Board of Contract Appeals
U. S. Department of Housing and Urban Development
Washington, D.C. 20410-0001

In the Matter of:	HUDBCA Nos.	Docket Nos.
MARK E. SCHELL,	93-C-D20	93-1950-DB(LDP)
BRENT M. WOHRLE,	93-C-D21	93-1951-DB(LDP)
DOUGLAS J. MIRTO,	93-C-D22	93-1952-DB(LDP)
and		
MARK E. SCHELL and ARC-O, CMH, INC. aka AMERICAN REAL ESTATE COOPERATIVE, INC.,	93-C-D44	93-2013-DB(LDP)
Respondents		

DETERMINATION BY ADMINISTRATIVE JUDGE JEAN S. COOPER

May 28, 1993

P R O C E E D I N G S

11:00 a.m.

JUDGE COOPER: On the record.

DECISION

STATEMENT OF THE CASE

By separate letters dated October 27, 1992, Mark E. Schell, Brent M. Wohrle, and Douglas J. Mirto were notified that the Columbus, Ohio Office of the United States Department of Housing and Urban Development (HUD) had imposed a Limited Denial of Participation (LDP) on each of them that prohibited their participation in programs administered by the HUD Assistant Secretary for Housing and the Federal Housing Commissioner for a period of one year from the date of the letters. The LDPs were effective immediately within the jurisdiction of HUD's Columbus Field Office.

The LDPs were issued against Schell, Wohrle, and Mirto, based upon a conclusion of law in the Judgement Entry and Order in the consumer rights case of State of Ohio, ex rel Lee Fisher, Attorney General v. Renters' Assistance Foundation, Inc. and American Real Estate Cooperatives, CMH, Inc., Case Number 91 CVH-07-5942, Common Pleas Court, Franklin County, Ohio. The conclusion of law in that case stated that the defendants in that case committed unfair, deceptive, and unconcionable acts

and practices under Ohio law, among other acts, by representing, to consumers, via oral statements, signs, logos and references to FHA guidelines and standards, that defendants had an affiliation, sponsorship, approval, or other business relationship with HUD/FHA, when in fact, defendants were neither HUD/FHA approved lenders nor HUD/FHA approved counseling agencies, and had no connection with any HUD/FHA program.

The stated basis for each of the LDPs was that Schell, Wohrle, and Mirto were all officers and/or key employees of Renters' Assistance Foundation, Inc., also known as Renters' Assistance, Inc.; and ARC-O, CMH, Inc., also known as American Real Estate Cooperatives, CHM, Inc., the defendants in the consumer rights case. As such, HUD considered them to be "principals" within the definition of 24 C.F.R. Section 24.105(p), and subject to the sanction of an LDP because they could reasonably be expected to participate in HUD programs in the future, if given a change to do so, citing 24 C.F.R. Section 24.705(a)(2), (4), (7), (8) and (10).

An LDP was also imposed on ARC-O, CMH, Inc. on October 22, 1992. Schell, Wohrle and Mirto requested an informal conference to present evidence to the Field Office Manager of the HUD Field Office in Columbus, Ohio, that the LDPs should be terminated or modified. An

informal conference was held on December 1, 1992, and all of the LDPs were affirmed in writing on December 16, 1992. Thereafter, Schell, filed an appeal from the affirmation of the LDPs on behalf of himself, as well as Wohrle, and Mirto and requested a hearing on their cases. On January 21, 1993, their cases were docketed for hearing.

Respondents Schell, Wohrle, and Mirto filed a joint Motion to Dismiss, stating that HUD lacked jurisdiction to sanction them because they are not, and never have been, HUD participants, contractors, or affiliates of such entities. They further stated that they have never submitted a proposal for, entered into, or could reasonably be expected to enter into a covered transaction, that they have never offered, been awarded, or could reasonably expect to submit offers for or be awarded a Government contract. Finally, they stated that they have never conducted any business with the Government as an agent or representative of another contractor and that they are not affiliates, directly or indirectly, of any participant or contractor.

An affidavit was submitted in support of the Motion to Dismiss. HUD filed a Response to the Motion to Dismiss, with supporting sworn statements, that Respondents Schell, Wohrle, and Mirto were subject to sanction by HUD as principals because they were officers

or key employees of entities that had submitted proposals to HUD for review and approval. The Motion to Dismiss was denied on April 2, 1993. The ruling on the Motion to Dismiss stated that the issue of whether Schell, Wohrle, and Mirto are subject to LDPs imposed by HUD would be the subject of proof and testimony at the hearing on the LDPs. The cases were consolidated for hearing. The hearing was scheduled for May 26-27, 1993 in Columbus, Ohio.

Subsequent to the scheduling of the consolidated hearing, the HUD Columbus Field Office imposed a second LDP on Mark Schell and ARC-O, CMH, Inc., also known as American Real Estate Cooperatives, Inc., as of March 24, 1993. The stated grounds for the second LDP was that ARC-O, CMH, Inc., while ineligible to participate in certain HUD programs because of an LDP issued against it on October 27, 1992, continued to submit mortgage applications, utilizing an unapproved program, to mortgagees for FHA-insured single family mortgages. Schell was named as a principal of ARC-O because he was an officer or key employee of that corporation. The causes cited by HUD for the second LDP were 24 C.F.R. Section 24.705(2),(4),(7), (9), and (10). The second LDP was affirmed on April 20, 1993, after an informal hearing in the Columbus Field Office of HUD, and Schell and ARC-O appealed that decision, and requested a hearing on it.

On May 10, 1993, the second LDP action was consolidated with the LDPs imposed on Schell, Wohrle, and Mirto on October 27, 1992, for hearing, after a prehearing conference was held on the matter. Respondents Schell and ARC-O challenge the second LDP on the ground that they are not HUD participants or principals.

This decision applies to each of the LDPs imposed by the Columbus Office of HUD against Respondents, as outlined in this statement of the case. It does not apply to the LDP imposed on ARC-O on October 27, 1992, but it does apply to the second LDP imposed on ARC-O on March 24, 1993. This decision is based on the record made at the hearing, considered as a whole. Respondent Mirto did not appear at the hearing. His interests were represented by Respondent Schell.

The parties have agreed to the issuance of this decision as a bench decision at the hearing, pursuant to 24 C.F.R. Section 26.24(d).

FINDINGS OF FACT

1. Renters' Assistance Foundation, Inc. (RAF) was incorporated as a chartered Ohio non-profit corporation on July 17, 1990. The purpose of RAF was to sell homes to individuals who were renters, and who needed financial guidance and counseling, as well as some financial

concessions, to help them become homeowners. (Ex. G-2; testimony of Brent Wohrle.)

2. In about July or August, 1990, RAF started to advertise a program, created by Donald Selley, to accomplish its purpose. The program was based on what Selley called the "five month rent" plan. RAF would pay the rent of its customers to the customer's landlord for five months. During that time, the customer would pay a sum equal to their rent plus an additional amount that, together, would equal an approximated monthly morgage payment. After the five months rent was paid by RAF to the customer's landlord, the customer would continue to pay a monthly sum equal to the difference between their rent and the approximated mortgage payment. They would resume paying their rent directly to their landlord. The monthly differential payments would continue until the customer had paid enough money to approximate the amount they would need for a down payment to buy a house. The entire five months rent paid by RAF would be credited to the down payment as well. (Testimony of Wohrle.)

3 RAF's advertising and program materials

contained numerous references to HUD-FHA requirements, and salesmen for the program were representing to customers directly and indirectly that the program had HUD-FHA approval for purposes of obtaining FHA mortgage insurance. (Exh. G-2; Testimony of Wohrle.)

4. In late August or early September, 1990, the HUD Columbus Field Office started to receive a number of inquiries from consumers, realtors and builders about the RAF program. Most wanted to know whether participants in the RAF program, as advertised, would be eligible for FHA mortgage insurance. Representatives of RAF were invited by the Columbus Field Office to attend a meeting on September 18, 1990, so that HUD could learn more about the RAF program. The RAF program had never been presented to HUD for its approval for FHA mortgage insurance, and HUD was concerned about the reprsentations being made to the public.

5. The September 18, 1990, meeting was attended by Donald Selley, Donald Woodland, and Jerry Sellman, an attorney, on behalf of RAF. HUD representatives asked a number of questions about how the RAF program worked, concentrating

on the flow and source of funds that RAF's customers would use as downpayment and closing costs. HUD concluded that the RAF program, as orally outlined on September 18, 1990, would not meet HUD requirements for a downpayment coming solely from the homebuyer (or a gift from a relative) because the seller was actually providing cash and concessions through RAF to the buyers to fund all or part of the downpayment and closing costs. There was also a subsequent meeting the next day between Selley and Woodland with Jerry Grier, HUD legal counsel. (Testimony of Dolin, Jakob, Juluke, Wohrle; Exh. G-20.)

6. By letter dated October 11, 1990, Robert W. Dolin, Manager of the Columbus Field Office, notified RAF that its proposal, as presented to HUD in the September 18, 1990 meeting, and with Grier the next day, did not meet FHA requirements for mortgage insurance. RAF and HUD mutually agreed that all references to the use of RAF's program in conjunction with FHA-insured mortgages would be discontinued. Dolin's letter states that:

> RAF is not to advertise, solicit or

> encourage the participation of any individual or business organization in any of its programs by indicating or intimating, in any way, that FHA mortgage insurance may be obtained in conjunction with its program

RAF was threatened with a Limited Denial of Participation if it did not comply with Dolin's letter. RAF did create a Declaration stating that its program was not sponsored by HUD-FHA, and it removed all references to FHA guidelines from its materials. (Exh. G-20; R-3.)

7. HUD's Columbus Field Office also took two other steps to make sure that RAF's program would not become part of HUD's FHA insurance program through RAF's customers. On October 11, 1990, HUD issued a News Release stating that RAF had no connection with HUD or FHA, and that it had no legitimate basis for collecting any fees or deposits in connection with any HUD-FHA mortgage insurance program. The News Release was directed to all HUD-approved lenders. On October 30, 1990, HUD's Columbus Field Office also issued a Bulletin to all HUD-approved mortgagees warning that RAF's "Homebuyer Grant"

Program, the name by which it was called in the legal documents created by RAF, did not meet FHA mortgage insurance requirements and guidelines, and that RAF had agreed to cease all refrences to HUD or FHA in its marketing. HUD-approved lenders were asked to report any contacts with RAF, or a related entity, ARC-O, CMH, Inc., to HUD. (Exhs. G-18, 19.)

9. ARC-O, CMH, Inc., officially titled American Real Estate Co-operatives, cmh, Inc., was incorporated on October 12, 1990. ARC-O Realty, Inc., a wholly owned subsidiary of ARC-O, CMH, Inc., was incorporated on July 8, 1991. Both ARC-O, CMH, Inc. and ARC-O Realty, Inc. were integral to RAF's program. (Exhs.R-1, R-2.)

10. RAF and ARC-O, CMH, Inc., provided "Homebuyer Grants," credit counseling, and financial planning services to assist consumers in purchasing primarily custom-built homes. They required consumers to undergo a series of interviews and credit evaluations, and also required consumers to pay various fees for credit reports, "grant application" processing, and contract binders. All of the fees were collected by RAF. (Exh. G-2; Wohrle testimony.)

11. Once a consumer's "grant application" was approved by RAF and ARC-O, a document entitled "Grant Agreement" was executed by the consumer and RAF and ARC-O, the consumer paid a $150 "binder fee" to consolidate all services on behalf of the consumer with builders, landowners, and mortgage financing, and to collect all pre-paid costs related to the contract sale of the home chosen by the consumer. The consumer was awarded a "Homebuyer Grant." RAF was designated as the "Grantor" in the Grant Agreement, and the consumer was designated as the "Grantee." Thse documents were used during the duration of this program. (Exh. G-2(a).)

12. The Grant Agreement form states that the Grantee seeks the assistance of RAF to enhance the Grantee's fnancial portfolio to enable the Grantee to become a qualified home buyer. It further states that RAF, as Grantor, agrees to award the Grantee a "Homebuyer Grant," which consists of five monthly payments made to the Grantee's designated landlord by RAF "as and for rental payments on behalf of said Grantee plus allowance of 100 % credit on all funds paid

toward home purchase." (Exh. G-2(a).)

13. The Grant Agreement set out how the Grantee would buy a new home. It states that ARC-O would arrange a contract with a local builder for the construction of the Grantee's new home,and the Grantee would choose the style and floorplan from the designated builder's selections.

14. The Grant Agreement also contained a "Notice" requiring the separate signature of the Grantee. It states as follows concerning the monthly payments made to ARC-O:

> I also agree that the above referenced payments become the sole property of ARC-O. I further understand and agree I have no right to, interest in, or title to the aforementioned monthly payments whatsoever. I understand and agree that these payments are placed into ARC-O's Builder Construction Account solely for the purpose of ARC-O verifying the timeliness and total amount of my payments, accounting of which will be used as payment verification at my real estate closing. (Exh. G-2(a).)

15. In the event of a default as a result of an Act

of God, the Grantee would be entitled to a refund of the monies paid to ARC-O, less the rent paid by RAF on the Grantee's behalf, expenses, and cost of ARC-O's services. In the event of a default for reasons beyond the Grantee's control, the Grantee would receive 50% of the monies paid to ARC-O, less rent, expenses and cost of services. However, in the event of a default caused by a Grantee that was not beyond the Grantee's control, all of the monies paid to ARC-O would be forfeited. (Exh.G-2(a).)

16. The way payments were received and made through RAF, ARC-O, CMH, Inc. and ARC-O Realty, Inc. was complex. The customer made all cash payments to ARC-O, CMH, to be credited to the customer's account. ARC-O, CMH, gave the part of this money attributable to rent payments to RAF, which in turn paid the customer's rent, in fact with the customer's own money run through ARC-O's general operating account. All monies received by ARC-O, CMH, from whatever source, were deposited in the general operating account of ARC-O, CMH. Those monies were used to pay salaries, office expenses, and the monthly draws of the licensed realtors employed by ARC-O

Realty, ARC-O, CMH's wholly owned subsidiary. The monthly draws were paid indirectly by ARC-O, CMH by a deposit to ARC-O Realty's account. When ARC-O Realty received a commission from a seller/builder for selling a house to one of RAF's and ARC-O, CMH's customers, it would pay ARC-O, CMH, part of that money, which would be used to actually fund the credit acount of RAF's and ARC-O, CMH's customers for their closing costs and downpayment. These commissions were usually collected in advance of the closing so that the necessary funds could be deposited in ARC-O, CMH's operating account. ARC-O, CMH would usually have a check prepared for the customer to bring to the closing that would reflect the downpayment needed and the credits earned by the customer in the program. (Testimony of Mark Schell.)

17. None of the payments made by the customers of RAF and ARC-O, CMH were escrowed. The money given to the customer for closing was actually composed at least in part from money paid by the seller that travelled through ARC-O, CMH's general operating account. However, the customers had made payments equal to this money

to ARC-O over the length of the program. (Testimony of Schell.)

18. Mark E. Schell is the Secretary-Treasurer of ARC-O, CMH, Inc. He is also the President, Secretary and Treasurer of ARC-O Realty, Inc. He is not, and never has been, a licensed realtor. He has never been an officer or employee of RAF.

19. Brent M. Wohrle was the Secretary-Treasurer of RAF, and became an employee of ARC-O, CMH, Inc. after RAF effectively ceased operating in early 1992. Wohrle is now employed with Four Seasons Limited Partnership.

20. Douglas J. Mirto was the President of RAF, and after RAF ceased operations, he became an employee of ARC-O, CMH, Inc.. He is currently employed elsewhere.

21. On September 20, 1990, Wohrle sent a letter and supporting documents to Jerry Grier, Chief Counsel for HUD's Columbus Field Office. In his letter, he states that RAF "would not offer its 5 month plan until details can be worked out with your office's satisfaction." He further wrote that RAF was proceeding with its conventional financing programs and "would like

to include a typical lease purchase which could be insured by FHA." He described RAF's proposal in the letter, and ended by the statement "We would appreciate a call upon your review." (Ex.G-21.).

22. In 1992 the Attorney General of the State of Ohio brought suit against RAF and ARC-O, CMH, Inc. for violations of consumer protection laws. The trial was held in May-June, 1992, and the Judgment Entry and Order was issued about October 14, 1992. During this period, most of the principal employees, shareholders and officers of RAF and ARC-O, CMH, Inc. abandoned the corporations. By the time of the trial, only Schell, Wohrle, and Mirto, plus a secretary-receptionist remained. Wohrle was designated by the Attorney General as the representative officer of RAF for purposes of the lawsuit. Schell, as the only remaining officer of ARC-O, CMH, Inc. was the ARC-O, CMH designee for purposes of the trial. (Ex. G-2, Testimony of Wohrle and Schell.)

23. HUD'S Columbus Office again started having frequent contact with RAF and ARC-O, CMH, Inc. in the spring of 1992. On April 16, 1992,

Schell, Wohrle, and Mirto, as well as Norm Tracy, Wohrle's father-in-law, holding themselves out as the representatives of ARC-O met with Donald Jakob, the Director of the Housing Development Division of HUD's Columbus office. The reason for the meeting was the receipt by Trustcorp of a number of applications for mortgage insurance from RAF-ARC-O, CMH customers who would not qualify for conventional financing but would qualify for a mortgage with FHA insurance. Trustcorp, a direct-endorsement lender approved by HUD, did approve and endorse two of these applications for FHA mortgage insurance, one from Eric and Cindy Mellendorf, and one from Richard Dalton. (Ex.G-15.)

24. HUD refused to finally endorse the Mellendorf and Dalton loans for FHA mortgage insurance, and returned the loans to Trustcorp to be kept in Trustcorp's loan portfolio. Trustcorp tried to get HUD to change its mind. In the files for the Mellendorfs and Dalton were letters from Schell on ARC-O, CMH, Inc. letterhead stating that the individuals had paid ARC-O, CMH, Inc. "the following list of monies toward purchase of their home." The list contained dates of

payments, amounts paid, check numbers, and amounts attributable from these payments to closing costs and downpayment. HUD believed that, had Trustcorp traced the source of funds in these transactions used for the downpayment and closing costs, that it would have discovered seller payments not allowed by HUD.

25. In a letter dated May 8, 1992, Jakob wrote to Schell at ARC-O, CMH, Inc. summarizing HUD's position concerning representations made by Schell, Wohrle, and Mirto at the April 16, 1992 meeting. Apparently they had described the ARC-O, CMH operations at the meeting. Jakob was very concerned that ARC-O customers were applying for FHA mortgage insurance, despite ARC-O's assurance that it was not going to participate directly or indirectly in FHA, and that its customers would get 95% conventional morgages or VA mortgages. Jakob also observed that Schell, Wohrle, and Mirto were <u>aware</u> that Trustcorp was holding loan applications for their customers and that the customers were pursuing FHA mortgage insurance. Jakob set out five conditions that would have to be met by Trustcorp and ARC-O, CMH, Inc. to allow these

loans to get FHA mortgage insurance. The conditions were not met, although Schell did make an attempt to do so. ARC-O, CMH, Inc. eventually reimbursed all of the monies paid by these customers to ARC-O, CMH and these individuals left the program. (Exhs. G-15, G-27, Testimony of Schell, Wohrle.)

26. On the first day of the trial of the consumer suit, ARC-O, CMH declared bankruptcy. After the trial of the consumer case against ARC-O, CMH and RAF, but before issuance of the court's judgment, ARC-O, CMH again sent materials to HUD's Columbus, Office, with letters askingfor HUD's blessing in advance of an adjusted program that would replace both ARC-O, CMH and RAF with a single entity, New Company Realty, Inc. A cover letter to a submission dated August 19, 1992, signed by Schell states that it is the intention of the company to continue its operations via 95% conventional financing, but that "in the instance that a client is found to not be qualified for a conventional loan <u>we will pursue FHA insured financing.</u>" (Emphasis supplied)

The cover letter of August 19, 1992, also

requested that HUD stop circulating the warning bulletin of October, 1990, which was based on the RAF program as it existed at that time. The submission was essentially a proposal for a new program whose participants HUD would allow to obtain FHA mortgage insurance. Schell had also sent letters to HUD on August 7, 1992, July 31, 1992, July 30, 1992, July 17, 1992, April 28, 1992 and April 29, 1992, all on behalf of ARC-O, its operations, and its need to have its customers not be blocked from FHA mortgage insurance, if neeeded. (Exh. G-26)

27. During this period HUD continued to find problems with the materials, letters, explanations, and proposals received from ARC-O, CMH both via the mail and orally from Schell, Wohrle, and Mirto, and HUD was not able to give the assurances or the favorable review sought by ARC-O.

28. The Judgement and Order issued by the Court of Common Pleas in State of Ohio, ex rel. Lee Fisher, Attorney General v. Renters' Assistance Foundation and American Real Estate Co-Operatives, CMH, Inc., found that they had utilized unfair, deceptive and unconscionable

practices that were in violation of Ohio law, and caused financial harm to participants in the amount of $122,217. The Judgment remains unsatisfied and the defendants both are under protection of the bankruptcy court. (Ex. G-2, Testimony of Schell and Wohrle.) At Conclusion of Law # 11, the court found that:

> Defendants committed unfair, deceptive, and unconscionable acts and practices. . . by representing to consumers, via oral statements, signs, logos and references to FHA guidelines, standards that the Defendants had an affiliation, sponsorship, approval or other business relationship with HUD/FHA when in fact Defendants were neither HUD/FHA approved lenders nor HUD/FHA approved counseling agencies, and had no connection with any HUD/FHA program.

(Exh.G-2)

29. Based upon the civil judgment, with its lengthy findings of fact, conclusions of law and evidentiary attachments, on October 27, 1992 Robert Dolin, manager of the HUD Columbus Field Office, imposed Limited Denials of Participation on ARC-O, CMH, Inc. as a participant, and on

Schell, Wohrle, and Mirto, among others as principals. The notice of LDP to each quoted the Conclusion of Law # 11 in the Judgment. (Ex. G-1.)

30. The LDPs were affirmed by Dolin after an informal conference. He stated that he was sure that he had the legal authority to impose the sanctions against Respondents when he did so. (Testimony of Dolin.)

31. After the court judgment, bankruptcy and LDPs ARC-O, CMH, Inc. continued to try to operate to satisfy the remaining contracts that RAF and ARC-O, CMH had entered into with their customers to provide homes. At some point, the licensed realtors all left ARC-O Realty, Inc. and Schell turned to unaffiliated realtors to sell the homes. One of those realtors was American Properties, located in the same office building as ARC-O, CMH, Inc. At that time, Schell, Wohrle, and Mirto were all that was left of ARC-O, CMH and Schell was the only one with a title. As HUD believes, Schell, Wohrle, and Mirto <u>were</u> ARC-O, CMH by the time of the trial. As late as January, 1993, a revised proposal by ARC-O was submitted to HUD for its evaluation. A letter

stating that builders who were participating with ARC-O in its program with conventional financing would not be punished by HUD was also sought. HUD declined to write such a letter, and the matter remains unresolved (Exh. G-26.)

32. Randy and Brenda Pettit had been customers of RAF that RAF had "prequalified" for its program, but the Pettits asked for a delay in their participation. They did not actually start making any of their payments to ARC-O, CMH, Inc. until January 23, 1992, when RAF had already ceased all operations. ARC-O, CMH made the rent payments for the Pettits pursuant to the program Grant Agreement. On or about November 2, 1992, American Properties drew up a Real Estate Purchase Contract for the Pettits that stated unequivocally that the contract was contingent upon the Pettits "obtaining satisfactory construction financing (FHA)" within 60 days. Veronica Lanning was the American Properties Company broker. (Joint Exhibit 25.)

33. A copy of the Pettit contract was probably filed with ARC-O, CMH but Schell states that he did not look at it or know of its FHA proviso. He also testified that American Properties "knew"

the Pettits could not use FHA financing and he does not know why the contract was written the way it was. (Testimony of Schell.)

34. The Pettits went to First Federated Mortgage, a direct endorsement lender approved by HUD, for their mortgage. They intended to apply for FHA mortgage insurance. The Pettits apparently told the loan officer at First Federated that their downpayment and closing costs had been accumulated through the RAF-ARC-O, CMH program. The mortgagee asked ARC-O, CMH, Inc. to verify this information. A letter signed by Mark Schell, dated January 18, 1993, on ARC-O, CMH, Inc. letterhead was provided to the mortgagee. It stated that the Pettits "have paid ARC-O, CMH, Inc. the following list of monies to be credited toward the purchase of their home." The letter contained a list of dates of payments, check numbers, amounts and their allocation between closing costs and downpayment, much like had been in the Mellendorf and Dalton loan files. First Federated contacted HUD's Columbus office to determine what to do with the Pettits. The Schell letter and contract of sale were provided

to HUD for inspection by First Federated. (Exh. G-25.)

35. Based upon the letter signed by Schell on January 18, 1993, and the contract of sale specifying FHA financing in the Pettit papers, HUD's Columbus Office concluded that Schell and ARC-O, CMH, Inc. had knowingly violated the terms of their LDPs by "submitting a loan" for FHA financing. A second LDP was imposed on Schell and ARC-O, CMH, Inc. on March 24, 1993.

36. Schell testified that he did not know the Pettits were intending to apply for FHA financing, that he did not look at their file to see their contract, and apparently, no questions were asked of First Federated when the mortgagee requested the information about the Pettits payments to ARC-O.

37. The only issue Schell raised at the informal hearing on the second LDP was that neither he nor ARC-O, CMH, Inc. were participants or principals, and could not be sanctioned. The second LDPs were affirmed on April 20, 1993.

Discussion

I. The October 27, 1992, LDPs

The basis for the LDPs imposed on Respondents

was the civil judgment and findings of fraudulent and deceptive business practices against RAF and ARC-O in the consumer rights suit brought by the Ohio Attorney General. HUD imposed LDPs on Schell, Wohrle, and Mirto as "principals" of RAF and ARC-O. ARC-O's LDP was based on its "participant" status.

HUD may not impose any sanction on a person or entity who is not a "participant," "principal," or an "affiliate" of a participant or principal. Each of these terms is defined in the regulation applicable to all HUD sanctions, including an LDP.

Respondents challenge HUD's legal authority to impose any sanction on them, stating that, as a metter of fact and law, they are not "principals" and ARC-O is not a "participant," as defined at 24 C.F.R. Section 24.105(m) and (p).

"Principal" is defined 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 a critical influence on or substantive control over a covered transaction, whether or not employed by the participant." 24 C.F.R. Section 24.105(p). Persons who have a critical influence on or substantive control over a covered transaction are defined to include, among others, [a]ccountants,

consultants ... in a business relationship with participants in connection with a covered transaction under a HUD program." 24 C.F.R. Section 24.105(p)(13).

Schell, Wohrle, and Mirto were each an officer of RAF or ARC-O. Although Schell was not employed in any capacity at RAF, both Mirto and Wohrle became employees of ARC-O by early 1992, when RAF had essentially ceased to operate. They attended numerous meetings with HUD personnel, holding themselves out as representatives of ARC-O. By late 1992, Schell, Wohrle, and Mirto were ARC-O's only employees, with the exception of a receptionist, and they made the business decisions for ARC-O together. I find that they are officers and "key employees" of RAF and ARC-O. The question is whether either RAF or ARC-O is a "participant," as defined at 24 C.F.R. Section 24.105(m).

A participant is defined as:

> Any person who <u>submits a proposal for</u>, enters into, <u>or reasonably may be expected to enter into a covered transaction</u>.

"Person" is defined to include entities such as corporations for purposes of the regulation. 24 C.F.R. Section 24.105(n). A loan transaction in which FHA mortgage insurance is applied for is a "primary covered trnasaction." See, 24 C.F.R. Section 24.110(a)(1)(i). A

"lower tier covered transaction" includes a contract for goods or services between a participant and a person under a covered transaction under which that person will have "a critical influence on or substantive control over that covered transaction." Accountants and consultants are specifically enumerated as such persons in a business relationship with a participant in connection with a covered transaction under a HUD program. See, 24 C.F.R. Section 24.110(a)(1)(ii)(c)(11).

HUD states that both RAF and ARC-O were participants because they submitted a proposal for, and reasonably may be expected to enter into a covered transaction. Respondents challenge that factual and legal assumption, stating that RAF and ARC-O never made proposals for a covered transaction.

"Proposal" is also defined in the regulation. It is defined as:

> A solicited or unsolicited bid, application, request, invitation to consider or similar communication by or on behalf of a person seeking to participate or to receive a benefit, directly or indirectly, in or under a covered transaction. 24 C.F.R. Section 24.105(q).

Between 1990 and 1992, first RAF and then ARC-O made requests to HUD and presended materials for HUD to

consider both on their own corporate behalf, and on behalf of their clients who wished to be able to receive FHA mortgage insurance even though the clients had been involved in a contractual relationship with RAF and ARC-O through their Home Ownership Grant program. They also made at least one request on behalf of a builder ~~least one~~ who wanted a letter from HUD that they could participate with RAF and ARC-O in their program and not be penalized by HUD. In each instance ARC-O would have received at least an indirect benefit as result of these requests and presentations, if HUD-FHA had agreed to allow clients to receive FHA mortgage insurance, or had written the letter requested, because more sales would have closed and ARC-O would have received more pass-throughs of commissions from ARC-O Realty, Inc.

Respondents have denied that they ever asked HUD-FHA to "approve" RAF's or ARC-O's program and technically this may be so, although the HUD personnel who heard their requests orally and received them in writing uniformly believed that HUD's approval of the program - - in whatever form it was currently being proposed - - was at the heart of ARC-O's and RAF's written materials, presentations, requests and overtures. Nonetheless, a request to approve the program as a whole is not required to fall within the definition of "proposal." I find as a

matter of fact and law that RAF, ARC-O, and Schell, Wohrle, and Mirto as officers and key employees, all made proposals to HUD on behalf of the two corporations and the clients of the two corporations, as well as at least one builder, seeking to participate in a covered transaction or to receive a benefit, direct or indirect, from such a transaction. Furthermore, in written communications from ARC-O under Schell's signature, it was stated that ARC-O would pursue FHA mortgage insurance on behalf of its clients as needed, in the present and in the future. Although the definition of "participant" is written in the disjunctive - meaning that submission of a proposal or a reasonable expectation of future entry into a covered transaction is sufficient to bring one within the definition, in this case I find that both provisos are met at least to ARC-O.

Thus, I find that ARC-O and RAF were, indeed, "participants" as defined at 24 C.F.R. Section 24.105(m), and that Schell, Wohrle, and Mirto are "principals," as defined at 24 C.F.R. Section 105(p). HUD had the legal authority to impose an LDP on them.

The stated basis for the original LDP's, the civil judgment, is an appropriate cause for imposition of an LDP pursuant to 24 C.F.R. Section 24.705(a)(8), citing to commission of an offense listed in 24 C.F.R. Section

24.305. The civil judgment rendered against RAF and ARC-O meets the regulatory cause of an "offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a person." 24 C.F.R. Section 24.305(a)(4). The nature of the deceptive practices found in that case are serious, broad-based, and raises the question of whether either company or its principals are responsible if such practices could occur within the program. Applicants were financially harmed, and have not been made whole. The court singled out the fact that RAF and ARC-O were holding themselves out to the public as meeting HUD guidelines by reference to such guidelines throughout their literature. Although HUD became aware of this in 1990, and believed that it had a cease and desist agreement with RAF about any mention or inference that the program was approved by HUD or met the HUD guidelines, such references continued at least orally. HUD had not just a right, but a public duty to take the findings and conclusions in the Attorney General's case as a basis for a sanction. Even though no individuals were named as defendants in that suit, it was not unreasonable for the HUD Columbus Office to believe that the civil judgment was adequate evidence that certain principals of RAF and ARC-O, although not named in the judgment, had control over or contributed to the causes

for the judgment.

Cause for an LDP must be established by adequate evidence. In this case, I find that cause had been established by adequate evidence. Schell, Wohrle, and Mirto all held positions in RAF and ARC-O by which they knew or should have known that the program materials were deceptive, that the program was not operating as advertised, and that they were in a position to cause a correction of the problems.

HUD was obligated, as am I, to consider mitigating circumstances in determining whether the LDP shall be continued. It is true that Schell and Wohrle were not the "masterminds" behind the program - it was their first venture into the world of real estate for both of them. They assumed that all of the experts, lawyers, and consultants brought in to set up corporations and draw up documents knew what they were doing. Nonetheless, some of the most offensive misrepresentations were being made by RAF and ARC-O sales people, and they knew or should have known what was happening if they were paying attention. The people financially injured have not been compensated, and it is appropriate, under these circumstances, to leave the LDPs imposed on Respondents in place. I know little or nothing of Mirto's role in the events that led to the civil judgment because he did not

see fit to appear at the hearing. He was the President of RAF at the time, and I draw negative inferences as to his responsibility based upon the high office he held in that corporation. I also am concerned that, despite avowals to the contrary, ARC-O's client's cases are still being submitted to mortgagees for FHA mortgage insurance, and that Respondents are doing little to intercede to make sure that this does not happen.

It is clear that by the time HUD imposed the first group of LDPs, that Schell, Wohrle, and Mirto, were for all intents and purposes, ARC-O, CMH, Inc. HUD concluded, apparently, that to sanction ARC-O, CMH, Inc. but not its only employee, would be ineffective, and that is the best reason for imposing the LDP on the individual operators of the skeleton business left, as of fall, 1992. I uphold those actions.

II. The second LDP imposed on Schell and ARC-O, CMH poses more serious problems because neither Schell nor ARC-O, CMH, Inc. submitted the Pettit loan for FHA mortgage insurance. I believe that Schell did not have actual knowledge of the terms of the Pettit sale contract which specified FHA financing. Also, because ARC-O Realty, Inc. was not the realtor in the Pettit transaction, I cannot attribute the realtors actions directly to Schell on the record before me.

However; both Schell and ARC-O, CMH, Inc. were under LDPs when Schell sent the January 18, 1993 letter to the mortgagee - at the mortgagee's request. Much greater care was required of Schell to make very sure that he was not participating, even indirectly, in HUD programs at that time. It is important to point out that Schell does not believe that he is either a HUD participant or principal of a participant in his role at ARC-O, CMH, Inc., and that may explain why he did not inquire further of the mortgagee to determine if more information than he provided was needed: namely, HUD's position on FHA insurance. Schell could have checked the Pettit's file. A copy of the sales contract was probably contained in it. He did not do so. By failing to check into the transaction as a whole, Schell facilitated the Pettit's attempt to obtain FHA financing, and both he and ARC-O, CMH would have benefitted indirectly, had the closing gone through, which it did not.

I find that Schell and ARC-O, CMH both violated HUD program requirements - which included the strictures imposed by their LDP - by allowing ARC-O materials to be submitted in a transaction for the purpose of obtaining FHA mortgage insurance - a purpose that Schell <u>should have</u> discovered had he used proper care, and had he shown a real understanding of ARC-O's role as both a beneficiary

and participant in HUD programs via its customer's mortgage application.

I uphold the second LDPSs as well on this basis.

Jean S. Cooper
Administrative Judge
HUD Board of Contract Appeals

May 28, 1993