UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

UNITED STATES DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, Petitioner, v. TEAM USA MORTGAGE, LLC, Respondent.	18-AF-0078-PF-006 December 6, 2018

CORRECTED INITIAL DECISION AND ORDER[1]

This matter arises from a *Complaint* filed by the U.S. Department of Housing and Urban Development ("HUD") against Team USA Mortgage, LLC ("Team USA" or "Respondent") seeking a civil penalty and assessment under the Program Fraud Civil Remedies Act ("PFCRA"), 31 U.S.C. §§ 3801-3812, as implemented by 24 C.F.R. part 28.

Team USA is a mortgage broker that originated HUD-insured loans during the time period relevant to this proceeding. The parties' dispute centers on a single-family mortgage that originated at a Team USA branch office in Brooklyn Center, Minnesota in or around January 2010 and was insured by HUD's Federal Housing Administration ("FHA") under the National Housing Act, 12 U.S.C. §§ 1701 *et seq.* The FHA paid insurance benefits to the mortgage holder in 2012 after the borrower defaulted on the loan. HUD alleges that the insurance claims constitute false claims and that Team USA caused these false claims to be submitted to HUD, in violation of PFCRA. HUD seeks $241,134.70 in penalties and assessments for this alleged violation.

PROCEDURAL HISTORY

On December 18, 2017, HUD filed a *Complaint* with this Court alleging that, at the time the subject mortgage was originated, Team USA's Brooklyn Center branch office was ineligible to originate FHA loans due to noncompliance with HUD requirements, rendering the subsequent FHA insurance claims "false" under PFCRA. On January 12, 2018, Respondent timely filed a

[1] Due to a clerical error, the initial decision served upon the parties was dated "December 12, 2018," even though it was actually issued on December 6, 2018, and the appeal rights were not appended. The Court now issues this corrected decision to rectify these errors.

hearing request and *Answer* raising twelve affirmative defenses. The Court issued a *Notice and Scheduling Order* setting the matter for hearing in April 2018.

On February 22, 2018, HUD filed a motion to strike nine of Respondent's affirmative defenses. On March 26, 2018, Respondent filed a motion seeking, among other things, to delete the nine defenses that HUD had asked the Court to strike. The next day, the Court issued an *Order on Motion to Amend and Motion to Strike* which deleted the nine defenses in question (Respondent's second, third, fourth, sixth, seventh, ninth, tenth, eleventh, and twelfth affirmative defenses); granted Respondent's request to renumber the remaining defenses (Respondent's first, fifth, and eighth affirmative defenses, which were renumbered Respondent's first, second, and third affirmative defenses, respectively); and denied Respondent's request to add three additional defenses.

On March 26, 2018, HUD filed a *Motion for Summary Judgment* arguing that the Team USA employee who had originated the subject loan, Patrick Oketch, had committed misconduct that caused the submission of a false or fraudulent insurance claim for which Respondent was vicariously liable. Respondent filed an opposition and cross-motion for summary judgment, and, with the Court's permission, HUD filed a *Reply* thereto. On April 20, 2018, the Court issued an *Order Denying Summary Judgment* on the basis that material facts remained in dispute.

The Court held a hearing on April 24-25, 2018 in St. Paul, Minnesota. At the outset, the Court excluded two of Team USA's proposed witnesses, Brenda Kallon and Deb Root, because their identities had not been disclosed to HUD in a timely manner, but permitted Team USA to offer late-disclosed exhibits. The Court also ruled on HUD's outstanding motion in limine to exclude evidence regarding mitigation of damages, which was denied, and Team USA's outstanding motion in limine to exclude evidence of prior bad acts by witness Dan Boler, which was sustained. The parties proceeded to offer testimony, documentary evidence, and argument. The parties also submitted post-hearing briefs on June 13, 2018, and response briefs on June 28, 2018.[2] The record is now closed and this matter is ripe for decision.

RELEVANT LEGAL PRINCIPLES

FHA Single-Family Mortgage Insurance Program

HUD, through the FHA, administers a mortgage insurance program for single-family homes pursuant to section 203 of the National Housing Act. 12 U.S.C. § 1709; see generally 24 C.F.R. part 203. HUD may insure a mortgage under section 203 only upon satisfaction of various statutory requirements. See 12 U.S.C. § 1709(b). For example, pertinent to this case, the borrower must make a down payment of at least 3.5 percent of the appraised value of the property. Id. § 1709(b)(9)(A). The statute further prohibits "[t]he seller or any other person or entity that financially benefits from the transaction" from providing any part of this down payment. Id. § 1709(b)(9)(C)(i).

[2] On July 5, 2018, HUD requested leave to file a reply brief instanter. Respondent later submitted a *Resistance to HUD's Motion for Leave to Respond*, which appeared to be, in essence, a sur-reply. On July 16, 2018, the Court issued an order denying HUD's request to file a reply on grounds that HUD had failed to identify new evidence or a novel argument that would warrant supplemental briefing. The Court also struck Respondent's *Resistance* as moot.

In addition, a mortgage is insurable under section 203 only if it is made to, and held by, a mortgagee that HUD has approved as responsible and capable of servicing the mortgage properly. 12 U.S.C. § 1709(b)(1); see 24 C.F.R. part 202. During the time periods relevant to this proceeding, HUD routinely approved certain mortgagees to serve as "loan correspondents." See 24 C.F.R. § 202.8 (2009).[3] HUD permitted these entities to originate FHA-insured mortgages that would then be underwritten and approved by a sponsor lender. Id. Team USA served as such a correspondent, meaning that HUD permitted it to originate mortgages and submit applications for mortgage insurance, but not to hold, purchase, or service insured mortgages. Id. § 202.8(a)(2). Rather, Team USA was required to transfer or sell any mortgages it originated to a sponsor lender.[4]

Team USA sold the loan at issue in this case to a sponsor lender approved by HUD as a Direct Endorsement ("DE") mortgagee. HUD launched the DE program in 1983 in an effort to "simplify and expedite the process by which mortgagees can secure mortgage insurance endorsements from HUD." 48 Fed. Reg. 11928, 11928 (Mar. 22, 1983). Under the DE program, HUD typically does not review insurance applications before the mortgage is executed. 24 C.F.R. § 203.5(a). Instead, "the [DE] mortgagee determines that the proposed mortgage is eligible for insurance under the applicable program regulations, and submits the required documents to the Secretary [of HUD]." Id.; see also United States v. Quicken Loans, Inc., 239 F. Supp. 3d 1014, 1019 (E.D. Mich. 2017) ("In the [DE] program, FHA authorizes certain lenders to evaluate the credit risk of potential borrowers, underwrite mortgage loans, and certify those loans for FHA mortgage insurance without prior HUD review or approval.").

As a mortgage insurer, HUD protects mortgage lenders against the risk of loss caused by borrowers' nonpayment. Accordingly, if a borrower defaults on an FHA-insured mortgage, the mortgage holder may submit an insurance claim to HUD for the outstanding principal balance on the loan and other costs. See generally 12 U.S.C. § 1710(a)(1). If the mortgage holder has acquired title to the property through foreclosure or other means, HUD may pay the insurance claim in exchange for conveyance of title. Id. § 1710(a)(1)(B). Neither the mortgagee nor the borrower retains any right or interest in the property after it has been conveyed to HUD, and HUD owes them no duty with respect to its handling or disposal. Id. § 1710(i).

PFCRA (Program Fraud Civil Remedies Act)

PFCRA, codified at 31 U.S.C. §§ 3801 *et seq.*, provides federal executive branch agencies with a civil administrative remedy for false claims. The statute imposes civil liability on any person who makes, presents, or submits, (or causes to be made, presented, or submitted), a claim that the person knows to be false, fictitious, or fraudulent, or knows to include or be supported by a written statement which asserts a false, fictitious, or fraudulent material fact. 31 U.S.C. § 3802(a)(1); see 24 C.F.R. § 28.10(a)(1). A "claim" includes "any request, demand, or

[3] In this Decision, all references to the Code of Federal Regulations refer to the version currently in effect, unless otherwise noted, as here.

[4] Effective May 20, 2010, HUD ended its correspondent program by discontinuing its practice of approving loan originators as correspondents and instead making FHA approval available only to those mortgagees who underwrite, service, and/or own loans. 75 Fed. Reg. 20718, 20720 (Apr. 20, 2010).

submission … made to an authority for property, services, or money (including money representing grants, loans, insurance, or benefits)." 31 U.S.C. § 3801(a)(3).

A person found to be liable under PFCRA is subject to a civil penalty of not more than $7,500.00 for each false, fraudulent, or fictitious claim made prior to February 19, 2013. Id. § 3802(a)(1); 24 C.F.R. § 28.10(a)(1) (2012); see 72 Fed. Reg. 5586, 5586 (Feb. 6, 2007). In addition, if the government actually paid the claim, the person is subject to an assessment of not more than twice its amount. 31 U.S.C. § 3802(a)(1), (3); 24 C.F.R. § 28.10(a)(6).

A person charged with a PFCRA violation in connection with a HUD program may request a hearing before an Administrative Law Judge to determine his or her liability and the amount of any civil penalty or assessment to be imposed. 31 U.S.C. §§ 3801(a)(7)(A), 3803(d), 3803(f). The hearing is conducted in accordance with the Administrative Procedure Act ("APA") and HUD's regulations implementing both the APA and PFCRA (found at 24 C.F.R. part 26, subpart B and 24 C.F.R. part 28, respectively). Id. § 3803(g)(1)(A); 24 C.F.R. §§ 28.1, 28.40. The government has the burden of proving the respondent's liability and any aggravating factors by a preponderance of the evidence, and the respondent has the burden of proving any affirmative defenses and mitigating factors by a preponderance of the evidence. 31 U.S.C. § 3803(f); 24 C.F.R. § 26.45(e).

STIPULATIONS

The parties have entered into the following stipulations of fact:

1. Team USA is a loan origination company currently headquartered in Quincy, Illinois.

2. In or around January 2010, Patrick Oketch was employed by Team USA as a branch manager and loan officer.

3. During his employment with Team USA, Oketch was a W-2 employee and not an independent contractor.

4. During his employment with Team USA, Oketch was prohibited from engaging in any professional mortgage activities on behalf of any entity other than Team USA.

5. Oketch's job duties included loan origination and branch management.

6. As a branch manager, Oketch also supervised the work of other employees in his branch office.

7. As a branch manager, Oketch would have had the authority to order a property appraisal.

8. As a loan officer, Oketch would have had the authority to order credit reports for loan applicants and obtain their asset documentation.

9. In or around January 2010, Team USA originated a HUD-insured mortgage loan ("Subject Loan") for a property located at 3117 5th Ave. South, Minneapolis, Minnesota ("Subject Property").

10. During the course of originating the Subject Loan, Oketch's credit plus account was utilized to order a credit report on the borrower for the Subject Loan.

11. During the course of originating the Subject Loan, Oketch ordered a property appraisal.

12. Following its origination, the Subject Loan was forwarded to, and processed by, Team USA's corporate office.

13. Team USA's corporate office processed the Subject Loan and forwarded it to Liberty Mortgage Corporation ("Liberty") for underwriting.

14. Using HUD's automated underwriting system, Liberty underwrote and approved the Subject Loan.

15. Relying upon Liberty's approval of the Subject Loan, HUD endorsed it for mortgage insurance.

16. The Subject Loan closed on January 27, 2010.

17. Team USA received approximately $6,800.00 in origination and other fees at the Subject Loan closing.

18. Fraudulent bank statements were included in the loan file for the Subject Property.

19. These fraudulent bank statements were forwarded to Team USA corporate office for processing, as well as to Liberty for underwriting.

20. FHA requirements provide that underwriters must verify income and assets of potential borrowers.

21. The use of fraudulent bank statements rendered the Subject Loan ineligible for HUD mortgage insurance.

22. If the borrower's bank statements included the accounts' actual balances, she would not have qualified for the Subject Loan.

23. Liberty falsely certified to the integrity of the data provided by Team USA for the Subject Loan.

24. Liberty falsely certified that the Subject Loan was eligible for HUD mortgage insurance.

25. Liberty falsely certified that it did not have any relationship, by affiliation or ownership, with the seller involved in the Subject Loan.

26. The Subject Loan went into default within one year of closing.

27. On or about August 22, 2012, HUD received an insurance claim for the Subject Loan.

28. In or around October 2012, HUD received a supplementary claim for the Subject Loan.

29. HUD paid out $191,472.90 in insurance benefits for the Subject Loan.

30. After the Subject Property was conveyed to HUD, HUD sold it for $66,000.00.

31. As of December 31, 2017, Team USA had over $300,000.00 in cash in multiple bank accounts.

32. During calendar year 2017, Team USA earned gross income of over $2.3 million. Its net income was $1,672.00.

33. During calendar year 2016, Team USA earned gross income of over $3.5 million. Its net income was $138,602.00.

34. During calendar year 2017, Bryan Root received $50,484.00 from Team USA in the form of owner withdrawals. Team USA also paid Bryan Root $98,527.34 in the form of "guaranteed payments."

35. During calendar year 2016, Bryan Root received $69,800.00 from Team USA in the form of owner withdrawals.

36. Bryan Root determines the amount of "guaranteed payments" he receives from Team USA.

37. Team USA is not legally obligated to provide "guaranteed payments" to Bryan Root.

FACTUAL BACKGROUND

Team USA is a mortgage broker that earns money by originating loans for fees. The company is currently owned by Bryan Root and was formerly owned by Dan Boler, both of whom testified at the hearing. As noted above, during the time periods relevant to this proceeding, Team USA was an FHA-approved loan correspondent. See 24 C.F.R. § 202.8 (2009).

In or around 2008,[5] Team USA hired Patrick Oketch to serve as a loan officer and branch manager for a branch office in Brooklyn Center, Minnesota. Oketch had prior experience in the

[5] Although Oketch testified he believed he worked for Team USA from 2009 to 2010, his employment agreements were executed in March 2008.

mortgage industry and testified that he applied to work for Team USA because he wanted his own branch office to originate loans. His job duties while working for Team USA included finding prospective borrowers, obtaining credit reports and other documents such as bank statements in order to prepare loan applications, and managing the employees at the Brooklyn Center branch office. According to Team USA, two other employees worked at this branch, including loan officer Ralph Killing.

The parties have stipulated that, in or around January 2010, Team USA originated an FHA-insured mortgage for a property located at 3117 5th Avenue South in Minneapolis, Minnesota. Killing is the loan officer whose name and signature appear on many of the documents in Team USA's loan file for the subject mortgage. Documents bearing Killing's name include the Uniform Residential Loan Application ("URLA"), the URLA addendum, and the Closed Loan Data Form (Team USA's internal checklist of loan documents included in the file). However, Oketch admitted at hearing that he, not Killing, was the person who originated the mortgage.

The loan origination process occurred as follows. On December 8, 2009, borrower Brenda Kallon signed an agreement with Team USA to begin the process, and Oketch ordered a credit report for Kallon through his Credit Plus account. Oketch also gathered income documentation and bank statements intended to verify that Kallon held sufficient assets to close the loan. Oketch admitted that the bank statements showed a minimal balance, so he used a PDF editing program to alter them to increase the amounts shown from less than $200.00 to more than $7,000.00.[6] He testified that he concealed this action from Team USA because he wanted the loan to close. Aside from gathering information on the borrower, Oketch also ordered an appraisal for the subject property. The appraisal report, which was signed on December 30, 2009, estimated the property value at $163,000.00, despite acknowledging that the property (including the house located thereon) had been purchased on August 28, 2008, for just $30,000.00.[7]

Meanwhile, Kallon had executed a sales contract on December 13, 2009, to purchase the subject property for $162,900.00 from Crane Financial, LLC ("Crane"). Oketch signed the contract on behalf of Crane. Oketch admits that he was the owner and sole principal of Crane, a business he founded for the purpose of flipping homes. He did not disclose his ownership interest in the subject property to Team USA.

The loan application Oketch had prepared was forwarded to Team USA's corporate office for processing by employee Laura Kopka, who appeared as a witness at the hearing. Kopka explained that processing a loan for Team USA involved going through a checklist to

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[6] Specifically, the altered bank statements showed that the borrower had $7,005.95 in a checking account and $144.23 in a share account as of December 31, 2009. However, an audit conducted by the mortgage holder in 2010 revealed that the two accounts had actually held just $168.21 and $4.23, respectively, on the date in question.

[7] Although the copy of the appraisal report submitted in Joint Exhibit 4 ("JX 4 version") acknowledges the prior sale, the copy that appears in Team USA's loan file in Respondent's Exhibit 9 ("RX 9 version") indicates that the property was not sold in the three years preceding the date of the report. The JX 4 version also includes the appraiser's opinion that the site value is $30,000.00, while the RX 9 version does not include this valuation. The two versions of the report bear the same dates and appear identical in all other respects, and the parties have not addressed the discrepancies.

ensure that the loan file was complete and in order before submitting it to the sponsor lender. She did not recall processing the Kallon loan. However, she testified that she was trained to identify "red flags" in loan applications and would have told Boler, her boss at the time, had she suspected anything was amiss in the file. For example, she would have notified Boler if she had noticed that Oketch owned Crane or had discovered a problem with the asset verification in the loan file.

After Kopka processed the loan application, apparently without noticing any red flags in the file, Team USA forwarded it to sponsor lender Liberty Mortgage Corporation ("Liberty"), an FHA-approved DE lender and wholly owned subsidiary of Branch Banking & Trust Company ("BB&T"), to be underwritten. Using HUD's automated underwriting system, Liberty underwrote and approved the loan. In doing so, Liberty certified to the integrity of the data in the loan file and certified that the mortgage was eligible for FHA insurance under the DE program.

The loan closed on January 27, 2010. According to Desktop Underwriter, the automated program Liberty had used to assess the credit risk on the loan and determine that it met HUD/FHA standards, the minimum down payment required under the National Housing Act was $5,701.50, and the borrower needed a total of $6,992.00 to close on the loan. The settlement statement indicates that Kallon paid $6,454.72 at closing. Given that Oketch falsified the bank statements verifying Kallon's assets, it is unclear where she obtained these funds. Oketch testified that he may have provided them. Ultimately, Kallon obtained a $159,948.00 loan and Team USA received approximately $6,800.00 in loan origination and other fees.

Neighborhood Watch, an online system run by HUD that stores data on lenders and individual loans, shows that HUD received the endorsement package for the Kallon loan on February 22, 2010, and endorsed it for FHA mortgage insurance the next day. On March 9, 2010, Liberty transferred the loan to its parent company, BB&T, after the first payment had been made. Thereafter, the borrower made just three more payments on the loan, causing it to go into default in July 2010.

As a result, BB&T conducted an early payment default audit and discovered that the bank statements used to qualify Kallon for the loan had been altered. On September 24, 2010, BB&T sent HUD's Office of Inspector General ("OIG") a letter advising that the bank statements in the Kallon loan file were fraudulent and that the borrower had lacked sufficient funds to close the loan. OIG assigned the matter to Special Agent Steve Holdren, who was already working on a separate mortgage fraud investigation involving both Oketch and Killing. Holdren testified that he subsequently obtained the loan binder from HUD's Denver Homeownership Center and began investigating BB&T's complaint.

William Morad, a Senior Housing Specialist for HUD's Quality Assurance Division ("QAD"), testified that his division also reviewed the Kallon loan and found income and asset discrepancies. Although HUD has not produced documentation of the QAD review, Team USA has submitted correspondence showing that QAD reviewed Liberty's entire mortgage operation in 2010 and found numerous violations of HUD's quality control requirements.[8] In October 2011, after receiving a letter from BB&T explaining that many of the violations could not be addressed because Liberty had been out of business since June 2010, QAD closed the review.

In August 2012, BB&T conveyed title to the subject property to HUD in exchange for FHA insurance benefits. HUD paid BB&T a total of $191,472.90 in benefits.[9] After taking possession of the property, HUD obtained an appraisal that valued it at just $63,500.00. On December 26, 2012, HUD sold the property for $66,000.00.

Meanwhile, Special Agent Holdren was still investigating Oketch. He testified that he conducted three proffer sessions with Oketch, including two in August 2013 during which Oketch admitted that he had falsified Kallon's bank statements, that he "had to have been the person" who had provided Kallon with the necessary funds to close the loan, and that he had used Killing's name on the URLA "so there would not appear to be a conflict," i.e., to conceal his (Oketch's) status as both the loan officer and seller in the transaction.[10]

On November 23, 2015, as a result of a federal investigation involving HUD, the FBI, and the U.S. Postal Service, Oketch pled guilty in the U.S. District Court for the District of Minnesota to the crime of money laundering conspiracy in connection with mortgage fraud he had committed in June and July 2008, prior to his employment with Team USA. He has never been charged with a crime for his conduct in regard to the Kallon loan.

In August 2017, the Department of Justice authorized HUD to initiate this administrative proceeding against Team USA under PFCRA. Both Boler and Root indicated that this was the first time they learned the Kallon loan had gone into default.

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[8] In a July 20, 2011 letter, QAD stated that certain loans, including the Kallon loan, were over-insured, and asked Liberty to pay down the principal balances. The deficiencies noted with respect to the Kallon loan included deficient documentation of the borrower's earnings (specifically, QAD found non-consecutive paystubs and discrepancies in reported income); deficient appraisal information (contradictorily, the appraisal report reflected both that the property was owner-occupied and that it was owned by a company); failure to perform a quality control review after early default; and documentation from BB&T indicating that the borrower's bank statements "appeared to be altered," but no evidence that BB&T had taken any further action. In response, BB&T stated that it had conducted a quality control review of the Kallon loan. However, BB&T did not address any of the other noted deficiencies. "Pursuant to our conversation with Barbara Whiteside in your office, she had told us that it should be sufficient only for us to make the requested restitution on these loans and not to attempt to address the other items in the audit since [Liberty] is out of business," BB&T stated.

[9] Data from Neighborhood Watch shows that BB&T submitted the initial insurance claim on August 23, 2012. HUD paid $162,824.87 in benefits on August 27, 2012. On October 23, 2012, BB&T submitted a follow-up claim for additional expenses related to its maintenance and conveyance of the subject property, resulting in an additional payout of $28,648.03 on December 13, 2012.

[10] By contrast, at one point during the hearing, Oketch indicated he was unaware that his financial interest in the property was prohibited. The Court finds this testimony less credible than his contrary admission during the proffer session, considering the clandestine actions he took in originating the loan (not only did he commit fraud, which reflects unfavorably on his credibility, but the fact that he concealed his actions from his employer suggests that he was aware of their wrongful nature), and considering that the prohibition was clearly set forth in his employment agreements.

DISCUSSION

HUD argues that the mortgage holder's request for insurance benefits for the Kallon loan constituted a false claim under PFCRA. HUD further contends that Oketch caused the false claim to be submitted and that Team USA is vicariously liable for Oketch's actions. Accordingly, HUD asks the Court to impose penalties and assessments against Team USA in the amount of $241,134.70 under PFCRA.

Team USA counters that HUD has failed to meet its burden of proving a PFCRA violation by a preponderance of the evidence because Oketch's conduct did not proximately cause the false claim to be submitted and because vicarious liability cannot be imposed under PFCRA. Team USA further argues that, even if the doctrine of vicarious liability is applicable, Team USA is not liable for Oketch's actions in this case because Oketch was not acting within the scope of his employment or with actual or apparent authority from Team USA when he engaged in the conduct in question. Should the Court impose liability, Team USA argues that the penalties and assessments proposed by HUD are excessive.

As noted above, PFCRA imposes liability on any person who causes a claim to be made, presented, or submitted that the person knows to be false or fraudulent or to be supported by a written statement of false or fraudulent material fact. 31 U.S.C. § 3801(a)(1). The Court finds Team USA liable under PFCRA and imposes penalties and assessments totaling $42,000.00, for the following reasons.

I. **The insurance claims submitted to HUD for the subject mortgage loan constituted "false claims" under PFCRA.**

Under PFCRA, a "claim" includes "any request, demand, or submission ... made to an authority for property, services, or money (including money representing ... insurance ...)." 31 U.S.C. § 3801(a)(3)(A). The mortgage insurance claims that BB&T submitted to HUD in August and October 2012 fall within this definition.

A "statement" supporting a claim can include "any representation, certification, affirmation, document, [or] record ... made ... with respect to a claim or to obtain the approval or payment of a claim (including relating to eligibility to make a claim)." Id. § 3801(a)(9)(A). In this case, the written statements supporting the insurance claims included the documents in the loan file compiled by Team USA, as well as the certifications made by the underwriter, Liberty, relating to the loan's eligibility for FHA insurance. Some of these statements were materially false or fraudulent.

First, the parties have stipulated that the loan file included fraudulent bank statements. Senior Housing Specialist Morad explained that, as a condition of FHA insurance, the lender must obtain bank statements or similar documentation verifying that the borrower holds sufficient assets to close on the loan. See also HUD HANDBOOK 4155.1 § 5-B-1-a (2011), available at https://www.hud.gov/sites/documents/41551HSGH.PDF (explaining that borrower's required financial contributions, including down payment and closing costs, "must come from acceptable sources and must be verified and properly documented"), superseded by HUD

HANDBOOK 4000.1 (2016). In this case, Oketch admits that he used a PDF editing program to falsify the borrower's bank statements to artificially inflate her assets because he wanted the Kallon loan to close. Morad indicated that HUD would never have insured a loan known to be predicated upon fraudulent bank statements. Indeed, the parties have stipulated that the fraudulent bank statements rendered the Kallon loan ineligible for FHA insurance and that the borrower would not have qualified for the loan in the first place if the statements had accurately reflected her account balances.[11] Thus, the fraudulent asset documentation in the loan file was material to the mortgage insurance claims because it enabled the approval, closing, and FHA endorsement of the loan.

The underwriter and DE lender for the loan, Liberty, certified to the integrity of the data in the loan file and to the loan's eligibility for FHA insurance. For the reasons discussed above, both certifications were false. These false certifications were material to the insurance claims because HUD relies on the DE lender's approval of a mortgage when endorsing it for insurance. See 24 C.F.R. § 203.5(a), (c) (indicating DE lender's responsibility to ensure loan's eligibility under the applicable program regulations and to exercise due diligence); United States v. Quicken Loans, Inc., 239 F. Supp. 3d 1014, 1019 (E.D. Mich. 2017) (explaining that DE lenders "evaluate the credit risk of potential borrowers, underwrite mortgage loans, and certify those loans for FHA mortgage insurance without prior HUD review or approval").

In addition, the evidence suggests that Oketch, who controlled the entity that was selling the property, covertly provided the borrower with funds to cover the down payment on the loan. The National Housing Act requires the borrower to make a down payment of at least 3.5% without financial assistance from the seller or any other person who benefits financially from the transaction. See 12 U.S.C. § 1709(b)(9). This requirement is intended to incentivize the borrower to repay the loan, thereby decreasing the lender and insurer's risk, by ensuring that the borrower has "skin in the game."

In this case, the borrower needed to make a down payment of at least $5,701.50, but the only assets disclosed in the loan file are the fictitious funds shown in the bank statements that Oketch altered, and the settlement statement does not reflect that the borrower made any down payment. At hearing, Oketch testified that he "believe[d]" he had provided the requisite funds to close the loan. On cross-examination, when pressed to confirm that he was unsure he had supplied the funds, he reiterated, "There's a good chance that I did." Further, during a proffer session in August 2013, he reportedly agreed that he "had to have been the person" who had provided the cash to close. Thus, the evidence supports a finding that Oketch funded the 3.5% down payment for the Kallon loan, rendering it ineligible for FHA insurance under 12 U.S.C. § 1709(b)(9)(C)(i). This provides an additional reason why the underwriter's certifications were materially false with respect to the loan's FHA eligibility.

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[11] Despite the stipulation, in its *Response Brief*, Team USA argues that the borrower could have qualified for the loan through other means, such as by obtaining a gift and corresponding gift letter. However, Team USA did not present evidence that the borrower actually received a gift or had access to any other assets that would have qualified her for the loan. Morad, who reviewed the loan file, testified that the falsified bank statements were the only asset documentation present in the file. Further, the evidence affirmatively indicates that the seller, Oketch, illegally supplied the cash to close, as discussed below.

Because the insurance claims BB&T submitted to HUD for the subject loan were supported by materially false written statements, including the falsified bank statements and the false certifications upon which HUD predicated its FHA endorsement, they were "false claims" within the meaning of PFCRA.

II. Oketch caused the submission of the false claims.

HUD argues that Oketch caused the submission of the false claims by misrepresenting the borrower's creditworthiness, thereby fraudulently inducing HUD to endorse the loan for FHA insurance. It is true that the loan was approved and endorsed for insurance based on the falsified data Oketch planted in the file; no insurance claims would have been submitted but for his actions. Thus, there is no question that Oketch's misconduct was a "but-for" cause of the false claims. If nothing more were required under PFCRA, this would be the end of the inquiry.[12]

Team USA, however, argues that Oketch's conduct, while material to the false claims, was not their *proximate* cause. Team USA asserts that HUD has failed to prove the requisite foreseeability and intent by Oketch and that, in any event, the chain of causation is broken by several intervening causes.

The concept of "proximate cause" reflects a "policy-based judgment that not all factual causes contributing to an injury should be legally cognizable." CSX Transp., Inc. v. McBride, 564 U.S. 685, 692-93, 701 (2011) (citing Palsgraf v. Long Island R.R. Co., 162 N.E. 99 (N.Y. 1928), which famously reasoned that an injury is not compensable unless it arises from a foreseeable risk to the plaintiff). Proof of proximate causation requires the injured party to establish "some direct relation between the injury asserted and the injurious conduct alleged." Holmes v. Sec. Investor Prot. Corp., 503 U.S. 258, 268 (1992). A "harm flowing merely from the misfortunes visited upon a third person by the defendant's acts" is too remote to be compensable. Id.

A HUD Administrative Law Judge has previously found that the submission of material false statements for the purpose of securing FHA insurance supports a PFCRA claim under the "proximate causation" standard. See HUD v. TXL Mortg. Corp., No. 15-JM-0030-PF-003, 2015 HUD ALJ LEXIS 1, at *13-17 (HUDALJ May 13, 2015). Similarly, in analogous cases under the False Claims Act (FCA), which has been described as a "sister scheme" to PFCRA,[13] courts have found that misrepresentations and false statements regarding a loan's eligibility for a government program are proximate causes of the government's loss. See, e.g., United States v. Eghbal, 548 F.3d 1281, 1284-85 (9th Cir. 2008), cert. denied, 558 U.S. 825 (2009); United States v. Spicer, 57 F.3d 1152, 1158-59 (D.C. Cir. 1995), cert. denied, 516 U.S. 1043 (1996).

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[12] See HUD v. City First Mortg. Servs., LLC, No. 14-JM-0119-PF-008, slip op. at 3 (HUDALJ Mar. 8, 2016) (order on motion to compel) (applying but-for causation standard to PFCRA cases). But see HUD v. TXL Mortg. Corp., No. 15-JM-0030-PF-003, 2015 HUD ALJ LEXIS 1, at *13-17 (HUDALJ May 13, 2015) (analyzing both proximate and but-for causation); HUD v. Martinez, No. 08-072-PF, 2008 HUD ALJ LEXIS 42, at *24-31 (HUDALJ Dec. 22, 2008) (analyzing but-for causation and "direct" causation).

[13] Vt. Agency of Natural Res. v. United States *ex rel.* Stevens, 529 U.S. 765, 786 (2000).

Likewise, in this case, the Court finds that Oketch's conduct proximately caused the submission of the false insurance claims and HUD's resulting loss. There is a direct relation between HUD's injury under the FHA program and the injurious conduct alleged, namely, Oketch's falsification of the borrower's bank statements and funding of the down payment despite his financial interest in the transaction. By this very conduct, Oketch intended to reduce the appearance of risk associated with the loan so that it would be approved under the FHA single-family mortgage insurance program in which his employer was a participant. HUD's consequent loss under the FHA insurance contract was not a "harm flowing merely from the misfortunes visited upon a third person." Rather, HUD, as the insurer, directly and foreseeably bore the loss when the borrower defaulted on the mortgage.

Team USA argues that the chain of causation was broken by HUD's failure to seek indemnification for its loss in accordance with its own regulations. Team USA reasons that HUD's decision to proceed with this PFCRA action against Team USA instead of seeking indemnification from someone else constituted an intervening cause that broke the causal chain of liability. This argument is unavailing, for several reasons.

First, the pertinent statute and the regulations in effect in 2010 did not require HUD to seek indemnification, and it is not clear that HUD even had the ability to do so. The relevant statute, section 256(c) of the National Housing Act, applies only to "Lender Insurance" mortgagees.[14] 12 U.S.C. § 1715z-21(c); see generally 62 Fed. Reg. 30222 (June 2, 1997) (interim rule implementing Lender Insurance program following enactment of section 256 in 1996). There is no evidence that any of the mortgagees involved with the Kallon loan fall within this category. Further, the statute does not mandate indemnification, but merely permits HUD to seek it. Id. (stating that Secretary "may require" indemnification under certain circumstances).

HUD's current regulations implementing the single-family mortgage insurance program require a Lender Insurance mortgagee to indemnify HUD in some circumstances, including in the case of fraud. 24 C.F.R. § 203.255(g). But the regulations in effect at the time the Kallon loan was underwritten, approved, and endorsed for insurance did not obligate such a mortgagee to indemnify HUD unless the parties had executed an indemnification agreement. See 24 C.F.R. § 203.255(f)(4) (2009); see also 77 Fed. Reg. 3598, 3603 (Jan. 25, 2012) (final rule explaining that lenders would no longer be given a decision whether to indemnify HUD). Thus, even if the subject loan had been endorsed under the Lender Insurance program, it is not clear that HUD would have been capable of obtaining indemnification from any given mortgagee in this case, as its ability to do so would have been dependent on its contractual relationship with that party.[15] In addition, Liberty had gone out of business by the time HUD learned of the default.

[14] Lender Insurance mortgagees are a subcategory of DE lenders that are authorized by HUD pursuant to section 256(a) to insure mortgages themselves. 12 U.S.C. § 1715z-21(a); 24 C.F.R. § 203.6 ("Under the Lender Insurance program, a mortgagee approved for the program conducts its own pre-insurance review, insures the mortgage, and agrees to indemnify HUD in accordance with § 203.255(f)."). In 2010, HUD announced plans to pursue amendment of the National Housing Act to apply the indemnification provision to all DE lenders, as opposed to just Lender Insurance mortgagees. See 75 Fed. Reg. 62335, 62336 (Oct. 8, 2010); HUD News Release No. 10-016, "FHA Announces Policy Changes to Address Risk and Strengthen Finances" (Jan. 20, 2010), available at https://archives.hud.gov/news/2010/pr10-016.cfm. However, 12 U.S.C. § 1715z-21 has not been amended since then.

[15] Data in the Neighborhood Watch system suggests there was no indemnification agreement for the subject loan. Neighborhood Watch also indicates this was not an "LI Loan."

Even if HUD had been able and obligated to seek indemnification, its failure to do so would have no bearing on Team USA's liability. HUD's pursuit of indemnification would not have blocked BB&T from filing the insurance claims. HUD had already agreed to insure the loan two years earlier when it endorsed the loan under the FHA insurance program. The National Housing Act states that the validity of an FHA insurance contract is incontestable in the hands of an approved mortgagee except in the case of fraud on the part of that mortgagee, 12 U.S.C. § 1709(e), and there is no evidence of fraud by BB&T. Thus, HUD was statutorily required to pay any valid insurance claim filed by BB&T.

Moreover, as previously explained in the Court's March 27, 2018 *Order on Motion to Amend and Motion to Strike*, any failure on HUD's part to mitigate its losses stemming from a false claim does not exculpate the person who caused the false claim to be submitted. The government has no duty to mitigate in PFCRA cases. HUD v. City First Mortg. Servs., LLC, No. 14-JM-0119-PF-008, slip op. at 4 (HUDALJ Mar. 8, 2016) (citing United States *ex rel.* King v. Solvay S.A., 304 F.R.D. 507, 513 (S.D. Tex. 2015)). Even if the government incurs no loss, such as if it declines to pay a false claim, or pays it but receives full indemnification, the wrongdoer who caused the claim to be submitted can still be held liable under the plain language of PFCRA.

For all the foregoing reasons, the Court finds that any failure by HUD to seek indemnification for its loss on the Kallon loan was not an intervening cause that severed the chain of proximate causation in this case.

Team USA next argues that the chain of causation was broken by Liberty and BB&T's failure to execute their DE lender responsibilities with the required fidelity, citing deficiencies identified by QAD after it reviewed Liberty's mortgage operation in 2010. However, the Court does not find that Liberty or BB&T took any actions amounting to an intervening cause that would sever legal liability for Oketch's actions. BB&T was not involved with the loan until after the fraud had been committed and the loan had been endorsed for FHA insurance, at which point HUD was locked into paying an insurance claim by operation of the incontestability clause discussed above. See 12 U.S.C. § 1709(e). Although Liberty failed to detect Oketch's fraud and consequently made false certifications to HUD, this mistake does not break the chain of causation, either, because it is directly traceable to Oketch's misrepresentations and submission of falsified asset documentation to support the loan.[16]

Accordingly, the Court finds that the evidence establishes proximate causation and rejects Team USA's argument that the chain of causation was broken by intervening causes.

III. **Oketch's conduct was "knowing" within the meaning of PFCRA.**

PFCRA imposes liability only when the person who causes the submission of a false claim "knows or has reason to know" that the claim is false or is supported by false or fraudulent

[16] The parties stipulated that, in addition to falsely certifying to the integrity of the loan data and the loan's eligibility for FHA insurance, Liberty also falsely certified that it had no relationship with the seller of the subject property. The implication is that Liberty *did* have a relationship with the seller. However, the record contains no evidence of such a relationship or of any conscious wrongdoing on Liberty's part.

written statements. 31 U.S.C. § 3802(a)(1). The phrase "knows or has reason to know" encompasses actual knowledge, deliberate ignorance, and reckless disregard, and no proof of specific intent to defraud is required. Id. § 3801(a)(5).

The misconduct at issue here was committed "knowingly" within the meaning of PFCRA. Oketch deliberately falsified the borrower's bank statements and provided the cash to close the loan while concealing his financial interest in the transaction. He admitted that he altered the bank statements because the borrower needed those funds for approval and he "wanted to get the loan through." Having purchased the property for approximately $30,000.00 and invested approximately $20,000.00 in repairs, he testified that he ultimately received about $160,000.00 from the Kallon transaction and used it to buy another property. He conceded that he knew the loan might have been un-sellable and would not have closed if his actions had been detected. In short, Oketch's testimony shows that he knew exactly what he was doing: making false statements relating to the borrower's creditworthiness and the loan's eligibility for the FHA single-family mortgage program so that it would be approved, even though it did not meet FHA standards.

Oketch testified that he did not necessarily expect the borrower to default on the mortgage. Specifically, when questioned by Team USA's counsel, Oketch agreed that the borrower had intended to live in the subject home for a period of time and that he believed she would continue making payments on the loan. However, in a proffer session with Holdren in 2013, Oketch revealed that he had obtained the borrower's information from her fiancé, who was an acquaintance of his, in exchange for about $7,000.00, and further stated that he himself had lived in the subject home until approximately July 2010 (the month the mortgage went into default). After moving out, Oketch told Holdren, he had referred the borrower's fiancé to Team USA loan officer Killing, who had rented the property to someone else for several months. This suggests that the borrower may have never intended to occupy the property and that Oketch knew the entire transaction was a sham.

But even if Oketch did not know that the loan would default and did not set out with the particular goal of harming HUD, PFCRA does not require proof of specific intent to defraud. It is enough that Oketch intentionally doctored the borrower's bank statements, funded the down payment, and concealed his status as both seller and loan officer in a deliberate effort to make it appear that the loan met the applicable underwriting standards, all the while knowing that the unaltered bank statements would not have qualified the borrower for an FHA loan. Based on this evidence, the Court finds that Oketch's actions were "knowing" under PFCRA.

IV. Team USA is vicariously liable for Oketch's misconduct.

HUD argues that the Court should hold Team USA vicariously liable for Oketch's fraud under well-established agency principles. HUD's primary argument is that Oketch was acting within the scope of his employment when he committed the fraud. HUD also contends that Team USA is liable for Oketch's conduct under an apparent authority theory.

Team USA contends that vicarious liability cannot be imposed under a statute that requires an element of scienter, and PFCRA is such a statute. Alternatively, even if PFCRA permits the imposition of vicarious liability, Team USA asserts that there is no basis to impute liability in this case because Oketch was acting outside the scope of his employment and without apparent authority when he committed the misconduct in question.

As a threshold matter, the Court rejects the argument that PFCRA's scienter requirement precludes the imposition of vicarious liability. Courts routinely impose vicarious liability under the FCA, which is a sister scheme to PFCRA and includes the same scienter requirement. See, e.g., United States v. Anchor Mortg. Corp., 711 F.3d 745,747-48 (7th Cir. 2013) (imputing to employer the knowledge of a branch manager who submitted fraudulent asset documentation); United States v. O'Connell, 890 F.2d 563, 567-69 (1st Cir. 1989) (imposing liability under apparent authority theory); United States v. Inc. Vill. of Island Park, 888 F. Supp. 419, 437-39 (E.D.N.Y. 1995) (same). Team USA has identified no legal basis to treat PFCRA cases differently.[17]

Turning to HUD's primary argument, under agency law, the doctrine of respondeat superior subjects an employer to vicarious liability for misconduct committed by an employee acting within the scope of his employment. Rest. (3d) Agency § 7.07(1) (2006). An employee acts within the scope of his employment when he is performing work assigned and controlled by the employer that is intended, at least in part, for the employer's benefit. Id. § 7.07(2); e.g.,Grand Union Co. v. United States, 696 F.2d 888, 890-91 (11th Cir. 1983). However, the employee is acting outside the scope of employment if he engages in "an independent course of conduct not intended ... to serve any purpose of the employer." Rest. (3d) Agency § 7.07(2).

HUD contends that the actions Oketch took when originating the loan, such as obtaining bank statements and pulling a credit report, were within the scope of his employment because they were consistent with his normal assigned job duties and were subject to Team USA's control. HUD further argues that Team USA received a "clear and significant benefit" from Oketch's conduct in that it earned $6,800.00 in fees from closing the loan. HUD points to United States v. Dolphin Mortgage Corporation, No. 06-CV-499, 2009 U.S. Dist. LEXIS 4295 (N.D. Ill. Jan. 22, 2009), as an example of a factually similar case in which a mortgage

[17] Team USA cites two FCA decisions where courts declined to impose vicarious liability: United States *ex rel.* Wuestenhoefer v. Jefferson, 105 F. Supp. 3d 641 (N.D. Miss. 2015), and United States v. Southern Maryland Home Health Services, Inc., 95 F. Supp. 2d 465 (D. Md. 2000). However, these decisions are unpersuasive and their reasoning has been criticized as out of step with the weight of FCA caselaw. The Wuestenhoefer Court rested its decision on United States v. Ridglea State Bank, 357 F.2d 495 (5th Cir. 1966), a 50-year-old case that "has been called into question by various courts." Wuestenhoefer, 105 F. Supp. 3d at 667 (acknowledging criticism of Ridglea, but finding the decision to be binding precedent anyway); see, e.g., United States *ex rel.* Vavra v. Kellogg Brown & Root, Inc., 727 F.3d 343, 349-53 (5th Cir. 2013) (declining to follow Ridglea in light of Supreme Court's more recent guidance on vicarious liability); United States *ex rel.* McCready v. Columbia/HCA Healthcare Corp., 251 F. Supp. 2d 114, 118 n.2 (D.D.C. 2003) (rejecting reasoning in Ridglea because the case was decided before Congress broadened the definition of "knowing" misconduct under both the FCA and PFCRA). And Southern Maryland Home Health—which, in any event, is of limited relevance here because it pertains only to non-managerial employees—has been criticized as an outlier among FCA cases. See United States v. Dental Dreams, LLC, 307 F. Supp. 3d 1224, 1242 (D.N.M. 2018) ("[T]his Court is not convinced that the *Southern Maryland* court's reasoning remains sound. Moreover, the district court in *Southern Maryland* acknowledged the considerable authority that then-existed in the FCA context imposing vicarious liability on employers."); United States *ex rel.* Fago v. M&T Mortgage Corp., 518 F. Supp. 2d 108, 125 (D.D.C. 2007) ("*Southern Maryland Home Health Services*, which was never appealed, has been criticized and goes against the great weight of authority in FCA cases."); United States *ex rel.* Shackelford v. Am. Mgmt., Inc., 484 F. Supp. 2d 669, 676 (E.D. Mich. 2007) ("As to the decision in *Southern Maryland* ... the Court simply disagrees with its reasoning. The Court therefore joins the majority of cases which hold that a principle is vicariously liable whenever its agents act within the scope of their employment or with apparent authority regardless of the employer's knowledge or culpability.").

originator's employee was found to be acting within the scope of her employment when she originated seven loans using false documentation.

Team USA counters that Oketch was acting outside the scope of his employment because he undertook an independent course of conduct not intended to benefit the company. Dolphin is distinguishable, according to Team USA, because the malefactor was motivated not by a personal financial interest in the loans, but by her interest in receiving a commission from closing them. Team USA also notes that it did not assign Oketch the task of creating fraudulent bank statements and suggests it did not supervise him closely.

Although Team USA benefited from Oketch's actions by collecting loan origination fees, the evidence suggests that, contrary to HUD's arguments, the benefit was purely incidental to his conduct. Oketch was personally motivated to sell the subject property because, as owner and sole principal of Crane, he received the loan proceeds, and he concealed his fraudulent conduct from Team USA, indicating he did not intend to benefit the company. Furthermore, although Team USA had the opportunity to control Oketch's conduct to some extent, Oketch deviated from his assigned job duties when he falsified the borrower's bank statements and funded the down payment, thereby engaging in an independent and unauthorized course of conduct with the goal of enriching himself, not his employer. Accordingly, his actions fell outside the scope of his employment.

Team USA cites HUD v. Professional American Mortgage Institute, Inc., No. 06-033-PF, 2006 HUD ALJ LEXIS 62 (HUDALJ Oct. 13, 2006), for the proposition that a mortgage company cannot be held liable for an employee's fraud when the employee acted outside the scope of employment. However, if employers could always escape liability on this basis, a mortgage originating company could never be held responsible for intentional fraud committed by its loan officers, even though, as the entity that hires and supervises them, it stands in the best position to prevent such fraud.

To avoid this undesirable result, courts apply the doctrine of apparent authority, which subjects an employer to vicarious liability for wrongs committed by an employee "in dealing or communicating with a third party on or purportedly on behalf of the [employer] when actions taken by the agent with apparent authority constitute the [wrong] or enable the agent to conceal its commission." Rest. (3d) Agency § 7.08; see also id. § 2.04, cmt. b; Am. Soc'y of Mech. Eng'rs, Inc. v. Hydrolevel Corp., 456 U.S. 556, 566-68 (1982); e.g., O'Connell, 890 F.2d at 567-69 (applying doctrine of apparent authority in FCA case); United States *ex rel.* Bryant v. Williams Bldg. Corp., 158 F. Supp. 2d 1001, 1008 (D.S.D. 2001) (same); Island Park, 888 F. Supp. At 437-39 (same). An employee acts with apparent authority "when a third party reasonably believes the actor has authority to act on behalf of the principal and that belief is traceable to the principal's manifestations." Rest. (3d) Agency § 2.03. Liability under the apparent authority theory is premised on "the fact that the agent's position facilitates the consummation of the fraud, in that from the point of view of the third person the transaction seems regular on its face and the agent appears to be acting in the ordinary course of the business confided to him." Hydrolevel Corp., 456 U.S. at 566.

In this case, from the perspective of HUD and Liberty, (who was acting on HUD's behalf as the DE lender), Oketch was acting within the scope of his apparent authority as Team USA's employee and agent when he originated the loan. Oketch ordered a credit report and appraisal report in his capacity as a Team USA employee; Team USA's name appears on both documents. Oketch used forms and software provided by Team USA to prepare the loan application. He appended the signature of another Team USA loan officer, Killing, to some of the loan documents to continue cloaking them in his employer's apparent authority while concealing his own role in the transaction. Team USA placed its imprimatur on Oketch's work when it forwarded the loan file to Liberty for underwriting and endorsement. On its face, the transaction appeared regular and the loan appeared to have been originated by a loan officer acting in the ordinary course of Team USA's business. A third party would have had no reason to suspect that Oketch had deviated from his assigned job duties. Thus, it was reasonable for HUD to rely on Oketch's apparent authority to originate the loan on behalf of Team USA.

By clothing Oketch with authority to originate loans, Team USA placed third parties such as HUD in a position to rely on that apparent authority. Accordingly, Team USA is liable for Oketch's conduct in originating the loan.

V. <u>Team USA's affirmative defenses are rejected.</u>

In its *Answer* to the *Complaint*, Team USA raised three affirmative defenses that have not been stricken: (1) the claim is barred by the applicable statute of limitations, (2) Oketch was acting outside the scope of his employment when he committed the acts giving rise to liability, and (3) Team USA lacks the ability to pay the amount assessed by HUD.

The Court has already rejected Team USA's argument that Oketch was acting outside the scope of his employment. Team USA's argument with respect to its ability to pay is similarly rejected, as inability to pay is not an affirmative defense that would absolve the company of liability for false claims, but is merely one factor to be considered when determining the appropriate penalty.

The Court also rejects Respondent's invocation of the statute of limitations as a defense. The insurance claims were submitted in August and October 2012. PFCRA's statute of limitations is satisfied as long as an administrative hearing is commenced "within 6 years after the date on which [the false or fraudulent] claim or statement is made, presented, or submitted." 31 U.S.C. § 3808(a); <u>see also</u> 24 C.F.R. § 28.35. In this case, the clock began running in August and October 2012, so the six-year limitations period had not yet expired when the Court issued the *Notice of Hearing and Order* in January 2018, commencing the hearing. <u>See</u> 31 U.S.C. § 3803(d)(2)(B) (providing that presiding officer commences a hearing by mailing or delivering notice of hearing to respondent).

PENALTIES AND ASSESSMENTS

HUD seeks a civil penalty of $7,500.00, which is the maximum allowed under PFCRA for a single false claim. <u>See</u> 31 U.S.C. § 3802(a)(1); 24 C.F.R. § 28.10(a)(1) (2012). HUD further seeks an assessment of $233,634.70. HUD reached this figure by reducing the

$191,472.90 claim to $150,000.00 to account for PFCRA's jurisdictional cap, see 31 U.S.C. § 3803(c)(1)(A); multiplying by two to seek an assessment of twice the amount of the claim, which is the maximum allowed under the statute, see id. § 3802(a)(1); and subtracting the $66,000.00 in proceeds HUD earned from the sale of the property, as well as the $365.30 in restitution Oketch has paid HUD in his related criminal case.

In support of the requested penalty and assessment, HUD asserts that the maximum statutory liability is the appropriate starting point for the Court's consideration, citing 24 C.F.R. § 28.40(b) ("Because of the intangible costs of fraud, the expense of investigating fraudulent conduct, and the need for deterrence, ordinarily twice the amount of the claim as alleged by the government, and a significant civil penalty, should be imposed."). HUD further argues that in this case, multiple aggravating factors support the imposition of the maximum statutory amounts.

Team USA, by contrast, argues that numerous mitigating factors are present which militate in favor of significantly reducing the penalty and assessment.

HUD's regulations mandate the consideration of one or more of eighteen factors when imposing penalties and assessments under PFCRA. See 24 C.F.R. § 28.40(b). These factors are discussed in turn below. HUD bears the burden of proving any aggravating factors by a preponderance of the evidence and Team USA bears the burden of proving any mitigating factors by a preponderance of the evidence. Id. § 26.45(e).

(1) The number of false, fictitious, or fraudulent claims or statements.

This case involves two related insurance claims.

(2) The time period over which such claims or statements were made.

Both claims were submitted in late 2012 after the mortgage holder had conveyed the subject property to HUD pursuant to 12 U.S.C. § 1710(a)(1)(B).

(3) The degree of Respondent's culpability with respect to the misconduct.

HUD argues that Team USA is "not blameless" in this case because it hired Oketch as a management-level employee, allowed him to commit mortgage fraud on its behalf, and violated two HUD safeguards. First, the company failed to review the subject loan after it went into default, contrary to HUD requirements. Second, the company's employment agreement with Oketch included a provision prohibited by HUD that obligated Oketch to reimburse Team USA if the company had to buy back a loan from a sponsor lender.

Under the circumstances, neither of the alleged violations significantly increases Team USA's culpability. Team USA's owners, Boler and Root, testified that the reason the company did not review the subject loan was because it was unaware of the default. HUD presented testimony that mortgage brokers can and should track the performance of FHA loans through the Neighborhood Watch system. However, it is unclear what a review of the loan after default would have accomplished in this case, as the fraud had already occurred and the loan had been endorsed for insurance by then.

As for the buyback clause in Team USA's employment agreement, Root conceded that it may have been a mistake to include it in the contract, but indicated that he meant no harm and was merely trying to provide legal cover for the company. Both he and Boler testified that Team USA had never enforced the provision against an employee. In fact, Boler stated that Team USA had never been required to buy back a loan in the first place. HUD insists that Team USA's inclusion of a prohibited contract provision in its employment agreement shows a lack of responsibility and diligence, but this overstates the significance of the issue. Ironically, the buyback provision would have tended to discourage the misconduct at issue here, but otherwise, it is completely unrelated to the facts of this case.

Team USA has presented evidence that it acted with due care and took various measures to prevent fraud. The company argues that it was not negligent in hiring or supervising Oketch because it conducted a background check before hiring him and periodically evaluated his work. The company has also presented evidence that it required Oketch to send all the mortgages he originated to the corporate office for processing. The record contains a copy of Team USA's quality control plan and two audit reports showing that the company was in compliance with HUD requirements in 2008 and 2009. In addition, Root testified that the company provides extensive training to its employees, who are expected to abide by its core values of honesty, integrity, and transparency. Root opined that Team USA has "a great corporate culture" and deters would-be wrongdoers from working for the company by implementing quality control measures and requiring employees to take extra steps in the loan origination process such as obtaining written verification of the borrower's employment.

None of these measures prevented the origination of a bad loan in this case. Oketch had signed the sales contract on behalf of the seller, but the loan was originated at a branch office he managed, and his name appeared in the loan file as the person who had requested the credit report and property appraisal. Despite the apparent conflict of interest, Team USA failed to detect any red flags in the loan application.

Nonetheless, there is no evidence of intentional or knowing wrongdoing by Team USA itself. Considering the mitigating evidence Team USA has presented and the fact that it is being held liable based on the misconduct of an employee, not its own misconduct, the Court finds its degree of culpability to be low.

(4) The amount of money or the value of the property, services, or benefit falsely claimed.

HUD paid out a total of $191,472.90 in insurance benefits. HUD argues that the amount of money claimed is a severe aggravating factor because it exceeds the $150,000.00 cap on PFCRA claims. The Court agrees that this is a relatively high amount for a PFCRA claim.

(5) The value of the government's actual loss as a result of the misconduct, including foreseeable consequential damages and the cost of investigation.

HUD has produced a notarized Statement of Account from its Single Family Acquired Asset Management System claiming a total loss of $140,639.04 on the Kallon loan. This figure accounts for the insurance payout, as well as expenses paid to maintain, market, and sell the property, less the $66,000.00 HUD received when it sold the property. HUD denies receiving any indemnification for the subject loan.

Team USA argues that HUD may have already received restitution or some other form of reimbursement for its loss, pointing to correspondence between BB&T and QAD referencing "restitution." However, this does not amount to solid evidence that BB&T paid restitution for the loan in question, and there is no evidence at all of what amounts HUD may have received. Team USA has also submitted a copy of a settlement agreement entered between BB&T and the U.S. Department of Justice on behalf of HUD whereby BB&T agreed to pay $83 million in exchange for a release from liability for certifying ineligible loans for FHA mortgage insurance between 2006 and 2014. However, the Kallon loan likely was not covered under the settlement, as the document specifies that the release of liability does not apply to Liberty. In sum, Team USA has not established that the government has collected any restitution, indemnification, or settlement money that would mitigate its loss on the subject loan.

Aside from the loss on the loan, HUD also claims that it incurred unknown expenses litigating this matter and spent between $8,510.00 and $9,435.00 investigating it, based on Holdren's testimony that he spent 185 hours investigating Oketch at an hourly rate of $46.00 to $51.00. However, Team USA points out that Holdren has failed to clearly distinguish between time spent on this matter and time spent investigating Oketch's other misconduct for which he was criminally prosecuted. Accordingly, in calculating HUD's total loss, the Court will reduce the estimated investigation costs. The Court also declines to include litigation expenses in the calculation because HUD failed to quantify them.

Accordingly, the Court estimates HUD's total loss to be approximately $145,000.00.

(6) The relationship of the civil penalties to the amount of the government's loss.

The proposed $7,500.00 civil penalty amounts to approximately 5% of HUD's total loss.

(7) The potential or actual impact of the misconduct upon national defense, public health or safety, or public confidence in the management of government programs and operations, including particularly the impact on the intended beneficiaries of such programs.

HUD asserts that fraud in the single-family mortgage insurance program erodes public confidence in the government's ability to manage its programs, increases the risk associated with the program, and raises costs to the low- and moderate-income families who participate in the program. The Court agrees, and further notes a negative impact on the public in that HUD's financial loss is ultimately borne by the American taxpayer.

Team USA suggests that HUD itself has eroded public confidence in its management of its FHA mortgage insurance program by initiating a PFCRA action instead of seeking indemnification under its own regulations. This decision "eviscerates consistency and predictability in an industry that relies on it," according to Team USA. The Court disagrees. As discussed above, HUD was not required to seek indemnification in this case and may not even have been capable of obtaining it. The fraud at issue in this case occurred under Team USA's watch due to misconduct by one of its managerial employees. Under the circumstances, HUD was well within its rights to initiate a PFCRA claim against Team USA.

(8) Whether Respondent has engaged in a pattern of the same or similar misconduct.

There is no evidence that Team USA has engaged in a pattern of misconduct.

(9) Whether Respondent attempted to conceal the misconduct.

There is no evidence that Team USA attempted to conceal the misconduct. In fact, Team USA was not aware of the misconduct until HUD initiated this PFCRA action.

(10) The degree to which Respondent has involved others in the misconduct or in concealing it.

HUD asserts that Team USA involved Liberty and BB&T in the misconduct. The Court does not consider this an aggravating factor. The evidence does not suggest that Team USA had a corrupting influence on Liberty or BB&T. Oketch was the person who drew all three mortgagees into the misconduct.

(11) If the misconduct of employees or agents is imputed to Respondent, the extent to which Respondent's practices fostered or attempted to preclude the misconduct.

HUD argues that Respondent failed to take certain required steps to detect and mitigate the risk of fraud. Specifically, HUD references the same two deficiencies it already cited in discussing Team USA's culpability: failing to review the Kallon loan and requiring employees to reimburse the company for loan buybacks.

For the reasons discussed above, the Court does not find either of these deficiencies to be particularly significant in this case. Team USA presented evidence that it conducted background checks, training, and periodic evaluations of its employees, as well as its branch offices; designed and implemented a quality control plan that included fraud detection measures such as spot checks of loan applications; and employed preventative practices such as requiring employees to obtain written verifications of employment and to send loan files to headquarters for processing, providing an additional layer of review before the file would be forwarded to the sponsor lender. Accordingly, the Court finds that Team USA engaged in measures intended to preclude the misconduct at issue here, which is a mitigating factor in this case.

(12) Whether Respondent cooperated in or obstructed an investigation of the misconduct.

Team USA was not aware of the misconduct through most of HUD's investigation, but cooperated fully as soon as HUD initiated the instant proceeding.

(13) Whether Respondent assisted in identifying and prosecuting other wrongdoers.

This factor is inapplicable in this case.

(14) The complexity of the program or transaction, and the degree of Respondent's sophistication with respect to it, including the extent of Respondent's prior participation in the program or in similar transactions.

The FHA single-family mortgage insurance program is complex, involving an extensive web of statutory, regulatory, and administrative requirements. However, Team USA is a mortgage broker and former FHA-approved loan correspondent owned by experienced members of the mortgage industry. At the time the Kallon loan originated, the company had 60 to 100 employees and operated numerous branch offices in various states. Given the scale of its operations and its owners' experience, Team USA appears to be a fairly sophisticated participant in the FHA insurance program who would be expected to implement robust fraud detection measures.

(15) Whether Respondent has been found, in any criminal, civil, or administrative proceeding, to have engaged in similar misconduct or to have dealt dishonestly with the government of the United States or of a state, directly or indirectly.

There is no evidence Team USA has been found guilty of similar misconduct.

(16) The need to deter Respondent and others from engaging in the same or similar misconduct.

HUD argues the need for deterrence is great because the agency relies on participants in federal housing programs to provide truthful information. HUD further notes that Team USA has not yet had to pay anything for fraud that was committed on its watch and argues that imposing consequences now will encourage lenders to take all available precautions to minimize the risk of fraud.

Team USA asserts that it has implemented practices above and beyond HUD's requirements and the industry's standards to ensure that it is originating high-quality loans. Root testified that all of Team USA's regular procedures were followed when the Kallon loan was originated and that he could not think of any additional measures that would have stopped Oketch from committing the fraud.

The Court acknowledges that Oketch concealed his fraudulent conduct, and sympathizes with Team USA to the extent it was victimized by covert misbehavior by an employee that may have been difficult to prevent. But Team USA is ultimately responsible for the conduct of its loan officers in originating loans, and in this case, Oketch's name appeared both on the sales contract and on documentation in the loan file that he had gathered to support the loan, which should have raised a red flag when Team USA processed the loan. Thus, a penalty and assessment are appropriate to serve as a deterrent to Team USA and similarly situated entities that originate FHA loans.

(17) Respondent's ability to pay.

Ability to pay under PFCRA "is determined based on an assessment of the respondent's resources available both presently and prospectively from which [HUD] could ultimately recover the total award." 24 C.F.R. § 28.5(c).

HUD asserts that the stipulated facts demonstrate Team USA has the ability to pay the proposed penalty and assessment immediately or over a period of several years. Specifically, the parties stipulated that Team USA had over $300,000.00 in its bank accounts at the end of 2017 and, in 2016 and 2017, earned net income of $138,602.00 and $1,672.00 while paying Root $69,800.00 and $149,011.34.

Team USA argues that its financial statements show it cannot afford a substantial fine, as its net worth was just $143,175.26 as of March 31, 2018. Team USA also notes that it must maintain certain levels of equity to preserve its various state licensures and asserts that it may not be able to continue in business in light of a judgment affecting its equity.

The total proposed penalties and assessments of $241,134.70 are significantly higher than Team USA's March 31, 2018 net worth. The Court credits Team USA's assertion that it must maintain certain equity levels to continue in operation as a mortgage broker. Root could save money by decreasing his own compensation, as suggested by HUD. However, overall, Team USA's evidence and arguments regarding its financial state suggest that a reduction of the proposed penalties and assessments is warranted to ensure that the judgment does not drive the company out of business.

(18) Any other factors that may mitigate or aggravate the seriousness of the false claim or statement.

Additional aggravating factors identified by HUD include the fact that Team USA has faced no adverse consequences yet and has portrayed itself as an "upstanding originator," which HUD claims the evidence does not support. However, as discussed above, Team USA has proven that it employed practices intended to prevent or minimize the risk of fraud, even though they were ineffective in this case, and its degree of culpability is low.

Team USA asks the Court to consider HUD's decision to forego indemnification and instead seek remuneration from Team USA nearly eight years after being placed on notice of potential problems with the Kallon loan. The Court agrees with the implication that, in some respects, it may have made more sense for HUD to seek relief from the DE lender rather than from Team USA. Liberty, the underwriter and DE lender in this case, was the party responsible for verifying that the information in the Kallon loan file was accurate and that the loan was eligible for FHA insurance. HUD relies heavily on the DE lender's certifications, as demonstrated by its endorsement of the subject loan almost immediately after Liberty submitted it and by Morad's testimony suggesting that HUD receives hundreds or thousands of endorsement packages daily and does not conduct a meaningful review of each one. HUD also expects DE lenders to "exercise the same level of care ... [as if] the mortgagee would be entirely dependent on the property as security to protect its investment." 24 C.F.R. § 203.5(c). Liberty failed to live up to this high standard of care when it underwrote the Kallon loan and shares liability for HUD's loss on the loan, even though HUD is seeking remuneration from Team USA for the entire loss.

Conclusion

HUD's total loss on the Kallon loan was approximately $145,000.00. The loss was attributable to the fraudulent conduct of an employee hired and supervised by Team USA who was entrusted as a managerial employee. Although Oketch concealed his fraudulent conduct from Team USA, the loan file contained red flags that should have alerted a diligent loan processor to Oketch's financial interest in the property and involvement in the origination process. A deterrent penalty is warranted under the circumstances.

However, the record reveals substantial mitigating factors. This case involves just one instance of fraud, and there is no evidence that Team USA or its current owner, Root, have ever engaged in similar misconduct. Team USA has also raised concerns about its ability to continue in business if an excessive penalty and assessment are imposed. See *In re:* Babar, No. 08-074-PF, 2009 HUD ALJ LEXIS 22, at *72 (HUDALJ Apr. 27, 2009) (finding that, in light of respondent's financial situation, deterrence could be achieved without imposition of maximum civil penalties).

Most significantly, Team USA's degree of culpability was low. Team USA presented evidence that it engaged in practices intended to detect and prevent fraud and comply with FHA requirements. Team USA is being held liable under a theory of vicarious liability, and HUD's loss is also attributable in part to the negligence of the DE lender and underwriter that failed to verify the accuracy of the asset documentation in the loan file. HUD cites no precedent for imposing the maximum civil penalties and assessments under these circumstances. Cf. HUD v. Henderson, No. 15-AF-0025-PF-002, 2015 HUD ALJ LEXIS 3, at *9-15 (HUDALJ Dec. 16, 2015) (assessing maximum penalties where respondent was found fully culpable for repeatedly submitting false statements in a deliberate scheme to defraud HUD); HUD v. Greene, No. 14-AF-0042-PF-002, 2014 HUD ALJ LEXIS 3, at *25-37 (HUDALJ Dec. 5, 2014) (declining to assess maximum penalties where respondent acted with reckless disregard, but did not intend to mislead HUD).

Upon careful consideration of the entire record and the eighteen factors discussed above, the Court finds that a penalty of $2,000.00 and an assessment of $40,000.00 are appropriate.

ORDER

Team USA is hereby **ORDERED** to pay HUD a civil penalty and assessment in the amount of $42,000.00.

So **ORDERED**,

Alexander Fernández
Administrative Law Judge

Notice of appeal rights. The appeal procedure is set forth in detail in 24 C.F.R. § 26.52. This order may be appealed to the Secretary of HUD by either party within 30 days after the date of this decision. The Secretary (or designee) may extend this 30-day period for good cause. If the Secretary (or designee) does not act upon the appeal within 30 days, this decision becomes final.

Service of appeal documents. Any petition for review or statement in opposition must be served upon the Secretary by mail, facsimile, or electronic means at the following:

U.S. Department of Housing and Urban Development
Attention: Secretarial Review Clerk
451 7th Street, S.W., Room 2130
Washington, DC 20410

Facsimile: (202) 708-0019

Scanned electronic document: secretarialreview@hud.gov

Copies of appeal documents. Copies of any Petition for Review or statement in opposition shall also be served on the opposing party(s), and on the HUD Office of Hearings and Appeals.

Judicial review of final decision. Judicial review of the final agency decision in this matter is available as set forth in 31 U.S.C. § 3805.