UNIVERSITY OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In The Matter of:
ANTONIO GIORDANO, et al
Respondents.

HUDALJ 04-068-LDP
Date: June 8, 2004

Timothy A. Vanderver, Jr., Esq.
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For the Respondents

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For the Government

Before: WILLIAM C. CREGAR
Administrative Law Judge

RECOMMENDED DECISION ON LIMITED DENIAL OF PARTICIPATION

\(^1\)Ms. Katz withdrew her appearance as Counsel for the Government on May 3, 2004. On that date Mr. Farrell entered his appearance.
This proceeding arose pursuant to 24 C.F.R. Part 24. On October 30, 2003, the Director, Boston Multifamily Hub, of the Department of Housing and Urban Development’s ("HUD") Massachusetts State Office imposed multiple Limited Denials of Participation ("LDPs") prohibiting Respondents’ participation in HUD programs for one year. On January 14, 2004, Respondents appealed the LDPs and requested a hearing. The hearing was held in Providence, Rhode Island, on April 21, 2004. Post-hearing briefs were filed respectively by Respondents on April 21, 2004, and May 10, 2004, and the Government on May 3, 2004. Accordingly, this case is ripe for decision.

Background

The essential facts are not in dispute. This case turns on two questions: 1) Whether Respondents as individuals and as partnerships violated HUD Regulatory Agreements and a Housing Assistance Payment ("HAP") contract by entering into “pledge agreements” with an agency of the State of Rhode Island without notifying HUD; and second, assuming arguendo that the Regulatory Agreements and Contract were violated, whether there is “adequate evidence” that entering into these agreements demonstrates that Respondents lack “present responsibility” to warrant the imposition of the sanction of LDPs.

I. HUD Regulatory Agreements and HAP Contracts

Woodland Manor II Associates and Hillcrest II Associates are partnerships owning multifamily projects with mortgages insured by HUD pursuant to Sections 231 and 221(d)(4) of the National Housing Act. As a condition of providing mortgage insurance, HUD required the mortgagors to enter into Regulatory Agreements which include the following provisions:

Owners shall not without the prior written approval of the Secretary:

(a) Convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer, or encumbrance of such property . . . .

(c) Convey, assign or transfer any beneficial interest in any trust holding title to the property, or any right to manage or receive the rents and profits from the mortgaged property.

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Hillside Health Center and Mount Saint Francis are mortgaged nursing homes owned by partnerships with the same names. The nursing home mortgages are insured by HUD under Section 232 of the National Housing Act and also governed by Regulatory Agreements. These agreements contain the following provisions:

Owners shall not without the prior written approval of the Secretary:

(a) Convey, transfer, or encumber any of the mortgaged property, or permit the conveyance, transfer, or encumbrance of the property. . . .

(c) Convey, assign, or transfer any beneficial interest in any trust holding title to the property, or the interest of any general partner in a partnership owning the property, or any right to manage or receive the rents and profits from the mortgaged property.

Westcott Terrace Associates, also a partnership, owns Westcott Terrace, a multifamily housing project that receives Section 8 subsidies from HUD under the terms of a HAP contract. The contract provides:

2.20 ASSIGNMENT, SALE OR FORECLOSURE

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3 Documents are identified as follows: “J. Ex.” for joint exhibit; “Govt. Ex.” for Government Exhibit; and, “Resp. Ex.” for Respondent’s Exhibit. References to the transcript pages are to “Tr.” followed by page numbers.
(a) The owner agrees that it has not made and will not make any sale, assignment, or conveyance or transfer in any fashion, of this Contract, the Agreement, the ACC, or the project or any part of them or any of its interest in them, without the prior written consent of the HFA and HUD.

(b) The owner agrees to notify the HFA and HUD promptly of any proposed action covered by paragraph (a) of this section. The Owner further agrees to request the written consent of the HFA and of HUD.

(c) For purposes of this section, a sale, assignment, conveyance, or transfer includes by is not limited to one or more of the following:

(i) A transfer by the Owner, in whole or in part,
(ii) A transfer by a party having a substantial interest in the Owner,
(iii) Transfers by more than one party of interests aggregating a substantial interest in the Owner,
(iv) Any similarly significant change in the ownership of interests in the Owner, or in the relative distribution of interests by any other method or means.

(3) The term “substantial interest” means the interest of any general partner.

Govt. Ex. 7

II. The Pledge Agreements

On October 15, 1999, the Rhode Island Economic Protection Corporation (“DEPCO”) obtained a judgment against Anthony L. Giordano and other Respondents in connection with loans issued by a state insured financial institution, the Marquette Credit Union. On December 14, 2000, the Respondents and DEPCO entered into a Settlement Agreement in which the obligors agreed to pay $8 million plus interest over a six-year term. The Settlement Agreement provided that the judgment would be secured by “a first priority lien, security interest, assignment, pledge, or mortgage as appropriate, in and to” the “collateral.” Govt. Ex. 8A ¶ 7. “Collateral” included:

(d) all of the Obligor’s general partnership interests and rights in and to that certain limited partnership known as Woodland Manor II Associates (WMII), including, without limitation, all partnership and contract rights, interests or claims of the Obligors in respect to WMII, and its assets and property.

(f) all of the general partnership interest of Antonio L. Giordano and rights in and to that certain partnership known as Mt. Saint Francis Associates, including, without limitation, all of his partnership and contract rights, interests and claims in respect to Mt. Saint Francis Associates, and its assets and property.

4The Rhode Island Housing and Mortgage Financing Corporation (“HFA”) financed the project.
To carry out the terms of the Settlement Agreement DEPCO and Respondents entered into “Pledge Agreements” in which collateral was defined to include:

The Pledgor’s limited and general partnership interests in the Partnership set forth on the attached Exhibit A, including, without limitation, the right to be admitted as a successor or a substituted limited or general partner.

Govt. Exs. 8B ¶ 1(A)(i).

The Pledge Agreements further provided:

4. The Pledgor hereby pledges, hypothecates, assigns, and transfers to the Secured Party all of the collateral and hereby grants to the Secured Party a lien on and a security interest in, its right, title and interest in the Collateral and all payments, distributions, privileges and any and all proceeds and products thereof (which shall be a first lien), all as collateral security for the obligations. . . .

7(b) Effective upon the occurrence of an Event of Default, the Secured Party is hereby appointed attorney-in-fact of the Pledgor for the purpose of carrying out the provisions of this Pledge Agreement. . . .

11(b) The Pledgor and Secured Party acknowledge that any exercise by the Secured Party of the Secured Party’s rights upon default will be subject to compliance by the Secured Party with any applicable statute, regulation, ordinance, directive, or order of any federal, state, municipal, or other governmental authority. . . .

12(b) The execution, delivery and performance of this Pledge Agreement and the granting of Collateral pursuant hereto. . . .

(ii) will not

(D) result in the creation or imposition of any lien of any nature whatsoever on any of the Pledgor’s or the Partnership’s assets (except liens created hereby); and

(iii) do not require the filing or registration with, or permit, license, consent or approval of, any government agency or regulatory authority. . . .

14. This pledge is for collateral purposes only, and the Secured Party shall
not, by virtue of this Agreement or its receipt of distributions from the Partnership, be deemed a partner, joint venturer, or other associate of the Pledgor; . . .

Govt. Exs. 8B, 9B.

On January 14, 2002, Anthony L. Giordano, executed a similar Pledge Agreement giving DEPCO rights to his partnership interests in Hillcrest Village II Associates and Hillside Health Center Associates, LP.

Respondents executed these Pledge Agreements relying upon the advice of their counsel, Edward Maggiacomo. He testified that it was his considered opinion based upon approximately 40 years of commercial law practice in Rhode Island that: 1) a pledge agreement affected no transfer of partnership rights to DEPCO unless and until there was a default on the payments; and, 2) because there was no transfer of partnership rights, HUD’s rights were unaffected and that, accordingly, the terms of the Regulatory Agreements and HAP Contract requiring prior notice to HUD and its approval did not come into play. Tr. pp. 72-73. Thus, he concluded that there was no need to notify HUD and to obtain HUD permission prior to executing the Settlement and Pledge Agreements. Tr. p. 140.  

III. Respondents’ Corrective Actions and HUD’s Imposition of LDPs

On November 12, 2002, a meeting was held at the HUD office concerning the processing of financing for the sale of Woodland Manor I and II. The proceeds of the sale were expected to be used towards payment of the amount owed to DEPCO. A HUD official informed Mr. Giordano that any financing would require HUD review of the agreements between Respondents and DEPCO. As a result of

5At the time the DEPCO settlement was being negotiated, Mr. Maggiacomo and DEPCO’s attorney, Mr. William Dolan, both believed that any agreements between Respondents and DEPCO would not alter HUD’s rights. In a letter, dated October 17, 2000, Mr. Maggiacomo requested that the settlement documents should be clarified to reflect that “[A]ny transfer of the Obligor’s general partnership interest will be subject to HUD. . . .” Resp. Ex. 13, Attach 1. In a letter dated April 14, 2004, to HUD’s counsel Mr. Dolan stated: “I always knew that DEPCO’s exercise of its rights might be restricted by the regulatory agreements.” Resp. Ex. 17.
this review, HUD officials concluded that the Regulatory Agreements had been violated. On December 31, 2002, Respondents and DEPCO executed a “Third Amendment to Agreement.” This document provides that: 1) DEPCO’s rights under the Settlement agreement are subordinated to HUD’s rights under the Regulatory Agreements and HAP Contract; and 2) DEPCO will not take any action to assume ownership, control or possession of the projects, and will not exercise various remedies without HUD’s prior written consent. Govt. Ex. 11 ¶ 2.

On October 30, 2003, nearly one year after Respondents corrected what HUD considered to be their mistake, HUD issued the LDPs against Respondents alleging that the Pledge Agreements violated the Regulatory Agreements and the HAP contract. Govt. Ex. 1. Respondents requested and received an informal hearing that was held on December 2, 2003. On December 22, 2003, Ellen Connolly, the Director, Boston Multifamily HUB affirmed the LDPs. She concluded that the Pledge Agreement amounted to an assignment or transfer of general partnership interests and quoted DEPCO’s attorney Mr. William Dolan, Esq., to the effect that DEPCO “was advised and aware that the ability of these individuals to pledge such interests might be limited by the terms of the Regulatory Agreements.” Govt. Ex. 2, p. 2. She was also unpersuaded that any violation was cured by execution of the Third Amendment to Agreement. She stated:

The fact remains that you and other signatories made a deliberate decision to execute the DEPCO agreements without seeking HUD approval, in violation of the Regulatory Agreements and HAP contract. This violation is not cured by the fact that when the violation was ultimately discovered, you agreed to take steps to ensure that HUD’s interests were protected.

Govt. Ex. 2, p. 2.

**Discussion**

An LDP is a discretionary administrative sanction imposed only when it is in the best interests of the government to do so. The Government need not do business with persons or entities that are not “responsible.” The key concept underlying the imposition of an LDP is “present responsibility.” The Government bears the evidentiary burden of demonstrating by “adequate evidence” that cause exists for imposing the LDP, that the LDP is in the public interest, and that the LDP
was not imposed for punitive purposes. 24 C.F.R. §§ 24.115, 24.705(a). A finding of a present lack of responsibility can be based upon past acts. See, Stanko Packing Co. V. Bergland, 489 F. Supp. 947, 979.

The Pledge Agreements Violate the HUD Regulatory Agreements

The LDP's allege that Respondents' execution of the Pledge Agreements violate HUD regulation 24 C.F.R. § 24.705(a):

(2) Irregularities in a participant's or contractor's past performance in a HUD program; . . .

(4) Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations; . . .

(8) Commission of an offense listed in 24 C.F.R. § 24.305, in particular:

(b) Violation of the terms of a public agreement or transaction so serious as to affect the integrity of an agency program, such as:

(1) A willful failure to perform in accordance with the terms of one or more public agreements or transactions; . . .

A review of the Pledge Agreements reveals that the parties intended to create a security interest and to state that DEPCO's takeover of the partnership interests in the event of a default would be subject to HUD requirements. Thus, Paragraph 4 of the Pledge Agreements creates a "lien" and a "security interest." Paragraph 7(b) appoints DEPCO as attorney-in-fact only after the occurrence of a default. Paragraph 11(b) states that the Secured Parties' rights are subject "to compliance by the Secured Party with any applicable statute, regulation, ordinance, directive, or order of any federal, state, municipal, or other governmental authority," (emphasis added). Paragraph 14 provides that the agreement is for collateral purposes only; i.e., it gives DEPCO no present right to partnership assets or rents.

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6 Citations are to the HUD regulations in force at the time the LDP was issued. Since that time, HUD has revised its regulations but not altered these standards. For example, language similar to 24 C.F.R. § 24.115 is now set forth in 24 C.F.R. § 24.110. See 68 Fed. Reg. 66533 at 66546 (November 26, 2003).
The type of security interest conveyed to DEPCO was described by Respondents and DEPCO as a “pledge.” A pledge is a bailment of goods (or an instrument representing an intangible) to a creditor as security. *Black’s Law Dictionary* 1038 (5th ed. 1979). The Pledge Agreements are just that - the creation of a pledge in an intangible represented by a formal instrument. The pledgor has the right to redeem the pledged property upon fulfillment of the debt. The pledgee has no right to exercise control or dominion over the property until and unless the pledgor has failed to comply with the security agreement, i.e., defaulted. It is clear from the Pledge Agreements that no present effect on the rights or the partners to collect rents and exercise control over the pledged property was given or intended.

The Regulatory Agreements prohibit: 1) the conveyance, transfer, or encumbrance of the mortgaged property; 2) the conveyance, assignment, or transfer of any beneficial interest in any trust holding title to the property, or any right to manage or receive the rents and profits from the mortgaged property, and 3) (in the case of Mount Saint Francis and Hillside) the conveyance, assignment, or transfer of the interest of any general partner in a partnership owning the property or any right to manage or receive the rents and profits from the mortgaged property. The first clause is inapplicable because the mortgaged property, i.e., the projects, were not conveyed, or transferred to DEPCO.

The question before me concerns the second and third clauses. The question presented is whether the Regulatory Agreements proscribe the creation of a security interest (the right to manage and receive rents and profits in the event of a default) without notice to HUD and HUD approval. Stated differently, the question presented is whether the creation of a future right conditioned upon the occurrence of a future event is an “assignment” or “transfer” within the meaning of the HUD Regulatory Agreements.

Although the parties have focused on the meaning of the words, “assignment” and “transfer,” I have concluded that resolution of this question turns on the meaning of the phrase, “any right.” The word, “any” is all inclusive. It includes not only the transfer of present rights but also the transfer of rights that are created or enforceable only after the occurrence of a subsequent event, i.e., a

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7 Neither party contends that the pledge agreements constituted an “encumbrance” of the mortgaged property.

8 The HAP contract uses similar language. It also prohibits “any sale, assignment, or conveyance or transfer in any fashion.”
default. Strong policy reasons support this conclusion. The public fisc should not be placed at risk without the consent of the Government entity responsible for protecting the public. Even though the parties recognized that HUD had rights that could not be altered without HUD’s consent, HUD might have been required to expend funds to assert its rights. Accordingly, Respondents acted improperly in not notifying HUD and obtaining its permission.

Respondents’ actions violated sections of 24 C.F.R. §§ 705(2) and (4) and, therefore, cause exists for the issuance of the LDPs. Respondents’ actions constituted irregularities in the performance of a HUD program and a failure to honor contractual obligations.

However, because Respondents took corrective action by executing the Third Amendment to the Pledge Agreements, I conclude that any violations were thereby cured and were not sufficiently serious as to affect the integrity of an agency program. In addition, as discussed infra, because I have concluded that Respondents’ legal position was not unreasonable, I conclude that they were not guilty of a willful failure to perform in accordance with the terms of one or more public agreements or transactions. Accordingly, Respondents did not violate 24 C.F.R. § 24.305 (8).

Respondents do not Lack Present Responsibility

Despite having violated the Regulatory Agreements, the circumstances of this case fail to demonstrate that Respondents lack present responsibility. Under the circumstances of this case, the possible reasons for denying participation are: 1) incompetence; 2) lack of sufficient financial resources; or 3) lack of integrity.

The record simply does not reflect that Respondents lack competence. However, in its Post-hearing brief the Government suggests that Respondents lack sufficient financial resources. Thus, the Government refers to record evidence of delinquent mortgage payments and late real estate tax payments for Hillside Health Center. Govt. Post-hearing Brief at p. 19. The record evidence to which the Government refers is a letter dated September 24, 2003, to Respondent Mary D. Gentili from HUD’s Multifamily Participation Review Committee (“MPRC”). Based on these

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9 Conduct is “willful” when “the actor has intentionally done an act of an unreasonable character in disregard of a known or obvious risk that was so great as to make it highly probable that harm would follow. In the Matter of Seb J. Passanesi, President Seb J. Passanesi, P.C. HUDALJ 92-1835-DB (December 16, 1992) citing Prosser and Keeton on the Law of Torts at 213, 5th ed., West Publishing Co. (1984).
delinquent and late payments the MPRC denied Respondents permission to participate in two other HUD insured projects. Govt. Ex. 12. In their appeal of the LDPs, Respondents had argued that the MPRC’s denial was a “defacto LDP.” In her response to Respondents’ argument Ms. Connolly stated:

HUD’s review of the affiliates’ requests for approval to participate and the ultimate disapproval of these requests resulted from a process separate and apart from the LDP process. Moreover, I note that the first identified basis for disapproval of participation concerns facts and circumstances surrounding Hillside Health Center, which is not related to the grounds for issuance of this LDP.

Govt. Ex. 2. (emphasis added).

The Government cannot have it both ways. Ms. Connolly could not have made it more clear that the delinquency referred to by the Government is not a ground upon which the LDPs were issued. Indeed, based on this statement Respondents could not have reasonably anticipated that they would have to defend against allegations of financial incapacity at the LDP hearing.¹⁰

Absent evidence of incompetence or financial incapacity, we are left with the remaining theory, i.e., that Respondents presently lack integrity. The Government has the burden to demonstrate Respondents’ purported present lack of integrity by “adequate evidence.” The Government has failed to satisfy this burden.

First, Mr. Maggiacomo’s legal position was not so blatantly incorrect as to indicate that it was made in bad faith or for improper motives. While I have concluded that the language of the Regulatory Agreements proscribe the creation of a security interest in the form of pledge (transfer of a conditional right) without HUD’s prior notice and permission, it is a close question, and I have located no case directly on point. I interpreted Respondents’ legal position to be that either: 1) the Regulatory Agreements did not prohibit the creation of rights which could not be exercised until and unless a subsequent event occurred; or 2) “rights” do not come into existence until the subsequent condition occurs. These are not unreasonable or irresponsible interpretations of the word, “rights” as used in the Regulatory Agreements.

¹⁰Additionally, in its Post-hearing Brief, the Government has referred to the 1999 DEPCO judgment as raising questions about Respondents “business dealings.” Govt. Post-hearing Brief at p. 19. Like the Hillside Health Center mortgage delinquency, this claim was not charged in the LDPs and, accordingly, Respondents were not provided with notice of this allegation. As a result, I have not considered this claim.
Second, the record fails to demonstrate that Respondents acted in bad faith or with improper motives. From the fact that at the November 12, 2002, meeting HUD discovered their existence only after requesting a review of the documents governing Respondents' relationship with DEPCO, the Government infers that Respondents illegally concealed the creation of the security interests. The Government’s belief that the Respondents’ lack integrity is illustrated by the statement in their Post-hearing brief that: “Once HUD caught them red-handed trying to get away with something illegal, they did what they did to avoid trouble,” i.e., executing the Third Amendment to the Pledge Agreements. Govt. Post-hearing Brief at p. 19. While this is a permissible inference, another equally valid inference can be drawn that the parties did not provide HUD notice of the security agreements because they reasonably believed that they were not required to do so. The inference the Government draws is unsupported by any “evidence” of wrongdoing and, under these circumstances, this mere inference does not constitute “adequate evidence.” In any event, the Government’s inference is refuted by the credible testimony of Mr. Maggiacomo and the written statements of Mr. Dolan that they were well aware of HUD’s rights and that these would be protected by DEPCO. Mr. Maggiacomo honestly interpreted the Regulatory Agreements as not requiring notification and prior permission. In response to my asking the reason he did not notify HUD, he credibly testified:

Your Honor, having lived and gone through this experience, I don’t know why. I mean we should [have] brought them in but [I] just never thought that it was necessary because we are not, nothing we did, in my opinion, involved the previous participation clearance requirement, and there was never, and as far as I know, I can’t answer for why Mr. Dolan or DEPCO never contacted HUD, I mean they were free to do it. We never said to them don’t do it, that was never an issue. I mean if I had the foresight to understand what HUD’s reaction to what I thought was a non-problem, obviously we would have said it from the beginning.

Tr. p. 140.

Mr. Maggiacomo’s testimony reveals that he made a good faith effort to interpret the Regulatory Agreements based upon his 40 years of experience with commercial law, not that Respondents were intentionally concealing the security agreement from HUD in knowing violation of HUD requirements. As he points out, DEPCO (a State agency) was free to inform HUD of the arrangement. Mr. Maggiacomo and Mr. Nolan were well aware that HUD had interests that DEPCO could not alter.
Third, the fact that Respondents took corrective action to insure that HUD’s rights were protected as soon as HUD made its position clear does not support the Government’s contention that Respondents engaged in willful misconduct.

I further conclude that the LDPs were imposed for punitive reasons contrary to HUD regulations. The fact that the LDPs were not imposed until one year after HUD and Respondents executed the Third Amendment to the Pledge Agreements is unexplained. See In the Matter of: C.K.J. Realty and Management, Inc. HUDBCA No. 98-A-111-D8 (Dec. 16, 1998) (Delay of 10 months in imposition of LDP following discovery of the violation supported inference that there were no imminent threat to the public). In denying Respondents’ appeals of the LDPs, Ms. Connolly stated: “This violation is not cured by the fact that when the violation was ultimately discovered, you agreed to take steps to ensure that HUD’s interests were protected.” Ms Connolly’s statement reveals that Respondents acted responsibly when they took steps to protect HUD’s interests. We are not told what if any additional actions Respondents could or should have taken to effect that “cure.” Finally, no lesser sanction was evidently considered. If it was, no reason is given for its rejection.

I conclude that: 1) the lack of adequate evidence for the LDPs; 2) the unexplained delay in imposing them; 3) HUD’s refusal to recognize Respondents’ willingness to comply with HUD requirements; and 4) HUD’s failure to consider lesser sanctions indicate that the LDPs were imposed as a punishment. Accordingly the LDPs violate HUD regulations.

**RECOMMENDED DECISION**

Although cause exists for having issued the LDPs, the Government has failed to demonstrate by adequate evidence that Respondents lack present responsibility. The record further demonstrates that the LDPs were imposed as a punishment. I therefore recommend that they be immediately rescinded.

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WILLIAM C. CREGAR
Administrative Law Judge