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

In the Matter of: ASSOCIATED MORTGAGE BANKERS, Petitioner.	19-AF-0157-AO-049 February 28, 2020

DECISION AND ORDER ON REMAND

This matter is before the Court upon a request for hearing filed by Associated Mortgage Bankers ("Petitioner" or "AMB") pursuant to 24 C.F.R. § 17.69(a) concerning an alleged debt that the Secretary of the United States Department of Housing and Urban Development ("HUD" or "the Secretary") seeks to collect from Petitioner via administrative offset. In accordance with 24 C.F.R. §§ 17.69 and 17.73, the HUD Office of Hearings and Appeals has jurisdiction to conduct a hearing in this matter to determine, by a preponderance of the evidence, whether the alleged debt is past due and legally enforceable.

The alleged debt at issue here arises from a HUD-insured mortgage that was originated by Petitioner and subject to an indemnification agreement. After the loan defaulted, HUD paid an insurance claim to the loan holder in exchange for assignment of the loan, then sold the Note at a loss in a bulk note sale. HUD is now attempting to recoup its loss from Petitioner by enforcing the indemnification agreement.

PROCEDURAL HISTORY

Petitioner filed its hearing request on December 17, 2014. The matter was initially assigned to HUD Administrative Judge Vanessa Hall, who issued a decision on December 16, 2016. However, on July 9, 2019, the U.S. District Court for the District of Columbia vacated Judge Hall's decision on jurisdictional grounds. Associated Mortg. Bankers, Inc. v. Carson, No. 1:17-cv-00075-ESH (D.D.C. July 9, 2019). Specifically, the District Court found, based on HUD's stipulations, that Judge Hall had not been properly appointed in accordance with the Appointments Clause of the United States Constitution. Id.[1] Accordingly, the District Court remanded the matter for a new hearing before a different, constitutionally appointed hearing official. Id.

[1] On appeal, Petitioner had argued that Judge Hall was not properly appointed, citing Lucia v. SEC, 585 U.S. _, 138 S. Ct. 2044 (2018). Lucia pertains specifically to administrative law judges, and arguably does not require administrative judges such as Judge Hall to be appointed in conformance with the Appointments Clause. However, HUD stipulated that Judge Hall had not been properly appointed. Accordingly, the District Court accepted Petitioner's argument without making any findings of fact regarding Judge Hall's appointment.

After remand, Petitioner's December 17, 2014 hearing request was assigned to the undersigned to conduct a new hearing.[2] On July 12, 2019, the undersigned issued a *Notice and Scheduling Order* which provided that the hearing would be limited to a review of the written record unless the parties showed good cause for an oral hearing within five days. The Court also set deadlines for the submission of documentary evidence and written argument. Petitioner duly submitted a position statement with supporting evidence on August 2, 2019, and HUD submitted the same on August 22, 2019.

Meanwhile, on July 19, 2019, Petitioner had filed a *Request for an Oral Hearing Pursuant to 24 C.F.R. § 17.69(c)*, as well as a *Motion for Discovery*, both of which HUD opposed. On August 19, 2019, the Court issued an order denying Petitioner's request for an oral hearing but granting its *Motion for Discovery*. The Court also established a deadline for Petitioner to submit any additional evidence obtained through discovery, accompanied by a position statement, as well as a deadline for HUD to respond. Petitioner submitted additional evidence and a position statement on October 16, 2019, and HUD submitted a response on November 8, 2019. Petitioner has also filed a motion to strike two of the exhibits to HUD's November 8 response, which HUD opposes.

In October 2019, Petitioner filed a motion to compel HUD to produce certain notes taken by HUD employee Brian Dillon. On October 28, 2019, the Court issued an order granting the motion to compel and denying HUD's cross motion for a protective order preventing the disclosure. The Court also established a deadline for Petitioner to submit a copy of Mr. Dillon's notes, if desired, accompanied by a position statement, as well as a deadline for HUD to respond. Petitioner submitted Mr. Dillon's redacted notes and a position statement on November 8, 2019, as well as a supplemental statement on November 14, 2019 (after HUD, at the Court's prodding, produced an unredacted copy of Mr. Dillon's notes), and HUD submitted a response on November 15, 2019.

The record is now closed and this matter is ripe for decision.

FACTUAL BACKGROUND

Petitioner is a mortgagee approved by HUD to originate loans insured by HUD's Federal Housing Administration ("FHA").[3] In October 2010, Petitioner originated a $505,000.00 FHA loan made to borrower B.A. Springer and secured by a mortgage on a property in Brooklyn, New York (FHA Case No. 374-5838647, "the Springer loan"). The loan closed on October 6, 2010, and was endorsed for FHA insurance on October 19, 2010. However, the loan soon proved to be non-performing. A delinquency was first reported in December 2010 by the then-owner and

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[2] Because the D.C. District Court ordered a new hearing, the hearing request was the only document transmitted to the undersigned at the time of assignment. No other documents from the proceedings before Judge Hall have been made part of the record in the instant proceeding unless re-submitted by the parties.

[3] 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. Mortgagees must obtain and maintain approval from HUD to participate in this program and must ensure that their loans meet all program eligibility requirements. See 12 U.S.C. § 1709(b); 24 C.F.R. parts 202 & 203. In exchange, HUD protects participating lenders against the risk of default by committing to pay insurance benefits pursuant to a valid insurance contract, which is incontestable in the hands of an approved financial institution or mortgagee. See 12 U.S.C. §§ 1709(e), 1710.

servicer of the mortgage, J.P. Morgan Chase Bank, N.A. ("Chase"), and the borrower defaulted on November 1, 2011.

In 2012, while reviewing Petitioner's mortgage finance operation, HUD's Quality Assurance Division ("QAD") found that Petitioner had engaged in non-compliant lending activities when it originated the Springer loan, exposing HUD to "an unacceptable level of risk." Because Petitioner had not complied with the Secretary's requirements when originating the loan,[4] HUD sent Petitioner a letter directing it to sign an Indemnification Agreement obligating it to indemnify HUD for any losses on the Springer loan; otherwise, HUD indicated it would refer the matter to its Mortgagee Review Board, which has the power to impose sanctions such as withdrawal of a mortgagee's FHA approval. Petitioner executed the Indemnification Agreement on December 5, 2012, and a HUD representative signed it on December 10, 2012.

In 2013, Chase sought to file an FHA insurance claim on the defaulted Springer loan. The National Housing Act authorizes HUD to pay insurance claims on defaulted loans under certain circumstances, including when the mortgagee assigns the loan to HUD. See 12 U.S.C. § 1710(a)(1). One mechanism through which HUD disposes of assets acquired in this manner is through its Single Family Loan Sales ("SFLS") program. Under this program, defaulted notes that have been assigned to HUD are bundled into pools which are sold in a closed auction to the highest aggregate bidder. The transfer of a note in this manner allows the assignor to file an FHA insurance claim on the underlying defaulted loan.

On May 22, 2013, Chase executed a Participating Servicer Agreement ("PSA") with HUD to participate in a bulk note sale designated SFLS 2013-2. See 78 Fed. Reg. 34667 (June 10, 2013) (providing public notice of SFLS 2013-2). By the terms of the PSA, loans that were subject to an indemnification agreement were ineligible for inclusion in the sale. Nonetheless, Chase identified the Springer Note as one of its notes to be sold, and HUD accepted the Note for inclusion in Pool 105 of SFLS 2013-2.

Bidding on Pool 105 took place on June 26, 2013. A total of four bidders competed for Pool 105 by submitting individual bids for each of its constituent loans. The top bidder was an entity called the SRMOF II 2012-1 Trust ("SRMOF"), which bid approximately 51% of the aggregate unpaid principal balance of the 2,278 loans in the pool. SRMOF was also the top bidder for the Springer loan, individually. SRMOF bid $360,531.24 for that loan, or approximately 73% of the unpaid principal balance, which was $491,590.76.[5] The sale of the Springer loan was settled on September 19, 2013.

Meanwhile, Chase had submitted an FHA insurance claim for $520,979.86, which included the unpaid principal balance on the Springer loan plus allowable costs and expenses. On August 10, 2013, HUD paid the claim in full.

[4] Section 256(c) of the National Housing Act permits HUD to require an approved mortgagee to indemnify the agency for its losses on insured mortgages under certain circumstances, including when HUD determines an insured mortgage "was not originated in accordance with the requirements established by the Secretary," as occurred in this instance. 12 U.S.C. § 1715z-21(c)(1); see also 24 C.F.R. § 203.255(g) (making indemnification mandatory in accordance with 256(c)); HUD Handbook 4155.2 § 2.C.2.a.

[5] The other three bidders bid approximately 70%, 57%, and 45% of the unpaid principal balance on the loan.

On July 28, 2014, HUD sent Petitioner a demand notice requesting payment of an alleged debt of $160,448.62 (the difference between the $520,979.86 insurance claim and HUD's $360,531.24 recovery on the sale of the Note). On October 13, 2014, HUD sent Petitioner a Notice of Intent to Collect by Treasury Offset. Thereafter, Petitioner timely filed a hearing request, initiating the instant proceeding.

LEGAL FRAMEWORK

Pursuant to Chapter 37 of Title 31 of the United States Code, executive agencies such as HUD are authorized to collect debts owed to the United States government through means including administrative offset. See 31 U.S.C. § 3716. Before attempting to collect a claim by administrative offset, the agency must provide the debtor with notice of its intent to collect, as well as "an opportunity for a review within the agency of the decision of the agency related to the claim." Id. § 3716(a)(1), (3).

To satisfy this obligation, HUD provides the debtor with "the right to a review of the case and to present evidence that all or part of the debt is not past due or not legally enforceable" through a hearing before this Court. See 24 C.F.R. § 17.69(a). After allowing the debtor to submit evidence, the Court must determine, by a preponderance of the evidence, whether there is a debt that is past due and whether it is legally enforceable. Id. § 17.69(c). The Court then issues a written decision that constitutes the final agency decision with respect to the past due status and enforceability of the debt. Id. § 17.73(a). Proceedings before this Court are conducted in accordance with the procedural rules set forth in 24 C.F.R. part 26, subpart A. See id. § 26.1 (applying part 26, subpart A to any case where a statute or regulation requires a hearing before a HUD hearing officer).

PRELIMINARY EVIDENTIARY MATTERS

I. Petitioner's Request to Exclude Evidence

On November 8, 2019, Petitioner filed a *Statement Regarding Brian Dillon's Recently Produced Notes* in which it asked the Court to exclude certain portions of a declaration offered by HUD employee Brian Dillon. Specifically, Petitioner asked the Court to strike those portions of the August 20, 2019 Declaration of Brian Dillon pertaining to his conversation with a listing agent who had been involved in the sale of the Springer property in 2014. In support of this request, Petitioner argued that Mr. Dillon's notes from his conversation with the listing agent, which HUD had recently produced during discovery, were heavily redacted; contained discrepancies that revealed a lack of credibility on Mr. Dillon's part; and were produced too late for Petitioner to question Mr. Dillon about the discrepancies at deposition in October 2019.

Several days later, following a telephonic conference held by the Court with counsel for both parties present, HUD produced a complete and unredacted copy of Mr. Dillon's notes. Thereafter, on November 14, 2019, Petitioner filed a supplemental position statement again questioning the credibility of Mr. Dillon's testimony. Petitioner did not expressly withdraw its prior request for the Court to exclude a portion of the testimony.

On November 15, 2019, HUD filed a *Response to Petitioner's Statement Regarding Brian Dillon's Recently Produced Notes* urging the Court not to exclude any part of Mr. Dillon's testimony. HUD pointed out that a complete copy of Mr. Dillon's notes had now been produced and that the previously redacted segments of the notes did not pertain to his conversation with the listing agent. HUD further argued that the discrepancies identified by Petitioner do not impair Mr. Dillon's credibility.

Upon review, the Court agrees that the minor differences between Mr. Dillon's notes and his testimony do not warrant excluding any portion of his declaration. Petitioner has identified only three discrepancies. First, Petitioner observes that Mr. Dillon's notes at one point include the phrase "it appears as though," but this phrase has been removed from his formal written testimony. The Court deems this change insubstantial. Next, Petitioner points out that Mr. Dillon's notes include the phone number for the borrower on the Springer loan, even though there is no indication he actually spoke to her. But Petitioner offers no explanation as to how this damages, or is otherwise relevant to, Mr. Dillon's credibility.

Finally, Petitioner points out that, according to Mr. Dillon's notes, the list price of the Springer property in 2014 was based on a "broker price opinion" ("BPO"), but according to his formal written testimony, the list price was based on an "appraisal." Petitioner asserts that this discrepancy is significant because HUD has taken the position that a BPO is less accurate than an appraisal. HUD counters that, while a BPO is indeed less accurate than an in-depth appraisal or a sale, a BPO is simply a special type of appraisal. Thus, the terms "BPO" and "appraisal" can be used interchangeably. HUD further argues that Petitioner has known all along that the "appraisal" referenced in Mr. Dillon's declaration was a BPO, as this fact was revealed by Mr. Dillon during the prior proceedings before Judge Hall in 2016. In support, HUD offers a copy of a declaration Mr. Dillon signed in 2016, which does indeed reference a BPO instead of using the generic term "appraisal." Thus, it does not appear that Mr. Dillon was trying to hide anything, and if Petitioner believed he were, Petitioner could have raised the issue at deposition in October 2019, as the discrepancy was already known to Petitioner at that time.

For the reasons stated above, the discrepancies cited by Petitioner do not impact the admissibility of Mr. Dillon's testimony. Non-privileged evidence is generally admissible in this proceeding unless it is irrelevant, immaterial, or unduly repetitious, 24 C.F.R. § 26.24, and Mr. Dillon's testimony does not suffer from any of these defects.[6] Accordingly, the August 20, 2019 Declaration of Brian Dillon is **ADMITTED TO THE RECORD IN FULL** and Petitioner's request to exclude the portion of the declaration pertaining to his conversation with the listing agent is **DENIED.**

II. Petitioner's Motion to Strike Evidence

On November 15, 2019, Petitioner filed a *Motion to Strike* asking the Court to strike two exhibits submitted with HUD's November 8, 2019 *Supplemental Secretary's Statement that Petitioner's Debt is Past Due and Legally Enforceable*: (1) an October 22, 2019 Declaration of Patricia Moroz, and (2) a November 7, 2019 Supplemental Declaration of Brian Dillon. The Dillon declaration largely pertains to the value of the Springer property, while the Moroz declaration discusses HUD's average recovery on certain real estate sales.

[6] Moreover, all of Petitioner's arguments regarding the *admissibility* of Mr. Dillon's notes pertained specifically to the *weight* the Court should give those notes in evaluating Mr. Dillon's testimony. None of Petitioner's arguments posited a reason as to whether the notes should actually be admitted.

Petitioner argues that HUD's submission of these two declarations is untimely because they contain information that was previously available to HUD. Petitioner further argues that the declarations are unreliable because they are inadequately supported and speculative. Petitioner also asserts that Ms. Moroz's declaration is not directly relevant and Mr. Dillon's contains hearsay evidence.

HUD counters that the declarations were properly submitted as rebuttal evidence, which HUD has a right to offer in this matter. HUD argues that Ms. Moroz's declaration is relevant and credible and Mr. Dillon's is relevant and reliable. HUD asserts that 24 C.F.R. § 17.69(a) places the burden upon Petitioner to prove the debt at issue in this matter is not legally enforceable, which Petitioner has sought to do by proving it was harmed by HUD's sale of the Springer Note because HUD could have received a better return on a sale of the underlying property. Because Petitioner bears the burden of proving its assertion of harm, it is not unfair to allow HUD to attempt to rebut this assertion through the submission of evidence going to the value of the property and whether HUD benefited from the sale of the Note.

Under 24 C.F.R. § 26.24, the parties to this proceeding have the right to present oral and documentary evidence unless otherwise limited by law or regulation, as well as the right "to conduct such cross-examination and submit rebuttal evidence as may be required for a full and true disclosure of the facts." 24 C.F.R. § 26.24(a). The Court may exclude irrelevant, immaterial, privileged, or unduly repetitious evidence. Id. However, "technical and hearsay objections to testimony as used in a court of law will not be sustained." Id.

In this case, the two declarations HUD seeks to admit are relevant because they contain information that is probative of material facts, such as the value of the Springer Note and underlying property. The declarations are not privileged or unduly repetitious. They were timely submitted by HUD to rebut Petitioner's October 16, 2019 *Additional Evidence and Position Statement*, as permitted by the Court's August 19, 2019 order, which authorized Petitioner to conduct limited discovery and submit additional evidence obtained through such discovery, and provided HUD an opportunity to respond.[7]

As for Petitioner's objections that the declarations of Ms. Moroz and Mr. Dillon are unreliable and not directly relevant to the case at hand, these objections go more to the weight of the evidence than to its admissibility in a bench trial, where there is no risk of confusing a jury. And as for Petitioner's assertion that Mr. Dillon's declaration contains hearsay evidence, 24 C.F.R. § 26.24(a) permits the admission of hearsay evidence in this administrative proceeding, although the Court will consider Petitioner's objections when assessing the probative value of the evidence.

[7] The Court notes that Petitioner's October 16 submission included evidence that arguably strayed beyond what was allowed under the Court's August 19 discovery order. For example, the submission included a declaration from Petitioner's former Chief Executive Officer and new information about the July 2014 sale of the Springer property. These materials appear to have been submitted as rebuttal evidence, not as new evidence obtained through the limited discovery permitted by the August 19 order. It would be especially inappropriate for the Court to accept this evidence without allowing HUD to address it as contemplated under the August 19 order.

For the foregoing reasons, the October 22, 2019 Declaration of Patricia Moroz and the November 7, 2019 Supplemental Declaration of Brian Dillon are hereby **ADMITTED TO THE RECORD** and Petitioner's motion to strike is **DENIED**.

DISCUSSION

In this proceeding, Petitioner challenges HUD's attempt to collect $160,448.62 from Petitioner pursuant to the Indemnification Agreement executed by the parties in December 2012. Petitioner argues that HUD breached the Indemnification Agreement and HUD's own regulations and policies and harmed Petitioner by mistakenly including the Springer loan in the SFLS program, which Petitioner further argues was not implemented in accordance with the law. For these reasons, Petitioner contends that the alleged debt is not past due or legally enforceable. HUD counters that Petitioner is liable for the alleged debt under the clear terms of the Indemnification Agreement.

This Court's task is to determine, by a preponderance of the evidence, whether the alleged debt is past due and legally enforceable. The Court concludes that it is, for the reasons set forth below.

I. <u>The Indemnification Agreement created an obligation for Petitioner to reimburse HUD for losses HUD sustained as insurer of the Springer loan.</u>

In December 2012, Petitioner signed a contract agreeing to indemnify HUD for any losses HUD may incur on the Springer loan up to five years from the loan's date of endorsement. Petitioner admits that it signed the Indemnification Agreement because it had engaged in lending practices that violated HUD's lending requirements when it originated the Springer loan. HUD has many tools at its disposal to enforce its FHA lending requirements, such as referral of a noncompliant mortgagee to the Mortgagee Review Board ("MRB") for sanctions that can include withdrawal of the mortgagee's FHA approval. In this case, Petitioner executed the Indemnification Agreement in consideration for HUD's agreement to forbear from referring Petitioner to the MRB, thereby allowing Petitioner to retain its status as an FHA-approved mortgagee. The parties do not dispute that this agreement created a valid indemnification contract.

Paragraph 1 of the Indemnification Agreement states that Petitioner agrees to indemnify HUD "for losses which have been or may be incurred related to the FHA Case Number 374-5838647," as follows:

> a) Where, as of the date HUD executes this Indemnification Agreement (Effective Date), a HUD/FHA insurance claim has not been submitted to HUD, [Petitioner] shall submit no claim for insurance. ... In the event of a valid claim for insurance on any of the mortgages covered by this Agreement, indemnification will be in accordance with paragraph (b), (c), (d), or (e), whichever applies ...

Paragraph 1(b) applies "[i]n the event of a reconveyance" from HUD to Petitioner of "property securing a mortgage listed in this indemnification agreement." Paragraph 1(c) applies "[w]here a

HUD/FHA insurance claim has been paid in full and the property has been sold by HUD to a third party." Paragraph 1(d) applies "[i]n any other case where a HUD/FHA insurance claim is pending or has been paid."[8]

In this case, HUD did not reconvey or sell the underlying property. However, HUD paid an FHA insurance claim on August 10, 2013. Accordingly, paragraph 1(d) applies. Paragraph 1(d) states, in full: "In any other case where a HUD/FHA insurance claim is pending or has been paid, [Petitioner] shall pay HUD the amount of HUD's Investment[9] in accordance with the terms of an invoice or bill the Department sends to [Petitioner]."

On July 28, 2014, HUD sent Petitioner a demand notice billing Petitioner $160,448.62 for the loss HUD had incurred due to its payment of an insurance claim on the Springer loan. Upon Petitioner's receipt of this bill from HUD, the plain language of the Indemnification Agreement created an obligation for Petitioner to pay HUD the amount of HUD's Investment, as defined in the Indemnification Agreement, in accordance with the terms of the demand notice. This obligation is now past due. The remaining question is whether it is legally enforceable.

II. The obligation created by the Indemnification Agreement is legally enforceable.

Petitioner argues that HUD violated its own policies and procedures and harmed Petitioner by placing the Springer loan in the SFLS program, even though it was not eligible for inclusion in the program, and selling it for a fraction of the value of the underlying property. Petitioner theorizes that, by taking these actions, HUD breached the Indemnification Agreement in multiple ways. Petitioner also asserts that HUD violated the Administrative Procedure Act by failing to conduct notice-and-comment rulemaking to promulgate regulations governing the SFLS program. HUD denies these charges.

After careful consideration, the Court rejects Petitioner's arguments, for the following reasons.

A. HUD did not harm Petitioner by selling the Note through the SFLS program.

As discussed above, HUD paid a $520,979.86 insurance claim on the Springer loan after it defaulted. To mitigate this loss, HUD accepted assignment of the Note from the mortgage servicer and sold it through the SFLS program, contrary to its own policies and procedures, for $360,531.24. This recoupment reduced HUD's loss to $160,448.62.

Although the Note sold for just $360,531.24, it had an unpaid principal balance of $491,590.76. Petitioner characterizes the difference as a "discount." Petitioner argues that the inclusion of the Note in an SFLS bulk note sale distorted its value and necessarily created this discount, which harmed Petitioner because it increased HUD's loss. In support of its argument that such sales necessarily create a discount, Petitioner cites several HUD documents which reference a "discount" on the sale of notes through the SFLS program, including a February 17, 2006 report evaluating HUD's Accelerated Claims Disposition demonstration program (the

[8] Paragraph 1(e) applies in the event of a streamline refinance, which is not at issue here.

[9] "HUD's Investment" is defined elsewhere in the contract, at the end of paragraph 1(a).

earliest iteration of the SFLS program); a June 8, 2012 news release on the launch of the Distressed Asset Stabilization Program ("DASP," an expansion of the SFLS program); and an August 8, 2014 report from the HUD Office of the Inspector General ("OIG") pertaining to HUD's billing for indemnification losses, which mentions the Accelerated Claims Disposition program in passing.

However, when deposed by Petitioner, John W. Lucey, Director of HUD's Asset Sales Office, convincingly explained why the references in HUD documents to an SFLS "discount" are simply "bad writing." Mr. Lucey testified that such references reflect the reality that the defaulted notes sold through the SFLS program are generally purchased at prices below the outstanding principal balance. However, calling this a "discount" suggests that the seller, HUD, has offered to reduce the price by a predetermined or set amount, which is misleading. The reduced sales prices actually reflect merely that the market is unwilling to purchase defaulted notes at their face value.

This makes sense because a mortgage note is nothing more than the borrower's promise to pay. When the underlying loan fails to perform, this signals that the borrower's promise is not worth as much as the lender believed. In this case, the fact that the Note sold for less than the unpaid principal balance indicates that the originator, Petitioner, overvalued the mortgage. Thus, HUD's return on the Note did not reflect a true "discount." Rather, HUD was unable to recover the full amount of the unpaid balance because Petitioner had originated a bad loan, and buyers deemed its actual value to be less than the unpaid balance reflected on the face of the Note.

There is also no evidence that selling notes in bulk through the SFLS program artificially depresses the value of each individual note. Petitioner suggests that this is the case, but presents no evidence as to what sort of return a seller can expect when it sells a defaulted note individually. In this case, prospective buyers submitted individual bids on each note included in the SFLS 2013-2 sale. According to HUD, this shows that the bidders conducted loan-level analysis of each note. While there is no direct evidence to corroborate this assertion, the winning bid for the subject Note certainly did not appear dependent on the value of the other notes in its pool, as it sold for approximately 73% of its unpaid principal balance, far higher than HUD's overall return of 51% on the notes in its pool.

Further, the record suggests that the intent and effect of the SFLS program is to sell distressed loans at their fair market value. For example, the June 8, 2012 HUD news release cited by Petitioner states that the troubled mortgages disposed through DASP are to be "sold *competitively* at a *market-determined* price generally below the outstanding principal balance" (emphasis added). HUD's Federal Register notice announcing SFLS 2013-2, the bulk note sale through which the Springer loan was sold, indicated that SFLS 2013-2 was to be "an open competitive whole-loan sale" and stated: "HUD has determined that this method of sale optimizes HUD's return on the sale of these Mortgage Loans, affords the greatest opportunity for all qualified bidders to bid on [them], and provides the quickest and most efficient vehicle for HUD to dispose of [them]." 78 Fed. Reg. 34667, 34668 (June 10, 2013). And Mr. Lucey testified that notes disposed through the SFLS program are sold in a competitive sealed-bid auction after the bidders are given a broker price opinion ("BPO"), the unpaid principal balance, and information about the borrower, which results in the notes being sold for what the market is willing to pay based on their value. None of this evidence supports Petitioner's argument that selling notes in bulk through the SFLS program artificially depresses their price.

Petitioner also maintains, however, that if HUD had liquidated the collateral (the Springer property) instead of selling the Note, the property would have sold for much more than the Note, thereby allowing HUD to recoup most, if not all, of its loss on the loan. Citing an April 2013 BPO obtained in advance of the Note's sale that valued the property at $550,000, as well as the fact that a buyer took out a $499,000 mortgage to purchase the property in July 2014, Petitioner asserts that the value of the property was much higher than HUD's return on the Note. Petitioner also offers a declaration from its former CEO, Donald E. Moran, stating that he is familiar with the real estate market in the vicinity of the Springer property and was "astonished" to learn that HUD had sold the property for just $360,531.24, as 2-unit properties in this neighborhood are highly sought after.

However, the preponderance of the evidence does not establish that HUD would have significantly increased its recovery by selling the property. Contrary to Mr. Moran's testimony, HUD sold the Note, not the property, for $360,531.24. The Note was naturally worth less than the property because, since the loan was in default, anyone buying the Note would assume a relatively high risk that he would need to undertake the lengthy and expensive process of foreclosing on and selling the property in order to actually collect any money. But if HUD had decided to hold onto the Note and sell the property instead, HUD itself (or the servicer acting as its agent) would have needed to undertake this lengthy and expensive process. Petitioner's estimate of the gross return HUD might have received on the sale of the property ignores the expenses—such as foreclosure costs, legal costs, holding costs (including expenses such as property taxes, upkeep, and repairs), and marketing costs—that HUD would have incurred if it had taken this route. The sale of the Note avoided these costs, which is one of the main reasons HUD has adopted the SFLS program as an efficient means to dispose of its distressed assets.[10]

Further, the evidence does not support a finding that the property would have sold for $550,000 or $499,000, as Petitioner claims. The $550,000 figure derives from an April 22, 2013 BPO obtained by HUD in advance of the Note sale. But HUD's witnesses characterize the BPO

[10] Mr. Lucey testified that note sales maximize HUD's recovery on defaulted loans by shortening the time the loan is being held in default status by a HUD servicer, which reduces insurance claim costs, thereby reducing HUD's loss. Mr. Lucey further explained that HUD's note sales program was expanded through DASP in the wake of the housing crisis of 2008 due to HUD's desire to avoid lengthy, expensive foreclosures. He asserted that, by comparing recoveries from the SFLS program to recoveries from real estate owned ("REO") properties, which are properties HUD has acquired through foreclosure, HUD has found that note sale recoveries are almost always better than REO recoveries in states with long judicial timelines for foreclosure, and are comparable in other states. Further, SFLS recoveries are especially high for large, national, single-servicer note pools such as Pool 105 of SFLS 2013-2, the pool in which the Springer loan was sold.

Petitioner argues that Mr. Lucey could not identify any public documents comparing note sale recoveries and property recoveries for SFLS 2013-2. However, HUD's quarterly reports on the Mutual Mortgage Insurance Fund submitted to Congress pursuant to 12 U.S.C. § 1708(a)(5) for the third and fourth quarters of Fiscal Year 2013, (when SFLS 2013-2 took place and the sale of the Springer Note was settled), indicate that recovery rates for note sales were above those for REO sales in the same jurisdictions during that time period; that HUD's overall loss rate for REO alternatives, including note sales, was lower than that for REO sales; and that HUD's increasing use of pre-REO alternatives, including note sales, was helping drive a reduction in HUD's overall loss rates. See U.S. DEP'T HOUS. & URBAN DEV., *FHA Single-Family Mutual Mortgage Insurance Fund Programs: Quarterly Report to Congress, FY 2013 Q3*, at 10, 23 (Aug. 23, 2013), available at https://www.hud.gov/sites/documents/MMIQTRLYQ3FINAL.PDF; U.S. DEP'T HOUS. & URBAN DEV., *FHA Single-Family Mutual Mortgage Insurance Fund Programs: Quarterly Report to Congress, FY 2013 Q4*, at 10, 24 (Feb. 26, 2014), available at https://www.hud.gov/sites/documents/MMIQTRLYQ42013FINAL.PDF. HUD is accountable to Congress for its stewardship of the Mutual Mortgage Insurance Fund, a responsibility the agency appears to take seriously. The Court will not assume, without evidence, that HUD is disposing of its distressed mortgage assets in a careless or fiscally irresponsible manner.

as merely a ballpark estimate of the property value formed in reliance on a cursory exterior examination of the property, as the homeowner was still occupying it, and an assumption that it was in good condition. An actual sale of the property would provide a much more accurate estimate of its value. Further, because HUD would have needed to foreclose on the property first, it would not have sold in April 2013. July 2014, the date the borrower sold the property herself, is likely closer to the date HUD would have been able to sell it after completing the lengthy foreclosure process. Thus, the July 2014 sale provides better information than the April 2013 BPO as to the actual value of the property.

Information from the July 2014 sale indicates the property was worth significantly less than $550,000. According to Petitioner, the value of the property at that time was $499,000 based on the amount of the mortgage taken out by the buyer. But according to Brian Dillon, the HUD employee handling debt collection activities for the Springer loan, the listing agent who sold the property in July 2014 said it was listed at $460,000 based on a BPO and ultimately sold for just $450,000 because it had a leaky roof and significant deferred maintenance.[11]

Records from the New York City Department of Finance confirm this sale price and show that the property was purchased by an investment company with a loan from a construction company. Mr. Dillon testified that he spoke to representatives for the purchaser, who told him that when their company buys property, it typically obtains private short-term financing or bridge loans for amounts greater than the value of the property to fund both the purchase and holding and renovation costs. Thus, the difference between the mortgage and sale price represented funds borrowed for repairs and renovation, and the sale price of $450,000 is a better estimate than the mortgage of the actual value of the property as of July 2014.

Further, even if the property was worth $450,000 when the borrower sold it, HUD likely would not have been able to sell a vacant, foreclosed property at its full value. Mr. Dillon, who previously worked as the Chief Property Disposition Officer for HUD's Albany field office and as a New York state appraiser before coming to HUD, testified that in his experience, the sale of a foreclosed property is likely to net approximately 15 to 20% less than its full value. To bolster Mr. Dillon's testimony, HUD submitted a declaration from Patricia Moroz, a HUD economist for the northeastern United States, explaining that she had compared commercially available home sale data against the data from HUD's Real Estate Owned property sales (i.e., sales of foreclosed properties) in the pertinent geographic area for the 12-month period ending in June 2014 and found that, if anything, Mr. Dillon's estimate of the price reduction the market applies to foreclosed properties is too low.

Without submitting any evidence to contradict Mr. Dillon's estimate, Petitioner asserts it is purely speculative and should not be credited. The Court recognizes that it is impossible to calculate exactly how much money HUD would have made if it had sold the property. However, HUD has submitted credible evidence supporting a finding that the sale price likely would have been significantly less than $450,000. And HUD's net return on the sale would have been further reduced by its incurrence of foreclosure costs, marketing costs, and holding costs. In sum, the preponderance of the evidence suggests that HUD would not have recovered

[11] It is unsurprising that the borrower did not maintain the property in good condition, as she apparently did not even have the funds to keep up with her mortgage. Petitioner's witness, Mr. Moran, testified that in his experience, a borrower in default would not have an incentive to maintain the property (or to negotiate the best price for it).

significantly (if any) more than the $360,531.24 it made on the Note sale. In any event, HUD almost certainly would have recovered far less than $520,979.86, the amount needed to fully recoup the insurance claim. Therefore, the loss that HUD seeks to pass on to Petitioner through the Indemnification Agreement would not have been significantly reduced if HUD had sold the Springer property instead of the Note.

For all the reasons discussed above, the preponderance of the evidence supports a finding that HUD did not harm Petitioner by selling the Note in a bulk note sale through the SFLS program, as opposed to selling it through some other means or selling the underlying property.

B. HUD did not materially breach the Indemnification Agreement.

Petitioner argues that HUD breached the Indemnification Agreement in five different ways, all of which stem from HUD's sale of the Note through the SFLS program. Specifically, Petitioner argues that HUD breached the agreement by failing to comply with all HUD servicing requirements; by paying an invalid insurance claim; by selling the Note instead of the property; by failing to account for a discount on the sale; and by violating the implied covenant of good faith and fair dealing.

Failure to Account for a "Discount." Petitioner argues that HUD breached the Indemnification Agreement by failing to account for a "discount" on the sale of the Note. As discussed above, the Indemnification Agreement obligates Petitioner to pay HUD "the amount of HUD's Investment in accordance with the terms of an invoice or bill the Department sends to [Petitioner]." Paragraph 1(a) of the contract defines "HUD's Investment" as including the full amount of the insurance claim HUD actually paid, plus interest and various other expenses such as taxes, maintenance, and loss mitigation. However, "[t]o the extent HUD recoups any losses ... or there is any discount on the property (e.g., an Officer Next Door discount), HUD will deduct the amount of the recoupment or discount from HUD's Investment."

Petitioner contends that, when calculating its Investment under the Indemnification Agreement, HUD failed to account for the fact that the Note was sold at a discounted rate. This argument ignores the plain language of the agreement, which specifies that the only sort of discount that will be subtracted from HUD's Investment is a discount "on the property." In this case, HUD did not sell the property. Further, the Court has already found that there was no true "discount" on the Springer Note. Accordingly, HUD did not breach the Indemnification Agreement by failing to account for a "discount."

Sale of the Note. Petitioner next asserts that the Indemnification Agreement required HUD to sell the Springer property instead of the Note. Petitioner relies on a convoluted argument that paragraph 1(d) of the Indemnification Agreement is inapplicable, and therefore HUD was required to proceed under paragraphs 1(b) or 1(c), which apply only when HUD has reconveyed or sold a property. However, the Court has already found that, under the plain language of the contract as applied to the facts of this case, paragraph 1(d) governs.

Paragraph 1(d) contains broad language requiring Petitioner to indemnify HUD "[i]n any other case [other than those described in 1(b) and 1(c)] where a HUD/FHA insurance claim is pending or has been paid," and does not prescribe the particular method by which HUD must dispose of whatever assets it has accepted in exchange for payment of the insurance claim.

Section 204 of the National Housing Act permits HUD, in exchange for its payment of insurance benefits, to accept assignment of a note and sell it. See 12 U.S.C. § 1710(a)(1)(A), (g). And paragraph 1(a) of the Indemnification Agreement expressly contemplates the sale of such a note, as it defines HUD's Investment on an insured loan as including "prorated losses from and expenses associated with *the sale of a note*" (emphasis added). Accordingly, Petitioner's argument that the Indemnification Agreement did not allow the sale of the Note is without merit.

Violation of Servicing Requirements. Petitioner next argues that HUD breached the Indemnification Agreement by failing to ensure that all HUD servicing requirements were observed with respect to the Springer loan. Paragraph 1(a) of the Indemnification Agreement states, in pertinent part:

> Where, as of the date HUD executes this Indemnification Agreement (Effective Date), a HUD/FHA insurance claim has not been submitted to HUD, [Petitioner] shall submit no claim for insurance. All HUD requirements for servicing and payment of mortgage insurance premiums will be observed with respect to such mortgages.

Petitioner asserts that HUD violated the servicing requirements for the Springer mortgage, and therefore violated paragraph 1(a) of the Indemnification Agreement, by selling the Note through the SFLS program. To identify the source of the servicing requirements allegedly violated by HUD, Petitioner points to the Participating Servicer Agreement ("PSA") executed between HUD and Chase, the servicer of the Springer loan, on May 22, 2013, which allowed Chase to participate in SFLS 2013-2; HUD's Participating Servicer Desk Guide for SFLS 2013-2; the Bidder Information Package provided by HUD to all qualified bidders in SFLS 2013-2; and an SFLS Participating Servicer Training PowerPoint presented by HUD in April 2014.

In particular, Petitioner focuses on the PSA. Section 2.01 of the PSA required the loan servicer, Chase, to prepare a report listing all "Eligible Mortgage Loans" Chase intended to submit for inclusion in SFLS 2013-2. The PSA defines an "Eligible Mortgage Loan" as one that meets a lengthy list of eligibility criteria, including that the loan not be subject to an indemnification agreement. Section 2.01 of the PSA stated that HUD would provide Chase with an SFLS Claim Identification Date for each eligible loan accepted into HUD's system, and further provided:

> HUD's identification process will be used only to identify mortgage loans submitted as potential SFLS Claims by Participating Servicers and not to screen mortgage loans for eligibility, with the exception of mortgage loans subject to an Indemnification Agreement. ... HUD will not issue an SFLS Claim Identification Date for any mortgage loans for which Indemnification Agreements are identified in HUD's system of records.

The other SFLS guidance documents cited by Petitioner—the Participating Servicer Desk Guide, Bidder Information Package, and SFLS training materials—similarly indicate that a loan that is subject to an indemnification agreement is not eligible for inclusion in the SFLS program. Petitioner characterizes this eligibility limitation as a "HUD requirement for servicing." Because the inclusion of the Springer loan in SFLS 2013-2 violated this purported servicing requirement, Petitioner argues that HUD has breached the Indemnification Agreement.

There is no question that, based on HUD's own guidance materials, the Springer loan should not have been included in SFLS 2013-2. It is unclear why neither the servicer nor HUD flagged the loan as being subject to an indemnification agreement before adding it to SFLS 2013-2. Both Chase and HUD should have had access to Neighborhood Watch, an online system run by HUD that stores data on lenders and individual loans and that should have included information about the Indemnification Agreement. Mr. Lucey, Director of HUD's Asset Sales Office, further testified that the individual within his office who handled SFLS 2013-2 should have conducted an "indemnification check" on the loans Chase had offered for inclusion in the sale, which would have entailed running a search in HUD's single family loan data warehouse. However, if such a check was conducted, it was ineffective, as HUD accepted the Springer loan for inclusion in SFLS 2013-2 despite the existence of the Indemnification Agreement. This clearly contravened the instructions in the PSA and other guidance materials for SFLS 2013-2, as was effectively conceded by one of HUD's witnesses, Mr. Dillon, in a December 8, 2014 letter to Petitioner.

Nonetheless, HUD argues that this mistake did not amount to a breach of the Indemnification Agreement. HUD contends that the language "All HUD requirements for servicing and payment of mortgage insurance premiums will be observed" imposes obligations only on Petitioner, not HUD. According to HUD, when read in context with the preceding sentence, this language simply indicates that Petitioner must continue to comply with all servicing requirements and pay insurance premiums if it has not yet submitted an insurance claim. Construing the sentence otherwise would be illogical, HUD argues, because such a construction would imply that HUD promised to pay insurance premiums to itself and service the loan properly, even though HUD did not own or service the loan, and promised that Chase would comply with all servicing requirements and that Petitioner's indemnification obligation would be free of all risks related to Chase's servicing activities, even though HUD does not monitor its servicers' day-to-day activities and Petitioner, as indemnitor, stepped into HUD's shoes and took on the same risks HUD assumes as an insurer when it allows approved lenders to originate and service insured loans.[12]

HUD's preferred construction is compelling. As drafter of the Indemnification Agreement, HUD likely intended to bind only the indemnitor, and the context supports HUD's interpretation. Also, it is not clear whether the inclusion of the Springer loan in SFLS 2013-2 constituted a violation of a "servicing" requirement, within the meaning of the Indemnification Agreement. The phrase "[a]ll HUD requirements for servicing," as used in the contract, may have been drafted with a specific set of servicing-related regulatory or handbook requirements in

[12] HUD also argues that it is bound only by contracts, regulations, and statutes, not by procedural guides or handbooks, and thus Petitioner cannot enforce HUD's own procedural guidance documents against the agency. HUD further argues that Petitioner cannot enforce the PSA against the agency because Petitioner has no third-party rights under that contract, which was executed after the Indemnification Agreement and specifically disclaims any third-party beneficiaries. These arguments, regardless of their merit, are not on point. Despite Petitioner's allegation that HUD has violated its own policies and procedures, Petitioner has not actually asked the Court to enforce the PSA or HUD's procedural guides or handbooks. Instead, Petitioner has cited these materials to provide guidance as to the meaning of certain terms in the Indemnification Agreement and the parties' reasonable expectations under the contract, in the same manner that HUD has cited extrinsic materials including its own policy documents and regulations for the stated purpose of demonstrating what the parties intended at the time of contracting.

mind, and may not be broad enough to encompass *all* HUD requirements pertaining to the loan in any manner whatsoever, even those that arise from third-party contracts and guidance materials promulgated after the Indemnification Agreement was executed.

But even if the Court were to accept Petitioner's interpretation of the Indemnification Agreement and find that HUD's erroneous inclusion of the Springer loan in the SFLS program violated a binding "servicing" requirement, this would not constitute a material breach of the Indemnification Agreement that excuses Petitioner from performance on the contract.

A material breach is one that goes to the very heart of a contract, substantially defeating the purpose of the contract and frustrating the parties' intentions. See, e.g., Hometown Fin., Inc. v. United States, 409 F.3d 1360, 1370 (Fed. Cir. 2005) ("A breach is material when it relates to a matter of vital importance, or goes to the essence of the contract."). By contrast, a nonmaterial breach violates only a minor detail of the contract without depriving the non-breaching party of the benefit of the agreement or affecting its overall outcome. A contract is enforceable despite a breach unless that breach is material, serious enough to affect the non-breaching party's duties under the contract. See Rest. (2d) Contracts § 369 (1981) ("Specific performance or an injunction may be granted in spite of a breach by the party seeking relief, unless the breach is serious enough to discharge the other party's remaining duties of performance."); e.g., *In re* Lavigne, 114 F.3d 379, 387 (2d Cir. 1997) ("[A] party is relieved of continued performance under a contract only when the other party's breach is 'material.'"); United States v. Kellogg Brown & Root Servs., 856 F.Supp.2d 176, 185 (D.D.C. 2012) (referencing defense of "prior *material* breach") (emphasis added).

In this case, HUD's sale of the Springer Note through the SFLS program did not substantially defeat the purpose of the Indemnification Agreement or frustrate Petitioner's intentions or reasonable expectations under the contract. First, the Court has already determined that the sale of the Note did not harm Petitioner. Second, the sale did not deprive Petitioner of the benefit Petitioner reasonably expected to derive from the contract. Petitioner argues that HUD's purported agreement to abide by all servicing requirements was an important component of that contract, citing testimony from Petitioner's former CEO, Mr. Moran, that he believed this provided an important protection for his company when he signed the Indemnification Agreement. However, he also testified that he had no opportunity to negotiate the contract and that HUD offered it as a "take-it-or-leave-it" deal. In fact, HUD required Petitioner to sign the contract in exchange for its agreement not to refer Petitioner to the Mortgagee Review Board for sanctions for noncompliant lending activities.

Therefore, the substantial benefit Petitioner reasonably expected to derive from the Indemnification Agreement was its ability to continue operating as a HUD-approved mortgagee without the threat of sanctions by the Mortgagee Review Board. Petitioner has not been deprived of this benefit, suggesting that there is no material breach of the contract that would excuse Petitioner from holding up its end of the bargain. See Rest. (2d) Contracts § 241 (1981) (indicating that, when determining whether a breach is material, courts should consider whether the injured party was deprived of the benefit he reasonably expected to obtain). Although it was reasonable for Petitioner to expect that HUD would abide by its own policies and procedures when handling the Springer loan, this was not part of the bargained-for consideration under the Indemnification Agreement and did not go to the heart of the contract. Accordingly, HUD's sale of the Note through the SFLS program, while erroneous, did not materially breach the Indemnification Agreement.

Payment of Invalid Insurance Claim. Paragraph 1(a) of the Indemnification Agreement indicates that the indemnification obligation arises only "[i]n the event of a valid claim for insurance" on a covered mortgage. Petitioner argues that, because the PSA and other procedural documents governing SFLS 2013-2 provided that only an "Eligible Mortgage Loan" could be submitted for FHA insurance benefits following the sale, and because the Springer loan was not an "Eligible Mortgage Loan" by dint of its being subject to an indemnification agreement, the servicer was not permitted to submit the insurance claim, and HUD should not have paid it. Therefore, Petitioner reasons that the insurance claim was invalid and that HUD breached the terms of the Indemnification Agreement by paying it.

HUD counters that, because the only type of insurance claims prohibited under the Indemnification Agreement are claims filed by Petitioner, a "valid claim" under the contract means any claim related to the Springer loan that is not filed by Petitioner. HUD asserts that this interpretation is supported by its own regulation at 24 C.F.R. § 203.255(g)(5), which explains that "[u]nder indemnification, the Lender Insurance mortgagee agrees to either abstain from filing an insurance claim, or reimburse FHA if a subsequent holder of the mortgage filed an insurance claim and FHA suffers a financial loss."

HUD's definition of a "valid claim" as any FHA insurance claim filed by someone other than Petitioner is extremely broad. The Court can envision circumstances in which it would seem unjust to hold the indemnitor liable for an insurance claim filed by someone else, such as if the claim involved such overt fraud that HUD could be legally faulted for paying it. However, such circumstances are not in play here. The Indemnification Agreement was signed because Petitioner's activities in originating the Springer loan exposed HUD, as the insurer, to heightened risk. The contract anticipated that Petitioner's activities would cause an insurance claim to be filed, resulting in a loss to HUD. Such a claim was, in fact, filed. The indemnification contract evinces an understanding that Petitioner will indemnify HUD under these circumstances.

Petitioner now seeks to evade this contractual obligation based on a technicality. Petitioner urges the Court to look to the PSA and related documents to import a limitation on the definition of a "valid claim" under the Indemnification Agreement. But the term "valid," as used in the Indemnification Agreement, cannot be synonymous with the PSA's use of the term "eligible," because under the PSA, an "Eligible Mortgage Loan," by definition, excludes any loan that is subject to an indemnification agreement.[13]

The plain language and terms of the Indemnification Agreement instead suggest that a "valid" insurance claim is simply one that was brought about by Petitioner's origination of the Springer loan, during which process Petitioner engaged in noncompliant lending activities that increased the risk of just such a claim being filed. The loan was ineligible for inclusion in SFLS 2013-2, but it was still eligible for FHA insurance benefits under the National Housing Act. See 12 U.S.C. § 1709(e) (stating that the validity of an FHA insurance contract is incontestable in the

[13] Thus, if a loan must be "eligible" under the PSA in order for the claim to be "valid" under the Indemnification Agreement, no claim covered by the Indemnification Agreement would ever be valid, because the very existence of the Indemnification Agreement would render the loan ineligible for insurance. This would defeat the purpose of the Indemnification Agreement.

hands of an approved mortgagee absent fraud or misrepresentation on the part of such mortgagee). Accordingly, the insurance claim was valid, and HUD did not breach the Indemnification Agreement by paying it.

Breach of Implied Covenant of Good Faith and Fair Dealing. Finally, Petitioner argues that HUD violated the implied covenant of good faith and fair dealing, thereby breaching the Indemnification Agreement, when it sold the Note through the SFLS program, which violated HUD's own policies and prevented HUD from recouping its loss on the loan.

"Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Rest. (2d) Contracts § 205 (1981). The meaning of "good faith and fair dealing" varies with context, but good faith performance or enforcement of a contract generally "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party" and "excludes a variety of types of conduct characterized as involving 'bad faith' because they violate community standards of decency, fairness or reasonableness." Id. cmt. a; see also Northwest, Inc. v. Ginsberg, 572 U.S. 273, 286 (2014) (noting that some states "use the doctrine 'to effectuate the intentions of parties, or to protect their reasonable expectations,'" while others use it "to ensure that a party does not 'violate community standards of decency, fairness, or reasonableness'") (citations omitted).

Although the covenant of good faith and fair dealing binds both the government and private parties, the government generally enjoys a legal presumption that it acts in good faith when carrying out its duties. See, e.g., Am-Pro Protective Agency v. United States, 281 F.3d 1234, 1239 (Fed. Cir. 2002); Adair v. Eng, 183 F. Supp. 2d 31, 60 (D.D.C. 2002); *In re* Cambridge Home Capital, LLC, No. 06-D-NY-GG004, 2009 HUD Appeals LEXIS 19, at *11 (HUDOA June 18, 2009). Accordingly, HUD argues that the Court should assume it acted in good faith in this matter absent evidence of bad faith or specific intent to injure, which are not present here. Even without the presumption of good faith, HUD argues that it did not violate the covenant of good faith and fair dealing because its actions in selling the Note through the SFLS program did not undermine Petitioner's reasonable expectations under the Indemnification Agreement or deprive Petitioner of the fruits of the bargain, nor has Petitioner established that its indemnification obligation would have been reduced if HUD had instead sold the property.

For the reasons already discussed above, the Court agrees that HUD's actions did not undermine Petitioner's reasonable expectations under the contract or deprive Petitioner of the benefit of the bargain. Although selling the Note through the SFLS program was against HUD's own policy, there is no suggestion the Note's inclusion in the sale was anything more than an innocent oversight, and Petitioner suffered no harm as a result.

Petitioner argues that the implied covenant of good faith and fair dealing can be breached not just by overtly malicious actions, but by "evasion of the spirit of the bargain, lack of diligence and slacking off, willful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance." But Petitioner has not established that HUD engaged in any such conduct. Petitioner entered into the Indemnification Agreement as a sanction for engaging in noncompliant lending activities. See HUD Handbook 4155.2 §§ 9.A.1.c, 9.D.1.b (characterizing indemnification agreement as a sanction). HUD performed its end of the bargain under the contract by refraining from referring Petitioner to the Mortgagee Review Board for further sanctions that could have included withdrawal of Petitioner's FHA approval. Further, when an insurance claim was filed on the Springer loan, HUD took steps to mitigate its loss on the loan, which benefited Petitioner by reducing Petitioner's obligation under the Indemnification Agreement.

Accordingly, HUD has faithfully performed on the Indemnification Agreement and has not breached the implied covenant of good faith and fair dealing.

C. Petitioner has not established that HUD's purported violation of the APA excuses Petitioner from performance under the Indemnification Agreement.

In addition to its arguments that HUD harmed Petitioner and breached the Indemnification Agreement by selling the Note through the SFLS program, Petitioner also broadly argues that the debt is unenforceable because HUD violated the Administrative Procedure Act, 5 U.S.C. §§ 501 *et seq.* ("the APA"), by failing to promulgate regulations through notice-and-comment rulemaking to govern the operation of the SFLS program.

Petitioner's argument is based largely on a July 14, 2017 report issued by the HUD OIG. The report found that, under the APA, HUD was required to promulgate regulations for the SFLS program via notice-and-comment rulemaking before implementing the program, but HUD failed to do so. In view of this purported statutory violation, Petitioner asks the Court for a declaration that HUD's actions in selling the Springer Note as part of the SFLS program were arbitrary, capricious, an abuse of discretion, and not in accordance with the law.

HUD counters that Petitioner's APA argument is time-barred and that, at any rate, its operation of the SFLS program is a valid exercise of its authority to conduct demonstration programs under 42 U.S.C. § 3542. HUD also asserts that this Court lacks jurisdiction to declare the SFLS program unlawful, as the Court's jurisdiction in this proceeding is limited to determining whether Petitioner owes a debt that is past due and legally enforceable. See 24 C.F.R. § 17.69(a).

Petitioner agrees with HUD that this Court does not have authority to declare a violation of the APA. Petitioner claims it is raising the APA argument merely to preserve it on appeal. Yet Petitioner also maintains that a violation of the APA would render the Indemnification Agreement unenforceable. Thus, although both parties agree that the Court cannot issue the declaration sought by Petitioner, the Court also cannot ignore Petitioner's APA argument.

Petitioner, however, fails to articulate how the alleged APA violation renders the Indemnification Agreement unenforceable. Petitioner baldly asserts that HUD's failure to comply with the APA "ultimately resulted in the alleged losses which HUD now seeks to pin on [Petitioner]." But the loss for which HUD seeks reimbursement was caused by Petitioner's origination of a bad loan that went into default, resulting in HUD's payment of FHA insurance benefits. It was not caused by HUD's operation of the SFLS program, whether lawful or not.

Petitioner is arguing, in essence, that HUD chose to engage in a form of loss mitigation—sale of the Note through the SFLS program—that was unlawful. Yet, for the reasons discussed above, the evidence does not establish that HUD's chosen method of loss mitigation was less effective than any other method HUD could have employed. In other words, Petitioner has not established that HUD's actions placed Petitioner in a worse position than it would have otherwise occupied under the Indemnification Agreement. In fact, it stands to reason that HUD's efforts at loss mitigation improved Petitioner's position, regardless of their lawfulness, because they mitigated HUD's loss. Petitioner has not articulated any legal theory explaining how HUD's actions breached the Indemnification Agreement or excused Petitioner from performance.

Because Petitioner has not explained how HUD's alleged violation of the APA renders the Indemnification Agreement unenforceable or otherwise releases Petitioner from its obligation under the contract, the Court cannot conclude that any such violation would be material to the instant proceeding. Accordingly, the Court need not reach the issue of whether HUD violated the APA.

CONCLUSION AND ORDER

For all the reasons discussed above, Petitioner owes HUD a debt that is past due and legally enforceable.

The stay of the referral of this matter to the U.S. Department of the Treasury is hereby **VACATED**. It is **ORDERED** that the Secretary is authorized to seek collection of this outstanding obligation by means of administrative offset of any federal payment due Petitioner.

So **ORDERED**,

Alexander Fernández
Administrative Law Judge

Finality of Decision. Pursuant to 24 C.F.R. § 17.73(a), this decision constitutes the final agency decision with respect to the past due status and enforceability of the debt.

Review of Decision. A motion for reconsideration of this decision, specifically stating the grounds relied upon, may be filed with the undersigned Judge of this court within 30 days of the date of this *Decision and Order on Remand*, and shall be granted only upon a showing of good cause.