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

In The Matter of:

WARREN B. MORRIS and
JUNE D. MORRIS,

Respondents.

HUDALJ 89-1390-DB

John R. Scott, Esquire
For the Respondents

Dane M. Narode, Esquire
For the Department

Before: ROBERT A. ANDRETTA
Administrative Law Judge

INITIAL DETERMINATION

Jurisdiction and Procedure

This is a debarment proceeding under Section 3 of Executive Order 12549, "Debarment and Suspension" (51 FR 6370-71, February 21, 1986). It is conducted pursuant to the regulations of the Department of Housing and Urban Development ("HUD") that are codified at 24 CFR Parts 24 and 26 (1989) (*See* 53 FR 19162, *et seq*, May 26, 1988), and jurisdiction is thereby obtained. On August 1, 1989, James E. Schoenberger, General Deputy Assistant Secretary of HUD ("the Secretary"), sent written notice by certified mail to the Respondents, Warren B. Morris and June D. Morris, that "... consideration is being given to debar [them] from further participation in primary covered transactions and lower tier covered transactions (see 24 C.F.R., Section 24.110(a)(1)) as either ... participant[s] or principle[s] at HUD and throughout the Executive Branch of the Federal Government and from participating in procurement contracts with HUD for a period of two years ..." from the date of the notice. In addition, the Secretary's letter of notice informed Respondents that they were suspended immediately from such business with the government "... pending the outcome of the proposed debarment action."

As his reason for proposing the debarment, the Secretary stated that the Department had received information of irregularities in the Respondents' business dealings with the government which would evidence irresponsibility and which provide cause for debarment under the regulations codified at 24 CFR 24.305 (b)(2), (d), and (f). More specifically, the Secretary stated that the evidenced shows that the Morrises violated their Regulatory Agreement and HUD requirements by:

1. Making unauthorized and ineligible disbursements from project funds;

2. Failing to properly submit billings for Section 8 Housing Assistance Payments;

3. Submitting deficient Excess Income Reports and Reports for Establishing Net Income;

4. Failing to submit on a timely basis Excess Income Reports and Reports for Establishing Net Income; and

5. Failing to obtain independent third-party management as requested by HUD after being notified that management of the project was unsatisfactory.

On August 21, 1989, the Morrises filed a timely request for a hearing, and Administrative Law Judge William C. Cregar issued a Notice Of Hearing And Order on September 27, 1989. In accordance with this Order, the Department timely filed its Complaint on October 27, 1989, and the Respondents timely filed their Answer on November 28, 1989. On January 31, 1990, this proceeding was reassigned to my docket, and a hearing was conducted in Fayettsville, Arkansas, on February 13, 1990. In accordance with an oral order at the hearing, as later modified in writing, the Respondents timely filed their post-hearing brief and proposed findings of fact and law on March 16, 1990, and the Department filed its post-hearing brief on April 16, 1990. Thus, this proceeding became ripe for determination on this last-named date.

Findings of Fact

The Department of Housing and Urban Development administers programs of mortgage insurance under the National Housing Act, as amended, 12 U.S.C. Sec. 1701, *et seq*, and provides rental subsidies for low income tenants under authorization of Section 8 of the Housing Act of 1937, 42 U.S.C. Sec. 1437f. Under Section 236 of the National Housing Act, 12 U.S.C. Sec. 1715z-l, the Secretary is authorized to assist private parties in providing rental and cooperative housing for low income tenants by insuring mortgages which satisfy certain eligibility requirements and by paying all but one percent of the interest on the mortgage loan for a project. Under Section 8 of the Housing Act, the Department subsidizes tenants' rent in accordance with formulations which depend upon their assets and income. Under this part of the plan, the Secretary establishes the "fair market rent" for each dwelling. In turn, the mortgagor must agree to collect and deposit "excess rental charges" and to comply with rules, regulations, and methods of operation that are established by HUD.

On September 30, 1980, Warren Morris signed a Regulatory Agreement ("the Agreement") with HUD, on behalf of himself and his wife, June Morris, for the purpose of receiving a loan under Section 236 to purchase Southgate Apartments ("Southgate). These apartments consist of two complexes, with twenty-two units in Sayre, Oklahoma,

and twelve units in Erick, Oklahoma both of which are about 200 miles west of Oklahoma City. The Agreement requires periodic reports, certification of tenant eligibility, provision of suitable management, high standards of operation, and other reasonable conditions for the loan and subsidies.

Under the Agreement, the Department's regional office personnel conduct periodic site inspections and management reviews to ensure that the project is being properly operated in accordance with the Agreement, HUD regulations, and ordinary prudent business practices. A management review was conducted in 1987, and the subsequent report cited numerous program irregularities. Management was given an unsatisfactory rating. On March 31, 1988, another such management review was conducted, and on May 25, 1988, an unsatisfactory rating was reported on the basis of 43 program irregularities. On the basis of these reports, HUD notified the Morrises that their owner-management arrangement was unsatisfactory and independent, third-party management was required. They did not obtain such management until March 27, 1989, when they were forced to do so under threat of losing program authorization.

The 1987 review disclosed $18,721.75 in ineligible disbursements from the project operating account, and the 1988 review disclosed another $8,897.21 in ineligible disbursements as of August. Further investigation revealed that $21,754 of ineligible disbursements had been taken in 1984, $17,306 had been taken in 1985, and $17,737 in 1986. Respondents did not repay the improperly-taken amounts, in spite of offers of compromise from HUD, and, in fact, continued to insist that the taking of the expenses was both proper and in accordance with previous HUD authorization.

Both management reviews also cited deficiencies in Respondents' reporting of "excess income" and net income, both of which are necessary for the calculation and determination of tenant eligibility and subsidy amounts as well as for review of compliance with the Agreement. The 1988 review also complained that the reports were not timely made. The so-called Excess Income Reports and the Reports for Establishing Net Income are required by the Agreement.

Thus, in spite of the government's enumeration of five reasons for the suspension and proposed debarment in its Notice, and its listing of four counts in its Complaint, the Department's reasons for suspending Respondents and proposing their debarment for two years are threefold: the taking of and refusal to pay back ineligible disbursements, inaccurate and untimely reporting, and failure to obtain third-party management when directed to do so.

The expenses taken by the Morrises were of a nature familiar to most of us as business expenses that are cognizable under the regulations of the Internal Revenue Service. For example, those reported in the 1987 management review as having been taken during that year were as follow:

Travel & food	$ 465.01
Gasoline, oil & grease	1,273.53
Motor vehicle repairs	72.99

Automobile taxes	50.40
Partner salaries	3,300.00
Officers' salaries	4,800.00
Dividends	8,760.00

In 1988, the list included a small amount for employees' Christmas presents, computer supplies, insurance, tickets to a fair housing banquet, tuition for a fair housing training course, phone bills, interest, and taxes. While none of these appear improper at first blush, the fact is that these expenses are not authorized under the Agreement. All such expenses are to be covered by a general management allowance which is calculated by a formula set by HUD and was paid to the Respondents. Changes in the management amount must be approved upon application to HUD.

In 1985, the Morrises submitted an application for a raise in their management amount to the maximum permissible per apartment unit. Along with the application, they submitted a proposed budget that included expenses of the type shown above. The increase in management amount was approved, and the Morrises believed that their proposed budget was "approved" as well. They continued to take such expenses in ignorance until the 1987 report was followed up by a letter from HUD which explained that such expenses could not be taken. The taking of such expenses continued. HUD met with Warren Morris to further explain the problem, and he continued to take the expenses. HUD wrote further letters. In one written on August 26, 1987, HUD acknowledged that some confusion or misunderstanding of its policies and requirements was understandable and waived over $11,000 of the ineligible disbursements, but demanded that $7,873.37 be paid back to Southgate. Further letters indicated to the Morrises that their allowable management fee was $10,800, and that this amount was meant to include such expenses as repairs, grass cutting, computer supplies and so forth. Nonetheless, the taking of such expenses continued, and Respondents never paid the ineligible disbursements back into the project's operating account. As of the time of the hearing, the amount owed by the Respondents to the operating account, after deletion of amounts forgiven by HUD, was $20,651.93.

At the hearing, the government spent a good deal of effort to show the inaccuracies of the Respondents' record-keeping and reporting. Each tenant's eligibility for subsidy, and the amount of subsidy, is dependent on the tenant's income and assets, including other government entitlements, such as Medicare. Bank accounts, part-time jobs, sharing of apartments, moving out and moving in dates all have to be accounted for on a monthly basis so as to calculate each tenant's monthly rent and subsidy from HUD. Everything must be verified, and a record of such verification must be included in the file.

The more the government tried to show how poorly these records were kept and the data was collected, the more it became apparent that, under the circumstances, Respondents and their Resident Manager actually did quite well. Most of the errors were minor, and, of those discussed in the hearing, more of them were against Respondents than for them. Every dollar of rent payment was listed separately, by tenant and apartment number, on bank deposit slips. Information about tenants' assets

and income was fairly complete, given the difficulties that must attend the collection of such information. Moreover, while HUD employees went in person to the project and reviewed each tenant's file, and then wrote reports critical of the record-keeping, they only reported deficiencies in the most general terms. While they could have explained what was wrong and what needed to be done to bring the files more nearly up to expectation, they merely referred to broad and general regulatory requirements. Their reluctance to be more forthcoming appeared spiteful. Eventually, the government withdrew Count III of the Complaint.

In both 1987 and 1988, the Department determined that the owner-management arrangement of Southgate apartments was unacceptable and required Respondents to obtain third-party management. Respondents did not do so until March 27, 1989, when HUD terminated its Section 8 subsidies. The Agreement requires Respondents to provide management that is acceptable to HUD and Respondent's failure to do so when required violates the Agreement. Much testimony on the subject indicates that the third-party management recommended by HUD and retained by Respondents is the only such entity available to these two relatively isolated locations, and that the financial and physical condition of Southgate has deteriorated sharply under it. While the two Southgate complexes prospered financially and were kept in good repair by their owner-managers, they are now in disrepair and near bankruptcy. The demand for third-party management was made because of the allegedly poor record-keeping and verification, but mostly because of the taking of and refusal to reimburse ineligible disbursements.

Applicable Law

As owner-managers of Southgate, Respondents were, at all times relevant to this complaint, participants in a covered transaction under HUD's nonprocurement programs and were, thus, principals as defined in 24 CFR 24.105(p)(2), (11), and (13), thus making 24 CFR Part 24, the regulations governing suspension and debarment from conducting business with the federal government, applicable to them. The taking of, and failure to repay, improper disbursements of project funds violates Paragraphs 6(b) and 6(e) of the Regulatory Agreement and is of such a serious and compelling nature as to effect the present responsibility of Respondents. Thus, it is cause for debarment under 24 CFR 24.305(b)(3), (d), and (f). Likewise, failure to provide third-party management when required to do so was violative of Paragraph 9(a) of the Agreement and is, accordingly, cause for debarment under 24 CFR 24.305(b)(3) and (f).

Discussion

It is obvious, and was especially so during the hearing, that no illegal intent was initially harbored by these Respondents, and, in fact, they are not charged with any criminal wrongdoing. All that they did, including their errors, was done in a good-faith belief that they were correct in doing so. This concept deteriorates in the face of what can only be called their stubbornness in refusing to amend the way they took their business expenses. For example, at the hearing, when asked whether he would again charge his own legal fees in this case to the project, Morris responded, "Yes, sir. I would ..." (T-610) To some extent, they are arguably correct that the resources needed

to properly manage and maintain Southgate, especially with the two locations nearly isolated 200 miles west of Oklahoma city, exceeds the allowable amount under HUD's formulations. It is also clear that the expenses themselves were proper in nature in that they were reimbursements for out-of-pocket expenses incurred in managing the apartments; viz computer supplies and vehicular needs, lawn mower gas, sheet rock, paint, fair housing training, and so on. But, they were bound by their Agreement to a limited management fee of $10,800 per year, and that was the issue they should have dealt with. HUD's warnings and willingness to compromise on the amounts owed should have been, and still must be, heeded with regard to these disbursements. Obviously, it will be impossible for HUD to ever allow owner-management of Southgate again unless the past amounts are taken care of and there is assurance that ineligible disbursements, or disbursements not authorized by HUD under some sort of agreement that recognizes the needs of Southgate, will not be taken again.

HUD has a right and a responsibility to insist upon third-party management so long as the Respondents are unwilling or unable to assure it regarding disbursements. But there is little question that the sooner Southgate is returned to the Morrises' management, the better for all involved, especially the tenants. HUD is not free of some of the responsibility for where all this has led. Its budget "approval" was misleading. Its inspection reports were unhelpful. Some of its demands were unreasonable, and some of its complaints were petty and irritating. It appears to have shared some of the Respondents' stubbornness. Thus, its earlier offer to compromise, to accept only $7,873.37 worth of reimbursement for the period prior to August 26, 1987, is still appropriate. Further, if Southgate is to be a successful home for low income people, HUD needs to be more cooperative with Respondents in making it so.

Conclusion and Order

Upon consideration of the need to protect the public interest, I conclude and determine that good cause existed, and continues to exist, to suspend and debar the Respondents from doing business with the Executive Branch of the Federal Government. In view of the government's initial request for a two-year debarment, its withdrawal of one of its three reasons therefore, and the comments and observations discussed above, it is ORDERED that Respondents are debarred from doing business with the federal government, and required to retain third-party management of Southgate, for a period of nine months from the date of Notice of debarment and suspension, August 1, 1989, or until they reimburse the operating accounts of Southgate for ineligible disbursements in the amount of $20,651.93, or any lesser amount which may be agreed to by HUD, and assure HUD in writing that they intend to operate within the guidelines of the Agreement, and any other allowances of management fees HUD may be willing to make in view of their management needs, whichever period is longer.

ROBERT A. ANDRETTA
Administrative Law Judge

Dated: April 25, 1990