

UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF ADMINISTRATIVE LAW JUDGES

In the Matter of:

JEFFREY J. WIRTH,
THE WIRTH COMPANIES, and
THE SMALL BUILDING
REDEVELOPMENT CORP.,

Respondents.

HUDALJ 93-1941-DB(LDP)
Decided: February 10, 1994

Kenneth Hertz, Esq.
For the Respondent

Michael Kalven, Esq.
For the Government

Before: THOMAS C. HEINZ
Administrative Law Judge

DECISION AND ORDER

Statement of the Case

This proceeding arose pursuant to 24 C.F.R. § 24.700 *et seq.* as a result of action taken by Thomas T. Feeney, the Manager of the Minneapolis-St. Paul Office of the U.S. Department of Housing and Urban Development ("the Department" or "HUD"), on June 15, 1992, and modified on November 10, 1992, imposing a twelve-month Limited Denial of Participation ("LDP") upon Respondents. The LDP prohibited Respondents from engaging directly or indirectly in the Department's property disposition programs within Minnesota. Pursuant to Respondents' request, an informal conference was held on October 23, 1992; and on November 10, 1992, the Manager of the Minneapolis-St. Paul office narrowed the scope of the LDP so that Respondents were excluded only from participating as a broker, agent, or representative in the Department's property disposition programs within the state of Minnesota (*see* 24 C.F.R. § 24.710(a)(3)). According to Mr. Feeney, the LDP was based on Respondent Wirth's failure to transmit \$500 due the Department from his broker's trust account.

On December 4, 1992, Respondents appealed the imposition of the LDP and requested a hearing (see 24 C.F.R. § 24.713). A hearing was held in Minneapolis on April 6, 7, and 8, 1993, at the close of which the parties were directed to file briefs. The last of those briefs was received on August 6, 1993, approximately seven weeks after the LDP expired, pursuant to its terms, on June 15, 1993. The parties filed supplemental briefs pursuant to Order on November 22 and November 29, 1993.

Findings of Fact

1. Jeffrey J. Wirth ("Respondent Wirth") is president of the Small Building Redevelopment Corporation ("Respondent SBRC"). Respondent Wirth is also chief executive officer, president, and owner, with his wife, of The Wirth Companies ("Respondent TWC") (GX.1)¹. All three Respondents are in the real estate business.
2. On February 27, 1992, Respondent Wirth, acting in his capacity as president of Respondent SBRC, submitted a bid to purchase a HUD residential property at 677-679 Lowry Avenue, N.E., Minneapolis, Minnesota. Respondent TWC acted as the broker in the transaction. According to the terms of the purchase contract, Respondent SBRC paid an earnest money deposit of \$500 to Respondent TWC. (GX.1)
3. The Sales Contract provides in part that "[s]hould Purchaser refuse or otherwise fail to perform in accordance with this contract, including the time limitation, Seller may, at Seller's sole option, retain all or a portion of the deposit as liquidated damages." (GX.1, para. 12)
4. Before Respondent Wirth submitted his bid on the 677-679 Lowry property, he inspected the exterior of a building that he mistakenly thought was the building at 677-679 Lowry. He inspected the wrong property. (TR.363)
5. HUD informed Respondent Wirth the next day, February 28, 1992, that his bid on the 677-679 Lowry property had been accepted. (TR.364) Three days later, on March 2, 1992, Respondent Wirth discovered his mistake: he had bid on a property that he did not want. (TR.365; GX.6)
6. On March 3, 1992, in an attempt to cancel the sale, Respondent Wirth spoke with the HUD property specialist in charge of the Lowry property, Mr. Duvlea, who informed Respondent Wirth that the paperwork had already been processed and the contract was entered into the system. Mr. Duvlea told Respondent Wirth that if he

¹The following reference abbreviations are used in this decision: "TR." for "Transcript"; "GX." for "Government's Exhibit"; and "RX." for "Respondents' Exhibit."

wanted to cancel the sale he would have to file an executed "Cancellation of Purchase Agreement." Mr. Duvlea warned Respondent Wirth that he might be required to forfeit his earnest money. (TR.291)

7. When Mr. Duvlea tried to determine how Respondent Wirth could have made his mistake, he discovered that the property at 677-679 Lowry was selling for \$35,900, that the address in the HUD newspaper advertisement was correct, and that a HUD "For Sale" sign had not been posted on the property that Respondent Wirth inspected. Respondent Wirth had inspected a double bungalow offered for sale for approximately \$135,000 by a Minnesota agency, MCDA, that had posted its distinctive sign on the property. (GX.2, 4; RX.5; TR.302)

8. In February of 1988 Respondent Wirth signed, on behalf of TWC, a document entitled, "Agreement to Abide by HUD's Earnest Money Policy," which provides in part:

As a condition of participation in HUD's single family property sales program, I agree to abide with that Department's earnest money policy....I understand that I am acting as an agent for HUD and as their trustee for the funds so collected and deposited....I agree to comply immediately with HUD's instructions for the ultimate disposition of each earnest money deposit. Such instructions may include forwarding to HUD all or a portion of the earnest money as forfeit under HUD's forfeiture policy. I agree to explain fully to each purchaser, prior to a contract being written, HUD's earnest money forfeiture policy and extension policy.

(GX.8.)

9. HUD's earnest money policy provides that all of the earnest money will be returned to the investor-buyer upon cancellation of a sale if, and only if, the buyer has unsuccessfully sought to obtain FHA-insured financing for the property. Under the policy, if the buyer does not pay the earnest money, payment is sought from the broker. (TR.259-60)

10. The Sales Contract on 677-679 Lowry submitted by Respondent Wirth on February 28, 1992, mistakenly indicated that the purchaser would be applying for an FHA-insured loan. (GX.1; RX.2; TR.380) The person responsible for that mistake cannot be identified.

11. Despite repeated requests from the Government, Respondents have refused to turn over the \$500 earnest money to HUD.

Subsidiary Findings and Discussion

An LDP is a type of debarment. The purpose of all debarments imposed by agencies of the Federal government, including debarments, suspensions and LDPs imposed by HUD, is to protect the public interest by precluding persons who are not "responsible" from conducting business with the federal government. 24 C.F.R. § 24.115(a). See also *Agan v. Pierce*, 576 F. Supp. 257, 261 (N.D. Ga. 1983); *Stanko Packing Co., Inc. v. Bergland*, 489 F. Supp. 947, 948-49 (D.D.C. 1980). The debarment process is not intended to punish; rather, it is designed to protect governmental interests not safeguarded by other laws. *Joseph Constr. Co. v. Veterans Admin.*, 595 F. Supp. 448, 452 (N.D. Ill. 1984). In other words, the purpose of debarment is remedial, not punitive. See 24 C.F.R. § 24.115.

In the context of debarment proceedings, "responsibility" is a term of art that encompasses integrity, honesty, and the general ability to conduct business lawfully. See 24 C.F.R. § 24.305; *Gonzalez v. Freeman*, 334 F.2d 570, 573 & n.4, 576-77 (D.C. Cir. 1964). Determining "responsibility" requires an assessment of the current risk that the government will be injured in the future by doing business with a respondent. See *Shane Meat Co., Inc. v. U.S. Dep't of Defense*, 800 F.2d 334, 338 (3d Cir. 1986). That assessment may be based on past acts. See *Agan*, 576 F. Supp. 257; *Delta Rocky Mountain Petroleum, Inc. v. U.S. Dep't of Defense*, 726 F. Supp. 278 (D. Colo. 1989).

Section 24.700 of 24 C.F.R. authorizes HUD office managers to impose an LDP on participants in HUD programs based on adequate evidence of, among other things:

Irregularities in a participant's or contractor's past performance in a HUD program; [or]

Failure to honor contractual obligations or to proceed in accordance with contract specifications or HUD regulations...

24 C.F.R. § 24.705(a)(2) and (4). "Adequate evidence" is "[i]nformation sufficient to support the reasonable belief that a particular act or omission has occurred." 24 C.F.R. § 24.105. Respondent TWC admittedly failed to obey HUD's instructions concerning the disposition of Respondent SBRC's earnest money deposit on the 677-79 Lowry property. In other words, Respondent TWC admittedly failed to honor obligations incurred in the 1988 agency contract, the "Agreement to Abide by HUD's Earnest

Money Policy." That failure constitutes cause for issuance of an LDP. However, an LDP is a discretionary action that must be taken only in the best interests of the Government. See 24 C.F.R. §. 24.700. It is therefore necessary to examine the circumstances of the violation.

There are three separate Respondents in this case, two of which are corporations. But the formalities of the corporate structure cannot be allowed to hide reality. Respondents TWC and SBRC are closely held corporations entirely owned and operated by Respondent Wirth and his wife. Respondent Wirth is, in effect, the owner-operator of both companies. Piercing the corporate veils reveals only one real party in interest in this case, and that is Respondent Wirth.

This case arises out of a conflict of interest inherent in the fact that Respondent Wirth simultaneously acted as both agent for the seller and agent for the buyer of realty.² The agency contract between Respondent TWC and HUD required TWC to collect the earnest money and turn it over to HUD, the seller, upon request. As an agent for HUD, the principal, Respondent TWC was obligated to act in the interest of its principal and follow HUD's instructions regarding the earnest money. On the other hand, turning the earnest money over to the seller obviously would be contrary to the interest of the buyer, Respondent SBRC, and Respondent Wirth is an agent of that corporation.

According to a letter dated November 19, 1992, sent to Respondents by a representative of the Minnesota Department of Commerce:

Whenever there is a dispute as to the disbursement of earnest money funds, the Broker is required to hold the funds in a trust account until either both parties mutually agree as to the disbursement of the funds or a judge makes a ruling in a court of law. [RX.7]

If the representative of the Minnesota Department of Commerce properly characterized Minnesota law, Respondent TWC could not obey HUD's forfeiture demand without violating state law, since according to the Department of Commerce letter, a broker cannot release earnest money funds to the seller if the buyer objects, and the buyer, Respondent SBRC, objected. Citing this obvious conflict, Respondents argue that the Government's forfeiture demand puts them in a "catch-22" situation where they could be

²Nothing in the record suggests that HUD violated any rule or regulation by permitting the same real party in interest to act simultaneously as agent for both buyer and seller.

subject to state penalties for violation of state law if they comply. Respondents argue further that Congress did not intend HUD in the administration of its property disposition program to preempt state or local laws regulating real estate brokers, and that HUD should not impose a sanction for behavior required by state law. However, analysis of Minnesota law reveals that the letter dated November 19, 1992, sent to Respondents by the Minnesota Department of Commerce mischaracterized Minnesota state law regarding earnest money funds in the hands of real estate brokers. Accordingly, there is no conflict between state law and HUD's administration of the property disposition program.³

Chapter 82 of the Minnesota Statutes sets out the obligations of real estate brokers to buyers and sellers of real property. Section 82.24 provides in relevant part:

All trust funds received by a broker or the broker's salespeople shall be deposited forthwith upon receipt in a trust account, maintained by the broker for such a purpose, in a bank, savings and loan association, credit union, or an industrial loan and thrift company with deposit liabilities designated by the broker or closing agent, *except as such money may be paid to one of the parties pursuant to express written agreement between the parties to a transaction...*[emphasis added]

Minn. Stat. § 82.24 (1992). The term "trust funds" as used in this provision covers all earnest money payments held in escrow by the broker. See Minn. Stat. § 82.17 subd. 7 (1992).

Administrative rules promulgated to regulate real estate brokers pursuant to Minn. Stat. § 82.28 provide in part that "[t]rust funds shall be maintained in a trust account until disbursement is made in accordance with the terms of the applicable agreement...." Minn. R. 2805.0500 subp.2 (1992). Neither the statutory nor the regulatory provisions of Minnesota law support the assertion in the Department of Commerce letter dated November 19, 1992, that under Minnesota law whenever a dispute arises between the purchaser and seller regarding earnest money in escrow, those funds cannot be disbursed *until* the dispute has been resolved. That assertion would be true only if the

³Although it has been clear since the oral hearing that much of Respondents' defense relies on the characterization of Minnesota law by the Department of Commerce, the Government failed to analyze the state law in both the initial and the supplemental briefs. Instead, the Government has rested upon a bald assertion that there is no conflict between HUD's program and the state law. The Government's failure to analyze state law has delayed resolution of this matter. Moreover, counsels' insistence that Respondents be "put to proof regarding" the state law ignores the juridical principle that facts, not laws are subject to "proof."

sales contract did not contain an agreement regarding disposition of the earnest money. When a dispute regarding earnest money arises *after* the parties have reached a written agreement concerning its disposition, as here, the trustee of the earnest money funds, the broker, is obligated to follow the terms of the agreement that preceded the dispute. HUD, Respondent SBRC, and Respondent TWC agreed in writing that:

Should Purchaser refuse or otherwise fail to perform in accordance with this contract, including the time limitation, Seller may, *at Seller's sole option*, retain all or a portion of the deposit as liquidated damages. [emphasis added]

(GX.1, para. 12) In other words, when as broker and purchaser Respondent Wirth entered into the sales contract with HUD, he agreed that HUD would have control of the earnest money. Furthermore, Respondent Wirth as purchaser unquestionably refused to perform in accordance with the contract: he canceled it. Accordingly, under the terms of the written sales agreement, Respondent Wirth as broker was obligated to obey the seller's instructions regarding disbursement of the earnest money. In his capacity as broker to the transaction, Respondent Wirth did not have the authority to decide that the sales contract was unenforceable and that he could therefore disobey the seller's instructions. And when Respondent Wirth as purchaser initialled paragraph 12 of the contract quoted above, he specifically agreed that the earnest money would be handled according to HUD's instructions. In sum, there is no "catch-22" situation here. Respondent Wirth, both as purchaser and as broker, agreed that he would follow HUD's instructions regarding the earnest money. He has reneged on that agreement, to which he was bound whether or not the sales contract was enforceable. In any event, the sales contract was enforceable.

The Sales Contract Was Enforceable

Respondent Wirth bid on the 677-679 Lowry property by mistake. He believed he was bidding on a different property. However, the mistake was entirely his own--a unilateral mistake that cannot be attributed to HUD. The address that appeared in the advertisement of the property, in the sales contract, and on the property itself was correct. (GX.1, 2; TR.302, 345) Both parties believed Respondent SBRC was bidding on 677-679 Lowry, and the contract was not tainted by fraud or misrepresentation. If there is a meeting of the minds of both parties upon the terms of a contract, and those terms are free from ambiguity, and there is no fraud or misrepresentation, a mistake of one of the parties alone, resting wholly in his own mind as to the subject matter of the contract, is no grounds for rescission. *Stong v. Lane*, 68 N.W. 765, 66 Minn. 94 (1896); FAR 14,406-4(c). The buyer is bound by his own inspection, whether complete or partial. *American Rag Co. v. United States*, 161 F. Supp. 414 (Ct. Cl.

1958); *Miller v. United States*, 241 F.2d 781 (2d Cir. 1957); *In re Coffield*, 64 BCA 4424 (1964) (where government was able to prove that at the time contractor inspected bus it was without a motor, even though the size and make of the motor was described in government sales catalogue, recovery was denied to contractor) .⁴

The District Court in *Devil's Lake v. Ins. Comp.*, 497 F. Supp. 595 (D.N.D. 1980), set out four prerequisites for obtaining relief from a unilateral mistake: (1) the mistake must have occurred despite the exercise of ordinary care; (2) the mistake must relate to the substance of the consideration; (3) the mistake was so serious that enforcement would be unconscionable; and (4) it must be possible to place the other party in the status quo ante. Respondent Wirth's mistake did not satisfy even the first of the four prerequisites for relief: the mistake did not occur despite the exercise of ordinary care. Although the evidence shows that because of anomalies in the numbering and signing of Minneapolis streets, more than one person has found his way to the wrong property

when searching for 677-679 Lowry, an experienced real estate professional like Respondent Wirth should have known that something was significantly wrong when he saw the property that he thought was 677-679 Lowry. It was unreasonable to believe that an obviously new double bungalow with attached garages, central air-conditioning, daylight basements, and brick trim would be on the Minneapolis market for only \$35,900. (TR.288, 302; GX.3, 19) In fact, the property was on the market for around \$135,000, nearly four times the asking price for the property at 677-679 Lowry. (TR.302) This was a classic "too-good-to-be-true" situation.

⁴See also 17 Comp. Gen. 560, 562 (1938):

The general rule is that when there has been a mistake in a bid on which a contract is based, the contractor must bear the consequences thereof. In order to authorize relief on account of a mistake in an accepted bid, it must appear that the mistake was mutual or that the error was so apparent that it must be presumed the contracting officer knew of the mistake at the time of acceptance and sought to take advantage thereof.

The mistake in the instant case was not mutual or apparent to HUD's contracting officer.

Furthermore, HUD's newspaper advertisement referred to off-street parking, not attached garages, and did not mention central air-conditioning, even though both features are commonly recognized as major selling points. In addition, a distinctive "for-sale" sign from a Minnesota agency was posted on the property rather than HUD's sign of the same color but different text; there was no lock-box, contrary to HUD's standard practice, which Respondent Wirth must have known through long experience with HUD's property disposition program; and the advertisement characterized the property as a "duplex," not a double bungalow.⁵ (TR.288) Despite all the indications that something was seriously amiss, Respondent Wirth did not seek to confirm the location of the property but instead rushed to submit his bid without even inspecting the interior of the building. The evidence suggests that Respondent Wirth thought that HUD had made a mistake of which he hoped to take advantage. It turned out that it was he who had made the mistake.

Both the Government and Respondents cite *Stong v. Lane*, 68 N.W. 765, the 1896 Minnesota case cited above. In *Stong* the court held that a land sale contract was unenforceable because the parties had not had a meeting of the minds regarding the subject of the contract, the same reason Respondent Wirth has cited from the beginning of this controversy as grounds for rescission. In the *Stong* case, the vendee, relying on the vendor's description of the location of a vacant building lot, inspected the wrong property before he made an offer to buy. The court found that "while the description given by the defendant was probably sufficient in law to identify the property, it was an exceedingly informal one, and one very liable to be misunderstood." *Id.* at 98, 68 N.W. at 767. In contrast to *Stong*, in the instant case the property was not described merely in terms of its location. The advertisement described a piece of improved real estate, and set out several of its salient features. The description was not exceedingly informal, and it accurately portrayed the property for sale. Further, the property that Respondent Wirth viewed did not match the description in the advertisement. In sum, I find that, taken as a whole, the description of 677-679 Lowry in HUD's advertisement was not "one very liable to be misunderstood" by an experienced real estate professional exercising ordinary care. Respondent Wirth's mistake therefore cannot be excused. The sales contract was enforceable, and the \$500 earnest money is due and owing HUD as liquidated damages.⁶

HUD Made No Counteroffer

⁵According to HUD's expert, in real estate parlance, the property Respondent incorrectly thought was 677-679 Lowry should be described as a "double bungalow," not a "duplex." (TR.299)

⁶According to HUD's earnest money policy, set out at 24 C.F.R. § 291.135 of the regulations, the "failure by an investor purchaser to close on an uninsured sale will result in forfeiture of the entire earnest money deposit." Whether or not Respondents were aware of that policy before this case arose, they are subject to its terms as a matter of law because the policy is codified in a duly promulgated regulation.

According to Respondent Wirth, when he submitted the bid on the 677-679 Lowry property, he left blank the boxes in section 4 of the contract form supplied by HUD indicating how he intended to pay for the property, even though he in fact intended to pay cash. (TR.380) However, someone placed a check mark in the "cash" box, crossed it out, and placed a check mark in the box indicating an intent to apply for HUD/FHA insured financing. (GX.57) Respondents contend that the changes were made by HUD and that they constitute a counteroffer that was never accepted, rendering the agreement unenforceable. This argument has no merit. The two HUD employees primarily responsible for handling the contract deny that they made these changes, and neither the identity of the person responsible for the changes nor the time when they were made can be determined from the record.⁷ In any event, even if a HUD employee made the changes in the contract form without authorization from Respondent SBRC, the contract remained enforceable. Section 286(1) of the *Restatement (Second) of Contracts* provides

If one to whom a duty is owed under a contract alters a writing that is an integrated agreement or that satisfies the Statute of Frauds with respect to that contract, the duty is discharged if the alteration is fraudulent and material.

The Comment to this section observes that an "alteration that is not *both* fraudulent and material does not have this effect and the duty remains enforceable according to its original terms." (emphasis supplied) Respondents do not argue, and the record is far short of proving, that the alterations were fraudulent. Having reached this conclusion, it is unnecessary to determine whether the alterations to the contract form were also material. Accordingly, I find that the sales contract between HUD and Respondents imposed enforceable duties and obligations upon the parties. Respondent Wirth failed to fulfill his obligations under that contract, thereby giving HUD cause to issue an LDP. The record contains no evidence to mitigate the offense.

Conclusion

Upon careful consideration of the record, I conclude that the manager of the Minneapolis-St. Paul Office of HUD exercised sound discretion in the best interests of the

⁷The Government persuasively argues that from HUD's perspective it is immaterial how a purchaser pays for a property, and that there is therefore no incentive for a HUD employee to alter section 4 of the contract form without authorization from the bidder.

Government when he issued the LDP against Respondent Wirth and his affiliates on June 15, 1992.

THOMAS C. HEINZ
Administrative Law Judge

Dated: February 10, 1994.