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{{6-30-92 p.A-1959}}

[¶5176] In the Matter of Ira Lee Brannan, David Brannan, and Stephen L. Brannan, Freedom Bank, DeLeon, Texas, Docket No. FDIC-91-37k (4-14-92).

The FDIC Board adopts ALJ's recommendation and finds violation of law and Regulation O in a loan to an affiliated institution; it rejects ALJ's recommendation and also finds violation in an unreimbursed tax overpayment to the Bank's holding company. Finding that individual respondents benefited from the violations, the board rejects ALJ's recommendation of $3,000 penalties and orders penalties of $200,000 for one respondent and $125,000 for each of the other two.

[.1] Regulation O—Definition—Extension of Credit

Once Bank's holding company was obligated to repay an overpayment of estimated taxes, a debtor-creditor relationship arose, creating an extension of credit for purposes of Regulation O. Bank then had an obligation to bring the loan into compliance by obtaining security and establishing an interest rate and other terms for the loan.

[.2] Regulation O—Civil Money Penalties for Violation—Factors

In assessing penalties for violations of Regulation O, the board considers financial resources and good faith of respondents, gravity of the violations, history of previous violations, and such other factors as justice may require.

[.3] Civil Money Penalties—Amount—Losses to Bank

Deterrence is a factor in determining the size of a civil money penalty and often requires assessing a penalty substantially higher than the losses to the bank, particularly where Respondents occupy positions of control over the Bank and its affiliates.

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[.4] Civil Money Penalties—Amount—Personal Gain

Application of estimated tax overpayment to relieve Respondent of his guaranty on another obligation was self-dealing, a direct personal benefit to him and a serious breach of fiduciary duty, and weighs in favor of substantial penalties.

[.5] Regulation O—Preferential Terms—Personal Gain

Where loan to an affiliate is on preferential terms, the economic benefit is the amount by which the terms, including interest rates and collateral, are favorable compared to those prevailing at the time for comparable arms length transactions.

[.6] Civil Money Penalties—Amount—History of Violations

Numerous prior violations involving Respondents weigh in favor of higher penalties.

[.7] Civil Money Penalties—Amount—Ability to Pay

While negative net worth may be a mitigating factor, deterrence nevertheless mandates substantial penalties where there are severe losses to Bank, prior violations and significant personal gain by Respondents.

In the Matter of
IRA LEE BRANNAN, DAVID
BRANNAN and STEPHEN L.
BRANNAN,individually and as officers
and/or directors and institution-
affiliated parties of
FREEDOM BANK
DELEON, TEXAS
(Insured State Nonmember Bank)
DECISION AND ORDER
FDIC-91-37k

I. *INTRODUCTION*

This proceeding arises out of a Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing, dated March 12, 1991, ("Notice"), against Ira Lee Brannan for $200,000, David Brannan for $125,000, and Stephen L. Brannan (collectively "Respondents")[1] for $125,000, issued pursuant to former section 18(j)(4) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. § 1828(j)(4), and Part 308 of the Federal Deposit Insurance Corporation ("FDIC") Rules of Practice and Procedure, 12 C.F.R. § 308.74-.76. The Notice alleges that Respondents violated section 23A of the Federal Reserve Act, 12 U.S.C. § 371c(c) (1), and Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. § 215, with respect to Freedom Bank (formerly known as Farmers & Merchants Bank), DeLeon, Texas ("Bank"), by allowing a loan to BGroup, Inc., an affiliate, secured by another affiliate's securities; and an overpayment of estimated income taxes to the holding company that was not reimbursed to the Bank. An evidentiary hearing was held October 8–9, 1991, in Austin, Texas before Administrative Law Judge James L. Rose ("ALJ").

The ALJ issued his Recommended Decision ("R.D.") on December 20, 1991, finding that Respondents had violated section 23A of the Federal Reserve Act when the Bank granted a $240,000 extension of credit to BGroup, Inc. The ALJ found, however, that the failure of B-Banc Corporation ("B-Banc"), the Bank's holding company, to repay the $81,211 tax overpayment was not an extension of credit and therefore did not violate any laws or regulations.

The ALJ concluded that civil money penalties of $3,000 per Respondent were justified. FDIC Enforcement Counsel ("Enforcement Counsel") filed exceptions to the ALJ's Recommended Decision.

II. *BACKGROUND*

A. *The 1989 Estimated Income Tax Payment*

The Respondents were each officers and/or members of the board of directors of the Bank. (Stip. at 3).[2] The Respondents had a controlling influence over the management, policies, and practices of the Bank, includ-

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[1] Assessments against the other named Respondents have been resolved.

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[2] Citations in this Decision shall be as follows:
Stipulations—"Stip. at ____."
(Continued)

ing extensions of credit, investments, and purchases of assets by the Bank. (Stip. at 6). In October 1986, an FDIC report of examination cited violations of Regulation O which included loans extended to Ira and Stephen Brannan. (Tr. At 124; FDIC Ex. 52, p. 6-b.). Additionally, a memorandum of understanding was entered in April 1987, among the Bank, the FDIC, and the Banking Commissioner for the State of Texas, which required these violations be corrected and procedures implemented to prevent recurrence. (FDIC Ex. 56; Stip. at 21).

B-Banc Corporation (herein B-Banc, now known as Freedom Bank Group, Inc.) owned 100 percent of the Bank's stock. (Stip. at 7). B-Banc was a six-bank holding company controlled by the Respondents and their related interests, and each Respondent was an officer and/or director of B-Banc. (Stip. at 8). The Respondents owned, controlled, or had the power to vote 25 percent of the B-Banc common stock. (Stip. at 10).

B-Banc filed a consolidated income tax return for itself and the Bank. (Stip. at 22). The tax settlement agreement between the Bank and B-Banc required any overpayment to be immediately refunded "when determined to be an overpayment." (FDIC Ex. 26, p. 1). Pursuant to its tax settlement agreement with B-Banc, the Bank paid the following estimated taxes to B-Banc in 1989:

Date	Amount
March 15	$11,076
July 3	$11,076
July 19	$59,059

(Stip. at 25). The Bank's cumulative pre-tax earnings in 1989 were reported in the Bank's Consolidated Reports of Condition and Income ("Call Reports") as follows:

Quarter Ending	Amount
March 31	$69,000

June 30	$264,000
June 30 (amended)	$34,000
September 30	$155,000
December 31	$522,000)

(Stip. at 26). Due to the Bank's negative income in 1989, it had no income tax liability and the estimated tax payments should have been refunded. (Stip. at 27) (FDIC Ex. 26, p. 1).

The $81,211 the Bank remitted to B-Banc for the payment of 1989 income taxes has not been refunded. (Stip. at 29). The debt owing to the Bank from B-Banc was not evidenced by a note; it was not secured; the Bank was not collecting interest; and there was no specific due date for the debt. (Tr. at 77–78). The Bank never requested B-Banc to sign a note or to pay interest, nor did the Bank set a due date. (Tr. at 16).

At the November 9, 1989, examination, the FDIC required the Bank to write off the $81,211 as a loss. (Stip. at 28). The Bank did not make written demand on B-Banc for repayment of the 1989 income tax payment until March 13, 1990. (Tr. at 16; Stip. at 32). While the exact amount is not clear, a substantial portion, if not all, of the $81,211 advanced for taxes was used to pay a debt of B-Banc to MBank Dallas, of which Respondent Ira Brannan was the guarantor. (Tr. at 235; FDIC Ex. 69, p. 6).

B. *The Loan to BGroup, An Affiliate*

On November 14, 1985, the Bank extended a credit to W.D. Brannan,[3] for $289,027.45, which was secured by 12,550 shares of B-Banc stock. (Tr. at 55). On November 25, 1986, the maturity date of W.D. Brannan's loan was extended to March 9, 1987. (Tr. at 55; FDIC Ex. 82, p. 1). On April 8, 1988, the Bank extended a credit for $240,000, secured by 12,550 shares of B-Banc stock, to BGroup, Inc., an affiliate company wholly owned by Respondents. (Stip. At 34 and 35). The proceeds of the $240,000 extension of credit to BGroup, Inc., were used to pay the loan in the name of W.D. Brannan. (Tr. at 48–49). The same 12,550 shares of B-Banc stock secured the credits to W.D. Brannan and BGroup, Inc. (Tr. at 51–52).

When the credit was extended to BGroup, Inc., the B-Banc stock was worth at the most $20.00 per share. (Stip. at 38). The extension of credit to BGroup, Inc, had no guarantors. (Tr. at 74). The most recent financial statement in W.D. Brannan's file is dated

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2 Continued: Transcript—"Tr. at ____."
FDIC Exhibit—"FDIC Ex. ____."

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[3] W.D. Brannan is the brother of Respondent Ira Lee Brannan. Ira Brannan is the father of Respondents Steven and David Brannan.

{{6-30-92 p.A-1962}}1987, and his most recent tax statement is dated 1985. At the time the Bank extended the credit to BGroup, Inc., no new documentation was received. (Tr. at 55–58; FDIC Ex. 82, pp. 12–13, 22–32). The Bank's board of directors approved the loan to BGroup, Inc. on May 20, 1988. (Stip. at 36). At some point in 1987, B-Banc sustained losses of nearly nine million dollars, and it was not possible to find another lender to grant the loan to BGroup, Inc., secured only by B-Banc stock. (Tr. at 225).

The $240,000 extension of credit to BGroup, Inc., was cited as a violation of section 23A of the Federal Reserve Act at the FDIC Examination on April 29, 1988, and the Bank promised to take corrective action.[4] (Tr. at 82, 115; FDIC Ex. 53, pp. 6–8). The loan was classified as a loss by the FDIC in an examination of the Bank on November 9, 1989. (Stip. at 37). BGroup, Inc., has never made a payment on the $240,000 extension of credit, and it is still outstanding. (Tr. at 21; Stip. at 39). B-Banc ceased doing business in May 1990, and the stock of B-Banc is now worthless. (Tr. at 166–167, 212).

C. *The ALJ's Recommended Decision*

After considering the testimony and documentary evidence presented by Enforcement Counsel and the Respondent, the ALJ made the following significant conclusions of law.

When it became apparent that the Bank would not have sufficient income to necessitate the payment of income taxes in the amounts already paid to B-Banc, B-Banc became obligated to return the excessive payments made to the Bank. (Conclusion of Law No. 7, R.D. at 22). Nevertheless, the payments of estimated income taxes by the Bank to B-Banc were not, nor did they ever become, extensions of credit to B-Banc within the meaning of 12 U.S.C. § 371c or Regulation O. (Conclusion of Law No. 8, R.D. at 22).

The ALJ also concluded that the loan to BGroup, Inc., was an extension of credit to an affiliate within the meaning of 12 U.S.C. § 371c. (Conclusion of Law No. 9, R.D. at 22). The collateral for this loan to

BGroup, Inc., consisted of the securities of an affiliate (B-Banc) and was therefore unacceptable under 12 U.S.C. § 371c(c)(4). (Conclusion of Law No. 10, R.D. at 22–23). As a result, the loan to BGroup, Inc., was an unsecured extension of credit to an affiliate in violation of 12 U.S.C. § 371c and Regulation O. (Conclusion of Law No. 11, R.D. at 23).

Finally, the ALJ concluded that none of the Respondents realized any gain as a result of the loan to BGroup, Inc., and that a civil penalty assessment against each Respondent of $3,000 is appropriate. (Conclusions of Law Nos. 12, 13, R.D. at 23).

D. *Enforcement Counsel's Exceptions*

Enforcement Counsel filed exceptions to the ALJ's findings and conclusions, arguing that: 1) the tax overpayment was an extension of credit within the meaning of Regulation O; 2) there were previous insider violations at the Bank; and 3) that the Bank lost $321,211 as a result of the violations. The FDIC also took exception to various conclusions of law in the Decision and to the recommended amount of civil money penalty. In addition, Enforcement Counsel seeks the adoption of twenty-five findings of fact and six conclusions of law which were not adopted by the ALJ. Exceptions to the ALJ's Decision and Brief of the Federal Deposit Insurance Corporation, FDIC-91-37k ("Exceptions").

III. *DISCUSSION*

Based upon a thorough review of the testimony, the documentary evidence, the briefs and arguments of the parties, the ALJ's Recommended Decision, and the Exceptions, the Board of Directors ("Board") of the FDIC adopts the ALJ's Findings of Fact Nos. 1 through 23 and 27, concurs with Conclusions of Law Nos. 1 through 7 and 9 through 11, but rejects Conclusions of Law Nos. 8, 12, and 13 and the proposed Order. In addition, the Board adopts, with one exception,[5] the Enforcement Counsel's proposed undisputed facts as set forth in the Exceptions. Further, the Board finds that the unreimbursed estimated tax overpayment was an extension of credit requiring compliance with Regulation O, and that the Respondents benefited directly or indirectly from both the tax overpayment and the preferential loan to the affiliate. The ALJ's proposed

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[4] The bank examiner did not recommend civil money penalties at this time due to the Bank's promise to promptly correct the violation. (Tr. at 131).

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[5] Specifically, the Board rejects Enforcement Counsel's proposed finding of fact No. 54 as ambiguous.

{{6-30-92 p.A-1963}}penalties do not take these findings into consideration. Therefore, the Board will reweigh the statutory factors as to the appropriate amount of penalties to be assessed with respect to the unreimbursed tax overpayment and the loan to BGroup, Inc.

A. *Violations*

[.1**]** 1. *The 1989 Estimated Income Tax Payment*

The Board finds that once the holding company was obligated to repay the estimated tax payment, a debtor-creditor relationship arose which is, by definition, an extension of credit for purposes of Regulation O. Therefore, at the time of the extension of credit between the Bank and its holding company, the Bank was obligated to comply with section 23A which requires that "[e]ach loan or extension of credit to...an affiliate by a member bank or its subsidiaries shall be secured at the time of the transaction by collateral. ...," 12 U.S.C. § 371c(c)(1), and Regulation O, which requires that an extension of credit to an affiliate be made on substantially the same terms, including collateral and interest, as are prevailing for comparable transactions with non-insiders. 12 C.F.R. § 215.4.

Regulation O implements section 22(h) of the Federal Reserve Act, 12 U.S.C. § 375b, and defines an "extension of credit" as:

> ...a making or renewal of any loan, a granting of a line of credit, or an extending of credit in any manner whatsoever, and includes:
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> * * *
>
> (8) Any other transaction as a result of which a person becomes obligated to pay money (or its equivalent) to a bank, whether the obligation arises directly or indirectly, or because of an endorsement on an obligation or otherwise, or by any other means whatsoever.

12 C.F.R. § 215.3(a)(1)-(8).

The ALJ focused his analysis on the term "transaction," and reasoned that the "transaction" at issue was the payment of estimated taxes, and since the payment of taxes was lawful at the time it was made, Regulation O did not apply. The ALJ reasoned that the Bank had no ability to require one already a debtor to pledge collateral. The ALJ is incorrect, however, since section 23A itself requires a bank to require additional collateral "where needed to keep the percentage of the collateral value relative to the amount of the outstanding loan or extension of credit...." 12 U.S.C. § 371c(c)(2). Thus, the regulatory duty of the bank to require collateral is not fixed upon inception of the debtor-creditor relationship. The term "transaction" was not meant to be read so narrowly as to exclude a de facto debtorcreditor relationship that arises between a bank and its affiliates.

While this "obligation" between the Bank's holding company and the Bank does not fit neatly into the eight examples of extensions of credit, neither does it fall within the five specific exceptions. 12 C.F.R. § 215.3(b)(1)-(5). Since Regulation O defines extension of credit as "an extending of credit in any manner whatsoever," the Board concludes that neither the statute nor the regulation were meant to be read narrowly. Any debtor-creditor relationship is, by definition, an extension of credit at the time the obligation arises, unless specifically excepted by the regulation.

The Respondents themselves admit that a debtor-creditor relationship arose at the time the Bank discovered that no taxes were due. *See* Reply Brief at 9 (citing Ex. 21–24). As soon as the Bank discovered that such an obligation arose and that the affiliate would not be immediately repaying the Bank, the Bank and its officers and directors had an obligation to bring the loan into compliance with section 23A and Regulation O, including obtaining adequate security and establishing an interest rate and other terms for the loan. 12 U.S.C. § 371c(c)(1); 12 C.F.R. § 215.4(a). The Board's interpretation is consistent with the purpose of the statute and Regulation O which is to regulate debtor-creditor relationships between affiliates. This is not to say that the Bank and its officers and directors were immediately subject to imposition of penalties as of the date the absence of tax liability became known. Had the funds been repaid to the Bank in the normal course, no penalty would have been necessary. Needless to say, that is not the case here since no part of this debt has been repaid by B-Banc.

The ALJ also rejected Enforcement Counsel's reliance on a policy statement which made it clear that section 23A and Regulation O applied to situations where a bank pays its holding company for deferred taxes, {{6-30-92 p.A-1964}}whenever such amounts cannot be restored immediately to the bank. FDIC Statement of Policy on Income Tax Remittance by Banks to Holding Company Affiliates, 43 Fed. Reg. 22,241 (1978). The Policy Statement, in pertinent part, provides that:

> If cash or other consideration that the bank had previously passed up to the parent cannot be restored immediately, that amount shall be recorded on its books as a loan to the parent company and an appropriate level of interest charged. This loan is subject to the provisions of section 18(j) of the Federal Deposit Insurance Act. Of course, as with any applicable insider transaction, the requirements of § 337.3 of the FDIC rules and regulations apply.

Id. The ALJ concluded that the Policy Statement was distinguishable since it dealt with deferred taxes as opposed to estimated taxes. However, Enforcement Counsel cited the Policy Statement for the proposition that, if deferred taxes paid by a bank to its holding company can not be repaid immediately, the cash or other consideration to the parent must be booked as a loan and is subject to statutes and regulations governing insider transactions. Under that Policy Statement, no separate "transaction" need occur for the statutes and regulations governing insider transactions to apply. While the Statement of Policy applies to deferred taxes rather than estimated tax payments, the lesson of the statement is clear, and the Board finds no reason it should not apply to estimated tax payments upstreamed to a parent that later turn out not to be owed.

The ALJ also explained his conclusion by making an analogy to the indebtedness that would "arise" in the event an insurance company became indebted to a bank after damage from a hailstorm. However, the analogy is misplaced. Insurance is a contractual obligation, not a transfer of funds. The insurance contract would govern the payment of any liability that arises. Here, the tax agreement states that overpayments were to be refunded immediately, but does not address failures to comply. The failure to reimburse funds created a debtor-creditor relationship between the Bank and its affiliate, and section 23A and Regulation O apply by operation of law. Section 23A and Regulation O require that the Bank obtain a signed note, at market interest rates, and secured by collateral. The Bank did not comply with the statute or regulation within a reasonable time and was therefore in violation.

2. *The Loan to BGroup, Inc.*

As the ALJ noted, Respondents do not dispute that the $240,000 loan to BGroup, Inc., an affiliate, by

the Bank was in violation of section 23A and Regulation O.R.D. At 10; *see also* Respondent's Brief at 6. The loan was secured by the stock of an affiliate and the Board agrees that this was a clear violation of Regulation O and section 23A.

[.2**]** B. *The Statutory Factors*
The five statutory factors the Board is required to consider are: the size of the financial resources and good faith of the persons charged, the gravity of the violations (losses to the bank and benefit received by violators), the history of previous violations, and such other factors as justice may require. 12 U.S.C. § 1818(i)(2)(G) (formerly 12 U.S.C. § 1828(j)(3)(B)). In assessing civil money penalties, the Board seeks to deprive the violators of any financial benefit derived as a result of the violation, provide a sufficient degree of punishment, and an adequate deterrent to the Respondents and others from future violations of banking laws and regulations. *See generally In the Matter of * * * Bank*, FDIC-85-2k, 1 P-H FDIC Enf. Dec. ¶5063 (1986). In this case, where the violations have caused the bank to suffer substantial losses, substantial penalties are particularly appropriate to punish and to provide an adequate deterrent. *In the Matter of * * *, individually, and as Chairman of the Board, Director and Principal Shareholder Of * * * Bank*, FDIC-85-87k, 2 P-H FDIC Enf. Dec. ¶5119, at A-1327, 1338 (1988).
Significant consideration is also given to the financial or economic benefit received by the respondents due to the violation. *J.D. Miller v. Federal Deposit Insurance Corporation*, ____ F.2d ____ (4th Cir. 1992) (1992 WL 14625); *Bullion v. Federal Deposit Insurance Corporation*, 881 F.2d 1368, 1378 (5th Cir. 1989). Financial benefit is often an appropriate "starting point" in determining the amount of a penalty. *Id.*; *In the Matter of * * * Bank*, FDIC-85-2k, 1 P-H FDIC Enf. Dec. ¶5063 (1986). At a minimum, civil money penalties should negate any actual or potential benefit received by the Respondents. *See id.* Additionally, the FDIC Manual of Examination Policy states that the violator should "pay a penalty over and {{6-30-92 p.A-1965}}above" the amount of loss to the bank or personal gain for violating the law. This amount should be assessed as a penalty, less any restitution made by the Respondents to the Bank, since no violator should benefit from a violation.

[.3**]** 1. *Losses to the Bank*
A significant factor relevant to the amount of any penalty is the amount of loss to the Bank. Both the $240,000 loan to BGroup, Inc., and the $81,211 estimated tax overpayment were classified as a loss and charged-off by the Bank. (Stip. at 28). As to the BGroup, Inc., loan, Respondents argued that they were trying to salvage a non-performing loan and that in doing so they actually benefited the Bank. Respondent's Reply Brief at 11. While an initial payment was made on the assumption of the loan, as the ALJ concluded, the evidence indicates that the Bank actually incurred "substantial losses" due to the assumption since it might have been able to foreclose on the collateral earlier, at a time when it still had some value (R.D. at 14). Additionally, the Bank could have obtained a deficiency judgment against W.D. Brannan, the original borrower, since the record indicates he had a net worth of $218,000, of which $85,000 could have been liquidated a the time the loan was assumed. (Tr. at 227-9).
The evidence indicates that the Bank has suffered total losses from the principal and unpaid interest on both the tax overpayment and loan transaction in an amount approaching $363,000. (Tr. at 131). Enforcement Counsel has calculated that such loss is approximately thirteen percent of the equity capital of the Bank. *See* Exceptions at 12. These are substantial losses and weigh heavily in favor of substantially higher penalties. The Board will not permit officers and directors to serve a depository institution in a destructive capacity without assessing a penalty that is appropriate in light of the losses to the Bank. *See* FDIC-85-87k, 2 P-H Enf. Dec. ¶5119, at A-1327 (1988) (assessing a penalty of $1,200,000 based, in part, on losses to the bank of over $900,000). Deterrence is a crucial factor in determining the size of a civil money penalty and often requires assessing a penalty substantially higher than the losses to the bank, *see id.*, particularly where Respondents occupy positions of such control over the Bank and its affiliates.[6]
The record indicates that the Bank foreclosed on a computer center operated by the holding company, but is unclear whether the foreclosure had any relationship to the holding company's liability for the tax overpayment. (*See* Tr. at 208–211, 237). Any income the Bank is receiving from operation of the computer center is merely compensation for the risk of running a business in the normal course, rather than for the Bank's losses. Even if the value of the computer center should be set off against the losses that the Bank incurred due to the estimated tax payment, the overall losses to the Bank are presently substantial.

2. *Benefit Received Related to Estimated Tax Overpayment*

The imposition of penalties would not necessarily be warranted for this violation if the Bank had

corrected the violation within a reasonable time. The Board recognizes that the violation did not originally arise as part of a scheme of insider dealing. However, unless violations are corrected within a reasonable period after their discovery, what began as an inadvertent violation can evolve into an intentional one. The Bank has not corrected this violation to date,[7] apparently due to the holding company's inability to repay. *See* R.D. at 6.

[.4**]** Instead of correcting the violation, the evidence indicates that a large portion, if not all, of the $81,211 estimated tax payment was used by the holding company to pay off a debt on which Respondent Ira Brannan, a director and officer of B-Banc and the Bank, was a guarantor. FDIC Ex. 69, p. 6; Respondent's Reply Brief at 13. The application of the estimated tax payment to relieve Respondent Ira Brannan of his guaranty was a direct, personal benefit to him. *See In the*

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[6] However, the Board will reduce the civil money penalties assessed to reflect restitution made by the Respondents to the Bank for its losses incurred from these loans.

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[7] Pursuant to former section 18(j)(4)(A) of the Act, 12 U.S.C. § 1828(j)(4)(A), the FDIC is entitled to assess civil money penalties of up to $1,000 per day for each day the violation continues. Thus, as of the date of the hearing, the FDIC was authorized to assess penalties of over $700,000 for this violation. 12 U.S.C. § 1828(j)(4); (Tr. at 131).

{{6-30-92 p.A-1966}}*Matter of * * * and * * * individually, and as directors, officers, and persons participating in the conduct of the affairs of * * *, BANK*, FDIC-87-61e, 2 P-H FDIC Enf. Dec. ¶5113, A-1237, A-1244 (1988). The evidence does not indicate whether David or Stephen Brannan received any direct benefit from this violation, though they would have indirectly benefited from the credit to B-Banc and the direct benefit received by their father.

Moreover, to the extent that Ira Brannan, as chairman of the board of the Bank, and president, chief executive officer, and chairman of B-Banc, was responsible for the Bank's failure to comply with regulation O which allowed B-Banc to pay off the loan of which he was the guarantor, this would appear to be a conflict of interest involving self-dealing and a serious breach of fiduciary duty. *See id.* An officer or director breaches his or her fiduciary duty unless he or she abstains from participating in decisions on any loan transaction where they have a personal interest. *See* FDIC-87-61e, 2 P-H FDIC Enf. Dec. ¶5113, A-1243 (1988) (respondent participated in the decision to extend credit to a borrower in which he had a personal financial interest, thereby breaching his fiduciary duty). This conduct, together with the substantial benefit received by Ira Brannan, weighs heavily in favor of substantial penalties against Respondents.

3. *Benefit Received relating to The Loan to BGroup, Inc.*

There is no dispute that the loan to BGroup, Inc., was in violation of section 23A and Regulation O. The only question is whether the amount of the penalties assessed by the ALJ are appropriate. As of the date of the hearing, the FDIC was authorized to assess civil money penalties for this violation of over $1,270,000 (Tr. at 131). The respondents stress that the violation was merely a "technical violation" of Regulation O which does not warrant a civil money penalty. *Id.* However, even if Respondents are correct that the violation was a technical one, civil money penalties can be assessed for even a "technical violation." *In the Matter of R. Wayne Lowe*, FDIC-89-21k, 2 P-H FDIC Enf. Dec. ¶5153 (1990).

The ALJ concluded, without analysis, that "[n]one of the Respondents received any gain from what they did." R.D. at 14. The ALJ's conclusion appears to be based on his belief that the violation was a mistake, and that the Respondents were apparently not seeking to profit, but rather to gratuitously save the Bank from a loss of about $260,000 by assuming a non-performing loan. R.D. at 14. The Board disagrees with the ALJ's conclusion since BGroup, Inc., a related interest of which the Respondents were sole shareholders, received a preferential loan which has not been repaid. Even if Respondents currently have no profits to show from the transaction, it does not follow that they did not receive benefit, even if it was only the avoidance or even postponement of additional losses, whether to themselves personally or their related interest. If this benefit can be quantified, it should be considered in determining an appropriate penalty.

[.5**]** Where loans to affiliates are preferential, the economic benefit is the amount by which the terms, including interest rates and collateral, are favorable compared to those prevailing at the time for comparable arms length transactions. *See J.D. Miller*, 1992 WL 14625. This loan was certainly preferential since the evidence indicates that it could not have been obtained from any other source. Tr. at 225). *See In the Matter of R. Wayne Lowe*, FDIC-89-21k, 2 P-H FDIC Enf. Dec. ¶5153 (1990). An

extension of credit that otherwise would not have been made obviously provides a direct economic benefit to BGroup, Inc., and therefore to the Respondents as principals of BGroup, Inc. *Id.* BGroup, Inc. Never made any payments on this loan, with the exception of an initial payment upon its assumption of $23,000 on principle and interest. Thus, BGroup, Inc., a "related interest" of Respondents, *see* 12 C.F.R. 215.2(k), received a substantial benefit in having the use of these funds, all to the detriment of the Bank. Therefore, while the record does not permit an exact quantification of the benefit received by each Respondent, the Board finds that Respondents benefited substantially from this loan because the loan itself and the terms could not have been obtained elsewhere, no payments have been made, and respondents gained control of 12,500 shares of B-Banc stock.

[.6**]** 4. *Prior Violations*

The ALJ considered only one prior violation of Regulation O by respondents. R.D. at 15. However, the record demonstrates that numerous violations involving preferential interest rates were cited in the 1986 Report {{6-30-92 p.A-1967}}of Examination of the Bank. The 1986 Report stressed that "[i]t is imperative that members of the bank's official family adhere to applicable laws and regulations." (FDIC Ex. 52 at 1-a-1). In 1987, a Memorandum of Understanding, signed by each Respondent, required these violations be corrected. (FDIC Ex. 56). In 1988, the Exam Report warned that several violations of section 23A "reflect poorly on management and warrant prompt corrective action" and "may subject the bank to substantial civil money penalties." (FDIC Ex. 53 at 1). The Report of Examination of November 1989 again stated that loans made to the Brannan family, particularly Chairman Brannan, are at the "center of concern." (FDIC Ex. 54). The Report noted that extensions of credit to chairman Brannan and his related interests totalled $427,000 in losses, approximately seventy-one percent of the loans classified as loss to the Bank. (FDIC Ex. 54).

Thus, Respondents have been on notice for several years that the section 23A and Regulation O violations would not be tolerated. The Board finds that these numerous prior violations involving Respondents weigh in favor of higher penalties. Additionally, the record contains some suggestion that the original loan to W.D. Brannan in 1985, may have been a violation of section 23A and Regulation O. Overall, the Bank and the Respondents have exhibited a marked lack of awareness of the law. This lack of care and compliance with established banking laws weighs in favor of higher penalties against Respondents. 12 U.S.C. § 1828(j) (4).

5. *Good Faith*

The ALJ found that the Respondents acted in "good faith." R.D. at 13. In reconsidering the amount of benefit and the prior violations, the Board does not find evidence of good faith in this record. *See* FDIC-87-61e, 2 P-H FDIC Enf. Dec. ¶5113, A-1243 (1988). Therefore, good faith will not be a mitigating factor in the amount of the penalties assessed.

[.7**]** 6. *Ability to Pay*

While the Board has considered the Respondents' negative net worth as a mitigating factor, the Board cannot permit directors and officers who have caused such substantial losses to a Bank to go unpunished, nor such violations to go undeterred. The Board takes notice that Ira Brannan is sixty-five years of age, apparently has a substantial negative net worth, and is unemployed. *See* Respondent's Reply at 13. However, the ALJ noted that, despite Ira Brannan's negative net worth, it is reasonable to expect that Ira Brannan could obtain at least some resources to pay civil money penalties. R.D. at 13. Therefore, in light of the severe losses to the Bank, the benefit received and the prior violations, deterrence nevertheless mandates substantial penalties in this case.

The Board also notes the ALJ's finding that, despite David and Stephen Brannan's negative net worth, they have more than sufficient resources, based in part on their employment as licensed professionals,[8] to pay the recommended assessments. R.D. at 13. While the net worth of the Respondents is a factor to be considered, the Board finds that a negative net worth does not preclude the assessment of substantially higher penalties than the $3,000 per Respondent recommended by the ALJ. *See* FDIC-85-25e; *United States v. Atkinson*, 788 F.2d 900, 904 (2d Cir. 1986); *United States v. Fountain*, 768 F.2d 790, 802–803 (7th Cir. 1985). Respondents' future earning capacity is appropriate to take into account in determining the size of the penalty. FDIC-85-87k, ¶5119 at A-1332-35 (1988) (considering Respondent's potential net income over the next 15 years).

C. *Amount of the Penalties.*

1. *Ira Brannan*

The Board finds that, while Ira Brannan is least able to pay a substantial penalty, he nevertheless reaped the greatest benefit from, and is the most culpable for the violations because of the benefit received and his position of control in the Bank and its holding company. In light of the substantial loss to the Bank, the Board must assess a penalty that punishes Respondent Ira Brannan for his violations, deters future violations, and which at least denies him the economic benefit of his violations. Therefore, after carefully considering all the statutory factors, the Board finds that Enforcement Counsel's

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[8] David Brannan testified that his current income is $40,00 a year. (Tr. at 176). There is no comparable evidence as to Stephen Brannan.

{{6-30-92 p.A-1968}}recommended penalty of $200,000 against Ira Brannan is appropriate.

2. *David and Stephen L. Brannan*

Both David and Stephen Brannan were involved in violations which benefited them at least indirectly and caused a substantial loss to the Bank. In light of this loss, the benefit received, and their involvement in the prior violations, a substantial penalty is warranted. The only mitigating factor is the negative net worth of each Respondent. Nevertheless, the Board fins that while Respondents David and Stephen Brannan may not be able to presently pay a substantial penalty, they are both currently employed as licensed professionals and therefore have the capacity to pay a penalty based upon potential future earnings. Therefore, after considering all the statutory factors, the Board finds that Enforcement Counsel's recommended penalties of $125,000 each against David Brannan and against Stephen L. Brannan are appropriate in order to adequately punish them for the violations and to provide an effective deterrent against future violations by these Respondents and others.

IV. *CONCLUSION*

The Board finds that Respondents violated section 23A of the Federal Reserve Act and Regulation O with respect to the unreimbursed tax overpayment and the loan to BGroup, Inc. The Board also finds that the Respondents either directly or indirectly benefited from both of these violations. Therefore, the Board has reconsidered the appropriate amount of penalty to be assessed with respect to the violations after re-weighing the statutory factors in light of the conclusions herein and concludes that penalties of $200,000 against Ira Lee Brannan, and penalties of $125,000 each against David Brannan and Stephen L. Brannan are appropriate.

ORDER

The Board of the FDIC, having considered the entire record in this proceeding, finds that Respondents have violated section 23A of the Federal Reserve Act and Regulation O in connection with a 1989 estimated income tax payment by the Bank to B-Banc and a preferential loan transaction from the Bank to BGroup, Inc., in April 1988. The Board further finds that the Respondents caused the Bank to suffer substantial losses, benefited directly or indirectly from these violations, have a history of prior violations, but currently have a negative net worth.

IT IS FURTHER ORDERED, that by reason of the violations set forth above,a civil money penalty of $200,000 be, and hereby is, assessed against respondent Ira Lee Brannan pursuant to former section 18(j)(3) of the Act, 12 U.S.C. § 1828(j)(3).

IT IS FURTHER ORDERED, that by reason of the violations set forth above, a civil money penalty of $125,000 be, and hereby is, assessed against Respondent David Brannan pursuant to former section 18(j)(3) of the Act, 12 U.S.C. § 1828(j)(3).

IT IS FURTHER ORDERED, that by reason of the violations set forth above, a civil money penalty of $125,000 be, and hereby is, assessed against Respondent Stephen L. Brannan pursuant to former section 18(j)(3) of the Act, 12 U.S.C. § 1828(j)(3).

IT IS FURTHER ORDERED, that the penalties payable by individual Respondent shall be reduced by the amount of restitution paid by such Respondent directly to the Bank for its losses from the violations, up to, but not to exceed $150,000 for Ira Brannan, and $100,000 each for David and Stephen Brannan; provided, however, that the restitution payment must be confirmed by the FDIC.

IT IS FURTHER ORDERED, that the Executive Secretary, or his designee, is instructed to execute and serve copies of the attached Decision and Order on Counsel for all parties, the Administrative Law Judge, the Bank, and the Banking Commissioner for the State of Texas.

By direction of the Board of Directors.

Dated at Washington, D.C., this 14th day of April, 1992.

/signed/ Hoyle L. Robinson

RECOMMENDED DECISION

In the Matter of
Ira Lee Brannan, David Brannan and
Stephen L. Brannan, individually and
as officers and/or directors and
institution-affiliated parties of
Freedom Bank
Deleon, Texas
(Insured State Nonmember Bank)

FDIC-91-37k

{{6-30-92 p.A-1969}}
James L. Rose, Administrative Law Judge:

This case was tried before me at Austin, Texas, on October 8 and 9, 1991, upon a notice of civil money penalty assessment against Ira Lee Brannan for $200,000. David Brannan for $125,000 and Stephen L. Brannan for $125,000. Assessments against the other named respondents were resolved prior to hearing.

The FDIC appeared by counsel. The Respondents were represented by Stephen L. Brannan, an attorney licensed in Texas. Following the close of the hearing, counsel submitted proposed findings of fact and conclusions of law along with supporting briefs, and reply briefs. Upon the record as a whole, including my observation of the witnesses, briefs and arguments of counsel.

I hereby make the following findings of fact, conclusions of law and recommended order:

I. STATEMENT OF THE CASE

This matter involves two situations occurring at Freedom Bank (f/k/a Farmers & Merchants Bank, herein the Bank) about which there is essentially no factual dispute.

The first concerns on April 8, 1988, loan for $240,000 to BGroup, Inc., a company wholly owned by the three Respondents. As will be set forth in more detail below, BGroup borrowed the money in order to purchase 12,550 shares of B-Banc stock and gave as collateral those shares. B-Banc is the holding company which owns the Bank, and others. Together, the three Respondents own more than 50 percent of B-Banc.

The FDIC alleges that this was a loan to an affiliate (BGroup) in violation Section 23A of the Federal Reserve Act. 12 U.S.C. § 371c because the collateral was securities of an affiliate (B-Banc).

The second concerns 1989 estimated income tax payments made by the Bank to B-Banc in the approximate amount of $81,000. Although the payments were made pursuant to a proper agreement and correctly calculated, it turned out that the Bank had no tax liability for 1989, due primarily to charge-offs required by the FDIC at the November examination. (FDIC Ex. 54) Thus B-Banc was required to reimburse the Bank, but has not done so.

The FDIC contends that when the Bank was found not to have a tax liability, the tax payments made to its holding company became unsecured extensions of credit to an affiliate in violations of Section 23A of the Federal Reserve Act, and Regulation O. 12 C.F.R. § 215.

II. ANALYSIS AND CONCLUDING FINDINGS

A. *The 1989 Income Tax Payments.*

Section 23A of the Federal Reserve Act (along with other sections) and Regulation O are meant to limit the use of a bank's funds by insiders.

As sought to be applied by the FDIC here, "each loan or extension of credit to" an affiliate "shall be secured at the time of the transaction by collateral having a market value equal to" an amount set forth in the statute. 12 U.S.C. § 371c(c)(1). And when it became clear, in late 1989, that the Bank would have no tax liability for the year, the payments previously made to B-Banc had to be remitted. "If B-Banc was unable to repay the Bank, immediate steps should have been taken to comply with section 23A, including the pledging of collateral in compliance with section 23A(c)(1), 12 U.S.C. § 37c(c) (1). No collateral was ever pledged to secure this extension of credit." (FDIC Brief, p-19).

Similarly, the FDIC argues that Section 215.4 of Regulation O was violated by this extension of credit

because it was not made on substantially the same terms, including collateral and interest, as those prevailing for comparable transactions with noninsiders. (FDIC Brief, p-19)

The FDIC does not dispute that the tax payments by the Bank to its holding company were lawful and calculated accurately. (FDIC Ex. 53, p-6) However, subsequent losses taken by the Bank (principally as required by the FDIC's November examination) resulted in a year-end income of negative $522,000. (Stip. 26) Indeed, as argued by the FDIC, as early as August 16, 1989, when the Bank filed its amended June 30 call report, its income had fallen from $264,000 to $34,000. Therefore, some of the previously made tax payments to B-Banc should have been refunded.

Unquestionably B-Banc was required to refund the tax payments made to it by the Bank. The Respondents do not contend oth- {{6-30-92 p.A-1970}}erwise. Nor do they dispute that B-Banc has to date failed to refund the tax payments, though the Bank demanded it do so by letter of March 13, 1990. (FDIC Ex. 20)

The issue is whether within this series of events is a covered transaction within the meaning of Section 23A. Specifically, the FDIC argues that on August 16, 1989, when it became clear that Bank's 1989 tax liability would be less than estimated payments already made, the excessive amount was "an extension of credit to the affiliate." And the subsequent revision of the Bank's income following the chargeoffs made the rest of the estimated tax payments an extension of credit.

Counsel for the FDIC acknowledge that Section 23A does not define extension of credit, but argue that the definition in Regulation O (which implements Section 23A) applies and covers this situation. "Regulation O defines extension of credit to include any transaction `as a result of which a person becomes obligated to pay money...to a bank, whether the obligation arises directly or indirectly....' 12 C.F.R. § 215.3(a) (8)." (FDIC Brief, p-18)

In both Section 23A and Regulation O, the critical word is "transaction." thus 12 U.S.C. § 371c(c)(1) states that collateral "shall be secured at the time of the transaction" by which credit is extended to an affiliate. The fact that an individual or a company (even an affiliate) owes a bank money does not necessarily mean that the debt is the result of a transaction.

In effect the FDIC contends that any event which creates a debt obligation to a bank from an affiliate is a transaction which establishes an extension of credit. I reject this contention.

For instance, suppose a bank has insurance to indemnify it for hail damage to its building and there is a hail storm. At the moment of the event covered by the policy, the insurance company "becomes obligated to pay money' to the bank. Suppose further that the insurance company is an affiliate of the bank. In this example, the event creating the debt is clearly not a transaction requiring the bank to meet the collateral requirements of Section 23A or Regulation O. The obligation arose by operation of law (and contract) on the occurrence of an outside event.

Such is analogous to the situation here. It cannot be said there was ever a transaction between the Bank and B-Banc which obligated B-Banc to pay money to the Bank. The Bank made lawful payments to B-Banc, some (then all) of which had to be returned as the result of an outside event—recalculation of the Bank's earnings. While this possibility was provided for in the tax remittance agreement (FDIC Ex. 26) it was independent of the tax payments made by the Bank to B-Banc—just as the hail storm was independent of the insurance contract.

There was a transaction here, as that word is commonly used. It was the payment of estimated taxes to B-Banc. In fact there were three transactions. However, discovery that the Bank would have to take unanticipated losses in 1989 was not a transaction. And it is this discovery which obligated B-Banc make repayment, an obligation B-Banc has yet to honor.

This does not mean that B-Banc and the Respondents are not in some way culpable for B-Banc's failure to remit the tax payments made by the Bank. But the FDIC does not seek to penalize B-Banc or the Respondents as owners and directors of B-Banc. This case deals only with the Respondent's acts (or omissions) as directors of the Bank. Further, the Respondents do not deny that B-Banc owes the $81,000. They contend that B-Banc is, and has been, financially incapable of making the repayment.

To accept the FDIC argument is to conclude that there was a transaction by operation of law and the respondents violated Section 23A and Regulation O because the Bank did not obtain appropriate collateral from B-Banc or charge prevailing interest.

The FDIC relies, in part, on an FDIC Statement of Policy, "Income Tax Remittance by Banks to Holding Company Affiliates:"

> If cash or other consideration that the bank had previously passed up to the parent cannot be restored immediately, that amount shall be recorded on its books as a loan to the parent company and an appropriate level of interest charged. This loan is subject to the provisions of section 18(j) of the Federal Deposit Insurance Act. Of course, as with any applicable insider transaction, the requirements of § 337.3 of the FDIC rules and regulations apply. (FDIC Statements of Policy, *FDIC Laws, Regulations, Related Acts* 5045 (April 19, 1978, FDIC Ex. 81)

This paragraph is taken from a statement of policy which proscribed the practice of paying deferred taxes to a parent holding {{6-30-92 p.A-1971}}company, and tells a bank what to do in the event it made such a payment and holding company is unable immediately to remit the money. It does not purport to deal with a situation (as here) where estimated taxes were appropriately transferred to the parent company then later it was determined that the payment was excessive.

Counsel for the FDIC recognizes that the applicability of this policy statement to the instant situation would be by analogy, but argues that the principle would be the same. I reject counsel's argument. In effect counsel argues that a substantial civil money penalty assessment should be levied on three individuals because their bank did not recognize and comply with an analogy to a policy statement. Such is too tenuous to support a civil money penalty assessment.

Further, even if this paragraph should be construed to deal with the situation here, that the Bank did not comply with it does not mean that there was an extension of credit within the meaning of Section 23A. At best this statement of policy deals with booking the obligation, not with securing collateral. And it is B-Banc's failure to pledge appropriate collateral on not being able to remit the tax payments which is the gravamen of this matter.

Section 23A, along with other sections of the Federal Reserve Act, and Regulation O were promulgated in order to restrain insiders from using bank funds to further their individual activities. I conclude these laws and regulations were not meant to transform an otherwise lawful act into an unlawful one upon the subsequent occurrence of a event over which the alleged perpetrator had no control—in this case revision of the Bank's net income.

There is no contention that the Respondent's knew that the Bank would have a negative income for 1989 when the estimated tax payments were made or that the payments would have to be remitted. Nor is there evidence that the Respondents engaged in any culpable activity with regard to the tax payments. The FDIC alleges only that the respondents were members of the Bank's board of directors and were controlling owners of B-Banc; and, when it happened that tax payments were excessive, an unsecured extension of credit was created within the meaning of Section 23A and Regulation O.

As litigated, the allegations against the Respondents are narrow. (Tr. 240.) The Bank extended a credit to an affiliate without obtaining the collateral required under Section 23A and Regulation O. The basis of the Respondent's culpability is not dependent on whether they controlled, or indeed had any interest in the affiliate. The issue is whether the Bank had a transaction with B-Banc which was an extension of credit. The issue is *not* when and under what circumstances the Bank should have booked the tax payments as a loan, or whether the Respondents are somehow responsible if the Bank failed to do so.

The statute which the FDIC contends these Respondents violated requires a bank which extends credit to an affiliate to secure appropriate collateral "at the time of the transaction." 12 U.S.C. § 371c(c)(1). For an originating credit this is no problem—collateral is required before the loan is funded. But for an existing obligation which a bank determines to treat as a loan, such a procedure is not available.

Unquestionably a bank has little ability to force one already a debtor to pledge collateral. The Bank might book the B-Banc obligation as a loan, but it could not make B-Banc give collateral, just as in the hail storm example, the bank could not force the insurance company to collateralize its obligation.

Since the Bank could not secure collateral from B-Banc absent the willingness of B-Banc, it appears that the FDIC is proceeding against the Respondents for their failure as principals of B-Banc either to repay the tax payments or pledge appropriate collateral. As directors of the Bank, they had no power to make B-Banc submit collateral, though as directors of B-Banc they might have done so.

But this action is against them as officers and/or directors of the Bank. Whatever their culpability as owners and directors of the holding company, jurisdiction would seem to lie in the Federal Reserve Board and not the FDIC.

I therefore conclude that the FDIC failed to prove by a preponderance of the credible evidence that any of the Respondents thus violated Section 23A or Regulation O for which they should be required to pay a civil money penalty.

{{6-30-92 p.A-1972}}
B. *The Loan to BGroup.*

The principals of BGroup are the three Respondents, thus there is no question that it is an affiliate of the Bank. BGroup was apparently formed for the purpose of holding B-Banc stock, and to this end borrowed $240,000 from the Bank on April 8, 1988, putting up as collateral 12,550 shares of B-Banc stock. At this time, B-Banc stock was worth "at most $20.00 a share." *Stip. 38)*

The Respondents admit that the "loan to BGroup is a technical violation of 12 USC Sec. 371c(c)(1)." (Resp. Brief p-6) However, they contend the loan was a renewal of a credit to W.D. Brannan which he was unable to pay at maturity.

W.D. Brannan had borrowed $289,027.45 from the Bank on November 14, 1985, pledging as security 12,550 shares of B-Banc stock. Due to his deteriorating financial condition he was unable to pay the loan: thus, the Respondents determined to renew the loan by making a principal payment of $5,000 and paying the accrued interest. According to their testimony, in all they paid about $23,000. This was corroborated by James R. Bruton, the Bank's president and a witness for the FDIC. (T. 49) Though the documentary evidence indicates that BGroup in fact received $240,000, according to the Respondents' generally undisputed testimony, they did not. W.D. Brannan was released and this credit was rebooked as a $240,000 loan to BGroup.

In any case, there is no doubt that BGroup received an extension of credit from the Bank and gave as collateral B-Banc stock. Since B-Banc stock is a security of an affiliate, it was not acceptable as collateral for an extension of credit to an affiliate. 12 U.S.C. § 371c(c)(4).

This was cited as a violation of Section 23A at the examination of April 29, 1988, and the Bank promised to take corrective action. (Tr. 115; FDIC Ex. 53, p. A-1) However, according to the testimony of David Brannan, they have been unable to move the credit because no other bank would make a loan with B-Banc stock as collateral. (Tr. 225-6)

I conclude that the FDIC did prove a violation of Section 23A with regard to the BGroup loan. Further, as directors of the Bank, the Respondents are accountable for the violation; and, pursuant to 12 U.S.C. § 1828(j)(3) may be assessed civil money penalties.

C. *Civil Money Penalty Assessments*.

The FDIC seeks an assessment of $200,000 against Ira Lee Brannan, and $125,000 each for David and Stephen Brannan. Since the violation of law occurred in 1988 and continues to date, it is clear that the proposed assessments are well within the amount allowed by statute, even if the Pre-FIRREA limit of $1000 per day is the applicable standard. However, the amount of any penalty assessed must be based on an analysis of the five statutory factors—size of financial resources, good faith, gravity of the violation, history of previous violations and such other factors as justice may require. 12 U.S.C. § 1818(i)(2)(G).

1. *Size of Financial Resources*.

Each of the Respondents submitted financial statements and the parties stipulated to the net worth of each. Also, Ira Lee and David Brannan testified concerning their respective financial condition.

As of April 30, 1991, Ira Lee Brannan has no occupation (Tr. 160) and a negative net worth of $1,130,802. (Stip. 40) As of June 12, 1991, David Brannan has a net worth of negative $1,875 (Stip. 41) and was employed as a controller of a company at an annual salary of $40,000. (Tr. 172, 176) He is a certified public accountant licensed in Texas. (Tr. 184) Stephen Brannan had a negative net worth of $54,663 as of May 15, 1990. (Stip. 44) He has been engaged in the private practice of law in Texas for 17 years.

The FDIC offered no evidence casting doubt on the Respondents' financial statements or testimony. Further, they appeared credible and their statements internally consistent. Therefore, I conclude the size of the financial resources of each Respondent is such that none could realistically pay a substantial assessment within a reasonable time. However, based on their employment as licensed professionals, David and Stephen Brannan have more than sufficient resources to pay the assessment recommended. Similarly, from his employment history, it is reasonable to expect that Ira Lee Brannan could obtain the resources to pay the assessment recommended.

2. *Good Faith*.

The examiner who first cited the BGroup violation suggested that it appeared inadvert- {{6-30-92 p.A-1973}}ent. This is consistent with the testimony of the Brannans. There is simply no evidence that they acted other than in good faith with regard to the BGroup credit.

3. *Gravity of the Violation*.

The FDIC does not dispute the Respondents' contention that the BGroup loan was essentially a renewal of the W.D. Brannan. The FDIC argues that notwithstanding, as finally structured there was a $240,000 loan to BGroup, an affiliate of the Bank, secured by the stock of B-Banc, also an affiliate. Therefore, the Bank violated Section 23A.

The significance of fact that this credit was originally to W.D. Brannan has to do with the seriousness of the subsequent violation. When written on November 14, 1985, the loan was lawful. Had the credit gone into default in April 1988, the Bank would have had to take a loss, but there would have been no violation of Section 23A or Regulation O. The violation occurred because the Respondents sought save the credit.

On the evidence of record, I conclude that the BGroup loan of $240,000 was not an original credit, but was the rebooking of an existing, and potentially nonperforming, credit. None of the Respondents received any gain from what they did. Had they been able to perform, then they reasonably would have benefited from the standpoint that as shareholders of the Bank, a loss would have been avoided. As it turned out, the Bank took a loss on the credit. Had this credit gone into default in April 1988, and the collateral sold, the loss may well have been less. Thus the Respondents' attempt to save the credit, and therefore the violation of Section 23A, was grave in that it caused the Bank to suffer a substantial loss.

Notwithstanding that the Respondents' action was a mistake, it was not an insider transaction from which they sought to benefit. Rather, it was a good faith effort to save the Bank from a loss of about $260,000; and on assuming the credit, the Respondents paid about $23,000 in interest and principal reduction. That there was a violation of Section 23A was inadvertent and not part of a plan of insider dealing.

The devastating effects of insider dealing is well known. Where established, violations of insider proscriptions should be treated as grave and penalties assessed accordingly. *See, e.g., Bullion v. FDIC*. 881 F. 1368 (5th Cir. 1899) where the principal respondent used his position as chairman of the bank's board of directors to cause the bank to make a loan in excess of the lending limits to insiders (about $1,500,000) which contributed to the bank's failure. An initial assessment of $125,000 was levied. The Circuit remanded for consideration of the respondent's financial condition. He was subsequently assessed a penalty of $175,000 in part because this amount represented his proven gain from the unlawful transaction. FDIC-87-71k.

But the facts here do not prove that these Respondents did more than engage in a technical violation of Section 23A in their attempt to save what was sure to be a nonperforming credit. Thus, I conclude that the violation is not so grave as to merit more than a minimal assessment.

4. *History of Previous Violations*.

At the examination as of October 24, 1986, an extension of credit was cited as an apparent violation of Regulation O. (Stip. 19) This was not the same as the violation in the BGroup loan; nevertheless, it was similar in that it related to loans to insiders. While this previous citation scarcely establishes a pattern of Section 23A or Regulation O violations, it is a factor to be considered against the Respondents in arriving at the appropriate assessment.

5. *Such Other Matters as Justice May Require*.

As the FDIC Board has held, the purpose of a civil money penalty is to deter the respondent and others and to insure that any gain from the violation is negated. Here there was no gain. I conclude that deterrence can be achieved for the violation proved by the imposition of a minimal penalty.

Counsel for the FDIC cited no case where the FDIC Board has levied a civil money penalty of the magnitude sought here for the violations alleged. Nor has independent research disclosed any. Substantial penalties are assessed where an insider has used the bank's money for his own entrepreneurial purposes. The more technical and inadvertent violations are remedied with minimal assessments or none at all. For instance, as to an alleged violation with regard to tax payments made by a sister bank to B-Banc (Freedom Bank, Ranger, Texas) the FDIC {{6-30-92 p.A-1974}}Regional Director determined not to seek civil money penalties. [Resp. Brief, attachment (letter from Kenneth L. Walker, FDIC Regional Director dated May 2, 1990.)]

In fairly recent cases involving allegations (and proof) of more serious violations of Section 23A and Regulation O than alleged here, the FDIC Board entered much lesser assessments than the FDIC seeks. Thus the Board found six violations of Regulation O (which were also violations of a cease and desist order, but this did not affect the assessment) from which the respondent had a proven gain of $15,000. The assessment was $15,000. 2 FDIC Enf. Dec. ¶5098 (1987). In another case involving a Section 23A and Regulation O violation, a civil money penalty of $25,000 was assessed. 2 FDIC Enf. Dec. ¶5093 (1987). *See also*, 2 FDIC Enf. Dec. ¶5987 (1987), where violations of Sections 23A and 22(h) were alleged and a default entered for $25,000.

In *Fitzpatrick v. FDIC*, 765 F.2d 569 (6th Cir. 1985), serious violations of Section 23A were found, yet a penalty of just $1000 was assessed, an amount which the Court concluded was so modest as to "have only moral force." 765 F.2d at 578.

Egregious violations of insider dealing proscriptions along with a proven personal gain to the principal respondent of $175,000 were found in *Bullion v. FDIC, supra*. The Court did not rule out the assessment of $125,000, but remanded the case for determination of the respondent's financial resources. On remand, the FDIC Board assessed a penalty of $175,000.

Although each case stands on its unique circumstances, an ordered scheme of justice requires some

measure of consistency. Here there was no financial gain to be negated, as in *Bullion*. Indeed, even accepting the FDIC's position with regard to the tax payment, the violations here were technical. Certainly there was no proven, or even apparent, plan by the Respondents to engage in insider transactions for their own benefit. On the facts here, a penalty of the magnitude asked for by the FDIC would not be in line with past decisions of the FDIC Board. Therefore, justice requires that a much lesser penalty be assessed.

The violation of Section 23A was inadvertent and did not result from an attempt by insiders to use the Bank's funds for their own purposes. Though there was loss to the Bank, there may well have been some loss even absent the transaction. Therefore, I conclude that a civil money penalty of $3,000 for each Respondent is appropriate. Such would be consistent with the financial resources of each.

Upon the foregoing, and the record as a whole, I hereby issue the following findings of fact, conclusions of law, and recommended order:

FINDINGS OF FACT

1. At all material times, Freedom Bank, DeLeon, Texas (herein the Bank), was a corporation existing and doing business under the laws of the State of Texas, having its principal place of business at DeLeon, Texas. (Stip. 1)

2. At all material times, Ira Lee Brannan, David Brannan, and Stephen L. Brannan (herein collectively the Respondents) were each an officer and/or a member of the Bank's board of directors. (Stip. 3)

3. At all material times, the Respondents exercised a controlling influence over the management, policies and practices of the Bank, including extensions of credit, investments and purchases of assets by the Bank. (Stip. 6)

4. At all material times. B-Banc Corporation (herein B-Banc, now known as Freedom Bank Group, Inc.) owned 100 percent of the Bank's stock. (Stip. 7)

5. At all material times, B-Banc was a six-bank holding company controlled by the Respondents and their related interests, and others, and each Respondent was an officer and/or director of B-Banc. (Stip. 8)

6. At all material times, the Respondents owned, controlled, or had the power to vote 25 percent of the B-Banc common stock. (Stip. 10.)

7. At all material times, the Respondents owned, controlled, or had the power to vote 25 percent of the voting securities of BGroup, Inc. (Stip. 11)

8. The Bank was examined by the FDIC as of October 24, 1986, April 29, 1988, and November 9, 1989. (Stip. 14, 15 and 16)

9. The Bank received reports of these examinations. (Stip. 17)

10. Included in the October 24, 1986, report of examination is a citation for an apparent violation of Regulation O. (Stip. 19)

11. At all material times, B-Banc would file a consolidated income tax return for itself and the Bank. (Stip. 22)

12. Pursuant to its Tax Agreement with B-Banc (FDIC Ex. 26), in 1989 the Bank remitted the following estimated taxes to B-Banc (Stip. 25):

a. March 15, $11,076.

b. July 3, $11,076.

c. July 19, $59,059.

13. The Bank's cumulative pretax earnings in 1989 were reported in its Consolidated Reports of Condition and Income as follows (Stip. 26):

Quarter Ending	Amount
sl	sl
March 31	$69,000
June 30	$264,000
June 30 (amended)	$34,000
September 30	$155,000
December 31	$(522,000)

14. Due to the Bank's negative income in 1989, it had no income tax liability. (Stip. 27)

15. B-Banc has not refunded to the Bank the $81,211 the Bank remitted to B-Banc for the payment of 1989 income taxes. (Stip. 29)

16. At the November 9, 1989, examination, the FDIC required the Bank to write off as a loss the $81,211. (Stip. 28)

17. On November 14, 1985, the Bank extended a credit to W.D. Brannan for $289,027.45 secured by 12,550 shares of B-Banc stock. (Tr. 55)

18. On April 8, 1988, the Bank extended a credit to BGroup, Inc., which was wholly owned by the Respondents, for $240,000, secured by 12,550 shares of B-Banc stock. (Stip. 34 and 35)

19. The credit to BGroup was used to pay off the credit to W.D. Brannan. (Tr. 49)

20. The same 12,550 shares of B-Banc stock secured the credits to W.D. Brannan and BGroup. (Tr. 51–52)

21. The loan to BGroup was subsequently approved by the Bank's board of directors on May 20, 1988. (Stip. 36)

22. At the time material, the B-Banc stock was worth as most $20.00. (Stip. 38)

23. The credit to BGroup is still outstanding on the books of the bank. (Stip. 39)

24. As of April 30, 1991, the net worth of Ira Lee Brannan was a negative $1,130, 802. (Stip. 40)

25. As of June 12, 1991, the net worth of David Brannan was a negative $1,875. (Stip. 42)

26. As of May 15, 1990, the net worth of Stephen L. Brannan was a negative $53,663. (Stip. 44)

27. Ira Lee Brannan is currently unemployed. David and Stephen Brannan are employed, respectively, as an accountant and an attorney.

CONCLUSIONS OF LAW

1. At all material time, the Bank was an insured state nonmember bank subject to the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-181k, the Rules and Regulations of the FDIC, 12 C.F.R. Part III, and the laws of the State of Texas. (Stip. 2)

2. At all material times the Respondents were institution-affiliated parties as that term is defined in 12 U.S.C. § 1813(u). (Stip. 4)

3. At all material times, the Respondents were principal shareholders of the Bank as that term is defined in 12 C.F.R. § 215.2(j) of Regulation O and 12 C.F.R. § 337.3(a) of the FDIC's Rules and Regulations. (Stip. 5)

4. At all material times, B-Banc and BGroup were affiliates of the Bank as that term is defined in Section 23A(b)(1) of the Federal Reserve Act, 12 U.S.C. § 371c(b) (1), made applicable to state nonmember banks by 12 U.S.C. § 1828(j)(1) and were related interests of the Respondents as that term is defined in 12 C.F.R. § 215.2k. (Stip. 12)

5. The FDIC has jurisdiction over the Bank, the Respondents and the subject matter of this proceeding. (Stip. 13)

6. The payments of estimated income taxes by the Bank to B-Banc on March 15, July 3, and July 19, 1989, were in accordance with a lawful tax agreement and were correctly calculated.

7. When it was determined that the Banc would not have sufficient income to warrant the payment of income taxes in the amounts remitted to B-Banc, B-Banc became obligated to return the excessive payments made.

8. The payments of estimated income taxes by the Bank to B-Banc were not, nor did they ever become, extensions of credit to B-Banc within the meaning of 12 U.S.C. § 371c or Regulation O.

9. The April 8, 1988, loan to BGroup was an extension of credit to an affiliate within the meaning 12 U.S.C. § 371c.

10. The collateral for this credit was securities of an affiliate (B-Banc) and therefore unacceptable under 12 U.S.C. § 371c(c)(4).

11. The loan to BGroup was tantamount {{6-30-92 p.A-1976}}to an unsecured extension of credit to an affiliate in violation 12 U.S.C. § 371c and Regulation O.

12. None of the Respondents realized any gain as a result of the loan to BGroup.

13. In order to deter the Respondents and others from violating Section 23A of the Federal Reserve Act and Regulation O, and taking into consideration the size of their financial resources, good faith, lack of gravity of the violation, history of a previous violation and other factors as justice may require an appropriate civil penalty assessment against each Respondent is $3,000 is appropriate.

Upon the foregoing findings and conclusions, it is hereby recommended that the Board of Directors of the FDIC enter:

ORDER TO PAY CIVIL MONEY PENALTIES

The Board of Directors of the FDIC, having considered the entire record in this proceeding, including briefs and arguments of counsel, and after taking into consideration the size of the financial resources of and good faith of the Respondents, the minimal gravity of the violation of law they have been found to have committed, the history of previous violations, and such other matters as justice may require,

concludes that a penalty of $3,000 be, and the same hereby is, assessed against Ira Lee Brannan, David Brannan and Stephen L. Brannan pursuant to 12 U.S.C. § 1828(j)(4).

IT IS FURTHER ORDERED that this Order shall be effective and the penalty orders shall be final and payable 20 days from the date of this Order. The provisions of this Order shall remain effective and enforceable except to the extent that and until such time as any provision of this Order shall have been modified, terminated, suspended, or set aside by the Board.

By direction of the Board of Directors.

Dated. Arlington, VA December 20, 1991.