Office of Appeals
U.S. Department of Housing and Urban Development
Washington, D.C. 20410-0001

In the Matter of: **Simone and Brian Kern,** Petitioners.	HUDOA No. 10-H-CH-LL135 Claim No. 721006143

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For Petitioners

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For the Secretary

DECISION AND ORDER

On October 26, 2009, Petitioners were notified that, pursuant to 31 U.S.C. §§ 3716 and 3720A, the Secretary of the U.S. Department of Housing and Urban Development ("HUD" or "the Secretary") intended to seek administrative offset of any federal payments due to Petitioners in satisfaction of a delinquent and legally enforceable debt allegedly owed to HUD.

On May 10, 2010, Petitioners made a request for a hearing concerning the existence, amount or enforceability of the debt allegedly owed to HUD. The Office of Appeals has jurisdiction to determine whether Petitioners' debt is past due and legally enforceable pursuant to 24 C.F.R. § 17.152. The administrative judges of the Office of Appeals have been designated to conduct a hearing to determine whether the debt allegedly owed to HUD is legally enforceable. 24 C.F.R. §§ 17.152 and 17.153. As a result of Petitioners' hearing request, this Office temporarily stayed referral of the debt to the U.S. Department of Treasury for offset on May 12, 2010. (Notice of Docketing, Order and Stay of Referral.)

Background

On or about July 3, 2007 Petitioners executed and delivered a Partial Claims Promissory Note ("Note") to the Secretary promising to repay a partial claim paid on their behalf by the Secretary to cure the arrearages on their primary FHA-insured mortgage and avoid the foreclosure of their home. (Sec'y Stat. ¶ 1.) The Note stated that payment would be due:

> ...When the first of the following events occurs:
> (i) Borrower has paid in full all amounts due under the primary Note and related mortgage, deed of trust of [sic] similar Security Instruments insured by the Secretary, or
> (ii) [t]he maturity date of the primary Note has been accelerated, or
> (iii) [t]he primary note and related mortgage, deed of trust or similar Security Instrument are no longer insured by the Secretary, or
> (iv) [t]he property is not occupied by the purchaser as his or her principal residence....

(Sec'y Stat., Ex. 1, Note, p.1.) On or around April 9, 2009, the FHA mortgage insurance on the primary mortgage was terminated as the mortgagee indicated that the mortgage was paid in full. (Sec'y Stat. ¶ 2.) Pursuant to the terms and conditions of the Note, payment is now due in full. (*Id.*)

The Secretary has filed a Statement alleging that HUD has attempted to collect this debt but Petitioners remain delinquent. (Sec'y Stat. ¶ 3.) The Secretary alleges that Petitioners are indebted to HUD in the following amounts:

> (a) $9,889.22 as the unpaid principal balance as of April 30, 2010;
> (b) $222.48 as the unpaid interest on the principal balance at 3% per annum through April 30, 2010; and
> (c) interest on said principal balance from May 1, 2010 at 3% per annum until paid.

(Sec'y Stat., Ex. 2, Dillon Decl. ¶ 5.)

A Notice of Intent to Collect by Treasury Offset dated October 26, 2009 was sent to Petitioners. (Dillon Decl. ¶ 6.) Petitioners' offer to settle this alleged debt for the sum of $1,500.00 was rejected by the Department. (Sec'y Stat. ¶ 9.)

Discussion

The Deficit Reduction Act of 1984, 31 U.S.C.A. §3720, provides federal agencies with a means of collecting debts owed to the United States Government. Petitioners bear the initial burden of submitting evidence to prove that the alleged debt is unenforceable or not past due. 24

C.F.R. § 17.152(b). In this case, Petitioners dispute both the existence and the enforceability of the debt. Petitioners dispute the existence of the debt by arguing that:

> "[Petitioners] listed the property for sale and sold it for a price which they were advised by Wells Fargo Home Mortgage [("WFHM")] would payoff the 'purchase money' first and second deeds of trust on the property. Both the first and second 'purchase money' loans on the property were managed by [WFHM] under Loan Number 936-0604856914 [sic]....[Petitioners] were under the understanding that loan number 936-0604856914 [sic], which, as you can see from the HUD Deed of Trust we previously provided you, included the money owed to the Secretary of Housing and Urban Development in the amount of $9,889.22 and should have been paid to the US Department of HUD by [WFHM]."

(Pet'r's Doc. Evid.) Petitioners further contend "[a] payoff in the amount of $187,145.86 was received by [Warranty Title's] office and was used in the final HUD closing payoff. Please note that the [WFHM] payoff amounted to over $11,025.86 more than the balance of the underlying Wells Fargo first mortgage." (Pet'r's Hr'g Req.) Petitioners add that at the time of the closing, Castle Meinhold & Stawiarski, LLC was handling the foreclosure for WFHM. (Pet'r's Doc. Evid.) As support, Petitioners submit a copy of the HUD-1 Settlement Statement that reflects a payoff of a first mortgage loan in the amount of $187,145.86 to Castle Meinhold & Stawiarski, LLC. (Pet'r's Hr'g Req. Attach. HUD-1 Settlement Statement, dated April 13, 2009.)

The Secretary contends nonetheless that the Settlement Statement submitted by Petitioner does not reflect a payoff of the debt that is subject of this proceeding. As support for his position, the Secretary submits a copy of the payoff statement from the Settlement and argues "while Petitioners have suggested that the subject Note was paid at closing, there is no reference to the HUD debt being paid on the payoff statement provided by Petitioners' representative." (Sec'y Stat., ¶6, Dillon Decl, ¶8, Exh A.) Upon reviewing the payoff statement from Castle, Meinhold and Stawiarski there is no indication that the total amount of the payoff included the payoff for the Note from which the subject debt arises. Accordingly, I find that Petitioners' argument that the debt has been paid must fail due to lack of sufficient evidence.

Petitioners next claim that, "[a]t one time, [Warranty Title, Inc.'s] title processing agent/office manager was advised by [WFHM] that the loan to HUD should have been paid from the money collected by [WFHM]." (Pet'r's Doc. Evid.) Petitioners submitted as documentary evidence a copy of a letter to Petitioners from WFHM dated December 4, 2009. However, the substance of the letter does not support this assertion. In the letter, a representative of WFHM states that, "...WFHM *did not collect the partial claim funds to pay off the partial claim*. Per the enclosed Partial Claims Promissory Note that you signed, the payoff of the partial claim *is to be made by you directly to HUD*." (emphasis added) (Pet'r's Doc. Evid.) To reinforce the point that the subject debt was expected to be paid by Petitioners, the Secretary produced as evidence a copy of the Note in which...the terms of the note provided to Petitioners "Payment shall be made at the following address: U.S. Department of HUD, C/O First Madison Services, Inc., 4111

South Darlington, Suite 300, Tulsa, OK 74135 or any such other place as Lender may designate in writing by notice to Borrower." (Sec'y Stat., Ex. 1, Note ¶ 3(B)). As a general rule, in order to prove that Petitioners are no longer liable for the debt, "there must either be a release in writing from the lender specifically discharging Petitioner's obligation, or valuable consideration accepted by the lender from Petitioner, which would indicate an intent to release." *In re Hedieh Rezai,* HUDBCA No. 04-A-NY-EE016, at 3 (May 10, 2004) (citing, *In re Cecil F. and Lucille Overby,* HUDBCA No. 87-1917-G250 (December 22, 1986)). Petitioners have proffered neither a release in writing from HUD as the lender on the Note, nor have Petitioners shown that valuable consideration was accepted by HUD that indicates an intent to release. On the contrary, Petitioners, by their own admission, have stated that payment was only made to WFHM through Castle, Meinhold & Stawiarski as WFHM's agent. (Pet'r's Doc. Evid.) Accordingly, Petitioners have failed to demonstrate that the debt that is the subject of this proceeding does not exist because they have failed to prove that they have been released from their legal obligation to pay the subject debt.

Petitioners then argue that HUD may not enforce the debt against Petitioners because "[had Petitioners] allowed the foreclosure to proceed in this matter, the second mortgage held by HUD would have been wiped out in its entirety since there was no equity in the real estate." (Pet'r's Hr'g Req.) Petitioners' argument lacks merit because the property owned by Petitioners that secured the Note was not a property that was the subject of a foreclosure proceeding. Even if Petitioners' property was foreclosed, this Office has held that "[i]f satisfaction of a senior deed of trust through a foreclosure sale prevents a junior trust holder from enforcing a junior trust deed on the same real property, the junior trust holder may collect the debt, now unsecured, by initiating collection efforts based on the obligations in the loan note." *In re Kimberly S. (King) Thede*, HUDBCA No. 89-4587-L74 (April 23, 1990) (*citing, In re Alan Juel*, HUDBCA No. 87-2065-G396 (January 28, 1986)). Consistent with *Thede* and *Alan Juel* HUD may initiate collection efforts based on the obligations in the loan note bearing Petitioners' signatures. Therefore, I find that this claim lacks merit and fails to prove that the subject debt does not exist.

Lastly, Petitioners argue that the doctrine of equitable subrogation precludes HUD from collecting the debt in this case. Specifically, Petitioners claim that "the doctrine of 'equitable subrogation' will probably allow the new lender on the property who paid off the [WFHM] [m]ortgage to step into the first position on the property. This doctrine was most recently set out in the case of Hicks v. Landre in December, 2005."[1] (Pet'r's Hr'g Req.) Although it is true that equitable subrogation would allow "a party secondarily liable who has paid the debt of the party who is primarily liable [to] institute a recovery action in order to be made whole," Petitioners' reliance on the doctrine and the *Hicks* case is misplaced. *Cotter Corp. v. Am. Empire Surplus Lines,* 90 P.3d 814, 833 (2004) (quoting *Behlen Mfg. Co. v. First Nat'l Bank of Englewood,* 28 Colo.App. 300, 309, 472 P.2d 703,707 (1970)). Upon reviewing the facts in *Hicks,* Hicks initiated a foreclosure action against the property because the judgment lien he held was not satisfied when the judgment debtors sold the property to the Londres. *Hicks v. Londre,* 125 P.3d 452, 455 (Colo. 2005). The Londres successfully raised an affirmative defense of equitable subrogation to prevent the foreclosure of their property. (*Id.*) Unlike *Hicks,* HUD in this case, has not proceeded with foreclosure on the property and thus Petitioners, who have no foreclosure

[1] Petitioners mistakenly cite the case as *Hicks v. Landre* when the correct citation is *Hicks v. Londre*, 125 P.3d 452, 455 (Colo. 2005).

rights to the property, are not in the position to raise as their defense equitable subrogation. Accordingly, Petitioners have failed to prove that the debt in this case is not legally enforceable based upon the doctrine of equitable subrogation.

ORDER

It is hereby **ORDERED,** for the reasons set forth above, that the Order imposing the stay of referral of this matter to the U.S. Department of the Treasury for administrative offset is **VACATED**.

The Secretary is authorized to seek collection of this outstanding obligation by means of administrative offset of any federal payments due to Petitioner, to the extent authorized by law.

Vanessa L. Hall
Administrative Judge

October 14, 2010