UNITED STATES OF AMERICA

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

BOARD OF CONTRACT APPEALS

Washington, D. C.

In the Matter of:	:	
VALLEY TITLE AND ESCROW COMPANY	:	HUDBCA No. 80-533-D58
	:	(Activity No. 80-716-DB)
Appellant	:	

C. Nicholas Pereos, Esquire
Suite 201
535 East Plumb Lane
Reno, Nevada 89502 — For the Appellant

Marylea W. Byrd, Esquire
Office of General Counsel
Department of Housing and
Urban Development
Washington, D. C. 20410 — For the Government

INITIAL DETERMINATION

Statement of the Case

By letter issued in July, 1980, Alan H. Brunet, President of Valley Title and Escrow Company, was notified by the Department of Housing and Urban Development ("HUD") that it intended to debar Valley Title and Escrow ("Valley Title" or "Appellant") from participation in departmental programs for a period of one year, for alleged contract violations in its capacity as the escrow agent in the sale of a property financed with a mortgage insured by the Department.

Appellant requested a hearing on the proposed debarment pursuant to 24 C.F.R. §24.7, and a hearing was subsequently held in Reno, Nevada to determine whether Appellant should be debarred. Post hearing briefs were filed on behalf of both Appellant and the Government.

APPLICABLE REGULATION

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

§24.4 Definitions.

* * *

(f) "Contractors or grantees." Individuals, state and local governments and public or private organizations that are direct recipients of HUD funds or that receive HUD funds indirectly through non-Federal sources including, but not limited to, borrowers, builders, mortgagees, real estate agents and brokers, area management brokers, management and marketing agents, or those in a business relationship with such recipients including, but not limited to, consultants, architects, engineers and attorneys; all participants, or contractors with participants, in programs where HUD is the guarantor or insurer; and Federally assisted construction contractors.

* * *

§24.6 Causes and conditions applicable to determination of debarment.

Subject to the following conditions, the Department may debar a contractor or grantee in the public interest for any of the following causes:

(a) Causes.

* * *

(3) Violation of contract provisions, as set forth below, of a character which is regarded by the Department to be so serious as to justify debarment action:

(i) Willful failure to perform in accordance with the specifications or within the time limit provided in the contract.

(ii) A record of failure to perform, or of unsatisfactory performance, in accordance with the terms of one or more contracts: Provided, That such failure or unsatisfactory performance has occurred within a reasonable period of time preceding the determination to debar. Failure to perform or unsatisfactory performance which the contractor can show was caused by events beyond its control which were not reasonably foreseeable shall not be considered to be a basis for debarment provided that no fault or negligence of the firm or individual was involved.

* * *

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

* * *

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

Findings of Fact

Valley Title and Escrow is a Nevada corporation doing business in Reno, Nevada. The president and principal stockholder of Valley Title is Alan H. Brunet.

In November, 1979, Valley Title served as the escrow agent in the sale of a home financed with a mortgage insured by the HUD Federal Housing Administration ("FHA"). The mortgagee was Western Pacific Financial Corporation ("Western"). The purchaser-mortgagors were [redacted] Albert, who bought the property from [redacted] Presley. Ralph Richie was the real estate agent. (G-2, G-4, T. 136, 160).

The contract of sale between the Alberts and the Presleys provided that a downpayment of $4,500, including a $100 deposit given to the real estate agent, would be deposited at Valley Title prior to sale closing. (G-11). The Alberts presented a "gift letter" to the mortgagee to substantiate the source of the downpayment. Joseph Albert's father, [redacted] Albert, was going to provide the cash for the downpayment as a gift to [redacted] Albert (T. 25, 77-78). The gift was apparently verified by the "gift letter" from [redacted] Albert and the mortgagee relied on it (T. 87).

Escrow Instructions from the buyer and seller to the escrow company likewise provided that the downpayment would be deposited as cash through escrow (G-2). The instructions were forwarded by Valley Title to Western for review so that the mortgagee could determine whether any items would not be allowed by HUD-FHA, as the insurer of the mortgage (T. 12). Based on the documents submitted, Western directed Valley Title to close the sale, as outlined in the Escrow Instructions, dated November 13, 1979 (G-1).

After the sale closed, Valley Title forwarded to Western the closing document package, which included a copy of Amended Escrow Instructions (G-12). The Amended Escrow Instructions and the Settlement Statement revealed that the $4,500 downpayment was paid to the seller outside escrow. (G-5, G-12). LaDonna Downs, the Branch Manager of Western testified that if the downpayment was made outside of escrow, she would normally require a copy of the receipt of payment from the escrow company (T. 61, 74).

There is a conflict in the evidence on when the mortgagee (Western) first had notification that the downpayment would be paid outside escrow. Kathy Alexander, an escrow officer with Valley Title, testified that she spoke with Cindy Worrell, the loan processor at Western, before the closing to explain that the downpayment would be made outside of escrow because the Alberts told Valley Title that Ralph Richie had the $4,500 and he could not be reached (T. 118). Ms. Alexander testified that she was not told by Ms. Worrell to hold up the closing (T. 119). Alexander did not speak with LaDonna Downs about the sale before closing (T. 125). The closing package was sent back to Western on the date of the closing by courier (T. 119). Alexander testified that she forwarded the Amended Escrow Instructions to Western "prior to close of escrow" (T. 121). LaDonna Downs testified that she was first aware that the downpayment had been made outside of escrow approximately a week after closing when she was called by a HUD field supervisor. Downs testified that the HUD field supervisor informed her that an anonymous tipster called HUD to say that the downpayment may in fact, have been made with a loan rather than cash. (T. 61).

Sometime after Downs was contacted by HUD, she called Kathy Alexander at Valley Title to request documentation of the payment of $4,500 outside escrow (T. 75-76). Downs did not recall the exact date she first spoke with Alexander about the downpayment change (T. 84). She recalled that Alexander told her that Ralph Richie had possession of the check for the downpayment (T. 84). She followed up that telephone conversation with a letter requesting copies of checks or receipts verifying money paid outside escrow. The letter is dated December 21, 1979, over a month after the sale closing. (G-8). Downs was never concerned with the actual source of the $4,500, despite the call from HUD, because she relied on the gift letter (T. 87). Kathy Alexander responded to Downs' letter about a month after receipt, using wording in her response that, Alexander testified, Downs essentially dictated to her. It contained no information as to the source of the funds paid outside escrow (T. 126).

The "anonymous tipster" was, in fact, a former employee of Valley Title, who had prepared the initial closing documents for the sale while still employed at Valley Title (T. 89). She called LaDonna Downs sometime after December 21, 1979 to notify Downs of what she had done. She apparently repeated to Downs the same story about the loan she had told to HUD (T. 89). Downs testified that she discussed the problem with her loan officer before submitting the loan package to HUD for issuance of an insurance certificate. Downs and Worrell decided that the gift money had only been delayed. They based this belief on a letter dated January 28, 1980 from [redacted] Albert to the Presleys apologizing for the delay in being able to provide the cash for the downpayment (G-10). On March 5, 1980, HUD received the request for the insurance certificate from Western (G-6). The HUD file reflects that the downpayment of $4,500 was made (T. 31).

In fact, the actual transaction between the buyer and seller was different than the documentation submitted to the mortgagee or Valley Title revealed. [redacted] Albert testified that [redacted] Albert met [redacted] Richie at a Muscle Bound meeting in Sparks, Nevada, at which time Richie told him about the availability of the Presley home. The Alberts told Richie that they did not have enough money to make the downpayment on the home. Richie assured them "there were legal ways to get around it." (T. 160). [redacted] Albert never intended to make a gift of $4,500 for the downpayment. Richie gave [redacted] Albert a check for $4,500, on which [redacted] Albert drew a money order for that amount payable to [redacted] Albert (G-7; T. 161, 162). Richie had told [redacted] Albert they would need a promissory note for $4,500, to be paid in monthly installments of $50 for 3 years with a balloon payment at the end of that period (T. 162-165). The Alberts are presently making such payments to the Presleys, based on a promissory note dated November 16, 1979. (G-14; T. 164).

Both [redacted] Presley told [redacted] Albert not to tell anyone about the promissory note agreement (T. 168, 183). The Alberts played their part with the mortgagee and the escrow company, pretending that the $4,500 was in the possession of [redacted] Richie (T. 168). However, there is no conflict in the evidence that Valley Title knew of the promissory note prior to closing, because it was executed in Valley Title's office on November 16, 1979, four days before closing (T. 120-121). [redacted] Alexander testified that she believed the parties did not intend to act upon the note but just drew it up to allow the sale to close. She believed that it would be torn up as soon as [redacted] Richie produced the illusive $4,500 check. (T. 129).

Two months after closing, when HUD, Western, and Valley Title all began to look into the underlying transaction, [redacted] Richie obtained the endorsement of [redacted] Presley on a check for $4,500 dated January 29, 1980, made out to [redacted] Presley. Richie left with the endorsed check (G-7; T. 153-155). A copy of the check, and one from [redacted] Albert to [redacted] Albert were somehow obtained by Bob Baird, the loan officer at Western who originated the Albert's loan. Baird provided copies of them to Valley Title. (T. 132). This documentation was provided to HUD in the loan package as evidence that the $4,500 had been paid to the Presleys.

HUD requires that when money passes outside of escrow, it needs documentation to determine whether the payment is in accordance with HUD regulations. HUD will not issue insurance on a mortgage unless all changes conform to HUD regulations. The documentation required includes the reason why the funds are passing outside of escrow and proof of the source of the funds (T. 14, 17). A downpayment may be borrowed but the collateral must be acceptable to HUD. It allows a loan secured by equity or other real estate, or assets such as gold or diamonds, but does not permit loans secured by household furniture or unsecured loans. (T. 37). HUD relies on the lender to document the source of money not in cash (T. 44) and never goes through the escrow agent for this information (T. 51). [redacted] Alexander testified that she believed only second trusts on the property to be purchased were prohibited by HUD (T. 122).

I find that both Valley Title and Western knew prior to closing that the downpayment of $4,500 would not be passed through escrow. The fact that LaDonna Downs was not informed of this is not proof that Valley Title concealed the information from the mortgagee. However, Valley Title did not send a copy of the promissory note to Western and I do not find that Western was aware of the note prior to closing. Whether the personnel at Valley Title believed that the note would be performed or not, they had an obligation to notify the mortgagee that it existed and to let the mortgagee decide whether to hold up the closing of the sale until the downpayment was made.

The Amendment to Escrow Instructions dated November 16, 1979 states that:

> Buyer and Seller hereby acknowledge that the sum of $4,500 has been passed outside of escrow to Sellers. (G-3).

In fact, Valley Title knew that the $4,500 had not passed outside of escrow on that date, nor had it been passed on date of closing. I find that Valley Title did not fulfill its obligations to the mortgagee and HUD to give notice fully and promptly when it becomes aware that the transaction would not proceed as originally stated in the escrow instructions. I find that Valley Title knew or should have known that a promissory note in lieu of a cash downpayment is suspect, on its face, in a HUD-insured loan transaction. It had the duty to immediately notify the mortgagee of its existence even if the parties to the note may have indicated that the note would not be acted upon by them. Good business practice would require disclosure. Common sense should have alerted Valley Title to the fact that notes are not written unless they are intended to be enforced, if needed.

I find that the scam to avoid a downpayment was successful because neither the escrow agent nor the mortgagee were sufficiently attentive to HUD's requirements concerning proper loan origination procedures. As soon as [redacted] Alexander notified Cindy Worrell that the transaction was not going to proceed as originally stated, Worrell should have immediately notified her superiors and HUD to obtain guidance. Instead, by silence and acquiescence, Valley Title believed it had the mortgagee's permission to go to closing. LaDonna Downs remained unconcerned about the possibility of a promissory note and never really pressed the escrow company for an explanation of it. However, if Valley Title had promptly notified Western about the promissory note, it is quite clear that the mortgagee would not have permitted the sale to close (T. 67). The failure to disclose that fact in a timely manner was the most serious act of ommission by Valley Title.

DISCUSSION

The purpose of debarment is to assure the Government that contracts will only be awarded to those contractors 1/ and grantees who are responsible. 24 C.F.R. §24.0. Carelessness

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1/ An escrow agent is a contractor or grantee within the regulatory definition because it is a contractor with participants in programs where HUD is the guarantor or insurer. 24 C.F.R. §24.4(f). See: Sharon Helen Barrow, HUDBCA No. 79-409-D42 (1980).

or ommission of duties in the performance of obligations can be a serious matter for a Government agency or department that relies on its contractors to help administer Government programs. John Harris Killingsworth, HUDBCA No. 77-522-DB (March 10, 1978). In the FHA mortgage insurance program, all participants in the process, including mortgagees and escrow agents, must strictly adhere to their obligations of verification and notification of irregularities to keep the program from being destroyed by fraud. Valley Title failed to carry out its obligatins in this regard.

The facts in this case are complex. Layer upon layer of fraud and deceit built up outside the control or purview of Valley Title, the mortgagee, and HUD. Valley Title was not a participant in that fraud. However, it had knowledge of events which it kept from the mortgagee and HUD. Valley Title was duped by the sellers and purchasers into believing improbable explanations for clearly suspect occurrences. If Valley Title had fulfilled its obligations to the mortgagee and HUD by reporting these occurrences, regardless of the explanations for them, the fraud might have been stopped. It is not important that it cannot be stated with assurance that this would have been the case. What is important is that Valley Title made serious misjudgments about its responsibilities that obscured signs of impropriety in the sale transaction.

I find therefore that a period of debarment is warranted. However, Valley Title's acts of ommission pale before the far larger implications of what happened in this case, considered as a whole. I do not find that a debarment of one year is necessary to protect the interest of the Government and the public. A period of two months from date of this decision will be sufficient for Valley Title to educate its employees about the obligations of an escrow agent to HUD and approved mortgagees in the FHA mortgage insurance program.

CONCLUSION

For the foregoing reasons, VALLEY TITLE AND ESCROW COMPANY shall be debarred from this date up to and including May 27, 1981.

Jean S. Cooper
Administrative Judge
HUD Board of Contract Appeals

Issued at Washington, D. C.
March 27, 1981.