

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

In the Matter of:

G & R FINANCIAL GROUP,
INC.,

Respondent.

HUDALJ 95-004-MR
Decided: March 1, 1995

Robert C. Pena, *pro se*
For the Respondent

Georjan D. Overman, Esquire
For the Government

Before: ALAN W. HEIFETZ
Chief Administrative Law Judge

INITIAL DETERMINATION AND ORDER

On December 7, 1994, Respondent, G & R Financial Group, Inc. ("G & R"), appealed the November 21, 1994, withdrawal of its HUD/FHA mortgagee approval for a three year period by the Mortgagee Review Board ("the Board") of the U.S. Department of Housing and Urban Development ("HUD" or "the Department"). The Board's action was taken pursuant to 24 C.F.R. Part 25, and was based upon the failure of Robert C. Pena, President of G & R, to fulfill his obligations pursuant to a June 28, 1993, Indemnification Agreement between him and the Department. Settlement negotiations ensued following a January 4, 1995, telephone conference, but no settlement was reached. Accordingly, on January 11, 1995, the parties agreed that the matter should proceed to a hearing, to be held on the submission of written briefs and documentary evidence. Respondent filed its submission on January 11, 1995 ("Respondent's Brief"), and the Government filed its Brief in Support of Withdrawal ("Government's Brief") on January 30, 1995. Respondent filed a Response to the Government's Brief on February 2, 1995. Having received no further pleadings, this matter is ripe for decision.

Findings of Fact

1. From March 12-16, 1990, the Monitoring Division of the Department's Office of Lender Activities and Land Sales Registration conducted an on-site review of F & S Mortgage Company ("F & S"). G. Ex. 1 at 1.¹ By letter dated June 21, 1990, William Heyman, Director of the Office of Lender Activities and Land Sales Registration, provided Robert C. Pena, President of F & S, with the results of the Department's review of the procedures used by F & S staff in originating HUD/FHA insured mortgages. Mr. Heyman stated that the Department had found various violations of HUD loan origination requirements, and requested, *inter alia*, that absent submission of documentation showing compliance with HUD requirements, F & S indemnify HUD/FHA in the event the Department paid claims on 14 improperly originated loans. Accompanying the letter was an indemnification agreement. *Id.* at 4, 6.

2. On July 24, 1990, Mr. Pena responded to Mr. Heyman's letter. G.Ex. 2. Mr. Pena provided explanations for the violations found by the Department and represented that F & S had implemented new loan processing policies. *Id.* Mr. Pena did not include an executed indemnification agreement with his response. *Id.* By letter dated October 17, 1990, Mr. Heyman advised Mr. Pena that the Department did not concur in the majority of the explanations he had provided for the loan origination violations. G.Ex. 3 at 3. The Department again requested that F & S execute an indemnification agreement and enclosed another copy of the agreement. Attachment to G.Ex. 3.

3. F & S did not execute the indemnification agreement. In October 1990, Mr. Pena closed the company and declared personal bankruptcy. In January 1992, Mr. Pena's debts were discharged. G.Ex. 4 at 1.

4. By letter dated April 30, 1992, and addressed to Sandra L. Allison, Director of HUD's Lender Approval and Recertification Division, Mr. Pena requested that the Department reapprove him as a mortgagee. *Id.* at 2. On October 19, 1992, G & R was incorporated. G.Ex. 5. On December 16, 1992, Mr. Pena, as President of G & R, applied to the Department for approval of G & R as a loan correspondent mortgagee. *Id.* The Department rejected the application on May 14, 1993, citing, *inter alia*, the unresolved findings of the 1990 Monitoring Division review and Mr. Pena's failure to execute an indemnification agreement. G.Ex. 6 at 1.

¹"G.Ex." refers to the exhibits submitted as attachments to the Government's Brief. "R.Ex." refers to the exhibits submitted as attachments to Respondent's Brief.

5. By letter dated June 3, 1993, from Orlando L. Lorie, Manager of HUD's Coral Gables, Florida Office, Mr. Pena was notified that the Department had imposed a Limited Denial of Participation ("LDP") against him. Mr. Lorie stated that the LDP was being imposed because Mr. Pena had made a false certification on the application he had submitted for approval of G & R as a loan correspondent mortgagee. According to Mr. Lorie, HUD considered the Monitoring Division's 1990 findings to be outstanding since Mr. Pena had "never responded" to its request that he execute an indemnification agreement. Given the outstanding findings, HUD took the position that Mr. Pena had falsely certified that he and G & R were not the subject of any such findings and were not engaged in imprudent or otherwise irresponsible business practices. Mr. Lorie advised Mr. Pena that as a result of the LDP he was prohibited from participating in programs administered by the Assistant Secretary for Housing-Federal Housing Commissioner throughout the jurisdiction of the Coral Gables Office. Mr. Lorie further stated that unless the LDP was withdrawn or modified as a result of evidence presented by Mr. Pena at a conference, the LDP would be in effect for a period of one year from the date of the letter. R.Ex. C.

6. By letter dated June 15, 1993, to J. Parker Deal, Director of the Monitoring Division, Mr. Pena again provided explanations for the Division's 1990 findings and sought reconsideration of the Department's rejection of G & R's loan correspondent mortgagee application. G.Ex. 7.

7. By letter dated June 24, 1993, Mr. Deal advised Mr. Pena that the Monitoring Division had reviewed his submission, but did not find that the material submitted resolved the outstanding findings. R.Ex. B at 1. Mr. Deal further stated:

As we have noted, our proposed resolution of the serious violations contained in the 14 loans, is that an indemnification agreement be executed. We remain open to receiving any documentation you might have to negate any findings or any suggestions for a proposed settlement of the losses the Department has or may sustain in these 14 loans. For your information, our records, presently, do not reflect any loss figures for these properties. However, it appears that several of the loans are in the foreclosure/claim process.

Id.

8. On June 25, 1993, Mr. Pena signed the Indemnification Agreement. G.Ex. 8. On June 28, 1993, Mr. Deal, on behalf of the Department, signed the Agreement. *Id.* Pursuant to the Indemnification Agreement, Mr. Pena agreed personally to indemnify the Department for losses that had been or might be incurred on 14 identified loans, should the loans to go into default within five years from the date of HUD/FHA endorsement for

insurance. *Id.* The agreement further provided:

Any material breach of the terms and conditions of this Agreement shall constitute independent grounds for imposition of administrative sanctions by the Mortgagee Review Board against [Robert Pena] pursuant to 24 CFR Part 25.

Id. at ¶ 2. By letter dated June 28, 1993, Mr. Deal transmitted a copy of the executed Indemnification Agreement to Mr. Pena, and advised him that, based on the Agreement, the Monitoring Division considered the findings made in the on-site review to be resolved. R.Ex. E.

9. An informal LDP conference was held on July 28, 1993. R.Ex. D. By letter dated August 20, 1993, Raymond A. Harris, Regional Administrator-Regional Housing Commissioner for HUD Region IV, notified Mr. Pena that, based upon the recommendation of John K. Grisso, the Designated Conference Hearing Officer, the LDP issued on June 3, 1993, had been withdrawn. *Id.*

10. On September 15, 1993, the Department issued a notice of approval of G & R as a HUD/FHA mortgagee. R.Ex. F.

11. On March 24, 1994, Mr. Deal responded to a March 13, 1994, letter Mr. Pena had sent requesting an extension of time to pay the Department an outstanding debt of \$140,276.59 arising from the Indemnification Agreement. G.Ex.10. Mr. Deal denied the extension request, and stated that if payment of the debt would present an "economic hardship," HUD would entertain a three-year payment plan request, to include an initial payment of \$35,069.00 and annual installment payments thereafter. *Id.* Mr. Deal directed Mr. Pena to respond to the letter and stated "that any further delay in resolving this issue may result in a referral to the Mortgagee Review Board for consideration of possible administrative sanctions against [him] and/or [his] company." *Id.*

12. On April 7, 1994, Mr. Pena responded to Mr. Deal's March 24, 1994, letter. G.Ex. 11. Mr. Pena asserted that because HUD knew prior to execution of the Indemnification Agreement, but failed to disclose to him, that certain loans covered by the agreement had already gone into default, he had been "enticed" into signing a "blank check" with HUD. Referring to the representations previously made by Mr. Deal that had induced him into signing the Indemnification Agreement, Mr. Pena stated:

[I]n June of last year you indicated that none of the fourteen loans in question were losses for HUD[.] You did state that there appeared to be collection and claim procedures underway which could result

in foreclosure. It was based upon this information that I executed the indemnification agreement dated June 25, 1993 which you endorsed on June 28, 1993 I executed the agreement and could see no reason to fear the foreclosure of loans that had been in existence for a considerable time. At no time was there any mention of four of the fourteen loans being in foreclosure. I am a prudent man and the past experiences I have just endured would most certainly stop me from [sic] assuming that I could cover over \$140,000.00 in foreclosures

Id. The payment plan proposed by Mr. Deal, according to Mr. Pena, did not comport with his financial capabilities. Representing that he would honor the commitment made by virtue of the Indemnification Agreement, Mr. Pena requested that consideration be given to establishment of a "workable" repayment plan. *Id.*²

13. On April 12, 1994, Mr. Pena, as President of G & R, again applied to the Department for approval of G & R as a loan correspondent mortgagee. G.Ex. 9. The Department approved the application on April 22, 1994. *Id.*

14. By letter dated May 6, 1994, the Board notified Mr. Pena that it was considering an administrative action against G & R pursuant to 24 C.F.R. Part 25 based upon his failure to comply with the Indemnification Agreement.³ G.Ex. 12. The Board also advised Mr. Pena that an installment payment plan he proposed had been determined to be unacceptable by the Monitoring Division. *Id.*⁴

²Mr. Pena further asserted that he had not been notified of any foreclosure proceedings and was thereby prevented from taking steps to reduce the losses incurred by HUD and his exposure under the Indemnification Agreement. Respondent has not pursued that argument in this proceeding. In any event, given his representations of experiencing great financial difficulty and of having limited financial resources, such notification would appear to have been futile.

³The Board explained that since Mr. Pena is the owner and President of G & R, it considered G & R to be his "alter ego," and therefore in violation of the Indemnification Agreement. G.Ex. 12. Respondent has not disputed the position taken by the Board in this regard.

⁴The May 6, 1994, letter directed Mr. Pena to respond within 30 days of receipt, and advised him that failure to do so would result in a determination by the Board without the benefit of a response. G.Ex. 12. In later correspondence with the Department, Mr. Pena represented that he had submitted a response to the May 6, 1994, letter on May 10, 1994, and that he had not received a reply. G.Ex. 13. The record does not include a copy of any May 10, 1994, submission.

15. On November 21, 1994, the Board issued a notice withdrawing G & R's HUD/FHA mortgagee approval for a three year period pursuant to 24 C.F.R. Part 25. G.Ex. 14. The Board stated that the withdrawal was based upon Mr. Pena's failure to comply with the June 28, 1993, Indemnification Agreement, which it deemed "a specifically required condition upon which HUD-FHA approval of G & R was granted." *Id.* Specifically, the Board stated that Mr. Pena had failed to remit to the Department \$180,521.40, which constituted the Department's claim losses in connection with four loans. *Id.* By letter dated December 1, 1994, and received by the Department on December 7, 1994, Mr. Pena appealed the withdrawal of G & R's mortgagee approval. G.Ex. 13. Mr. Pena included a settlement offer in the letter. *Id.*

16. By letter dated December 23, 1994, the Board advised Mr. Pena that it had considered and declined to accept his settlement offer "as the Board ha[d] determined that such a settlement would not be in the best interests of the Department." *Id.* Further settlement negotiations occurred during January 1994, but were unsuccessful. *See* Orders (Jan. 4, 1994 and Jan. 11, 1994).

Discussion

HUD regulations provide that when any report, audit, investigation or other information before the Board discloses grounds for an administrative action against a mortgagee, the Board shall, depending on the nature and extent of the violations, take one of several actions. 24 C.F.R. § 25.5. In determining which, if any, administrative action is appropriate, the Board considers, "among other factors, the seriousness and extent of the violations, the degree of mortgagee responsibility for the occurrences and any mitigating factors. . . ." *Id.* at § 25.9. Where the Board determines that a serious violation or a repeated violation by the mortgagee has occurred, the Board may issue an order withdrawing the mortgagee's HUD/FHA approval, resulting in the mortgagee's exclusion from participation in HUD/FHA mortgage insurance programs. *Id.* at §§ 25.5(d)(1); 25.3. *See also id.* at § 25.5(d)(3). The withdrawal must be "for a reasonable, specified period of time, not less than one year, commensurate with the seriousness of the ground(s) for withdrawal." *Id.* at § 25.5(d)(2). *See also id.* at § 25.3.⁵ Review of an administrative action taken by the Board is *de novo*, and is conducted to determine whether the action is supported by a preponderance of the evidence. *Id.* at §§ 25.8(c), 25.8(e), 26.24(a).

⁵ A withdrawal can be permanent, but only where the violation is egregious or willful. 24 C.F.R. § 25.5(d)(2). *See also id.* at § 25.3. Moreover, the regulatory provision cited in the Government's Brief to support the proposition that a withdrawal generally is not to exceed six years was removed from 24 C.F.R. Part 25 when the Department promulgated new Mortgagee Review Board procedures in 1992. *See* 57 Fed. Reg. 31048, 31053 (1992).

The grounds for administrative action by the Board, including withdrawal of HUD/FHA mortgagee approval, are set forth at 24 C.F.R. § 25.9. The grounds upon which the Board has taken action against Respondent are:

(g) Failure to comply with any agreement, certification, undertaking, or condition of approval listed on either a mortgagee's application for approval or on an approved mortgagee's branch office notification;

* * *

(j) Violation of the requirements of any contract with the Department, or violation of the requirements set forth in any statute, regulation, handbook, mortgagee letter, or other written rule or instruction;

* * *

(p) Business practices which do not conform to generally accepted practices of prudent lenders or which demonstrate irresponsibility;

* * *

(w) Any other reasons the Board, Secretary or Hearing Officer, as appropriate, determine to be so serious as to justify an administrative sanction[. . .]

Id. at §§ 25.9(g), 25.9(j), 25.9(p), 25.9(w).

In arguing that withdrawal of its mortgagee approval is unwarranted, Respondent asserts that prior to execution of the Indemnification Agreement, HUD knew, but did not disclose to Mr. Pena, that losses had already been incurred on certain loans covered by the Agreement, and that HUD knew that payment of those losses, particularly as a lump sum, exceeded Mr. Pena's financial capability. According to Respondent, had Mr. Pena been advised of the extent of those losses, he would not have agreed to the terms set forth in the Indemnification Agreement, but rather would have negotiated an agreement which included a feasible payment plan. Respondent, in essence, seeks to avoid operation of the Indemnification Agreement and thereby avert withdrawal pursuant to principles of contract law. Although Respondent has not identified any specific principle upon which it bases its argument, the factual predicate presented raises issues of mistake, misrepresentation, and unconscionability.

Under the principle of mistake, a contract may be voidable where one or both parties made a contract that is based upon an erroneous belief, *i.e.*, a belief that is not in accord with the facts as they existed at the time the contract was made. *See* Restatement (Second) of Contracts §§ 151, 152, 153 (1981). Neither an improvident act nor a party's prediction or judgment as to future events, even if erroneous, is a mistake which may result in contract avoidance. *Id.* at § 151, Comment a. Under the principle of misrepresentation, a contract may be voidable where the assent of one party to a contract is induced by a fraudulent or material assertion of the other party that is not in accord with the facts. *Id.* at §§ 159, 164. Under the principle of unconscionability, a contract may be unenforceable when a determination is made, in view of the contract's setting, purpose and effect, that contract performance will result in oppression and unfair surprise. *Id.* at § 208, Comments a and b. Among the factors which may contribute to a finding of unconscionability in the bargaining process is the "belief by the stronger party that there is no reasonable probability that the weaker party will fully perform the contract." *Id.* at § 208, Comment d.

Regardless of the principle employed, Respondent's argument is without merit as it is premised upon a finding, not supported by the record evidence, that when the Indemnification Agreement was executed, losses on loans covered by the Agreement had already been calculated and that HUD did not disclose that knowledge to Respondent. To support its argument, Respondent submitted copies of title searches purportedly showing that certain properties which were the subject of loans covered by the Indemnification Agreement had been conveyed by HUD prior to execution of the Agreement. *See* R.Ex. G. Such conveyance, however, does not demonstrate that any calculation of loss had been completed. Conveyance is a prerequisite to the calculation of any loss, but the date of conveyance is not necessarily coterminous with the date any loss is calculated. Moreover, the fact that any property may have been removed from HUD's inventory prior to execution of the Indemnification Agreement is consistent with representations made by HUD and upon which Mr. Pena acknowledges he relied in signing the Agreement. The Department expressly advised Mr. Pena that its records at the time did not reflect any loss figures for the properties, but that several of the loans were in the foreclosure/claim process. *See* Finding No. 7, *supra*. Having been on notice that several loans were already in jeopardy of loss, due diligence required that Mr. Pena make whatever further inquiry was necessary to determine the amount and likely timing of any loss he might incur as a result of executing the Agreement. Having failed to make that inquiry, he signed the Agreement at his peril.

Respondent raises several additional arguments in support of its position that its mortgagee approval should not be withdrawn. To demonstrate the absence of any deceit on the part of Mr. Pena in his dealings with the Department, Respondent points to the Department's withdrawal of the LDP issued against Mr. Pena in 1993. No allegation of fraud, however, has been made by the Department against Mr. Pena in this proceeding, nor is such a showing needed to establish the grounds for which the Board has taken administrative action against Respondent. Rather, the withdrawal is based on Mr. Pena's failure to comply with the terms of the Indemnification Agreement, which itself was a condition upon which approval of Respondent as a HUD/FHA mortgagee was based. Respondent further asserts that Mr. Pena has already endured significant personal hardship as a result of the Department's dealings with him, and that Mr. Pena has fully cooperated with the Department and has demonstrated his willingness to accept responsibility for any debt owed to the Department. In the latter regard, Respondent refers chiefly to what it considers to be Mr. Pena's repeated but rebuffed attempts to reach a settlement in this proceeding. Given the factual background and procedural history of this proceeding, Mr. Pena's consternation is understandable. However, the fact remains that Mr. Pena entered into an agreement with the Department with full knowledge of the ultimate extent of his financial exposure and of the possible consequences of his failure to comply with the terms of the agreement. As Mr. Pena has failed to adhere to the terms of the agreement, his conduct constitutes grounds for withdrawal of Respondent's mortgagee approval under 24 C.F.R. §§ 25.9(g), (j), (p), and (w).

Under the terms of the Indemnification Agreement, Mr. Pena is liable to the Department. The only remaining dispute is over the terms of payment under the Agreement. Mr. Pena and the Department have failed to come to a satisfactory settlement that would obviate Mr. Pena's responsibility for payment within the strict terms of the Agreement. Settlement of this matter on terms other than those dictated by the Agreement is solely within the discretion of the Board and cannot be compelled by this forum. Having entered into an agreement which placed him at substantial financial risk, Mr. Pena is now subject to HUD's demand for accelerated payment. Given the nature of the grounds for withdrawal, as well as the circumstances surrounding this proceeding, withdrawal of approval for the period proposed is appropriate. *See* 24 C.F.R. §§ 25.5(d)(2), 25.3. It is commensurate with the present risk posed by continued dealings with Respondent.

Conclusion and Order

The Department has demonstrated by a preponderance of the evidence that good cause exists to withdraw Respondent G & R Financial Group, Inc.'s mortgagee approval for a period of three years. Accordingly, it is

ORDERED, that the action of the Mortgagee Review Board is *affirmed*.

/s/

ALAN W. HEIFETZ
Chief Administrative Law Judge

