UNITED STATES OF AMERICA

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BOARD OF CONTRACT APPEALS

Washington, D. C.

In the Matter of:	:	
SAMUEL T. ISAAC & ASSOCIATES, INC. and SAMUEL T. ISAAC,	:	HUDBCA Nos. 80-452-M2 80-485-D29
Respondents	:	

Samuel T. Isaac, President
Samuel T. Isaac & Associates, Inc.
2113 Lakeside Drive
Lexington, Kentucky 40502

Joseph Hurley, Esquire
Joseph LoBue, Esquire
U. S. Department of Housing
and Urban Development
Washington, D. C. 20410

DETERMINATION

Statement of the Case

This determination results from two actions by the U.S. Department of Housing and Urban Development ("HUD") seeking to sustain the permanent withdrawal by HUD's Mortgagee Review Board ("MRB") of HUD-FHA mortgagee approval of the Respondent Samuel T. Isaac and Associates ("STI") and, initially, to debar the Respondent Samuel T. Isaac ("Isaac") and affiliates from further business dealings with the Government for a period of five years. No affiliate other than STI has been specifically named by or represented in response to the Government's notices or Amended Statement of Charges. The two actions have been consolidated. The Government has subsequently in its brief sought to enlarge the period of Isaac's debarment to one of indefinite duration, but not less than five years.

By a letter dated October 16, 1979, Isaac, as President of STI, was notified by Assistant Secretary for Housing Lawrence B. Simons, acting in his capacity as Chairman of the MRB, that STI's HUD-FHA mortgagee approval had been withdrawn effective upon

receipt of that letter. The action was based upon an allegedly false certification by STI on a FHA Form 2434, Mortgagee's Certificate, made in connection with HUD's initial endorsement for insurance of the mortgage for HUD-FHA Project No. [redacted], United Auto Workers Senior Citizen Center, Pekin, Illinois ("UAW Project" or "the Project"), to the effect that STI had a firm commitment by the Government National Mortgage Association ("GNMA") to provide permanent financing for the UAW Project. As a basis for the action, the MRB also cited STI's failure as mortgagee to maintain the requisite beneficial interest in the insured mortgage in violation of 24 C.F.R. §207.261(e). The notice did not cite specific grounds for withdrawal under 24 C.F.R. §25.5.

Assistant Secretary Simons, acting in his capacity as Assistant Secretary for Housing, subsequently notified Isaac by letter dated December 12, 1979, that HUD proposed to debar Isaac and his affiliates for a period of five years from the date of the notice for causes identified in 24 C.F.R. §§24.6(a)(5) and (6) as a result of an Inspector General's investigation which revealed irregularities of a serious nature in Isaac's business dealings with the Government. Isaac and his affiliates were immediately suspended pending final determination of the issues raised by that action.

In the December 12, 1979, letter the Assistant Secretary, who also served as Federal Housing Commissioner ("Commissioner") of the Federal Housing Administration ("FHA"), asserted that this allegedly false certification had caused HUD to issue mortgage insurance on the UAW Project which would not have been issued without such an assurance, and that the collection of $151,843.00 based on that certification was made under a false pretense. The Assistant Secretary also asserted that Isaac had failed to pay Insured Advances Nos. 17 and 18, which had been approved by the Chicago Area Office on February 9, and March 16, 1979, respectively; that these omissions were violations of paragraph 16 of the Mortgagee's Certificate and paragraph 4(a) of the Building Loan Agreement, FHA Form 2441, dated October 13, 1977, between United Auto Workers Senior Citizen Center, Inc. ("Mortgagor") and STI; and that the omissions caused at least a portion of the $90,737.00 discount or financing charge paid to the Respondents for the construction loan to be unearned.

Respondents, who were represented by counsel, demanded hearings in each case and were granted several continuances to accommodate settlement negotiations. In a series of letters to Respondents throughout this period of continuances, the MRB deferred its final decision as to the scope and duration of the withdrawal of mortgagee approval in order to allow the MRB to review Isaac's efforts to effect a final endorsement for the UAW Project. In a letter dated May 30, 1980, the MRB advised Isaac that,

> the Board will consider the accomplishment of a final endorsement for the UAW project to be a mitigating factor when it makes a final determination with respect to the scope and duration of the withdrawal of Isaac.

STI's mortgagee approval was withdrawn permanently on August 19, 1980, effective forty-five days from receipt of the letter. However, the MRB Chairman advised Isaac that if final endorsement of the UAW Project were accomplished within the forty-five day period, and if Isaac had provided the MRB with a written response to the Office of Inspector General Audit Report 80-AT-94-0011, dated April 10, 1980 (the "Audit Report"), the MRB would reconsider the scope and duration of its withdrawal action.

By order of October 15, 1980, the two cases were consolidated and a schedule was established for hearing. The Government was directed to file a Statement of Charges by October 24, and the Respondents to respond by November 14, 1980.

However, by letter dated October 22, 1980, the MRB notified Isaac, as President of STI, that the Audit Report by HUD's Inspector General had disclosed additional irregularities constituting additional grounds for seeking withdrawal of STI's mortgagee approval pursuant to 24 C.F.R. Part 25, Subpart A, and that the original grounds for withdrawal of mortgagee approval were amended. These irregularities were related to Salem Village Phase I, HUD-FHA Project No. [redacted] ("Salem I"); Salem Village Phase II, HUD-FHA Project No. [redacted] ("Salem II"); and Salem Village Towers, HUD-FHA Project No. [redacted] ("Salem III"), in Joliet, Illinois (collectively the "Salem Projects"). The reasons cited, along with specific factual allegations related to particular findings in the Audit Report, involved alleged mismanagement and misuse of escrow funds by Respondents in violation of 24 C.F.R. §§203.7(a)(2), and (3), 1/ and 207.19(a)(2) and (7); HUD Handbooks 4191.1 Rev., Sec. 2la, and 4350.1; and HUD Forms 2001C, 2434, and 2580. This notice did not cite specific grounds for withdrawal under 24 C.F.R. §25.5.

By a second letter also dated October 22, 1980, Assistant Secretary Simons advised Isaac, as President of STI, of the amendment of the original grounds for the proposed debarment, based upon the Audit Report. Specifically, the Assistant Secretary cited as additional causes for debarment for five years from the December 12, 1979, notice under 24 C.F.R. §24.6(a)(4) and (5): the failure to fund fully certain escrow accounts, to make timely transfer of funds to those accounts, and the use of

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1/ All references to 24 C.F.R. §203.7 herein relate to the form of the regulations at the time of the events in issue and prior to publication of amendments to these regulations on July 30, 1980.

funds deposited in escrow accounts for purposes other than those for which they were collected in violation of 24 C.F.R. §203.7(a)(3), Form 2001C (Application for Approval as Mortgagee), and HUD Handbook 4191.1 Rev.; the misuse of escrow funds to pay the principal and interest due the permanent noteholders of the Salem Projects in violation of 24 C.F.R. §203.7(a)(3) and Form 2001C; the improper investment of $50,000 of escrow funds from Salem I and Salem II in the UAW Project in violation of 24 C.F.R. §203.7(a)(3), Form 2001C, Form 2434 (the Mortgagee's Certificate), and HUD Handbook 4350.1; and the failure to establish an Initial Operating Deficits Account and a Residual Receipts Account for Salem III in violation of 24 C.F.R. §203.7(a)(2) and (7), and Form 2580 (the Maximum Insurable Mortgage).

The Government filed an original Statement of Charges on October 29, 1980, and an Amended Statement of Charges on January 12, 1981. The Amended Statement of Charges deleted Count 6 of the original Charges, renumbered the successive Counts, and added a Count 10 which alleged that Respondents had engaged in a pattern of improper conduct as an additional basis for the proposed sanctions. The Amended Statement of Charges made no reference to 24 C.F.R. §203.7(a)(7), §207.19, or HUD Handbook 4191.1, which had been cited in the notices. All Counts cited as grounds for withdrawal of mortgagee approval 24 C.F.R. §25.5(h). Counts 5 through 8 also cited §§25.5(c) and (d), and Count 9 also cited §§25.5(b) and (d). All Counts except Counts 2 and 10 alleged causes for debarment under 24 C.F.R. §§24.6(a)(4) and (5). Counts 2 and 10 alleged causes under 24.6(a)(4) only; Count 1 also alleged cause for debarment under 24.6(a)(6). Respondents generally denied the allegations in their Answer filed on November 19, 1980.

In response to the prehearing order, Respondents filed a Witness List on December 8, 1980, which identified some forty witnesses, including all members of the Mortgagee Review Board and a substantial number of other high ranking Federal and state government officials and Members of Congress who would be called to testify.

Appellant's counsel of record was permitted to withdraw by Order dated January 26, 1981. Isaac, having filed a corporate resolution authorizing him to represent STI, thereafter represented STI and himself and, in part over Government objection, was allowed additional time to comply with prehearing requirements.

By an Order dated February 19, 1981, and a written opinion dated March 3, 1981, Respondents' Motion To Strike Count 10 of the Amended Charges was granted, and evidence relating to Respondents' attempts to effectuate final endorsement of the UAW Project was excluded as irrelevant and immaterial to the issues in these consolidated cases. The parties were advised that

issuance of subpoenas and testimony of witness would be limited accordingly. The ruling also limited the scope of the hearing on Counts 1-9.of the Amended Charges to exclude consideration of the process by which HUD officials made their decisions to withdraw STI's mortgagee approval, to debar the Respondents, and to deal with Respondents' attempts to effectuate final endorsement of the UAW Project.

Thus narrowed in scope, the consolidated de novo hearing required thirty days, commencing on March 3, and continued intermittently in Washington, D. C., and Chicago, Illinois, until May 22, 1981. At the conclusion of the hearing, the parties were directed to file simultaneous briefs, together with proposed findings of fact and conclusions of law, by September 15, and reply briefs by November 3, 1981. The Government filed its brief and proposed findings in timely fashion on September 15, 1981. Over the repeated objections of the Government, Respondents were granted extensions of time for filing their brief, first until November 9, 1981, and then until January 15, 1982. On January 18, 1982, Respondents' filed another request for a further extension until April 15, 1982 which was denied. However, Respondents were granted leave to file a brief out of time, subject to certain reservations. A Government Motion To Dismiss for lack of prosecution was denied.

Nevertheless, Respondents have not filed a brief or proposed findings as ordered or allowed. On May 5, 1983, Isaac filed a letter of explanation and argument, certain medical records describing his progressive medical disability, and copies of portions of the hearing transcript referred to in that letter. On May 11 the Government requested leave to file a Reply Brief, which was granted by Order dated May 12, 1983. The Reply Brief, filed on May 24, 1938, argued that the medical records are immaterial to a decision in these cases, and advanced certain arguments relating to the Respondents' obligation to make Insured Advances Nos. 17 and 18. That same date, the Government also filed a Motion to Close the Record and To Disregard Medical Records. The record upon which this decision would be based was ordered closed as of July 29, 1983. I find that the medical records have no relevance to the issues which I must decide and, accordingly, I have disregarded them.

Findings of Fact

The charges divide into two groups: those related to alleged irregularities involving the UAW Project, and those related to alleged irregularities involving the Salem Projects. I have considered each group separately. Certain general findings, however, are applicable to both groups of charges.

General Findings of Fact

1. To qualify as an eligible private lender, STI by its President, Isaac, executed an Application for Approval as Mortgagee (FHA Form No. 2001C) on July 3, 1974, in which STI specifically agreed, among other things, that it would comply with the provisions of the FHA Regulations and other requirements of the Commissioner; that it would segregate and deposit escrow funds in special accounts (except as otherwise permitted by FHA in writing); and that it would use escrow funds only for the purpose for which they were received (Exh. G-10).

2. On August 7, 1974, FHA approved STI as a mortgagee to originate, purchase, service, and sell FHA insured mortgage loans. That status continued until STI's receipt of the MRB's notice of withdrawal of such approval dated October 16, 1979. (Joint Exh. 1, Para. II(1); Exh. G-10.)

3. The contractual relationship between HUD and STI as a HUD-approved mortgagee was, as a matter of established programmatic practice and necessity, one of trust and confidence, involving minimal supervision by HUD and heavy reliance by HUD upon the mortgagee's initiative and diligence to satisfy all of its obligations, including adherence to applicable regulations and HUD's program requirements, in a responsible and prudent manner. HUD Handbook 4060.1, "Mortgagee Approval Handbook" provides that "HUD-approved mortgagees are required to originate and service HUD-insured mortgages in accordance with accepted practices of prudent lending institutions and HUD's requirements" (Tr. 2047-49, 4/13; 2165-66, 2169-72, 2210-11, 2288, 4/14; Exh. A-110A, para. 1-5 at 1-4). 2/

4. At all relevant times, Isaac was president, chief executive officer, one of two directors, and owner of 51 percent of the stock of STI. His wife was the other director and owner of 49 percent of the stock of STI. I find that STI was, in effect, Isaac's alter ego, since Isaac ran the corporation, made the decisions, and executed virtually all significant documents on STI's behalf. (Tr. 128, 3/20; 17, 46, 5/21.)

2/ Citations to transcripts herein are by page number, followed by the date that testimony in the transcript was recorded. All hearing dates occurred in 1981.

General Findings in Relation to Counts 1-4

5. The UAW Project is a multifamily project for the elderly located in Pekin, Illinois. The mortgage securing its construction loan was insured by HUD/FHA under Section 231 of the National Housing Act. At all times relevant to this Determination, the mortgagor of the project was the United Auto Workers Senior Citizen Center, Inc. ("Mortgagor"). The sponsor was Local 974 of the United Auto Workers Union. STI was the mortgagee of record. Isaac was the principal officer of STI responsible for the UAW Project. Hansen, Nakawatase, Rutkowski & Wyns, Inc. ("Architect") was the architect for the project. Donald Rutkowski was the architect's representative. A. J. Maggio Company ("Contractor") was the general contractor. August J. Maggio was president of the Contractor and was personally involved in the construction of the Project. (Joint Exh. 1, paras. I(1), II(3); Exh. A-5, A-17a, A-19; G-1; Tr. 147, 3/3; 128-29, 3/20; 1595-96, 4/10; 68-69, 5/12.)

6. Pursuant to Section 231 of the National Housing Act, the mortgage note for the UAW Project was initially executed and endorsed by HUD for mortgage insurance to the extent of advances approved by HUD on October 13, 1977. The total mortgage amount for the Project was $6,073,700. (Exh. A-5, A-17, A-19.)

7. The First National Bank, The Herget National Bank, The First National Bank of Peoria, First State Bank of Pekin, and Minonk State Bank (collectively, "Participating Banks") funded $4,350,000 of the construction loan under the mortgage pursuant to participation agreements with STI (Exh. A-21, A-21A, A-22, A-22A, A-23A, A-24, A-24, A-24A, A-25, A-25A, A-26; Tr. 190, 208, 3/20).

8. The Illinois Housing Development Authority ("IHDA"), a financing authority and agency of the State of Illinois, at all relevant times administered the Housing Assistance Payments Contract for the Project (Tr. 2202, 4/14; 2449, 4/16).

9. Although it retained a housing consultant for expert advice, the Mortgagor relied on Isaac to handle the arrangements related to financing and construction of the UAW Project. Isaac knew that Owen Ewing, the Mortgagor's president, had no expertise in multi-family housing. Isaac held himself out as having the requisite expertise, and he assumed effective responsibility and control over the Mortgagor's compliance with HUD's requirements and for arranging for financing and construction of the project. (Tr. 95, 3/3; 113-17, 5/11.)

Count I - False Certification of GNMA Commitment

10. STI agreed and certified in paragraph 18(d) of its Mortgagee's Certificate dated October 13, 1977, that "We have a firm commitment from Government National Mortgage Association to purchase the loan when fully disbursed and fully insured at a financing charge or discount of 151,843 (2½%) and we have collected in the form of cash the sum of $151,843.00 to cover said charge or discount." (Exh. G-1; Tr. 148-49, 3/3; 1451, 4/9.)

11. STI did not have the commitment from GNMA that it certified it had. Isaac had contacted GNMA prior to October 13, 1977, to reserve funds to provide for such permanent financing, but had been advised unexpectedly that no funds were available. (Joint Exh. 1 paras. II(18)-(20); Tr. 134-38, 143, 3/20.)

12. STI's certification in paragraph 18(d) of the Mortgagee's Certificate reflected the exercise of one of three options provided in the instrument. Box "c", under paragraph 18, of the standard FHA Mortgagee's Certificate form permits the mortgagee to certify that it will retain the permanent loan; Box "d" permits the mortgagee to certify that it has a permanent investor who has given a firm commitment to purchase the loan; and Box "e" permits the mortgagee to certify that it neither intends to retain the permanent loan nor has a firm commitment from another entity to purchase the loan. If certification were made under Box "e", the mortgagee would be required to retain the permanent loan if it were unable to locate a permanent investor. HUD would insure a loan, other requirements being met, whether Box "c", "d", or "e" were checked, in reliance upon the certification of a HUD/FHA approved mortgagee. Isaac knew and expected that HUD, in processing the application for insurance, would accept and rely upon the certification STI would provide in this regard as a HUD/FHA approved mortgagee. (Exh. G-1; Tr. 159, 162, 3/3; 194-95, 3/18; 133-36, 3/20; 2097-98, 4/13; 2210, 2285-86, 4/14.)

13. Isaac personally directed the completion of paragraph 18 of the Mortgagee's Certificate in the form in which it was submitted, including, specifically, that Box "d" be checked. He initialed approval of the indicated changes on or before October 13, 1977. (Exh. G-1; Tr. 134-36, 143, 3/20.)

14. By initially endorsing the $6,073,700 mortgage note on October 13, 1977, HUD agreed to insure the mortgagee against loss in the event of default to the extent of advances approved by the

Commissioner. In doing so, HUD accepted and relied upon STI's certification as a HUD/FHA approved mortgagee that STI had a firm commitment from GNMA to purchase the loan as prescribed in the certification. Such reliance is customary and programmatically necessary. ((Exh. A-5, A-17; Tr. 159, 3/3; 112, 149, 3/18; 133, 3/20; 1454, 1497, 4/9; 2097-98, 4/13; 2210, 2284-86, 2293-94, 4/14.)

15. STI had submitted the Mortgagee's Certificate, completed except as to date, to HUD for review prior to October 13, 1977. As a result of STI's certification, HUD processed the application for insurance of the loan on the assumption that the GNMA purchase would assure a permanent interest rate of 7½ percent, which was substantially below prevailing market interest rates. A 7½ percent interest rate was well known in the mortgage banking industry to have been an element of the GNMA Tandem Program for the purchase of qualified permanent loans since 1976. A false certification in the Mortgagee's Certificate would be viewed as a serious matter in the mortgage industry. It was so viewed by officials of HUD. (Exh. A-5, A-19; Tr. 180-81, 3/5; 145, 217, 3/16; 149-50, 198, 205-08, 254-55, 258, 3/18; 133-36, 3/20; 1496-98, 1508, 1544, 1583-86, 4/9; 2164-66, 2285, 2288-89, 4/14.)

16. Although Isaac knew prior to October 13, 1977, that Tandem Program funds were not available from GNMA and that he did not have a commitment from GNMA to purchase the loan, Isaac did not disclose these facts to HUD or other interested parties until long after initial endorsement of the UAW Project mortgage had occurred on October 13, 1977. Contrary to Isaac's contention, there was no so-called Section 11(b) program which was operational in October 1977 or which was likely to have been available for use in connection with the permanent financing of the UAW Project at that time. The Section 11(b) program to which Isaac referred derived from Section 11(b) of the United States Housing Act of 1937, 42 U.S.C. §1437, and 24 C.F.R., Part 811, Subpart A. The Section 11(b) program would not have involved GNMA unless it involved so-called combination financing which would have used an FHA insured mortgage as collateral for the issuance of a GNMA guaranteed security. Such a program did not exist until substantially after October 1977. To the extent that it eventually did exist, it involved only hospital mortgages. The programs involving GNMA guaranteed mortgage backed securities did not in any event involve commitments from GNMA to purchase loans. STI was not then formally qualified to issue such securities backed by multifamily mortgages. I find that Isaac's certification did not reflect an actual or reasonable belief on Isaac's part that the Section 11(b) program or that a GNMA mortgage backed security program, or a program involving a mortgage backed security in combination with the Section 11(b) program could actually be used to provide permanent financing for

the UAW Project. I find further that a commitment by GNMA to guarantee a mortgage backed security bears no substantial procedural or substantive relationship to a commitment to purchase an FHA guaranteed mortgage loan. (Joint Exh. 1, para. II(20); Tr. 219, 3/5; 105-08, 3/16; 160, 3/18; 135, 157-58, 3/20; 2040-41, 4/13; 212-60, 267-70, 283-86, 5/21.)

17. In their various undertakings and commitments, the Participating Banks, the Contractor, and Owen Ewing, the president of both Mortgagor and Sponsor, and others involved with the project relied upon the Respondents' representations that STI had a commitment from GNMA to purchase the loan until they were advised to the contrary, long after the closing and initial endorsement. (Exh. G-46-G-50; Tr. 95, 3/3; 158, 160, 3/18; 217-19, 228, 3/20; 1321-23, 1394, 1399 4/9; 1597-99, 1639, 1663-64, 4/10; 79, 83-84, 95-96, 114, 116-17, 5/11; 42-43, 55-57, 103-04, 5/12; 32-44, 49-50, 5/21.)

18. The unavailability of 7½ percent permanent financing from GNMA adversely affected the economic feasibility of the UAW Project; it substantially increased the risk to HUD as insurer; and it substantially increased the risk to the participants in its construction and financing. (Exh. A-5, A-19, A-46; G-3, G-4; Tr. 156-58, 3/3; 180-88, 3/5; 1399-1401, 1452-53, 4/9; 1632, 1639, 1813-17, 4/10; 2040-41, 2058, 4/13; 2293-94, 4/14.)

Count 2 - Improper Collection of Discount

19. Both HUD and Isaac knew that GNMA's fixed customary charge of 2½ points represented the fee or discount which would be payable by the Mortgagee on behalf of the Mortgagor at final endorsement if GNMA purchased the loan pursuant to a prior commitment under the Tandem Program. GNMA's charge for purchase of the UAW Project loan would have amounted to $151,843. STI collected that amount from the Mortgagor and certified that it had done so in the Mortgagee's Certificate. I find that Isaac did not intend STI to be the permanent lender at the time the discount was collected. (Joint Exh. 1, para. II (21); Exh. G-1, para. 18(d); A-60; Tr. 188-89, 3/5; 136-37, 3/20; 1092, 4/8; 1451-52, 4/9; 1762, 4/10; 44-45, 5/12; 155-57, 159-62, 5/20.)

20. STI's collection of the $151,843 discount from the Mortgagor, when STI did not actually have a commitment from GNMA or any other permanent lender, was inconsistent with custom and practice in the mortgage finance industry. Practitioners within that industry would customarily collect a discount to be paid to a permanent investor only if they had a firm commitment from the investor. (Tr. 189, 3/5; 151-52, 258-60, 3/18; 1487, 4/9; 1762, 1764, 4/10.)

21. Although the $151,843 collected by STI belonged to and was held on behalf of the Mortgagor, STI used those moneys to fund residential FHA-insured loans for its own and Isaac's

account, without disclosing such use either to HUD or to the Mortgagor. (Tr. 138-39, 3/20; 762, 4/10.)

Count 3 - Failure To Disburse Approved Construction Advances

22. Isaac certified on behalf of STI at paragraph 16 of the Mortgagee's Certificate, that "So long as the contractor and/or mortgagor ... shall be ready, able and willing to complete the Contract for the construction of the project, we will upon notice from you [the Commissioner], advance the undisbursed balance of the mortgage for that purpose." (Joint Exh. 1, para. II (22); Exh. G-1, para. 16.) Neither the Contractor nor the Mortgagor were at any time unable or unwilling to continue construction of the Project. They neither communicated nor implied any such inability or unwillingness by word or conduct. In fact, the Contractor actually completed construction of the UAW Project on May 3, 1979, even though STI did not advance the full amount of the construction loan. HUD recognized the completion of the UAW Project as of June 15, 1979. The Mortgagor's failure at relevant times to make any payments necessary for construction of the Project was directly caused by the Respondents. (Tr. 203-05, 3/4; 1482, 4/9; 1615, 1626-27, 1632, 1802-03, 4/10; Exh. A-17A at Art. 20.)

23. STI submitted an Application for Insurance of Advances of Mortgage Proceeds (FHA Form 2403) for Advance No. 17 on January 30, 1979. STI submitted a similar Application for Advance No. 18 on March 13, 1979. HUD approved the first advance in the adjusted amount of $296,078.03 on February 13, and the second in the amount of $268,443.01 on March 20, 1979, and so notified the Respondents in each instance. (Joint Exh. 1, Para, II(23); Exh. G-3, G-4; Tr. 167-71, 3/20.)

24. Each such application for Insurance of Advances incorporated both explicit and implicit assurances that, when HUD approved it, STI would make the advance requested out of mortgage proceeds. STI explicitly represented in each application "To the best of our knowledge, information and belief, the sum requested is now payable. We intend to disburse said sum ... on or about [February 10, 1979, in the case of Advance No. 17, and March 23, 1979, in the case of Advance No. 18] provided we receive prior approval." In each case, STI stated in its cover letter, "We would greatly appreciate your usual expedient processing ...." Application No. 18 implied by explicit calculations that the approximate amount of the advance requested in Application No. 17 had already been made. (Exh. G-3, G-4; Tr. 169, 265, 3/18; 186-87, 3/20; 82-83, 3/31; 1463-64, 4/9.)

25. Nevertheless, although HUD had approved the advances and notified the Respondents that it had done so, STI did not make the advances, to the substantial detriment of the UAW Project and interested parties (Exh. G-3, G-4; Tr. 204-05, 3/4; 1335-36, 4/9; 1636, 1814-15, 4/10).

26. STI also certified in the Mortgagee's Certificate, that it would fund the entire construction loan and represented in that Certificate that STI had collected a $212,211 fee for this service. Isaac arranged for funding of a substantial portion of the loan by the Participating Banks. Isaac specified the terms of the participation agreements, which were evidenced by commitment letters and participation certificates prepared by Isaac. Isaac supplied substantially all of the information upon which the parties relied in entering into these participation agreements and received a one percent differential between the eight percent interest STI agreed to pay to the Participating Banks for their contributions and the nine percent construction loan which STI was obligated to provide as mortgagee of record and principal mortgagee of the UAW Project. By January 1979, STI had disbursed all of the $4,350,000 which the Participating Banks had advanced to STI as their agreed shares of the construction loan. STI did not disburse construction advances Nos. 17 and 18 or any proceeds of the mortgage loan after February 1979. STI has failed and refused to disburse the balance of the principal amount of the construction loan for the UAW Project, which amounts to $1,483,327.58. (Joint Exh. 1, para. II(16); Exh. G-1, paras. 5(b), 18(b); A-21A, A-23, A-24, A-25A, A-26; Tr. 182, 3/3; 8-9, 3/4; 167-71, 176-77, 179, 182, 188, 193, 222-28, 3/20; 1329, 1335, 1396-97, 4/9; 1627, 4/10; 32-55, 5/21.)

27. Although Respondents contend that STI was not obligated to make the advances because there were various defaults under various instruments, including defaults by the Contractor and the Mortgagor, Respondents transmitted no notice of default to HUD until 1981 when the hearing of this case was in progress. Moreover, Isaac attended at least two meetings with responsible HUD officials in April 1979 in connection with attempts to arrange permanent financing for the UAW Project and additional construction financing from the Participating Banks or other sources, but he did not give notice of any default, or claim that the mortgage loan was out of balance, or cite any other default or cause for STI's failure and refusal to disburse Advances Nos. 17 or 18 when he had these opportunities. (Tr. 98-107, 3/19; 165, 171, 177-79, 196, 3/20; 748-50, 4/6; 921-23, 4/7; 1454-57, 1483-84, 4/9; 55-77, 113-17, 119, 5/15; 72-75, 105, 107, 5/19; 78-79, 83-85, 93-94, 120-21, 123-24, 162-64, 186, 5/20; 19-21, 24-25, 27-28, 5/21.)

28. The Construction Contract between the Contractor and the Mortgagor provided at Article 2, Paragraph A, for a February 1, 1979, completion date. It also provided that "The time by which the work shall be completed may be extended in accordance with the terms of the said AIA General Conditions [the current edition of AIA Document A201, "General Conditions of the Contract for Construction"] only with the prior written approval of the Commissioner." (Exh. A-17A at 2; Tr. 1851, 4/10.) The Drawings and Specifications governing completion of the Project under the Building Loan Agreement between the Mortgagor and STI are defined

in that instrument to include "General Conditions of the Contract for Construction" (AIA Document A201) (Exh. G-2, para. 2, at 1). The applicable form of AIA Document A201 provides in relevant part:

> 8.3 DELAYS AND EXTENSIONS OF TIME
>
> 8.3.1 If the Contractor is delayed at any time in the progress of the Work by ... any causes beyond the Contractor's control, ... or by any cause which the Architect determines may justify the delay, then the Contract Time shall be extended by Change Order for such reasonable time as the Architect may determine.
>
> 8.3.2 All claims for extension of time shall be made in writing to the Architect no more than twenty days after the occurrence of the delay; otherwise they shall be waived. In the case of a continuing cause of delay only one claim is necessary. (Exh. G-118.)

29. By a succession of Requests for Construction Changes (FHA Form 2437) ("change order") each dated October 20, 1978, the Contractor sought an extension of the completion date, first to May 3 and ultimately to June 15, 1979, citing abnormal weather conditions beyond its control. The standard form of change order which was used provides a space for the mortgagee to certify that a specific sum "is on deposit with us to cover the net increase resulting from acceptable changes pursuant to the conditions of [the relevant request]." (Exh. A-136A, 136B, 136C; Tr. 153, 3/18; 1024, 4/7; 1693, 4/10.) All three versions of this change order indicated in the space provided that the extension would have no effect on cost. STI never certified in the space provided that it had funds on deposit to cover a net increase in cost. There was no evidence in the record of a net increase resulting from the change that would have required the mortgagee's certification. In fact, construction was completed at less than the project cost. The Architect, the Mortgagor, who did not actually sign the third form of the request for change order, and HUD's field representative gave the necessary approval for the routine extension because of abnormal weather conditions during specified months. This was done with the knowledge of and without objection by the Respondents. Respondents have not contested the Contractor's claim that adverse weather conditions justified the extension. There is no evidence that Respondents ever communicated a specific reason for the failure to transmit the change order to HUD prior to the hearing. HUD had no opportunity to give formal approval to the change orders because the Respondents, to whom the change orders had been delivered in October 1978, never transmitted them to HUD until after the hearing had begun in 1981. (Exh. A-82A, A-136A, A-136B, A-136C;

Tr. 1024, 4/7; 1191, 4/8; 1480, 4/9; 1612, 1693, 1714-15, 4/10; 2040, 4/13; 70-73, 76-82, 104-05, 111-21, 129, 5/12; 93, 5/20.)

29. Paragraph 4 of the applicable Building Loan Agreement between the Mortgagor and STI provides in relevant part:

> (e) The Borrower agrees that the loan shall at all times remain in balance. The Lender shall, in accordance with the provisions of this agreement, continue to advance to the Borrower funds out of the proceeds of the loan as long as the loan remains in balance and the Borrower is not in default hereunder or under the Note or Mortgage. The loan shall be deemed to be in balance only when the undistributed proceeds of the loan (after provision for reserves, fees, expenses and other deposits required by the Lender or the Commissioner) equal or exceed the amount necessary (based on the Commissioner's estimate of the cost of construction) to pay for all work completed and all materials delivered, for which payment has not been made, and the cost of completing construction of the project in accordance with the Drawings and Specifications. (Exh. G-2 at 2.)

30. HUD's review indicated that there were sufficient funds available in the mortgage amount as approved to cover the additional soft costs, consisting of interest, taxes, insurance, and the mortgage insurance premium, necessitated by the extension of the completion date to June 15, 1979, as approved by HUD. The change orders correctly represented that the indicated extension of the completion date would not increase construction cost. As a result, additional contributions or deposits by either the Mortgagor or the Participating Banks were not needed to pay for any costs of the extension in excess of available mortgage proceeds. There is no evidence, other than Isaac's unsupported testimonial claim, apparently based on fundamental misconceptions, that the loan was ever out of balance. Convincing evidence was adduced to the contrary, and I find that the mortgage loan was never out of balance at any relevant time. (Tr. 1480-82, 4/9; 1615, 1693, 1793, 1890, 4/10; 2049-52, 4/13; 2282-83, 4/14; 127, 5/12; 72, 95-96, 5/15; 93, 109-10, 124-28, 131-33, 148-49, 158-61, 178-79, 181-82, 5/20; 24-25, 104-05, 5/21.)

31. Despite ample opportunity, at no time prior to the hearing did Respondents assert that proper procedures had not been followed in connection with the Contractor's request for the extension of the completion date. Not until the hearing was in progress did Respondents assert that the extension of the completion date would have caused the loan to be out of balance or claim that they were excused for that reason under the terms

of the Building Loan Agreement from the obligation to make further advances. Rather, Isaac encouraged both the Contractor and the Architect to believe that he would arrange approval of the requested change order. There is no evidence in the record that supports the Respondents' testimonial suggestion that STI was entitled to collect additional fees, interest, or other charges, as a condition of its approval of such an extension. There was no proof of a prior agreement to that effect with the Mortgagor. Nor was there proof of either a petition to or an approval by HUD, and Isaac disclaimed at the hearing that he had made such a request. In fact, as a matter of choice and tactics, Isaac, despite his awareness and concern, did not disclose to the interested parties any of the bases which he later claimed would justify STI's failure and refusal to make construction advances Nos. 17 and 18. (Exh. G-1, paras. 18(b), 18(f), G-3, G-4; A-1, A-5; Tr. 265-68, 3/18; 748-52, 4/6; 921-23, 4/7; 1454-55, 1483, 4/9; 1613, 1664-65, 1678, 1685, 1715, 1836-37, 4/10; 2040, 4/13; 2219-24, 4/14; 106-07, 113-16, 126-29, 5/12; 119, 5/15; 84-85, 89, 93, 96, 109-12, 132, 5/20; 19-28, 32-56, 135, 138, 141, 196, 5/21.)

32. I find that, notwithstanding the technical considerations cited by the Respondents, the reason that STI did not make the insured construction advances Nos. 17 and 18, whose approval it had requested and received from HUD, was that Respondents had not provided for the full amount of construction financing and did not have funds available to make such advances or to disburse the balance of the construction financing. The considerations cited were merely attempts to justify Respondents' conduct after the fact. (Tr. 169-77, 3/20; 936, 4/7; 1664-65, 4/10; 2039-40, 2047-48, 4/13; 21-22, 5/21.)

Count 4 - Required Beneficial Interest

33. The October 16, 1979, letter from the MRB Chairman charged STI with violation of 24 C.F.R. §207.261(e) "due to its failure to maintain the required interest in the insured mortgage ...." Count 4 of the Government's Amended Statement of Charges alleged that STI "failed to retain the necessary interest in the Pekin project but rather arranged for 100 percent participation by other participants."

34. As principal mortgagee, STI was required by certain provisions of the HUD regulations and the applicable Handbook to retain at all times, unless otherwise permitted in writing by the Field Director in his discretion, at least a ten percent beneficial interest in the insured mortgage up to the date of final endorsement. 24 C.F.R. §207.261; HUD Handbook 4430.1 (Nov. 1972) at para. 1-29. HUD has interpreted the applicable regulation and Handbook 4430.1 to require actual funding by the approved mortgagee of 10 percent of the amount of the insured mortgage to satisfy the beneficial interest requirement. HUD

does not require prior approval of participation in a project mortgage by third parties if such participation totals less than 90 percent. HUD relies upon self-policing by its approved mortgagees for enforcement of this beneficial interest requirement. (Joint Exh. 1, paras. II(11), (12); Tr. 129-34, 157-58, 280, 3/18; 242-48, 3/20; 2039, 4/13.)

35. There is broad recognition of the principle that the mortgagee of record is assumed to have 100 percent of the beneficial interest in a loan which he is obligated to fund, unless he assigns or otherwise transfers participating interests. It is common practice for the mortgage lender not to invest its funds until the shares of any participants have been completely advanced. Respondents did not obtain HUD's approval for third parties to participate in the project mortgage in excess of the 90 percent limit prescribed by the applicable HUD Regulations. Respondents did not have as much as $607,370.00, the requisite ten percent, invested in the UAW Project. Although Isaac claimed to have invested $244,000 in the project, Respondents actually had invested no more than $190,372.42 of their own funds in the UAW Project after they had liquidated part of their investment. (Joint Exh. 1, paras. II(15), (33); Tr. 95-96, 3/3; 7-8, 11-13, 50-51, 3/4; 16-17, 3/17; 133-34, 3/18; 244-45, 3/20; 2203, 4/14.)

36. STI entered into participation agreements with the five Participating Banks which provided that the banks would fund $4,350,000, or 71 percent of the $6,073,700 UAW Project mortgage amount, which they did (Exh. G-46-G-50; A-21-A-25A; Tr. 190-93, 3/20).

37. The Respondents denied knowing that they were required to retain a ten percent beneficial interest in the loan. The record shows, however, that Isaac, as President of STI, had actual knowledge of the limit on third party participation at least by April 1979. Nevertheless, the Respondents liquidated $50,000 of their $244,000 investment in the UAW Project in May 1979 by substituting an investment of escrow funds of the Salem I and Salem II projects which Respondents controlled. Respondents attempted to effect 100 percent participation by third party investors in the UAW project mortgage, as they had previously done in the Salem Village projects, but were unsuccessful. The Respondents admitted making the attempt, but in ignorance of the beneficial interest requirement. (Joint Exh. 1, paras. II(32) - (33); Exh. G-51-G-55; Tr. 228-31, 238-48, 250-51, 255-56, 3/20; 748-50, 4/6; 2199-2200, 4/14; 21-23, 5/21.)

Salem Projects - General

38. At all relevant times, the mortgages for Salem I, Salem II, and Salem III were insured by HUD under §§232, 231 and 236, respectively, of the National Housing Act. The mortgagors for Salem I, Salem II, and Salem III were Salem Village I, Inc., Salem Village II, Inc. and Salem Village III, Inc., respectively.

The sponsor of Salem I, Salem II, and Salem III was at all relevant times Lutheran Social Services of Illinois, formerly called Lutheran Welfare Services of Illinois. (Joint Exh. 1, paras. I(2),(3),(4); II(2), (2-6); Tr. 40, 45, 3/20.)

39. STI served as FHA mortgagee of record for Salem I and Salem II from initial indorsement on August 28, 1974, through final endorsement of the Salem I and Salem II mortgage notes for HUD/FHA mortgage insurance and until March 1977, when STI assigned the mortgages and mortgage notes to the Teachers Retirement Systems of the State of Kentucky ("Kentucky Teachers"). STI then serviced the Salem I and Salem II mortgage loans on behalf of Kentucky Teachers until at least late 1980. (Joint Exh. 1, paras. II(24), (25), (27); Tr. 39-44, 3/20.)

40. From initial endorsement on October 14, 1976, and continuing after final endorsement of the Salem III mortgage note for HUD/FHA mortgage insurance on April 30, 1979, STI served as FHA mortgagee of record of Salem III until early 1981. STI serviced the Salem III mortgage loan until a temporary restraining order terminating those responsibilities was issued on March 14, 1980, by the United States District Court for the Northern District of Illinois (the "restraining order"). (Joint Exh. 1, paras. I(4), II(2), II(24); Tr. 45-47, 3/20.)

41. From the mortgagors, STI collected principal, interest, and escrow funds for Salem I, Salem II, and Salem III. The escrow funds were collected for FHA mortgage insurance premiums, hazard insurance premiums, and Reserves for Replacement for the projects (Joint Exh. 1, paras. II(27), (29), (31).) 24 C.F.R. §203.4(c)(2) requires a mortgagee such as STI to agree

> That, except with the prior approval of the Commissioner, it will segregate escrow commitment deposits, work completion deposits, and all periodic payments under mortgages insured by the Commissioner, received by it on account of ground rents, taxes, assessments, and insurance premiums, and will deposit such funds in a special account or accounts with a financial institution whose accounts are insured by the Federal Deposit Insurance Corporation or by the Federal Savings and Loan Insurance Corporation and shall use such funds for no purpose other than that for which they were received.

24 C.F.R. §203.7 provides in part:

> (a) Approval of a mortgagee may be withdrawn at any time by notice from the Commissioner, by reason of:
>
> * * *
>
> (2) The failure of a nonsupervised mortgagee to segregate all escrow funds received from mortgagors on account of

ground rents, taxes, assessments and insurance premiums, and to deposit such funds to a special account or accounts with a financial institution whose accounts are insured by the Federal Deposit Insurance Corporation or by the Federal Savings and Loan Insurance Corporation;

(3) The use of escrow funds for any purpose other than that for which there were received;

* * *

STI agreed to these requirements in its Application of Approval as Mortgagee as well as in specific escrow agreements (Exh. G-6, G-10).

Count 5 - Misappropriation of Clearing Account Funds

42. STI had a regular business procedure for handling all mortgage payments received, regardless of investor, including STI, which also owned and "warehoused" loans. This procedure provided for the initial receipt and inspection of checks by STI's cashier, and thereafter the delivery of the checks by the cashier in groups to a computer operator who keyed all payments into a computer on the day of receipt, confirmed that payments were correct, and returned the checks to the cashier. At the end of the day on which they were received, all such mortgage payments would be deposited routinely in the "Samuel T. Isaac and Associates, Inc. Clearing Account," Customer No. 10-072-112-00, in the Central Bank and Trust Company in Lexington, Kentucky ("Clearing Account"). On the morning after receipt of any mortgage payment, STI would prepare a check to transfer the entire mortgage payment, including principal, interest, escrows, servicing fees, and late charges, from the Clearing Account to the appropriate custodial account. Payments of principal and interest to the appropriate investor, servicing fees to STI, and escrow disbursements as appropriate would be made from the appropriate custodial account. Escrow reserves would be retained in the appropriate custodial account until needed. (Exh. G-79; Tr. 83-84, 89-90, 3/20; 248-49, 4/1; 789-91, 793-97, 4/7; 20, 22-26, 5/14.)

43. Such use of the Clearing Account in the course of STI's regular business procedure permitted immediate deposit of mortgage payments as received, pending computer identification of the appropriate custodial or escrow accounts to which the payments should have been immediately transferred on the following morning. Under this procedure, after such appropriate transfers, the Clearing Account should have had a zero or fixed minimum balance (Exh. G-16, para. 21(a)(1); A-110A, para. 2-3(d)(3); Tr. 283, 4/1; 792-93, 4/7).

41. Each of ten consolidated monthly mortgage payments for Salem I, Salem II, and Salem III which were received by STI from the Sponsor during the ten-month period between May 1, 1979, and February 29, 1980, was deposited and credited to the Clearing Account within one to three days after receipt. Payments for Salem III were stopped by the restraining order on March 14, 1980. Each of nine consolidated payments for Salem I and Salem II received by STI from the Sponsor during the nine month period between March 1 and November 30, 1980, were deposited and credited to the Clearing Account within one to three days after receipt, except the two payments received on September 15, and November 14, 1980. Those two payments were deposited directly into the "Samuel T. Isaac and Associates, Inc. Custodian for Teachers Retirement System of the State of Kentucky Account," Account No. [redacted], in the Citizens Union National Bank and Trust Co., in Lexington, Kentucky ("Kentucky Teachers Account"), which served as the Salem I and Salem II escrow account. Of the seventeen mortgage payments which were deposited in the Clearing Account, the portion of each which was allocable to Salem I and Salem II was subsequently transferred by STI from the Clearing Account to the Kentucky Teachers Account by check. Pursuant to its regular procedures and HUD's requirements, STI would have prepared each check on the day after receipt of each consolidated payment to effect those transfers. However, because those checks were not presented promptly for payment, the related transfers and deposits did not occur for periods ranging from 33 days to 67 days after receipt of the several consolidated payments during the period from May 14, 1979, through September 16, 1980. (Joint Exh. 2, paras. I(5), II(20), (20b)-(20e), (20g)-(20i), (20k)-(20n), (20p)-(20s), (20u)-(20v), (22), II(1)-(19), (22); Exh. A-31 at 7-8, Exhibit 4 at 24; Exh. G-23-G-34, G-56, G-65, G-91A; Tr. 344-56, 4/1; 525, 4/2; 790-91, 822-23, 4/7; 25, 5/14.)

45. Of the ten mortgage payments STI deposited in the Clearing Account during the ten-month period between May 1, 1979, and February 29, 1980, each portion which was allocable to Salem III was subsequently transferred by STI by check from the Clearing Account to the "Samuel T. Isaac and Associates, Inc. and Various Mortgagors Mortgage Trust Account," Account No. [redacted], in the Central Bank and Trust Company in Lexington, Kentucky ("Mortgage Trust Account"). Pursuant to its regular procedures and HUD's requirements, STI would have prepared each check on the day after receipt of each such mortgage payment to effect such transfers. However, because those checks were not presented promptly for payment, the related transfers and deposits did not occur, in four of seven instances after the Salem III loan began amortizing in August 1979 through March 27, 1980, for periods of from 33 to 41 days after receipt of the related mortgage payments. (Joint Exh. 2, paras. I(6), II (21a)-(21j), (22); Exh. G-66, G-73; A-31 at 7-9, schedule between pp. 25 and 26; Tr. 790-94, 822-27, 4/7; 25, 5/14.)

46. Substantial delays of up to 54 days or more also occurred during these same periods in the transfers of funds from the Clearing Account to the custodial accounts maintained for other investors (Exh. G-116 at Exhibit II; Tr. 822-23, 4/7).

47. These delays in transferring and actually debiting funds from the Clearing Account and crediting them to the various custodial accounts maintained by STI caused a substantial float to accumulate in the Clearing Account. The float was recorded on the bank reconciliations prepared by STI for the Clearing Account as outstanding checks, and fluctuated in varying amounts over time. For example, this float amounted to $80,955.28 on May 31, 1979, and amounted to $272,062.30 on December 31, 1979 (Exh. G-139-G-146; Tr. 822-27, 4/7).

48. During the period extending from May 4, 1979 through November 2, 1979, at least eight discrete and identifiable transfers totaling $190,017.50 were made from the Clearing Account either to STI's corporate accounts or to the accounts of an affiliated corporation. The record discloses no legitimate business purpose under STI's regular procedures and accounting system or otherwise that justified these transfers. The transfers were reflected on bank reconciliations prepared by STI for the Clearing Account simply as amounts "Due from STI." Isaac admitted that these transfers were inappropriate, but has suggested that they represented estimated payments of fees and interest of approximately $25,000 per month which were due periodically to STI to service warehoused and other loans held for STI's account and to pay mortgagee servicing fees which were due to STI. However, because STI's computerized accounting procedures made the exact amounts to which STI was entitled at any particular time readily and promptly ascertainable, I find that it was not necessary for STI to rely on lump sum transfers from the Clearing Account directly to STI in varying amounts allegedly representing estimated servicing fees or interest. Moreover, the amounts of such transfers were not regular in timing or amount, their purpose was not recorded, and a substantial amount of the transfers was later repaid. The cumulative effect of these transfers was actually a continuing deficit in the Clearing Account from May 31 through December 31, 1979, which approximated, at any given time, the unrepaid amount of funds improperly transferred to STI. Also, on 284 separate days, from May 17, 1979, through September 15, 1980, the bank balances for the Clearing Account were less than the cumulative amounts of Salem I, Salem II, and Salem III mortgage payments which had not yet been transferred as they should have been, from the Clearing Account to the proper custodial accounts. Similarly, on 29 separate days during that period, the bank balances for the Clearing Account were less than the total of the escrow portions of mortgage payments for the three Salem Projects. Those deficits occurred because the escrow portions of the mortgage payments had not been transferred to the proper custodial accounts and therefore should have remained on deposit

in the Clearing Account. (Joint Exh. 2, paras. II(1)-(19), (21)(a), (b), (c), (d), (22); Joint Exh. 3, paras. A(1)-(188); Exh. G-24, G-28, G-32, G-35, G-66, G-70, G-72-G-90; G-116, Observations at 1; G-139-G-146; A-31 at 5-6, 22; Tr. 86-88, 3/20; 252-67, 275-76, 278-304, 317-23, 4/1; 637-42, 4/6; 792-806, 823-27, 4/7; 65-70, 5/13; 60-61, 63-70, 5/14; 51-53, 5/15; 15-16, 5/21.)

Count 6 - Salem III Escrow Funds

49. Initially, Salem III escrow funds were comingled in the Mortgage Trust Account with escrows for single-family loans which included mortgages for two GNMA pools being formed and loans warehoused by STI. A separate Salem III escrow account was established, with escrows for mortgage insurance premiums, hazard insurance, and reserve for replacements fully funded by STI on April 2, 1980. From February 12 through March 4, 1980, the Mortgage Trust Account contained a refund by HUD to STI of a duplicate mortgage insurance premium for Salem III in the amount of $33,722.50, which had been paid out of Salem I and Salem II escrow funds. One, and possibly two, $37,123.19 HUD interest subsidy payments for Salem III paid on March 6 and April 1, 1980, respectively, were also retained by STI for approximately ten months without being passed on to the Salem III investors as required. (Joint Exh. 3, paras. D(1)-(6); Exh. G-37, G-56-G-58, G-112, G-114; A-32; Tr. 86-92, 99-102, 121-25, 3/20; 249, 4/1; 594-97, 622-25, 4/6.)

50. From May 3, 1979, through February 14, 1980, Isaac authorized and requested ten specific transfers of funds totaling $331,252.64 from the Mortgage Trust Account to corporate accounts of STI and affiliated corporations. Bank reconciliations prepared by STI for the Mortgage Trust Account reflect these transfers as amounts "Due from STI." (Exh. G-112, G-113, G-113a, G-128-138; Exh. A-31 at 5-6, 21; Tr. 634-37, 4/6; 65, 5/13; 67-70, 144-52, 5/14; 51, 58, 5/15.)

51. A transfer of $42,757.05 made December 19, 1979, from the Mortgage Trust Account to STI's corporate account in the Farmer's Bank and Capital Trust Company was used by Isaac to pay off a bank loan for which STI was obligated as a result of a single-family loan it had made. A second transfer of $25,000 made December 21, 1979, from the Mortgage Trust Account to STI's corporate amount was used to pay off two other single-family loans for which STI was obligated. The record discloses no escrow related purpose for any of the ten transfers of escrow funds, including the two specific transfers described. (Tr. 66-67, 3/18; 106-11, 3/20; 517, 4/2; Exh. G-43, G-44, G-113, G-113A, G-128-G-138; A-31 at 6, and Exhibit 1 at 21).

52. These transfers described in Findings of Fact 50 and 51 created a continuous deficit owed by STI to the Mortgage Trust Account which ranged from $30,000.00 to $148,757.05 at various

times during the period from May 3, 1979, through March 31, 1980. During that period the bank balances of the Mortgage Trust Account contained insufficient funds on at least 151 days to cover the escrow funds deposited in the account on behalf of Salem III, in addition to the Salem I and Salem II escrow funds held in the account from February 12 through March 4, 1980 (Joint Exh. 2, paras. 21(a), 22; Joint Exh. 3, paras. B(1)-(79), D(1)-(6); (Exh. G-31-G-34, G-62, G-99-G-114, G-128-G-138; A-31 at 21; Tr. 597-637, 4/6).

Count 7 - Misappropriation of Salem I and II Escrow Funds

53. Between January 1, 1979, and April 4, 1980, Respondents transferred certain funds received from the mortgagor for Salem I and II, including principal, interest, and escrow funds, from the Clearing Account to the Kentucky Teachers Account (Joint Exh. 1 at para. 30).

54. As of May 1, 1979, all Salem I and Salem II mortgage payments received by STI had been deposited in the Kentucky Teachers Account and all principal and interest payments to the permanent investor were current. During the period from May 1, 1979, through November 30, 1980, principal and interest payments due on a monthly basis were made to the permanent investor from the Salem I and Salem II escrow account. However, because of lengthy delays in the transfer of the Salem I and Salem II mortgage payments from the Clearing Account to the Kentucky Teachers Account, these principal and interest payments were paid to the permanent investor out of cumulative escrow funds in the Kentucky Teachers Account. This use of escrow funds occurred because the current mortgage payments out of which such principal and interest payments should have been made had not yet been deposited in that account. Until such deposits were made, there were varying shortages of escrow funds in the Kentucky Teachers Account from time to time from May 31, 1979, through September 16, 1980. (Joint Exh. 2, paras. II(10)-(19), (20b)-(20e), (20g)-(20i), (20k)-(20n), (20p)-(20s), (20u)-(20v), (22); Joint Exh. 3, paras. C(1)-(20), Exh. G-24, G-26, G-28, G-30, G-36, G-63-G-65, G-91A, G-93-G-98; Tr. 83-85, 3/20; 358-84, 4/1; 829-33, 4/7.)

55. STI followed a similar practice in making timely principal and interest payments to FNMA from accumulated escrow funds for single-family loans, because it had delayed transfers of single family mortgage payments from the Clearing Account to the FNMA custodial account maintained by STI for the purpose (Tr. 827-29, 831-33, 4/7).

Count 8 - Improper Investment of Salem I and Salem II Reserve Fund for Replacements Escrow

56. Paragraph 1(c)(1) of Chapter 4, Section 10, of HUD Handbook 4350.1 Supp. 1 (October 1971), provides that if all other HUD requirements are met, moneys in the Reserve Fund for Replacements, which remains "at all times under the control of the mortgagee whose position is that of an escrow agent," may be invested without approval of HUD in bonds issued or guaranteed as to principal by the United States Government or an instrumentality thereof (Joint Exh. 1 at para. 13).

57. Paragraph 13 of the Mortgagee's Certificates (Form 2434) for Salem I and Salem II, which were executed on August 28, 1974, provides that the mortgagee may "... upon appropriate request by the mortgagor, permit the conversion of the whole or a substantial part of such cash deposits [Reserve Funds for Replacements] into the form of obligations of, or fully guaranteed as to principal by, the United States of America." (Joint Exh. 1, at para. 14.)

58. On May 4, 1979, Respondents withdrew $100,000 from the Kentucky Teachers Account. Respondents redeposited $50,000 of this money on May 5, 1979, into the same account. Respondents invested the remaining $50,000 in the UAW Project pursuant to a Participation Agreement dated April 30, 1979. That Participation Agreement was executed by Isaac acting on behalf of STI as corporate borrower and by Isaac acting on behalf of STI as Trustee for Teachers Retirement System of Kentucky. The invested funds were Reserve for Replacement escrow funds of the Salem I and Salem II projects. (Joint Exh. 1 at paras. II(32)-(33); Exh. G-45; Tr. 56-59, 3/18; 112-13, 3/20.)

59. At the time he effected this investment transaction in late April and early May 1979, Isaac knew that the last construction advance for the UAW Project had been paid to the Contractor on or about February 8, 1979, and that STI had not advanced funds pursuant to either Request for Advance No. 17 or No. 18. Isaac also knew that no interest had been paid to STI by the mortgagor for the UAW Project for more than three months and that the Mortgagee's Certificate falsely represented that STI had a firm commitment from GNMA to purchase the UAW loan. (Joint Exh. 1, paras. II(16), II(18)-(2); Tr. 1616-17, 1810-11, 4/10.)

60. The mortgagors and sponsor for Salem I and Salem II had orally requested that interest be obtained for the escrow funds involved, but did not discuss any specific investment with STI, and did not approve the purchase of the Participation Certificate in the UAW Project (Tr. 116-17, 3/20).

61. The term of the Participation Agreement was twenty months. Pursuant to that Agreement, STI was obligated to pay interest in monthly installments at eight percent per annum, but only if interest was received from the mortgagor of the UAW Project. Because no interest was received from the mortgagor of the UAW Project, no interest was paid by STI to the mortgagor for Salem I and Salem II during the term of the Participation Agreement (Exh. G-45; Tr. 117-18, 3/20; 71-72, 3/31).

62. Although Isaac was advised by HUD on several occasions that the investment was improper, Isaac challenged HUD's interpretation of the applicable regulation and extended the investment by renewing the Certificate for an additional twelve month term in December 1980, notwithstanding the nonpayment of interest, after apparently nominal attempts to sell the Participation Certificate were unsuccessful (Exh. A-31 at 2, 10-12; A-34(A)-(E); Tr. 58-59, 3/18; 114-20, 3/20).

Count 9 - Failure to Establish and Maintain Salem III Escrow Accounts as Required

63. At HUD's direction, Respondents collected $70,070.00 from the Salem III mortgagor on October 14, 1976, to fund an Initial Operating Deficits Account for Salem III. This collection was subject to a specific Escrow Agreement which required STI to hold and disburse the escrow funds "at the sole direction of the Commissioner." However, instead of establishing the escrow account as required, STI carried the amount of $70,070.00 as an account payable on STI's corporate books until Respondents refunded that same amount to the mortgagor March 4, 1980. No interest was credited to the mortgagor's account, but STI used these funds to close FHA and VA single-family loans for its own account. (Joint Exh. 1, at paras. II(35),(36), (38); Exh. G-6 at para. 5; A-31 at 12-13, A-33; Tr. 16-17, 34-35, 51-52, 3/4; 257-61, 266, 3/20.)

64. At HUD's direction, the Salem III mortgagor also deposited $73,171.44 in cash remaining from the Allowance To Make the Project Operational ("AMPO") for Salem III with STI on April 30, 1979, to fund the Residual Receipts Account for Salem III. The funds in that Residual Receipts Account were by contractual agreement under the control of the Commissioner, to be disbursed for the benefit of the project only on the direction of the Commissioner. Respondents had not established a Residual Receipts Account for Salem III by January 31, 1980, the date of an Office of Inspector General audit report with pertinent findings. Instead of establishing the escrow account as required, STI carried the amount of $73,171.44 as an account payable on STI's corporate books until compelled by court order to account for and transfer to a Court appointed receiver all escrow funds for Salem III. While STI had custody of the

Residual Receipts escrow, it used the funds to close single-family FHA and VA loans for its own account, although Respondents assert that interest on the investments was paid to the Mortgagor. (Joint Exh. 1, para. II (35), (38); Exh. A-31 at 12-13, A-50(F), A-51(A)-(B); Exh. G-7 at para. 2(c); G-8 at para. 10(c); G-9, fn. at 4; G-59 at 5, G-60, G-61; Tr. 17-18, 3/4; 53-55, 3/18; 257-59, 263-66, 3/20; 754-55, 4/6; 121-24, 5/13.)

DISCUSSION

Applicable General Principles

Two ultimate issues must be determined in these appeals: first, whether Isaac and affiliates, including STI, should be debarred because they lack sufficient present responsibility to do business with the Government; second, whether there is sufficient basis to justify a determination of the Mortgagee Review Board to withdraw its approval of STI as a HUD/FHA approved mortgagee. See Mechanics National Bank and Mechanics National Mortgage Corp, HUD Docket No. 77-5-MR (Mar. 5, 1979).

Because these determinations are made on a de novo record, I have defined the scope of the hearing in separate rulings which excluded as irrelevant and immaterial any examination of the processes, including any political or other influences which Respondents have suggested might have been brought to bear upon the MRB or other HUD officials, in making the determinations to withdraw mortgagee approval and to propose Respondents' debarment. My rulings also excluded consideration of the Respondents' efforts to effect final endorsement for insurance of the project mortgage for the UAW Project after the acts, omissions, and events identified in the notice and Amended Statement of Charges.

As a HUD/FHA approved mortgagee and its principal, respectively, who are participants, or contractors with participants, in programs where HUD is the insurer and who are both direct and indirect recipients of HUD funds, STI and Isaac are "contractors or grantees" as defined in 24 C.F.R. §24.4(f). Therefore, they are subject, under appropriate circumstances, to the sanctions of debarment and temporary suspension. Their status as "contractors or grantees" is not in dispute.

STI, by reason of its previous approval by HUD/FHA as a nonsupervised mortgagee, is subject to withdrawal of that approval under 24 C.F.R., Parts 25 and 200. To qualify for approval as an HUD/FHA approved mortgagee, STI, through Isaac, agreed that it would conform to HUD's regulations and other requirements as a condition for HUD's approval of STI's participation in FHA insurance programs. Its failure to do so

provides ample grounds for withdrawal of HUD's approval of STI as a mortgagee. 3/

The purpose of a debarment is to protect the public interest by ensuring that the Department does not do business with a contractor or grantee who is not responsible. 24 C.F.R. §§24.0 and 24.5(a). "Responsibility" is a term of art in Government contract law that has been defined to include not only the ability to complete a contract successfully, but also the honesty and integrity of the contractor. Roemer v. Hoffman, 419 F. Supp. 130 (D.C. D.C. 1976); 49 Comp. Gen. 139 (1969); 39 Comp. Gen. 468 (1959); 34 Comp. Gen. 86 (1954). Although the test for debarment is the present responsibility of the contractor, present lack of responsibility of a contractor can be inferred from past acts. Schlesinger v. Gates, 249 F. 2d 111 (D.C. Cir.), cert. denied, 355 U.S. 939 (1958); Stanko Packing Co. v. Bergland, 489 F. Supp. 947, 949 (D. D.C. 1980); 46 Comp. Gen. 651, 658-59 (1967). Debarment, however, is not penal or punitive in nature. It is a measure properly taken by the Government to effectuate its statutory obligation to protect the public interest. See L.P. Steuart & Bros. v. Bowles, 322 U.S. 398 (1944); Gonzales v. Freeman, 344 F. 2d 570 (D.C. Cir. 1964). The existence of a cause for debarment does not necessarily require that a contractor be excluded from departmental programs, since debarment is discretionary with the Department and is to be rendered in the best interest of the Government. 24 C.F.R. §24.6(b)(1).

Under the debarment standard of present responsibility, a contractor or grantee may be excluded from HUD programs for a period which is based upon projected business risk. Roemer v. Hoffman, supra; Stanko Packing Company v. Bergland, supra. Where present responsibility is the only applicable standard, any alleged mitigating circumstances affecting responsibility must also be considered. Roemer v. Hoffman, supra. It follows that debarment is inappropriate if the affected participant can

3/ To the extent that the failure of the MRB Chairman to cite specific subsections of 24 C.F.R. §24.5 as grounds for withdrawal of STI's mortgagee approval might constitute a defect in those notices issued as required by 24 C.F.R. §25.4(b), I find that the Respondents were not prejudiced. They had ample notice of the activities which were the basis for the sanction from the factual recitations in the two notices and the citations to regulations that were included. In addition, the more specific citations to 24 C.F.R. §25.5(b), (c), (d), and (h) contained in the detailed factual recitations and under the several Counts in the Amended Statement of Charges were consistent with and did not expand the scope of the irregular activities described in the two notices, except as I have specifically indicated.

demonstrate that, notwithstanding any past nonresponsible conduct, it no longer constitutes a business risk and can be relied upon to utilize Government resources properly. See generally, 24 C.F.R. §24.0.

Essentially the same considerations that govern debarments under 24 C.F.R., Part 24 determine the scope and extent of the sanction of withdrawal of mortgagee approval under 24 C.F.R., Part 25. Mechanics National Bank, supra. The authority to withdraw approval delegated to the Mortgagee Review Board by the Secretary of HUD is the authority to refuse permission to a previously approved mortgagee to continue to participate in FHA insurance programs. 24 C.F.R. §25.3. That authority is very similar to the Secretary's authority to debar contractors and grantees. See 24 C.F.R. §24.5. In supervising the implementation of statutorily authorized mortgage insurance programs, the Secretary has a duty to protect those programs from negligence, fraud, and other forms of abuse.

An essential resource for coping with deviations from proper standards of conduct applicable to participants in those programs is a refusal by the MRB to permit continued participation by those who have failed to meet program requirements in the past. Like the sanction of debarment, withdrawal of mortgagee approval is a civil sanction, not a penalty, directed at protecting the public's interest in the continued unimpaired implementation of FHA mortgage insurance programs. See Mechanics National Bank, supra.

Because of the character of Respondents' business relationships and responsibilities to HUD and other interested parties, the evaluation of Isaac's present responsibility and that of his alter ego, STI, is properly made

> against the general compass and constraints of well recognized fiduciary standards. The level and quality of confidence and trust which necessarily inheres in the relationships between [Respondents] and HUD, and many of [Respondents'] dealings with third parties as well, justifies such a view. As an HUD/FHA approved mortgagee, [STI, and Isaac] as its principal, should have had an acute sense of responsibility to conduct themselves in general so as to satisfy those high standards, and so as not to reflect adversely in their general conduct upon the United States Government, or HUD in particular, with whose interests their interests are inextricably intertwined. This relationship of trust governs the general context in which the specific regulatory requirements imposed by HUD, and accepted by HUD/FHA mortgagees such as [STI], must be adhered to. With the mantle of HUD's approval, such mortgagees are inevitably benefited in their business dealings with third parties who rely upon the implication of competence and trustworthiness which that mantle bestows.

Ramsey A. Agan, HUDBCA 83-773-D17 (Apr. 21, 1983) at 14. The resulting obligations permeate all of the significant relationships created by the Respondents' activities as an HUD/FHA approved mortgagee and its principal. Because, in my judgment, Respondents' relationships with HUD, with the several mortgagors, and with the Participating Banks, were largely fiduciary in character, the Respondents were obliged to act in utmost good faith in their dealings with those interested parties and to refrain from taking advantage of those parties by the slightest misrepresentation, concealment, threat, or adverse pressure of any kind, and from placing themselves in a position where their own interests might conflict with those of their principals. See, e.g., Compagna v. Unites States, 474 F. Supp. 573 (D.C. N.J. 1979); W.A. McMichael v. D & W Properties, 356 So. 2d 1115, (La. App. 1978); cf. United States v. Bernstein, 533 F. 2d 775, 796-97 (2nd Cir.), cert. denied, 429 U.S. 998 (1976); First National Bank, Henrietta v. SBA, 429 F. 2d 280, 287 (5th Cir. 1970).

I reject as frivolous the Respondents' contention that their allegedly substantial compliance with HUD's myriad requirements should excuse what they contend, in effect, were inconsequential deviations from applicable requirements. Indeed, for an HUD/FHA approved mortgagee, a fiduciary, to advance such a contention might itself be construed as a manifestation of a lack of present responsibility. It is elementary that the proper handling of funds belonging to others, especially escrow funds, is basic to proper performance as an HUD/FHA approved mortgagee and fiduciary. Numerous deviations from such standards which comprise a pattern of irresponsible conduct and reflect an irresponsible attitude establish a need for sanctions to protect the public interest against the misfeasor.

Likewise, Respondents' contention is not persuasive that, upon notice, they corrected such deviations, albeit under pressure from HUD and in one instance under pressure of the contempt power of a court of law. Neither of these contentions constitutes a valid defense nor significant evidence in mitigation because, as the Government has shown, the deviations are in derogation of fundamental and generally recognized fiduciary standards of diligence and fair dealing as well as applicable HUD requirements.

In fact, the record does not support Respondents' contention that the deficiencies relating to the Salem Projects identified in the April 10, 1980, Audit Report of STI's HUD-related mortgagee activities were expeditiously remedied. The Respondents did

not correct most of the deficiencies until five to nine months after Respondents had notice of the findings of the Audit Report. 4/

Count 1 - False Certification

Isaac tried and failed unexpectedly in September 1977 to obtain a firm commitment from GNMA to purchase the mortgage loan in order to assure permanent financing for the UAW Project. Nevertheless, though he could not get the commitment, he falsely certified on behalf of STI in paragraph 18(d) of the Mortgagee's Certificate executed on October 13, 1977, that STI had such a commitment from GNMA to purchase the loan when fully disbursed at a discount of 2½ percent, and that STI had collected cash in the amount of $151,843 to cover that discount. The misrepresentation was clearly knowing and willful. Isaac did nothing to correct or disclose the false and misleading information when Isaac knew others were relying upon it. He did not express any reservation or attempt any justification for his action until long after the event. Respondents' contention that STI could anticipate using the so-called 11(b) program whose implementation, they allege, was imminent, is unreasonable. In addition, such a plan was not reasonably within the scope of Respondents' certification in paragraph 18(d). Nor, I find, could the issuance of a GNMA guaranteed security backed by the UAW Project mortgage be reasonably construed to be included within the scope of STI's certification that there was a GNMA commitment to purchase the construction loan in paragraph 18(d) of the Mortgagee's Certificate.

Respondents do not dispute that the certification was made or that there was no GNMA commitment as certified. Their defense, in effect, has been that the false certification was inconsequential and immaterial. Respondents contend that HUD would necessarily and inevitably have approved the loan and proceeded to initial endorsement, whatever source of permanent financing had been indicated by an approved mortgagee. They contend that even if STI, as an HUD/FHA approved mortgagee, had certified in the space provided on the Mortgagee's Certificate

4/ Respondents have made no showing that would require consideration of their claim that the sanction reflects discriminatory enforcement by HUD. See Stephen H. Jones, 617 F. 2d 233 (Ct. Cl. 1980). Even assuming that such a claim could be so couched as to support a proper exercise of jurisdiction, that defense, whatever its validity might be in a criminal action, is not available in a civil action, especially where enforcement of contractual obligations to which Respondents were parties is in issue. United States v. Snepp, 595 F. 2d 926 (4th Cir. 1979), rev'd in part on other grounds, 444 U.S. 507 (1980). Cf. Oyler v. Boles, 368 U.S. 448, 546 (1962) (Selective criminal enforcement is not proscribed unless based on certain impermissible grounds); United States v. Berrios, 501 F.2d 1207, 1211 (2d Cir. 1974).

that STI itself would assume the loan, or that STI was still arranging for permanent financing, HUD would have endorsed the loan if all other circumstances, including the 7½ percent interest rate and 2½ percent discount, had remained the same.

I find these contentions unpersuasive and the defense based on them to be without merit. Nor do I find that these contentions raise persuasive mitigating considerations. The Government proved that Respondents' representation regarding the anticipated source of permanent financing was a basic component in HUD's analysis and processing of the UAW Project's application for mortgage insurance. HUD and third parties actually relied upon the false representation, which affected crucial aspects of their involvement in the UAW Project. I find that the diverse adverse consequences of Respondents' false certification were generally foreseeable by Respondents and were proximately caused by the false certification regarding the GNMA commitment which Isaac made on behalf of STI.

I find that the false certification falls squarely within the scope of 24 C.F.R. §24.6(a)(6), which makes a cause for debarment, "Making or procuring to be made any false statement for the purpose of influencing in any way the action of the Department." While I find that there is nothing in §24.6(a)(6) that requires a finding of materiality as to the false statement as a prerequisite to invoking the sanction, I find that such a requirement, if read into that section, would present no difficulty in this case. 5/ I find that Respondents' false statement in paragraph 18(d) of the Mortgagee's Certificate was material to the Department's decision-making process. I therefore find that the false statement, which was intentionally made by an HUD/FHA approved mortgagee acting in a fiduciary capacity as to HUD and other interested parties, constitutes a breach of basic obligations of which is wholly inconsistent with responsible business dealings with the Government.

5/ Looking to the analogous, but stricter standards defining materiality in relation to a criminal prosecution under 18 U.S.C. §1001, I find Respondent's false certification to be of such character and to have been made under such circumstances that it "ha[d] a natural tendency to influence, or was capable of influencing, the decision of the tribunal in making a determination required to be made." Cf. Brethauer v. United States, 333 F. 2d 302 (8th Cir. 1964); Gonzales v. United States, 286 F. 2d 118, 122 (10th Cir. 1960), cert. denied, 365 U.S. 878 (1961); Weinstock v. United States, 231 F. 2d 699, 701-02 (D.C. Cir. 1956). I find that "The provision in the contract ... had a purpose. It was not meaningless and useless verbage." See Brethauer v. United States, supra at 306. [FOOTNOTE CONTINUED ON PAGE 31.]

Both separately considered and within the context of this record viewed as a whole, I find a false certification such as that made by the Respondents regarding the existence of a permanent GNMA takeout to be a willful, fundamental and egregious false statement and violation of basic principles of conduct governing an HUD/FHA approved mortgagee's relations with HUD. As such, it is itself a cause both for permanent withdrawal of STI's HUD/FHA approval as a mortgagee under 24 C.F.R. §25.5(h), and for debarment of these Respondents for an indefinite period of at least five years under 24 C.F.R. §24.6(a)(4), (5), and (6). I infer from the nature of this willful and egregious conduct and its context that Isaac and STI both lack the present responsibility requisite to dealings with the Government and are unlikely to be responsible for the foreseeable future.

[FOOTNOTE CONTINUED FROM PAGE 30]

The test of the materiality of a false representation under the more stringent criminal standard looks to the intrinsic capabilities of the false statement itself, rather than the possibility of the actual attainment of its end as measured by collateral circumstances. See United States v. Goldfine, 538 F. 2d 815 (9th Cir. 1976). Whether or not the Government was actually deceived, or suffered monetary loss because of false representations is immaterial under that test. Gonzales v. United States, supra; United States v. Jones, 464 F. 2d 1118 (8th Cir. 1972), cert. denied, 409 U.S. 1111 (1973).

Stated a different way, the test is "[C]ould the false statements have affected or influenced the exercise of a governmental function?" Brandow v. United States, 268 F. 2d 559, 565 (9th Cir. 1959). In Respondents' case, the answer is clearly "Yes". The inference is inescapable that, among other things, the misrepresentation was basic to the analysis of project feasibility by HUD that assumed the availability of permanent financing at 7½ percent interest. Those below-market terms were dependent upon the availability of a permanent takeout under the GNMA Tandem Program.

Count 2 - Improper Collection of GNMA Discount

The $151,843, which Respondents collected from the Mortgagor of the UAW Project at the October 13, 1978, closing, was determined as to amount by the standard 2½ point discount routinely imposed by GNMA in connection with its purchase of HUD/FHA insured mortgages under the GNMA Tandem Program. Had there been the GNMA commitment to purchase the loan as Respondents certified, that money collected by STI would have been held for the Mortgagor's benefit by STI in its fiduciary capacity as mortgagee until final endorsement, when it would have been paid over to GNMA in connection with GNMA's purchase of the loan. But since there was no commitment by GNMA to justify either the collection or the amount of the discount, the Respondents collected the $151,843 from the Mortgagor under false pretenses.

Fairness and forthright dealings as to such matters is required as a matter of the fiduciary's duty. The Respondents were explicitly obligated to adhere to applicable regulations and requirements imposed by HUD. Consequently, the lack of responsibility inherent in STI's collection of the GNMA discount would not be mitigated by a claim of mistake or inadvertence. In this case, however, the impropriety was knowing and intentional.

Moreover, Isaac's relation as expert adviser and packager to the Mortgagor obviously imposed a fiduciary obligation of fairness and forthright dealing which was breached by STI's collection of the GNMA discount under such false pretenses. Respondents further breached their fiduciary duty by using the discount, which they collected on behalf of the mortgagor, for their own benefit by investing the funds in single family mortgages for STI's account and by failing to account to the Mortgagor for such use. Thus, the Respondents' misconduct in relation to the collection of the purported GNMA discount adds manifestly serious and compelling cause for withdrawal of STI's mortgagee approval under 24 C.F.R. §25.5(h) as charged in the Amended Statement of Charges. Such conduct, I find, is of such serious compelling nature affecting responsibility as would of itself warrant a substantial period of debarment of these Respondents for not less than five years under 24 C.F.R. §24.6(a)(4). Although the Assistant Secretary did not identify this subsection of the regulation in his notice of proposed debarment to Respondents, I find that Respondents had adequate notice from the Amended Statement of Charges, including the detailed factual statements in it, that the Assistant Secretary considered the collection of the discount and the false

representation concerning the basis for it causes for debarment, even though the Government abandoned 24 C.F.R. §24.6(5) and (6) as the technical causes for debarment in its Amended Statement of Charges.

Although the Chairman of the MRB did not give specific notice in his letter dated October 16, 1979, that a ground for withdrawal of approval was STI's improper collection of the GNMA discount and the false statement concerning it, I find that this basis for the action is so inextricably intertwined with the false certification of the GNMA commitment, which was specifically cited, that the factual allegations in the Amended Statement of Charges provided sufficient notice for the permanent withdrawal of STI's mortgagee approval to be based upon the Government's proof under Count 2.

Count 3 - Failure To Make Construction Advances

Respondents contend that STI did not wrongfully fail to make construction advances Nos. 17 and 18, because at the relevant times the Mortgagor was in default, and the Contractor was in default of its agreement to complete construction by a contractually specified date, and, among other things, the loan was out of balance. I find, however, that STI's failure to make the advances was not justified by any proof or argument which Respondents have advanced.

I find that the basic reason why STI did not make the two construction advances was that STI had not satisfied its obligation to provide for construction financing. The belated discovery by the interested parties in early 1979 that the Respondents had falsely certified that GNMA had committed to purchase the loan had predictably disastrous effects upon Respondents' ability to obtain and provide the balance of funds necessary to complete construction. The discovery disclosed that permanent financing for the UAW Project was not assured over a year after closing and when construction was nearing completion.

I find further that the Respondents' belated claims that the construction Contractor and the Mortgagor were in technical default are mere pretext. Isaac remained silent at meetings with HUD officials and at other opportunities regarding the circumstances which he admits were known to him upon which he bases the claims he has now belatedly advanced to justify his position. Respondents gave no formal notice of the alleged defaults until the hearing of this case was in progress.

Both Applications for Advances of construction funds Nos. 17 and 18 were forwarded by STI to HUD for approval in such a manner that STI clearly intended HUD to rely on STI's representations that the advances should be routinely approved, insured, and made. Not only was there no suggestion of irregularity in

connection with these two requests for approval of construction advances by STI, but the form of Request for Advance No. 18 even represented by implication that Advance No. 17 had already been made. The record shows that all interested participants, except the Respondents, were in agreement that the extension of time requested by the Contractor for completion of the construction contract was appropriate. Respondents did not dispute, or offer evidence that contradicted the contractor's justification for the extension based upon abnormal weather conditions. There is no evidence that any default occurred or basis for a claim arose, or was discovered by Isaac, between the time of submission of these requests for approval of the advances and the time that such advances should have been made in the ordinary course of business.

In fact, silence served Isaac's purposes. All parties relied upon him. He was in a position of trust. Only he knew then of the false certification as to the GNMA takeout and of his failure to provide the balance of the financing. Silence and comforting assurances allowed him time to maneuver and to manipulate the delayed completion of construction in an attempt to squeeze additional fees and interest from the mortgagor and additional funds from the Participating Banks and other sources. It is evident that Isaac was largely, if not exclusively, responsible for the circumstances which he now claims relieved him of the obligation to make construction advances Nos. 17 and 18.

I find therefore, that STI breached its obligation to HUD under paragraph 16 of the Mortgagee's Certificate, which required it to disburse the advances so long as the Contractor and Mortgagor were ready, able, and willing to complete the contract. The Respondents did not prove that either the Contractor or the Mortgagor was not so disposed. In fact, the Contractor, despite the lack of advances, proceeded diligently to substantial completion of construction on May 3, 1979 at less than estimated cost. The Mortgagor could not meet its obligations because it was wholly dependent upon advances of funds from the loan by STI.

Nor is there evidence that supports Isaac's claim at the hearing that the project loan was out of balance at any time or that Isaac was entitled to any extra fee or other compensation for approving the requested extension. The change order for the extension recited that the extension would involve no extra cost, and Isaac's assurances and other conduct in relation to the Contractor and HUD in particular, as well as other interested parties, estop him from relying upon belated technical objections to the manner in which the Change Order was prepared and processed. Thus, I find that Isaac's failure to approve the Change Order which would have excused the Contractor's delayed completion of construction did not cause a default by the Contractor which would have justified a refusal by STI to make the construction advances. Rather, it was a mere dilatory tactic

to cover Isaac's failure to have provided for the balance of the construction financing that STI was obligated by its contractual relations with HUD to provide, and for which it had charged and collected a substantial fee.

Thus, I find that Respondent's have not proved substantial justification for STI's failure to make Construction Advances Nos. 17 and 18, and that their failure to do so is additional, as well as independent, cause for withdrawal of STI's HUD/FHA approval as mortgagee under 25 C.F.R. §25.5(h) and, both separately and in the context of this record as a whole, for Respondent's debarment for not less than five years under 24 C.F.R. §24.6(a)(5). I find that debarment is warranted under §24.6(a)(4) also, even though such cause was not enumerated in the Assistant Secretary's notice to the Respondent of the proposed debarment because Respondents had detailed factual notice of the activities in issue which are appropriately included within this general cause. The Government abandoned §24.6(a)(6) as cause for debarment under this count. Because this ground for withdrawal of mortgagee approval was not cited even indirectly in the MRB Chairman's notice dated October 16, 1979, I do not rely upon it as a ground for withdrawal of HUD/FHA approval of STI as mortgagee.

Count 4 - Failure to Retain Required Beneficial Interest

The Government did not prove that STI, as principal mortgagee of record, failed to retain or maintain the ten percent beneficial interest in the insured mortgage as required by 24 C.F.R. §207.261(e)(2). Since the Respondents were charged with knowledge of the beneficial interest requirement as it was incorporated in the published regulation, their claim that they were unaware of the requirement is no excuse for a violation, if one occurred. 26 Fed. Reg. 24537, Dec. 21, 1971; Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947). As a HUD/FHA approved mortgagee, STI had expressly agreed to comply with HUD's rules, regulations and requirements and had a duty to be informed as to their applicability.

The Government asserts that HUD has interpreted the applicable regulations to require that the principal mortgagee invest its own funds in an amount equal to at least ten percent of the insured mortgage loan prior to final endorsement. However, I have discovered no explicit definition of "beneficial interest" and I have discovered no other express or implied requirement in the applicable regulations, the Handbook 4430.1, or any other authority which provides a basis for the application of that principle to the facts of this case in such a manner as to establish a clear violation of §207.261(e)(2) or the Handbook.

More particularly, I have found no explicit HUD requirement that the principal mortgagee must advance its own funds in the full ten percent amount at any particular time prior to final

endorsement, or in any specific priority or relationship to advances by other loan participants, so long as the participation of third parties remains less than ninety percent of the amount of the insured loan. The Participating Banks provided $4,350,000 out of a total insured mortgage loan of $6,073,700. This was only seventy-one percent of the loan. Although STI's investment of either $244,000 or $190,372.42 after $50,000 of its investments was liquidated with Salem I and Salem II escrow funds, did not amount to at least ten percent of the amount of the insured loan, I cannot determine under existing regulations that a violation of the requirement occurred, because actual participation in the loan by third parties remained well below ninety percent and STI remained obligated on the balance. Even STI's unjustifiable failure or refusal to advance ten percent of the funds when needed or required and the Respondents' unsuccessful attempt to participate the entire balance of the loan have not been shown to be events, defined by any authority of which I am aware, which would diminish or eliminate the mortgagee's beneficial interest in at least the unparticipated balance of the insured mortgage loan. I am compelled to find that the beneficial interest thus defined, as I believe it must be in the absence of clear authority to the contrary, exceeds ten percent so long as STI is liable. Consequently, no violation has been proved as a basis for debarment or withdrawal of STI's mortgagee approval.

Counts 5 and 6 - Mishandling and Misappropriation of Clearing Account, Mortgage Trust Account, and Escrow Funds Related to the Salem Projects

The requirements governing the handling of escrow accounts by HUD/FHA approved mortgagees are explicit. "The use of escrow funds for any purpose other than that for which they were received" is cause for withdrawal of the approval of an HUD/FHA approved mortgagee. 24 C.F.R. §§25.5, 203.4, 203.7. The Respondents' handling of the escrow funds with which they were charged in relation to the Salem Projects, whose mortgages were HUD/FHA insured, did not conform to this requirement in repeated and varied instances. Respondents did not significantly impeach those conclusions of the HUD Inspector General's Audit Report dated April 10, 1980, which were incorporated in the Government's Complaint and which constitute the basic assessment of Respondent's improper management of the several escrow and related accounts for the Salem Projects. In fact, STI's actual conduct was for the most part not in dispute. The significance of that conduct was primarily in issue. Nevertheless, I find that the Respondents offered no defense or evidence in mitigation sufficient to justify or excuse the deficient conduct charged.

It is not disputed that STI had established procedures for routine handling of payments from mortgagors. Such payments were regularly comprised of principal, interest, and escrow components. STI's established procedures, properly adhered to,

were responsive to the basic regulatory and contractual requirements that STI segregate and deposit escrow funds for HUD/FHA insured loans in a special account in a Federally insured banking or savings and loan institution as required by 24 C.F.R. §§203.4(c)(2) and 203.7(a)(2). Since such payments were immediately deposited in STI's Clearing Account when received, proper procedures under the governing HUD Handbook 4191.1 "Administration of Insured Home Mortgages", paragraph 21(a)(1), required that they be transferred to the appropriate custodial or escrow accounts within 48 hours. That time frame is considered by HUD to be a reasonable time as applied to the handling of payments related to multifamily mortgages. I find that time frame to be reasonable in this case.

Thus, a record of many transfers during the period from May 1979 through February 1, 1980, which were delayed from thirty-three to sixty-seven days for Salem I and Salem II mortgage payments, and transfers during the period from December 1979 through February 1980, which were delayed by more than thirty-three days for Salem III mortgage payments, establishes serious and pervasive mishandling of fiduciary accounts. A record of similar substantial delays related to the handling of FNMA owned loans corroborates the conclusion that the pervasive delays affecting the Salem Village escrow accounts were not isolated, accidental, or the result of oversight.

Since the checks necessary to effect such transfers were promptly prepared, but often were not deposited in the proper accounts until much later, there were substantial delays before the Clearing Account was debited to reflect the appropriate transfers. The substantial float in the Clearing Account which resulted from these delays allowed Respondents to withdraw funds from the Clearing Account and to transfer them to the corporate accounts of STI and affiliated corporations, which they did, recording the transactions simply as claims due from STI. Obviously, the Respondents' exploitation of this float was highly improper, and I find that it reflected willful, calculated, and egregious misfeasance.

The Respondents' defense of such conduct is unpersuasive at best. Neither the proved pattern of withdrawals nor any evidence of specific obligations to STI supports Respondents' assertion that the withdrawals were applied to principal and interest amounting to approximately $25,000 per month properly due to STI to service STI's unsold warehoused loans and other loans on STI's account, and to pay servicing charges. Several characteristics of these withdrawals made them more consistent with the improper use of funds for unrelated transactions than for payment of specific, albeit undocumented, obligations due and owing to STI. Among such characteristics are the erratic timing and the substantial variations in the amounts of these withdrawals, which, among other things, were not made in $25,000 monthly increments. The fact that a substantial amount of the

withdrawals was apparently repaid is also inconsistent with the Respondents' assertion. Of compelling significance, in addition, is the fact that, since the information necessary to calculate exact obligations due to any investor was available by computer almost immediately after STI deposited the relevant mortgagors' payments in the Clearing Account, there was no need for such transfers to STI in estimated rather than exact amounts.

Isaac and STI's controller, Ralph Harrell, tried to explain the delays as the consequence of sixty to ninety day lags in STI's preparation of account reconciliations. But, even if I were to accept the implied admission of poor business and fiduciary management as an excuse, I find no justification for making such payments to the fiduciary for its own account in preference to making prompt transfers of obligated escrow funds to the custodial and escrow accounts that it was required to maintain by regulation and contract for its customers. I find that the deficiencies related to these obligations which occurred in the Clearing Account as a result of such transfers are inexcusable.

I find also that the Salem Projects' escrow funds were necessarily included in these improper withdrawals, although on this record the proportions cannot be specified with precision. The record shows that the balances in the Clearing and Mortgage Trust Accounts were frequently insufficient to cover the total amounts of the obligations which were owed at particular times to particular escrow accounts. The Salem Projects' escrow funds were comingled in the Clearing and Mortgage Trust Accounts with funds related to other accounts. As a result, I find that Salem Projects' escrow funds were used in violation of HUD's regulations and procedures for purposes other than those for which they were received. The resulting violations of 24 C.F.R. §203.7 clearly justify withdrawal of STI's mortgagee approval under 24 C.F.R. §25.5(c), (d) and (h), and §203.7(a)(2), as to Count 5 only, and (3). Similarly, I find that these violations were willful and egregious in character and that they provide ample cause, separately and in the context of this record as a whole, for Respondents' debarment for an indefinite period of not less than five years under 24 C.F.R. §24.6(a)(4) and (5).

Count 7 - Misappropriation of Salem I and Salem II Escrow Funds To Pay Interest and Principal to Investor

The record sustains Count 7 of the Amended Statement of Charges which alleges that Respondents misappropriated Salem I and Salem II escrow funds, in order to make timely payments of interest and principal to Kentucky Teachers, the permanent investor for those projects. Those funds had been accumulated in escrow in the custodial Kentucky Teachers Account for other purposes. Such timely payments of principal and interest had the convenient and incidental effect of protecting the Respondents' from disclosure of the delayed transfers of the mortgage payments

into the Kentucky Teachers Account. Timely transfers of the mortgage payments were required to fund the obligatory escrow deposits. Because of the delays, the escrows were not properly funded. However, the permanent investor, being itself timely paid, had no immediate reason for suspicion or further investigation.

A portion of the deficiency in escrows maintained in the Kentucky Teachers Account was also caused by an erroneous duplicate payment from that custodial account of a HUD mortgage insurance premium in the amount of $36,722.50, and the improper investment of $50,000 from the Salem I and Salem II Reserve Fund for Replacements Escrow in the Participation Certificate for the UAW Project. In addition, the funds used by STI to pay principal and interest to Kentucky Teachers had to come from escrow funds at the time such payments were made until the delayed deposit of the next mortgage payment was made to replace the previously misapplied escrow funds. The impropriety of such continuing manipulation of fiduciary accounts is obvious. The circumstances shown are such that I find the manipulation had to be intentional. Since the escrow requirements are so clear, the regulatory and contractual violations in the context of this record are egregious. Thus, I find that such misuse of escrow funds in violation of HUD's regulations and procedures is another cause for withdrawal of mortgagee approval under 24 C.F.R. §§25.5(b) and (c), and 203.7(a)(3). Such misuse of escrow funds also warrants Respondents' debarment for an indefinite period of not less than five years under 24 C.F.R. §§24.6(a)(4) and (5).

Count 8 - Misappropriation of Reserve Fund for Replacements Escrow for Improper Investment

The Respondents' withdrawal of $50,000 from the Salem I and Salem II Reserve Fund for Replacements, on May 4, 1979, was conduct which was improper and wholly lacking in fiduciary or business responsibility. The Salem I and Salem II Reserve Fund for Replacements was an escrow prescribed by paragraph 13 of the respective Mortgagee's Certificates applicable to the two projects. Not only was it improper for the Respondents to apply such escrow funds to purposes other than those prescribed for the escrow, but the purpose for which STI applied those escrow funds was itself eggregiously inappropriate under the circumstances.

The $50,000 was applied to the purchase of a participation certificate in the UAW Project. The instrument was clearly not a bond. The Respondents have advanced a technical argument that the investment qualified as an obligation fully guaranteed as to principal by the United States as contemplated by the applicable Mortgagee's Certificates and the HUD Handbook 4350.1 at Section 10, Chapter 4, paragraph 1(c)(1). This argument is specious and, in my opinion, conspicuously lacking in good faith.

As an HUD/FHA approved mortgagee, STI was charged with knowledge of the applicable regulations. Under the circumstances disclosed by this record, STI had a duty to be prudent in investing such funds to preserve their liquidity and security. Not only was the investment not fully guaranteed as to principal, but, as Isaac, an experienced businessman, well knew, it was also at best a risky and illiquid investment. Under the circumstances, I find that the Respondents' effort to obtain a ruling against HUD's position that the investment did not qualify under the applicable regulations was undertaken for delay, since the contention made in the relevant context was, in my opinion, frivolous. There is no evidence, and Isaac did not claim, that he relied upon an opinion of counsel.

The explicit requirements for the investment of funds from the Reserve Fund for Replacements are set out in the Insured Project Servicing Handbook, 4350.1, Supp. 1, Chapter 4, Section 10, Subsection 1. c(1). Those requirements provide that "A mortgagor is permitted to invest Replacement Reserve Funds in bonds issued, or guaranteed as to principal by the United States government or instrumentality thereof." Subparagraph c(5) of that section also permits such investment in interest bearing accounts in a bank or savings and loan association where such deposits are guaranteed by the United States government or an instrumentality thereof. Subparagraph c(2) requires the investment to be made payable to the bearer, or to be registered and deposited in a manner to permit conversion to cash at any time.

The unmistakable purpose of the Reserve Fund for Replacements escrow is to preserve immediate liquidity for the prompt repair or replacement of needed facilities and equipment. The investment of the Reserve for Replacement escrow funds of the Salem I and Salem II projects in the UAW Project pursuant to a participation agreement drafted by Isaac and signed by Isaac on behalf of all parties, was only possible because of STI's unilateral and virtually unmonitored control of the funds of those projects and Isaac's control of the UAW Project. As an experienced mortgagee, Isaac, acting on behalf of STI, must have known that enforcement of the participation agreement would be vulnerable to delays and uncertainty which would impair its liquidity. Therefore, I find that the investment would not qualify under the applicable HUD requirements and Isaac knew it.

However, even if the investment might have been technically permissible, under some conceivable circumstances, it clearly was not permissible under the circumstances disclosed by this record. The UAW Project, as Isaac well knew, was already in trouble when the investment was made. Moreover, the terms of the participation certificate contained a disclaimer against subsequent sale or distribution and granted thirty day right of first refusal to STI. More importantly, it subjected the payment of interest to the prior receipt by STI of interest payments from

the borrower. Since the borrower had not been paying interest for several months at the time of the investment because STI, on the pretexts previously discussed, had not been disbursing the balance of the construction loan, it was obvious that the investment of the Reserve Fund for Replacements escrow in the UAW Project participation certificate was inconsistent with the proper exercise of fiduciary responsibility, as well as a clear violation of HUD's regulatory and related requirements. The fact that Isaac's misrepresentation regarding the existence of the commitment by GNMA to purchase the permanent loan put the validity of the contract with HUD for mortgage insurance at risk under Section 203(e) of that National Housing Act, 12 U.S.C. §1709(e), is an added factor making that investment in the UAW Project inappropriate under the circumstances. 6/

The impropriety of that investment was exacerbated by such a lack of disclosure of the nature of the investment to the mortgagors that any purported consent by the mortgagors would have been meaningless. STI also did not obtain HUD's written permission to make the investment required by the Insured Project Servicing Handbook 4350.1, Chapter 4, Section 10, Subsection 1. a(1). Since Isaac signed for both parties to the transaction, and the investment liquidated or substituted the escrow funds for part of STI's existing investment in the UAW project, the transaction was further tainted by conflict of interest undisclosed by the fiduciary. Manifestly willful, this particularly egregious conduct reflects such a fundamental and basic lack of responsibility that it provides both independent and supplemental justification for permanent withdrawal of mortgagee approval under 24 C.F.R. §§25.5(c), (d), (h), and 203.7(a)(3) and cause for debarment for an indefinite period of not less than five years under 24 C.F.R. §§24.6(a)(4) and (5).

Count 9 - Misappropriation of Salem III Escrow Accounts

HUD required the Salem III mortgagor to deposit $70,070 in cash with STI on October 14, 1976, to fund an Initial Operating Deficits account for the Salem III project. That escrow was

6/ "... [T]he validity of any contract of insurance so executed shall be incontestible in the hands of an ... approved mortgagee ..., except for fraud or misrepresentation on the part of such ... approved mortgagee."

subject to a standard HUD Escrow Agreement which required STI to "hold and disburse this escrow at the sole direction of the Commissioner ..." HUD also required the Salem III mortgagor to deposit $73,171.44 remaining from the Allowance to Make the Project Operational with STI on April 30, 1979, as part of the Residual Receipts account for Salem III. Both escrow deposits were subject to 24 C.F.R. §203.4(c)(2), which require that such escrow deposits be segregated and deposited in a special account insured by the Federal Deposit Insurance Corporation or by the Federal Savings and Loan Insurance Corporation. Under the applicable regulations, such funds could not be used for any purpose other than that for which they were received.

I find that STI's failure to deposit the funds in accounts of the character prescribed and STI's retention of the required amounts as accounts payable on its corporate books were obvious violations of basic regulatory and contractual requirements relating to the escrows involved. But Respondents' use of the funds to close single-family FHA and VA loans for their own account and profit was not only a willful violation of basic regulatory requirements. I find that such use was an intentional and inexcusable violation of fundamental fiduciary responsibilities as well. Such an egregious failure to conform to basic standards of conduct applicable to a HUD/FHA approved mortgagee and fiduciary independently justifies the permanent withdrawal of approval of STI by the MRB under 24 C.F.R. §§25.5(b) and (c), and 207.3(a)(2) and (3). In the overall context of this record, it also warrants the debarment of the Respondents for an indefinite period of not less than five years under 24 C.F.R. §§24.6(a)(4) and (5).

Duration of Debarment Period

In both notices of proposed debarment issued by Assistant Secretary Lawrence B. Simons and in both the original Statement of Charges and the Amended Statement of Charges, the Government proposed that Respondents be debarred for five years from the date of the original notice. In its brief, however, citing the seriously deficient, pervasive, and protracted character of the Respondents' deficient conduct as a contractor or grantee, as established on the record before me, the Government contends that Isaac's conduct was both willful and egregious, thereby necessitating an indefinite period of debarment of not less than five years to protect the public interest. In support of its position, the Government contends in its Brief at 119 that

> The hearing held herein is de novo in nature, and the hearing officer is charged not only with determining whether

> the charges have been substantiated, but also to formulate an appropriate remedy. [Citation omitted.] Therefore, the periods prescribed by the Assistant Secretary for Housing and the Mortgagee Review Board are not controlling in the hearing officer's determination of the duration of the sanctions.

The permissible periods of debarment are defined in the definition of "Debarment" at 24 C.F.R. §24.4(a):

> "Debarment" means, exclusion from a participation in HUD programs for a reasonable, specified period of time commensurate with the seriousness of the offense or the failure or adequacy of performance generally not to exceed five years. However, the hearing officer may exclude a party for an indefinite period because of egregious and willful improper conduct .... (Emphasis supplied.)

24 C.F.R. §24.7(a) provides that the initiation of a debarment action must be made by written notice from the Assistant Secretary, proposing the action. The regulation prescribes that the notice of proposed action involves:

> (1) Stating that the action is being considered, (2) Setting forth the reasons for the proposed action, and (3) Indicating that such party will be accorded an opportunity for a hearing if he so requests within 10 days from his receipt of notice, and that he may be represented by counsel ....

Since 24 C.F.R. §24.7(a) does not affirmatively require a statement of the proposed period of debarment, the definition of "Debarment" at 24 C.F.R. §24.4(a) could be construed as providing the only grant of authority in the regulations to impose an indefinite period of debarment.

In some circumstances, notice of the period of proposed debarment could significantly affect decisions of the Respondent regarding how best to protect his rights and interests. A perception that, if he were to elect to contest the proposed debarment for a specified period announced by the Assistant Secretary by requesting a de novo hearing before a hearing officer, he could be exposed to a more severe sanction than that proposed by the Assistant Secretary, could have a chilling effect upon his exercise of this basic right to a hearing.

I find, however, that these considerations are not controlling in this case. Cf. North Carolina v. Pearce, 395 U.S. 711, 724 (1969); Container Freight Transp. Co. v. ICC, 651 F.2d

668, 670 (9th Cir. 1981). The Respondents, who have not filed a brief, have not opposed the Government's position or its rationale. More significantly, I find that the conduct of these Respondents has been so egregious, and so pervasively and willfully improper that the inference that they will continue to lack responsibility for the indefinite future is compelling. I am unconvinced by such evidence as was offered in mitigation. I find, therefore, that a finite debarment period of five years will not provide sufficient protection to the Government and the public interest. Since I do not believe that the Respondents would have altered their conduct of this protracted case had the Assistant Secretary initially sought an indefinite period of debarment, I find that an indefinite period of debarment of not less than five years is appropriate and necessary to protect the Government in the public interest from having to do business with these Respondents. If circumstances were to change in such a way in the future as to require reconsideration of my determination, an appropriate source of relief is available under 24 C.F.R. §24.11.

Conclusion

This record provides an adequate and independent evidentiary basis for a permanent withdrawal of the Department's approval of STI as an FHA/HUD approved Mortgagee. The record also provides an adequate and independent evidentiary basis for a finding of egregious and willful improper conduct and, therefore, warrants debarment of the Respondents, Isaac and STI, for an indefinite period of not less than five years from the date of this decision. Under the circumstances, I find it inappropriate to give credit for the time that the Respondents have been suspended, since the extended period that they were suspended was for the most part attributable to their own actions and continued with their consent or without their objection.

So ORDERED this 10th day of November, 1983.

Edward Terhune Miller

EDWARD TERHUNE MILLER
Administrative Judge