UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF HEARINGS AND APPEALS

In the Matter of :	19-AM-0025-AO-006 19-AM-0069-AO-029 (Consolidated Cases)
Ark Mortgage, Inc,	
Petitioner.	7-207101840A 7-207102220A

DECISION AND ORDER

This proceeding is before the Office of Hearings and Appeals upon a request for hearing filed by Ark Mortgage, Inc., of Spring Valley, N.Y. ("Petitioner") concerning the existence, amount, or enforceability of a debt allegedly owed to the U.S. Department of Housing and Urban Development ("HUD" or "the Secretary").

The Debt Collection Improvement Act of 1996 authorizes federal agencies to use administrative offset as a mechanism for the collection of debts owed to the United States government. *See* 31 U.S.C. §§ 3716, 3720A. The HUD Office of Hearing and Appeals has jurisdiction to determine whether Petitioner's debt is past due and legally enforceable pursuant to 24 C.F.R. §§ 17.61 *et. seq*. The administrative judges of this Court, in accordance with the procedures set forth in 24 C.F.R. §§ 17.69 and 17.73, have been designated to conduct a hearing to determine, by a preponderance of the evidence, whether the alleged debt is past due and legally enforceable. The Secretary bears the initial burden of proof to show the existence and amount of the alleged debt. Pursuant to 24 C.F.R. § 17.69(b)-(c). Thereafter, Petitioner must show by a preponderance of the evidence that all or part of the alleged debt is either not past due or not legally enforceable.

PROCEDURAL BACKGROUND

On or about December 3, 2018, Petitioner filed its initial hearing request in 19-AM-0025-AO-006, pertaining to HUD Claim No. 720710184, with the HUD Office of Hearings and Appeals. On or about January 28, 2019, Petitioner filed another *Request for Hearing* pertaining to HUD Claim No. 720710222. Both cases were later consolidated on February 28, 2019. *See Ruling and Order of Consolidation*, dated February 28, 2019. On or about December 4, 2018, and pursuant to 24 C.F.R. § 17.77, this Court initially stayed the issuance of an administrative offset order until the issuance of this written decision. (*See Notice of Docketing, Order and Stay of Referral*, dated December 4, 2018 ("*Notice of Docketing*") at 2). The Court also provided an opportunity for Petitioner to file additional documentary evidence. *Id.* On February 27, 2019, Petitioner filed *Petitioner's Submission of Documentary Evidence in Support of Its Position that the Alleged Debts are Unenforceable* ("*Pet. Resp-1*"). On or about April 14, 2019, the Secretary filed *the Secretary's Statement that Petitioner's Debt Is Past Due and Legally Enforceable* ("*Sec'y. Stat*."), pertaining to HUD Claim No. 720710184, along with documentary evidence in support of the Secretary's position. On or about April 19, 2019, the Secretary filed a second *Secretary's Statement* pertaining to HUD Claim No. 720710222 ("*Sec'y Stat-1*"). On April 26, 2019, Petitioner filed *Petitioner's Response to Secretary's Statement That Petitioner's Debt is Past Due and*

Legally Enforceable ("*Pet. Resp-2*"), pertaining to HUD Claim Nos. 720710184 and 720710222. On October 18, 2019, the Secretary filed the *Secretary's Supplemental Statement that Petitioner's Debt is Past Due and Legally Enforceable,* ("*Sec'y. Supp. Stat*"). On October 25, 2019, Petitioner filed *Petitioner's Reply to Secretary's Supplemental Statement* ("*Pet. Resp-3*").[1]

The Secretary maintains that Petitioner is indebted to the Department under the indemnification provisions of two loan agreements between the U.S. Department of Housing and Urban Development and Ark Mortgage, Inc. of Spring Valley, N.Y. Those agreements have been designated, for purposes of discussion, as the "Vivian Loan" and the "Rodriguez Loan." The applicable indemnification provisions on the Vivian Loan are set forth in a Settlement Agreement, dated April 14, 2004. The applicable indemnification provisions on the Rodriguez Loan are set forth in an Indemnification Agreement, dated July 25, 2006. Petitioner maintains that it has no liability under either indemnification agreement because the parties had not come to a "meeting of the minds," when they executed the contracts, thereby rendering the agreements "invalid." Alternatively, Petitioner argues that it's liability for the payments contemplated under the indemnification agreements should be reduced: 1) by virtue of HUD's failure to follow regulations applicable to Federal Housing Administration ("FHA") loan servicers, 2) by the mitigation of damages doctrine, and 3) by application of the implied covenant of good faith and fair dealing. *Pet. Resp-2*, ¶ 4; *Pet. Resp-3*, ¶ 1.

FINDINGS OF FACT

The Vivian Loan

1. In September 2002, HUD's Quality Assurance Division ("QAD") Lender Monitoring Team conducted a review of Petitioner's mortgage finance operations to determine whether Petitioner—a HUD-authorized Direct Endorsement mortgage lender had complied with HUD's rules and regulations when underwriting and issuing HUD/FHA-insured mortgages. *Sec'y Stat.,* Exhibit A, Declaration of Brian Dillon[sic] at ¶ 4, (Exhibit A actually contains the Declaration of Kathleen M. Porter, which purports to provide a sworn declaration of the facts specifically referred to in the *Sec'y Stat.*).[2]

2. During its review, the QAD found that while underwriting the mortgage of Thomas Vivian, FHA case number 352-4392456 ("Vivian Loan"), Petitioner engaged in non-compliant lending activities which exposed HUD to an unacceptable level of risk. *Sec'y. Stat.*, ¶ 4.

[1] *Petitioner's Request to Consolidate Docket Numbers 19-AM-0069-AO-029 and 19-AM-0025-AO-006* was filed on February 27, 2019, and has been granted, along with *Petitioner's Motions for Leave to File Reply Briefs* in this case. Extensions of time have also been granted to both parties to allow time to file pleadings in this case and to discuss possible settlement. Further delays in court processing were also incurred due to Covid-19.

[2] For purposes of these Findings of Fact, I find that the Secretary's apparent, inadvertent references to the "Dillon Declaration" contained in the *Secretary's Statement* actually refer to the Kathleen M. Porter Declaration attached as Exhibit A to the *Sec'y Stat.* The Secretary's references to the Dillon Declaration shall be treated accordingly. The Porter/Dillon Declaration attaches additional Exhibits A – F, not to be confused with Exhibit A of the *Sec'y. Stat.*

3. On April 14, 2004, Petitioner entered into a Settlement Agreement with HUD and agreed to indemnify HUD for any loss HUD incurred as insurer of the Vivian Loan. *Id*. It is the indemnification provisions of this Settlement Agreement that give rise to the Department's liability claims against Petitioner.

4. In the Settlement Agreement, Petitioner agreed to indemnify HUD for "any claim[s] for insurance" on specific loans, including the Vivian Loan, "which are in default, or go into default, from the loans' endorsement date, through and up to five years from the Effective Date of [the Settlement Agreement]." . *Sec'y. Stat*., Exhibit A, Porter/Dillon Decl., Exhibit A, Settlement Agreement at ¶ 4.

5. Paragraph 11 of the Settlement Agreement expressly states that "[t]his Settlement Agreement is voluntary and entered into by AMI after consultation with legal counsel and due consideration of the terms contained herein. AMI will not seek the termination or reconsideration of this Settlement Agreement, directly or indirectly, after the Effective Date identified in Paragraph 1 …" *Id.* at ¶ 11 (emphasis added).

6. The Vivian Loan was endorsed for insurance on September 20, 2001, and on November 1, 2008 the loan went into default. *See* Porter/Dillon Decl. at ¶ 5.

7. HUD paid an insurance claim for a Partial Claim in the amount of $11,326.72 on December 13, 2002 and a Part A claim in the amount of $273,799.93 on September 27, 2018. Combined with a $75.00 miscellaneous fee, the total claim amount for the Vivian Loan was $285,201.65. Porter/Dillon Decl. at ¶ 5; Ex. C of Porter/Dillon Decl.

8. The Secretary alleges that Petitioner is indebted to HUD in the following amounts:

   (a) $285,126.55 as the unpaid principal balance as of March 31, 2019;
   (b) $11,090.28 as the unpaid interest on the principal balance at 1% per annum through March 31, 2019;
   (c) $17,549.22 as unpaid penalties as of through March 31, 2019;
   (d) $179.56 as unpaid administrative costs as of March 31, 2019; and
   (e) interest on said principal balance from April 1, 2019 at 1% per annum until paid.

   Porter/Dillon Decl. at ¶ 7.

10. A Notice of Intent to Collect via Treasury Offset was sent to Petitioner on November 12, 2018. *Id.* at ¶ 6. As of March 31, 2019, Petitioner failed to make payment as set forth in the Agreement. *Id.* at ¶ 7.

The Rodriguez Loan

11. In 2006, the QAD conducted an additional review of Petitioner's mortgage finance operation. Porter/Dillon Decl. at ¶ 8.
12. During its review, the QAD determined that while underwriting the mortgage of Olaf Danilo Rodriguez, FHA case number 352-5450237 ("Rodriguez Loan"), Petitioner had

engaged in non-compliant lending activities which exposed HUD to a level of risk that was deemed "unacceptable" by HUD. *Id*.

13. To resolve the QAD's 2006 findings, Petitioner agreed on July 26, 2006 to indemnify HUD for any loss HUD incurred as insurer of the Rodriguez Loan. *Id*.

14. In the Indemnification Agreement, Petitioner agreed to "indemnify HUD for losses which have been or may be incurred related to [the Rodriguez Loan], which is in default, or goes into default, through and up to five years from [July 21, 2006]." Porter/Dillon Decl. Ex. D. ("Indemnification Agreement"), ¶ 1.

15. The Rodriguez Loan was subsequently endorsed for insurance, and on May 1, 2009 the loan went into default. *See* Porter/Dillon Decl. at ¶ 9; Porter/Dillon Decl. Ex. E. at pp. 1–3.

16. HUD paid a Part A insurance claim in the amount of $220,644.72 on October 21, 2018. *See* Porter/Dillon Decl. ¶ 9; Porter/Dillon Decl. Ex. E. at p. 15.

17. The Secretary seeks the following payments under the terms of the Indemnification Agreement (Porter/Dillon Decl., ¶ 11):

    (a) $200,644.72 as the unpaid principal balance as of March 31, 2019;
    (b) $4,536.47 as the unpaid interest on the principal balance at 1% per annum through March 31, 2019;
    (c) $13,455.71 as unpaid penalties as of through March 31, 2019;
    (d) $104.56 as unpaid administrative costs as of March 31, 2019; and
    (e) interest on said principal balance from April 1, 2019 at 1% per annum until paid.

    Id.

18. A Notice of Intent to Collect via Treasury Offset was sent to Petitioner on December 3, 2018. *Id.* at ¶ 10. Petitioner has not made the agreed payments under the Indemnification Agreement to HUD. *Id.,* ¶ 11.

19. In Exhibit A to Porter/Dillon Decl., Settlement Agreement, ¶ 4(a), Petitioner agreed to indemnify HUD on the Vivian Loan for "***any claim*** for insurance ... [and] where HUD incurs ***any expenses or losses*** in honoring its FHA obligations ... the amount of indemnification is HUD's Investment...." (emphasis added).

23. For purposes of indemnification, HUD's Investment in the Vivian Loan includes, but is not limited to, "the full amount of the insurance claim actually paid by HUD, all taxes and assessments paid..., [and] all maintenance and operating expenses paid ... (including costs of rehabilitation and preservation)...." *Id.,* ¶ 4(b)(1).

24. HUD determined that the claim for insurance filed by the lender on the Vivian Loan was a valid claim; thus, the claim was paid in accordance with HUD's regulatory authority to do so. *See* Porter/Dillon Decl., ¶ 5.

25. Petitioner signed the 2006 Rodriguez Indemnification Agreement on July 26, 2006, and agreed that, "[i]n the event of a valid claim for insurance on [the Rodriguez Loan], indemnification will be in accordance with paragraph (b), (c), (d), or (e) [of the Indemnification Agreement], whichever applies." Exhibit D to Porter/Dillon Decl., Rodriguez Indemnification Agreement at ¶ 1(a).

26. Paragraph 1(d) of the Indemnification Agreement provides that "[i]n any . . . case where a HUD/FHA insurance claim . . . has been paid, the [Petitioner] shall pay HUD the amount of HUD's Investment in accordance with the terms of an invoice or bill the Department sends to [Petitioner]." *Id.* at ¶ 1(d).

27. Paragraph 1(a) provides that, "HUD's Investment includes, but is not limited to: the full amount of the insurance claim actually paid, [and] all taxes and assessments paid or payable by HUD...." *Id.* at ¶ 1(a).

28. HUD determined that the claim for insurance filed by the lender on the Rodriguez Loan was a valid claim. HUD paid the insurance claim along with related expenses per the terms of the Rodriguez Indemnification Agreement. HUD maintains that it did so in accordance with it's regulatory authority to do so. *See* Porter/Dillon Decl. at ¶ 9.

DISCUSSION

It is axiomatic that the courts will give contract language its plain meaning in order to determine its enforceability. If the contract provisions are clear and unambiguous, the Court need not resort to parol evidence or additional rules of contract construction. Contract interpretation begins with the plain language of the contract. *Gould, Inc. v. United States*, 935 F.2d 1271, 1274 (Fed. Cir. 1991); *accord Hol-Gar Mfg. Corp. v. United States*, 169 Ct. Cl. 384, 390 (1965). A court should first employ a "plain meaning" analysis in any contract dispute. *Aleman Food Services, Inc. v. United States*, 994 F.2d 819, 822 (Fed. Cir. 1993).

The intention of the parties to a contract controls its interpretation. *Firestone Tire & Rubber Co. v. United States*, 444 F.2d 547, 551 (Ct. Cl. 1971). In construing the terms of a contract, however, the parties' intent must be gathered from the instrument as a whole in an attempt to glean the meaning of terms within the contract's intended context. *Kenneth Reed Constr. Corp. v. United States*, 475 F.2d 583, 586 (Ct. Cl. 1973); *Tilley Constructors v. United States*, 15 Cl. Ct. 559, 562 (1988). Contract interpretation requires examination first of the four corners of the written instrument to determine the intent of the parties. *Hol-Gar Mfg. Corp. v. United States*, 351 F.2d 972 (Ct. Cl. 1965). An interpretation will be rejected if it leaves portions of the contract language useless, inexplicable, inoperative, meaningless, or superfluous. *Ball State Univ. v. United States*, 488 F.2d 1014 (Ct. Cl. 1973); *Blake Constr. Co. Inc. v. United States*, 987 F.2d 743, 746-47 (Fed. Cir. 1993).

The two applicable indemnification agreements here appear to contain straight-forward language insofar as the disputes in this case are concerned. Petitioner argues that the Settlement Agreement of April 14, 2004 (governing the Vivian loan), and the Indemnification Agreement of July 26, 2006 (governing the Rodriguez loan), (together referred to as the "Indemnification Agreements"), contained ambiguous language and did not incapsulate the "meeting of the minds" required to reach a valid contractual agreement. *Pet. Resp-3,* ¶ 1. Alternatively, Petitioner argues that even if the agreements were valid, then "HUD breached both Indemnification Agreements when HUD, as "the administrator" of the FHA program, did not ensure that the loans were properly serviced. Petitioner further argues that this alleged breach included HUD's failure "to mitigate damages by allowing the loans to languish in default for a combined total of 18 years." *Pet. Resp-3,* ¶ 1.

Petitioner also alleges, in passing, that "HUD fraudulently induced AMI into entering into the Indemnification Agreements." *Pet. Resp-3,* ¶ 5. However, I find that Petitioner has alleged no appreciable facts to support this assertion. Neither the Indemnification Agreements, nor the documentary evidence of record in this case contains any provision requiring HUD to act as a guarantor of FHA compliance with regulatory servicing requirements. Petitioner has also not come forward with any misrepresentation of material fact by HUD officials, committed either by omission or commission. The court, therefore, finds, as a preliminary matter, that Petitioner was not fraudulently induced to enter into the Indemnification Agreements with the Department.

1. The Indemnification Agreements Were Not Ambiguous

The Secretary argues that "this Court need only look within the four corners of the indemnification agreements between HUD and Petitioner to determine Petitioner's liability [and that] [p]arties to an Indemnification Agreement are bound by the terms of the agreement …" *Sec. Stat.,* ¶ 49. The Secretary further states that "the [Office of Hearings and Appeals] is not authorized to create new contractual rights at the request of a party obligated under terms of a legally enforceable indemnification agreement." *In re: Susquehanna Mortgage Corp. (Claim A),* HUDBCA No. 04-A-NY-EE048, 9 (Sep. 16, 2005) (quoting *In re Homestead Funding Corporation,* HUDBCA No. 04-A-NY-EE044 (Feb. 1, 2005)). *Id.*

The Secretary points to black-letter principles of contract interpretation that provide:

> "[i]n interpreting a contract provision, the polestar . . . is the intention of the parties to the contract as revealed by the language used, taken as an entirety" and that "courts should interpret a contract considering the objective intent manifested in the language of the contract in light of the circumstances surrounding the transaction."

Id., ¶ 50. *(quoting, Lederman v. Prudential Life Ins. Co. of America,* 385 N.J. Super. 324, 339–40 (App. Div. 2006) (internal quotation marks omitted); *see also In re Susquehanna Mortgage Corp* at 9.

Petitioner argues that under the Indemnification Agreements, HUD agreed to accept responsibility for the servicing activities of FHA lenders, and their compliance with applicable

regulations. Petitioner argues, at length, that "the basic tenants[stet.] of contract law" require a finding that there was no meeting of the minds between the parties, and that HUD failed to mitigate damages under the Vivian and Rodriguez loans. *Pet. Resp-2,* ¶ 2. (*citing, Restatement (Second) of Contracts §* 17 (1981)). Petitioner excerpts portions of the language from the Rodriguez Indemnification Agreement, e.g., that "[a[ll HUD requirements for servicing... will be observed with respect to [the Rodriguez loan]", and from this, determines that HUD had thereby agreed to reduce AMI's liability to pay the HUD Investment for insurance payouts and related expenses in the amounts attributable to foreclosure delays by FHA servicers. *Id.*

Petitioner further argues that the Secretary " 'confirms' that servicing rules, such as 24 C.F.R. § 203.356(b), which are stipulated to in both indemnification agreements, require HUD to ensure that certain rules are followed, including the reasonable diligence requirements regarding foreclosure…" *Id.* Petitioner states that:

> "AMI did not enter into the Vivian Agreement with the belief that HUD would allow the Vivian Loan to compound holding costs while it sat in default for at least nine years, five of which HUD reports the property sat vacant. AMI did not enter into the Rodriguez Agreement with the belief that HUD would allow the Rodriguez Loan to compound holding costs while it sat in default for over nine years. February 27 Submission, Exhibit D. These exorbitant and unreasonable time periods are in direct contradiction to HUD's servicing rules found in 24 C.F.R. §§ 203.355 and 203.356, Mortgagee Letter 2001-19, and Mortgagee Letter 2005-30, which HUD agreed to follow through its contractual language in the indemnification agreements.

Id. (citations omitted).

However, a full reading of the Vivian Indemnification Agreement, ¶ 2, makes it clear that no such agreement by HUD to be bound by FHA-servicing liability can be fairly gleaned from the language excerpted by Petitioner. In fact, the duty to comply with these rules and regulations regarding the Vivian loan applies expressly to Petitioner, and Petitioner alone. The complete sentence reads: "AMI shall fully comply with all rules, regulations, and other requirements of HUD pertaining to the origination and servicing of HUD/FHA-insured mortgages." (emphasis added). Exhibit A to Porter/Dillon Declaration, ¶ 2. In fact, nowhere in the language of the entire Vivian indemnification language of the Settlement Agreement is there a provision imposing any duty on the part of HUD to guarantee regulatory compliance by FHA loan servicers. I find no ambiguity in the Vivian Agreement on the issue of HUD's entitlement to be indemnified by Petitioner for HUD's payment of insurance claims and related expenses on the Vivian loan.

This finding comports with the Secretary's position that "there is no language in either the Rodriguez or Vivian agreements, express or implied, that requires HUD to comply with FHA loan servicing requirements." *Sec'y. Supp. Stat.,* ¶ 17. Moreover, the Secretary argues, such a requirement would be impractical "when one considers that HUD does not service the loans that it insures, and that one purpose of an indemnification agreement is to ensure that if the lender is still servicing the non-compliant loan, the lender will continue to service the loan in compliance with HUD's loan servicing requirements whether housed in Mortgagee Letters or HUD regulations."

Sec'y. Supp. Stat., ¶ 4.

I also find no ambiguity in the provisions of Paragraph 11 of the Vivian Agreement that expressly state:

> "[t]his Settlement Agreement is voluntary and entered into by AMI after consultation with legal counsel and due consideration of the terms contained herein. AMI will not seek the termination or reconsideration of this Settlement Agreement, directly or indirectly, after the Effective Date identified in Paragraph 1 …"

Exhibit A to Porter/Dillon Decl., Settlement Agreement, ¶ 11. (emphasis added). This express language, taken in context with the entire agreement, is dispositive in my view. Contrary to Petitioner's assertions to the contrary, it demonstrates that AMI entered into the agreement with it's "eyes wide open," as an experienced HUD-approved, Direct Endorsement Mortgage Lender, represented by legal counsel, and with the intention to be fully bound by the unambiguous terms of the contract. The Court finds that the applicable terms of the Indemnification Agreements were not ambiguous and that HUD did not breach those agreements.

In light of the finding that the applicable language of the Vivian Agreement is not ambiguous, it is not necessary to reach Petitioner's ancillary arguments regarding the doctrine of *contra proferentum.* There is no dispute that HUD was the drafter of the Settlement Agreement. As Petitioner points out, ordinarily, ambiguous contract terms may be construed "against the drafter based on public policy factors, primarily equitable considerations about the parties' relative bargaining strength." *Lamps Plus, Inc. v. Varela*, 139 S. Ct. 1407, 1417 (2019); *See also* Restat 2d of Contracts, § 206. *Pet. Resp-3,* ¶ 4. Petitioner further argues that the Government, as the contract drafter, had the duty to ensure that the "words of the contract correctly and concisely communicate the proper notions and intentions of the parties, and the Government must bear the burden of a failure to carry that responsibility." *Id*, ¶ 5. I find that the full language of the Settlement Agreement makes it entirely clear, however, that HUD never agreed to accept responsibility, financially, or otherwise for guaranteeing regulatory compliance by the FHA servicer on the Vivian loan.

Similarly, the Indemnification Agreement for the Rodriguez loan also did not contain any ambiguity with respect to Petitioner's liability for "HUD's Investment" under the agreement, including reimbursement for:

> "the full amount of the insurance claim actually paid, all taxes and assessment paid or payable by HUD (including costs of rehabilitation and preservation), loss mitigation, prorated losses from and expenses associated with the sale of a note, reasonable penalties for failure to pay amounts owed within the timeframe established on HUD invoices, interest on the amount owed at 5% per annum calculated from the date of the first bill, all sales expenses and any other expenses HUD may incur in connection with its claim disposition programs regarding FHA insured programs."

Exhibit D to Porter/Dillon Declaration, ¶ 1 a). The extent of Petitioner's liability for payment of "HUD's Investment" is spelled out in particular detail. Petitioner's argument alleging ambiguity in the Rodriguez loan is set forth below:

> "In the Rodriguez Agreement, HUD expressly wrote that '[a]ll HUD requirements for servicing and payment of mortgage insurance premiums will be observed with respect to such mortgages.' *Id.* ¶ 1(a). It is reasonable for AMI to believe this provision applied solely to HUD as AMI is not an FHA servicer and has never serviced an FHA loan. Read in context with the entire agreement, it is also reasonable to determine that the statement applies to HUD, the drafter of the contract and the party to the contract that is responsible for overseeing all FHA servicing. It is, however, unreasonable for the Secretary to argue that a contract provision that HUD drafted regarding current and future servicing of the loan applies to AMI as HUD knew, as the administrator of the FHA program, that AMI was only an FHA originator and had sold the loan roughly five months prior to the execution of the Rodriguez Agreement."

Pet. Resp-3, ¶¶ 4-5. Petitioner's argument here suffers from the same faults as it's argument on the Vivian loan. Nowhere is there language in the agreement, and Petitioner points to none, that states that HUD agrees to accept liability for regulatory compliance by FHA lenders. Despite Petitioner's blithe treatment of this complete absence of language requiring HUD to "oversee" all FHA servicing, this does not suffice to create ambiguity where none exists.

The sentence that Petitioner excerpts above regarding compliance with "all HUD requirements for servicing and payment of mortgage insurance premiums," follows the sentence where AMI affirms that it has not submitted a HUD/FHA insurance claim prior to entering into the Indemnification Agreement, and agrees not to submit a claim for insurance. Thus, it makes sense that the next sentence certifies that AMI would follow "all HUD requirements for servicing and payment of mortgage insurance premiums…" It makes no sense that HUD would require itself to make insurance payments to itself. Again, in the Court's view, Petitioner's turgid reading of this language cannot form the basis for any finding of contract ambiguity. *See Ball State Univ. v. United States*, 488 F.2d 1014 (Ct. Cl. 1973); *Blake Constr. Co. Inc. v. United States*, 987 F.2d 743, 746-47 (Fed. Cir. 1993). Thus, the Court finds the Indemnification Agreements to be unambiguous and legally enforceable. Having proved the enforceability of the contract, the Court further finds that HUD did not breach the Vivian or Rodriguez Indemnification Agreements.

2. Mitigation of Damages

Having demonstrated that the Indemnification Agreements are entitled to be fully enforced, we turn to Petitioner's defense of failure to mitigate damages. This defense rests on the same pillar as Petitioner's ambiguity argument, i.e., that the indemnification language somehow fixes liability upon HUD for the alleged regulatory failures of FHA loan servicers.

This Court has long held that the duty to mitigate damages applies to non-breaching, as well as breaching parties. *In re Cambridge Home Capital, LLC.*, HUDOA No. 06-D-NY-GG004, 4 (June. 18, 2009) (quoting *Robinson and Florida Businessmen's Ass 'n v. United States*, 305 F. 3d 1330, 1333 (Fed. Cir. 2002)) (internal quotations omitted).

Petitioner argues that HUD's Office of Inspector General ("OIG") reported to the Secretary in October 2016 that HUD neglected to put into place adequate controls to enforce the reasonable diligence requirements required by 24 C.F.R. § 203.356(b). Exhibit A to *Pet. Resp-3*, HUD OIG Audit Report Number 2017-KC-0001. Petitioner states that:

> "[t]he OIG reported that HUD paid an 'estimated $2.23 billion in *unreasonable and unnecessary costs,'* including debenture interest and holding costs that were incurred after missed foreclosure or conveyance deadlines, on 238,978 properties between 2010 and 2015. OIG Report Pg. 1 (emphasis added). The OIG reported that HUD had significant internal control deficiencies and that HUD's Single Family Default Monitoring System ("SFDMS") and A43C Claims System were seriously deficient. OIG Report Pg. 9, 16. Because of these deficiencies, HUD neglected to ensure that foreclosure was completed by October 2004, as required by HUD's contractual obligation, on the Vivian Loan. February 27 Submission, Exhibit A; 24 C.F.R. § 203.356(b); Mortgagee Letter 2001-19. Similarly, HUD neglected to ensure that foreclosure was completed in December 2010, as required by HUD's contractual obligation, on the Rodriguez Loan. February 27 Submission, Exhibit D; 24 C.F.R. § 203.356(b); Mortgagee Letter 2005-30. Instead, both the Vivian Loan and the Rodriguez Loan were foreclosed upon in 2018, more than a combined 21 years after foreclosure should have been completed."

Id. Petitioner states that HUD seeks payment for "unnecessary and unreasonable costs" that were also pointed out by the OIG:

> "SFDMS did not perform automated checks, nor did it throw warning flags if a servicer missed a foreclosure deadline. Servicers could report on their delayed FHA-insured loans for years without an automated notification being sent to HUD. OIG Report Pg. 9; [and that] [t]he Claims system, like SFDMS, did not perform automated checks or throw flags if a servicer missed a foreclosure deadline. It also did not compare dates reported on the claim with servicers' monthly reporting in SFDMS to identify inconsistencies. OIG Report Pg. 9.

Id. Petitioner argues that the amount of insurance claims might have been reduced:

> [w]hile it is reasonable for servicers to pay costs to preserve the property and complete the foreclosure process, it is unnecessary and unreasonable for HUD to pay for such costs after the date the servicer was required to convey. *The claim would have been*

reduced if servicers conveyed on time...

Id. Exhibit A to *Pet. Resp-3,* OIG Report Pg. 1 (emphasis added).

Again, Petitioner can point to no language in the Indemnification Agreements that authorizes or requires HUD to perform such actions. For its part, HUD maintains that it has never conducted loan servicing duties, and has no legal authority to do so. *Sec. Supp. Stat.*, ¶ 20.

Petitioner, however, points to the FHA servicing deficiencies, and places responsibility for those deficiencies at HUD's doorstep. Petitioner states that:

> "HUD did not disclose to AMI that its internal systems were deficient. The Secretary claims that AMI should have known that HUD's internal systems were deficient, particularly because an OIG report from 2016 called attention to the issue.

Pet. Resp-3, ¶ 7. Pointedly, however, the Secretary points out that the 2016 OIG Report was not even issued until some 12 years after the Indemnification Agreements were entered into in 2004 and 2006. *See Sec. Supp. Stat.*, ¶ 21.

Petitioner cites no statute or regulation that prohibits HUD from paying the claim of a lender that misses the reasonable diligence timeframe for foreclosure contained in Mortgagee Letter ("ML") 2005-30, and none of the Mortgagee Letters that Petitioner cites contain such a prohibition. While 24 C.F.R. § 203.356(b) does require lenders to exercise reasonable diligence in prosecuting foreclosure proceedings to completion, neither this nor any other regulation requires HUD to reduce the amount of insurance benefits it pays to a lender because of the delay—except for the regulation requiring the curtailment of debenture interest. *See* 24 C.F.R. § 203.402(k)(1)(i).

Nevertheless, Petitioner argues that AMI's liability should be mitigated on the grounds that HUD should have somehow forced the FHA servicer to foreclose on the Vivian loan at an earlier date:

> "the reporting history for the Vivian Loan shows that foreclosure was not initiated timely after the partial claim (within six months of default) when the borrower became delinquent again nor was foreclosure completed within the required "reasonable diligence" timeframe (14 months). Thus, the allowable unpaid principal balance should be reduced to the original principal loan amount of $131,493 plus the first recorded partial claim of $11,326.72.

Pet. Resp-1, ¶ 9.

HUD argues that it has no such powers to force the initiation of foreclosure proceedings, and that its only ability to "sanction" FHA servicers is to curtail payment of debenture interest. Specifically, 24 C.F.R. § 203.402(k)(1)(i) states, in part, that where a lender fails to meet the reasonable diligence timeframe to prosecute foreclosure as required by 24 C.F.R. § 203.356(b),

debenture interest must be curtailed. *Id.* Consistent with 24 C.F.R. § 203.402(k)(1)(i), the Single-Family Application for Insurance Benefits submitted by the lenders show that insurance proceeds paid on the Vivian and Rodriguez claims were reduced due to the curtailment of debenture interest. *See Pet. Resp-1*, Ex. C. at pp. 1-2, 5-7; *Pet. Resp-1*, Ex. F. at p. 5. This is the only consequence to lenders for failing to meet reasonable diligence foreclosure timeframes and Petitioner cites no HUD statute, regulation, or non-binding Mortgagee Letter to the contrary. *Sec'y. Stat.,* at ¶¶ 27-28; see 24 C.F.R. § 203.402.(k)(1)(i).

Petitioner misstates the enforceability of Mortgagee Letter 2000-05, which provides guidance to lenders on HUD's Loss Mitigation Program requirements. Those provisions seek to avoid foreclosure resulting from default. Thus, ML 2000-05 advises that HUD will provide incentive fees to lenders who successfully use various loss mitigation tools, i.e., special forbearance, loan modification, partial claim, pre-foreclosure sale, or deed-in-lieu of foreclosure to cure the default and prevent judicial foreclosure. *Sec. Stat.,* ¶ 32. *See* ML 2000-05 at p. 7.

The complete language of ML 2000-05 states that, "[f]ailure to comply with the provisions of the Loss Mitigation Program ***may*** result in the loss of incentive compensation and other benefits; reduced reimbursement of foreclosure and acquisition costs; and interest curtailment related to foreclosure delays." ML 2000-05 at p. 6 (emphasis added).

Moreover, Petitioner has failed to prove that the lenders holding the Vivian and Rodriguez loans failed to comply with HUD's Loss Mitigation Program guidance prior to proceeding with foreclosure. Even if they did, ML 2000-05 contains no mandate that HUD must reduce foreclosure-related reimbursements to a lender who failed to follow HUD's Loss Mitigation guidelines. The language is optional and non-binding and does not support the proposition that Petitioner attempts to assert.

And even though the OIG Report was not in effect at the time the Indemnification Agreements were entered into, the Secretary points to language in the OIG Report, itself, that acknowledges HUD's inability to force compliance with FHA servicing guidelines:

> "HUD has few options to compel servicers to convey and file a claim in a timely manner. Program regulations allow HUD to disallow mortgage interest when a servicer misses a foreclosure deadline, but HUD has no further recourse to protect itself from servicers that have already missed a deadline but have yet to convey. Therefore, if a servicer missed its deadline to initiate foreclosure, it already forfeited its mortgage interest and had no further financial or regulatory incentives to meet its remaining deadlines.

OIG Report 2017-KC-0001 (October 14, 2016) at 7.

This Court has recognized that "HUD has a duty to mitigate its damages by making those efforts that are fair and reasonable." *See, In re Cambridge Home Capital, LLC.,* HUDOA No. 06-D-NY-GG004, 4 (June. 18, 2009) (quoting *Robinson and Florida Businessmen's Ass 'n v. United*

States, 305 F. 3d 1330, 1333 (Fed. Cir. 2002)) (internal quotations omitted). However, that duty to mitigate damages does not include the imposition of contractual obligations that are not contained in the underlying agreements themselves. Nothing in the Indemnification Agreements required HUD to take action to mitigate losses by ensuring the Vivian and Rodriguez Loans were foreclosed upon timely after default. HUD does not deny that the properties underlying the Vivian and Rodriguez loans sat for nine years in default before foreclosure was completed on them in 2018. But Petitioner has not demonstrated that HUD had agreed to accept responsibility for FHA servicer obligations to meet the regulatory time-frames, or that HUD even had the authority to intervene in the foreclosure process absent denying payment of debenture interest.

The Secretary correctly points out that an agency interpretation, guidance, or non-binding regulation "does not by itself give it the 'force and effect of law.'" *Chrysler Corp. v. Brown*, 441 U.S. 281, 302 (1979). This is particularly so, where mere guidance, such as ML 2000-05 has not been promulgated under law. This Court clarified this view in *In re Cambridge Home Capital, LLC.*, HUDOA No. 06-D-NY-GG004, 4 (Jun. 18, 2009). In *Cambridge*, a case in which the Petitioner argued that HUD failed to comply with pre-foreclosure requirements contained in a HUD Mortgagee Letter, this Court noted that "while HUD may be required to follow promulgated regulations, whether they are specifically incorporated into contractual language or not, *this is not the case with non-promulgated regulations or guidelines*." *Id.* at p. 4 (emphasis added):

> *"In order for the Mortgagee Letter to be legally binding, [HUD] is required to have promulgated the rules outlined in the Mortgagee Letter pursuant to a specific statutory grant of authority and in conformance with the procedural requirements set forth by statute. . . . Since the policies and procedures set forth in the Mortgagee Letter are interpretive rules and were not properly promulgated, I find that they do not carry the force and effect of law."*

Id. (internal quotations marks and citations omitted). In the instant case, as in *Cambridge*, the Mortgagee Letters cited by Petitioner "were neither published in the Federal Register nor disseminated to the public for scrutiny and comment." *Id.*

I therefore find that HUD did not breach the Indemnification Agreements, and did not fail to mitigate any damages under the agreements.

3. HUD Did Not Violate the Implied Covenant of Good Faith and Fair Dealing

Petitioner argues that HUD also violated an implied covenant of good faith and fair dealing that ran with the Indemnification Agreements. Petitioner states that it is not required to demonstrate improper motive on the part of HUD, or malicious intent toward AMI in order to prove the defense. In this regard, Petitioner seeks to distinguish the instant case from the "disappointed bidder cases," cited by the Government. *See Corel Corp. v. United States*, 165 F. Supp 2d. 12, 43, 62 (D.D.C. 2001). Petitioner further argues that "proof of bad faith is not required to show a breach of the implied duty of good faith and fair dealing in most cases." *TigerSwan, Inc. v. United States*, 110 Fed. Cl. 336, 345-46 (2013); and evidence of the Government's "intent to harm the contractor is not ordinarily required," such as when the government acts with a lack of diligence or

negligence, or fails to cooperate. *Id. at* 346; *see also Westlands Water Dist. v. United States,* 109 Fed. Cl. 177, 204 (2013) ("[a] showing of bad faith is not an element of a claim for breach of the implied duty of good faith and fair dealing). *Pet. Resp-3,* ¶ 5.

The Secretary disagrees with Petitioner's application of the case law. To meet its burden of proof, the Secretary argues that Petitioner must demonstrate that HUD's payment of the Vivian and Rodriguez insurance claims was done with a "specific intent to injure" Petitioner or that HUD was "motivated by animus towards the Petitioner." *Id.* (quoting *Keeter Trading Co., Inc. v. United States,* 85 Fed. Cl. 613, 618 (Fed. Cl. 2009) (internal quotation marks omitted).The covenant of good faith and fair dealing may likewise be breached "if, in ways unenvisioned by the contract, a party proceeds in a fashion *calculated* to frustrate or hinder performance by its contracting partner." *Keeter Trading Co.*, 85 Fed. Cl. at 618 (emphasis added).

This Court has upheld, for many years, the legal presumption that HUD acts in good faith when engaged in its contractual duties. (HUD "enjoys a legal presumption that it is acting in good faith when carrying out its duties." *In re Cambridge Home Capital, LLC.* at 5 (citing *Spezzaferro v. Fed. Aviation Admin.*, 807 F.2d 169, 177 (Fed. Cir. 1986)). The Secretary argues that "in order to prove that a federal agency has acted in bad faith, Petitioner "must show 'clear and convincing evidence of improper motive on the part of [HUD]' to overcome this presumption." *Id.* (quoting *Am-Pro Protective Agency, Inc. v. United States,* 281 F.3d 1234, 1239 (Fed. Cir. 2002)); *see also Libertatia Assocs., Inc. v. United States,* 46 Fed. Cl. 702, 706 (2000) (describing the standard as "clear and strong evidence" of "specific acts of bad faith" by the government)." *Sec. Supp. Stat*., ¶ 43-46.

Here, Petitioner offers no appreciable evidence to prove bad faith on the part of HUD. Rather, Petitioner relies solely on its argument that HUD acted unreasonably or negligently when it paid insurance claims and related expenses specifically delineated in the Vivian and Rodriguez Indemnification Agreements. Absent further clear and compelling evidence, HUD's payment of insurance claims in a manner consistent with its regulatory authority does not demonstrate a "specific intent to injure" Petitioner, that HUD was "motivated by animus," or that HUD's actions were in any way "calculated to frustrate or hinder" Petitioner's performance under the contract.

In light of this Court's earlier findings, *supra,* that the Indemnification Agreements created no duty on the part of HUD to assume responsibility, financial or otherwise, for regulatory compliance by FHA loan servicers, this Court can find no factual basis with which to overcome the legal presumption that HUD acted in good faith at all times relevant to these proceedings. Nor can this Court find any basis to support any finding of fraud, negligence, breach of contract, failure to mitigate damages, or failure to comply with the implied covenant of good faith and fair dealing on the part of HUD with respect to the Vivian and Rodriguez loans. I find that the Government is, therefore, entitled to an administrative offset against Petitioner to enforce the full amount of its insurance claims sought in this case.

ORDER

The Court finds that Petitioner, Ark Mortgage, Inc. is indebted to the Department in the full amounts claimed by the Secretary. Accordingly, it is

ORDERED that the Secretary is authorized to seek collection of this outstanding obligation by means of administrative offset in the amounts claimed by the Secretary. It is

FURTHER ORDERED that the *Stays of Referral* of this matter to the U.S. Department of the Treasury for administrative offset, imposed on December 4, 2018, and February 21, 2019 are hereby **VACATED**.

SO ORDERED,

H. ALEXANDER MANUEL
Administrative Judge

APPEAL NOTICE: You have the right to move for reconsideration of this case before the HUD Office of Hearings and Appeals within 20 days of the date of this ruling or decision; or, thereafter, to reopen this case. Ordinarily, such motions will not be granted absent a demonstration by the movant that there is substantial new evidence be presented that could not have been prevented previously. An appeal may also be taken of this decision to the appropriate United States District Court. For wage garnishments cases, See 24 C.F.R. § 17.81, 31 C.F.R. § 285.119f), and 5 U.S.C. 701, *et seq*. For administrative offset cases, See 24 C.F.R. § 17.73(a), and 5 U.S.C. § 701, *et seq*