers that he did not accept personal checks. (Tr. 49, 51-52). According to Respondent, the seller then asked if he could accept the checks. (Tr. 51-52). Respondent testified that [REDACTED] Meyers then wrote a check or checks for the amount of the down-payment and gave it to the seller. (Tr. 51-52). Respondent also testified that he allowed the Meyerses to make the payment by personal check because the commitment from the lender to loan funds at a specified rate was about to expire, the parties were known and trusted by him, the seller was willing to accept the buyers' personal check rather than not close at that time, and the buyers had travelled a long distance for the closing. (Tr. 60-61).

In contrast, [REDACTED] Meyers testified at the hearing that "he did not remember writing any personal checks" at the closing and that he did not "believe that he wrote any checks at all." (Tr. 80). [REDACTED] Meyers testified at the hearing that she did not write any checks at the closing because the seller was going to pay all of the closing costs and because they did not have sufficient funds to pay the closing costs. (Tr. 108-09).

I find Respondent's version of the closing to be more credible than the Meyers's version for a number of reasons. [REDACTED] Meyers made a statement to a HUD auditor on June 29, 1992 (Resp. Exh. 1), in which she stated that funds for the down-payment for the two transactions at issue were obtained through a gift from a relative, that two checks for the closing costs were written from a Bank of the West checking account, and that the two checks were given at the closing to either the Respondent or the seller. Respondent's testimony about the passing of a check is corroborated by the statement [REDACTED] Meyers made to the HUD auditor. [REDACTED] Meyers retracted her statement to the HUD auditor at the hearing, and testified that she had lied to the HUD auditor because she was afraid that she had committed a "Federal offense . . . if any of the statements that we made . . . and signed our name to weren't exactly what happened." (Tr. 113). She admitted during the hearing that she intentionally signed a false mortgagor's certificate and that she intentionally made false statements to a HUD auditor because she was afraid of being fined or imprisoned. (Tr. 115). I also find the testimony of [REDACTED] Meyers somewhat inconsistent with respect to the writing of a personal check at closing, and he testified that it was possible that "whatever happened on these two properties . . . may be confused with what happened on [the sale of another property]." (Tr. 85). [REDACTED] Meyers also testified that if his spouse had made a statement to HUD auditors that she wrote either one or two checks for the properties at the closing, "it is very likely that is what she believed at the time." (Tr. 84).

Both of the Meyerses admitted knowingly making false statements on the closing documents and [REDACTED] Meyers admits that she made false statements on more than one occasion. The Meyers lack of credibility is blatant. On the other hand, I find Respondent's testimony reasonably credible and internally consistent, notwithstanding the fact that he could not

remember every detail of the closing. Respondent's inability to remember some of the details of the closing is neither surprising nor unusual when considered in conjunction with the amount of time that has passed since the closing was conducted. His recollection of the passing of a personal check is credible, because it was "abnormal" for a personal check for substantial funds to be utilized at closing. Moreover, Respondent's testimony that he was willing to permit the closing to occur because he trusted these individuals is also credible in light of his lengthy business relationship with these individuals, and in the absence of any other evidence of wrongdoing throughout this relationship. Based upon the foregoing, I find the evidence preponderant that a personal check was tendered by the Meyerses to Moshref at closing in payment of the sums due from them as stated by Respondent.

13. On or before December 22, 1986, Respondent prepared settlement statements for each transaction. (Govt. Exh. 6, 8; Tr. 37, 42-43). Respondent, on each HUD-1 and again on the addendum thereto, certified that "[t]he HUD-1 Settlement Statement which I have prepared is a true and accurate account of this transaction [and that] I have caused or will cause the funds to be disbursed in accordance with this statement." (Govt. Exh. 6, 8; Tr. 37, 42-43).

14. The HUD-1 for the Meadgreen transaction indicated that the contract sales price for the property was \$93,000. (Govt. Exh. 6, line 101). The borrowers' settlement charges were \$4,929.03. (Govt. Exh. 6, line 103). Thus, the gross amount due from the borrowers was \$97,929.03. (Govt. Exh. 6, lines 120 and 301). The earnest money deposit was \$500 and the FHA-insured loan amount was \$82,350. (Govt. Exh. 6, lines 201 and 202). Thus, the total paid by/for the borrowers was \$82,850. (Govt. Exh. 6, lines 220 and 302). Based upon these figures, the settlement statement for the Meadgreen transaction indicated, at the line 303 "Cash from Borrower" entry, that a \$15,079.03 down-payment had been paid by the borrowers to Respondent. (Govt. Exh. 6, line 303). In addition, the line 603 "Cash to Seller" entry on the settlement statement indicated that \$32,608.32 had been disbursed by Respondent to the seller. (Govt. Exh. 6, line 603).

15. The HUD-1 for the Charolais transaction indicated that the contract sales price for the property was \$100,000. (Govt. Exh. 8, line 101). The borrowers' settlement charges were \$5,225.49. (Govt. Exh. 8, line 103). Thus, the gross amount due from the borrowers was \$105,225.49. (Govt. Exh. 8, lines 220 and 301). The earnest money deposit was \$500 and the FHA-insured loan amount was \$89,600. (Govt. Exh. 8, lines 201 and 202). Thus, the total paid by/for the borrowers was \$90,100. (Govt. Exh. 8, lines 220 and 302). Based upon these figures, the settlement statement for the Charolais transaction indicated, at the line 303 "Cash from Borrower" entry, that a \$15,125.49 down-payment had been paid by the borrowers to Respondent. (Govt. Exh. 8, line 303). In addition, the line 603 "Cash to Seller" entry on the settlement statement indicated that \$15,465.11 had been disbursed by Respondent to the seller. (Govt. Exh. 8, line 603).

16. Respondent did not receive and deposit into his escrow account the down-payment amounts reflected on the line 303 "Cash from Borrower" entries on the settlement statements. (Tr. 39, 43). In situations where cash is not paid into his escrow account, Respondent

"normally" reflects this fact on the settlement statement as "POC." (Tr. 40). Respondent was aware that the acronym "POC" means "paid outside of closing." Respondent did not indicate on the settlement statements that the line 303 down-payment amounts were "POC." (Tr. 40, 46). Respondent's internal account book, which was not submitted to the lender or HUD, indicated that the line 303 down-payment amounts were "POC." (Govt. Exh. 7, 9; Tr. 40, 46). Respondent testified at the hearing that the notation "POC" in his account book meant that money was paid to the seller, other than by [Respondent]." (Tr. 46).

17. Respondent also did not disburse from his escrow account the amounts reflected on the line 603 "Cash to Seller" entries on the settlement statements. (Tr. 41, 48-49). With respect to the Meadgreen transaction, Respondent disbursed a check (#2336) from his escrow account in the amount of \$17,529.29 to the seller on December 23, 1986. (Govt. Exh. 7; Tr. 41). However, the line 603 "Cash to Seller" entry on the Meadgreen settlement statement indicated that Respondent had disbursed to the seller \$32,608.32. (Govt. Exh. 6, line 603). With respect to the Charolais transaction, Respondent disbursed a check (#2362) from his escrow account in the amount of \$339.62 to the seller on December 24, 1986. (Govt. Exh. 9). However, the line 603 "Cash to Seller" entry on the Charolais settlement statement indicated that Respondent had disbursed to the seller \$15,465.11. (Govt. Exh. 8, line 603).

18. Respondent prepared and signed a formal, typewritten disbursement sheet for the Charolais transaction (Govt. Exh. 10), but not for the Meadgreen transaction. (Tr. 46-48). This disbursement sheet, which was submitted to the lender and to HUD, indicated under "Receipts" that \$15,625.49 had been received by Respondent from the Meyerses. (Govt. Exh. 10). It also indicated under "Disbursements" that \$15,625.49 had been disbursed by Respondent to Moshref. (Govt. Exh. 10; Tr. 48-49).

19. On or before December 22, 1986, the Meyerses signed a Mortgagor's Certificate for each of the transactions. Each Mortgagor's Certificate stated, among other things, that "[a]ll charges and fees collected from me as shown in the settlement statement have been paid from my own funds." (Govt. Exh. 14, 15; Tr. 77). Respondent had the Meyerses sign these documents on December 22, 1986, or prior thereto. (Tr. 76-77; 105; Govt. Exh. 5A).

20. Respondent, as closing agent on the two transactions at issue, received a total fee of about \$860.00. (Govt. Exh. 6, 8; Tr. 158-62).

21. In 1987, the Meadgreen and Charolais properties were each reconveyed by the Meyerses to Moshref. (Govt. Exh. 11, 12; Tr. 57-58). Respondent acted as the trustee under the deeds of trust. (Govt. Exh. 11, 12; Tr. 57-58).

22. Respondent maintained at the hearing that there was nothing about the way the two transactions at issue were handled or closed by him in his office that was not in keeping with the way real estate transactions are typically handled in Texas. (Tr. 163-64 169-70). He was handling 5 to 6 closings a month up to the time he was suspended and many more closings in the 1980's. (Tr. 14). Respondent testified that under current Texas title insurance regulations,

the closer must collect "good funds," at closing, by collecting either a cashier's check or through a wire transfer. (Tr. 15-16).

23. [REDACTED] Pope, a board certified Texas real estate specialist, testified at the hearing that he has "[n]ever heard about [any closing where] the money on the front of the settlement statement line 303 [was] paid directly from the buyer to the seller," and that such payment must always go "through the settlement agent, whoever is handling the closing." (Tr. 176-77). In Pope's opinion, the only way to assure that money actually passes hands is to deposit and disburse all of the funds from the escrow account. (Tr. 177). Pope stated that he would not accept a personal check for a substantial sum of money at closing under any circumstance. Pope acknowledged that on December 22, 1986, nothing in the then-existing regulations of the Texas State Board of Insurance required funds to be deposited into the closing agent's escrow account before disbursement, and that such a requirement was not a part of any other regulations then in effect. (Tr. 185-88).

24. In 1989, the HUD Office of Inspector General ("OIG") undertook an audit of the lender, United Austin Mortgage Company. (Tr. 122-23). This audit was conducted by the auditor-in-charge ([REDACTED] Fox, and other OIG auditors. (Tr. 122-23). In connection with the audit, the two transactions at issue were selected for review. (Tr. 123). Many of the facts underlying this matter were discovered during the course of that review, including the fact that the expenses at issue had not actually been paid by the Meyerses. The suspension and proposed debarment of Respondent commenced following a recommendation from the OIG. (Tr. 123-37).

Discussion

Respondent, as a closing agent in FHA-insured transactions, is a "participant" and "principal" as those terms are defined in HUD's regulations. 24 C.F.R. §§ 24.105(m), 24.105(p)(15); 24.110(a)(1)(ii)(C)(13).

Applicable regulations provide that debarment may be imposed for:

(b) [v]iolation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program.

* * * * *

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

* * * * *

(f) 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 or requirements under a grant, assistance award or conditional or final commitment to issue or guarantee. 24 C.F.R. §§ 24.305(b), (d), and (f).

The Government bears the burden of demonstrating by adequate evidence that cause for suspension exists, and by a preponderance of the evidence that cause for debarment exists. However, the existence of a cause for debarment does not automatically require imposition of an administrative sanction. On gauging whether or not to sanction a person, all pertinent information must be assessed, including the seriousness of the alleged acts or omissions, and any mitigating circumstances. 24 C.F.R. §§ 115(d), 24.314(a) and 24.320(a). Respondent bears the burden of proving the existence of mitigating circumstances. 24 C.F.R. §§ 24.313(b)(4).

Underlying the Government's authority not to do business with a person is the requirement that agencies only do business with "responsible" persons and entities. 24 C.F.R. § 24.115. The term "responsible," as used in the context of suspension and debarment is a term of art which includes not only the ability to perform a contract satisfactorily, but the honesty and integrity of the participant as well. 48 Comp. Gen 769 (1969). The test for whether a debarment is warranted is present responsibility, although a lack of present responsibility may be inferred from past acts. *Schlesinger v. Gates*, 249 F.2d 111 (D.C. Cir. 1957); *Stanko Packing v. Bergland*, 489 F.Supp. 947, 949 (D.D.C. 1980). Debarments shall be used to protect the public interest and not for the purpose of punishment. 24 C.F.R. § 24.115(b).

The Government asserts that the debarment of Respondent is justified on the grounds that Respondent caused or induced the submission of false settlement statements and false mortgagor's certificates. The Government further asserts that the evidence establishes that Respondent either knew or had reason to know that these statements were false, or that he should have known that the statements were false. Respondent admits that the settlement statements and mortgagor's certificates contained false statements as alleged, but asserts that the evidence is insufficient to find that he knew of, caused, or induced the making of the false statements at issue. For the reasons set forth below, I find that: (1) Respondent did not have actual knowledge of the false statements at issue; (2) Respondent should have known that the false statements had been made; and (3) Respondent's failure to adequately perform his duties as closing agent constitutes a legal cause of the false statements.

There is no testimony in this case from any witness sufficient to establish that Respondent had actual knowledge of the false statements made by the Meyerses at closing and no documentary evidence establishing such knowledge. In light of my finding that a personal check or checks were passed by the Meyerses to Moshref at closing, it is clear that actual knowledge has not been established in this case. Even the Meyerses admit that they only assumed knowledge on the part of Respondent because of his close business relationship with Moshref, and this is the only direct testimony the Government offered on this issue. The Government also places substantial weight on the existence of the two letters from Respondent to the Meyerses (Govt. Exhs. 5 and 5a), and argues that the letters evidence an attempt by Respondent to cover-up his knowledge of the false statements. I find the Government's reliance on these letters misplaced. Government Exhibit 5, which apparently was not sent to the

Meyerses, states in a general sense that the balance of the closing costs and down-payment were due at closing. What the Government wholly ignores is the fact that Government Exhibit 5 also states that the Meyerses could pay these costs directly to Moshref, outside of closing, and that if this occurred, Moshref would have to verify at closing that he had previously received the funds from the Meyerses. As Government Exhibit 5 does not direct the Meyerses to bring a certified check to closing, I cannot reasonably infer on the basis of the existence of this letter that it was drafted to cover-up the fact that the Meyerses were not going to pay any of the costs at issue. It is at least equally likely on the face of this letter, that Respondent knew prior to closing that the Meyerses might pay Moshref directly. For the foregoing reasons, I cannot infer from the existence of these two letters that Respondent had knowledge of the fraudulent scheme at issue.

The Government also argues, among other things, that "in light of [Respondent's] close, ongoing business relationship with Moshref and the Meyerses, Respondent had every incentive to extend full cooperation to them, and that they, in turn, knew that he could be trusted to go along with these . . . transactions." There is no evidence in this case of misconduct or impropriety in that business relationship and there is no evidence in this case sufficient to compel the conclusion that long-term business relationships are likely to lead to serious misconduct or to increase the propensity for the making of false statements. In addition, it cannot be presumed that long-term business relationships, *per se*, lead to misconduct. Under the circumstances, I find this argument baseless.

The Government also argues that Respondent knew that the Meyerses were not paying the costs at issue because Respondent received a \$1,000 check in payment of the earnest money from Moshref drawn on Moshref's account. The Government has not established that payment of the earnest money by Moshref to Respondent was unusual in any respect and Respondent's explanation for his accepting this check is both reasonable and credible. On the record before me, I find the facts surrounding the earnest money payment by Moshref wholly insufficient to raise any specter of possible wrongdoing by any of the parties to the transactions at issue.

Finally, the Government refers to certain differences in the recording of the costs at issue in Respondent's internal accounting records for these transactions and the recording of such costs on the HUD-1 settlement statements. Respondent's internal accounting records record the down-payments as "POC - Moshref," i.e., paid outside of closing to Moshref, while the HUD-1 settlement statements do not indicate that the payments were POC. The Government argues that this evidence raises questions concerning Respondent's credibility, and that this evidence is additional proof that Respondent knew or had reason to know that the Meyers had not paid these costs. I do not find Respondent's differing treatment of the transactions in these documents significantly probative of the issues in this case. These facts do not show that Respondent knew that the Meyerses had not paid the costs at issue. Both the internal accounting records and the HUD-1 settlement statements reflect that the Meyerses paid these costs, whether the costs were paid at or outside of closing. I also cannot draw a negative inference with respect to Respondent's credibility on the basis of the differences in these records, because the Government's evidence demonstrates that it is difficult to characterize a payment made directly by a buyer to a seller at closing as either paid at closing or outside of

closing. While the Government argues at great length that every payment not made through the escrow account must be marked POC on the HUD-1 settlement statement, the Government's expert witness, Pope, testified that a cash payment made at closing directly from the buyer to the seller is not POC, despite the fact that the payment was not made through the escrow account. In light of this evidence, I find Respondent's explanation of the POC entry in his records credible, especially in light of the fact that there is no provision on the HUD-1 settlement statement for recording payments made directly at closing by buyers to sellers. In addition, even if I were to find that Respondent believed that the funds at issue were paid outside of closing, that finding would be irrelevant to the charge that Respondent knew that the payment had not been made at all. I, accordingly, do not find this evidence persuasive.

I find that the Government has not established that Respondent had actual knowledge of the false statements at issue. However, for the reasons set forth below, I find that the Government has established that Respondent should have known of the existence of the false statements, and that his failure to exercise due care was a legal cause of the false statements. Applicable HUD regulations do not define the "should have known" standard. At common law, a person "should know" a fact if:

[a] person of reasonable prudence and intelligence, or of the superior intelligence which [such a person may have] would ascertain the fact in question in the performance of his duty to another, or would govern his conduct upon the assumption that such fact exists. Restatement, Second, Torts § 12(2); Restatement, Second, Agency § 9.

The comments to the Restatement provide that "should know" indicates that the individual is under a duty to another to use reasonable diligence to ascertain the existence or non-existence of the fact in question and that he would ascertain the existence thereof in the proper performance of that duty. *See* Restatement, Second, Torts § 12(2), Comment a. The words "should know" express the idea that the individual of whom they are spoken has a duty to ascertain facts, or, if he does not ascertain them, to act with reference to the likelihood that such facts exist. Restatement, Second, Agency § 9, Comment e. With respect to establishing legal cause, the Restatement provides that an individual's negligent conduct is a legal cause of harm to another if: (a) his conduct is a substantial factor in bringing about the harm, and (b) there is no rule of law relieving the individual from liability because of the manner in which his negligence has resulted in the harm. *See* Restatement, Second, Torts § 431; 57A Am Jur 2d, *Negligence* § 475 (1992), and cases cited therein; *McClure v. Allied Stores of Texas, Inc.*, 608 S.W. 2d 901 (Tex. 1980).

There are certain aspects of the closings at issue which raise substantial doubts with respect to the prudence, diligence, and judgement exercised by Respondent at these closings. Respondent had a number of prudent options which could have been exercised in lieu of permitting the parties to exchange a personal check in payment of settlement costs. One option would have been to stop the closings. Respondent also could have checked with the bank to determine if the buyers had sufficient funds in the personal checking account to pay the closing costs. Respondent also could have required the deposit of the personal check into the escrow

account, and completed the closings when the check cleared. As Respondent chose to go forward, Respondent, at the very least, should have made a notation on the HUD-1 settlement statements clarifying that the buyers had made a substantial payment at closing with a personal check. The Government argues correctly that by failing to do so, Respondent prepared misleading and confusing settlement statements. The Government also argues correctly that HUD, the lender, and the title company reasonably relied on the settlement statements prepared by Respondent as indicating that the funds at issue had been deposited into and disbursed from Respondent's escrow account. Respondent's failure to obtain "good funds" constitutes a serious breach of his fiduciary duty as closing agent. Likewise, Respondent's failure to prepare HUD-1 settlement statements which accurately reported the means of payment by the buyers was also a serious breach of his fiduciary duty. While I credit Respondent's explanation that he permitted the closings to continue because he trusted the buyers and seller, this explanation is not comforting. Such trust has no place in the FHA-insured loan program, because it exposes the FHA to the very risks which the program attempts to avoid, and because the closing agent is the FHA's last line of defense against risky loans. Respondent essentially chose to look the other way while the parties engaged in an abnormal transaction by utilizing a personal check to pay substantial closing costs. The utilization of a personal check to pay these costs heightened the possibility that fraud was occurring, and gave rise to an obligation on the part of Respondent to exercise greater caution. Had Respondent taken due care, he could have readily ascertained that the checking account no longer existed; it would have been apparent that the parties were attempting to commit fraud; and the transaction could have been stopped. It is also highly likely that HUD, the lender, or the title company would have halted the transactions if the settlement statements had indicated that a personal check had been utilized to "pay" substantial closing costs.

I find Respondent's lack of care in conducting these closings to be a legal cause of the false statements, because his failure to exercise due care facilitated the making of the false statements. I further find that Respondent should have known of the false statements because he could have ascertained that the false statements had been made had he properly performed his duties, and because he should have proceeded with more caution upon the buyers' failure to bring a certified check to the closings. I find on this basis that the Government has established cause for debarment of Respondent under 24 C.F.R. § 305(f).

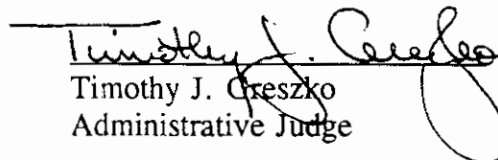
HUD has temporarily suspended Respondent pending determination of debarment, based upon adequate evidence of the possible existence of causes for debarment and an immediate necessity to protect the public. 24 C.F.R. §§ 24.400 and 24.405. HUD proposes to debar Respondent for three years. Debarment is to be for a period commensurate with the seriousness of the cause(s). 24 C.F.R. § 24.320(a). If suspension precedes a debarment, the suspension period shall be considered in determining the debarment period. 24 C.F.R. § 24.320(a). The existence of a cause for debarment does not necessarily require that a person be debarred; the seriousness of the person's acts or omissions and any mitigating factors must be considered in making any debarment decision. 24 C.F.R. §§ 24.300 and 24.314.

There are a number of mitigating factors in this case. The alleged misconduct occurred at one closing session over six years ago. There is no evidence of any wrongful, negligent or imprudent conduct on the part of Respondent either before or after that time, and there is evidence of responsible conduct since that time. See *Howard L. Perlow*, HUDBCA No. 92-7131-D5 (Dec. 3, 1992), citing *Carl W. Seitz and Academy Abstract Co.*, HUDBCA No. 91-5930-D66 (Apr. 13, 1992). Moreover, the Government has failed to prove that Respondent had actual knowledge of the fraudulent scheme. The closings at issue appear to have involved an isolated situation which turned out to be based, in large part, upon misplaced confidence in business associates and faulty judgement, as opposed to dishonesty. In addition, Respondent clearly understands that under current Texas real estate regulations, he cannot accept a personal check in payment of closing costs, because those regulations require that he take only "good money," such as a certified check. Considering this testimony, I find it unlikely that Respondent will accept a buyer's personal check for closing costs in the future.

I am also concerned, however, by the fact that Respondent characterized these closings inconsistently at the hearing as both "in keeping with the way real estate transactions are typically handled in Texas," and as "abnormal." This testimony is not indicative of a full understanding of the defects in the settlement statements and procedures at issue. For that reason, and considering the mitigating factors set forth above, I conclude that a debarment for a period of eighteen months is necessary to protect the public interest. An eighteen month debarment should provide Respondent with a sufficient opportunity to thoroughly review HUD's FHA-insurance program requirements for closing agents, and to apply that knowledge to any future closings which he might conduct under the program. This period of debarment also reflects the fact that Moshref, who was more culpable than Respondent, was debarred for a period of three years. (Govt. Post-Hearing Brief, Attachment A).

Determination

For the foregoing reasons, it is my determination that Respondent shall be debarred through August 7, 1993, credit being given for the time during which Respondent was suspended.


 Timothy J. Czeszko
 Administrative Judge