

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

In the Matter of:

**F.D. "RED" RUTLEDGE,**

Respondent

HUDBCA No. 92-C-7561-D41

Docket No. 92-1825-DB

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**DETERMINATION BY ADMINISTRATIVE JUDGE JEAN S. COOPER**

January 15, 1993

**Statement of the Case**

By letter dated February 20, 1992, the U.S. Department of Housing and Urban Development (HUD) notified F.D. "Red" Rutledge, Respondent in this case, that the Department intended to debar him from participation in primary and lower-tier covered transactions, as provided in 24 C.F.R. §24.110(a), as either a participant or a principal at HUD for a period of five years. Pending determination of debarment, Rutledge was suspended pursuant to 24 C.F.R. § 24.405(a)(2).

HUD proposes the five year debarment of Rutledge based on alleged willful violations of HUD/FHA-insured loan origination practices while Rutledge was a loan officer at Stratford Mortgage Corporation (Stratford). HUD charges Rutledge with participating in fraudulent schemes to misrepresent the sources of mortgagors' funds for downpayments and closing costs, thus allowing mortgagors to avoid making the minimum required investment in the purchase of properties involving HUD/FHA-insured mortgages, and causing HUD to insure mortgages for a higher amount than was actually allowable, in violation of HUD program requirements. HUD also charges that Rutledge allowed the submission of false information and certifications to HUD to further fraudulent schemes to induce HUD to insure mortgages. Finally, HUD charges Rutledge with failure to properly conduct required face-to-face interviews, while representing that he had held these interviews, and with allowing interested third parties to handle verification forms, in violation of HUD program requirements. Rutledge has denied all of the Government's charges.

#### RELEVANT HANDBOOK REQUIREMENTS FOR LOANS INSURED BY HUD-FHA

HUD Handbook 4000.2 REV-1 (Mortgagee's Handbook - Application Through Insurance - Single Family) (Exh. G-87) describes the HUD policies and procedures required of approved mortgagees in preparing and submitting applications to HUD for mortgage insurance. Chapter 5 of Handbook 4000.2 REV-1 describes the loan origination responsibility of the mortgagee. Paragraph 5-1 of the Handbook requires that mortgagees develop loans:

in accordance with accepted practices of prudent lending institutions and HUD requirements. They must obtain and verify information with at least the same care that would be exercised in originating a loan in which the mortgagee would be entirely dependent on the property as security to protect its investment.

Paragraph 5-2 of Handbook 4000.2 REV-1 describes the procedures for obtaining borrower approval from HUD for mortgage insurance by use of HUD Form 92900, Application for Insured Mortgage. It states that the Form 92900 provides the information necessary to determine the borrower's probable ability to make the payments on the mortgage and to maintain the property. Paragraph 5-2(a) of the Handbook provides, in pertinent part:

In accordance with prudent lending practices, a face-to-face interview with the loan applicant must be conducted by a company employee, at which time the fully completed loan application should be reviewed with the loan applicant. HUD requires that the Form HUD 92900 be completed prior to the applicant(s) signing the form. The applicant(s), in signing, are certifying that the information on the form is true and correct to the best of their knowledge and belief.

Paragraph 1-6 of HUD Handbook 4000.2-REV-1 (Exh. G-85) notes that HUD relies on the assumption that every financial statement and application certification is accurate and

truthful. Mortgagees or any of their employees are required to report any violation of law or regulation that they detect.

HUD Handbook 4060.1, entitled Mortgage Approval Handbook (Exh. G-88), also contains instructions in Appendix 1 applicable to the gathering of information necessary to complete the Form 92900. Appendix 1 of Handbook 4060.1 states in pertinent part:

Preparation of Form HUD-92900 Application

- (1) In accordance with prudent lending practices, at least one time prior to the submission of the final application to HUD, a face-to-face interview with the loan applicant must be conducted by a company employee. The most preferable time for such face-to-face interviews is immediately prior to the signing of the final loan application (Form HUD-92900), at which time the fully completed loan application should be reviewed the loan applicant. The interview the loan applicant should include a review of the occupancy certification to minimize the likelihood of a false certification regarding intention to occupy.
- (2) The preliminary credit application form used by the mortgagee should require, in accordance with accepted prudent loan origination practices, that the applicant mortgagor list each outstanding liability, including mortgage liabilities, and each asset, including real property. The mortgagee should obtain complete responses to all questions. All conflicts in information should be resolved and the loan file documented.
- (3) As required by HUD regulations, 24 C.F.R. Sections 203.2(a)(2) and 203.10, all loans submitted to HUD must be fully processed by employees of the mortgagee.
- (4) In accordance with prudent lending practices, the mortgagee must not permit the applicant mortgagor, or its own employees to sign any credit document or other form in blank.
- (4) HUD Handbook 4000.2 paragraph 3-7 requires the mortgagee to obtain and verify the correctness of information with at least the same care that would have been exercised had it been entirely dependent on the property as security to protect its investment. Accordingly, the final application Form HUD-92900 must list all assets and liabilities known to the mortgagee. Consideration should be given by the mortgagee to requiring some level of

review by management or supervisory officials of all cases submitted to HUD for mortgage insurance.

HUD Handbook 4002.2 REV-1 (Exh. G-89) sets out the applicable minimum investment requirements for borrowers. Section 2-7 of Handbook 4002.2 REV-1 states in pertinent part:

- 2.7 MINIMUM INVESTMENT BY BORROWER. The borrower's investment in the property must be equal to the difference between the total cost of acquisition and the amount of the mortgage to be insured, but at least 3 percent of the cost of acquisition. In no instance may his/her investment be less than the difference between the cost of acquisition (the total cost including repairs, alterations or additions, plus closing costs, but exclusive of non-realty items or prepaid expenses) and the amount calculated by applying the appropriate formula from paragraph 2-6b to the acquisition cost.

HUD Handbook 4155.1 REV-2, Section 2-11 C and D, (Exh. G-92) requires that seller inducements to buy, including decorating allowances, mortgage payments, payment of closing costs or costs normally paid by the borrower be subtracted from the sales price for purposes of computing the maximum mortgage amount.

### Findings of Fact

1. F.D. "Red" Rutledge has been a loan officer since 1966, and has been employed in that capacity by Stratford since 1985. Between 1988 and 1990, 75% of Rutledge's business involved loans insured by HUD through the Federal Housing Administration (FHA). (Tr. 646-648.)

2. Stratford was a direct endorsement (DE) lender. As a DE lender, Stratford underwrote loans for HUD, and submitted them to HUD after closing for issuance of a mortgage insurance certificate. HUD relies on its DE lenders to originate and underwrite loans using prudent lending practices, and following HUD requirements and procedures outlined in relevant HUD Handbooks. (Tr. 26-27.)

3. It was Rutledge's duty as a Stratford loan officer to stimulate client contacts and business, and to conduct preliminary loan application interviews with borrowers. He was also required by Stratford to go over the loan application once it was completed and to get it signed before a loan could close. During the preliminary loan application interview, he was to collect information about the creditworthiness of the borrowers, including their sources of cash to close the loan. It was Rutledge's duty to record the information given to him during the preliminary loan application interview on the FNMA Form 1003, to have the borrower sign and date it, and then sign and date it himself. Only a full-time employee of the mortgagee may conduct a preliminary loan application interview and sign the FNMA Form 1003. On the FNMA Form

1003, the interviewing loan officer is to mark whether the information was gathered in a face-to-face interview, by telephone, or by mail. (Exhs. G-1, G-6A, G-9, G-13, G-17, G-21, G-33, G-40, G-48, G-53, G-56, G-61, G-64, G-68, G-71, G-82; Tr. 27, 30-31; 648-649; 685-686.)

4. Rutledge was the loan officer for loan transactions involving [REDACTED] Pratt, [REDACTED] Payne, [REDACTED] Baker, [REDACTED] Chatman, [REDACTED] Dominguez, [REDACTED] Mathis, [REDACTED] Lara, [REDACTED] Raabe, [REDACTED] Russell, Eulogio, [REDACTED] Perales, [REDACTED] Wilson, [REDACTED] DeLeon, Jr., [REDACTED] Raquena, and [REDACTED] Sosa. In each transaction, Rutledge marked on the FNMA Form 1003 that he had personally gathered the information directly from the borrowers by means of face-to-face interviews. Rutledge signed each FNMA Form 1003 as the borrowers' interviewer. (Exhs. G-1, G-6A, G-9, G-13, G-17, G-21, G-33, G-40, G-48, G-53, G-56, G-61, G-64, G-68, G-71, G-82.)

5. The only borrowers that Rutledge interviewed personally and completely to gather the information for the FNMA Form 1003 were the Dominguezes and the Raabes. Although Rutledge testified that he believed that he had interviewed the borrowers face-to-face, I find that, based on the preponderance of the credible evidence, Rutledge did not personally and completely interview any of the other borrowers to obtain the information for the FNMA Form 1003. Rutledge may have met some of the borrowers. He conducted partial interviews with some of them, and he briefly reviewed the official loan application with some before closing. However, he did not conduct complete preliminary loan interviews, at which borrowers initially present the information the lender uses to collect and verify required documentation of credit-worthiness. I find that Jeff Bosse, a developer and realtor, or Bosse's wife, Donna, conducted the preliminary loan application interviews of [REDACTED] Pratt, [REDACTED] Chatman, [REDACTED] Lara, Eulogio, [REDACTED] Perales, [REDACTED] DeLeon, [REDACTED], [REDACTED] Raquena, and [REDACTED] Sosa. Furthermore, I find that Corina Ewing, a salesperson for Custom Builders, interviewed [REDACTED] Payne, [REDACTED] Mathis, [REDACTED] Russell, and [REDACTED] Wilson. Jeff or Donna Bosse directly interviewed the Spanish-speaking borrowers who could not speak English. The Bosses conducted all of these interviews without the participation of Rutledge. With regard to the Perales transaction, Rutledge admitted that he got the information to put on the FNMA Form 1003 from Donna Bosse, who conducted the interview in Spanish. In the transactions which involved Jeff Bosse, Bosse would gather what he characterized as "prequalification information," but which actually was most of the information needed for the FNMA Form 1003. Rutledge would run a credit check on the applicants using the information gathered by Bosse. The credit check would provide Rutledge with most, if not all, of the remaining information that he needed to fill out the FNMA Form 1003. Rutledge admitted that he obtained information from Ewing and the Bosses, but claimed that he verified it and gathered additional information in a subsequent interview. The borrowers who testified had a clear recollection of the person or persons to whom they gave the financial information which appears on the FNMA Form 1003. A number of the witnesses had no recollection of Rutledge. They do not remember Rutledge interviewing them to either obtain credit information from them or to verify it. I find that Rutledge copied the information gathered by the Bosses or Ewing onto the FNMA Form 1003, together with information from

the credit checks, and then had the Bosses or Ewing obtain the signatures of the borrowers on the completed FNMA Form 1003 in most cases. If Rutledge went over the information on the FNMA Form 1003 with the borrowers, he did it very briefly and did not inquire about their source of funds to close the loan, or other information critical to development of reliable financial data on which to make a loan. I further find that the Bosses and Ewing were obtaining the signatures of borrowers on blank verification forms and providing these signed verifications to Rutledge to give to the Stratford loan processors for further handling. It is a violation of HUD program requirements for interested third parties to handle verification forms. (Tr. 27, 67-68, 100-107, 123, 130, 133, 143-144, 158-159, 180, 216-217, 260-262, 283, 348-349, 377, 390-391, 395, 443-444, 482-483, 502-504, 512-515, 522-523, 568-569, 593-596, 695, 737-738, 753-754, 844-847.)

6. Jeff Bosse, Sherna Stone, Mickey Foster, Charles Soden, and Corina Ewing, all developers or their representatives, implemented schemes to present false information about borrowers to Stratford to influence Stratford to approve loan applications that would not otherwise be approved or would be approvable for a lesser loan amount than requested. Both Ewing and Bosse were able to introduce much of this false information into the loan approval process by providing it to Rutledge for the FNMA Form 1003. This false information included information about employment status and earnings of borrowers, cash and other assets that they had available for closing, and the source of funds for the closing costs and downpayment required by HUD. Such false information was provided in the Pratt, Payne, Baker, Lara, Perales, and Wilson transactions. It was subsequently "verified" on the required verification forms. False gift letters and explanatory letters documenting sources of funds were created at the suggestion of, and with the assistance of Bosse, Stone, Foster, or Ewing, in the Chatman, Dominguez, Russell, and Mathis transactions. There is no reliable evidence, however, that Rutledge knew or suspected that any of this information or documentation was false. (Exhs. G-4, G-9, G-10, G-14, G-16, G-37, G-53, G-54, G-55, G-56, G-57, G-61, G-62, G-63, G-71, G-72, G-73, G-74, G-76, G-77, G-78, G-79, G-82, G-83, G-84; Tr. 64-66, 70-71, 110, 115-118, 130, 149, 161, 165-166, 174, 178, 181, 189, 192-197, 203-204, 222, 227-228, 245-246, 248-249, 263-264, 335-339, 342, 378, 393, 396-398, 428-429, 444-446, 485-486, 569-570, 574-575, 577-578, 593-597, 626-629.)

7. Many of the borrowers obtained cash from Charles Soden, Sherna Stone, the President of Integra Homes, Jeff Bosse, or Corina Ewing to use as downpayments or to meet closing costs. Jeff Bosse gave money to ██████ Pratt to meet closing costs and to the Laras for ceiling fans and cabinets to be installed as "extras". Bosse also paid back rent and opened a bank account in the amount of \$800 for ██████ Chatman. Charles Soden gave ██████ Baker \$5,250 "to pay off bills" and directed the Bakers to state that it was a Christmas bonus, if asked. Mickey Foster, a sales agent for Integra Homes, gave \$5,000 to ██████ Dominguez so that they could cover closing costs. Corina Ewing gave cash to ██████ Payne, ██████ Mathis, ██████ Raabe, ██████ Wilson, and ██████ Russell so that they could meet closing costs. When ██████ Russell made the required \$500 downpayment, Ewing reimbursed him for it. (Tr. 69, 115-116, 136, 189, 192-193, 224-225, 237, 240-241, 248, 264, 289, 337, 338, 342, 356, 393, 427-428, 429, 574-575, 597.)

8. Although certain borrowers, including [REDACTED] Baker, [REDACTED] Raabe, and [REDACTED] Wilson, assumed that Rutledge must have known about the schemes to provide undisclosed cash and false information, Valerie Pratt, Jane Payne, Earl Mathis, Nanci Dominguez, and David Wilson had the opposite impression. There was no evidence of actual statements or acknowledgements by Rutledge to any borrower to support their suspicions. There was some testimony about newspaper advertisements stating "no down payment," but none of these advertisements were placed in evidence, and Rutledge denied seeing them or even hearing about them. In addition, borrowers were told by the developer's representatives that if Rutledge or others inquired about a source of funds, they were to state that it had been a "gift" or, alternatively, told them not to say anything at all. Rutledge forcefully denied that he knew or suspected that cash was being given to borrowers by developers. The evidence in the record is insufficiently probative to support a finding that Rutledge knew about any of the cash payments to borrowers, or the false gift letters and temporary bank deposits designed to cover up the sources of these payments. (Tr. 67-68, 117-118, 143-144, 149, 225, 240-241, 274-275, 288, 350-361, 363-366, 383-384, 579, 610-615, 632, 636-638, 650-652, 663, 677-678, 680, 689, 693, 695, 744-745, 762-763, 852, 854, 856.)

9. It was not the duty of Rutledge to evaluate the information and documentation received to support a loan application. He did not prepare either the HUD Form 92900 or the HUD 1 Settlement Statement. These functions were the duty of the loan processor, the underwriter, and the loan closer at Stratford. Rutledge knew of no fraudulent schemes to place false information on the Form 92900 or HUD 1. (Tr. 764-769, 779-782.)

10. Rutledge claimed that he reviewed the information on the Form 92900 with borrowers face-to-face before closing, but I find that his recollections of doing this were general rather than specific, and that the borrowers did not remember him performing this function in most cases. In at least two cases, Rutledge went over the Form 92900 with the borrowers at the closing, after the loan had already been pre-approved by the underwriter without the borrowers' signatures on the loan application. In other cases, the underwriter was "pre-approving cases" before a loan application was even written. (Tr. 826-834.)

11. A face-to-face interview is a HUD requirement, and it is also a prudent lending practice in the industry. The required face-to-face interview need not take place during the preliminary loan application interview, nor must it be conducted by a loan officer. HUD suggests that the best time to conduct it is when the information on the Form 92900 is reviewed with the borrowers before they sign it, and before the loan package is sent to the underwriter for approval. (Exh. G-87.)



### Discussion

HUD is proposing the five year debarment of Rutledge based on his alleged participation in schemes to defraud HUD by inducing the Department to insure mortgages based on false information and documentation, and by participating in schemes to evade HUD's minimum investment requirement by concealing donations of cash made by realtors and developers to borrowers. The Government charges that Rutledge advanced these schemes by failing to interview borrowers face-to-face but reporting that he had done so, and by permitting interested third parties to handle verification forms. HUD cites 24 C.F.R. §§ 24.305(b), (d), and (f) as grounds for Rutledge's debarment.

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

The Government may only debar participants, principals and their affiliates, as defined in 24 C.F.R. § 24.105. Rutledge is a "participant" because he has acted on behalf of Stratford in covered transactions, which include HUD-insured loan originations, and is reasonably expected to do so in the future, if permitted. He is a "principal" because loan officers are specifically listed in the regulatory definition of principals. 24 C.F.R. § 24.105(p)(2). Therefore, Rutledge is subject to debarment by HUD.

The record in this case does not establish that Rutledge participated in schemes to defraud HUD by either knowingly allowing false information and documents to be included in loan applications, or by covering up cash contributions to borrowers from realtors or developers to evade HUD's minimum investment requirement. It is abundantly clear from the record that such schemes to defraud were present in the transactions at issue in this case, but it was developers, along with borrowers, who perpetrated these schemes. There is no probative evidence in the record to find that Rutledge possessed knowledge of these schemes.

Nonetheless, Rutledge breached his duty to follow prudent lending practices. From the inception, Rutledge impaired the loan origination process by ceding control of it to interested third parties, in violation of HUD program requirements and prudent lending practices. Without the benefit of an initial screening interview, which a prudent lender would perform, unscrupulous developers took advantage of the process. A face-to-face interview may not deter most frauds. Nevertheless, the failure to perform this interview ensures that the screening



process is left to those who would most benefit from careless lending practices. See In the Matter of Joan Galati, HUDBCA No. 88-3455-D64 (March 10, 1989). To the detrimental reliance of HUD and Stratford, Rutledge stated on the FNMA Form 1003 that he had completed this essential function for every case at the preliminary loan application stage, when, in actuality, Rutledge did not conduct a face-to-face interview in which he obtained the information on the FNMA Form 1003. His slipshod practices at the first stage of the lending process provided fertile ground for fraudulent transactions to flourish. Rutledge's failure to collect information directly from borrowers set up Stratford and the Department as targets vulnerable to fraud. Rutledge also permitted interested third parties to handle verification forms, in direct violation of HUD program requirements. Had Rutledge not given verification forms to Bosse or Ewing, false information may still have corrupted the transactions because the schemes to defraud existed before Rutledge entered the transactions in the role of loan officer. Nonetheless, by relinquishing control over the verification forms, the most sensitive documents that could be handled by a lender, Rutledge made it more possible for Bosse's and Ewing's respective schemes to take place. See, In the Matter of Kay Yarbrough, HUDBCA No. 92-C-7514-D33 (October 28, 1992).

HUD's requirement of a face-to-face interview is a general one. This requirement does not dictate when the interview must transpire, or who must conduct it. However, HUD does suggest that it should be done after the Form 92900 is filled out, when it can be used to make sure that the information on the Form 92900 is correct. The loan officers at Stratford were expected to conduct face-to-face interviews at the beginning of the loan process so that Stratford could be sure that it was verifying and developing complete and correct information. Interviews of borrowers at both times in the lending process serve an important purpose. Optimally, a loan officer or other lender's representative should conduct face-to-face interviews both when the preliminary loan application is taken and after the Form 92900 is filled out. This would ensure a reliable verification process and an accurate application for mortgage insurance. However, HUD's requirement is fulfilled by the completion of an interview at any time before the loan package is submitted for underwriting. Subsequent to that time, any face-to-face interview held is irrelevant because there can be no assurance that the decision to approve and underwrite a loan is based on true, complete and correct information. Rutledge apparently went over the Form 92900 in at least two cases on closing day, after the loan had already been underwritten.

HUD has carried its evidentiary burden to establish cause for debarment of Rutledge. I find that Rutledge violated HUD program requirements applicable to the public transactions of originating loans to be insured by HUD. 24 C.F.R. § 24.305(b)(3). I further find that Rutledge committed material violations of HUD program requirements applicable to insurance of mortgages. 24 C.F.R. § 24.305(f).

HUD has temporarily suspended Rutledge pending determination of debarment, based on adequate evidence of the possible existence of causes for debarment and an immediate necessity to protect the public. 24 C.F.R. §§ 24.400 and 24.405. HUD proposes to debar Rutledge for five years. According to HUD's regulations, debarment is to be for a period proportionate to the seriousness of the irregularities upon which it is based. Debarments generally should not

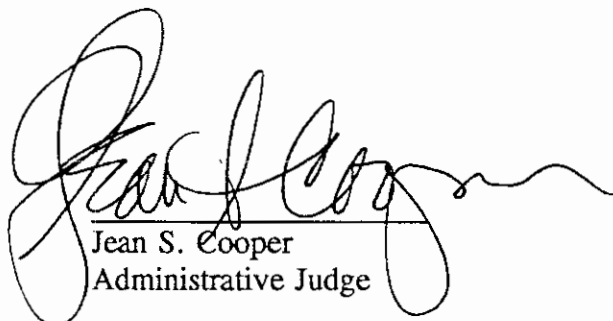
exceed three years. Where circumstances warrant, a longer period of debarment may be imposed. 24 C.F.R. § 24.320(a)(1).

HUD has failed to prove the major charge in its case, that Rutledge knowingly participated in fraudulent schemes devised by Jeff Bosse, Corina Ewing, Charles Soden, and Sherna Stone. If HUD successfully had proven Rutledge's participation in or knowledge of either the false information scheme or the unreported payments of cash to borrowers, five years would have been an appropriate period of debarment. However, of the charged conduct, HUD only successfully proved that Rutledge failed to personally interview borrowers to obtain the information for preliminary loan applications and negligently allowed interested third parties to handle verification forms. These irresponsible actions are indeed serious, but they do not warrant a five year debarment. See, Yarbrough, Supra.

Because Rutledge was not an active participant in the fraud, I find that no more than a three year period of debarment is warranted. Debarment is a prospective sanction and Rutledge has been suspended from participation in Departmental programs since February 20, 1992. A debarment from this date up to and including February 20, 1995 is necessary to protect HUD and the public, credit being given for the time during which Rutledge has been suspended.

#### DETERMINATION

For the foregoing reasons, F.D. "Red" Rutledge shall be debarred from this date until and including February 20, 1995.



Jean S. Cooper  
Administrative Judge