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: November 20, 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 SECOND REMAND

Background

On September 15, 1997, this civil money penalty action was again remanded to me for further consideration of my determination that the Government's Complaint should be dismissed. The Order on Secretarial Review, issued by Secretarial Designee Todd Howe, clarified for the second time the legal standard to be applied to determine the "materiality" of a statutory violation. By Order issued on September 23, 1997, I allowed the parties to file briefs addressing specified matters raised by the Howe Order. The Government timely filed a brief. Although Respondent did not file a brief, it filed an opposition to the Government's appeal of the Initial Decision on Remand and stated that it would rely on the pleadings it had previously submitted.

Respondent is a loan correspondent that originates HUD-FHA insured mortgages for sale to loan sponsors. In the Initial Decision issued on February 4, 1997, 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. *See* 12 U.S.C. §§ 1735f-14(a)(1), (b) (emphasis added). *See also* 24 C.F.R. §§ 30.320. Although it was clear that Respondent, through Martin, knew that the credit information submitted to HUD was false, there was no evidence upon which I could find that the false information was material. In the Initial Decision I found that the Government had not shown that any false statement made any difference in HUD's decisions to insure the loans, that HUD relied to its detriment on any of those statements, or that the statements had any other significance. Thus, I concluded that the Government had not met its burden of proof and that the Complaint must be dismissed.

[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.

On May 5, 1997, then Secretarial Designee Michael A. Stegman issued an Order on Secretarial Review ("Stegman Order") "modifying and remanding" the Initial Decision. That Order found that I had applied a "but for" causation standard, and it rejected that standard to determine materiality of a violation. The Order also rejected the Government's suggestion that materiality would be shown if a statement had "a natural tendency to influence, or be capable of influencing, the decision of the decision making body to which it was addressed."[2] The Secretarial Designee then drew a distinction between a material *violation* and a material *fact*, and stated that "the proper standard for what is a 'material violation' warranting a civil money penalty is whether the violation is 'significant.'" Although he seemingly rejected an "influence on the decision maker" standard for determining whether a material violation has occurred, he acknowledged that the "'consequences'" or "'impact'" of a violation, while not dispositive, are certainly relevant to whether a violation is "'material.'" In dicta, he suggested that the "totality of the circumstances" be reviewed to determine whether a violation is significant. In making that statement, he referred to a legal dictionary definition of materiality that included "'having influence or effect,'" and then suggested that "[o]ne potential frame of reference is the criteria in the statute and regulations that ALJs should examine to determine the *amount* of the civil money penalty. . . ." Stegman Order at 10 (emphasis added).

On June 18, 1997, having reexamined the entire record in light of the Stegman Order, I issued an Initial Decision on Remand finding that there was no basis for reversing my previous determination that there were insufficient facts to sustain the Government's burden of proof on the issue of materiality. I found that evidence of purported "discrepancies" between the relevant credit reports, the basis of the Government's action against Respondent, was incomplete, incoherent, and inconsistent. Without predicate facts, there was no logical way to determine whether any discrepancy between credit reports, or any alteration to a credit report actually made by Stephanie Pryor, was significant or merely cosmetic.[3] Under the circumstances, I concluded that the imposition of a civil money penalty would be arbitrary, capricious, and unsupported by substantial evidence. *See* Initial Decision on Remand at 3-5.

On September 15, 1997, Secretarial Designee Howe issued his Order on

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[2]The Government cited *United States v. Gaudin*, 515 U.S. 506 (1995) in support of its suggestion.

[3]I note that a recent random sample by a large regional credit bureau found high-to-low variations of 100 points or more for credit scores on the same applicant pulled at the same time using data from three different credit repositories. Kenneth R. Harney, *Credit Scores for Mortgage Applicants Can Vary Sharply, Depending on Data Source*, The Washington Post, October 25, 1997, at F1.

Secretarial Review ("Howe Order") "modifying and remanding" the Initial Decision on Remand. The Howe Order states that the Government's burden is to prove "the materiality of the Respondent's violation, not...the materiality of any false information." To judge the materiality of a violation, the Howe Order directs administrative law judges to apply the "totality of the circumstances" standard by considering the eight regulatory factors used to determine *the amount of the penalty*. In other words, a violation, to be considered material, need not be predicated on a material fact. Liability for a civil money penalty, therefore, may be predicated on any fact, whether material or immaterial, arising out of the "totality of the circumstances" that are used to determine the amount of any civil penalty, and that heretofore have been considered only after a finding of liability has already been made. *Compare* Howe Order at 5-6 *with* 12 U.S.C. § 1735f-14(c)(3);

24 C.F.R. § 30.215.[4] Moreover, the Howe Order limits the Government's evidentiary burden as follows:

> [T]he Government need not necessarily establish a factual predicate for every one of the eight factors. . . .*Sufficient evidence for one or more of the factors*, if sufficiently compelling, may lead to the conclusion that a Respondent's violation is material. For example, if a Respondent's offense is sufficiently grave, if the failure to issue a penalty would undermine the interest in deterring fraud on HUD, and if a Respondent is culpable for the violation, then the violation may be material even if the violation did not influence any HUD decision.

Howe Order at 6 (emphasis added).

Consistent with that Order, I turn now to consider the extent to which the eight factors listed in the Order apply to a determination of materiality in this case, and the factual predicate established under each applicable factor:

1. The Gravity of the Respondent's Offense

The Stegman Order concluded that a material violation is one that is significant. Because "gravity" is synonymous with "significance," to determine significance by a consideration of gravity begs the question. In any event, the record reveals no evidence upon which one may base a determination of the gravity of Respondent's submission of false information to HUD in connection with HUD-FHA insured mortgages.

2. Any History of Prior Offenses by Respondent

Although a history of prior offenses might indicate knowledge that current conduct is unlawful, it does not bear on the nature, extent, or seriousness of the current conduct. Heinous current conduct is made no less heinous by the absence of any prior offense. In any event, the Government acknowledges that there is no evidence of any prior offense by Respondent. *See* Government's Second Brief on Remand at 4-5.

[4]The Government did not brief the applicability of these eight regulatory factors to the issue of materiality after the remand by the Stegman Order, perhaps for the same reasons it continues to question the relevance of all these factors to the issue of materiality of a violation. *See* Government's Second Brief on Remand at 3 n.3.

3. The Respondent's Ability to Pay the Penalty

Application of the equal protection clause of the United States Constitution prohibits using a respondent's ability to pay a penalty to determine liability for that penalty. U.S. Const. Amend. XIV. A wealthy respondent must be in precisely the same jeopardy as a poor one when accused of violating the law. In any event, the Government has not shown that Respondent has the ability to pay the civil money penalty sought. Rather, it points to the regulatory requirement that loan correspondents maintain a certain minimum net worth, and it speculates that Respondent therefore "should easily be able to pay civil money penalties in the full amount of $15,000." *See* Government's Second Brief on Remand at 5. However, the record does not show whether Respondent maintained a minimum net worth at the time of the hearing.

4. Injury to the Public Interest or the Federal Government from the Respondent's Violation

The record contains no testamentary or documentary evidence of any injury to the public or the Federal Government. However, applying the "totality of the circumstances" standard defined in the Howe Order, I am constrained to infer that because the operation of a governmental benefit program depends upon true and complete information supplied by applicants for those benefits, the knowing submission of *any* false information by an applicant, regardless of its actual effect, inherently undermines the integrity of that program. The Government, as the administrator of the program, and the public, as the beneficiary of the program, are therefore adversely affected by the knowing submission of any false statement in connection with an application for mortgage insurance.

5. Any Benefit, Potential or Actually Received, to the Respondent or Other Persons

An analysis of this factor turns on evidence of the effect of Respondent's conduct. In the absence of any evidence of the effect that a false statement had on the decision maker, it is impossible to determine any actual or potential benefit that might inure to anyone as a result of the false statement. In other words, there is no way to determine whether the false statement is merely cosmetic or whether it affects the granting of a benefit such as the provision of federal insurance. The record in this case provides no evidence of the effect of the false statements at issue.

6. The Deterrence of Future Violations from Imposing Penalties, or the Undermining of this Deterrence in not Imposing Penalties

Respondent's past conduct is the issue at hand, but by definition, deterrence relates only to future, not past, conduct. Nevertheless, under the "totality of the circumstances" standard, I am constrained to infer that the need to deter future violations is present in this case as it is in any case where penal sanctions are sought. Deterrence is an inherent factor in every prosecution by the Government.

7. The Degree of the Respondent's Culpability

The extent to which one is responsible for an action is not probative of the nature of the action itself. One may be fully responsible for a useless act, or not responsible at all for one that is grave. Nevertheless, in this case, Respondent's culpability for the false statements is beyond cavil. Martin, Respondent's alter ego, was the mastermind of the entire scheme and was solely responsible for its direction and implementation.

8. Any Other Matters Relevant to the Significance or Seriousness of the Respondent's Violation

In addressing this factor on brief, the Government cites Respondent's "low regard for its fellow participants in the mortgage business" and its "arrogance" in instructing Ms. Pryor to lie about her role and in failing to respond to the Mortgagee Review Board's 30-day notice. Although aggravating circumstances do not and cannot prove whether a violation has occurred and are irrelevant until a violation has been found, under the "totality of the circumstances" standard, I am constrained to find that the evidence cited by the Government must be considered under this eighth factor.

The Materiality of Respondent's Violations Under the "Totality of the Circumstances" Standard

In the Initial Decision and the Initial Decision on Remand, I found that Respondent knowingly caused false credit information to be submitted to HUD. The previously quoted language from the Howe Order specifically states that "if the failure to issue a penalty would undermine the interest in deterring fraud on HUD," or if "sufficiently compelling" evidence under any one of the other seven factors exists, then the violation may be material. Because deterrence is an inherent factor in any penal sanction, the failure to issue a civil penalty in *any* case where a violation has been proven would undermine the interest in deterring future violations. Likewise, the knowing submission of *any* false statement, regardless of its effect, undermines the integrity of a governmental program because, by its nature, a false statement insidiously weakens the fabric of that program. Accordingly, under the "totality of the circumstances" standard, the knowing

filing of any false statement, regardless of its actual effect, is a sufficient evidentiary predicate under the fourth and sixth factors described above to establish

materiality and a per se violation of 12 U.S.C. §§ 1735f-14(a)(1) and (b)(1)(D). Moreover, in this case, I am also constrained to conclude that evidence of both Respondent's culpability and the aggravating circumstances of the violation is sufficient to establish the materiality of the violation.

Because, under the "totality of the circumstances" standard, I conclude that Respondent's violations were material, I further conclude that Respondent has knowingly and materially violated two HUD Handbook provisions. *See* 12 U.S.C. §§ 1735f-14(a)(1), (b)(1)(H). HUD Handbook 4155.1 REV-4, ¶ 3-3(B) provides:

> **Credit reports** submitted with each loan must be accurate and complete, and provide a detailed account of the credit...and public records information of each borrower....The report submitted to HUD must be an original with no...alterations.

G.Ex.3. Respondent violated this Handbook provision by submitting credit reports to HUD that were altered.

HUD Handbook 4060.1 REV-1, ¶ 6-1(H), requires mortgagees to report "significant discrepancies" to HUD. That Handbook provides:

> Notification to HUD of Significant Discrepancies. Mortgagees are required to report any violation of law or regulation, false statements or program abuses by the mortgagee, its employees or any other party to the transaction to the HUD Regional Office, the HUD Area Office or to the HUD Regional Office of Inspector General....[5]

G.Ex.1. Because under the "totality of the circumstances" standard, *any* knowingly submitted false statement is materially false, it is also, by definition, a "significant discrepancy" that, under the Handbook, must be reported by the mortgagee to HUD.

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[5]Respondent did not, however, violate HUD Handbook 4000.2 REV-2, ¶ 1-21 which states:

> REPORTING FRAUD AND ABUSE. Any violation of law or regulation, or any false statements or program abuses detected by a mortgagee or any of its employees *should be reported* immediately to the HUD Field Office or the HUD Regional Office of Inspector General.

G.Ex.2 (emphasis added). Unlike the reporting requirement set forth at HUD Handbook 4060.1 REV-1, ¶6-1(H), quoted above, this provision is precatory and imposed no absolute duty to report.

Respondent failed to report materially false statements to HUD, in violation of the Handbook. *See* Initial Decision at 10-11, Finding of Facts 25-27.

The Appropriate Amount of Civil Money Penalty to be Imposed

Having concluded that under the totality of the circumstances standard, and with respect to the Ingram and Chase loans, Respondent knowingly *and* materially violated 12 U.S.C. § 1735f-14 by submitting false information to HUD and violated two HUD Handbook provisions, I now turn to a consideration of the appropriate amount of the civil money penalty to be imposed. The maximum penalty which may be imposed is $5,000 for each violation. *See* 12 U.S.C. § 1735f-14(a)(2); 24 C.F.R. § 30.220(d). The applicable statute requires that each violation - the submission of false information and the handbook violations - constitutes a separate violation with respect to each mortgage or loan application. *See* 12 U.S.C. §§ 1735f-14(a)(2), (b)(1)(D), (H). *See also* 24 C.F.R. §§ 30.220(d), 30.320(e), (u). The applicable statute and regulations (*see* 12 U.S.C. § 1735f-14(c)(3); 24 C.F.R. § 30.215) further require that in determining the amount of the penalty, I again consider the factors addressed below:[6]

1. The Gravity of the Offense

Because under the "totality of the circumstances" standard, the knowing submission of a false statement is a material violation, such an offense is, by definition, grave.

2. Any History of Prior Offenses

The Government concedes that there is no history of prior offenses.

3. Respondent's Ability to Pay the Penalty

Although the Government has not shown that Respondent has the ability to pay a civil money penalty, the burden is on Respondent affirmatively to demonstrate that it lacks the ability to pay any penalty, because such information is within its control and knowledge. *See Campbell v. United States*, 365 U.S. 85, 96 (1961). No such evidence has been adduced. Therefore, Respondent's ability to pay is not a factor in determining the amount of any penalty to be assessed.

[6]The headings that follow track the statute.

4. The Injury to the Public

As noted previously, the public has been injured because the integrity of the insurance program has been compromised by Respondent's knowing submission of false statements in connection with two applications for loan insurance.

5. Any Benefits Received

There is no evidence of any benefit, actual or potential, to Respondent or to any other person as a result of the submission of any false statement caused to be made by Respondent. There is no evidence that the Chase and Ingram loans were insured in reliance on any false statement, or that any remuneration received by Ms. Pryor for making alterations would inure to Respondent's benefit.

6. Deterrence of Future Violations

In order to deter future knowing and material violations of the statute and regulations, and to protect the integrity of an important governmental program in the future, a substantial civil money penalty is warranted.

7. Such Other Factors as the Secretary May Determine in Regulations to be Appropriate

By regulation, the Secretary has mandated consideration of the culpability of the violator and such other matters as justice may require. *See* 24 C.F.R §§ 30.215(b)(8) and (9). Respondent, through its alter ego Martin, was fully responsible for devising and implementing the scheme to submit false credit reports to HUD. No one else shares that blame. Ms. Pryor was simply a tool to be used for Respondent's ends. In addition to culpability for the false statements, Respondent was also responsible for the aggravating circumstances surrounding the violation. Martin suborned perjury in order to conceal the scheme to submit false information to HUD. He instructed Ms. Pryor to lie during a deposition in a related civil action, telling her to deny that she knew him and to state that all the changes she made to the credit reports had been authorized and were, therefore, proper. He further instructed her to repeat those same lies during a meeting she was to have with an FBI agent. *See* Initial Decision at 12, Finding of Facts 29-31. Finally, and integral to the scheme, Martin failed in his responsibility to report it to the appropriate HUD officials, and he failed to cooperate with those who attempted to investigate the matter.

The Government seeks imposition of $15,000 in civil money penalties, less than the statutory maximum of $5,000 it could seek for each of the two submissions of false

statements and for the violations of the two handbook provisions. *See* 12 U.S.C.

§ 1735f-14(a)(2). Giving great weight to the reprehensibility of Respondent's scheme to submit false information to HUD and then to conceal the scheme, Respondent's full culpability for implementation of the scheme, the damage to the integrity of the HUD-FHA mortgage insurance program, and the need to deter such conduct in the future, imposition of the full $15,000 civil money penalty requested is warranted.

Accordingly, it is **ORDERED** that, within 10 days from the date that this Initial Decision on Second Remand becomes final, Respondent shall pay $15,000 to the Secretary of the U.S. Department of Housing and Urban Development.

Except as is provided in 24 C.F.R. § 30.905, pursuant to which, *inter alia*, Respondent has the right ot file a notice of appeal with the Secretary as described in 24 C.F.R. § 30.910, this Initial Decision on Second Remand shall become final 90 days after its issuance.

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ALAN W. HEIFETZ
Chief Administrative Law Judge

CERTIFICATE OF SERVICE

I hereby certify that copies of this INITIAL DECISION ON SECOND REMAND issued by ALAN W. HEIFETZ, Chief Administrative Law Judge, in HUDALJ 96-008-CMP, were sent to the following parties on this 20th day of November, 1997, in the manner indicated:

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