

Drug-Use--Cooperative Occupancy Agreement

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Subject: Drug-Use--Cooperative Occupancy Agreement

March 15, 1993

MEMORANDUM FOR: William W. Hill, Director, Operations
Division, HMHO

FROM: David R. Cooper, Assistant General Counsel,
Multifamily Mortgage Division, GHM

SUBJECT: Addendum for Occupancy Agreement - River Oaks
Towne Houses Cooperative

This responds to your request regarding a proposed addendum ("Addendum") to an occupancy agreement ("Occupancy Agreement") for the River Oakes Towne Houses Cooperative ("Cooperative"). (Attachments A and B.) We understand that the Cooperative is a management type cooperative with a mortgage insured by the Department under section 213 of the National Housing Act ("Act"). The Cooperative is not otherwise assisted or subsidized by the Department.

We understand that the Board of Directors of the Cooperative submitted the Addendum to the Department for approval.¹ The Board of Directors has itself approved the Addendum and proposes to use it with respect to all future move-ins. The Cooperative ultimately plans to incorporate the Addendum into the Occupancy Agreement itself. The Addendum deals with criminal activity, including drug-related criminal activity. More specifically, the Addendum provides that any member of the Cooperative, member of the Cooperative's household, guest, or other person under a member's control, shall not engage in criminal activity (including drug-related criminal activity), or engage in any act intended to facilitate any such criminal activity, on or near any property owned by the Cooperative. The Addendum further provides that any violation of the foregoing prohibitions shall be considered a material breach of the terms of the Occupancy Agreement, and the Cooperative shall have the right to terminate a member's right of occupancy thereunder.

Regional Counsel for Region V previously reviewed the Addendum and withheld legal approval of it. (Attachment C.)

¹ 24 C.F.R. 213.29 and Handbook 4550.1, "Basic Cooperative Housing Insurance Handbook," 3-1, and Handbook 4550.2, "Pre-sale-Management Type Cooperatives," 5-19(b), prescribes use of a HUD-approved Occupancy Agreement.

Regional Counsel noted that members in a Cooperative have both ownership and occupancy interests. Further, Regional Counsel had two main objections to the Addendum, namely, that it appeared to terminate a cooperative owner's occupancy and membership rights without due process, and that it did not establish (in paragraph 6 thereof) what would happen to a member's membership certificate and membership rights in the event the Cooperative acted under the Addendum to terminate a member's right to occupancy.

Your incoming request forwarded a copy of the Addendum to this office, and also called our attention to the Regional Counsel's objections to it. You further asked if there is currently an acceptable addendum on this matter, i.e., termination of cooperative ownership because of unlawful activities such as drug-related criminal activity.

To begin, this office is not aware of an existing acceptable HUD-approved addendum on this issue for cooperatives.² (As discussed later in this memorandum, the Department has approved language on drug-related criminal activity for use in leases for subsidized rental projects.) However, this does not end our inquiry because we are not certain that (as initially determined by the Regional Counsel) the Addendum itself is legally unacceptable. To make such a determination two issues must be considered. First, whether approval of the Addendum by HUD, and implementation and enforcement thereof by the Cooperative, could result in a violation of a member's right to due process of law. Second, if we conclude that the Addendum does not raise due process problems, whether the proposed Addendum is legally acceptable to the Department as it is presently drafted. (Whether it is administratively acceptable is a determination for you to make.) As set forth in detail below, we believe that, subject to the conditions set forth in the "Conclusion" section of this memorandum, the Department may approve the Addendum.

² The Department's Model Form of Occupancy Agreement does not contain language relating to drug-related criminal activity. See Appendix 1-8 of Handbook 4550.1 and Appendix 2-22 of Handbook 4550.2. We do note, however, that Article 5 of said Model Form does provide that members of the Cooperative shall not "commit or permit any nuisance on the premises or commit or suffer any immoral or illegal act to be committed thereon." Although the Handbook permits HUD-approved variations to its model forms of the organizational documents for insured cooperatives, in this case Article 5 of the Cooperative's Occupancy Agreement follows the Model Form as to the quoted language in this footnote. See 3-1 and 3-2 of Handbook 4550.1 CHG.

Due Process Concerns

First, we deal with the issue of due process. The issue at hand is one of procedural due process, i.e., the guaranty of procedural fairness where government action would deprive a person of life, liberty, or property without procedural safeguards, such as notice and a fair hearing. In this regard, the guaranty of due process found in the Fifth Amendment of the Federal Constitution declares that no person shall "be deprived of life, liberty, or property, without due process of law; ..." U.S. CONST., amend. V. The Fourteenth Amendment to the Constitution similarly binds the states, providing "nor shall any State deprive any person of life, liberty, or property, without due process of law; ..." U.S. CONST., amend XIV, 1.

In general, the protection of the due process clauses of the Fifth and Fourteenth Amendments can be invoked only when the action complained of constitutes federal or state action, respectively. 16C C.J.S. 955. Accordingly, the due process clause of the Fifth Amendment applies to actions of the federal government, not those of private individuals. *Gerena v. Puerto Rico Legal Services, Inc.*, 697 F.2d 447, 449 (1st Cir. 1983) citing *Public Utilities Commission v. Pollak*, 343 U.S. 451, 461 (1952). Therefore, in the matter at hand, any member's potential claim for a violation of due process rights under the Fifth Amendment can only stand if approval of the Addendum by HUD, and use of the Addendum by the Cooperative, constitutes "federal action."

There are two legal decisions which lend support to the notion that such steps, i.e., HUD's approval of, and the Cooperative's use of, the Addendum would not lead to a due process claim being successfully asserted by a member of the Cooperative whose occupancy or membership rights were terminated under the terms of the Addendum. In the first case, *Blum v. Yaretsky*, 457 U.S. 991 (1982), the Supreme Court found that, despite extensive state regulation, funding and licensing, the State of New York could not be held responsible for the decisions of private nursing homes to discharge or transfer Medicaid patients without notice or an opportunity for a hearing.³ The court found that the

³ *Blum* deals with the due process requirements of the Fourteenth Amendment and, therefore, of state rather than federal action. However, the standards used for determining the existence of federal government action under the Fifth Amendment are identical to those used for finding state action under the Fourteenth Amendment. *Gerena* at 449. See also *Miller v. Hartwood Apartments, Ltd.*, 689 F.2d 1239, 1243 (5th Cir. 1982); *Warren v. Government National Mortgage Association*,

nursing homes' decisions to transfer or discharge their patients were decisions of private parties, and as such did not involve state action.⁴

Of particular significance to the matter at hand is the Fifth Circuit Court of Appeal's application of the principles of Blum in the case *Miller v. Hartwood*, 689 F.2d 1239 (5th Cir. 1982). As noted, the Blum case dealt with state action under the Fourteenth Amendment. However, in *Miller* the court applied the principles of Blum to determine whether federal action was present where tenants were evicted from a HUD Section 8 new construction apartment complex. *Miller* at 1242 and 1243. Significantly, the court found that there was no federal action present. Therefore, the plaintiff tenants could not successfully assert that their rights to due process had been violated by the termination of tenancy and eviction.

In *Miller* a private corporation owned and operated a Section 8 new construction apartment project pursuant to 42 U.S.C. 1437f and 24 C.F.R. Part 880. *Id.* at 1240. All of the tenants leased their apartments from the project owner pursuant to a standard HUD Section 8 new construction

611 F.2d 1229, 1232, cert. denied, 449 U.S. 847 (1980); *Geneva Towers Tenants Organization v. Federal Mortgage Investors*, 504 F.2d 483, 487 (9th Cir. 1974).

⁴ In *Blum* the court noted three principles to consider when deciding whether state action exists. First, the court found that the complaining party has to demonstrate "a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself." *Blum* at 1004. Further, regulation by the State "does not by itself convert a business' action into that of the State for purposes of the Fourteenth Amendment." *Id.* Second, the court found that a "State normally can be held responsible for a private decision only when it has exercised coercive power or has provided such significant encouragement, either overt or covert, that the choice must in law be deemed to be that of the State." *Id.* Significantly, "mere approval of or acquiescence in the initiatives of a private party is not sufficient to justify holding the State responsible for those initiatives under the terms of the Fourteenth Amendment." (emphasis added). *Id.* at 1005. Third, the required nexus to make a private entity's action into state action might be present if the private party "has exercised powers that are traditionally the exclusive prerogative of the State." *Id.*

lease agreement. Id. After moving into their apartment, the plaintiff tenants developed problems with the project manager. Id. at 1241. The project owner sent a notice to the tenants advising them that they were in material noncompliance with their lease and advising them that failure to comply in the future would result in eviction. Id. After the tenants allegedly failed to appear at an informal meeting, they were sent a second notice advising them that their tenancy would be terminated in 30 days because they continued to be in substantial noncompliance with their lease. Id. As they refused to vacate, they were evicted pursuant to state court proceedings. Id.

In Miller the court applied the principles of Blum and found that the owner's nexus with the federal government, i.e., HUD, did not amount to a nexus sufficient to support the tenants' claim that there was federal action in the eviction. In reaching its conclusion, the court emphasized the private operation of the project. It pointed out that under the program's governing statute owners had sole responsibility for "all ownership, management, and maintenance responsibilities, including the selection of tenants and the determination of tenancy ..." Id. at 1243. Also, it was the owners, and not HUD, who oversaw compliance with the lease provisions. Id. at 1244. The court acknowledged that HUD regulations "establish the broad guidelines" with which the owners must comply. Id. Nevertheless, it found that it is the owners who "operate the projects on a day-to-day basis and are, in all senses of the word, private owners." Id.

We believe that the Miller case offers support for the notion that HUD approval of, and the Cooperative's use of, the Addendum would not result in a due process claim being successfully asserted by a member whose occupancy and membership rights were terminated under the Addendum. Under Miller, the Department could argue that there is no federal action implicated by a termination of such rights and, therefore, no supportable cause of action for a violation of the due process clause of the Fifth Amendment.

In this regard, we think that the court's general focus in Miller, namely, on the day-to-day private operation of the project, is applicable to the Cooperative. Basically, the court in Miller found that control over the terms of tenancy rested with the owners of the project. HUD did not get involved in, or approve of, individual questions of

tenancy and eviction.⁵ We do agree that the Department's position in Miller may have been strengthened by the fact that the program's enabling statute expressly vested ownership, management and maintenance responsibilities, including determinations of tenancy, with the owners. However, the more relevant point is that the section 213 mortgage insurance program operates along these same lines. We found no indication in the section 213 statute, regulations or handbooks that HUD would be involved in the termination of an individual member's occupancy or membership rights under the Addendum (or, for that matter, under the Occupancy Agreement in general). Also, we note that in Miller the owner acted pursuant to HUD standard lease forms, as well as HUD regulations that outlined conditions for termination of tenancy. *Id.* at 1243. However, in the case at hand, the Addendum does not reflect the use or implementation of a HUD-mandated form or requirement. Instead, HUD is merely being asked to approve of an endeavor advanced by a private owner. As the Supreme Court stated in Blum "mere approval of or acquiescence in the initiatives of a private party" is not enough to hold the government responsible for those initiatives under the due process clauses of the Constitution.⁶ Blum at 1005.

Nevertheless despite our view that Miller and Blum offer a reasonable argument to support the legal adequacy of the Addendum, there is still risk that a court could find federal action in connection with approval and use of the Addendum and, therefore, that due process requirements are applicable to terminations under it. First of all, the Miller decision only covers the Fifth Circuit. Accordingly, another Circuit could take a different position. Second, we note that the Department mandates a form of Occupancy Agreement for use in the section 213 mortgage

5 In Miller it was noted that "if the apartments had been staffed by government-paid personnel, or if the questions of tenancy and eviction were required to be submitted for governmental approval," the issue (and possibly the conclusion of the court) could be different. Nevertheless, it is clear that the Cooperative is not staffed by HUD personnel. Further, individual questions regarding the termination of occupancy or membership rights are not required to be submitted to HUD for review or approval.

6 As noted, Blum involved state action and the Fourteenth Amendment. However, as indicated earlier, the standards for determining federal action under the Fifth Amendment are the same as those for finding state action under the Fourteenth Amendment.

insurance program. See 24 C.F.R. 213.29 and Handbook 4550.1 3-1 and Handbook 4550.2, 5-19(b). Therefore, the Cooperative must obtain Departmental approval to change its Occupancy Agreement to include the Addendum. In view of these circumstances, it is conceivable that a court could find that the Department's involvement exceeded "mere approval of or acquiescence in" the Cooperative's use of the Addendum.⁷ However, to counter such an assertion, the Department could point out that in Miller the court indicated that all tenants used a standard HUD Section 8 new construction lease agreement. Miller at 1240. In addition, the Section 8 new construction program regulations in effect at the time of the Miller decision (as well as now) required HUD approval of lease modifications. See 24 C.F.R. 880.607(d) (1982 and 1992). Further, the fact that the Addendum is subject to Departmental approval, does not preclude the Department from arguing in the instant case that it never directed, encouraged, or coerced the Cooperative to utilize such Addendum. The Department simply allowed the Cooperative to do something that it wished to do.

In addition, we recognize that a court could distinguish the Miller case because Miller involved a rental project. The instant case involves a greater and more tangible property interest, namely, ownership in the Cooperative. However, in terms of the "federal action" issue, we do not believe such a distinction would be dispositive. With regard to assessing whether there is federal action to trigger due process requirements, the critical issue is the degree of federal involvement.

⁷ In the event a court finds that there is federal action, it would look to whether the procedures for termination of occupancy and membership rights under the Addendum are procedurally fair. If the Office of Housing wants to strengthen the fairness of the procedures, it can look to 24 C.F.R. Part 247 (covering evictions in certain subsidized and HUD-owned projects) for guidance. We would be happy to work with your Office if you want to take this approach. However, we must warn you that if you mandate procedural additions to the Addendum, it could increase the likelihood of a court finding that due process requirements apply because there is federal action (i.e., the Government is not merely acquiescing in the initiative of a private party). See footnote 4, supra. Of course, so long as the procedure for terminating rights is a fair one, the question as to whether technically due process requirements apply may not be a major concern to you. Legally, the heart of procedural due process is "fairness."

Recommendation On Due Process

In sum, despite the risk that a court could find distinguishing features between the Miller decision and the circumstances involving the Cooperative, we think that a case can be made, based upon Miller and Blum, that since the proposal to employ the Addendum comes at the initiative of a private party and not the Government, there is no "federal action" triggering any due process requirements. To the extent that a court agreed with this analysis, the Addendum would be legally sustainable as written. Since there is a reasonable argument to support such a result, we have no due process objection to the Department's approval of this Addendum.

General Considerations

We have concluded there is a basis to assert (under Miller and Blum) that the Department's approval of the Addendum, and the Cooperative's use thereof, would not lead to a violation of the due process clause of the Fifth Amendment. Therefore, we need next to consider whether the Addendum is otherwise legally acceptable to the Department in its present form.

First we point out that the Addendum in large part follows a "Drug-Free Housing Lease Addendum" at one time approved for use by the Office of General Counsel at the request of Region IV's Regional Counsel ("Region IV Addendum") for subsidized multifamily rental housing. (Attachment D.) The Region IV Addendum was approved for use by owners of multifamily assisted housing who wished to include or attach it to the form of the Department's Model Lease for Subsidized Programs that appears in Appendix 19a of Handbook 4350.3, "Occupancy Requirements of Subsidized Multifamily Housing Programs," which form was being utilized in their projects. Thus, the language that appears in the Addendum has, in large part, been previously approved for use in assisted rental projects.⁸

⁸ Presently the Office of Housing is actually mandating (rather than just allowing, as was the case with the Region IV Addendum) the inclusion of specific language relating to drug-free housing in the leases of projects which are required to follow the Model Lease for Subsidized Programs. More specifically, said leases are to provide that a landlord may terminate the lease agreement for, among other things: "criminal activity that threatens the health, safety, or right to peaceful enjoyment of the premises by other tenants or any drug-related criminal activity on or near such premises,

Second, in connection with the subject issue and the Cooperative, we need to consider Region V's concern that the Addendum does not delineate (in paragraph 6 thereof) what will happen to a member's membership certificate and membership rights in the event the Cooperative acts under the Addendum to terminate a member's right to occupancy. We agree that both the Addendum and the Cooperative's Occupancy Agreement do not make this clear. This is because the Addendum only speaks to the termination of occupancy rights under the Occupancy Agreement.

Nevertheless, we point out that the Department's Model Form of Occupancy Agreement also does not explicitly state what is to happen if the Cooperative terminates a member's occupancy rights under Article 13 thereof. This is because Section 9 of the Department's Model Form of By-Laws expressly provides a mechanism for the disposition of a member's membership certificate and occupancy agreement in the event the Cooperative terminates the rights of a member under the Model Form of Occupancy Agreement.⁹

The Addendum is, as set forth in paragraph 5 thereof, to be considered a part of the Cooperative's Occupancy

engaged in by a tenant, any member of the tenant's household, or any guest or other person under the tenant's control; ..." See Handbook 4350.3 CHG-22, 4-6. While this language varies from the Region IV Addendum, it continues to make drug-related criminal activity a ground for eviction. We also note that the foregoing policy of the Department does not apply to cooperatives insured under section 213 of the Act. The Department does not mandate the inclusion of language dealing with drug-related criminal activity in the occupancy agreements (or, for that matter, in any of the other organizational documents) for such cooperatives.

⁹ Section 9 of the Model Form of By-Laws, entitled "Termination of Membership for Cause," states that where a corporation, i.e. , a cooperative, terminates the rights of a member under an occupancy agreement, the member must deliver his membership certificate and occupancy agreement to the cooperative. The cooperative will then elect to either: (1) repurchase the membership at the lesser of its "transfer value" (as such term is defined in the By-Laws) or the amount the member originally paid for the membership certificate, or (2) proceed to effect a sale of the membership at a price acceptable to the cooperative. The member shall receive such amount, subject to possible reduction for items like legal and other expenses incurred by the cooperative in connection with the default of the member and resale of his membership. See Appendix 1-11, Handbook 4550.1.

Agreement itself. Therefore, if the Cooperative's By-Laws follow the Department's Model Form of By-Laws, the language of Section 9 of said Model By-Laws would address the concern raised by Region V. Of course, to be certain it will be necessary for the Cooperative to demonstrate that this is in fact the case prior to the Department's granting of approval of the Addendum.¹⁰

There is an additional comment on the Addendum which we would like to make. We note that paragraph 3 of the Addendum refers to and gives examples of "unlawful activities." The Addendum, by its express terms, proscribes (in paragraphs 1 and 2 thereof) "criminal activity, including drug-related criminal activity." Paragraphs 1 and 2 do not use the term "unlawful activities." Accordingly, we assume that the reference in paragraph 3 of the Addendum is an elaboration of the prohibition on "illegal acts" that appears in Article 5 of the Occupancy Agreement. This is because it is clear that all "unlawful" acts are not "criminal" acts and, therefore, could not be covered by the prohibitions of paragraphs 1 and 2. For example, while it may be unlawful to "disturb" other residents, it is not necessarily a criminal act to do so. We have no legal objection to this elaboration of the prohibition against illegal acts that appears in Article 5 of the Occupancy Agreement.

Finally, we have noted in our conclusion below, what appears to be a typographical error in the Addendum.

CONCLUSION

As noted above, we think that a case can be made, under the Blum and Miller decisions, that the Department's approval of, and the Cooperative's use of, the Addendum would not constitute federal action and would, therefore,

¹⁰ Without prejudging the outcome, i.e., that the Cooperative's By-Laws follow Section 9 of the Model Form of By-Laws, we would only note that as presently written, i.e., without the Addendum, Article 13 of the Cooperative's Occupancy Agreement presently contemplates the possible termination of a member's occupancy rights for a number of reasons, such as a member's bankruptcy (Article 13(c)) or a member's default in the performance of obligations under the Occupancy Agreement (Article 13(i)). Therefore, there would seem to be a great flaw in the organizational documents of the Cooperative if they in fact do not currently provide a mechanism to terminate the membership rights and collect the membership certificate in connection with a termination of occupancy rights under the Occupancy Agreement and, therefore, the Addendum, if approved.

not afford a member a basis to successfully assert that a termination of occupancy or membership rights under the Addendum violated the due process requirements of the Fifth Amendment. Of course, as indicated in footnote 7, *supra*, there is always a risk that a court could find federal action in connection with approval and use of the Addendum, and thereby subject a termination effected under the Addendum to due process scrutiny. But, in view of the Blum and Miller decisions we do not withhold legal approval of the Addendum on due process grounds. Nevertheless, in order to fully address the other concerns discussed in this memorandum, the following conditions must be satisfied for the Department to approve the Addendum:

1. The Cooperative must demonstrate that its By-Laws contain language comparable to that in Section 9 of the Department's Model Form of By-Laws in order for the Department to be certain that there is a mechanism in place that will address what will happen to a member's membership rights and membership certificate in the event of a termination of occupancy rights under the terms of the Addendum.

2. In paragraph 5 the reference to "Lease Addendum" appears to be a typographical error. We believe that the correct reference is "Occupancy Addendum" as that is the proper title of the document. This should be pointed out to the Cooperative for their information.