

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

In the Matters of:

PFG MORTGAGE INC., AND
ROBERT OTTO POTTER,

Respondents.

HUDBCA Nos. 92-G-7577-MR6 and
92-G-7598-D58

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DETERMINATION BY ADMINISTRATIVE JUDGE TIMOTHY J. GRESZKO

October 9, 1992

Statement of the Case

On March 17, 1992, Arthur J. Hill, Assistant Secretary of Housing - Federal Housing Commissioner and Chairman of the Mortgagee Review Board ("MRB"), United States Department of Housing and Urban Development ("HUD" or "Government"), issued a notice of immediate withdrawal of PFG Mortgage, Inc.'s ("PFG") HUD/FHA mortgagee approval for a period of six years. The withdrawal of PFG's HUD/FHA mortgagee approval was based upon the conviction of Robert Potter, PFG's Chief Executive Officer, in 1989 in the Superior Court of California, County of Ventura, of grand theft and conspiracy to commit grand theft. The notice states that Potter's conviction constitutes cause for withdrawal of PFG's mortgagee approval under 24 C.F.R. §§ 25.9 (m), (p) and (w). By letter dated

March 30, 1992, PFG appealed the immediate withdrawal of its HUD/FHA mortgagee approval. A hearing was held in this matter in Santa Ana, California on May 19, 1992.

In a separate action, by letter dated May 21, 1992, Hill notified Potter that HUD proposed debarring him from further participation in primary covered or lower-tier covered transactions as either a participant or principal at HUD and throughout the Executive Branch of the Federal Government, and from participating in procurement contracts with HUD. The proposed debarment was also based upon Potter's 1989 conviction for grand theft and conspiracy to commit grand theft. The proposed debarment was for a three-year period. In addition, Potter was temporarily suspended from further participation in HUD programs pending a final determination of debarment.

By letter dated June 11, 1992, Potter appealed the Government's suspension and proposed debarment and requested the Board to consolidate these cases arising from these separate Departmental actions, and to incorporate the positions and defenses outlined in his Post-Hearing Briefs from *PFG Mortgage, Inc.*, HUDBCA No. 92-G-7577-MR6, into the debarment action, which had been docketed as *Robert Otto Potter*, HUDBCA No. 92-G-7598-D58. The request to consolidate was granted. This determination is based upon the entire record in this consolidated case.

Findings of Fact

1. PFG is a mortgage lending company with an office in Mission Viejo, California. At all relevant times, PFG held a HUD/FHA mortgagee approval issued by the Department pursuant to 24 C.F.R. § 203.4. (Tr. p. 49; Govt. Exhs. 1, 3, 5, 7, 8, 9).

2. On August 9, 1989, Robert Potter, current Chief Executive Officer ("CEO") of PFG, and Stephen Hughes, an officer of PFG, were convicted in the Superior Court of California, Ventura County, of grand theft and conspiracy to commit grand theft. These convictions were based on the actions of Potter and Hughes with respect to eleven conventional mortgages, originated in 1982 and 1983 involving the use of inflated property values and false financial statements. The court found that "as a result of these offenses, Santa Paula Savings and Loan, Santa Barbara Savings and Loan, Home Federal Savings and Loan, Security Savings and Loan, Alan Fields and Joseph Daley are out \$1,183,183." (Tr. pp. 13, 16, 18; Resp. Exh. 2).

3. Potter was sentenced by the California Superior Court to serve five years in the state prison. After Potter paid \$1 million in restitution, the court stayed the five-year incarceration sentence in the state prison, based upon the payment of restitution and compliance with certain terms and conditions of the probation, which included incarceration for 365 days in the Ventura County jail, and a continuing sixty-month probation. Stephen Hughes is no longer associated with PFG. On the day of Potter's release from jail, Hughes disappeared with PFG funds in excess of \$200,000. Another individual, Kash Pashakan, who served as president of PFG in Potter's absence, appears to have embezzled \$3.4 million from

PFG during the period of Potter's incarceration and has also disappeared. Potter's restitution was paid, in substantial part, by the sale of certain notes by Hughes to the Federal Home Loan Mortgage Corporation. ("Freddie Mac"). These notes were ultimately dishonored as fraudulent. (Tr. pp. 114, 117; Govt. Exh. 3).

4. By letter dated April 2, 1991, the MRB sent a letter to PFG stating that it was considering an administrative action against PFG based upon Potter's conviction. PFG responded to the MRB's letter, stating that the alleged offenses occurred in 1982 and 1983; that HUD's action was punitive; and that Potter was filing an appeal of his conviction. On December 12, 1991, the MRB sent Potter a letter stating that PFG's HUD/FHA mortgagee approval would be withdrawn unless PFG submitted adequate evidence that Potter had divested himself of all ownership interest in PFG and had resigned as an officer and director of PFG. (Govt. Exhs. 3, 5; Tr. p. 53).

5. On March 6, 1992, the MRB decided to withdraw PFG's HUD/FHA mortgagee approval because Potter would not sever his relationship with PFG. On March 17, 1992, the MRB issued a Notice of Administrative Action to PFG stating that PFG's HUD/FHA approval was withdrawn for six years. The MRB withdrew PFG's mortgagee approval because it considered Potter to be the sole owner and "alter ego" of PFG. The MRB determined that the conviction of Potter demonstrated that PFG was not a responsible entity and that HUD would be at risk if it conducted business with PFG. (Tr. pp. 40, 54, 55, 63, 64; Govt. Exh. 7).

6. On May 19, 1992, a hearing on PFG's appeal of immediate withdrawal was held before this Board. Potter, representing PFG, called only one witness, John Bowne, to testify at the hearing. Bowne has been counsel to PFG approximately twenty-five times over an eight year period and has known Potter for at least eight years. Bowne has confidence in Potter's business skills, has used PFG's services, and has recommended PFG's services to a number of clients. (Tr. pp. 7, 9, 21, 24, 25).

7. Freddie Mac has filed civil and criminal complaints against PFG alleging a loss of approximately \$8.5 million. Freddie Mac will no longer do business with PFG. Part of the alleged loss is attributable to the fraudulent notes sold by Hughes to Freddie Mac to obtain funds to pay Potter's restitution in 1989. Potter has obtained a \$9 million civil judgement against Pashakan and assigned it to Freddie Mac. The basis of that judgement was that Pashakan had forged Potter's signature on numerous checks while Potter was incarcerated and had absconded with substantial sums of money belonging to PFG. (Tr. p. 97).

8. As a result of Potter's cooperation, Hughes and Douglas Walters, another former employee of PFG, were issued felony complaints in the Municipal Court of the South Judicial District of Orange County, California. These complaints relate, in part, to the fraudulent notes used to obtain Potter's restitution. Potter also acknowledges that the actions for which he was convicted were improper and wrong; that he is remorseful and determined never to place himself, his family or business in a position where he is subject to prosecution

or other sanction for improper conduct; and that he understands the importance of following appropriate procedures so as to insure a proper course of conduct. Potter further states that since 1982-1983, his businesses have originated and sold over one billion dollars of loan products to institutional investors without being required to repurchase a single loan. He also states that he has never been, is not now and does not ever intend to be a HUD-participant, except to the limited extent that PFG and its predecessor have held a HUD mortgagee approval number. (Declaration of Robert Potter dated September 8, 1982).

Discussion

Withdrawal of Mortgagee Approval

The authority to withdraw mortgagee approval is delegated to the MRB. 25 C.F.R. § 25.2. The MRB has the authority to refuse permission to allow a mortgagee or a principal to continue to participate in FHA-insurance programs. This authority is similar to the Secretary's authority to debar contractors and grantees under 24 C.F.R. Part 24. The same considerations operative in debarments are operative in determining the scope and extent to be given to the withdrawal sanction. *Mechanics National Bank and Mechanics National Mortgage Company*, HUDBCA No. 77-5-MR (March 6, 1979).

In examining the propriety of the withdrawal of PFG's HUD/FHA mortgagee approval, and the suspension and proposed debarment of Potter, two distinct issues must be resolved. First, a determination must be made whether cause exists for the imposition of the sanctions at issue. Second, assuming that cause exists, a determination must be made whether there are mitigating factors which would indicate whether imposing sanctions is necessary to protect the public.

The regulations of the MRB with respect to the proceedings arising from MRB administrative actions are set forth at 24 C.F.R. Part 25. As a HUD-approved mortgagee, PFG is clearly covered by the Departmental regulations governing sanctions issued by the MRB. Pursuant to 24 C.F.R. § 25.5, the MRB may take one or more of the administrative actions provided in that section, if "adequate evidence" for an administrative action exists under 24 C.F.R. § 25.9. Pursuant to 24 C.F.R. § 25.9, any administrative action under 24 C.F.R. § 25.5, which includes withdrawal, shall be based on one or more of the following grounds:

Indictment or conviction of a mortgagee or any of its officers, directors, principals or employees for an offense which reflects upon the responsibility, integrity, or ability of the mortgagee to participate in HUD/FHA programs as an approved mortgagee. 24 C.F.R. § 25.9(m);

or

Business practices which do not conform to the generally accepted practices of prudent lenders or which demonstrate irresponsibility. 24 C.F.R. § 25.9(p);

or

Any other reasons the Board, Secretary, or Hearing Officer, as appropriate, determine to be so serious as to justify an administrative action. 24 C.F.R. § 25.9(w).

The Government asserts that Potter's conviction constitutes cause for withdrawal of PFG's mortgage approval for six years pursuant to 24 C.F.R. §§ 25.9 (m), (p), and (w). As there is no dispute that Potter is the CEO of PFG, and that Potter was convicted of grand theft and conspiracy to commit grand theft, the Government has clearly established cause for withdrawal under 24 C.F.R. § 25.9.

Debarment

Section 24.110(a) of 24 C.F.R. provides in part that the regulations apply to all individuals who have participated, are currently participating, or may reasonably be expected to participate in transactions under Federal programs. A participant is defined in 24 C.F.R. § 24.105(m) as:

Any person who submits a proposal for, enters into, or reasonably may be expected to enter into a covered transaction. This term also includes any person who acts on behalf of or is authorized to commit a participant in a covered transaction as an agent or representative by another participant.

A principal is defined in 24 C.F.R. § 24.105(p) as an:

Officer, director, owner, partner, key employee, or other person within a participant with primary management or supervisory responsibilities; or a person who has critical influence on or substantive control over a covered transaction, whether or not employed by the participant. Persons who have critical influence on or substantive control over a covered transaction are:

* * * * *

(9) Ultimate beneficiaries of HUD programs.

* * * * *

(13) accountants, consultants, investment bankers, architects, engineers, attorneys and others in a business relationship with participants in connection with a covered transaction under a HUD program.

HUD may not apply the sanction of debarment unless the individual or entity to be sanctioned is a "participant or principal," as defined by the applicable departmental regulation at 24 C.F.R. §§ 24.105(m) and (p). In this case, Potter, as the President and owner of PFG Mortgage, Inc., an FHA-approved mortgagee, may reasonably be expected to participate in covered transactions in the future. Thus, he is a participant and a principal as defined by 24 C.F.R. §§ 24.105(m) and (p). By representing to the public that his company is FHA-approved, he is an ultimate beneficiary of HUD programs. Under the circumstances, he is clearly subject to the suspension and debarment provisions of the Departmental regulations.

Underlying the Government's authority 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. The term "responsible," as used in the context of suspension and debarment, 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. 949, 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(d). However, the existence of a cause for debarment does not necessarily require that the contractor be debarred. The seriousness of the contractor's acts and any mitigating factors are considered in determining the seriousness of the offense, and present responsibility must be evaluated in determining whether the sanction is necessary to protect the public interest and is in the best interest of the Government. *Roemer v. Hoffman*, 419 F.Supp. 130 (D. D.C. 1976) 24 C.F.R. §§ 24.115(d), 24.314(a) and 24.320(a).

HUD has the burden of proof for establishing cause for debarment. Potter has the burden of proof of establishing mitigating circumstances. 24 C.F.R. § 24.313(b)(4). The cause for debarment must be established by a preponderance of the evidence. 24 C.F.R. § 24.313(b)(3). However, since the proposed debarment is based upon Potter's conviction for grand theft and conspiracy to commit grand theft, the standard is deemed to have been met pursuant to 24 C.F.R. § 24.313(b)(3). *See also* 24 C.F.R. § 24.305(b)(3).

Mitigating Factors

A determination must also be made as to whether the sanctions are necessary to protect the Department and the public interest. In making that determination, other factors including the seriousness and extent of the infractions and any mitigating factors must be taken into consideration. 24 C.F.R. § 25.9. A withdrawal shall be for a reasonable, specified period commensurate with the seriousness of the ground(s) for withdrawal, generally not to exceed six years. 24 C.F.R. § 25.5(d)(2). Debarments generally should not exceed three years, unless warranted by the circumstances. 24 C.F.R. § 24.320 (a)(1).

At the hearing on May 19, 1992, and in the Post-Hearing Brief, Respondents argue in mitigation that the sanctions should not be imposed because: (1) the offense occurred ten years ago; (2) the offense did not involve HUD properties; (3) the offense did not involve a violation of any HUD regulations; (4) Potter has not engaged in any wrong-doing since that time and he has done over one billion dollars in business in the interim; and (5) HUD was not harmed by the grand theft. These arguments are not persuasive. "To protect the public, it is paramount that individuals who do business with the government are forthright and responsible in their dealings." *In the Matter of Sidney Spiegel*, HUDBCA No. 91-5908-D53, 91-5920-D62, (July 24, 1992). This also applies to individuals or entities who present themselves as approved by the government. 24 C.F.R. Part 24 and Part 25 were designed to serve this purpose. "Without the assurance that those who do business with the government are honest and have integrity, there is no guarantee that government funds are being properly spent." *Sidney Spiegel, Id.* The fact that HUD was not harmed by the misconduct at issue is irrelevant, because the offense was one involving base dishonesty, which impacts directly upon the question of Respondents' present responsibility.

This Board has viewed a substantial passage of time following misconduct leading to the imposition of an administrative sanction as being a potentially mitigating factor. *ARC Asbestos Removal Co., Inc.*, HUDBCA No. 91-5791-D25 (April 12, 1991). However, the passage of time does not, *ipso facto*, establish present responsibility. *Carl W. Seitz and Academy Abstract Company*, HUDBCA No., 91-5930-D66 (April 13, 1992). A determination of present responsibility does not focus merely on the number of years which have passed since the misconduct occurred, but must also look to other indicia relevant to the risks that the Government might face in the conduct of business with a specific individual. *Carl W. Seitz, Id.* It is well-established that a lack of present responsibility can be inferred from past acts. *Schlesinger v. Gates, Id.* Given Potter's offenses, such an inference is adequately raised, because of the seriousness of these offenses, which raise substantial doubts with respect to Potter's honesty, character and trustworthiness, and because these offenses reveal an ongoing pattern and practice of misconduct.

In support of his assertion that PFG is presently responsible, Potter offered the testimony of Bowne, which suggests that PFG is a responsible mortgagee. Potter also submitted an affidavit which demonstrates remorse, and which asserts that he is aware of the gravity of the misconduct at issue, that he will avoid improper conduct in the future, and that he will voluntarily refrain from participation in HUD programs. The Government presented testimony in this case in rebuttal of PFG's character evidence. This evidence in substance shows that Freddie Mac has filed both civil and criminal complaints against Potter with respect to certain fraudulent notes sold by PFG to Freddie Mac. The uncharged misconduct may not be used to justify the withdrawal of PFG's HUD/FHA mortgagee approval. If the MRB desired to proceed against PFG on the basis of the uncharged misconduct, the MRB should have given PFG adequate notice of the charges and an opportunity to defend itself against the charges. Having failed to do so, this evidence may only be considered in rebuttal of Respondents' mitigating evidence.

I find the evidence adequate to raise doubts with respect to the capability of Potter and PFG to conduct business in responsible fashion. In light of the rebuttal evidence, I do not find the mitigating evidence sufficient to obviate the need for the imposition of a sanction. The crime at issue involved a substantial sum of money, and there is no indication in this record of any attempt on Potter's part to rectify this misconduct until much later when he was prosecuted for such acts. Under the circumstances, I do not find the passage of time to be substantially mitigating, because Potter continued to benefit from the fruits of his wrongdoing during most of that time period. Bowne's testimony, while credible, is not persuasive evidence of present responsibility because it does not address Respondents' reputation and character in the financial community or within the community of investors that Respondents have served. Such evidence would constitute a more objective indication of Respondents' degree of present responsibility. There is also no evidence in this record going to PFG's current corporate structure and employment practices, and no evidence that PFG has sufficient controls in place to protect against acts of employee fraud.

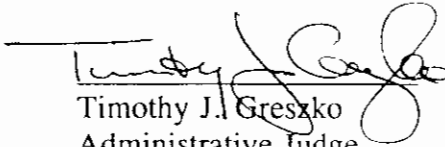
Based on the foregoing, I find that PFG and Potter have failed to rebut the presumption of lack of present responsibility that flows from Potter's conviction for grand theft. I do not find Potter's offer to voluntarily refrain from participation in HUD programs compelling evidence of a lack of risk to this Department - there is little, if anything, to stop him from changing his mind. While I find Potter's remorse to be genuine, I cannot find, on this basis alone, that his debarment for a period of three years is unwarranted. As the withdrawal of PFG's mortgagee approval is based upon the same evidence as the debarment, and in the absence of evidence that the Department faces any greater risk from PFG than it does from Potter, I find that the withdrawal of PFG's mortgagee approval should terminate upon the expiration of the period of debarment.¹

Conclusion

Based on the record in this matter, and for the foregoing reasons, I find that the withdrawal of PFG's HUD/FHA mortgagee approval is appropriate and in the public interest. The withdrawal of PFG's HUD/FHA mortgagee approval shall continue until May 20, 1995. I further find that the Department has established that Potter lacks present

¹/ Under current Departmental regulations, PFG's mortgagee approval will not be automatically restored. At the expiration of the period of withdrawal, PFG may file an application for approval. *See* 24 C.F.R. § 25.4. The regulations further provide that approval shall not be granted if either the applicant mortgagee or any officer, partner, director, principal or employee is indicted for or have been convicted of an offense, which reflects upon the responsibility, integrity or ability of the mortgagee to participate in HUD programs as an approved mortgagee. *See* 24 C.F.R. § 203.2 (1)(2). My determination as to the length of the sanction, as well as the six-year withdrawal sanction imposed by the MRB, appear to be superseded by the effect of 24 C.F.R. § 203.2(1)(2), because the MRB cannot approve PFG as a mortgagee at the expiration of the sanction, if Potter continues his relationship with PFG, since Potter has been convicted of a criminal offense. While I find no evidence of punitive intent, the indefinite effect of such a sanction would appear punitive.

responsibility, and that it is in the public interest to debar him for a period of three years. Potter's debarment shall continue until May 20, 1995, appropriate credit being given from the date of his suspension.


Timothy J. Greszko
Administrative Judge