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

In the Matter of: ASSOCIATE TRUST FINANCIAL SERVICES, Respondent	HUDALJ 96-008-CMP Decided: June 18, 1997

V. Peter Markuski, Jr., Esq.
For the Respondent

Felicia R. Lasley, Esq.
For the Government

Before: ALAN W. HEIFETZ
Chief Administrative Law Judge

INITIAL DECISION ON REMAND

Background

On May 5, 1997, the Secretarial Designee issued an Order on Secretarial Review ("Secretarial Order") "modifying and remanding" for further consideration the February 4, 1997, Initial Decision in this civil money penalty action. By Order issued on May 13, 1997, I allowed the parties to file briefs on the issues raised by the Secretarial Order. The Government timely filed a brief. Respondent did not file a brief.

Respondent is a loan correspondent that originates HUD-FHA insured mortgages for sale to loan sponsors. In the Initial Decision, I found that Robert L. Martin, Jr., Respondent's president and owner, had concocted a scheme to alter credit reports that

HUD relied upon in its decision to insure loans for Theresa Ingram and Doris Chase. The alterations deleted or minimized unfavorable information about the borrowers' credit histories. I also found that the alterations were effectuated in the offices of Mortgage Credit Reports, Inc. ("MCR"), the credit reporting agency that prepared those credit reports at Respondent's request. Martin paid Stephanie Pryor, an MCR employee, to make those alterations. The borrowers took no action to present false or fraudulent evidence of their credit histories to anyone.

Despite these adverse findings against Respondent, I was unable to conclude that the Government had elicited the requisite evidence to meet the statutorily mandated standard for imposition of a civil money penalty[1]. The statute provides that a civil money penalty may be imposed on a mortgagee that "knowingly and *materially*" violates a listed provision in the statute (emphasis added). *See* 12 U.S.C. §§ 1735f-14(a)(1), (b)(1)(D). *See also* 24 C.F.R. §§ 30.320(e), (u). Although it was clear that Respondent, through Martin, knew that the credit information submitted to HUD was false, there simply was no evidence upon which I could find that the false information was material. Thus, I concluded that the Government had not met its burden of proof, that Respondent was not liable for any civil money penalty, and that the Complaint must be dismissed.

In "modifying and remanding" the Initial Decision, the Secretarial Designee stated that "the proper standard for what is a 'material violation' warranting a civil money penalty is whether the violation is 'significant,'" and directed, in light of that standard, that I consider the following issues:

> (1) Does the record reflect that, pursuant to the legal standard of a "material violation" described above, the Government satisfied its burden of proof for Counts I and II of the Government's Complaint for civil money penalties?
>
> (2) If the Government satisfied its burden of proof to establish "material violations," what is the proper amount of civil money penalties that the Government should impose on the Respondent?

In the Order scheduling the filing of briefs on remand, I noted that there is no

[1]Based on my findings in the proceeding seeking withdrawal of Respondent's mortgagee authority, which was heard concurrently with this civil money penalty action, the Mortgagee Review Board, on February 28, 1997, unanimously voted to withdraw Respondent's mortgagee approval for a period of two years.

inconsistency between the Initial Decision and the Secretarial Designee's Order. Both recognize that to prove that false information submitted to HUD is "material," the

evidence must show that the information in "significant."[2] Thus, I concluded that the Secretarial Designee's Order contemplated that I reexamine my previous determination that there were insufficient facts to sustain the Government's burden of proof on the issue of materiality of any false information. If reexamination of the record were to reveal such facts, the Secretarial Designee's Order directs me to determine whether there are sufficient facts in the record to support the amount of the civil money penalty sought.

As a matter of law, any action HUD may take against a respondent cannot be sustained if it is arbitrary, capricious, or unsupported by substantial evidence. 5 U.S.C. § 706. In other words, governmental action must be based on reason, supported by predicate facts. The adjudication of a case, then, depends upon pondering a given set of facts to perceive the relationship among those facts and reaching a logical conclusion. *See Aylett v. Secretary of HUD*, 54 F.3d 1560 (10th Cir. 1995).

In a case such as this, the predicate facts concern the similarities and dissimilarities between two separate credit reports for each of two separate borrowers. The credit reports must be similar enough so that a comparison between the two is feasible. They must be dissimilar enough to show that for governmental purposes, they are "significantly" different and, therefore, violate the pertinent statute.

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[2] In the Initial Decision, I concluded as follows:

> All that the Government has shown in this case is that Martin caused false statements to be made in documents that were sent to HUD; not that any of those false statements made any difference in HUD's decisions to insure the loans, that it relied to its detriment on those statements, *or that the statements had any other significance*.

Initial Decision at 17 (emphasis added). While the Secretarial Order stated that the standard by which a violation is determined to be material is not that it had an "influence on the decision-maker," the Order also stated that a violation must be shown to be "significant," and that in making a materiality determination, the "consequences" or "impact" of a violation are relevant considerations. Secretarial Order at 8-9.

In stunning testimony, Matilde Mestre, the Government's key witness (who was called to present evidence on these predicate facts) was unable to identify one of the credit reports she was to compare with another; was never examined on a second credit report she was alleged to have compared with another; failed to explain how credit reports that are prepared several months after the originals can be appropriately compared; was unable to explain various notations on the credit reports; and was never asked about the significance of any "discrepancy" she may have found between any two credit reports.[3] Accordingly, the predicate facts are incomplete, a relationship

among those facts cannot be perceived, and a logical conclusion cannot be reached to justify imposition of a civil penalty.

Ms. Mestre, a HUD employee in the Quality Assurance Division, reviewed both the credit reports included in each endorsement package and the follow-up reports ordered on the same borrowers' credit histories by Respondent's sponsor, National Mortgage Company ("NMC"). She determined that "discrepancies" existed between the reports, and referred the matter to the Mortgagee Review Board.[4]

In her direct examination on the "discrepancies" she found on credit reports related to the Ingram loan, Ms. Mestre identified a credit report dated March 7, 1994, that was included in the endorsement package for that loan. However, when she was shown a follow-up credit report for Ms. Ingram, dated July 12, 1994, Ms. Mestre stated that she didn't "know if she had ever seen it before." Tr. 96. Although these two reports are

[3]Government counsel on brief was not the trial counsel who examined this witness.

[4]The testimony elicited by the Government from certain nongovernmental witnesses is not probative of the materiality issue. Both NMC and MCR found certain discrepancies between the credit reports included in the endorsement packages and those NMC ordered as follow-ups. Both concluded that the discrepancies rendered the credit reports in the endorsement packages false. Both concluded that a false credit report was a serious matter warranting an explanation from Respondent and, failing such a response, referral to HUD and the FBI. However, while that testimony showed that Martin's conduct was considered to be serious by NMC and MCR, it does not shed any light on the significance of any specific discrepancy either company found. Martin's scheme may have been nefarious, but no witness was asked to identify any particular discrepancy and its significance. As noted in the Government's brief, Ms. Pryor was told not to make any change "so clean" or "too obvious." Gov. Brief on Remand at 11. The question then remains - were the changes so subtle as to be insignificant or trivial? Did Martin pay Pryor for a useless act?

dated four months apart, on cross-examination she testified that both sets of credit reports that she examined were "run" about the same time. Tr. 113.

With regard to the Chase loan, Ms. Mestre identified a credit report dated November 23, 1993. When asked on direct examination what the term "O9" on the payment history meant, her response was, "I don't know." When she was also asked on direct examination what the credit report indicated overall, she testified that other than for an unpaid collection, "it looks okay." Tr. 109. Notwithstanding the unpaid collection, FHA insured the loan. She was unable to explain on cross-examination why, on the Chase credit report, there appeared two different ratings, an R1 and an R9, for the same account. She volunteered, "But, I'm not really that familiar with how the [credit] bureau

operates." Tr. 119. The follow-up report on the Chase loan was dated July 11, 1994, almost eight months after the one Ms. Mestre identified on direct examination. However, as noted above, on cross-examination, she testified that both sets of credit reports that she examined were "run" about the same time. She was not examined at all on the July 11, 1994, follow-up credit report.

Retreating to the last refuge of a failed argument, the Government relies on axiomatic propositions: the violation is material because it is "obviously," "evidently," and "clearly" so. *See* Government's Brief on Remand at 9-13. However, even against the backdrop of Respondent's reprehensible conduct, axioms are no substitute for evidence. Whereas the truth of an axiom requires no proof, the plain language of the Program Fraud Civil Remedies Act requires evidentiary proof that a violation is material before a civil penalty may be imposed. The Government's argument cannot be adopted because it reads the materiality requirement right out of the statute.

Proving materiality in this case is not difficult. All that needed be done was properly to prepare Ms. Mestre, or another HUD employee with the requisite background and experience, to identify the two credit reports for each loan, to specify what particular discrepancies existed between those two reports, and to ask what was the "significance," the "consequences," or the "impact" of those discrepancies. In other words, what difference did it make to HUD that any discrepancy existed? Or did any false statement in a credit report filed with HUD have "a natural tendency to influence agency action or is capable of influencing agency action."[5]

Having reexamined the entire record in light of the Order on Secretarial Review, I find that there is no basis for reversing my previous determination that there are insufficient facts to sustain the Government's burden of proof on the issue of the

[5] *United States ex rel. Berge v. Board of Trustees of the Univ. of Ala.*, 104 F.3d 1453, 1460 (4th Cir. 1997), *citing United States v. Norris*, 749 F.2d 1116, 1122 (4th Cir. 1984), *cert. denied*, 471 U.S. 1065 (1985). *See also United States v. Gaudin*, 515 U.S. 506 (1995).

materiality of any false information.[6] Accordingly, I decline to disturb the Order in the Initial Decision on Proposed Imposition of Civil Money Penalty.

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ALAN W. HEIFETZ
Chief Administrative Law Judge

[6]There is no warrant for giving separate consideration to the allegations in the Complaint that Respondent violated provisions of HUD Handbooks. *See* Initial Decision at 17 n.32. Moreover, in light of my conclusion on the issue of materiality, I do not reach the question whether there are sufficient facts in the record to support the amount of the civil money penalty sought by the Government.

CERTIFICATE OF SERVICE

I hereby certify that copies of this INITIAL DECISION ON REMAND issued by ALAN W. HEIFETZ, Chief Administrative Law Judge, in HUDALJ 96-008-CMP, were sent to the following parties on this 18th day of June, 1997, in the manner indicated:

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