UNITED STATES OF AMERICA

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BOARD OF CONTRACT APPEALS

Washington, D. C.

In the Matter of	:	
SHARON HELENE BARROW,	:	HUDBCA No. 79-409-D42
	:	(Activity No. 79-656-DB)
Appellant	:	

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DETERMINATION

Statement of the Case

By letter dated May 29, 1979, Sharon Helene Barrow, Appellant herein, was notified that the Department of Housing and Urban Development intended to debar her and her affiliates from participation in HUD programs for a period of five years for alleged business irregularities in her role as Escrow Officer for the Mechanics National Bank. Appellant was temporarily suspended pending determination of debarment.

On June 21, 1979, Appellant filed a complaint for Mandatory Injunction and Declaratory Judgment in United States District Court to enjoin HUD from suspending or debarring her. On June 22, 1979, the District Court temporarily enjoined HUD from suspending or debarring Appellant until she had an administrative hearing pursuant to 24 C.F.R. §24.7. Appellant thereafter agreed to dismiss her action in District Court provided she be given an expeditious hearing. A hearing was held in Los Angeles, California on August 2, 1979. Appellant filed a motion to dismiss the debarment action at the hearing on the ground that she was not a contractor or grantee within the meaning of the Departmental regulation applicable to debarment. The motion was denied after oral argument. Thereafter, parties filed post-hearing briefs based on the transcript of hearing and documentary evidence.

APPLICABLE REGULATION

The Departmental regulation applicable to debarment, 24 C.F.R., Part 24, provides in pertinent part as follows:

> §24.4 Definitions.
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> * * *
>
> (f) "Contractors or grantees." Individuals ... and public or private organizations that are direct recipients of HUD funds or that receive HUD funds indirectly through non-Federal sources including, but not limited to, borrowers, builders, mortgagees, real estate agents and brokers, area management brokers, management and marketing agents, or those in a business relationship with such recipients including, but not limited to, consultants, architects, engineers and attorneys; all participants, or contractors with participants, in programs where HUD is the guarantor or insurer....
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> * * *
>
> §24.6 Causes and conditions applicable to determination of debarment.
>
> Subject to the following conditions, the Department may debar a contractor or grantee in the public interest for any of the following causes:

(a) Causes....(4) Any other cause of such serious compelling nature, affecting responsibility, as may be determined by the appropriate Assistant Secretary, to warrant debarment.

* * *

(b) Conditions. (1) The existence of any of the causes set forth in paragraph (a) of this section does not necessarily require that a contractor or grantee be excluded from Departmental programs. In each instance, whether the offense or failure, or inadequacy of performance, be of a criminal, fraudulent, or other serious nature, the decision to debar shall be made within the discretion of the Department and shall be rendered in the best interest of the Government. Likewise, all mitigating factors may be considered in determining the seriousness of the offense, failure or inadequacy of performance, and in deciding whether the Administrative Sanction is warranted.

ISSUES PRESENTED

1.) Whether Appellant is a contractor or grantee within the meaning of the regulation.

2.) Whether there were mitigating circumstances surrounding Appellant's conduct as Escrow Officer of Mechanics National Bank that explain Appellant's actions.

3.) Whether debarment of Appellant is warranted in the best interest of the Government and the public.

Findings of Fact

Appellant is the owner of Canyon Escrow, an independent escrow company in the State of California (T. 150). She established Canyon Escrow in November, 1976 (T. 150). Prior to that, Appellant worked as a bookkeeper in a bank and a real estate company, a title searcher, a legal secretary, and for a thirteen-year period, in various positions with independent escrow companies (T. 123-126). In 1972, the President and Chairman of the Board of Mechanics National Bank (MNB) hired her as the manager of the Escrow Department of MNB. (T. 126-127).

MNB had a Mortgage Loan Department managed by a Mr. Manginelli (T. 128). MNB was a HUD-approved mortgagee, making loans for the purchase of homes that had mortgages insured by HUD-FHA (T. 23). The loan origination procedure for FHA-insured loans begins when a prospective home buyer applies for a loan with a HUD-approved mortgagee. The mortgagee gathers personal, financial and credit information from the prospective buyer and verifies it. After the information is verified, the mortgagee sends it to HUD-FHA for a credit review. HUD then decides whether the application is acceptable. (T. 23-24). HUD relies entirely on the information submitted by the mortgagee in evaluating the mortgagee's application for FHA insurance on the mortgage. (T. 24). If HUD gives credit approval to the application, the mortgagee goes to loan settlement, which is conducted by escrow companies and departments in California. The escrow entity is a loan settlement agent for the mortgagee. It closes the loan. The mortgagee then requests HUD to issue an insurance endorsement. At that point, HUD is officially liable for any future loss on the loan (T. 24).

To protect itself, HUD-FHA uses a verification system 1/ in which the mortgagee bears the burden of making sure the information submitted to HUD is correct (T. 32). FHA Form 2900 is the "central exhibit" of the loan file (T. 29), on which a buyer lists all credit and personal and financial information that HUD will use to evaluate the application (T. 29 G #2,3). The Form 2900 is signed by the buyer and certified for correctness by the mortgagee (T. 30, G #3). The penalty for making a false statement on the Form 2900 is a fine up to $5,000 and imprisonment of up to two years (G #5(b)). Line 12 of that form shows assets for closing (G #3). This information shows HUD whether the buyer will have the money to complete the purchase (T. 30). HUD regulations prohibit the buyer from borrowing the amount of money shown on line 12 of Form 2900 (T. 32). This money is placed in escrow for the closing of the loan (T. 32).

HUD requires a verification of deposit for any funds in a depository in excess of $100 which the buyer states will be used to complete the transaction (T. 25-26). The verification is signed by the depository or individual holding the funds (T. 25). HUD will not approve an insured loan without the FHA Form 2004.F Verification of Deposit (VOD) being in the application package (T. 26). 2/ This HUD policy was in effect in 1974-75, as well as the present (T. 39).

1/ This includes independent credit checks and verifications of employment and deposits.

2/ The one exception to this requirement is when the funds for closing are in the buyer's personal possession (T. 35,38).

The guide for mortgagees in originating HUD-insured loans is HUD Handbook 4000.2 (T. 45). It outlines the proper information-gathering and verification procedures. The verification procedures are particularly important to HUD because they tell HUD whether a buyer-mortgagor is likely to be able to go to closing and make payments on the loan as they come due. (T. 30-31). If the buyer-mortgagor is unable to make such payments, the mortgage is likely to go into default and the mortgagee will tender the property back to HUD after foreclosure. HUD is then liable to pay off the mortgagee in the amount of the unpaid balance and foreclosure costs (T. 31).

Escrow entities do not originate loans or qualify a buyer (T. 156, A #3). They implement instructions from a mortgagee that may or may not require verifications and they do not verify deposits unless they are specifically directly to do so (T. 162). Appellant was unfamiliar with the VOD form required by HUD at the time she started with MNB because she had only dealt with them rarely and never signed one on behalf of an escrow (T. 177-178). Manginelli of the MNB Mortgage Loan Department informed Appellant that HUD required such verifications. (T. 135). The function of the MNB Escrow Department would be to verify deposits in excess of $100 on the HUD Form VOD that buyers stated they had placed in the MNB Escrow Department for purposes of a downpayment and closing costs (T. 25-26). Appellant testified that Manginelli directed her to do this verification by comparing the amount listed by the buyer on line 12 of the Form 2900 and the amount stated on the VOD by the buyer as being on deposit at MNB. If the two amounts were the same, Appellant was to sign the VOD on behalf of MNB (T. 133-34).

Appellant followed Manginelli's directions in regard to the VOD's (T. 158). At the time she received a VOD from the loan processor, it had already been signed by the buyer and the MNB loan officer (T. 136-37, 139). Appellant relied on these signatures as a certification that the information on the form was true and correct because (a) she believed the MNB loan processor had already checked on the accuracy of the information (T. 137, 139, 178) and (b) the penalty for a false statement on the Form 2900 was so harsh that the buyer would not make a misstatement as to cash on deposit (T. 136-137). She therefore believed that her only real "verification" purpose was to make sure the information listed on the different forms matched up (T. 167, 170-171).

Appellant had never been a loan processor or worked for a mortgagee before coming to work for MNB. (T. 132). Her contacts with the Mortgage Loan Department of MNB concerning verification of deposits were her only contact with the

origination process. She testified that she did not know HUD used the VOD's in deciding whether to insure a loan (T. 139, 178). Appellant stated that she believed the VOD was an "intrabank form" on which the bank "told itself" how much it had on deposit (T. 139, 165). Appellant also relied on the language on the VOD itself (T. 136-137) which provides:

> Your response is solely a matter of courtesy for which no responsibility is attached to your institution or any of your officials. (G #1).

She believed this language meant that the verification was a mere formality (T. 139). However, the head of HUD's mortgagee credit section disagreed with Appellant's interpretation of the language on the VOD. He stated that the language in question refers to the buyer assuring his bank he will not take action against the bank for releasing such information. It is not an assurance from HUD to the depository (T. 48). Appellant did not have a copy of the HUD Handbook for mortgagees (4000.2 and 4005.8) to guide her in evaluating the VOD (T. 174, 175). Manginelli had only provided her with excerpts from HUD Handbook 4155.1 (A #1), which was designed for use by HUD employees, not mortgagees (T. 42-43, 45).

The Government presented uncontroverted evidence that Appellant verified funds on deposit in at least three transactions where the funds were not on deposit at the time Appellant signed the VOD's (G #1-7). Appellant agreed with the Government that this had occurred (T. 171, 174). She testified that she was unaware the funds were missing in each of these transactions at the time she signed the VOD's because she was following Manginelli's verification directions and had not actually checked any of the accounts before making her certification (T. 148). She discovered that funds were not on deposit when the Escrow Department worked on the file in question after HUD approved the loan. (T. 140). Appellant would pull the file to determine what was needed to close escrow. If she saw that money she had verified was not, in fact, on deposit, she would notify the loan processors that the funds were not there (T. 141). Appellant would then try to contact the buyer to tell them to deposit the funds immediately (T. 142). She testified that she only recalled this happening on a few occasions (T. 142). As receipts and money came into escrow, secretaries in the Escrow Department received it, made

out a general ledger ticket, deposited it in the account, and posted the ledger (T. 169). Appellant further stated that "anyone" could bring in escrow deposits and get a receipt. (T. 144). Appellant herself did not post ledgers or a debit and credit sheet for escrow accounts (T. 169-170). Appellant did occasionally receive money (T. 170). However, she had never met any of the buyers in the transactions in question (G #4, 5, T. 95,96).

When Appellant discovered that funds she had verified were not present, she discussed the problem with Manginelli and the MNB loan processors who had signed the VOD's before they were given to Appellant. (T. 150, 158). Manginelli told her to keep doing the VOD's as he had directed because "there was no problem" (T. 158-159). Appellant testified that she continued to do the VOD's in the manner directed by Manginelli even after she discovered errors because of his assurances (T. 159) and the fact that she knew a loan would not close until the buyer had the proper amount of money in escrow (T. 142, 148). She testified that she did not realize her verification at MNB were being done "incorrectly" (T. 159) and she further stated that if she had known they were not for MNB but HUD, she would have verified them differently in spite of Manginelli's directions (T. 178).

There is no evidence that Appellant was aware that her "verifications" were a step in covering up a fraudulent practice by a local real estate broker, Peter Petsas. The Government presented evidence that in the transaction involving [redacted] Gray as buyer, Petsas "put up" the downpayment of $400 for the buyer and at the time Gray signed the Form 2900 and VOD, he did not have an account with MNB as stated on those forms. (G #5). J[redacted]. Mathews, another buyer, gave similar testimony. Petsas induced him to buy a property he had only intended to rent by assuring Mathews it would be "cheaper" (T. 85-86). Mathews signed a blank Form 2900 and VOD (T. 87, 94, 104). Although Mathews' Form 2900 and VOD stated he had $500 on deposit with MNB, he did not. (T. 87, 88). He gave Petsas $125.00 and thereafter made payments directly to MNB (T. 93). Neither Mathews nor Gray had ever met Appellant or spoken with her. (T. 95, 96, G #5). The Nolan transaction appears, for all practical purposes, to be identical to the Mathews transaction (G #4). No mention is made of Appellant in the transcript of testimony of P[redacted] Nolan (G #4). However, in each of these transactions, the VOD is signed by Appellant (G #1, 4A, 5A). If Appellant had actually checked the files for receipts in the Gray and Mathews transactions, she would have found that the monies alleged to have been on deposit at the time of her verification were not there. Subsequently, the funds were deposited in the accounts by Petsas. Appellant

admits these facts (T. 171, 174). Petsas' scheme could not have succeeded if Appellant had checked the records. However, there is no evidence that Appellant was aware of this scheme, and I find that her role in it was without her knowledge or intent to mislead or defraud.

Appellant left MNB in 1976 and opened an independent escrow corporation called Canyon Escrow (T. 150). Canyon Escrow has five employees, including Appellant, and is not affiliated with any mortgagee (T. 154). Canyon Escrow verifies deposits for HUD in a far different way than MNB. Appellant describes the process as follows:

> When they bring this form in to us from a loan company, we take a photocopy of our receipt in our file and that photocopy of that receipt is attached to that form. That is the only way funds are verified in our office, no other way. And, if the funds are not in that file on that particular day then they are not verified in any way, shape or form (T. 157).

I find that the manner in which Canyon Escrow has been verifying deposits for HUD since November, 1976 comports with the procedures described by the chief of HUD's mortgage credit section as the proper procedure for verifying deposit.

Appellant also testified about her present evaluation of what happened at MNB and how she has changed as a result of her experience. She stated:

> I feel that the instructions that were given me at the bank were unclear and I followed the instructions because I was an employee of the bank. The instructions when given to me were in error. Since I went through the hearing and everything else, I have become probably one of most cautious people in the world when verifying anything.... If it's not in the package it does not get the signatures of anyone or myself or anyone in my office and that's the way it is (T. 158).

DISCUSSION

The threshold issue in this case is whether Appellant is a "contractor or grantee" within the meaning of the Departmental regulation. If she is not, HUD and any administrative judge or Board acting pursuant to 24 C.F.R., Part 24 would lack jurisdiction over Appellant. MNB was a mortgagee and, as such, is expressly included in the definition. 24 C.F.R. §24.4(f). Although Appellant was employed by MNB, she was not in MNB's Mortgage Loan Department and, in fact, has never worked as a loan processor at any time in her career. However, the purpose of the regulation is to encompass all individuals, governments, and organizations who have a direct or indirect impact on HUD programs. Clearly, if escrow companies are called upon to verify deposits of buyers and that verification is used by HUD to make an underwriting decision, the escrow company will have an impact on HUD's mortgage insurance program. The enumerated examples of "contractors or grantees" in the regulation are not exclusionary. The definition clearly states that the defined class is not limited to the cited examples. 24 C.F.R. §24.4(f).

The California escrow system is not typical of mortgage loan systems in other states. What is done by mortgagees in other states is done by escrows in California. An escrow is essentially the agent for a mortgagee, taking instructions from the mortgagee in closing loans. This relationship means that, at the very least, escrow entities are "contractors" with mortgagees, who are "participants, in programs where HUD is the guarantor or insurer". 24 C.F.R. §24.4(f). Thus, an independent escrow company or an escrow department of a depository that has a mortgagee function would be a "contractor or grantee" within the meaning of the regulation. I find that HUD has jurisdiction pursuant to 24 C.F.R., Part 24 in this matter because Appellant, as an employee of a mortgagee at the time the operative events occurred, was a "contractor within the meaning of 24 C.F.R. §24.4(f). Similarly, Appellant and her affiliate, Canyon Escrow, are presently contractors within the meaning of the Departmental regulation.

The purpose of debarment is to assure the Government that "awards be made only to responsible contractors". 24 C.F.R. §24.0. Debarment is an administrative sanction, not a penalty, and "shall be used for the purpose of protecting the public." 24 C.F.R. §§24.5(a), 24.6(b). "Responsibility" is a term of art in Government contract law. It has been defined to encompass both the ability to perform and the honesty and integrity of the contractor, 34 Comp. Gen. 86 (1954); 39 Comp. Gen. 468 (1959); 49 Comp. Gen. 132 (1969).

HUD is seeking to debar Appellant pursuant to 24 C.F.R. §24.6(a)(4) for serious lack of responsibility, based on her inaccurate verifications of three deposits in her capacity as manager of the Escrow Department for Mechanics National Bank from 1972-1976. By implication, HUD is also relying on 24 C.F.R. §24.6(a)(6), which states that a ground for debarment is the making of "any false statement for the purpose of influencing in any way the action of the Department." The record is devoid of any evidence that Appellant intended to influence the action of the Department when she signed Verification of Deposit forms for MNB. Therefore, I do not find that the Government has established a ground for debarment pursuant to 24 C.F.R. §24.6(a)(6).

The charge of serious lack of responsibility, however, is a closer question. Appellant's explanation of the "verification" process as directed by Manginelli would surely have raised questions in anyone's mind because it does not appear to be a reasonable system for verifying anything. It was really little more than proofreading. Appellant stated that she had no idea the VOD was used by HUD to decide whether to underwrite a loan. The VOD is clearly marked as a HUD form. However, this does not prove the disingenuousness of Appellant's position because it is not clear on the form whether it is primarily for the use of the mortgagee in deciding whether to make a loan or for HUD's decision to insure. Appellant knew almost nothing of HUD's procedures and did not even have the proper HUD Handbook to guide her. She therefore placed unwarranted reliance on Manginelli and the loan processors in Manginelli's department.

HUD is obliged to attempt to protect itself from loan participants, including escrows, who may be less careful with loans for which HUD will be ultimately liable in the event of default. An escrow has an obligation to HUD to make certain that escrow funds are on deposit and that the loan will not close until such deposits are made. It cannot rely on the mere statements of the mortgagee and buyer that the funds are on deposit.

The real problem in the Gray, Mathews and Nolan transactions was the fact that Peter Petsas was "putting up" the downpayments for the buyers in violation of HUD regulations. Proper verifications of deposits would not have revealed the source of the deposits because, as Appellant testified, anyone can walk into an escrow with money to be credited to an account. In each of the transactions, the loans did not close until the funds were on deposit in the MNB Escrow Department.

Nonetheless, Appellant's conduct of her duties as Manager of the Escrow Department in regard to verifications of deposits were not carried out in a responsible manner. After she discovered that the loan processors were giving her incorrect information on the VOD's, she should have actually checked the escrow accounts of the buyers. Manginelli's vague assurances should not have deterred her from making sure that she only signed her name to true statements. She was on notice from the first error that she could not rely on the loan processors. Appellant's decision to continue following Manginelli's directions may have made sense to her at the time but, on reflection, even she admits it was wrong.

Since late 1976, Appellant has been running an independent escrow company. The method used at Canyon Escrow to verify deposits satisfies HUD procedures and responsible business conduct. While Appellant's blind reliance on Manginelli and her ignorance of HUD procedures was not responsible, there are coherent explanations in mitigation of the judgments she made at MNB. Appellant's professional conduct since 1976 has been responsible, and she has learned to be very careful in her business as a result of her experience at MNB.

Although evidence of past lack of responsibility can be grounds for a present finding of lack of responsibility, the test for debarment is present responsibility. Schlesinger v. Gates, 249 F.2d 111 (D.C. Cir. 1957); Roemer v. Hoffmann, 419 F. Supp. 130 (D.C.D.C. 1976). The Departmental regulation clearly states that mitigating factors may be taken into account when making a determination whether debarment is necessary. 24 C.F.R. §24.6(b)(1). Case law likewise dictates that all factors bearing on present responsibility must be considered in debarment actions. Roemer v. Hoffmann, supra, at 131.

I find that Appellant is presently a responsible contractor, based on evidence of responsible business conduct since 1976 and the mitigating factors surrounding her conduct at MNB. With the exception of the evidence of the three loan

transactions which occurred five or six years ago, Appellant's record appears otherwise unblemished. Consequently, it is not in the public interest to debar Appellant or her affiliate, Canyon Escrow.

DETERMINATION

Based on the record considered as a whole, Appellant is presently a responsible contractor and it is not in the public interest or the interest of the Government that she be debarred.

Jean S. Cooper
Administrative Judge
HUD Board of Contract Appeals

Issued at:
Washington, D. C.
March 31, 1980.