

**UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND**

NORA SMITH

Plaintiff

v.

HOUSING AUTHORITY OF
BALTIMORE CITY

Defendant

and

U.S. Department of Housing and
Urban Development

Third Party Claimant

CIVIL ACTION NO.

**MEMORANDUM OF LAW IN SUPPORT OF THE
U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT'S
MOTION TO QUASH WRIT OF GARNISHMENT AS TO FEDERAL FUNDS**

I. Introduction

The U.S. Department of Housing and Urban Development (HUD) asserts that funds contained in the Housing Authority of Baltimore City's (HABC) bank accounts at Bank of America are Federal funds that cannot be garnished. Furthermore, the use of these funds to pay any judgment is governed by OMB Circular A-87, which prohibits the payment of Federal funds for such a purpose without express written permission from HUD. As a result, the Writ of Garnishment pending against HABC's Bank of America accounts should be quashed as to all federal funds contained therein.

II. Statement of Facts

On June 2, 2010, a Writ of Garnishment was issued to Bank of America, the bank where HABC deposits its funds, for \$1,144,500, representing the judgment plus interest in the case of *Smith v. HABC*, No. 0404 September Term, 2007 (Md. Ct. Spec. App. January 26, 2010) (Ex. A). (Writ, Ex. B). Plaintiff Nora Smith had sued HABC individually and on behalf of her minor child, Lamar Lynch, for injuries he sustained from exposure to lead while living in an HABC property. The case went to trial in 2002, and the Plaintiff was awarded a \$630,000 judgment. The judgment was subsequently reduced to zero because HABC was deemed to have sovereign immunity based on the Maryland Court of Appeal's decision in *Jackson v. Housing Opportunities Comm'n of Montgomery County*, 289 Md. 118 (1980). (*Smith* slip op., Ex. A). In November 2009, the Maryland Court of Appeals overturned the *Jackson* decision, concluding that HABC did not have sovereign immunity. *Brooks v. Housing Authority of Baltimore City*, No. 14, Sept. Term 2008, (Md. Nov. 17, 2009). In January 2010, the previously reduced *Smith* judgment was reinstated in the amount of \$630,000. (*Smith* slip op, Ex. A). The Plaintiff has now attempted to execute the judgment by filing a Writ of Garnishment in the amount of \$1,144,500, representing the original judgment plus interest. (Writ, Ex. B).

HUD now seeks to quash the pending Writ of Garnishment against the federal funds held in HABC's Bank of America accounts. When a writ of garnishment has been filed pursuant to Maryland Rule 2-645, a third person claimant of the garnished property has the right to file a motion seeking release of the garnished property within 30 days after service of the garnishment on the garnishee. MD Rule 2-645(i), 2-643(e). Because the garnishment action is currently pending against all of HABC's accounts with Bank of America, HUD is filing this motion as a third person claimant of the garnished accounts, seeking a release of the accounts from the

judgment since they contain Federal funds that are not be subject to garnishment. This Court has jurisdiction over the matter pursuant to 28 U.S.C. §§ 1331, 1346 and 42 U.S.C. §1437 et seq.

III. Argument

A. HABC's accounts with Bank of America contain Federal funds not subject to garnishment.

1. Federal funds are not subject to Garnishment

HABC's accounts with Bank of America contain Federal funds that are not subject to garnishment, and therefore the Writ of Garnishment currently pending against those accounts should be quashed. "Unless the federal government consents, sovereign immunity prevents federal funds from being subject to attachment or garnishment proceedings." *United States Department of Housing and Urban Development v. K Capolino Construction Corp.*, 2001 WL 487436, at *4 (S.D.N.Y. May 7, 2001). "The United States has an interest in federal funds disbursed to a non-governmental entity for a federal purpose and such interest is not subject to state judicial process without the consent of the United States." *Capolino*, 2001 WL 487436, at *4.

In *Buchanan v. Alexander*, the Supreme Court first established that "federal funds in the hands of a grantee remain the property of the federal government unless and until expended in accordance with the terms of the grant and are not subject to attachment or garnishment." *Capolino*, 2001 WL 487436, at *4 (citing *Buchanan v. Alexander*, 45 U.S. 20, 21 (1846)). The Court reasoned that if funds that are specifically appropriated for a national purpose can be diverted by state process, the functions of the government could be affected. *Buchanan*, 45 U.S. at 21. Despite its age, *Buchanan* continues to be controlling on the garnishment of Federal funds. See *Palmiter v. Action, Inc.*, 733 F.2d 1244 (7th Cir. 1984) (holding that "it is well settled that federal monies are not subject to garnishment proceedings until they have been paid out for

the purposes for which they were appropriated”); *Neukirchen v. Wood County Head Start, Inc.*, 53 F.3d 809, 812 (7th Cir. 1995) (holding that it is “axiomatic that the doctrine of sovereign immunity prevents a judgment creditor from attaching federal property, absent consent by the United States”). *Buchanan* and its progeny, as discussed below, demand that the pending Writ of Garnishment be quashed.

Courts have applied the principles articulated in *Buchanan* to attempted garnishments of housing authority funds. In *Capolino*, a judgment holder was seeking to garnish the bank accounts of the White Plains Housing Authority when HUD sought a preliminary injunction on the grounds that the funds in the housing authority’s bank accounts were Federal funds. 2001 WL 487436, at *3. In granting the preliminary injunction, the *Capolino* court relied on *Buchanan* in determining that Federal funds in the hands of a grantee, like the White Plains Housing Authority, remain the property of the Federal government and are not subject to attachment or garnishment. *Capolino*, 2001 WL 487436, at *4. *Capolino* adopted HUD’s position that permitting the funds granted to the housing authority to be used to pay a judgment “would interfere with the provision of low-income housing for which the funds were intended to be used.” *Id.* at *5. *Capolino* made clear that the Federal funds granted to a housing authority by HUD are not subject to garnishment.

More recently, other courts have held that HUD funds in the hands of a housing authority are not subject to garnishment. In *United States v. First National of Nebraska, Inc.*, 2009 WL 324177, at *1 (D. Nebraska, Feb. 9, 2009), First National Bank exercised an offset against the Columbus Housing Authority’s bank accounts in partial satisfaction of a defaulted loan. In denying First National’s motion for summary judgment, the court quoted extensively to *Capolino*, concluding that due to the immunity of Federal funds from attachment or garnishment,

First National failed to establish that it had an enforceable security interest in the funds that the Columbus Housing Authority deposited in the bank. *First National*, 2009 WL 324177, at *2.

In *Alan Stanton Corporation v. City of North Las Vegas Housing Authority (NLVHA)*, Case No. 2:10cv147, slip op. at 2 (D. Nev. June 16, 2010), the plaintiff construction company garnished \$206,000 from an account belonging to NLVHA, allegedly owed for services provided to the housing authority. (Ex. C). The court determined, pursuant to the *Buchanan* line of cases, that because the housing authority account contained funds from HUD, they were Federal funds not subject to garnishment, and ordered that the money garnished from the housing authority's accounts be returned. *Id.* at 8-11. (Ex. C).

Thus, the courts that have examined the question of whether housing authority funds can be garnished have determined that they cannot be. Similarly, as demonstrated below, the HABC accounts that are the subject of the pending Writ of Garnishment contain Federal funds that are not subject to garnishment. As a result, the pending Writ of Garnishment should be quashed with respect to Federal funds.

2. The funds granted to HABC by HUD are Federal funds that can only be used for their designated purpose.

After the federal government disburses funds to a grantee, those funds remain federal funds as long as the funds are disbursed for a federal purpose and the United States has an interest in those funds. *Capolino*, 2001 WL 487436, at *4. In determining whether the United States has an interest in funds that have been disbursed to a grantee, "courts have considered whether the funds were dispensed according to conditions, whether the United States retains a reversionary interest in the funds, and whether the United States employs accountability procedures to ensure that the grants are being spent as directed." *Id.* (citing *Henry v. First Nat'l Bank of Clarksdale*, 595 F.2d 291, 308-309 (5th Cir. 1979)). There are several sources of

authority that demonstrate that the HUD grants to HABC are Federal funds that can only be used for designated purposes: the enabling statutes for the Section 8 and Section 9 programs and the implementing regulations; the Annual Contribution Contracts executed between HUD and HABC for each of these programs; the Moving to Work Agreement between HUD and HABC concerning HABC's use of funds; OMB Circular A-87; and the General Depository Agreement between Bank of America and HABC. Each of these sources is examined below in order to show that HUD maintains an interest in the funds disbursed to HABC, even when such funds are on deposit in HABC bank accounts.¹

HABC receives funding from HUD pursuant to Section 9 (public housing) of the United States Housing Act of 1937, 42 U.S.C. §1437g (2003). Under Section 9 of the Housing Act, HUD provides housing authorities with operating funds as well as capital funds, both of which are to be used for specific purposes. 42 U.S.C. §1437g(d) and (e). Capital funds are to be used by public housing agencies to carry out capital and management activities, such as the development and modernization of housing projects, addressing deferred maintenance needs, and expenditures to improve the security and safety of residents. 42 U.S.C. §1437g(d)(1); 24 C.F.R. Part 905. Operating funds are to be used by public housing agencies for the operation and management of public housing, including activities such as the cost of managing public housing units, engaging in preventative maintenance, energy costs associated with public housing units, and the cost of insurance. 42 U.S.C. §1437g(e)(1); 24 C.F.R. Part 990. Thus, by statute, there are conditions attached to the way in which funds can be spent by HABC, which demonstrates that HUD maintains its interest in the funds even after they are disbursed to HABC.

¹ In addition to direct disbursements from HUD to HABC, HUD considers any project rents or other amounts received by HABC in connection with any Federal program to be Federal funds in which HUD retains an interest. See *Capolino*, 2001 WL 487436, at *5 (holding that HUD established an interest in rents received from public housing tenants). See *infra* footnotes 2 and 4.

The primary mechanism by which HUD maintains control over the funds disbursed to housing authorities is the Annual Contributions Contract (ACC). Both capital funds and operating funds for the public housing program are distributed to HABC pursuant to an ACC (hereinafter PH ACC) that sets forth the conditions under which the funds are disbursed.² The PH ACC between HUD and HABC states, among other provisions, that HABC shall “at all times develop and operate each project solely for the purpose of providing decent, safe, and sanitary housing for eligible families...” (PH ACC, Section 4, p. 2, Ex. D). This provision shows that the grant of funds is not open-ended, but rather is constrained and conditioned to be used only for the designated purposes.

The PH ACC also states that “[t]he HA shall develop and operate all projects covered by this ACC in compliance with...all applicable statutes, executive orders, and regulations....” (PH ACC, Section 5, p. 3, Ex. D). The regulations at 24 C.F.R. Part 905 and 24 C.F.R. Part 990 set forth in detail the restrictions on the way in which housing authorities like HABC may administer public housing capital and operating funds. Significantly, with respect to capital funds, the regulations explicitly give HUD the right “to recapture the obligated amounts for violation by the PHA of the requirements of this section.” 24 C.F.R. §905.120(e). With respect to operating funds, the regulations state that “[a]ll PHAs that receive financial assistance under this part shall submit an acceptable audit...” 24 C.F.R. §990.320. These regulations demonstrate that HUD has a reversionary interest in the funds disbursed to HABC, and also employs measures of accountability in order to insure the funds are spent properly.

² The PH ACC preserves HUD’s interest not only in funds that are disbursed directly from HUD to HABC, but also to funds defined as “operating receipts,” which may include project rents and other funds that are not disbursed directly from HUD to HABC. The PH ACC defines “Operating Receipts” as “all rents, revenues, income, and receipts accruing from, out of, or in connection with the ownership of such project.”

OMB Circular A-87 is also incorporated by reference into the PH ACC, and governs the use of HUD's grants to HABC. PH ACC Section 5 (Ex. D); 2 C.F.R. Part 225; 24 C.F.R. § 85.22(b). Circular A-87 establishes that damages are not payable without HUD's express, written permission.³ Therefore, HABC cannot pay the *Smith* judgment from Federal funds unless it receives written permission from HUD to do so.. This provision further demonstrates that HUD maintains control over Federal funds in HABC accounts.

The PH ACC further states that after HUD funds are deposited in HABC's account, HABC may withdraw funds from the account "only for (1) the payment of the costs of development and operation of the projects under ACC with HUD; (2) the purchase of investment securities as approved by HUD; and (3) such other purposes as may be specifically approved by HUD." (PH ACC, ¶9(C), p. 4, Ex. D). These provisions clearly identify the conditions under which HABC may spend the grant funds, demonstrating HUD's interest in the funds even after they have been disbursed to HABC.

In order to insure that the grant funds are being spent as directed, the PH ACC requires that HABC maintain records "that identify the sources and application of funds in such a manner as to allow HUD to determine that all funds are and have been expended in accordance with each specific program regulation and requirement." (PH ACC, ¶9(C), p. 4, Ex. D). If HABC does not use these funds for the purposes for which they were intended, HUD is entitled to declare a substantial default of the ACC and exercise any of the legal remedies available to insure that the money is used for proper purpose, including taking over HABC projects and the funds associated

³ **Fines and penalties.** Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments. OMB Circular A-87 Appendix B, ¶ 16 (codified at 2 C.F.R. Part 225, App. B).

with them. (PH ACC, ¶17, Ex. D). These provisions demonstrate that there are accountability procedures in place to insure that the grants to HABC are being spent as directed, and that HUD has a reversionary interest in the funds. This is further evidence that the funds disbursed to HABC are Federal funds in which HUD maintains its interest.

In addition to Section 9 funding, HABC also receives funding under Section 8 of the Housing Act, 42 U.S.C. §1437f. Under Section 8, the designated purpose of the assistance payments is “aiding low-income families in obtaining a decent place to live and...promoting economically mixed housing.” 42 U.S.C. §§1437f (a). Similar to the Section 9 program, HUD provides funds to HABC pursuant to an ACC (hereinafter S8 ACC), which requires the housing authority to comply with program regulations and requirements in exchange for subsidies HABC uses to provide housing voucher payments for low income families. 42 U.S.C. §1437f(b); 24 C.F.R. Parts 982 and 983. The statutory authorization for the Section 8 program makes clear that the funds are to be used for a specified purpose. The language of the S8 ACC between HUD and HABC makes clear that the funds given to HABC for the Section 8 program may only be used for the designated purpose of aiding low-income families in obtaining a place to live: “The HA must use program receipts to provide decent, safe, and sanitary housing for eligible families in compliance with the U.S. Housing Act of 1937 and all HUD requirements. Program receipts may only be used to pay program expenditures.”⁴ (S8 ACC, ¶11, Ex. E).

This is not the only provision of the S8 ACC that demonstrates the Federal nature of the funds disbursed to HABC under the Section 8 program. For example, the S8 ACC also states that “[t]he HA must comply, and must require owners to comply, with the requirements of the

⁴ “Program receipts” is defined by the ACC to mean “Amounts paid by HUD to the HA [housing authority] for a program, and **any other amounts** received by the HA in connection with the program.” (emphasis added) (S8 ACC, ¶1, Ex. E). HUD considers any project rents or other amounts received by HABC in connection with this program to be Federal funds in which HUD retains an interest.

U.S. Housing Act of 1937 and all HUD regulations and other requirements.” (S8 ACC, ¶10, Ex. E). Therefore, funds distributed to HABC are not only subject to OMB Circular A-87 as described above, but also the HUD regulations which set forth in detail the way in which program funds are to be used. 24 C.F.R. Parts 982, 983. The extensive regulatory restrictions on the way in which housing authorities administer the Section 8 program demonstrate HUD’s control over the use of funds.

The S8 ACC specifically states that HABC may “only withdraw program receipts for use in connection with the program in accordance with HUD requirements.” (S8 ACC, ¶13, Ex. E). These specific conditions on the way in which the funds may be used underscore HUD’s continued interest in the funds even after they have been disbursed to HABC. In addition the S8 ACC states that the bank in which the HUD funds are held “must permit withdrawals of deposited funds by HUD,” demonstrating that HUD retains an ongoing interest in the funds. (S8 ACC, ¶13(d), Ex. E). Given the statutory language specifying the purpose for which Section 8 funds are to be used, the contractual restrictions of the S8 ACC, and HUD’s authority to withdraw the funds, it is clear that HUD maintains its interest in the Federal funds disbursed to HABC.

In addition to the ACCs, HABC also has what is referred to as a “Moving to Work Agreement” with HUD. (Ex. F). The essence of this Agreement is that HABC may combine the different kinds of funds they receive from HUD (for example Section 8 and Section 9 funds) making those funds fungible, to be used by HABC for the administration of its housing programs. (MTW Second Amendment, p. 1, Ex. F). However, the Moving to Work Agreement specifically states that “such funds remain Federal funds, and are subject to any and all other Federal requirements ... (e.g., including but not limited to ... OMB Circulars and

requirements)...” (MTW Second Amendment, p. 2, Ex. F). Thus, this further confirms HUD’s expectation that the funds granted to HABC maintain their character as Federal funds until they are used for their designated purpose.

Lastly, the General Depository Agreement between HABC and Bank of America makes clear that HUD maintains its interest in the Federal funds disbursed to HABC. The ACCs for both Section 8 and Section 9 require that HABC deposit and invest all Federal funds under a General Depository Agreement (GDA) the form of which is prescribed by HUD, but which is executed by HABC and its bank, in this case Bank of America. (PH ACC, ¶9, Ex. D; S8 ACC ¶13, Ex. E; GDA, Ex. G). The preamble to the GDA reaffirms that HUD has entered into a contract with HABC “for the purpose of providing financial assistance to develop and operate lower income housing projects” and that pursuant to the contract, HABC “is required to select as depositories of its funds financial institutions whose deposits or accounts are insured....” (GDA, preamble, p.1, Ex. G). Thus, the language of the GDA demonstrates HUD’s control of the manner in which HABC handles the funds disbursed to it. In paragraph 5, the GDA states that HUD can stop all withdrawals from HABC accounts, and can require the bank to obtain written permission from HUD before permitting any withdrawals from the account. (GDA, ¶5, Ex. G). Clearly, HUD’s ability under this provision to completely freeze HABC’s ability to make withdrawals from the accounts covered by the GDA demonstrates that HUD maintains an interest in the funds disbursed to HABC.

There are additional provisions that demonstrate the Federal nature of the funds deposited under the GDA. For example, HUD is specifically named as a third party beneficiary with the ability to sue in order to enforce the terms of the Agreement. (GDA, ¶8, Ex. G) Furthermore, the GDA states that “the provisions of this Agreement may not be modified by either Party

without the prior written approval of HUD.” (GDA, ¶ 10, Ex. G). Thus, the language of the General Depository Agreement supports HUD’s position that the funds granted to the Housing Authority maintain their character as Federal funds that can be controlled by HUD, even when deposited in HABC bank accounts.

The specific purposes for which Congress has designated the funds granted to HABC, in combination with the restrictions of the ACCs, MTW Agreement, and the General Depository Agreement make clear that the funds HABC receives from HUD maintain their character as Federal funds that can only be used for their designated purpose.

3. Funds contained in the Bank of America accounts that are the subject of the pending Writ of Garnishment are Federal funds.

The pending Writ of Garnishment is against the HABC funds deposited at Bank of America. (Writ, Ex. B). HUD has disbursed funds to HABC. (ACC amendments, Ex. H). As established above, all HUD funds disbursed to HABC must be deposited into accounts that are covered by a GDA and used only for their designated purpose. (PH ACC Section 9, Ex. D; S8 ACC ¶13, Ex. E; GDA, Ex. G). Bank of America has confirmed that all of HABC’s accounts at Bank of America are covered by the GDA. (BOA letter, Ex. I; HABC letter, Ex. J). HABC, who is required to track the source and application of funds pursuant to the ACCs, has confirmed that Federal funds are contained in accounts covered by the GDA. (HABC letter, Ex. J). In fact, HABC’s Chief Financial Officer has stated under the penalty of perjury that of the accounts listed in the May 7, 2010 letter from Bank of America, “[a]ll of the accounts, except for the Discretionary Income Funds Checking (account ending 8354) and the Expert Pay MD Child Support (account ending 2752), contain Federal funds.”⁵ (HABC letter, Ex. J) Therefore, the

⁵ While HABC has represented that these accounts contain non-federal funds, to the extent that any federal funds are found to be in these accounts, HUD reserves the right to oppose the garnishment of such funds.

pending Writ of Garnishment is against Federal funds, and should be quashed with respect to all Federal funds.

B. OMB Circular A-87 further restricts the use of Federal funds

The Office of Management and Budget assists the President of the United States in the development and execution of his policies and programs. OMB has a hand in the development and resolution of all budget, policy, legislative, regulatory, procurement, e-gov, and management issues on behalf of the President. OMB Circular A-87 is entitled “Cost Principles for State, Local, and Indian Tribal Governments,” and is codified at 2 C.F.R. Part 225. This circular establishes principles and standards for determining the allowable costs incurred by HABC. 24 C.F.R. § 85.22(b); PH ACC Section 5, Ex. D; S8 ACC, ¶10, Ex. E)⁶

As a result, the use of HUD funds granted to HABC is further subject to the principles articulated in OMB Circular A-87. A fundamental premise articulated in the Circular is that “[g]overnmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award.” 2 C.F.R. §225 App. A(2). This means that the money disbursed to HABC cannot be used for any purpose except those which have been set forth in the statutes and documents that govern the grants, such as the ACCs and MTW agreement.

⁶24 C.F.R. Part 85 is entitled “Administrative Requirements for Grants and Cooperative Agreements to State, Local and Federally Recognized Indian Tribal Governments. Section 85.22(b) states as follows: “*Applicable cost principles.* For each kind of organization, there is a set of Federal principles for determining allowable costs. Allowable costs will be determined in accordance with the cost principles applicable to the organization incurring the costs. The following chart lists the kinds of organizations and the applicable cost principles. [Chart] For the costs of a—State, local or Indian tribal government. Use the principles in—OMB Circular A-87.”

OMB circular A-87 places a specific restriction on the use of funds to pay damages, such as those that are the subject of the pending Writ of Garnishment:

Fines and penalties. Fines, penalties, damages, and other settlements resulting from violations (or alleged violations) of, or failure of the governmental unit to comply with, Federal, State, local, or Indian tribal laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the Federal award or written instructions by the awarding agency authorizing in advance such payments.

OMB Circular A-87 Appendix B, ¶ 16 (codified at 2 C.F.R. Part 225, App. B).

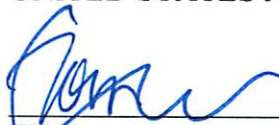
Because the funds distributed under the ACC are subject to this provision, HABC is not permitted to use HUD funds to pay the judgment unless and until HUD gives HABC express permission in advance to do so. As a result, Federal funds in HABC's accounts with Bank of America cannot be used to satisfy the Writ of Garnishment, and therefore the Writ of Garnishment should be quashed as to the Federal funds.

V. Conclusion

For the reasons set forth above, the United States Department of Housing and Urban Development respectfully requests that the pending Writ of Garnishment be quashed as to the Federal funds.

Respectfully submitted,

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