UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
OFFICE OF THE SECRETARY

In the Matter of:	)	
MANTUA GARDENS EAST, INC., JAMES H. GRIER,	)	
Respondents.	)	HUDALJ 12-F-043-CMP-3
	)	MAY 28 2013

BACKGROUND

On May 15, 2012, the U.S. Department of Housing and Urban Development ("HUD") filed a complaint seeking civil money penalties against Mantua Gardens East, Inc. ("MGE"), owner of a multi-family property which received FHA-insured financing under HUD's Section 236 program and rental subsides under HUD's Section 8 program, and James H. Grier, MGE's president and chairman of the Board. The complaint sought civil money penalties of: 1) $212,500 against both MGE and Mr. Grier (collectively "Respondents") pursuant to 12 U.S.C. § 1735f-15 for violations of the Section 236 Regulatory agreement between HUD and MGE (Counts 1-7); and $1,260,000[1] against MGE[2] pursuant to 42 U.S.C. § 1437z-1(b) for violations of the requirements of the Section 8 program and the Housing Assistance Payment ("HAP") contract between MGE and HUD (Counts 8-99).

A hearing was conducted before Administrative Law Judge Alexander Fernández ("ALJ") from September 10-12, 2012. On February 1, 2013, the ALJ filed the Initial Decision and Order ("Decision"). The ALJ found that the Respondents were in violation on each of the charged counts. Decision at 28-29. The ALJ found both Respondents liable for $262,500 for violations of the Section 236 regulatory agreement and MGE liable for $2,325,000 for violations of the requirements of the Section 8 program and the HAP contract. Id. The ALJ then reduced damages in two ways. First, the ALJ reduced the penalty for the Section 8 and HAP violations to $450,000 based on the "ability to pay" factor outlined in the penalty assessment regulation at 24 C.F.R. § 30.80(c). Id. at 29. The ALJ then found that HUD had calculated the penalties in bad faith and reduced both the Section 236 program penalties and the Section 8 and HAP contract penalties by

[1] The original complaint was amended to dismiss Counts 17, 25, 44, 47, 62, 70, 89, and 92, which reduced the civil money penalties sought from $1,380,000 to $1,260,000.
[2] Pursuant to 12 U.S.C. § 1735f-15, civil money penalties may be imposed against an officer of the mortgagor. However, under 42 U.S.C. § 1437z-1(b), civil money penalties may only be imposed against the landlord corporation.

25%. Id. at 27.

On March 1, 2013, HUD filed an appeal of the Decision ("HUD Appeal").[3] On appeal, HUD raised two issues. First, HUD claimed that the ALJ's reduction in penalties due to the "ability to pay" factor was incorrect both by law and by fact. HUD Appeal at 7-13. HUD argued that the record does not support the ALJ's conclusion that MGE only had the ability to pay $450,000 and that the ALJ misapplied the "ability to pay" factor by requiring the survival of MGE's business. Id. Second, HUD claimed that the ALJ's reduction in penalties due to HUD's alleged bad faith was incorrect by both law and fact. Id. at 14-21. HUD argued that the record does not support the ALJ's finding of bad faith and that the ALJ exceeded his authority in reducing the penalty for bad faith. Id.

The Respondents filed a cross-appeal of the Decision ("Respondent Appeal") on March 2, 2013, claiming that all of the penalties should be vacated for two reasons. First, Respondents claimed that they were no longer subject to the Section 236 regulatory agreement at the time of the violations, either because their request for voluntary termination was constructively approved or because the FHA insurance was transferred to a non-FHA approved entity. Respondent Appeal at 1-2. Second, Respondents claimed that the finding of HAP contract violations was in error because the expiration of the tenants' leases nullified the HAP requirements. Id. at 5-6. Respondents also make several miscellaneous claims, asserting that the ALJ was biased; that Respondents had no ability to pay any amount; and that no taxpayer money was lost. Id. at 2, 6-9.

Both HUD and the Respondents filed response briefs ("HUD Response" and "Respondent Response" respectively) on March 22, 2013.

On appeal, the Secretary, or his designee, conducts a de novo review and may adopt or reject any of the ALJ's findings or conclusions of law. See HUD v. Corey, HUDALJ 11-M-207-FH-27, at 2, n.2 (July 16, 2012). However, the Secretary, or his designee, may only consider evidence contained in the record[4] and must consider and include in the determination such factors as may be set forth in applicable statutes or regulations. See 5 U.S.C. § 557(b); 24 C.F.R § 26.52. After considering the evidentiary record and applicable law, the Secretary, or his designee, may "affirm, modify, reduce, reverse, compromise, remand, or set aside any relief granted in the initial decision." 24 C.F.R § 26.52(k).

In his decision, the ALJ laid out 66 findings of fact. Decision at 3-9. As the ALJ notes, the facts in this case are almost wholly uncontested by the Respondents. Id. at 10. Therefore, we affirm the ALJ's findings of fact numbered 1-4 and 6-66 and modify the ALJ's finding of fact numbered 5 to conform to the evidentiary record.[5] In light of these

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[3] At the same time, HUD filed a brief requesting leave for their Appeal Brief to exceed 15 pages. See 24 C.F.R. § 26.52(b). We have accepted this request.

[4] Under circumstances not present here, the Secretary, or his designee may remand the matter to the ALJ for reconsideration in the light of new evidence.

[5] In Finding of Fact 5, ALJ appears to erroneously find that that MGE obtained its loan directly from FHA. This error appears to be inadvertent as the ALJ uses the correct relationships between the parties in his later analysis. We correct Finding of Fact 5 to read "MGE obtained a $720,000 loan from Firstrust and received

facts and based on analysis of the applicable law, we uphold the ALJ determination of liability on all counts and modify the penalty amounts to $262,500 jointly and severally for Mr. Grier and MGE and $1,260,000 for MGE.

DISCUSSION

1. The Section 236 Regulatory Agreement Was Enforceable When Respondent Violated Section 236 Program Rules.

The Section 236 low-income housing program was created in the Housing and Urban Development Act of 1968.[6] This case involves one of the program's existing projects. Under the Section 236 program, a developer was able to finance a multifamily housing project with an FHA-insured mortgage loan and monthly interest reduction payments (IRPs) paid to the FHA-approved mortgagee on behalf of the mortgagor. Id. In exchange, the mortgagor agreed to operate the insured multi-family property in accordance with various regulatory and contractual obligations. Id. Once a contract for mortgage insurance was signed, it could only be terminated by prepayment;[7] a voluntary agreement between the mortgagor and HUD; or a transfer of the mortgage to HUD. 24 C.F.R. § 207.253.

HUD may impose a civil money penalty of up to $37,500[8] on the mortgagor, and officers or directors of such mortgagor, of a property that includes five or more living units and that has a mortgage insured pursuant to the National Housing Act of 1937. 12 U.S.C. § 1735f-15(c)(1)(A)(i). Violations which trigger these penalties include the knowing and material:

1) Conveyance, transfer, or encumbrance of the property without prior written approval by HUD. 12 U.S.C. § 1735f-15(c)(1)(B)(i).

2) Assignment, transfer, disposition, or encumbrance of the property's personal assets, including rents and other revenues. 12 U.S.C. § 1735f-15(c)(1)(B)(ii).

3) Failure to provide HUD with complete annual financial reports, including audited reports. 12 U.S.C. § 1735f-15(c)(1)(B)(x).

4) Failure to provide a HUD approved project manager. 12 U.S.C. § 1735f-15(c)(1)(B)(xiv).

The ALJ found the Respondents in violation of the following:

FHA insurance. In conjunction with the loan and insurance, MGE executed a mortgage note."

[6] Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 2019(a), 82 Stat. 476, 498 (1968) Section 236 is codified at 12 U.S.C. § 1715z-1. It has not been active as a production program for some time.

[7] However, HUD must reject a timely notice for prepayment, if it determines that the project still serves a need for low-income housing in the area. 12 U.S.C. § 1715z-15(a)(1).

[8] This amount has since been increased for violations occurring after February 19, 2013. See 78 FR 4057.

1) Count 1: Encumbering the rents of the property via a $50,000 loan with Wachovia in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(ii);

2) Count 2: Encumbering the real property of the project via the same Wachovia loan in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(i);

3) Count 3: Withdrawing money from the project's reserve fund without HUD's permission in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(ii);

4) Count 4: Firing the HUD approved project manager without HUD's permission in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(xiv); and

5) Counts 5-7: Failure to provide HUD adequate financial disclosure reports for the project in violation of 12 U.S.C. § 1735f-15(c)(1)(B)(x). Decision at 14.

We find that the record supports the ALJ's findings of these violations. Respondents do not contest the factual allegations behind any of these violations. Instead, Respondents raised an affirmative defense. Respondent Appeal at 1-2. Respondents asserted that they were no longer subject to the regulatory agreement at the time of the violations, either because their request for voluntary termination was constructively approved or because the FHA insurance was transferred to a non-FHA approved entity. Id. After review of the record and legal authorities, we find that neither argument supports the defense raised by Respondents.

On December 30, 1970, MGE[9] obtained a $720,000 loan from Firstrust Savings Bank ("Firstrust")[10] that was insured by HUD. As evidence of the loan, Respondent executed a mortgage note that was secured by a mortgage on the project property ("Project").[11] Decision at 4. The Note's maturity date was May 1, 2012, and it was serviced by Firstrust. Id. At the same time, MGE entered into a regulatory agreement with HUD that: 1) required Respondents to provide housing only to low income families; 2) required Respondents to maintain a reserve account, controlled by Firstrust, to pay for repairs and maintenance at the project; 3) prohibited Respondents from conveying, transferring, or encumbering any of the project's real property without prior written approval from HUD; 4) prohibited Respondents from assigning, transferring, disposing of, or encumbering the project's personal property without prior written approval from HUD; and 5) required the Respondents to hire a project manager that was satisfactory to HUD. Id.

a. Respondents' Attempt To Terminate the Regulatory Agreement Was Not Constructively Approved By HUD.

On November 1, 2005, Mr. Grier requested Firstrust's assistance in voluntarily

[9] MGE was previously known as Friends Housing, Inc.
[10] Formerly known as First Federal Savings and Loan Association.
[11] The Mantua Gardens East Project consists of 52 units in 19 row houses in the Mantua neighborhood of Philadelphia, PA.

terminating the regulatory agreement. Decision at 5. In response, Firstrust filed an Insurance Termination Request with HUD on behalf of the Respondents. HUD denied this request on July 3, 2006, citing failure to submit reports and sign a Use Agreement. Id. Respondents claimed that HUD misplaced the missing documents and that the real reason for the denial was to retaliate against Mr. Grier for filing a complaint against HUD's Philadelphia Regional Office in 1998. Id.; Respondent Appeal at 2. The Respondents provided no evidence to support this claim and made no attempt to challenge the basis of HUD's denial at the time of the denial. Decision at 11. Nevertheless, Respondents claimed that because the denial was improper, the request for termination was constructively approved and the regulatory agreement was severed. Id.; Respondent Appeal at 2.

We agree with the ALJ that there is no legal authority for the constructive approval of the voluntary termination of a regulatory agreement. In support of their "constructive approval" argument on appeal, Respondents cited an *amicus curiae* brief from the Supreme Court case, Norfold S. Ry. Co., v. Shanklin, 529 U.S. 344 (2000). Respondent Appeal at 2. A brief on behalf of one of the litigating parties to a case is not a binding legal authority. Further, the concept of constructive approval discussed in both the brief and case itself is unrelated to the current situation. The Court in Shanklin was determining whether, when railroad devices received federal funding, they were constructively approved by the federal government and that approval pre-empted state regulation. Id. at 351. The Court in Shanklin considered whether a positive government action constituted an approval, while here, Respondent is averring that negative government action, (i.e., the denial of a voluntary termination request) constitutes approval. The facts here are distinguishable from those in Shanklin, and Respondents' reliance on an amicus brief from that case is misplaced. Here, the Respondents' voluntary termination was never "constructively approved" by HUD.

b. The Sale of the Mortgage Note Did Not Terminate the Regulatory Agreement.

On February 21, 2008, Mr. Grier formed Mantua Gardens East, LLC ("LLC"), a single member limited liability company. Decision at 6. On February 25, 2008, LLC sent a check to Firstrust for $170,218.28 as full payment for the purchase of the MGE mortgage note, which left LLC as the mortgagee of MGE's FHA insured mortgage. Id. However, LLC was never an FHA-approved mortgagee.

The Respondents contended that the regulatory agreement terminated upon the sale of the loan to LLC because LLC was not an FHA-approved mortgagee. Respondent Appeal at 3. Respondents also claimed that, when LLC purchased the mortgage from Firstrust, the mortgage was paid in full and the project was no longer subject to the regulatory agreement. Id.

We agree with the ALJ that that Respondents' actions did not result in the prepayment of the loan under applicable law and, once again, Respondents have cited no authority to support their claims that their actions constituted a prepayment resulting in

the termination of the regulatory agreement. The sale of the loan to LLC not only failed to qualify as a prepayment of the loan as argued by Respondents, it also did not satisfy any of HUD's other requirements for the termination of the insurance contract. HUD has very specific requirements for the premature cancellation of an insurance contract. Such contracts can only be prematurely terminated by prepayment, voluntary agreement, or a transfer of the mortgage to HUD. 24 C.F.R. § 207.253, 207.253a. The Respondent's actions met none of these conditions. There is no provision for termination of a regulatory agreement when the mortgage note is sold to a non-FHA insured mortgagee.

Further, there was no acceptable prepayment. In order for there to be an acceptable prepayment that would terminate the regulatory agreement, the Secretary must make several determinations, including that the project was no longer meeting the housing needs of lower income families. 12 U.S.C. § 1715z-15. There was no request for Secretarial approval of a prepayment in this case.[12] Therefore, the agreement was not cancelled as a result of prepayment of the mortgage.

Because the regulatory agreement was not terminated by "constructive approval" of the request to terminate the agreement or through the sale of the mortgage note, we agree with the ALJ's determination that the Respondents were subject to the regulatory agreement over the entire period. As such, Respondents were subject to the agreement's restrictions.[13] Therefore, we agree with the ALJ determination that Respondents were in violation on all counts related to the Section 236 Program rules.

2. MGE Was Still Subject to the Section 8 and HAP Statutory, Regulatory, and Contractual Notice Requirements.

HUD may impose civil money penalties of up to $25,000 on the owner of a property that receives project based Section 8 assistance for knowingly and materially breaching a HAP contract. 42 U.S.C. § 1437z-1(b); 24 C.F.R. § 30.68(b) and (c). At least one year prior to terminating a HAP contract, the owner must provide written notification to HUD and the affected tenants. 42 U.S.C. § 1437f(c)(8)(A). In the event an owner does not provide the required notice, the owner may not evict the tenants or increase the tenants' rent payments until such time as the owner has provided notice and one year has elapsed. 42 U.S.C. § 1437f(c)(8)(B). On July 20, 1983, MGE executed a five year HAP contract with HUD, which was renewed consistently until June 2011. Decision at 5.

The ALJ determined that MGE committed the following violations:

1) Counts 8-54: Terminating the HAP contracts without the necessary prior notification in violation of 42 U.S.C. § 1437f(c)(8)(A); and

[12] There was a request to terminate by agreement in 2006, but not a request to prepay the loan.
[13] During this time period, Respondents may have also been subject to an agreement signed in conjunction with a Flexible Subsidy Loan issued by HUD. However, because we have determined that Respondents were subject to the regulatory agreement, we do not need to make such a determination.

2) Counts 55-99: Raising tenant rent payments without the necessary prior notification in violation of 42 U.S.C. § 1437f(c)(8)(B). Decision at 10.

MGE has not disputed it violated the statutory requirement to notify HUD and the tenants of the termination. We agree with the ALJ that the record supports the ALJ's finding that MGE improperly terminated the HAP contracts without the proper notice.

MGE has disputed the charge that it raised rents without prior notice. Respondent Appeal at 5. MGE claimed that, because the tenant leases had expired, there was no prior agreed upon rent to increase. MGE further claimed that there was no actual increase in rent. We reject both arguments and affirm the ALJ's decision that MGE improperly raised rents.

a. MGE Raised Rents Without Prior Notice.

On September 6, 2011, MGE issued a notice to all tenants informing the subsidized tenants they would have to sign new leases and pay rents that were $100 below the HUD-defined market rent. Id. MGE later sent a notice to raise the rent to HUD market value, but expressed a willingness to lower the rent in some cases. Id. MGE did not provide one year's notice of the change.

MGE argued that, because the HAP contract had expired, there was no lease agreement between MGE and the tenants. Respondent Appeal at 5. Therefore, there could be no rent increase because there was no prior agreed upon rent to increase. Id. MGE provided no legal justification for this view. We find this argument unpersuasive and lacking legal merit. While the prohibition on raising rents before notice is given is a contractual obligation found in the HAP contract, it is also a statutory requirement. Pursuant to 42 U.S.C. § 1437f(c)(8)(B), property owners may not evict the tenants or increase the tenants' rent payment, when an owner has not provided the one year notice of termination required by the statute. Therefore, the notice requirement is not merely a contractual obligation that expires when the contract expires, but a statutory requirement that property owners must follow. See Park Vill. Apts. Tenants Ass'n v. Mortimer Howard Trust, 2007 U.S. Dist. LEXIS 14516 (N.D. Cal. Feb. 13, 2007) (rejecting the argument that the expiration of a tenant's lease voids the statutory notice requirement). MGE was still statutorily obligated to provide notice even though there was no lease agreement. Id.

MGE also claimed there was no increase in rent. Respondent Appeal at 5. MGE proceeded to introduce new claims regarding a number of situations where it kept low rental amounts Id. These arguments are unpersuasive. On the record, MGE did make note of negotiating some rents at half the HUD market value. Tr. At 830. However, this does not show that the tenants' actual portion of the rent did not increase, as required by the statute. 42 U.S.C. § 1437f(c)(8)(B). The tenants were now paying all of the rent, instead of just the difference between the market value and the HAP payments. We therefore uphold the ALJ's determination that MGE improperly raised the tenants' rent without proper notification.

3. The ALJ Incorrectly Reduced Respondents' Penalties.

Having determined that the Respondents' actions subjected them to civil money penalties on all of the counts, the ALJ then addressed the appropriate amount of penalty. Decision at 14. HUD sought $212,500 in joint and several penalties against Mr. Grier and MGE for violations of the Section 236 regulatory agreement and $1,260,000 in penalties against MGE for violations of the HAP contract.

The HUD regulation at 24 C.F.R. § 30.80 requires the ALJ to weigh the following factors in determining the penalty amount:

(a) The gravity of the offense;
(b) Any history of prior offenses;
(c) The ability to pay the penalty, which ability shall be presumed unless specifically raised as an affirmative defense or mitigating factor by the respondent;
(d) The injury to the public;
(e) Any benefits received by the violator;
(f) The extent of potential benefit to other persons;
(g) Deterrence of future violations;
(h) The degree of the violator's culpability;
(i) With respect to Urban Homestead violations under § 30.30, the expenditures made by the violator in connection with any gross profit derived; and
(j) Such other matters as justice may require.

Each factor must be considered, but all of the factors do not need to be applied in order to calculate a penalty. Yetiv v. HUD, 503 F.3d 1087, 1091 (9th Cir. 2007) (rejecting "the proposition that a decision based on appropriate considerations may be set aside simply because the standard used to reach it requires consideration of other factors that were found to be inapplicable"). Additionally, not all the factors need to be present to impose the maximum penalty. Id. In this case, the ALJ examined the relevant factors and determined that the initial penalty was $262,500 jointly and severally for Mr. Grier and MGE for violations related to the Section 236 program, and $2,325,000 for MGE based on violations related to the HAP contracts. Decision at 16-25. However, the ALJ then reduced the amount of penalties assessed because of mitigating factors. In reducing the penalty, the ALJ relied primarily on the factor concerning the Respondents' ability to pay the penalty and the factor that considers such other matters as justice may require. While the ALJ appropriately assessed the initial penalty, he erred with regard to the subsequent penalty reductions for the reasons set forth below.

a. The ALJ Incorrectly Applied The "Ability To Pay" Factor When Reducing MGE's Penalties.

The ability to pay a civil money penalty is "determined based on an assessment of the respondent's resources available both presently and prospectively from which the Department could ultimately recover the total award." 24 C.F.R. § 30.10. The ability to

pay a penalty is presumed unless the respondent raises it as an affirmative defense and provides documentary evidence. 24 C.F.R. § 30.75(b); 24 C.F.R. § 30.80(c). The respondent must prove the lack of an ability to pay by a preponderance of evidence. 24 C.F.R. § 26.45(e). "Respondents have the burden to show that they are unable to pay a penalty because that information is within their knowledge and control." In re Lord Commons Apartments, LLC, HUDALJ 05-060-CMP (July 20, 2007); See also Campbell v. United States, 365 U.S. 85, 96 (1961) (The court does not place the "burden upon a litigant of establishing facts peculiarly within the knowledge of his adversary."); In re Premier Investments I, Inc. HUDALJ 06-022-CMP (June 29, 2007) (Respondents "have the burden to establish that they are not able to pay the amount of penalty sought.").

In this case, the ALJ made the determination that Mr. Grier had the ability to pay the $262,500 for which he was jointly and severally liable with MGE. Id. at 25-26. However, the ALJ made the determination that the ability to pay factor required reducing the damages to MGE from $2,325,500 to $450,000. Id. at 26. In reaching this decision, the ALJ made the determination that $450,000 was the most MGE could reasonably be expected to pay while remaining in business. Id.

HUD appealed the ALJ's decision to reduce the penalty for MGE, and Respondents' appealed the ability to pay determination for both MGE and Mr. Grier. HUD Appeal at 4; Respondent Appeal at 6. In the complaint, HUD sought civil money penalties from MGE in the amount of $1,260,000, stipulating MGE could not pay more than that amount. HUD Appeals at 4. For the reasons outlined below, we uphold the ALJ's determination not to reduce the penalty to Mr. Grier, but reject the ALJ's determination to reduce the penalty to MGE.

The ALJ correctly noted that Mr. Grier introduced no evidence to show the lack of an ability to pay the penalty amount. Decision at 25. Mr. Grier was given several opportunities to file a financial statement, but refused to do so. Id. Because Mr. Grier did not provide any affirmative evidence indicating he cannot pay the penalty, the ALJ ruled he had the ability to pay the penalty. Id. at 26. On appeal, Mr. Grier claimed he had low income and had filed for bankruptcy. Respondent Appeal at 6. However, no evidence to support these claims was introduced in the record. We therefore agree with the ALJ that Mr. Grier has the ability to pay $262,500.

The ALJ then determined that MGE did not have the ability to pay either the $1,260,000 in penalties requested by HUD or the $2,325,000 penalty amount for which the ALJ found MGE liable. Therefore, he ordered MGE to pay $450,000. Decision at 25. On appeal, HUD claimed the ALJ erred in two ways. First, HUD contended the ALJ improperly considered whether MGE would survive as an entity after paying the penalty. HUD Appeal at 7. Second, HUD contended that there was insufficient evidence on the record to show that MGE lacked the ability to pay the assessed penalty. Id. Based upon the record, the ALJ erred in reducing the penalty. MGE did not meet its burden to show it was unable to pay the assessed penalty.

In determining to reduce the penalty to $450,000, the ALJ relied upon the

assertion that MGE's primary asset, the Project, is valued at approximately $1,500,000 Decision at 25. However, the ability to pay a penalty must be determined from *all* resources available to the respondent. See 24 C.F.R. § 30.10. A respondent's ability to pay can be affected by income, rents, the ability to borrow, and other factors. See OLA Props., Inc. v. HUD, 336 Fed. Appx. 419, 422 (5th Cir. 2009). In OLA Props, the Court found the respondent had the ability to pay the penalty because the respondent presented no evidence that his income and ability to obtain a loan on his property would not provide the needed funds to pay the penalty. Id. In other areas involving similar laws, courts have even included the potential sale of property to prove the ability to pay. Krueger v. Cuomo 115 F.3d 487, 493 (7th Cir. 1997) (A fair housing case holding that the fact that the respondent would have to sell one of his four properties was not enough to mitigate a penalty. Under 24 C.F.R. § 180.671(c)(ii), one of the factors for a fair housing penalty is the "respondent's financial resources").

In this instance, no evidence was presented showing MGE's ability to pay any penalty amount. The ALJ admitted that the "record is entirely devoid of evidence that would show what penalty amount the Respondents could realistically pay." Decision at 26. However, instead of ending the ability to pay inquiry at this point because MGE did not meet its burden to prove an inability to pay as required by regulation, the ALJ improperly made his own factual determination that MGE could only pay $450,000 (30% of the Project's estimated value). Id. The ALJ provided no explanation as to why $450,000 was the proper amount and neither party ever requested that penalty amount. This determination is not supported by the record or any legal authority.

The situation presented here is on point with that presented in e in In re Entercare. In that case, the ALJ found that the respondent failed to meet the burden of showing the inability to pay. In re Entercare, HUDALJ 01-061-CMP (December 31, 2002). In discussing the "ability to pay" factor, the ALJ determined:

> Respondent has the burden to establish that it lacks the ability to pay the civil money penalty in the amount sought by the Government. Respondent has failed to meet its burden. Despite having been provided an opportunity to provide a complete statement of its present financial health, it has not done so. The Compilation Report not only was not prepared in accordance with GAAP, the standard required by HUD; it is incomplete. It could also be inaccurate and misleading. The auditor's disclaimer states that not all financial information was disclosed. He states: "If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, revenues, and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters." Because this tribunal is "not informed about such matters," it cannot rely upon the Compilation Report to assess Respondent's ability to pay a penalty. There is no other source of reliable financial information. Id. (internal citations omitted).

Like in Entercare, MGE failed to provide a complete picture of its financial

health and instead only provided financial statements that were not confirmed by independent auditors. Decision at 8. MGE also provided no other reliable information about its financial situation. Therefore, MGE did not meet the regulatory burden and the penalty cannot be reduced because of the "ability to pay" factor.

Because MGE did not meet its burden to show the amount it could pay, we reverse the ALJ determination that MGE could only pay $450,000.

b. The ALJ Improperly Applied The "Such Other Matters As Justice May Require" Factor In Further Reducing MGE's Penalties.

After reducing MGE's penalty to $450,000, the ALJ then reduced that penalty by 25% to reflect "HUD's improprieties." Decision at 27. According to the ALJ, HUD's requested penalty amount was chosen as a "result of a biased, outcome-determinative consideration of the enumerated factors" of 24 C.F.R. § 30.80 and was not based on HUD's stated reasoning. Id. at 14. The ALJ found that that the penalty amount HUD requested was "one specifically calculated to bring financial ruin upon Respondents." Id. at 15. According to the ALJ, this was a "wholly inappropriate use of HUD's statutory power." Id. HUD appealed the reduction in penalty, claiming that the ALJ exceeded his authority in reducing the penalty for HUD's alleged malfeasance and regardless, that the record does not support a finding of malfeasance. HUD Appeal at 14-21.

Generally, federal officials acting within their official responsibility are presumed to have acted in good faith. In re Smith, Determination, HUDALJ 91-1609-DB(LDP) (Oct. 28, 1991). This presumption can only be overcome by evidence which shows a clear abuse of discretion. Id. For the reasons set forth below, we do not believe that the record provides clear evidence of an abuse of discretion. Therefore, we reject the ALJ's additional 25% reduction in penalties.

The ALJ reached the conclusion that HUD acted inappropriately in reaching the penalty amount by relying almost entirely on one statement made in the testimony of Rebecca Shank, Division Director of the Operations Division for the Departmental Enforcement Center. Decision at 15. Ms. Shank testified:

> I think where we came from it was looking at, 'well, what is the property worth?' and the combined amount for the HAP contracts is about what the property may be worth. The idea might be that it would be appropriate to force the sale of the property from this nonprofit to another nonprofit to run it in a way that is in accordance with our requirements. Tr. 240, 12-21.

The ALJ interpreted this statement to mean that HUD began the penalty inquire "with the goal of bankrupting Respondents" and that the initial request of $1.6 million, against an estimate value of MGE at $1.5 million, was not a coincidence. Decision at 15-16. The ALJ charged that instead of using MGE's "ability to pay a fine as a mitigating factor, as is standard practice, the Government perverted the intent of this factor by setting its

penalty request at a figure it knows Respondents cannot financially survive." Decision at 16.

Viewing the record as a whole, including Ms. Shank's entire testimony, it is clear that the "ability to pay" factor was used by HUD to actually reduce the penalty. Directly before making the statement upon which the ALJ relied, Ms. Shank noted that HUD's penalty request regarding the HAP contract violations were "not the maximum amount that could have been applied" and later confirmed that "[t]here was a decision to reduce that amount." Tr. 240, 1-2, 6-7. Ms. Shank's statement was in response to the ALJ asking "how HUD came to that," namely the decision to reduce the amount. Tr. 240, 10-11. From this context, the most logical conclusion to draw is that HUD used the estimated worth of MGE under the ability to pay factor to determine a penalty amount. Additional testimony by Ms. Shank confirms this conclusion. In response to the very next question, Ms. Shank testified that HUD considered all of the factors. Tr. 241, 5-9. Ms. Shank then discussed each of the factors, and how they applied to the Respondents, including again bringing up the Project's estimated value when discussing the ability to pay. Tr. 241-248. Considering her testimony as a whole, Ms. Shank's testimony fails to establish improper intent by HUD.

Ms. Shank made a statement similar to the one relied upon by the ALJ but to which he did not refer. This statement too fails to show improper action by HUD. Ms. Shank testified:

> We can say, 'we think this property has a value of a million and a half, so to the extent that if we were to get different management, different owner, it could be used for the purpose of low income housing,' continue to use that if it would be sold to someone else. Tr. 218, 7-13.

Immediately preceding this statement, Ms. Shank discussed how the regulatory factors were "tough" to implement and how HUD tries to find ways to implement them. Tr. 217-218, 12-6. Ms. Shank specifically discussed evaluating the egregiousness of the violation and what kind of deterrent effect any specific penalty might have. Id. As further evidence of this, Ms. Shank discussed other factors of the regulation, testifying:

> I think that there was a balancing here, and to the extent that $25,000 was asked for, I think it incorporated the severity, the fact that these were knowing, intentional violations, and the fact that the tenants were hurt. Tr. 218, 14-19.

In this context, Ms. Shank's statements show how HUD applied the factors of section and are not an indication that HUD only sought to force a bankruptcy and sale.

In sum, the record fails to support the ALJ's conclusion that HUD acted inappropriately in calculating the penalty request. Moreover, reducing the penalty by over 80% would effectively render the other regulatory factors meaningless. We therefore vacate the 25% reduction in penalty and find that the record and law supports a holding

that MGE pay $1,260,000 in penalties for the violations of the HAP contract.

c. The ALJ Correctly Found That Respondents Misused Taxpayer Money.

The Respondents objected to the ALJ's conclusion that Respondents misused taxpayer money when examining the "injury to the public" factor. Decision at 16; Respondent Appeal at 3. We find this objection unpersuasive. Respondents received taxpayer money in the form of HAP payments and IRP payments for more than 30 years. Decision at 3-9. Encumbering the Project, its reserve funds, and potential rental income is a direct misuse of the specified purpose of that taxpayer money. Therefore, we agree with the ALJ's conclusion that Respondents misused taxpayer money.

4. Respondents Claim That The ALJ Was Biased Is Denied.

On appeal, Respondents claimed that the ALJ was biased and should have been barred from hearing the case. Respondent Appeal at 6. Respondent Response Brief at 2. As well as providing no evidence to back up this claim, this claim was never put forth on the record. We are prohibited from examining any new evidence not present on the record unless there are reasonable grounds why it was not initially presented. 24 C.F.R. § 26.52(i). In this case, there is no reason these claims could not have been previously put forth. Therefore, we do not accept the Respondents' contention of bias by the ALJ.

ORDER ON SECRETARIAL REVIEW

Upon review of the record of this proceeding, and based on analysis of the applicable law, we uphold the ALJ determination of liability on all counts and modify the penalty amounts to $262,500 jointly and severally for Mr. Grier and MGE, and $1,260,000 to MGE.

IT IS SO ORDERED.

Dated this 5/08th day of May, 2013

Brent Colburn
Secretarial Designee