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

In the Matter of:	
PREMIER INVESTMENTS I, INC., an Indiana Corporation, and DAVID K. REED, President, Premier Investments I, Inc. Respondents.	HUDALJ 06-022-CMP OGC Case No. 06-001-CA Decided: June 29, 2007

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For the Respondents

Before:Constance T. O'Bryant
Administrative Law Judge

ORDER GRANTING GOVERNMENT'S MOTION FOR SUMMARY JUDGMENT

On February 28, 2006, the U. S. Department of Housing and Urban Development ("HUD" or "the Department" or "the Government") served a Complaint against Premier Investments I, Inc., and David K. Reed, President of

Premier Investments, I, Inc. ("Respondents") seeking civil money penalties for violations of the National Housing Act, (the Act), 12 U.S.C. § 1735f-15(c)(1)(B)(x), as implemented by HUD's regulations found at 24 C.F.R. Part 30. HUD seeks a penalty of $95,000 against Respondents, jointly and severally.

On April 10, 2007, the Government filed a Motion for Sanctions and a Motion for Summary Judgment. Respondents responded to both motions on April 20, 2007. On May 17, 2007, the Court denied the Motion for Sanctions and reserved ruling on the Motion for Summary Judgment. On May 30, 2007, the Government filed a Motion for Leave to File Attached Supplement to Government's Motion for Summary Judgment. That Motion for Leave to File is GRANTED.

After consideration of the Government's Motion for Summary Judgment, as supplemented, and Respondents' response thereto, I conclude that the Motion should be, and it hereby is, GRANTED.

BACKGROUND

The Government may impose a civil money penalty on the Mortgagor of a property that includes five or more living units and that has a mortgage insured, coinsured, or held pursuant to the National Housing Act (*see* 12 U.S.C. §1735 f-15(c)(1)(A)(I)), for the

> (b) Failure to furnish the Secretary, by the expiration of the 90-day period beginning on the 1st day after the completion of each fiscal year, with a complete annual financial report based upon an examination of the books and records of the mortgagor prepared and certified to by an independent public accountant or a certified public accountant and certified to by an officer or the mortgagor, unless the Secretary has approved an extension of the 90-day period in writing.

12 U.S.C. §§1735f-15(c)(1)(B)(x).

Premier Investments I, Inc., ("Premier") owns Heritage House Rehabilitation Center ('the Project"), a 94-unit nursing home and intermediate care facility located in Connersville, Indiana. Heritage House was financed in 2001 under the 232 and 223(f) loan programs of the National Housing Act, 12 U.S.C. §1735 *et. seq*. The Regulatory Agreement was executed by HUD and Respondent, Premier Investments I, Inc. David K. Reed is the President of Premier Investments I, Inc. In exchange for receiving the benefits of the HUD-insured loan, Mr. Reed executed a Regulatory

Agreement with HUD on behalf of Premier for the Project. Section 9(e) of the Regulatory Agreement states:

> Within 60 days following the end of each fiscal year HUD shall be Furnished with a complete annual financial report based upon an examination of the books and records of mortgagor prepared in accordance with the requirements of HUD, certified to by an officer of the Mortgagor and, when required by HUD, prepared and certified by a Certified Public Accountant, or other person acceptable to HUD.

That period for filing was extended to 90 days following the end of the fiscal year by operation of a subsequent regulation. *See* 24 C.F.R. § 5.801.

The parties agree that the fiscal year end for Heritage House is December 31. Thus, the due date for filing the required annual financial statement for fiscal years 2002, 2003 and 2004 is March 31, 2003, March 31, 2004 and March 31, 2005, respectively. It is undisputed that Respondent Premier failed to make timely audited annual financial statements for all years in question.

On April 12, 2004, HUD gave written notice to Respondents, as required by 24 C.F.R. § 30.70, that it was considering seeking a civil money penalty against Respondent Premier for its failure to properly file the required annual financial statements for fiscal year 2002. On June 21, 2004, HUD gave required written notice that it was considering seeking a civil money penalty against Respondent Premier for its failure to properly file the required annual financial statement for fiscal year 2003. And, on June 28, 2005, HUD sent notice to Respondent Premier that it was considering seeking a civil money penalty against Respondent Premier for its failure to properly file the required annual financial statement for fiscal year 2004. Also on that date, HUD sent notice to both Respondent Premier and its President, David K. Reed, that it was considering seeking a civil money penalty against Respondent Premier and its President, David K. Reed, jointly and severally, for $95,000 for failure to properly file the required annual financial statements for fiscal years 2002, 2003 and 2004.

Respondents responded to the June 28, 2005 notices on August 24, 2005. They claimed that unaudited statements had been provided to HUD numerous times by Premier, that completion of audited financial statements was cost prohibitive, and that Premier had not been able to retain a certified public accountant ("CPA") to

perform the audits in a timely manner.

DISCUSSION

It is a violation of the Regulatory Agreement to knowingly fail to file an annual financial statement if the failure to file is a material failure. *See In the Matter of Associate Trust Financial Services,* HUDALJ 96-008-CMP (May 12, 1997). Materiality is evaluated by application of a "totality of the circumstances" standard, which requires a consideration of the eight regulatory factors found in 24 CFR 30.80. Id. *See also, U. S. Department of Housing and Urban Development v. Crestwood Terrace Partnership,* HUDALJ 00-002-CMP (January 30, 2001). However, only one of the eight factors need be established to make a finding of materiality. *In the Matter of American Rental Management Company*, JUDALJ: 99-01-CMP (May 26, 2000).

The parties liable for violations of HUD regulatory agreements and subject to the imposition of civil money penalties include any mortgagor of a multifamily property and any officer or director of a corporate mortgagor. Thus, David K. Reed, who is the President and sole principal of Premier Investments I, Inc., may be found personally liable for Respondent Corporation's violations of the Regulatory Agreement. 12 U.S.C. § 1735f-15(c)(1)(B)(3).

The Government seeks summary judgment on the grounds that there is no genuine issue of material fact concerning whether Respondents committed knowing, willful, and material violations of the National Housing Act. Fed. R. Civ. P. 56(b).

Respondents oppose the motion. They argue that the Government has failed to show that Respondents' failure to file audited financial statements for fiscal years 2002, 2003, and 2004 was done knowingly, and/or that the failure to file was a material violation.

Respondent Premier's President had actual knowledge of the specific requirements that financial statements must be filed within ninety (90) days following the end of each fiscal year, and that the statements were to be certified to by an officer or responsible owner. These were expressly provided in the terms of the Regulatory Agreement. Also, Respondents were obligated to keep informed of the Secretary's requirements, and thus knew or should have known of the Handbook requirements that financial statements be certified to by an independent public accountant or other person acceptable to the Secretary, and that the audited financial

statements be filed electronically. Moreover, they knew or should have known that they were required to maintain the Corporation's books and accounts of operations of the mortgaged property in accordance with requirements prescribed by the Secretary.

SUMMARY JUDGMENT

Summary judgment will be granted where no genuine issue of material fact exists and the moving party is entitled to judgment as a matter of law. *Anderson v. Liberty Lobby, Inc.* 477 U. S. 242 (1986). If "[u]ndisputed facts . . . point unerringly to a single, inevitable conclusion," summary judgment is appropriate. In re Varrasso, 37 F. 3d 760, 764 (1st Cir. 1994). In the case at hand, the facts that are undisputed point to a single conclusion that Respondents failed to file the required audited annual financial statements for fiscal years 2002, 2003, and 2004, and that their failure to do so constituted a knowing and material violation of the Act.

The uncontradicted evidence establishes that, for the fiscal years in question, Respondents never filed audited annual financial statements with HUD. They filed at least one unaudited annual financial statement, but thisdoes not meet their regulatory obligation.

Respondents argue that, even assuming facts above are true, the Government has failed to show a reckless disregard for the requirements of annual audited financial statements being provided to HUD. Respondents argue that they acted in good faith and not with reckless disregard of the requirements of the Act. They state that upon receiving notice from HUD of the failures to file, they made contact with HUD and sought assistance in obtaining information about the required audits, but received no assistance from HUD. Respondents subsequently retained the services of a certified public accountant who was unable to complete the audited financial statement for the fiscal year ending December 31, 2002. Moreover, that "subsequent to the filing of the Complaint in this case, Respondents again retained the services of certified public accountants for the purpose of completing all outstanding audits in working towards a settlement of this matter." Affidavit of David K. Reed, ¶ 6. Finally, they state that Respondents have now sought the assistance of a third CPA firm to attempt to promptly have audits prepared for the years 2002, 2003 and 2004. "Not only do Respondents' actions fail to show that their alleged violations were committed knowingly, the actions of the Respondents clearly show not a reckless disregard for the requirements of the Act, but a conscious regard to try to comply

with the requirements of the Act . . . therefore summary judgment is inappropriate."

I find, that Respondents had actual knowledge of the requirements to file audited financial statements within 90 days of the fiscal year end based on their execution of the regulatory agreement, as modified by 24 C.F.R. § 5.5801. See paragraph 9(e) of the Regulatory Agreement. (Ex. 2). *See HUD v. Crestwood Terrace Partnership*, HUDALJ 00-002-CMP (Jan. 30, 2001). In addition, a letter from Dauby O'Connor & Zaleski, dated December 1, 2003 and addressed to David Reed, shows that David Reed was aware of the auditing requirement. The letter indicated that Premier Investments had hired a certified public accounting firm for the purpose of completing a financial audit of Heritage House for the fiscal year ending on December 3, 2002, to be conducted in compliance with HUD auditing requirements. Ex. 9.

The facts agreed to by Respondents establish their knowing failure to file audited annual financial statements. Respondents erroneously focused only on the reckless disregard part of the definition of "knowing and knowingly." Under 24 CFR§ 30.10, knowing is "having actual knowledge *or* acting with deliberate ignorance or reckless disregard for the prohibitions. . ." (Emphasis added.) There is no requirement that a respondent act with both actual knowledge and reckless disregard of the requirements. The good faith actions alleged and the denial of reckless disregard do not negate knowledge of the requirements or violation of the Act, but rather may be considered as mitigating circumstances in determining the amount of any civil money penalty.

Thus, there is no genuine issue of material fact as to whether Respondents knowingly failed to file audited financial statements for the years in question. The Government has established a knowing violation.

Respondents argue that a genuine issue of material fact exists as to whether Respondents' alleged violations were "material" violations. Both HUD and Respondents agree that the under 24 C.F.R. § 30.10, material or materially means "in some significant respect or to some significant degree." *See American Rental Management*, HUDALJ: 99-01-CMP (May 26, 2000), and that materiality is evaluated by application of a "totality of the circumstances" standard, which requires a consideration of the eight regulatory factors found in 24 C.F.R. § 30.80.

Respondents argue that a finding of materiality in this case is inappropriate based on

consideration of those factors.

"Materially" is defined in HUD's civil money penalty regulations at 24 C.F.R. § 30.10 as meaning "in some significant respect or to some significant degree." The Secretary of HUD has stated how the materiality issue should be determined. In his Order on Secretarial Review, *In the Matter of Associate Trust Financial Services, HUDALJ 96-008-CMP*, September 15, 1997, the Secretary ordered that in civil money penalty cases materiality is to be determined by application of a "totality of the circumstances" standard, which is to be determined in turn by consideration of the eight regulatory factors at 24 C.F.R. § 30.80 -- factors required to be considered in determining the amount of civil money penalty. In this regard, I have previously expressed my concern about the logic of deciding whether to impose a civil money penalty by considering the factors used to determine the size of a penalty if a penalty were to be imposed. *See Crestwood*, at 8. *See also American Rental Management Company, et al.* (HUDALJ 99-01-CMP, May 26, 2000.) Nevertheless, the Secretary's Order in *Associate Trust* constrains me to do just that, and I do so below.

Respondents argue that if they eight factors are considered, a finding of materiality is inappropriate. They contend that they have made diligent good faith efforts to comply with the annual reporting requirements, that they have no history of prior offenses, that no one has benefited from the failure to file, that it would constitute a financial hardship on Respondents and would severely jeopardize the project's financial stability, that there is no present injury to tenants or to the public and that this is not a case where a finding of liability and imposition of a civil money penalty would serve as a deterrent effect on others.

The regulations require the Secretary to consider the factors listed in 24 C.F.R. § 30.80 to determine the appropriate penalty for each violation. They are:

Gravity of the offense

HUD considers a violation of the requirement to file audited annual statements extremely serious. Timely audited financial reports are necessary, it argues, to protect the HUD insurance fund. Risks to the fund can arise from unauthorized distribution and misuse of project funds by HUD insured mortgagors. Abuses can lead to significant losses to the taxpayers in the event of default. Abuse may also lead to significant harm to the tenants because the project may not be able

to set up escrows and other funds to meet the project's physical needs. In this case, Respondents have never submitted audited financial statements to HUD since executing the HUD/FHA insured mortgage of $3,808,000. Moreover, the project was the subject of an unsatisfactory management review which cited possible unauthorized distributions of project funds and designated as a troubled property due to multiple mortgage delinquencies. Unauthorized distributions and mortgage delinquencies are the very violations the annual audit review process was intended to prevent. Without submission of the audited financial statements it is impossible for the Department to assess the scope of the project's financial problems and to respond with assistance for the purpose of preserving the project and protecting the insurance funds. I agree with HUD that the gravity of the offense is a factor that warrants the imposition of a civil money penalty for the reasons stated.

History of Prior Offenses

Although the Government argues that the Respondent Corporation has a history of prior offenses, having failed to submit any audited statement during the entire six-year period in which HUD has insured the mortgage loan for the project, I find that there is no history of prior offenses. Respondent Corporation has not been previously adjudicated to have violated the Act.

Ability to Pay Penalty

As to ability to pay a penalty, Respondents allege that they would not be able to pay the penalty requested and keep the project financially sound. However, they have the burden to establish that they are not able to pay the amount of penalty sought, and their allegations are insufficient to carry that burden.

Injury to the Public

In *Crestwood*, I held that "in considering the factor of injury to the public, an assessment of the harm caused to the integrity of HUD's programs and the costs of enforcement and litigation that resulted therefrom should be made." *Crestwood* at 7, citing *Associated Trust* at 9, and *American Rental Management* at 14, 17-18. I also noted that damage to the integrity of HUD programs, exhibited by an inability to accurately assess risk to its insurance fund, occurs when Respondents fail to submit audited financial statements. *Crestwood* at 7.

HUD Handbook 4370.1 states that harm to the insurance fund occurs when audited financial statements are not timely submitted. Moreover, in this case HUD has expended considerable staff and money to try to obtain compliance with Respondents' obligations under the Regulatory Agreement. Accordingly, injury to the public has been established.

Benefit to Respondents

There is no evidence that Respondents' failure to submit audited financial statements has benefited them. The evidence shows that they have on more than one occasion hired a CPA to undertake the audit of their financial statement; however, the audits have not been completed because of the disarray of their financial records.

Deterrence

There is a need for deterrence in this case. In *In the Matter of Associate Trust Financial Services*, HUDALJ 96-008-CMP (Nov. 20, 1997), the court stated that "deterrence is an inherent factor in every prosecution of the government." In *Crestwood Terrace, supra*, the court stated "similarly situated Defendants must be put on notice that failing to comply with the requirements of a regulatory agreement with HUD will be costly to them." At 8.

Respondents' argument against finding materiality is not persuasive. As the Government points out, although the above eight factors are to be considered, only one needs be present to establish materiality. In this case, the uncontradicted facts show the presence of several of the factors. The evidence shows a serious breach of agreement and a degree of culpability on the part of Respondents who were responsible for filing the required audited financial statements, and the need for deterrence. The evidence shows that Respondents, after HUD's repeated requests, failed to submit the required audited annual financial statements for the fiscal years 2002, 2003 and 2004. Their excuses do not relieve them of the responsibility for filing the audited statements. *See American Rental Management, supra, at* 15. Moreover, there is a need for deterrence in this case. In *In the Matter of Associate Trust Financial Services*, HUDALJ 96-008-CMP (Nov. 20, 1997), the court stated that "deterrence is an inherent factor in every prosecution of the government." In *Crestwood Terrace, supra*, the Court stated "similarly situated Defendants must be

put on notice that failing to comply with the requirements of a regulatory agreement with HUD will be costly to them." At 8. Finally, HUD argues that the gravity of the offense, alone, is sufficient to establish materiality. I agree. Accordingly, I grant the Motion for Summary Judgment as to the violation and find that Respondents committed knowing and material violations of the National Housing Act and HUD's Regulatory Agreement with Respondents and that a civil money penalty may properly be assessed against them.

CIVIL MONEY PENALTY

For violations occurring after January 7, 2002, the Government may impose a civil money penalty against an officer or the mortgagor for failure of the mortgagor to furnish the Secretary with the required audited financial report. See 12 U.S.C. §1735f-15(c)(1)(A)(ii), (A)(iii) and (B)(x); 24 CFR 30.45(c)(2) and (3) (2002) (added by 66 Fed. Reg. 63,436 at 63,441-42 (December 6, 2001)).

Respondent Premier is the mortgagor for the Project, which is a multi-family housing complex and has a mortgage financed with a loan insured against default under the National Housing Act. Furthermore, Respondent Premier knowingly and materially violated 12 U.S.C. §§1735f-15(c)(1)(B)(x). Therefore, the Government may impose a civil money penalty against Respondent Premier if the appropriate factors for consideration are met, as set forth at 24 C.F.R. § 30.80.

The amount of civil money penalty the Secretary may award varies by time period. For violations, or portions of continuing violations, that occur on or after 2002, the Secretary may impose a civil money penalty in the amount of $30,000. For violations, or portions of continuing violations, that occur on or after April 16, 2003, the Secretary may impose a civil money penalty in the amount of $32,500 for each offense. The Government seeks a civil money penalty of $30,000 for the failure to file the required annual financial statement in 2002, $32,500 in 2003, and $32,500 in 2004.

Respondents state that the imposition of a civil money penalty in the amount requested by the Government would impose a financial hardship on them and severely jeopardize the project's financial stability. They state that there currently is a judgment outstanding against the property for at least $153,000, and that it would be impossible for the facility to remain current on its outstanding mortgage and the

previous judgment if the Government's request for $95,000 in civil money penalty is granted. *See Affidavit of* David Reed at ¶ 8. They argue that unaudited statements had been provided to HUD numerous times by Premier, that completion of audited financial statements was cost prohibitive, and that Premier had not been able to retain a CPA who would perform the audits in a timely manner.

Under the circumstances of this case, I conclude that the Government has established a rational relationship between the penalty imposed and the unrebutted facts of this case. The evidence shows that as a result of Respondents' violations, HUD insurance fund was and is at great risk. As a result of the poor financial recordkeeping maintained by Premier there remains the potential of misuse of the project's revenues, which HUD has been unable to monitor because of Respondents' failure to file any audited financial statement. Respondents' own accounting firm stated that it could not perform an independent audit because of the disorganized and incomplete state of the Heritage House books and records. Ex.10. And, the fact of the existence of a $153,000 judgment against Premier does not argue against the penalty. Although Respondents suggest that the financial difficulties facing the Corporation is a mitigating factor, they should not be rewarded for their failure to properly manage the property or to maintain their records and books and accounts in an organized and business manner. The documents show that HUD expended a significant amount of time and resources trying to get Respondents to comply with the requirements of the Act, giving them time and opportunity to get their records in order. Finally, although Respondents claim they are unable to pay the requested penalty, they have not offered proof of their financial inability to do so. For all these reasons, the amount of civil money penalty requested by the Government will be granted.

CONCLUSION & ORDER

I find that Respondents knowingly and materially committed violations pursuant to 12 U.S.C § 1735f-15(c)(1)(B)(x) by failing to timely file audited financial statements for fiscal years 2002, 2003, and 2004.

I find that the Government's request for civil money penalties against the Respondents, jointly and severally, in the amount of $30,000 for Respondents' failure to submit a proper financial statement in fiscal year 2002, and in the amount of $32,500 per year for Respondents' failure to file a timely audited financial report for fiscal years 2003 and 2004, is appropriate.

The Government's Motion for Summary Judgment is GRANTED. Respondents shall, jointly and severally, pay to the Secretary of HUD the total civil money penalty of $95,000, which is immediately due and payable by Respondents without further proceedings.

This Order shall constitute the final agency action, pursuant to 24 C.F.R. § 26.39.

So ORDERED, this 29th day of June, 2007.

/s/

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CONSTANCE T. O'BRYANT
Administrative Law Judge