



Respondents requested an informal conference on the LDP, which was conducted on April 8, 1996, by Casimir Kolaski. Kolaski affirmed the LDP on May 10, 1996. By letter dated June 6, 1996, Respondents requested a hearing pursuant to 24 C.F.R. § 24.713 to contest the LDP. The parties agreed to an extension of the regulatory period for commencement of the hearing. The hearing was held on August 13, 1996, in Boston, Massachusetts.

These Findings of Fact and Recommended Decision are based on the Administrative Record filed in this case by the Government, the hearing record, and written submissions of the parties.

#### FINDINGS OF FACT

- 1) LPI was the project manager or management agent for HUD-owned projects, as well as HUD-insured and subsidized projects. The President and owner of LPI is Lorenzo Pitts (Pitts). (Admin. Rec., Tabs A, B; Tr. 181.)
- 2) The HUD Regional Inspector General issued an audit report dated January 29, 1993, on the HUD-related operations of LPI. The audit found that LPI had failed to maintain accountability over project funds, overcharged HUD at least \$195,292 for various maintenance services, failed to account for approximately \$1.7 million in maintenance payrolls, failed to follow proper procurement procedures, and used \$225,000 from HUD-insured and subsidized projects in violation of the applicable Regulatory Agreements and Section 8 contracts. (Admin. Rec., Tab A.)
- 3) On June 14, 1993, an LDP was imposed on Respondents, based on the audit findings. The LDP also applied to the Fort Hill Trust, the Esperanza Trust, and the Wardman Trust, all owned by Pitts. The LDP was terminated on April 29, 1994, after Respondents entered into repayment agreements and executed notes to resolve the audit findings. (Exh. G-1, G-2; Tr. 20.)
- 4) To resolve the audit finding that LPI had overcharged HUD at least \$195,292 for maintenance services, LPI entered into a repayment agreement with HUD dated December 23, 1993, in which LPI agreed to repay HUD the overcharges over a 36-month period, starting January 1, 1994. Pitts signed the repayment agreement on behalf of LPI. Pitts also executed a note on behalf of LPI for the debt, which accrued interest at a rate of 4% a year. HUD agreed to forbear from pursuing its legal and equitable remedies against LPI so long as timely payments were made under the terms of the repayment agreement and the note. (Admin. Rec., Tab B.)
- 5) To resolve the audit finding that LPI had failed to account for approximately \$1.7 million reimbursed by HUD for maintenance payrolls at several HUD-owned properties, LPI entered into a repayment agreement with HUD dated December 27, 1993, in which LPI agreed to repay HUD \$88,602 over a 12 month period, starting

January 1, 1994. Pitts signed the repayment agreement on behalf of LPI. Pitts also executed a note on behalf of LPI for the debt, which accrued interest at a rate of 4% a year. HUD agreed to forbear from pursuing its legal and equitable remedies against LPI so long as timely payments were made under the terms of the repayment agreement and the note. (Admin. Rec., Tab C.)

6) To resolve the audit finding that LPI had failed to account for expenditures at a project owned by the Wardman Trust that was encumbered by a mortgage insured by HUD and covered by a HUD Regulatory Agreement, LPI entered into a repayment agreement with HUD dated April 6, 1994, that it would repay the project \$57,355 by making monthly payments of \$1,593.20 over a three year period, starting January 1, 1994. The repayment agreement provided that if LPI failed to make timely payments, the entire balance would become immediately due, and HUD would no longer forbear from pursuing its legal and equitable rights against LPI and the Wardman Trust. Pitts signed the repayment agreement on behalf of both LPI and the Wardman Trust. (Admin. Rec., Tab D.)

7) To resolve the audit finding that LPI had failed to account for expenditures at a project owned by the Fort Hill Trust that was encumbered by a mortgage insured by HUD and covered by a HUD Regulatory Agreement, LPI entered into a repayment agreement with HUD dated April 6, 1994, that it would repay the project \$26,069 by making monthly payments of \$724.13 over a three year period, starting January 1, 1994. The repayment agreement provided that if LPI failed to make timely payments, the entire balance would become immediately due, and HUD would no longer forbear from pursuing its legal and equitable rights against LPI and the Fort Hill Trust. Pitts signed the repayment agreement on behalf of both LPI and the Fort Hill Trust. (Admin. Rec., Tab E.)

8) To resolve the audit finding that LPI had failed to account for expenditures at a project owned by the Esperanza Trust that was encumbered by a mortgage insured by HUD and covered by a HUD Regulatory Agreement, LPI entered into a repayment agreement with HUD dated April 6, 1994, that it would repay the project \$27,374 by making monthly payments of \$760.38 over a three year period starting January 1, 1994. The repayment agreement provided that if LPI failed to make timely payments, the entire balance would become immediately due, and HUD would no longer forbear from pursuing its legal and equitable rights against LPI and the Esperanza Trust. Pitts signed the repayment agreement on behalf of both LPI and the Esperanza Trust. (Admin. Rec., Tab F.)

9) LPI made timely payments on the repayment agreements and notes through August, 1995. After August, 1995, LPI made no payments on any of the notes or repayment agreements until June, 1996. (Answer to complaint; Admin. Rec., Tabs G, H., Tr. 59.)

10) Starting in mid-September, 1995, LPI experienced severe reimbursement delays for payroll and other direct expenses on a contract for management of Fieldstone, a HUD-owned project. The delays were primarily caused by anomalies in a computerized billing and reimbursement program operated by another HUD contractor, and were not caused by LPI. Because of a cash shortfall created by the reimbursement delays, Pitts and LPI's controller, John Egan, decided that LPI would not pay its obligations on the repayment agreements and notes due in September, 1995. According to both Pitts and Egan, there was insufficient cash on hand to pay both payroll and the agreements and notes. Respondents did not notify HUD that no payments would be made in September on the repayment agreements and notes. They were hoping that the problems with the computerized reimbursement would be corrected, and that payments could be made. (Exh. G-5; Tr. 121-122, 127-128, 135-136, 139, 141-142, 161, 171, 187-188.)

11) The reimbursement problems continued into October and November, 1995, and corporate cashflow worsened. By November, Pitts had to borrow money to even make payroll. During this period, LPI failed to make any payments on any of the repayment agreements or notes, but did not notify HUD that it would not be making payments, or the reasons for its' default. Pitts was trying to obtain a bank loan to make payments on the notes, without success. He stated that the reason that he did not call anyone at HUD to discuss the situation was because he was embarrassed. Egan and Pitts never considered giving HUD notice of LPI's inability to make payments on the agreements and notes in September and October. Finally, in mid-November, 1995, after missing the November payments on the agreements and notes, Pitts asked Robert McLaughlin, counsel for Respondents, to intercede with HUD on behalf of LPI. (Tr. 126, 128, 162, 169, 189-190.)

12) By letter dated November 16, 1995, McLaughlin wrote to Kolaski, then Acting Regional Administrator for HUD's Boston Regional Office, to request a six-month suspension of the monthly payments due under the various repayment agreements and notes. The letter cited unexpected and severe financial constraints on LPI, arising out of Pitts' loss of designation as the developer of the Granite B4 project, from which Pitts had expected to recoup over \$600,000. It also cited the delays in reimbursement of \$91,00 due LPI for managing Fieldstone. The letter stated that it was not a request for a reduction or restructuring of LPI's obligations, and asked for a meeting with Kolaski or a member of his staff to discuss the request. The letter made no reference to the payments already past due. As of the date of McLaughlin's letter, no one at HUD was aware of LPI's problems with getting reimbursed for its payroll expenses for Fieldstone, or that LPI had made no payments on the repayment agreements or notes since August. (Admin. Rec., Tab G.)

13) Kolaski gave McLaughlin's letter to James Drazen, Chief of HUD's Real Estate Owned Branch in Massachusetts, to investigate the Fieldstone reimbursement delays. Fieldstone was part of HUD's Demonstration Disposition program. Although HUD owned Fieldstone, the Massachusetts Housing Finance Agency (MHFA) administered all contracts applicable to the project, including the one for payroll reimbursement, under the program. Drazen was HUD's coordinator of the program with MHFA. Drazen received what he considered to be correct answers from MHFA on what had caused the delays, but he did not understand the magnitude of the problem at the time. He believed, from what he was told by MHFA, that LPI was only owed \$46,000 for unreimbursed expenses on Fieldstone, not \$91,000, and that much of the delay was attributable to LPI, which it was not. Drazen reported this information to Kolaski. He also called McLaughlin to tell him what he had learned from MHFA, and told McLaughlin about a faster method for reimbursement that HUD approved for companies in financial distress. LPI received no payroll reimbursements between September 21 and November 28, 1995. The computerized reimbursement problem was corrected in late November, after Drazen interceded, but LPI did not receive all of the reimbursements due it until mid-December, 1995. (Exh. G-5; Tr. 23, 66-70, 75-76, 81, 95, 105, 138.)

14) HUD did not actually become aware that LPI had ceased making payments on the agreements and notes until sometime in late November, 1995. Teresa Anelli, an asset manager in the Multifamily Housing Division of the Massachusetts State Office of HUD, noticed that no copies of payment checks from LPI had been received by HUD for a while. She called LPI to inquire, and spoke to Egan. Egan told her that a letter had been sent, outlining a proposal for suspension of payments, referring to McLaughlin's letter of November 16, 1995. Anelli did not see McLaughlin's letter and she was unaware that Kolaski had given it to Drazen to investigate. She drafted a payment demand letter for the signature of Jeanne McHallam, Director of the Multifamily Housing Division, with the approval of her supervisor and the branch chief. (Tr. 17. 20-21, 41-42, 70-71.)

15) By letter dated December 13, 1995, McHallam made a demand to Pitts and LPI on behalf of HUD for payment of \$22,986.56 past due under the repayment agreements, and stated that HUD would declare the entire balance due of \$189,436.68 unless the overdue payments were made. McHallam also demanded copies of the checks to show that LPI was making the required payments to the various project accounts covered by the repayment agreements. The letter stated that if Pitts had any questions or if he would like to arrange a meeting with HUD, he should contact Anelli. Pitts did not contact Anelli, did not respond to the letter, and made no payments in response to the letter. (Admin. Rec., Tab H; Tr. 21.)

16) As of December, 1995, LPI could have paid part, but not all, of the amounts past due on the repayment agreements and notes, but it paid nothing on any of them. LPI could have caught up completely on some of the agreements with the cash reimbursements that it received. Pitts and Egan decided to make no payments in December, 1995, because LPI was unable to pay all of the amounts in arrears, and they thought that HUD would only accept full payment. Neither Pitts nor Egan contacted HUD to see if less than full payment would be acceptable, and they did not notify HUD that no payments would be made on the agreements in December. (Tr. 129, 163, 175-176, 178, 192-193, 212.)

17) Anelli received no communication or payments from LPI in response to the December 13, 1995, demand letter, and none of the scheduled payments on the agreements and notes were made by LPI in December, 1995, or January, 1996. Anelli drafted a second demand letter for the signature of McHallam, dated January 16, 1996. By the time that Anelli drafted the January demand letter, she had seen McLaughlin's November 16, 1995, letter, but her branch chief had decided that the reasons stated in it were irrelevant to the default under the repayment agreements and notes. HUD had not seriously considered McLaughlin's request for a six month moratorium on payments due, and Anelli saw no reason to make reference to it in drafting the January demand letter. The January demand letter reiterated the terms of the November demand letter. It also stated that HUD was considering imposition of an LDP against Pitts, LPI, and all entities under Pitts' control because of the defaults on the agreements and notes, unless the arrearage on the agreements and notes were paid. It also stated that if the funds were not repaid, HUD might demand a change in management agent for the affected projects. (Admin. Rec., Tab I; Tr. 50-52, 176.)

18) Respondents made no response to the January demand letter, and continued to make no payments on any of the notes or agreements. On February 28, 1996, Kolaski imposed an LDP on Pitts and LPI for their unexcused default on the repayment agreements and notes. (Admin. Rec., Tab J; Tr. 21.)

19) Respondents requested an informal hearing on the LDP. At the informal hearing, held by Kolaski on April 8, 1996, they presented a two-page document entitled "Lorenzo Pitts, Inc. Budget 1996," which purported to show that LPI could not make the payments it had agreed to make in the repayment agreements and notes. Pitts believed that these financial difficulties were caused by his failure to be designated as the developer of the Granite 4B project and by the reimbursement problems with Fieldstone. Pitts already knew that he had lost the Granite 4B project when he executed the repayment agreements and notes in 1993. Thus, any financial difficulty due to Granite 4B was foreseeable when Pitts executed the repayment agreements and notes. At the informal conference, Pitts stated that he could

possibly make a \$30,000 payment to cover the arrearage on the agreement and notes if the LDP were lifted. The money would come from a private loan. Pitts made no firm offer to pay anything at the informal conference, brought no payments with him, and had made no payments between the time that the LDP had been imposed and the informal conference held. However, it was agreed that, by April 19, 1996, LPI would provide Kolaski with a written proposal to restructure its repayment obligations. (Admin. Rec., Tabs K, L; Exh. R-4; Tr. 25, 143, 195.)

20) Anelli examined the 1996 budget that Respondents had presented at the informal conference, and discussed it with her supervisor and branch chief. It was decided that HUD would request an audited financial statement from LPI, because of questions about the reliability of the financial information presented at the informal conference. A letter dated April 16, 1996, from Kolaski to Pitts, requested that Pitts provide a copy of an audited financial statement for LPI for 1995 to substantiate its claims of financial hardship. (Admin. Rec., Tab L; Tr. 26-27, 56-57.)

21) By letter dated April 18, 1996, LPI provided HUD with a proposal for restructuring its repayment obligations. The cover letter from McLaughlin stated that the audited financial statement for 1995 had not yet been prepared, but that Egan had advised McLaughlin that it was "being worked on." It also stated that Pitts had arranged a personal loan for \$30,000 "to be available for an immediate payment toward the arrears if the restructuring is acceptable to HUD." (Admin. Rec., Tab M.)

22) Kolaski issued a written decision, dated May 10, 1996, affirming the LDP. In the decision, he states that Respondents acknowledge that they have made no payments on the repayment agreements and notes since August, 1995, and that the evidence they presented did not convince Kolaski that they were unable to make partial payments on all of the notes and agreements or full payments on at least some of the notes. Kolaski further observed that, although Pitts had arranged for a \$30,000 loan, he had not tendered any funds on behalf of LPI toward payment of the debts. Therefore, he found that LPI's alleged inability to make full payments did not provide a basis for reducing or terminating the LDP. (Admin. Rec., Tab N.)

23) On June 10, 1996, Kolaski received an unaudited financial report on LPI for fiscal year 1995 that was essentially a compilation of unaudited, uncertified information provided to the certified public accountant by LPI management. HUD did not consider the report to be reliable. LPI represented to HUD that it could not afford an audited financial report. HUD agreed to accept the Federal tax return for LPI for tax year 1995 in lieu of an audited financial statement for that year. (Admin. Rec., Tab O; Tr. 28.)

24) On June 14, July 5, and August 6, 1996, LPI made payments to HUD and to the project accounts at a rate of 2/3 of the monthly payments due under the various repayment agreements and notes. These payments reflected the monthly payment amounts proposed by LPI in its restructuring proposal. The restructuring proposal had not yet been accepted by HUD when these payments were made. The June, 1996, payment was the first payment of any kind received from LPI on any of the repayment agreements or notes since August, 1995. (Exh. R-13; Tr. 59-60, 112.)

25) In early August, 1996, HUD proposed a debt restructuring plan that accepted LPI's proposal to make monthly payments of 2/3 of the amounts set out in the repayment agreements and notes, but HUD did not accept LPI's proposal in its entirety. At the hearing, the parties indicated that they would likely go forward with the restructuring plan proposed by HUD, which requires payment of a lump sum of \$39,589.93 toward the arrearage. Although Pitts admitted that a personal loan for \$30,000 to make the lump-sum payment would probably be available even if the LDP were not lifted ahead of schedule, prior written communications and oral statements, as well as his testimony at the hearing predicated the loan on the LDP being lifted. Pitts characterized this position, including his testimony on the matter, as "negotiating." The putative lender was not present at the hearing, and provided no oral or written statement as to any conditions for the loan. (Exh. G-3; Admin. Rec., Tab O; Tr. 30, 32-33, 39-40, 198-200.)

26) Of the 10 properties presently managed by LPI, Pitts owns, or is the general partner of partnerships that own all but one of the projects, Fieldstone, which is owned by HUD. He expects that all of the mortgages will stay current on the properties in which he has an ownership interest. HUD intends for LPI to continue managing Fieldstone. None of LPI's current management contracts are in jeopardy as a result of the LDP. (Tr. 132, 151, 153, 179, 201-207.)

27) Pitts gave assurances at the hearing that LPI would pay its financial obligations in the future, and that he had "learned his lesson" and that "it will not happen again." Pitts stated that he would immediately notify HUD in the future, and request a meeting, if LPI were not able to comply with any of its agreements, for whatever reason. Pitts offered no reasons for his practice of not communicating with HUD, other than personal embarrassment. He offered no explanation for his long-term failure to offer or make partial payments on the defaulted repayment agreements or notes, other than his untested belief that HUD would not accept anything less than full payment. (Tr. 210-212.)

RECOMMENDED DECISION

A Limited Denial of Participation is a discretionary sanction that is imposed in the best interests of the Government. 24 C.F.R. § 24.700. HUD cites irregularities in Respondents' past performance in a HUD program, 24 C.F.R. § 24.705(a)(2); failure to honor contractual obligations, 24 C.F.R. § 24.705(a)(4); and failure to pay a substantial debt or a number of outstanding debts, which is a listed cause for debarment, 24 C.F.R. § 24.705(a)(8), as causes for the LDP. The standard of proof for an LDP is adequate evidence, defined as information sufficient to support a reasonable belief that a particular act or omission has occurred. 24 C.F.R. §§ 24.705(a) and 24.105.

LPI is subject to an LDP because it is a management agent of projects owned, subsidized, and insured by HUD. As such, it is a principal participating in covered transactions. Likewise, Pitts, as President of LPI, and owner of various entities that own HUD-insured and subsidized projects, is a principal subject to an LDP. 24 C.F.R. §§ 24.105, 24.110(a).

The purpose of all Government sanctions, including an LDP, is to protect the public interest, and to implement the policy of the Federal Government to conduct business only with responsible persons, including business entities. See 24 C.F.R. § 24.115(a). No sanction is to be imposed for the purpose of punishment. 24 C.F.R. § 24.115(b). Case law applicable to sanctions requires that all mitigating factors must be considered in deciding whether or not to impose a sanction, Gonzales v. Freeman, 334 F.2d 570 (D.C. Cir. 1964). The test for whether a sanction is needed to protect the public interest is the present responsibility of the person or entity to be sanctioned, although a finding of a lack of present responsibility may be inferred from past acts. Schlesinger v. Gates, 249 F.2d 11 (D.C. Cir. 1957).

LPI is a small, closely held corporation, controlled and directed by Pitts, who is its President and majority owner. The testimony at the hearing made clear that Pitts participated on a daily basis in corporate decisions; he was not a figurehead or a passive officer. LPI is Pitts' affiliate, as defined at 24 C.F.R. § 24.105. Therefore, I attribute responsibility for the acts and omissions of the corporation to Pitts.

There is adequate evidence that there were serious irregularities in the way that LPI carried out its duties as a management agent. Although no testimony was presented at the hearing on the findings in the 1993 audit report, the report was in evidence, and the various repayment agreements state that they are for the purpose of resolving the audit findings. The applicable findings in the audit report are paraphrased in the opening paragraph of each repayment agreement, which were signed

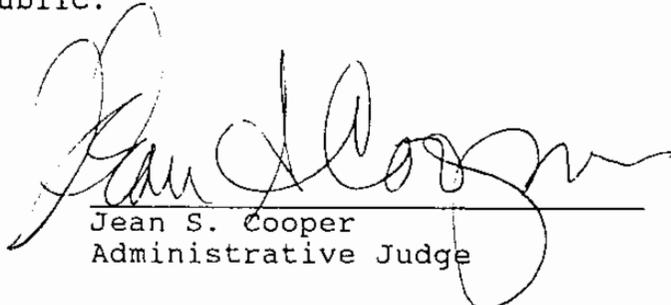
by Pitts on behalf of LPI. Because of the direct linkage of the findings in the audit report to the terms of the repayment agreements, no further proof of the audit findings is required to make findings based on them.

The audit report describes LPI as a company with rampant disregard for financial obligations, contractual requirements, and fiscal responsibility, and one which used HUD as a universal pocketbook for expenses, whether related to LPI's management of HUD-related projects or not. If even a fraction of the audit findings were correct, the audit report contains ample and compelling evidence of serious irregularities in Respondents' past performance in covered transactions, and their serious lack of responsibility as principals and participants in 1993.

Respondents were to reestablish their responsibility by satisfying the terms of the repayment agreements and notes. There is no dispute that Respondents defaulted on every one of the repayment agreements and notes in September, 1995. They failed to even notify HUD of their impending default. Worse, they failed to make partial payments to show their good faith, despite their default, when they had the financial means to do so. This is adequate evidence that Respondents failed to honor their contractual obligations, and that they failed to pay a number of substantial uncontested debts to HUD and various project accounts.

Respondents continued their startling and irresponsible course of conduct for nine months, although they had the financial means to make full payment on some of the agreements, and at least partial payments on the others, by December, 1995, at the latest. The reimbursement problems with Fieldstone, which were not the fault of Respondents, initially caused the defaults. This may mitigate somewhat the failure to make payments on the agreements and notes in September through November, 1995, but it does not mitigate the failure to even notify HUD of the default for almost three months. After November, 1995, there is no mitigation in the record for Respondents' course of conduct. It was not until it was beyond all doubt that the LDP would not be lifted by Kolaski that LPI made its first payment of any kind since the defaults. Under the circumstances, these recent payments were more likely made to persuade HUD to lift the LDP and accept LPI's restructuring proposal, rather than in recognition of the contractual and financial obligations that Respondents had at all times. Pitts approached the ruin of his long business relationship with HUD as just one more item for negotiation. He was still "negotiating" from the witness stand at the hearing as to whether he would accept a personal loan that could cure much of the arrearage on the various repayment agreements and notes.

HUD has carried its burden of proof that multiple causes for imposition of the LDP existed in February, 1996, and still exist today. I find that Respondents lack the present responsibility to fulfill their financial and contractual obligations without a sanction in place, and that it is in the public interest to ensure satisfaction of those obligations. Furthermore, continuation of the LDP, per se, will not cause Respondents to default on the agreements and notes in the future because Pitts owns or controls every project that LPI manages, except Fieldstone, and HUD presently intends to keep LPI as the manager of Fieldstone. HUD has shown remarkable forbearance in its dealings with Respondents, and continues to work with Respondents, despite their outrageous course of conduct. At the least, HUD and the public it serves deserve to be protected from doing any additional business with Respondents until they reestablish their responsibility by satisfying their existing obligations. I recommend the LDP remain in effect until its expiration on February 28, 1997, to provide that limited measure of protection to HUD and the public.



Jean S. Cooper  
Administrative Judge

August 29, 1996