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

In the Matter of: **Cambridge Home Capital, LLC,** Petitioner.	HUDOA No. 06-D-NY-GG004 Claim No. 7-207036640A

Scott D. Burke, Esq.
Weiner Brodsky Sidman Kider PC
1300 19th Street, N.W.
Fifth Floor
Washington, DC 20036

For Petitioner

Julia M. Murray
U.S. Department of Housing and
Urban Development
Office of Regional Counsel
For New York/New Jersey
26 Federal Plaza, Room 3237
New York, NY 10278

For the Secretary

DECISION AND ORDER

On October 10, 2005, Petitioner, Cambridge Home Capital, LLC, was 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 Department") intended to seek administrative offset of any federal payments due to Petitioner in satisfaction of a delinquent and legally enforceable debt allegedly owed to HUD.

Petitioner made a timely request for a hearing concerning the existence, amount or enforceability of the debt allegedly owed to HUD. The Administrative Judges of this Office are 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 Petitioner's hearing request, referral of the debt to the U.S. Department of the Treasury for administrative offset was temporarily stayed by this Office on June 5, 2008 until the issuance of a written decision by the administrative judge. 24 C.F.R. §17.156.

Background

An audit performed by HUD's lender monitoring team in 2004 found non-compliant lending activities by Petitioner in 11 out of 18 loans, and found that the Petitioner's activities exposed HUD to an unacceptable level of risk. (Secretary's Statement ("Sec'y Stat."), filed February 22, 2006, ¶ 3, Ex. 1, Office of Inspector General, Audit Report No. 2004-NY-1003 ("the IG Report), dated July 19, 2004, at p. iii and pp. 4-5; Declaration of Michael C. DeMarco, Director of Insurance Operations Division, HUD Financial Operations Center ("DeMarco Decl."), dated December 6, 2005, ¶ 4.) In the case of FHA case number 374-3772590 ("the Loan"), the audit revealed that Cambridge financed the purchase with proceeds in the amount of $319,450, which was insured by HUD despite the fact that the borrower's debt-to-income ration exceeded HUD / FHA standards. (Sec'y Stat. ¶ 4, Ex. 1, IG Report at Appendix B-06, p. 34.) As a result of those findings, Petitioner agreed to indemnify HUD for the amount of any insurance claim HUD paid in connection with the Loan, in addition to certain costs and interest ("the Indemnification Agreement" or "the Agreement"). (Sec'y Stat. ¶ 2; DeMarco Decl., Ex. A; Petitioner's Documentary Evidence ("Pet'r's Evid."), filed January 13, 2006.) The Indemnification Agreement was executed by Petitioner on May 5, 2005 and by HUD on June 1, 2005. (Pet'r's Evid., Ex. A.)

On or about January 1, 2002, the Loan went into default. (Sec'y Stat. ¶3.) At the time of default, the note and mortgage associated with the Loan were assigned to Midland Mortgage Co. ("Midland"). (Sec'y Stat. n. 2.) On May 16, 2003 the property ("the Property"), on which the mortgage on the Loan was secured, was sold through a pre-foreclosure sale. (Supplemental to Secretary's Statement ("Sec'y Suppl."), filed April 17, 2009, ¶ 6; DeMarco Decl. ¶ 4.; Petitioner's Response ("Pet'r's Resp.") filed May 12, 2009, ¶ 18.) The proceeds from the pre-foreclosure sale were insufficient to pay off the Loan in its entirety. Subsequently, HUD paid insurance benefits to Midland, the mortgagee, in the amount of $96,245.42. (Sec'y Suppl. ¶ 7; DeMarco Decl. ¶ 4.) Petitioner failed to make payments to HUD as agreed in the Agreement and is currently in default. (Sec'y Stat. ¶ 6.)

The Secretary alleges that Petitioner is delinquent in paying HUD's claim under the Agreement and that Petitioner is indebted to the Secretary in the following amounts:

(a) $96,265.42 as the unpaid principal balance as of November 22, 2005
(b) $0 as the unpaid interest on the principal balance at 1.00% per annum through December 22, 2005; and
(c) Interest on said principal balance from December 23, 2005, at 1% per annum until paid.

(Sec'y Stat. ¶ 9, DeMarco Decl. ¶ 7.)

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. Petitioner bears 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).

Petitioner does not dispute the existence of the debt. Rather, the Petitioner disputes the amount of the debt, arguing that HUD: (1) failed to act in accordance with its own loss mitigation regulations; (2) failed to mitigate its damages; and (3) breached the covenant of good faith and fair dealing.

Petitioner suggests that an appraisal ordered by Midland (which determined the value of the Property to be $280,000) was invalid, because it utilized comparable sales "that were too dissimilar to the Property to be a fair basis for estimating its value." (Pet'r's Evid. at 5; Ex. B Appraisal Report ("the Midland Appraisal") prepared December 26, 2002.) The Midland Appraisal is a key consideration because lenders rely on the appraised value to determine the appropriate sale price for foreclosed property. Petitioner claims that HUD violated its own regulations and program guidelines by approving the pre-foreclosure sale, which relied on the Midland Appraisal, and by not limiting the pre-foreclosure sale period to three months, as required by Mortgage Letter 00-05. (Pet'r's Resp. ¶¶ 11 and 17; Mortgagee Letter 00-05 ("the Mortgagee Letter"), dated January 19, 2000 at 29.) Petitioner contends that a subsequent appraisal ("the Cambridge Appraisal"), which was ordered by the Petitioner and which determined the value of the property to be $350,000, was more accurate and should have been utilized by HUD. (Pet'r's Evid. at 5-6.)

1. Mortgagee Letter Having the "Force and Effect of Law"

Petitioner argues that HUD failed to act in accordance with its own regulations and is, therefore, equitably stopped from recovering the full amount of the claim. (Pet'r's Evid. at 4.) Specifically, Petitioner argues that HUD is bound by the policies and procedures outlined in Mortgagee Letter 00-05, which sets the minimum acceptable net sales proceeds from a pre-foreclosure sale at 82% of the as-is appraisal value and limits the period for pre-foreclosure sales to three months. (Pet'r's Resp. ¶ 15; Mortgagee Letter at 29.)

In order for the Mortgagee Letter to be treated as having the "force and effect of law," the Mortgagee Letter must prescribe "substantive" or "legislative-type" rules that must also be properly promulgated. Chrysler Corp. v. Brown, 441 U.S. 281, 282, 99 S.Ct. 1705, 1708 (1979). Substantive or legislative regulations are "issued by an agency pursuant to statutory authority and implement the statute...." Id. at 302-303, 1718. Substantive rules must also affect individual rights and obligations in order to have the "force and effect of law." Id. at 302, 1718.

To determine whether the Mortgagee Letter has the "force and effect of law," it is also appropriate to consider its purpose. The language in the Mortgagee Letter states that its purpose is to "announce clarifications of policy and procedural changes...." (Mortgage Letter at 1.) See, Brown v. Lynn, 392 F.Supp. 559, 562 (N.D. Ill. 1975), reh'g denied, 392 F.Supp. 559 (N.D.Ill. Feb 12, 1975) (court held that the HUD Handbook does not contain legally binding regulations because of express language stating that "the purpose of the HUD Handbook is to provide procedural information and policy guidelines"). In Batterton v. Francis, the United States Supreme Court held that "a court is not required to give effect to an interpretive regulation."

Batterton v. Francis, 432 U.S. 416, 425 (1977). Thus, in order to prevail, Petitioner would need to establish that the Mortgagee Letter was intended to have the "force and effect of law", that it was not designed to provide mere procedural guidelines to lenders, and that it was intended to implement a specific federal statute. The Court has serious doubts that Petitioner could establish any of these criteria. However, the Court does not find it necessary to reach these questions since it is clear that the guidelines referred to by Petitioner were never publicly promulgated.

In order for the Mortgagee Letter to be legally binding, the Department is required to have promulgated the rules outlined in the Mortgagee Letter pursuant to a specific statutory grant of authority and in conformance with the procedural requirements set forth by statute. Chrysler Corp., 441 U.S. at 302-303, 99 S.Ct. at 1717-1718. These requirements are "prerequisites to giving a regulation the binding effect of law." Chrysler Corp., 441 U.S. at 315, 99 S.Ct. at 1724. The policies and procedures contained in the Mortgagee Letter were neither published in the Federal Register nor disseminated to the public for scrutiny and comment. Since the policies and procedures set forth in the Mortgagee Letter are "interpretive rules" and were not properly promulgated, I find that they do not carry the "force and effect of law."

It is, therefore, unnecessary to reach the issue of whether it was reasonable for HUD to approve the pre-foreclosure sale price based upon the Midland Appraisal, because HUD is not legally bound to follow the policies and guidelines requiring that appraisal. In a previous case where Petitioner raised the issue of HUD's non-compliance with its own property disposition handbook, the former Board of Contract Appeals held that it was not necessary for HUD to follow those guidelines because they were not specifically incorporated into the Indemnification Agreement. See, Susquehanna Mortgage Corp., HUDBCA No. 04-A-NY-EE048, dated September 16, 2005. We now clarify that while HUD may be required to follow promulgated regulations, whether they are specifically incorporated into contractual language or not, this is not the case with non-promulgated regulations or guidelines.

2. Duty to Mitigate Damages

Petitioner further alleges that HUD is not due the full amount of its claim because it failed to mitigate damages. Specifically, Petitioner claims that HUD "manufactured its own loss" by allowing the pre-foreclosure sale to take place. (Pet'r's Evid. at 9). It is true that HUD has a duty to mitigate its damages by making "those efforts that are fair and reasonable under the circumstances." Robinson and Florida Businessmen's Ass'n v. United States, 305 F.3d 1330, 1333 (Fed. Cir. 2002); see also, Toyota Industrial Trucks U.S.A., Inc. v. Citizens Nat'l Bank of Evans City, 611 F.2d 465, 471 (3rd Cir.1979) (holding that the reasonableness of an action should be judged by the facts and circumstances at the time the action is taken). In the circumstances presented here, HUD has established a minimum for acceptable net sales proceeds from a pre-foreclosure sale and has required that an appraisal be performed by an appraiser who meets "standard eligibility requirements for performing Single Family appraisals." (Mortgagee Letter, at 29.) Consequently, I find that HUD acted reasonably and promptly under the circumstances of this case when it approved the pre-foreclosure sale.

Notwithstanding Petitioner's suggestion that HUD might have been able to obtain a higher sale price for the Property had it not approved the pre-foreclosure sale, I find no

persuasive proof of that fact in the record. Given the facts and circumstances of this case, there is nothing to suggest that the comparable sales utilized in the Midland Appraisal were inherently unreasonable. In any case, the question as to which appraisal more accurately reflected the property's fair market value is not dispositive. HUD "need not seek out the optimum conditions for resale nor hold out for the property's fair market value." Robinson, 305 F.3d at 1333; see also Ketchikan Pulp Co. v. United States, 20 Cl.Ct. 164, 166 (Fed. Cl. 1990) (holding that the government is not required to "ferret out the single best situation which will absolutely minimize the breaching party's damages.") The proper inquiry is whether HUD acted reasonably under the circumstances. As noted above, I find that the comparable sales in the Midland Appraisal were reasonable and that HUD was entitled to, and did justifiably rely upon, that appraisal.

3. Good Faith and Fair Dealing

Petitioner claims that by failing to "maximize the return on the sale of the Property and minimize the amount of loss sustained by HUD and Cambridge Home Capital," HUD breached the covenant of good faith and fair dealing. (Pet'r's Evid. at 10.) The covenant of good faith and fair dealing applies to both the Government and private parties. Keeter Trading Co., Inc. v. United States, 85 Fed.Cl. 613, 617 (Fed.Cl. 2009). The Government enjoys a legal presumption that it is acting in good faith when carrying out its duties. Spezzaferro v. Fed. Aviation Admin., 807 F.2d. 169, 173 (Fed.Cir. 1986). Accordingly, Petitioner must show "clear and convincing evidence of improper motive on the part of the government" to overcome this presumption. Am-Pro Protective Agency, Inc. v. United States, 281 F.3d 1234, 1239 (Fed.Cir. 2002). In order to carry this evidentiary burden of proof, Petitioner must show that HUD relied on the Midland Appraisal and approved the pre-foreclosure sale with a "specific intent to injure" or show that HUD was "motivated by animus" towards the Petitioner. Keeter Trading Co., 85 Fed.Cl. at 618 (citing North Star Alaska Hous. Corp. v. United States, 76 Fed.Cl. 158, 188 (Fed.Cl. 2007)). Under the facts of this case, the mere reliance on an appraisal, even if it was potentially inaccurate, does not demonstrate a "specific intent to injure" or that HUD was "motivated by animus". Petitioner offers no evidence to prove bad faith on the part of HUD, but instead relies solely on its argument that the Midland Appraisal was inaccurate and that it was unreasonable, and perhaps negligent, for HUD to approve a pre-foreclosure sale based on it. Accordingly, I find that Petitioner has failed to meet its burden of overcoming the presumption that HUD acted in bad faith.

Petitioner has failed to file sufficient documentary evidence to support its argument that the debt that is subject of this proceeding is unenforceable or not past-due, and has therefore failed to meet its burden of proof as set forth in 24 C.F.R. § 17.152. In the absence of sufficient documentary evidence filed by Petitioner, I find the debt that is subject of this proceeding to be legally enforceable against Petitioner.

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.

/s/ original signed

H. Alexander Manuel
Administrative Judge

June 18, 2009