

UNITED STATES OF AMERICA

before the

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

In the Matter of:

LAWRENCE C. HUMPHREY,

Appellant

HUDBCA No. 81-640-D41

Benjamin F. Blake, Esquire
Law Offices of Bolden and Blake
2615 Cadillac Tower
Detroit, Michigan 48226

Jennifer Bingham, Esquire
Office of General Counsel
U. S. Department of Housing
and Urban Development
Washington, D. C. 20410

INITIAL DETERMINATION

Statement of the Case

By letter dated August 21, 1981, the Assistant Secretary for Housing notified Appellant that the Department of Housing and Urban Development (HUD) proposed to debar him and his affiliates for five years because of the alleged failure of the company of which he is president, Premier Mortgage Corporation (PMC), to remit closing proceeds on nine Secretary-owned properties. The letter also notified Appellant of his right to request a hearing on this matter pursuant to 24 C.F.R. §24.7.

By letter to the Assistant Secretary dated September 3, 1981, filed with the Office of the Administrative Law Judge on September 17, 1981, Appellant requested a hearing. However, after a hearing date was set, he elected to have the matter decided on the written record. The Government and Appellant filed briefs and exhibits in support of their positions on November 16 and December 7, 1981, respectively.

Findings of Fact

On February 26, 1979, PMC and HUD entered into a Sales Closing Package Service Contract (Contract [REDACTED] 5354; Government Exhibit 1) under which PMC acted as closing agent for

single family homes owned by the HUD Secretary pursuant to provisions of the National Housing Act. The contract required, inter alia, that PMC forward net proceeds from sales of these properties and accompanying closing statements to the HUD Detroit Area Office. Paragraph 11 of the contract stated:

Net proceeds and accompanying closing statements not received in the office within 48 hours following the date of closing statement approval, the closing Agent is to provide this office with a letter of explanation regarding the cause of the delay of closed sale package. [Sic.]

The term of the contract was one year, but this period could be extended for an additional year by written agreement.

On January 28, 1980, the Property Disposition Branch of the HUD Detroit Area Office sent Appellant, as president of PMC, a letter which stated:

In reviewing your closing agent contract performance within the past year, we have found that your company has not performed in a satisfactory manner:

The following are critical items that your company has failed to perform in a satisfactory manner:

1. Since June 1979 your company has been late in submitting the closing packages to this Office on over a hundred cases. * * *

This office has talked to you about late submission of closing packages several times since June 1979.

2. Since June 1979 this office has sent 25 cases back to your office for corrections. There have been a multitude of phone calls made to you by Mr. Carl Pittler and Mr. Charles Womble, in regards to various problems. In addition our closing clerks have made numerous calls to your company in reference to mistakes.

Since it appears that your company cannot comply with the terms of your contract, we are giving you 30 days notice. At the end of your one year contract this office will not renew the optional second year with your company. (Government Exhibit 3.)

On February 11, 1980, Appellant sent the following letter to the Chief of the Property Disposition Branch:

I am writing you in reference to our Cash Sale Closing Contract with HUD.

On February 6, 1980, I called Mr. Charles Womble, Department head of that section and requested that no further deals be sent to our company at this time and informed him that a letter would follow. The reason for this request is that I have discovered some serious discrepancies regarding the accounting in this department.

I have called in an outside CPA to audit this operation and give me a full report of his finding. He has informed me that this should be accomplished within 30 days. At that time, I can assure you, I will immediately address any deficiencies found by taking whatever action is necessary to the fullest extent of my ability and resources.

On February 19, 1980 ^{1/}, HUD officials from the Property Disposition Branch visited PMC to collect \$105,614.21 in outstanding sales proceeds for the following nine Secretary-owned properties (Government Exhibits 3 and 5):

<u>Address</u>	<u>Net Proceeds</u>	<u>Date Sold</u>
[REDACTED] Russell	\$ 11,227.14	12/6/79
[REDACTED] Mansfield	11,526.37	12/27/79
[REDACTED] Avondale Rd.	15,449.86	12/6/79
[REDACTED] Rutland	12,239.65	12/27/79
[REDACTED] Buffalo	15,959.85	12/19/79
[REDACTED] Wendy	19,482.01	1/2/80
[REDACTED] Brush	1,556.08	1/22/80
[REDACTED] Rhode Island	261.93	1/21/80
[REDACTED] Lauren	17,911.32	1/15/80

Appellant advised the HUD officials that he did not have the proceeds due on these properties (Affidavit of Charles W. Womble, paragraph 6).

1/ Both the Government's brief (at page 2) and an affidavit by Charles W. Womble, Chief of the Area Office's Property Disposition Section, state that this visit occurred on February 19, 1981. In this regard, the Government's brief indicates that an Inspector General audit first determined the amount due from PMC on January 22, 1981 (also at page 2). However, the February 19, 1980 date is specifically mentioned in a memorandum from Womble to the HUD Area Counsel dated February 22, 1980, to which is attached the complete list of nine properties and the proceeds due on each.

On March 3, 1980, John T. Addison, II, a Certified Public Account employed by Appellant (Appellant's brief, page 2), sent a letter to the Regional Inspector General for Audit which states:

Mr. Lawrence C. Humphrey, President of Premier Mortgage Corporation has informed me that the corporation has commingled the funds of a HUD Custodial Sales account with the operating funds of the company.

The custodial account involved is for the proceeds from the sale of HUD properties for which the mortgagee was acting as a closing agent for HUD.

The funds were commingled by the treasurer, H.H. Patton, to cover bank overdrafts in the operating accounts of the corporation.

Due to the serious nature of the above, I have informed Mr. Humphrey that your office must be notified. He has notified the Detroit office of HUD, which have picked up all unclosed cases and terminated sending any new cases.

Mr. Humphrey is waiting to meet with HUD agency representatives to discuss disposition of cases which the corporation has closed, but has not remitted the proceeds. (Government Exhibit 7.)

The record is unclear, and specific findings cannot be made, as to when and how Appellant first became aware of the commingling and what prompted his original letter to HUD dated February 11, 1980. On the one hand, Addison's affidavit states that he was retained by Appellant to investigate PMC's HUD account in February 1980; that he discovered the commingling; and that (presumably after) informing Appellant that the HUD Regional Inspector General must be advised, Appellant notified the HUD Area Office. This version of what transpired is consistent with Addison's March 3rd letter, supra. However, on the other hand, Appellant's own affidavit states that, while he was informed by Addison "during the latter part of 1979 that the accounting and financial records of PMC were not being maintained on a daily basis by the treasurer and chief bookkeeper" and contacted HUD as a result of concern "about the condition of the HUD account from reviewing the CPA's report and [his] independent review of PMC's records", he was first informed by the CPA of the commingling subsequent to the February 11th letter.

To complicate matters further, Addison's March 3rd letter indicates that Appellant notified him of the commingling. These questions are not resolved by Addison's letter to Appellant dated October 26, 1981. (Appellant Exhibit 1.)

In any event, the commingling with operating funds 2/ was effected by PMC's treasurer and chief bookkeeper, H. H. Patton, who was discharged by Appellant (Appellant's affidavit, paragraph 18). On October 19, 1981, Patton was debarred by the Assistant Secretary for Housing for a period of five years as a result of the commingling (Government Exhibit 11). 3/

The record is silent as to whether any of the outstanding proceeds have been remitted to HUD.

Discussion

The Assistant Secretary's letter dated August 21, 1981, which charges Appellant with the failure to remit sales proceeds on the nine properties, cites 24 C.F.R. §24.6 as regulatory authority for the proposed debarment. Under that provision, HUD "... 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.

2/ I make no finding as to whether the commingled funds were used for purposes other than PMC's operating expenses in view of Addison's emphasis of the limited nature of his investigation. See footnote 4, infra.

3/ Patton did not request a hearing under 24 C.F.R. §24.7.

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

Appellant does not dispute that the retention of sales proceeds constituted a violation of PMC's contract with HUD. Rather, at issue is the extent to which this violation should be attributed to Appellant as company president. In this regard, the Assistant Secretary's letter asserts that "As president of PMC [Appellant was] vested with the responsibility for control of the company transactions and for ensuring that its operations were conducted in a proper manner." Appellant argues, in his brief, that while PMC, as a corporate entity, may be liable for the acts of its officers, he, as president, is not and that, as a practical matter, he "was involved full time in income production and public relations activities for PMC on a day to day basis which caused him to rely heavily on the corporate treasurer and chief bookkeeper with respect to the financial operations of PMC." (At page 2.) He also argues that the Government has not shown that he lacked good faith or was negligent in not discovering the retention of proceeds before he did.

The purpose of HUD debarments is to protect the public interest by ensuring that the Department only does business with responsible contractors and grantees. 24 C.F.R. §§24.0 and 24.5(a). The term "contractors and grantees" includes "public or private organizations" as well as individual participants. §24.4(f). The Department has the right to expect and demand that corporate and other entities which benefit from the public's business seek to conserve public funds.

A corporation, however, can only function through its officers, directors, and shareholders. Warren Brothers Roads Co. v. United States, 355 F. 2d 612, 616 (Ct. Cl. 1965), citing 39 Comp. Gen. 468, 471 (1959); Holmes v. Bateson, 583 F. 2d 542, 560 (1st Cir. 1978); Trap Rock Industries, Inc. v. Kohl, 284 A. 2d 161, 166-67 (N.J. 1971). Holding a corporate contractor or grantee to a standard of "responsibility" necessarily means, therefore, that those who control its activities, policies, and management have a special obligation to monitor the corporation's public activities and may be required to account for any negligence or wrongdoing committed. Cf. Warren Brothers Roads Co. v. United States, and Trap Rock Industries, Inc. v. Kohl, both supra.

In this regard, an individual who assumes the position of corporate president and represents a company in its dealings with

HUD should expect to be held responsible for that company's internal management. Cf. In the Matter of The Mayer Company, Inc., HUDBCA No. 81-544-D1 (December 1, 1981); In the Matter of John Harris Killingsworth, Docket No. 77-522-DB (March 10, 1978); In the Matter of Gerald F. Sands, HUD Docket No. 75-357.A-DB (July 14, 1977); In the Matter of Waite, Inc., DOL Case No. 530-556 (October 10, 1976).

With respect to the instant case, the record reflects that Appellant consistently represented PMC, through correspondence, telephone calls and personal meetings, in its relationship with HUD. (See e.g., Government Exhibits 3, 4 and 5.) Appellant acknowledges that PMC "is a small Michigan corporation" (Appellant's affidavit, paragraph 6). Under these facts, he cannot be excused of management responsibilities on the basis of other activities or because of his own judgmental reliance on the treasurer and chief bookkeeper for PMC's accounting affairs. Trap Rock Industries, Inc. v. Kohl, supra, 284 A. 2d at 167; In the Matter of The Mayer Company; In the Matter of John Harris Killingsworth; and In the Matter of Gerald F. Sands, all supra. He knew or should have known that the Department looked to him, as the company's chief officer and representative, to safeguard the sales proceeds. Cf. In the Matter of Mark B. Horner, HUDBCA No. 79-410-D43 (March 11, 1980).

However, the conclusion that Appellant must assume responsibility for PMC's management is not dispositive of this matter. The key question is whether the record reflects mismanagement. I conclude that it does.

First, as noted, Appellant has acknowledged having been aware of accounting difficulties since the latter part of 1979. However, he did not advise HUD of problems until February, 1980. In this regard, all of the nine properties involved were sold either in December, 1979 or January, 1980. Therefore, had Appellant asked HUD, during the latter part of 1979, not to give PMC further properties to handle, the \$105,000 delinquency would not have occurred.

Second, questions remain as to Appellant's business judgment in authorizing a limited investigation of PMC's accounts 4/ and

4/ A letter to Appellant from Addison, dated October 26, 1981 (Appellant Exhibit 1) states:

This letter is to confirm the following:

- (1) That at your request, we performed a limited investigation of the corporation's HUD cash sale transactions in an effort to determine the cause of deficiency of monies in this account.

[footnote continued]:

in not pressing for an interim report before a nine month period (from the previous audit) had elapsed.

Finally, the record reflects not only that Appellant was advised of accounting difficulties by his accountant in late 1979, but also that, since June, 1979, he was personally and specifically told by HUD officials of serious management problems with the HUD account. In this regard, the letter from the Property Disposition Branch to Appellant dated January 28, 1980 (Government Exhibit 3) states that "This office has talked to you about late submissions of closing packages several times since June 1979 ... Since June 1979 this office has sent 25 cases back to your office for corrections. There have been a multitude of phone calls made to you by Mr. Carl Pittler and Mr. Charles Womble" The problems alluded to in this letter are all red flags which should have warned Appellant to pay closer attention to and play more of a personal role in managing the HUD account.

Appellant argues that the Government has not demonstrated a lack of good faith on his part. It is true that the Government has neither proven nor argued that Appellant personally intended to misappropriate HUD's funds. However, bad faith is not a required element of mismanagement--a problem which may cost the Federal Government a great deal more money than fraud overall, whatever the intentions of those responsible. Again, this is not a case involving vicarious liability for employee impropriety, as it is characterized in Appellant's brief, but rather hinges upon Appellant's direct responsibility as the chief officer of a HUD corporate contractor. 5/

4/ [footnote continued]:

- (2) As a result of performing limited procedures, it became apparent that the HUD cash sale monies had been commingled" with the operating funds of the corporation to cover bank overdrafts in the corporation's operating accounts.

* * *

- (4) During the course of performing limited procedures, we did not become aware that any of these "commingled funds" were used for purposes other than the operating expenses of the corporation.

5/ In view of this conclusion, I do not reach the issue of respondeat superior raised by the Government.

I therefore find that cause exists to debar Appellant under 24 C.F.R. §24.6, and that Appellant is a contractor or grantee under 24.4(f), which includes "... direct recipients of HUD funds ... real estate agents and brokers, [and] ... marketing agents ...".

The final issue to be considered is the period of debarment which, under 24 C.F.R. §24.4(a), must be "... for a reasonable, specified period of time commensurate with the seriousness of the offense or the failure or inadequacy of performance generally not to exceed five years." The standard of "present responsibility" affords a logical means of determining what is "reasonable" and "commensurate with the seriousness" of the charge on which this debarment is based.

Under the debarment standard of present responsibility, a contractor or grantee may be excluded from HUD programs for a period based upon projected business risk. Roemer v. Hoffmann, 419 F. Supp. 130, 131 (D.D.C. 1976); Stanko Packing Company, Inc. v. Bergland, 489 F. Supp. 947, 949 (D.D.C. 1980). A finding that a contractor or grantee is not presently responsible may be based upon past acts. Schlesinger v. Gates, 249 F. 2d 111 (D.C. Cir. 1975); Stanko Packing Company, Inc., v. Bergland, supra; 46 Comp. Gen. 651, 658-659 (1967). On the other hand, where present responsibility is the only applicable standard, any alleged mitigating circumstances affecting responsibility must be considered (Roemer v. Hoffmann, supra) and the debarment must be lifted if the affected participant can demonstrate that it no longer constitutes a business risk. Cf. 24 C.F.R. §24.0.

With respect to mitigating circumstances, Appellant contends that his previous record indicates that he has been a responsible contractor. In this regard, he states:

Contract [REDACTED] 5354 dated February 26, 1979, was the third PMC/HUD contract in a series of contracts awarded over a period of several years with transactions totaling several millions of dollars.

I have no personal knowledge of a prior incident in which PMC did not have the funds to remit to HUD from the net proceeds on the sale of HUD properties.

The cash closing sales which PMC disbursed for HUD from March, 1978 to February, 1979 amounted to approximately \$3,215,068.00, and from March, 1979 to March, 1980 amounted to approximately \$4,430,648.91. (Affidavit, paragraphs 2-4.)

However, Appellant's history with HUD as president of PMC is marred by more than retention of sales proceeds on nine Secretary-held properties. On November 14, 1980, the Chairman of the HUD Mortgagee Review Board notified him that PMC's status as a HUD-FHA approved mortgagee was withdrawn by the Board because of PMC's failure to submit the required annual audit report for the year ending March 31, 1980. The Chairman's letter also stated that "... there are outstanding application fees and mortgage insurance premiums in the amounts of \$775.00 and \$4,067.37 that have not been remitted to the Department." (Government Exhibit 9.) Further, as noted, HUD officials complained repeatedly to Appellant, since June, 1979, of late submissions of closing packages and various mistakes on over a hundred properties.

These problems and violations of HUD procedures and requirements, while not cited by the Assistant Secretary as cause for debarment, may nonetheless be considered in determining present business risk. Unfortunately, they offset any favorable weight to be accorded the business experience cited by Appellant.

Moreover, the fact that Appellant may have handled millions of dollars for HUD without incident cannot in any event excuse the mismanagement of \$105,000 which, as far as the present record reflects, still may not have been recovered. More importantly, it affords no assurance that the management deficiencies which allowed the misappropriation to go unnoticed for such an extended period of time (as well as other undesirable business practices to exist) have been resolved.

I conclude, therefore, that although no question of Appellant's personal integrity has been raised, he nonetheless may be considered nonresponsible until he can demonstrate that the Department will no longer be at risk by his future participation in its programs, as authorized by 24 C.F.R. §24.11. 6/ Any such demonstration would be expected to address

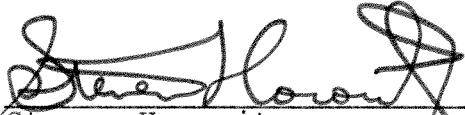
6/ §24.11(c) provides for reinstatement "... upon the submission of an application, supported by documentary evidence, setting forth appropriate grounds for the granting of relief such as ... bona fide change of ownership or management, or the elimination of the causes for which the debarment was imposed." §24.11(a) states that a request for reinstatement cannot be made until at least six months after the date of the final determination of debarment.

deficiencies in Appellant's business practices and procedures as reflected in the present record, as well as his role in and responsibility for securing PMC's repayment of all funds due HUD. CF. 24 C.F.R. §24.11(b). Absent this showing and its acceptance by the reviewing official, Appellant is subject to the full five year debarment period proposed by the Assistant Secretary.

In determining when the five year maximum period shall run, Appellant shall be credited with the period of time during which he has already been excluded from HUD programs. In this regard, although the Assistant Secretary's letter proposing debarment did not impose a suspension, Appellant has been subject to an Order of Temporary Denial of Participation since July 29, 1981 based upon the same cause as this action. (Government Exhibit 10.)

CONCLUSION AND ORDER

Appellant is debarred from participating in HUD programs for a period which shall not extend beyond July 28, 1986.



Steven Horowitz
Administrative Judge

Dated: December 21, 1981.