

{{11-30-92 p.A-2006}}

¶5181] **In the Matter of Ronald J. Grubb, Bank of Hydro, Hydro, Oklahoma, Docket Nos. FDIC-88-282k and FDIC-89-111e (8-25-92).**

In a consolidated action, the FDIC Board finds that repeated extensions of credit to respondent and his related interests warrant his removal from banking and assessment of a \$50,000 civil money penalty. This decision affirms the administrative law judge's recommendation regarding the civil money penalty, but rejects his recommendation as to removal and prohibition.

**[.1] Practice and Procedure—Recommended Decision—Exceptions—Oral Argument**

The grant of a request for oral argument is within the discretion of the Board. Where the factual and legal arguments are fully set forth in the parties' submissions and the lack of oral argument will not prejudice the respondent, the Board denies the request.

**[.2] Regulation O—Related Interests**

An entity in which respondent has a one third interest is an affiliate for purposes of Regulation O. Letters of credit and loan to it are not exempt as indebtedness to the bank for the purpose of protecting the bank against loss.

**[.3] Regulation O—Lending Limitations—Collateral**

It is a violation of the requirement that insider loans be secured for respondent to treat his unsecured guaranty as collateral for extension of credit to his business interests.

**[.4] Regulation O—Lending Limitations—Security Interest**

A judgment as to which appeal rights have not expired and which is not a perfected security interest cannot qualify as collateral with an ascertainable market value for purposes of FDI Act Section 23A.

**[.5] Regulation O—Overdrafts—Offsets**

The right of offset, created by the text of the bank's checking account signature card, does not constitute collateral for purposes of Section 23A.

{{11-30-92 p.A-2007}}

**[.6] Cease and Desist Order—Violation—Civil Money Penalty**

Failure to document reasons for purchasing loan participation and for extensions of credit to borrowers with classified loans, as required by cease and desist order, are violations of the order whether or not losses to the bank result.

**[.7] Civil Money Penalty—Factors Determining—Good Faith**

An attitude of treating the bank's resources as if they were his own funds to enjoy without restraint does not reflect well on respondent's good faith for purposes of determining a civil money penalty.

**[.8] Civil Money Penalty—Factors Determining—Gravity of Violation**

For purposes of quantifying the gravity of violation, loans which have been charged off can be considered even if they are later repaid. Also counted, in addition to direct losses to the bank, are unpaid interest and the benefit to respondent of below-market interest and prohibited overdrafts.

**[.9] Civil Money Penalty—Factors Determining—Other Matters**

Improvement in the bank's financial condition is not a matter required by justice to be considered in determining the amount of a civil money penalty.

**[.10] Removal—Factors Determining Liability—Fiduciary Duty**

Respondent breached his fiduciary duty to the bank by failing to see that it operated in compliance with law and regulations, and by ignoring conflicts created by transaction which he devised for his own benefit.

**[.11] Removal—Factors Determining Liability—Unsafe and Unsound Practices**

Loans in violation of Regulation O, without collateral or with unperfected security interests, to borrowers with negative net worth or with outstanding classified loans are abusive insider transactions constituting unsafe or unsound banking practices.

**[.12] Removal—Factors Determining Liability—Losses to Bank**

Determination whether a bank has suffered, or probably would suffer, a substantial loss is to be made as of the time of issuance of the removal notice; subsequent redemptive acts are irrelevant to a removal action.

**[.13] Removal—Factors Determining Liability—Prejudice to Depositors**

Repeated violations, breaches of fiduciary duty and unsafe or unsound practices, with their resulting losses to the bank, subjected depositors to the risk of serious prejudice.

**[.14] Removal—Factors Determining Liability—Disregard for Safety and Soundness**

Continuing or repetitive violations constitute willful disregard for the safety and soundness of the bank.

**[.15] Neither respondent's banking skills and experience nor his conduct at other banks he owns should be considered mitigating factors in a removal and prohibition action.**

**In the Matter of  
RONALD J. GRUBB,  
individually and as a director and/or person  
participating in the conduct  
of the affairs of  
BANK OF HYDRO  
HYDRO, OKLAHOMA  
(Insured State Nonmember Bank)  
DECISION AND ORDERS  
FDIC-88-282k and  
FDIC-89-111e**

*INTRODUCTION*

This proceeding is a consolidated action brought by the Federal Deposit Insurance Corporation ("FDIC" or "Petitioner") against Ronald J. Grubb ("Respondent"), individually and as a director and/or person participating in the conduct of the affairs of Bank of Hydro, Hydro, Oklahoma

("Bank"), seeking civil money penalties pursuant to former sections 18(j)(3) and 18(j)(4) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §§ 1828(j)(3) and 1828(j)(4), and the FDIC Rules of Practice and Procedure, 12 C.F.R. Part 308; and also seeking removal pursuant to former section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1) and the FDIC Rules of Practice and Procedure, 12 C.F.R. Part 308.<sup>1</sup> Respondent is charged with violations of section 23A of the Federal Reserve Act ("Act"), 12 U.S.C. § 371c, as made applicable to insured State nonmember banks by section 18(j)(1) of the FDI Act; section 22(h) of the Act, 12 U.S.C. § 375b, and sections 215.4(a), (b), and (c) of Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. Part 215, as promulgated thereunder and made applicable to insured State nonmember banks by section 18(j)(2) of the FDI Act, 12 U.S.C. § 1828(j)(2), and section 337.3(a) of the FDIC Rules and Regulations, 12 C.F.R. § 337.3(a); and a Cease-and-Desist Order issued by Petitioner.

The Decision of the Board of Directors ("Board") of the FDIC finds that the repeated extensions of credit to Respondent and his related interests which are alleged in the Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay and Notice of Hearing ("Assessment Notice") and Notice of Intention to Remove and/or Prohibit From Further Participation ("Removal Notice") involved over forty violations of section 23A of the Act and Regulation O, resulted in substantial financial loss to the Bank totalling \$606,033, of which Respondent subsequently repaid \$484,607; that these transactions constituted breaches of Respondent's fiduciary duty of the Bank, involved unsafe or unsound practices, and resulted in economic benefit to Respondent; and that such violations, practices, and breaches demonstrate Respondent's willful or continuing disregard for the safety or soundness of the Bank.

As Administrative Law Judge Steven M. Charno ("ALJ") found, Respondent continually used the Bank as his own "personal purse that he might employ without regard to regulatory constraints." R.D. at 18.<sup>2</sup> Furthermore, the violations and prohibited loans continued even after similar violations cited in the 1986 Report of Examination were discussed with Respondent.

The Board orders Respondent to pay a civil money penalty of \$50,000 and further orders that Respondent is removed as a director of the Bank and prohibited from serving or acting as an institution-affiliated party and/or from participating in any manner in the conduct of the affairs of any insured

depository institutions.

## REQUEST FOR ORAL ARGUMENT

Respondent's Exceptions include a request for oral argument before the Board. Respondent argues that this case presents some unique characteristics because of the "Grubb Lawsuit" discussed at page 22 below, and that the FDIC Dallas Regional Office has exhibited a prejudicial attitude toward him; hence, Respondent's briefs cannot adequately present Respondent's position, and Respondent will be prejudiced if the Board fails to grant oral argument.

[1] The grant of a Request for Oral Argument is an extraordinary matter within the discretion of the Board. 12 C.F.R. § 308.17. The Board has previously discussed those circumstances in which it would grant such a request. See *In the Matter of Harold Hoffman*, 2 P-H FDIC Enf. Dec. ¶5140; *FDIC Docket No. FDIC-85-42b*, 1 P-H FDIC Enf. Dec. ¶5062. After considering Respondent's request, the Board finds none of those circumstances in the instant case. The factual and legal arguments are fully set forth in the parties' submissions. As to the assertions of prejudice against Respondent by the

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<sup>1</sup> Because the charges specified in the Notice of Intention to Remove and/or Prohibit From Further Participation occurred prior to the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 101 Stat. 183 (August 9, 1989) ("FIRREA"), Respondent's conduct will be measured by the substantive provisions of sections 8(e)(1), 8(i)(2)(i), and 8(j)(4) of the FDI Act, 12 U.S.C. § 1818(e)(1), as they existed prior to amendment. The scope and effect of any removal order by the Board, however, is determined by post-FIRREA section 8(e)(6) and 8(e)(7) of the FDI Act, 12 U.S.C. §§ 1818(e)(6) and 1818(e)(7)(1989).

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<sup>2</sup> Citation in this Decision shall be as follows:

Recommended Decision—"R.D. at \_\_\_\_."

Transcript—"Tr. at \_\_\_\_."

Exhibits—"FDIC Ex. \_\_\_\_" or "Resp. Ex. \_\_\_\_" or "Resp. Late-Filed Ex. \_\_\_\_."

{11-30-92 p.A-2009} FDIC Regional Office, Respondent offers no supportive evidence. In any event, such prejudice, if true, would be irrelevant to the disposition of this proceeding, which will be decided on whether the allegations in the Assessment Notice and Removal Notice are supported by the preponderance of evidence in the record as a whole, including the testimony of the parties' witnesses, the Exhibits, and the Joint Stipulation of Facts. Thus, oral argument will not aid the Board in this matter, and Respondent will not be prejudiced by the lack of oral argument. Accordingly, the Board denies Respondent's Request for Oral Argument.

### I. STATEMENT OF THE CASE

#### A. DESCRIPTION OF THE CHARGES

On December 22, 1988, the FDIC issued the Assessment Notice against Respondent<sup>3</sup> for the alleged violations of section 23A of the Act and of Regulation O cited above. The Assessment Notice, as amended, alleged (1) violations of the lending limits of section 23A(a)(1)(A) of the Act, the collateral security requirements of section 23A(c)(1) of the Act, and the creditworthy requirements and lending limits of sections 215.4(a)(2) and 215.4(c), respectively, of Regulation O, with respect to the issuance and subsequent renewals of a letter of credit on behalf of MGM Production Company ("MGM"), an alleged "affiliate" of the Bank and "related interest" of Respondent, as those terms are defined in section 23A(b)(1) of the Act and section 215.2(k) of Regulation O, respectively; (2) violations of the creditworthy requirements of section 215.4(a)(2) of Regulation O, the lending limits of section 215.4(c) of Regulation O, and the prior approval requirements of section 215.4(b) of Regulation O, with respect to overdrafts on checking accounts maintained at the Bank on behalf of Respondent and certain of his "related interests," namely MGM, Falcon Management Company ("Falcon Management"), and Ron Grubb Investments ("RGI"); (3) violations of the overdraft prohibition of section 215.4(d) of Regulation O with respect to overdrafts on Respondent's personal account; (4) violations of the collateral requirements of section 23A(c)(1) of the Act with respect to the overdrafts of MGM and Falcon Management; (5) violations of the creditworthy requirements of section 215.4(a)(2) of Regulation O with respect to the issuance and renewal of a loan to Falcon Production Company ("Falcon Production"), an alleged "related interest" of Respondent, and violation of the lending limits of section 215.4(c) of Regulation O with respect to the renewal of that loan; (6) violations of sections 215.4(a)(2) and 215.4(c) of Regulation O with respect to certain payments to Respondent in connection with the so-called Falcon Production ORE transaction; (7)

violations of sections 215.4(c) and 215.4(a)(2) of Regulation O with respect to four extensions of credit made to Respondent during 1986 and 1987; (8) violations of the November 29, 1985 Cease-and-Desist Order issued by the FDIC to the Bank by (a) capitalizing uncollected interest on two occasions, (b) twice failing to document the reasons for extensions of credit to classified borrowers, (c) failing to document the reasons for purchasing a loan participation, and (d) failing to amend the loan policy to reflect changes required by the FDIC Pursuant to former section 18(j)(4) of the FDI Act, 12 U.S.C. § 1828(j)(4), Respondent was assessed a \$50,000 civil money penalty for participation in the alleged violations of the Act, Regulation O, and the Cease-and-Desist Order.

On July 13, 1989, Petitioner issued the Removal Notice to Respondent pursuant to section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1).<sup>4</sup> The Removal Notice realleged that Respondent violated section 23A of the Act and various provisions of Regulation O as described above. It further alleged that Respondent's illegal conduct resulted in Respondent's engaging or participating in unsafe or unsound banking practices and breaches of his fiduciary duty to the Bank, and demonstrated his willful or continuing disregard for the safety or soundness of the Bank; and that as a result of Respondent's acts, omissions and/or practices, the Bank has suffered or will probably suffer substantial financial loss or other damage in the amount of approximately \$606,033, and resulted in Respondent's receiving financial

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<sup>3</sup> The Assessment Notice named four additional individuals as Respondents in this proceeding. All four were dismissed from the action as a result of negotiated settlements with the FDIC.

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<sup>4</sup> The Removal Notice named two additional individuals as Respondents. Both were dismissed from the action as a result of negotiated settlements with the FDIC. [{{11-30-92 p.A-2010}}](#) gain amounting to \$887,560. The Removal Notice seeks to permanently prohibit Respondent from further participation in the conduct of the affairs at the Bank or any other FDIC-insured institution. In December 1989, the civil money penalty and removal actions were consolidated for hearing and decision.

## B. SUMMARY OF PROCEEDINGS

Following prehearing conferences on October 3, 1989, December 28, 1989, and April 10–11, 1990, and the submission by the parties of a Joint Stipulation of Facts and prehearing briefs together with proposed findings of fact and conclusions of law, a four-day evidentiary hearing was held in the matter before the ALJ on December 3–6, 1990 in Oklahoma City, Oklahoma. The parties submitted initial post-hearing briefs, together with proposed findings of fact and conclusions of law, on June 24, 1991, and simultaneous reply briefs on July 12, 1991. In December 1991, the ALJ allowed Respondent to file three late-filed exhibits and proposed supplemental findings of fact and conclusions of law based thereon. Petitioner filed a brief opposing receipt of the exhibits. The ALJ received the late-filed exhibits in evidence, R.D. at 2.

## C. SUMMARY OF THE TRANSACTIONS ON WHICH THE PARTIES BASE THEIR CHARGES AND DEFENSES

The alleged violations set forth in the Assessment Notice and the Removal Notice occurred from December 1985 through February 1988. Transactions both previous and subsequent to this period are relied on by Respondent in defense. Because of the number and complexity of transactions involved in this proceeding, they are summarized below.<sup>5</sup>

### 1. *General Background.*

(a) The Bank had total assets of \$27.7 million and total capital of \$2.328 million as of the April 27, 1990, Examination. FDIC Ex. 335 at 2.

(b) Respondent Ronald J. Grubb owns 94 percent of the Bank through his control of Hydro Bancshares, Inc., and is a director and person participating in the affairs of the Bank. He bought his first bank in 1974 and has owned controlling interests in 17 banks in Oklahoma and Texas. He purchased an interest in the Bank in 1977, Tr. at 580-83, and obtained control of the Bank in 1981, FDIC Ex. 3. In 1985, respondent owned more than 50 percent of nine banks, and 35 percent of another, FDIC Ex. 1. At of 1990, he owned controlling interests in 6 banks, FDIC Ex. 335.

(c) The 1985 Report of Examination of the Bank stated that the Bank's condition reflected a serious deterioration from the last examination; that loan classifications had doubled; that 53 percent of all

classified loans were originated by Respondent; that it was recommended that Respondent refrain from further lending and completely divorce himself for the loan area. Consequently, Respondent resigned as chairman of the board of the Bank, but continued to serve as a director. The president of the Bank also resigned, although he also continued to serve as a director.

(d) Fred Schamburg, who graduated from college in 1981 and immediately went to work for the Bank as a trainee, was promoted to president of the Bank during the 1985 Examination, Tr. at 917. He served in that position at least until November 1991, Resp. Late-filed Ex. 330.

(e) On November 29, 1985, an FDIC Cease-and-Desist Order became effective against the Bank, based on the results of the 1985 Examination.<sup>6</sup>

(f) During the period 1985 through 1988, the Bank had but one outside director, who

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<sup>5</sup> This summary is based upon facts which are stipulated by the parties or otherwise are part of the record and uncontroverted. If there is no record reference, the facts are derived from the Joint Stipulation of Facts.

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<sup>6</sup> In summary, the Cease-and-Desist Order required the Bank to (1) obtain independent, outside directors, (2) retain management acceptable to the FDIC, (3) maintain adjusted primary capital equal to or greater than 8.0 percent of adjusted total assets, (4) reduce adversely classified assets, (5) establish an adequate allowance for loan losses, (6) refrain from extending additional credit to any borrower whose loan has been classified "Doubtful" or "Loss" and is still uncollected, or whose loan has been classified "Substandard" and is uncollected unless the board of directors has signed a written statement giving reasons why failure to extend such credit would be detrimental to the best interests of the Bank, and refrain from purchasing participations in loans unless the board of directors documents the reasons for the purchase prior to their purchase, (7) adhere to loan policies and procedures, and review and modify its current written loan policies and procedures and present same to the FDIC for approval, (8) refrain from declaring or paying any cash dividend in excess of 50 percent of the earnings and profits for the year under consideration, (9) refrain from purchasing or repurchasing loan participations if the loan has been adversely classified or exhibits other unfavorable characteristics, (10) eliminate concentrations of credit, and (11) eliminate technical exceptions to loan documentation.

{{11-30-92 p.A-2011}} was elected in March 1987 and resigned in May 1988. FDIC Ex. 1-4.

*2. Bank Examinations during the Relevant Period.*

(a) Petitioner's Exhibits 1-4 consist of Reports of Examination on the Bank dated May 10, 1985, July 18, 1986, December 31, 1987, and January 23, 1989 (the last three Examinations having been conducted jointly with the Oklahoma State Banking Department).

(b) The 1985 Report of Examination classified "Substandard" three loans outstanding to Respondent totalling \$330,000, stating, "It is apparent that the debtor does not warrant unsecured debt. The credit is classified Substandard due to its unsecured status and the deteriorating financial condition of the borrower."

At the conclusion of each examination, Respondent and other Bank directors met with the examiners regarding the results of the examination, and Respondent and other Bank directors received copies of each Report of Examination. After the 1986 Examination, both the FDIC and the Oklahoma State Banking Department sent Respondent and other Bank directors letters regarding alleged violations of law and alleged violations of the FDIC's Cease-and-Desist Order discovered in the 1986 Examination and recited in the 1986 Report of Examination. After the 1987 and 1989 Examinations, the FDIC sent letters to Respondent and other Bank directors regarding alleged violations of law and alleged violations of the FDIC's Cease-and-Desist order discovered at the 1987 and 1989 Examinations and cited in the 1987 and 1989 Reports of Examination.

*3. Transactions Involving Alleged Violations.*

(a) *MGM Letters of Credit.* MGM was an oil and gas production company, one-third owned by Respondent (see page 20, below). On February 14, 1986, the Bank issued a standby, irrevocable letter of credit, effective March 10, 1986, for \$265,000, to secure a bond issued by Travelers Insurance Company ("Travelers") in that amount to bond off mechanic's liens for MGM's benefit in the lawsuit (see page 21, below). The letter of credit was guaranteed by Respondent, who signed a "blank" promissory note and a "blank" guaranty agreement but was not secured by a pledge of collateral.

When the letter of credit was issued, MGM had lost the lawsuit (increasing the risk that the letter of credit would be called) but was appealing it. Also at that time, the Bank had loans outstanding to Respondent which had been adversely classified "Substandard" during the 1985 Examination.<sup>7</sup> When issued, the letter of credit exceeded 10 percent of the Bank's capital and surplus by \$37,700 and, when aggregated with the Bank's \$110,000 loan to Falcon Production, another related interest of Respondent

(see page 14, below) exceeded 15 percent of the Bank's capital and surplus by \$34,050.

The 1986 Examination Report cited the letter of credit as a violation of section 23A of the Act.

On March 9, 1987, and again on March 9, 1988, the Bank issued replacement, standby, irrevocable letters of credit for \$265,000, again guaranteed by Respondent but without perfected security interests in any pledged collateral. On the dates of issuance, the Bank had outstanding loans to Respondent and Falcon Production which had been adversely classified "Substandard" at the 1986 Examination and "Doubtful" at the 1987 Examination. The 1987 letter of credit was classified "Doubtful" at the 1987 Examination.<sup>8</sup>

On April 14, 1988, the lawsuit having been lost by MGM on appeal, the Bank disbursed \$235,801 on MGM's behalf, pursuant to the letter of credit,<sup>9</sup> and treated the payments as a loan to MGM. The loan was

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<sup>7</sup> Shortly thereafter, the loans were repaid with the proceeds of a Certificate of Deposit which had served as collateral for a previous letter of credit for MGM at another bank controlled by Respondent, Tr. at 847, 848.

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<sup>8</sup> "...President Schamburg also indicated that there is a reasonable expectation that the letter of credit may have to be funded, as the appeal situation indicates that MGM lost the initial lawsuit, and accordingly, could also lose the appeal. Bank Director Ronald J. Grubb has executed a blank, signed note and guaranty form to support the letter of credit in event of funding. No collateral has been pledged to secure this contingent liability. No financial information is available on MGM to determine repayment capacity, and with guarantor Grubb's weak financial condition as detailed on page 2-a-2, coupled with the letter of credit's unsecured status, a Doubtful classification is accorded." December 31, 1987 Report of Examination, FDIC Ex. 3 at 2-a-9.

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<sup>9</sup> The parties so stipulated. However, the payments were not made to Travelers pursuant to the bond, but directly to a lien holder and to MGM's attorney for legal fees. The latter payment appears to be beyond the obligation of the Bank under the letter of credit and hence a new extension of credit to MGM. [{{11-30-92 p.A-2012}}](#) guaranteed by Respondent, but the Bank did not have a perfected security interest in any pledged collateral. At the time the loan was funded, the Bank's aggregate extensions of credit to Respondent, MGM, and Falcon Production exceeded 15 percent of the Bank's capital and surplus by \$192,025.

The MGM loan was charged off by the Bank as a loss in late 1988, Tr. at 960. The principal of the loan was repaid by Respondent on November 14, 1991, Resp. Late-filed Ex. 330.

(b) *Overdrafts*. During 1986 and 1987, the Bank maintained checking accounts on behalf of MGM, Falcon Management, a corporation wholly owned by Respondent, and RGI, Respondent's sole proprietorship, and Respondent. All of these accounts were overdrawn at various times between July 1, 1986, and November 30, 1987.

(c) *Dealings With Falcon Production*. Respondent was one of the original incorporators of Falcon Production and served as its President and one of its directors. For several years, it was an inactive company without assets. In 1985, Respondent sold the corporation to his son, Shawn J. Grubb, Tr. at 629; but Respondent had the authority to borrow on the account of Falcon Production from the Bank and had been granted power of attorney by his son for purposes of conducting the business of Falcon Production.

On December 31, 1985, the Bank made a one year, single payment loan to Falcon Production in the amount of \$110,000 for the purpose of purchasing a mineral lease from Respondent. Respondent signed the promissory note and security agreement, and personally guaranteed the Bank from any loss by signing a guaranty agreement. At that time, the Bank had an outstanding loan to Respondent that was adversely classified "Substandard" at the 1985 Examination. The Falcon Production loan was secured with collateral represented by a mineral mortgage. The proceeds of the loan were used as payment on Respondent's personal loans at the Bank which had been classified "Substandard" in the 1985 Examination Report. The 1986 Report of Examination classified the Falcon Production loan "Substandard".<sup>10</sup>

On February 12, 1987, the Bank renewed the loan to Falcon Production on the same terms, again with the note and security agreement signed by Respondent and personally guaranteed by him. In addition to the mineral mortgage, Falcon Production posted as collateral a second mortgage on a 479 acre farm in Harmon County, Oklahoma. At that time, the Bank had an outstanding loan to Respondent that was adversely classified "Substandard" at the 1986 Examination; and the Bank's extensions of credit to MGM, Respondent, and Falcon Production exceeded 15 percent of the Bank's unimpaired capital and

unimpaired surplus.

On February 2, 1988, Falcon Production failed to make the principal and interest payments due on the loan. The first mortgage was also past due, Tr. at 971. On February 22, 1988, the Bank accepted a deed from Falcon Production to the Harmon County farm in lieu of foreclosure, and paid off the outstanding superior lien held by the Equitable Life Assurance Society of the United States in the amount of \$134,447. The Bank accounted for the real estate acquired by crediting the Falcon Production loan in the amount of \$124,311, for the past due principal and accrued interest, and listing the acquired property as Other Real Estate ("ORE") in the amount of \$342,000, representing 90 percent of the appraised value of \$380,000, according to an appraisal of the property dated January 15, 1988. Resp. Ex. 36.

On February 17, 1988, the Bank had disbursed funds to Falcon Production in the amount of \$48,553 by depositing that amount into Falcon Production's account at the Bank, which was used to pay an insufficient funds item drawn by Respondent on the account to make payment on Respondent's personal loan at the Bank's affiliate, First State Bank of

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<sup>10</sup> "Collateral for this loan is supposed to consist of a mortgage of mineral rights on 110 acres in Blaine County, Oklahoma; however, the mortgage document reflects the mortgagor as Falcon Production Company, even though Ronald J. Grubb is the reported owner of the property. . . . There were no title investigation reports or appraisals on these mineral rights in the credit file. An informal memorandum in the credit file prepared by Mr. Grubb indicated that he had purchased the mineral rights in 1982 for \$110,000 and has since leased the rights on two occasions at \$1,000 per acre. Unaudited financial information for Falcon Production Company dated 12-31-85 disclosed. . . deficit NW (15.4M). President Schamburg indicated that repayment of this debt was to come from income generated by the company from the purchase and sale of oil and gas leases, but no income information was available on the company, and President Schamburg indicated that sales of oil and gas leases were very slow at present due to the overall depressed state of the oil industry." July 18, 1986, Report of Examination, FDIC Ex. 2 at 2-a-2.

[\[11-30-92 p.A-2013\]](#) Mooreland, Mooreland, Oklahoma. On February 22, 1988, the Bank disbursed an additional \$34,688 to Falcon Production, of which \$34,000 was transferred to the account of RGI at the Bank. These two payments, totalling \$83,241, purportedly represented Falcon Production's "equity" in the transferred real estate, the difference between 90 percent of appraised value and the amounts paid and credited by the Bank in satisfaction of the first mortgage loan and the Bank's loan to Falcon Production.

On February 22, 1988, the Bank's extensions of credit to MGM and Respondent exceeded 15 percent of the Bank's unimpaired capital and unimpaired surplus.

(d) *Respondent's Personal Loans.* During the 1985 Examination of the Bank, Respondent's personal loans in the amount of \$330,000 were classified "Substandard" because they were unsecured and because his financial net worth had been steadily declining. All of these loans had been paid off by April 1986, with the proceeds of the Falcon Production loan and of Respondent's certificate of deposit at BankCentral which had previously been securing the letter of credit issued by that bank on behalf of MGM.

The Bank made four extensions of credit to Respondent during 1986 and 1987: a \$75,000 loan on April 25, 1986; a \$150,000 loan on June 5, 1986, which was used to renew the principal and unpaid interest of the April 25th loan and to provide \$73,884 in new funds; a \$100,000 loan on October 29, 1986, approximately \$39,000 of which was used to pay Respondent's overdrafts on another account with the Bank; and a \$250,000 loan on April 14, 1987, which consolidated the June and October 1986 loans and provided a three year term with monthly payments of \$1,922 and a final balloon payment of \$243,815.

During the July 1986 Examination, and prior to the October 1986 loan, Respondent was informed by the FDIC that the June 1986 loan was a violation of Regulation O and also had been adversely classified "Substandard". He thereupon executed the 1986 Assignment of the "Grubb Judgment" (see page 23, below). A few months later, the Bank loaned Respondent an additional \$100,000 in October 1986. When the April 1987 loan was made to Respondent, the Falcon Production loan and the June 1986 loan to Respondent had been classified "Substandard" at the 1986 Examination. Respondent purportedly granted the Bank additional collateral security at the time of the April 1987 loan. The April 1987 loan was classified "Doubtful" at the 1987 Examination.<sup>11</sup>

When loans were made to Respondent in 1986 and 1987, the Bank's extensions of credit to Respondent, MGM, and Falcon Production exceeded 15 percent of the Bank's unimpaired capital and unimpaired surplus.

In August 1988, Respondent ceased making payments on the April 1987 loan. In December 1988, the Bank charged off as loss the accrued but uncollected interest in the amount of \$10,895, Tr. at 469. The January 23, 1989 Report of Examination classified the loan as "Loss".<sup>12</sup> Shortly thereafter, Respondent executed the 1989 Assignment, perfected on February 15, 1989, as security for the loan up to \$250,000.

<sup>11</sup> "Collateral consists of Mtges on a service station in Clinton, Oklahoma and a condominium in Pagosa Springs, Colorado. Both of these Mtges are signed only by Mr. Grubb and his wife has refused to sign. The bank does not have title information on these two properties; therefore, the ownership and lien positions are uncertain. President Schamburg estimates the service station to be work 210M. Mrs. Grubb reportedly refused to signed [sic] the Mtges due to domestic issues. . .

"A review of Grubb's financial statements indicates that he is highly leveraged and his financial condition has been deteriorating. His NW has declined from 8,891M in 1984 to 7,490M in 1985, and in 1986 to 2,985M...

. . ."Grubb has also won a favorable judgment which is now in appeal and its outcome still unknown. All of these factors indicate that Mr. Grubb's financial condition and income is in a state of significant and uncertain change. A classification of Doubtful is assigned to the credit due to the deteriorating financial condition of the borrower, uncertainty associated with collateral lien position, if any, and the long term amortization period." December 31, 1987 Report of Examination, FDIC Ex. 3 at 2-a-2, 2-a-3.

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<sup>12</sup> "Payments of 1,922 were being made until August, 1988 when curtailment ceased entirely. Chairman Grubb stated that the reason he could no longer meet his payment schedule was due to his acquisition of the assets of MGM Production Company, Inc.... The bank has taken an assignment on the [Grubb] judgement, but has not properly perfected its lien. The judgement has been pledged to other creditors and a list provided by Chairman Grubb's accountant during the examination reflects that this bank is to receive the above principal only, but no interest.... Chairman Grubb and his wife are presently involved in divorce litigation and the bank will apparently lose its lien [on the service station] if she is awarded the property in a settlement. This property was appraised on 12-23-88 at 136M. The bank also holds a deed of trust on a condominium in Colorado, but no title opinion reflecting the lien position has been obtained.... This property was appraised at 70M on 7-2-88. A joint PS of Ronald J. and Clela L. Grubb dated 12-31-87 reflects...a NW of 1,099.3M with contingent liabilities of [\(Continued\)](#)

[{{11-30-92 p.A-2014}}](#) of 1989, the Bank charged off as loss \$248,806 representing the unpaid principal balance on the loan.

By letter dated April 20, 1990, the Oklahoma State Banking Commissioner (at the request of Respondent's counsel, acting on behalf of the Bank) indicated no objection to the rebooking of the loan, based upon the second jury verdict and the supersedeas bond in the Grubb Lawsuit (page 22, below); provided it remain in nonaccrual status, and with the further requirement that the Bank obtain a subordination agreement from the F&M Bank regarding its assignment of the judgment. FDIC Ex. 342. This requirement was fulfilled by the November 30, 1990 Subordination Agreement with F&M Bank, Resp. Ex. 320. The principal of the April 1987 loan was repaid by Respondent on November 14, 1991, Resp. Late-filed Ex. 330.

#### 4. *Transactions Relied on by Respondent in Defense.*

(a) *MGM Production company Formation.* In September 1982, the Bank made a one-year loan of \$500,000 to Doyle Matthews and Joey May, of which \$300,000 was participated out to another bank controlled by Respondent. No payments were due on the loan until maturity, Tr. at 829. The borrowers' financial statements indicated a combined net worth of \$7.8 million. Collateral consisted of accounts receivable, oil and gas drilling and production equipment, and an assignment of mortgage on numerous oil well and related leases owned by Tulsa Petroleum Resources, Inc. ("TPR"). Tr. at 824–833; Resp. Ex. 288.

On November 12, 1982, mechanic's and materialman's liens were filed by third parties against the TPR assets and revenues generated thereby, Tr. at 825. In October and December 1982, May and Matthews made payments on their loan, Tr. 828–833; Resp. Ex. 288.

In November 1982, Respondent, May, and Matthews formed MGM. respondent was a one-third owner. On November 23, 1982, MGM executed an agreement to purchase the assets of TPR, Tr. at 825. In December 1982, MGM borrowed \$450,000 from Citizens National Bank & Trust Co., Oklahoma City, Oklahoma, Oklahoma City, Oklahoma, for the purpose of purchasing the assets of TPR, Tr. at 1190-94. The proceeds were used to pay off the Matthews and May loan from the Bank, Tr. at 614–616. The loan, totalling \$180,305.15 in principal and \$7,257.30 in interest, was paid off on March 23, 1983, Resp. Ex. 288.

Also in March 1983, bonds for up to \$265,000 were posted by Travelers, backed by a standby, irrevocable letter of credit from BancCentral, Amarillo, Texas, a bank controlled by Respondent, to bond off the liens. Suit was commenced on one or more of the liens in March or April, 1983. The lawsuit was lost by MGM in state district court after trial in March 1984 but was appealed, Tr. at 661–680. The bond

and the BancCentral letter of credit were renewed in 1985, at which time Respondent posted a CD in the amount of \$265,000 to secure the letter of credit.

In early 1986, Respondent sold his interest in BancCentral. When the letter of credit was replaced by one issued by the Bank, Respondent's CD at BancCentral was used to pay off his loans at the Bank which had been classified "Substandard" at the 1985 Examination, Tr. at 848-849; FDIC Ex. 153.

(b) *The "Grubb Judgment" and Its Assignment.*

(i) *Background.* In February 1983, Respondent and a partner purchased Security State Bank, Weatherford, Oklahoma ("Security State") from The First National Bank and Trust Company of Oklahoma City, Oklahoma City, Oklahoma ("First National"), which had foreclosed on the stock under a pledge agreement. As part of the transaction, First National restructured some debt and advanced approximately \$5 million in the form of a loan to Respondent and his partner to recapitalize Security State. Thereafter, in September 1983, Respondent caused Hydro Bancshares, Inc. (the Bank's holding company) to contribute \$1.5 million to the capital of Security State. In February 1984, Respondent paid First National \$222,629.88 in interest on the loans in order to obtain renewals of the loans. In March 1984, Respondent made a \$1 million capital contribution to Security State. Security State was closed on September 21, 1984.

(ii) *The Lawsuit and Judgments.* On August 31, 1984, Respondent filed suit in United States District Court for the Western

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12 Continued: 15,726.5M. Major assets include 3,734.9M in bank stock and 2,750M for the above judgement receivable. A loss of the above law suit would leave the borrower insolvent. Chairman Grubb expressed only slight disagreement with the severity of the classification, but offered no real supporting information." January 23, 1989 Report of Examination, FDIC Ex. 4 at 2-a-2.

[{{11-30-92 p.A-2015}}](#) District of Oklahoma for damages against First National, alleging that First National violated federal and state securities laws in the sale of the Security State stock, and asking for rescission of the notes to First National in connection with the transaction ("Grubb Lawsuit"). First National counterclaimed for payment on the notes. Sometime in 1985,<sup>13</sup> Respondent was awarded a jury verdict of \$2,722,629.88 plus attorney fees and post-judgment interest, and the counterclaim of First national on the notes was dismissed ("1985 Grubb Judgment"). First National appealed to the U.S. Court of Appeals for the 10th Circuit, and was required to post a supersedeas bond backed by U.S. Treasury obligations. While the appeal was pending, First National was declared insolvent by the Comptroller of the Currency on July 14, 1986 and the FDIC was appointed Receiver.

After being made a party to the suit, the FDIC as Receiver moved to exonerate the supersedeas bonds posted by First National under 28 U.S.C. § 2408, asserting, *inter alia*, that a judgment creditor is entitled only to a pro rate share of the failed bank's estate. The motion was denied in *Grubb v. FDIC*, 833 F. 2d 222 (10th Cir. 1988).

On the substantive appeal, in a decision dated February 16, 1989, the U.S. Court of Appeals for the 10th Circuit upheld the judgments below on liability and dismissal of First National's counterclaims, but remanded for a new trial on damages unless Respondent accepted a remittitur reducing the award to \$222,629.88. *Grubb v. FDIC*, 868 F. 2d 1151 (10th Cir. 1989).

In July 1989, Respondent rejected the remittitur and thereafter the damages claim was retried. In December 1989, a jury awarded Respondent approximately \$2.7 million. On October 26, 1990, the Court entered judgment in the principal amount of \$2,725,157.65 ("1990 Grubb Judgment"). Respondent was also awarded prejudgment interest in the amount of \$1,606,660, and attorneys fees of \$467,000. The FDIC as Receiver paid the judgment for attorneys fees in December 1990, and appealed the other judgments. By agreement dated November 13, 1991, Respondent and the FDIC as Receiver settled the appeal for \$3,250,000, which was paid to Respondent from the supersedeas bond, Resp. Late-filed Ex. 329.

(iii) *Assignments of the Judgments.* On July 23, 1986, Respondent executed a Security Agreement with the Bank, granting a security interest in "Judgment Bond posted by First National Bank" in the Grubb suit, in the amount of \$3,355,000, Resp. Ex. 310 ("1986 Assignment"). This assignment was never perfected by the Bank.

On February 9, 1989, Respondent executed an Assignment of Judgment granting the Bank a security interest in the "Judgment Bond" with respect to the principal of Respondent's April 14, 1987 loan in the amount of \$250,000. The 1989 Assignment was perfected by the Bank on February 15, 1989, by filing with the Clerk of Court, FDIC Ex. 352, the day before the damages portion of the 1985 Judgment was remanded for new trial or acceptance of the remittitur.

On November 30, 1990, Respondent executed an Assignment of Judgment as Collateral, assigning to the Bank part of his rights, title, and interest in and to the judgments, proceeds and supersedeas bonds in the Grubb suit, pursuant to a Supplemental Security Agreement of the same date ("1990 Assignment").

Also on November 30, 1990, the Bank and Respondent executed a Subordination Agreement with The F & M Bank and Trust Company, Tulsa, Oklahoma ("F&M"), which recognized the first lien position of F&M and provided that the Bank would be paid the first \$484,606 of cash proceeds from the security in exchange for an assignment to F&M of all rights of the Bank in and to the indebtedness of Respondent and the collateral. The 1990 assignment was perfected by filing the Clerk of Court on December 4, 1990. See Resp. Ex. 320–322.

D. SUMMARY OF THE ALJ'S  
RECOMMENDED DECISION, PROPOSED  
FINDINGS, CONCLUSIONS & ORDER

ALJ Charno issued a 51-page Recommended Decision, Findings of Fact and Order ("R.D.") dated March 25, 1992, summarized below, in which he found many violations of section 23A and Regulation O, and concluded that the imposition of a civil money penalty in the amount of \$50,000 is reasonable and appropriate, but that the Removal Notice should be dismissed.

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<sup>13</sup> The Judgment on Jury Verdict is dated October 31, 1985, Resp. Ex. 319.

{{11-30-92 p.A-2016}}

1. *Alleged Violations.*

(a) *MGM Letters of Credit.* The ALJ concluded that the letters of credit issued on February 14, 1986 and March 9, 1987, each in the amount of \$265,000, violated the lending limit of section 23A(a)(1)(A) of the Act; that the letters of credit issued February 14, 1986, March 9, 1987, and March 9, 1988, as well as the funding of the last letter of credit on April 14, 1988 in the amount of \$235,801, violated the collateral requirements of section 23A(c)(1) of the Act; that the first two letters of credit and the funding of the last letter of credit violated the lending limits of section 215.4(c) of Regulation O; and that all three letters of credit violated the creditworthy requirements of section 215.4(a)(2) of Regulation O because the adverse classification of loans to Respondent on the dates of these extensions of credit to MGM, the guarantor of the MGM extensions of credit, constituted "unfavorable features" thereunder. In so concluding, the ALJ rejected Respondent's arguments that MGM is not an "affiliate" of the Bank; that his personal guaranty constitutes sufficient collateral under section 23A(c)(1) of the Act; and that the transactions are exempt from Regulation O. Finally, the ALJ rejected as "moot" the Petitioner's requested findings that the issuance of each letter of credit violated the creditworthy requirements of section 215.4(a)(2) for additional reasons ("blank" promissory notes and guaranty agreements, no collateral, no financial information on MGM, and marked deterioration of Respondent's financial condition).

(b) *Overdrafts.* The ALJ concluded that the MGM and Falcon Management overdrafts were not secured by acceptable collateral in violation of section 23A of the Act; that the overdrafts of Respondent, MGM, Falcon Management, and RGI violated the lending limits of section 215.4(c) of Regulation O and the prior Board approval requirements of section 215.4(b) of Regulation O and the creditworthy requirements of section 215.4(a)(2) of Regulation O; and that the overdrafts on Respondent's personal account violated section 215.4(d) of Regulation O. In so doing, the ALJ rejected Respondent's arguments that the lending limits of Regulation O and the collateral requirements of section 23A were not violated because all overdrafts were subject to rights of offset created by the text of the Bank's checking account signature cards and therefore were secured by segregated deposits which constituted collateral; that overdrafts were properly approved by the Bank's directors; and that the overdrafts on his personal account were covered by the exceptions contained within section 215.4(d) of Regulation O because a written agreement with the Bank provided for repayment and pledged his other accounts to repay any particular overdraft.

(c) *Falcon Production Transactions.*

(i) *Loans.* The ALJ concluded that Falcon Production was a related interest of Respondent; that the loan of \$110,000 to Falcon Production on December 31, 1985, and its subsequent renewal violated the creditworthy requirements of Regulation O because when made and renewed Respondent, the guarantor, had outstanding loans from the Bank which had previously been classified "Substandard"; and that the renewal of the loan to Falcon Production on February 12, 1987, violated the lending limits of section 215.4(c) of Regulation O.

(ii) *Other Real Estate Transaction.* The ALJ found that Respondent arranged the ORE transaction in order to allow the Bank to hold the real estate until he could reacquire it and to obtain additional funds during a period when any further loan to him by the Bank was proscribed by the lending limits of Regulation O. The ALJ concluded that the payments to Falcon Production representing "equity" in the real estate collateral were extensions of credit to Respondent under section 215.3(a)(8) of Regulation O because he was obligated to repay these amounts to the Bank since they were received in violation of Section 414B of the Oklahoma Banking Code, 6 Okla. Stat. Ann. § 414B and also received as a result of unsafe or unsound banking practices; and that both extensions of credit violated the creditworthy

requirements of section 215.4(a)(2) of Regulation O and the lending limits of section 215.4(c) of Regulation O. In so concluding, the ALJ rejected Respondent's arguments that the equity payments were "loan acquisition costs" and therefore permitted under section 414B of the Oklahoma Banking Code; and that the equity payments did not constitute unsafe or unsound banking practices.

(d) *Respondent's Personal Loans*. The ALJ concluded that the four loans by the Bank to Respondent in 1986 and 1987 violated the lending limit restrictions of section 215.4(c) of Regulation O; and violated the creditwor-

[{{11-30-92 p.A-2017}}](#)thy requirements of section 215.4(a)(2) of Regulation O because extensions of credit to Respondent by a bank in which he held a controlling interest, in violation of the lending limits of Regulation O, was a conflict of interest and hence an "unfavorable feature" under section 215.4(a)(2) of Regulation O (citing *Docket No FDIC-84-23b*, 1 P-H FDIC Enf. Dec. ¶5061 (1986)). The ALJ rejected Respondent's argument that the loans were adequately secured with collateral and that in any event Respondent's financial condition was adequate to support these extensions of credit.

(e) *Order to Cease and Desist*. The ALJ concluded that the alleged violations of the Cease-and-Desist Order occurred and that Respondent, as a member of the Bank's board of directors, had an affirmative obligation to monitor and insure the Bank's compliance with the provisions of that order, citing *Docket No. FDIC-85-303k*, 1 P-H FDIC Enf. Dec. ¶5089 (1987), and *Docket No. FDIC-80-34k*, 1 P-H FDIC Enf. Dec. ¶5004 (1981). In so concluding, he rejected Respondent's defenses that these violations were mere technical failures properly to document board discussions and decisions in the minutes, and that the President of the Bank, Fred Schamburg, had assumed responsibility for these lapses.

2. *Civil Money Penalty*. The ALJ ruled that Respondent's violations of section 23A, Regulation O, and state law render him liable for a civil money penalty, and that the size of the penalty must be determined by taking into account the size of the financial resources and good faith of Respondent, the gravity of the violation, the history of previous violations, and such other matters as justice may require, in accordance with former 12 U.S.C. § 1828(j)(3). The ALJ also cited the Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies ("Interagency Policy"), stating that the elements listed therein would be considered as relevant in the context of the five statutorily mandated factors.

(a) *Financial Resources*. The ALJ, noting that the parties stipulated Respondent's total income as of December 31, 1989, exceeded \$450,000, including annual salaries from various banks which total more than \$200,000, and that Respondent conceded he could pay a \$50,000 penalty over a three-year period, found that, as long as Respondent continues to receive the stipulated remuneration for his activities as a banker, he will have sufficient financial resources to allow him to pay a \$50,000 civil money penalty.

(b) *Good Faith*. The ALJ found that no prohibited overdrafts or violations of paragraphs 6(c), 6(d) or 7(b) of the Cease-and-Desist Order took place after the 1987 examination of the Bank, and therefore Respondent made a successful effort, albeit belatedly, to "correct" these types of violations; that the principal balances of the Bank's loans to Respondent and MGM were ultimately repaid on November 14, 1991, thereby at least partially "correcting" the violations caused by these loans; that, "I am not inclined to make much of Respondent's failure to repay these loans at an earlier date," because "the record is clear that Respondent was without the financial resources to retire these debts until his lawsuit against the FDIC came to fruition;" that Respondent repaid the principal balances of his personal loan and the MGM loan the day after receipt of \$3,250,000 in settlement of his lawsuit against the FDIC, and his delay in repayment was not demonstrative of bad faith; that Respondent's attitude with respect to the Falcon Production ORE transaction is representative of his general attitude toward the Bank:

While he does not appeal ever to have engaged in a transaction with the intention of securing a profit which would cause a loss to the Bank, he has often treated the Bank's resources as if they were his personal purse which he might employ without regard to regulatory constraints.

R.D. at 18.

The ALJ also found that Respondent's personal honesty had not been called into question, that he did not attempt to conceal his activities or otherwise deceive either regulators or the Bank's management, and that he cooperated with the inquiries of Petitioner and the Oklahoma State Banking Department. He concluded that, while the degree of good faith demonstrated by Respondent would tend to preclude the imposition of a penalty in excess of \$50,000, a penalty in that amount is reasonable.

(c) *Gravity of the Violation*. The Recommended Decision states that the gravity of Respondent's violations may be measured by (1) their effect upon the Bank and (2) the [{{11-30-92 p.A-2018}}](#) extent to which Respondent benefited from the violations. As to the first measure, the ALJ found that the Bank's aggregate extensions of credit to Respondent and his related interests between February 1986 and December 1990 were at all times in excess of regulatory lending limits, but the weight to be accorded this lengthy duration is lessened by Respondent's financial inability to make

restitution prior to November 1991. As to the second measure, the Recommended Decision notes the FDIC has measured benefit to the violator by the amount of actual loss suffered by a bank as a result of the violation; and finds that neither the prohibited overdrafts nor the violations of the Cease-and-Desist Order, nor the principal balances of the MGM loan or the personal loans to Respondent, nor the principal balance of the extension of credit to Falcon Production, nor the Falcon Production ORE transaction, results in "actual loss"; but that Respondent failed to pay accrued interest of \$10,895 on his personal loan and \$12,979 on the extension of credit to MGM, resulting in significant actual losses to the Bank. The ALJ concluded that the minimum civil money penalty which can be imposed in this proceeding is \$23,874, and the penalty actually imposed should substantially exceed that minimum.

(d) *History of Previous Violations.* The ALJ found that Respondent was informed of his alleged violations at the conclusion of bank examinations in 1986, 1987, and 1989.

(e) *Matters Required by Justice.* The ALJ notes that Respondent made restitution to the Bank of more than \$484,000, and that his violations "were not shown to have created an unsafe or unsound condition at the Bank. Indeed, probative evidence of record establishes that significant improvements in the Banks' financial condition took place under Respondent's management between 1985 and 1991." On the deterrent factor, the ALJ found that in the ORE transaction, "[r]espondent misused his position to obtain additional credit denied him by law while retaining the power to reassert control over the real estate he conveyed to the Bank. This breach of fiduciary duty justifies a penalty approximately twice as great as the economic benefit which Respondent received as a result of his violations."

The ALJ concluded that the imposition of a \$50,000 civil money penalty is supported by substantial evidence of record.

3. *Removal.* The Recommended Decision states that Respondent has been shown to have engaged in violations of law and regulation which have economically benefited him and hence, under section 8(e)(1) of the FDI Act, the FDIC is entitled to an order removing him from banking if the violations demonstrate Respondent's willful or continuing disregard for the safety and soundness of the Bank, noting that the Petitioner made no allegations that the violations involved Respondent's personal dishonesty. The Recommended Decision contains no findings or conclusions concerning the alternative statutory criteria for removal, that is, whether Respondent's activities also constituted (1) breaches of his fiduciary duty or (2) unsafe or unsound banking practices, or whether Respondent's conduct (1) caused substantial loss or damage to the Bank or (2) seriously prejudiced the interests of the Bank's depositors, stating Petitioner's contentions in that regard are "moot."

The Recommended Decision notes that "willful" disregard has been defined by the FDIC as "conduct which is practiced deliberately in contemplation of the results," while "continuing" disregard has been held to be "that conduct which is voluntarily engaged in over a period of time with heedless indifference to the prospective consequences," citing *Docket No. FDIC-85-215e*, 1 P-H FDIC Enf. Dec. ¶5069 (1986). The Recommended Decision frames the question for determination to be whether Respondent's repetitive violations of law and regulations were shown to have been made either (1) deliberately with intended consequences or (2) voluntarily and without regard to consequences.

The ALJ found that the repetitive nature of the violations of lending limits "came into being when the Bank renewed extensions of credit which Respondent had become financially unable to repay," and held that becoming financially unable to repay a loan cannot constitute "deliberate" or even "voluntary" conduct and does not demonstrate a lack of regard for the Bank's safety of soundness. The ALJ stated that, "[i]ndeed, the record establishes that Respondent willingly pledged collateral which proved sufficient to insure the ultimate repayment of the principal balances of all of the extensions of credit challenged in the Proceeding," R.D. at 22. He concluded that these hypothecations demonstrate that Respondent, "though unable to prevent the continu-  
{{11-30-92 p.A-2019}}ing lending limit violations found herein, took positive action to insure the Bank's safety and soundness in connection with those loans. . .," R.D. at 22, 23. The ALJ concluded that a "similar pattern" emerges with respect to Respondent's other violations. He stated:

After receiving the report of the July 18, 1986 examination, Respondent and his related interests committed the following new violations: (1) overdrawing accounts on eight occasions, each of which was "corrected" by voluntary repayment within one week of the overdraft and none of which was shown to have exposed the Bank to a possibility of "abnormal risk or loss," (2) failing by virtue of inaction to insure the Bank's compliance with the Cease and Desist Order on five occasions, none of which was alleged to have exposed the Bank to a possibility of "abnormal risk or loss," and (3) the Falcon Production ORE transaction. (Footnotes omitted.)

While noting that the latter transaction involved three new violations and created an abnormal, "albeit ultimately unrealized," risk to the Bank, the ALJ found there is no evidence that Respondent's imposition of such a risk on the Bank was deliberate or was one of a series of voluntary acts over time.

The ALJ also found it "significant" that neither Respondent nor his related interests was alleged to have committed "any type of new violation after November of 1987," and concluded that Respondent was not shown to have demonstrated a willful or continuing disregard for the safety or soundness of the Bank.

Finally, noting that the issuance of a removal order is a discretionary act on the part of the FDIC, the ALJ stated that two additional facts merit consideration:

First, the violations engendered in significant part by the deterioration in Respondent's financial condition were not duplicated at the five other banks which he controlled. Second, Respondent brings to banking an unquestioned array of aptitudes, skills and experience which the industry can ill-afford to lose at this juncture.

The ALJ concluded that the Removal Notice should be dismissed.

#### E. EXCEPTIONS TO THE ALJ'S RECOMMENDED DECISION

Respondent's Exceptions total 45 pages, and refer to and incorporate many proposed findings and conclusions as well as arguments set forth in Respondent's earlier briefs. Petitioner's Exceptions total 65 pages plus a 5-page appendix. Those exceptions of the parties which, after careful review, the Board considers to merit discussion are discussed in the text of the Decision.

## II. SUMMARY OF THE BOARD OF DIRECTORS' DECISION

The Board has carefully reviewed the record, the parties' briefs, exceptions, and other pleadings on the merits and the Recommended Decision. The Board's review of the Recommended Decision was unnecessarily made more difficult by the ALJ's failure to include complete findings of fact and conclusions of law.<sup>14</sup> Nevertheless, the Board finds that the ALJ's statement of the facts and legal conclusions, except as to the appropriate remedies, are supported by the evidence in the record as a whole with certain exceptions which will be noted later. Specifically, the Board agrees with and adopts the statutory and regulatory violations set forth in the Summary of the Recommended Decision, *supra*.

The Board also agrees that the imposition of a civil money penalty is appropriate in this proceeding, although it disagrees with certain of the findings and conclusions of the ALJ in his analysis.

The Board has determined that the ALJ erred by not addressing all of the allegations in the Assessment Notice and Removal Notice and that he should have made findings of fact and conclusions of law as to each such allegation. The ALJ having failed to do so, the Board has undertaken an independent review of those issues that were alleged in the notices and the evidence presented at the hearing but not addressed by the ALJ. These issues are whether the transactions complained of (1) constituted breaches of Respondent's fiduciary duty to the Bank; (2) constituted unsafe or unsound practices; (3) caused substantial loss or damage to the Bank; or (4) could cause serious prejudice to the interests of the Bank's depositors. The Board's Findings of Fact and Conclusions

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<sup>14</sup> See *Docket No. FDIC-87-61e, FDIC-87-62k*, 2 P-H FDIC Enf. Dec. ¶5113 (1988).

{11-30-92 p.A-2020} of Law on these issues are set forth in the Appendix to this Decision.

The Board does not agree that the Removal Notice should be dismissed. For the reasons set forth below, the Board finds, in addition to the numerous statutory and regulatory violations, that Respondent engaged in unsafe or unsound practices and breached his fiduciary duty, resulting in substantial financial loss to the Bank, possible serious prejudice to the interests of the Bank's depositors, and financial gain or other benefit to Respondent; and that such violations, practices, and breaches demonstrate a willful or continuing disregard by Respondent for the safety or soundness of the Bank, in violation of section 8(e) (1) of the FDI Act. Considering all relevant facts of record, the Board in its discretion concludes it is appropriate to remove Respondent as officer and/or director of the Bank and to prohibit Respondent from participation in any manner in the conduct of the affairs of the Bank or any other FDIC-insured institution.

## III. DISCUSSION

### A. VIOLATIONS OF LAW, REGULATION, AND THE CEASE-AND-DESIST ORDER

The Board agrees with and adopts the ALJ's Findings of Fact Nos. 1–27, R.D. at 24–26, and Conclusions of Law Nos. 1–17, R.D. at 41, 42.

1. *MGM Letters of Credit*. The Board agrees with and adopts the ALJ's findings of fact, conclusions of law and discussion of these transactions, R.D. at 2–6; Findings of Fact Nos. 28–50, and Finding of Fact No. 51 after substituting the figure \$250,000 for the figure \$484,606; and Conclusions of Law Nos. 18–20, 25, 28, 31, 33, and 37; and adopts Conclusions of Law Nos. 26, 27, 29, 30, 32, 34, 36, and 38 after substituting the words "continued to violate" for the word "violated" in each such Conclusion, R.D. at 41–

[.2] Respondent takes a number of exceptions.<sup>15</sup> First, Respondent argues that MGM is not an "affiliate" of the Bank, despite his one-third ownership. He claims he acquired his interest in MGM in order to save the Bank from a loss on the 1982 loan to May and Matthews, and that the Bank agreed, in consideration of the pay-off of the May and Matthews loan in early 1983, to issue a stand-by letter of credit to secure the bonding off of the liens in the materialman's suit. Hence, claims Respondent, MGM is a company ". . . where control results from the exercise of rights arising out of a bona fide debt previously contracted..." and therefore excluded from the definition of "affiliate" in section 23A(b)(2)(E) of the Act. For much the same reasons Respondent argues that the letters of credit and loan to MGM are exempt from Regulation O because they represent "indebtedness to a bank for the purpose of protecting the bank against loss ..." under 12 C.F.R. § 215.3(b)(4) and hence ... are not extensions of credit for purposes of Regulation O.<sup>16</sup>

The Board agrees with the ALJ that Respondent's argument with respect to section 23A(b)(2)(E) of the Act is "without logical or factual support," R.D. at 4. The Board has previously held that statutory exceptions to limitations on extensions of credit to related interests must be strictly construed. *Docket No. FDIC—85-82e*, 2 P-H FDIC Enf. Dec. § 5137 (1989). Logically, "control" for purposes of section 23A(b)(2)(E) must be control by the bank.<sup>17</sup> Factually, Respondent's assertions as to his motives in forming MGM and purchasing the assets of TPR, and the existence of an agreement by the Bank to issue a letter of credit if and when needed in exchange for payment of the May and Matthews loan, are unsupported by any evidence except his own testimony.<sup>18</sup> The

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<sup>15</sup> While taking numerous exceptions to the Recommended Decision, Respondent requests that, "the ALJ's recommended decision be adopted insofar as it is consistent with the issuance of a \$50,000.00 civil money penalty," provided removal not be ordered. Respondent's Exceptions at 41. Nevertheless, we will address most of Respondent's exceptions on the merits.

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<sup>16</sup> If the MGM letters of credit and loan do not constitute extensions of credit under Regulation O, many of the lending limit violations alleged in the Assessment Notice and the Removal Notice would be eliminated.

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<sup>17</sup> The argument that an *insider* can gain control of a company by exercising rights arising out of a bona fide debt to the *bank*, and thus avoid insider status for future transactions between the company and the bank, is indicative of Respondent's failure to distinguish between his own financial interests and those of the Bank which he controls.

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<sup>18</sup> Respondent's interpretation of events of 1982 and 1983 was challenged by the testimony of Mr. Wayne Allen Nichols, a loan officer at Citizens National Bank & Trust, Oklahoma City, Oklahoma. He testified with respect in his discussions with Respondent and Matthews and May in December 1982, in connection with MGM's application to that bank for a loan in the amount of \$1.3 million to purchase the assets of TPR. In December 1982, ([Continued](#))

{{11-30-92 p.A-2021}} alleged agreement by the Bank was never reduced to writing in any form, nor is there evidence that any officer or director of the Bank except Respondent was aware of the obligation.<sup>19</sup> The Bank's pre-existing obligation was not discussed at the February 21, 1986, special meeting of the Loan and Discount Committee at which the issuance of the letter of credit was approved. FDIC Ex. 153. The Board must conclude that the obligation was either nonexistent or "authorized" only by Respondent, not the Bank.

Moreover, Respondent's assertion that the Matthews and May loan was a loss in 1982 is unsupported by any evidence other than Respondent's testimony. Indeed, the evidence of record belies Respondent's assertion. In November 1982, when MGM was formed, the May and Matthews loan was 10 months from maturity, the borrowers had a combined net worth of \$7.8 million, and the loan was secured by collateral in addition to that to which the materialmen's liens attached on November 12, 1982, Tr. at 824–833; Resp. Ex. 288.<sup>20</sup>

Finally, the Board finds that in the many discussions between the FDIC and directors of the Bank concerning the serious violations of section 23A and Regulation O related to the MGM transactions, from July 1986 onward, Respondent never mentioned the Bank's 1982 undertaking to issue a letter of credit to MGM, nor claimed that MGM was not an affiliate of the Bank, until after the issuance of the Assessment Notice in December 1988. For example, the joint letter from directors of the Bank dated December 1,

1986, responding to the 1986 Report of Examination and the FDIC's letter dated November 21, 1986, discussing the violations, never mentions the MGM transactions. FDIC Ex. 14. Nor does Respondent's letter to the FDIC dated March 25, 1988, responding to the FDIC's letter dated March 4, 1988 "concerning the violations of certain regulations in Bank of Hydro's examination dated December 31, 1987," assert that MGM is not an affiliate. Rather, the letter states that:

To correct the MGM Production Company violation, we intend to obtain individual loans from the 3 individuals involved in MGM, including myself, to back up the Letter of Credit. The 3 individuals will be responsible for their own debt and separate collateral to secure the debt. These individuals will service the debt out of their own funds and not MGM Production Company's revenue.

Respondent testified, in response to a question by the ALJ, that the first time he mentioned to the FDIC or to any bank examiner for the State his explanation concerning the 1982 loan that resulted in MGM was "when it became apparent to me they were serious in pursuing this action." Tr. at 820.

Based on the record as a whole, the Board must conclude that the alleged nexus between the 1982 May and Matthews loan and the 1986 letter of credit on behalf of MGM while admittedly imaginative was conceived after the fact. The assertions are more instructive as to Respondent's attitude that he and the Bank are one economic entity than as to the true history of the MGM transactions.

For the same reasons, the Board rejects Respondent's argument that the MGM transactions did not constitute extensions of credit under section 215.3(b)(4)(i) of Regulation O.

Respondent next argues that the MGM transactions did not violate the collateral requirements of section 23A(c)(1) of the Act because Respondent's personal guarantee was adequate collateral, citing *Black's Law Dictionary* 238 (5th ed. 1979); *Connelly v. Wells*, 142 Conn. 529, 115 A. 2d 444, 447 (1955); and *United States v. Bland*, 159 F. Supp. 295, 403 (D. Md. 1958). The Board does not dispute that "collateral security" is sometimes defined to include the obligation of a third person. For example, the statutory definition of collateral security under the Maryland Retail Installment Sales Act, which

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<sup>18</sup> Continued: that bank loaned MGM \$450,000 on an unsecured basis but with a negative pledge not to encumber the assets being purchased. The existing collateralized loan to the Bank was never mentioned. The purport of his testimony is that MGM applied for a loan to purchase assets that were considered by the borrowers to be a good business deal, not a bail-out of a loss situation.

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<sup>19</sup> President Schamburg testified that he first learned about the "May and Matthews scenario" in the spring of 1986 before the letter of credit was issued, Tr. at 1001, 1002.

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<sup>20</sup> Apparently, Respondent fails to see the inconsistencies inherent in his arguing that the May and Matthews loan was a loss to the Bank in November 1982, on the one hand, and that his personal loans and the MGM loan should not have been considered losses to the Bank in 1988 and 1989, on the other. [{{11-30-92 p.A-2022}}](#) was at issue in *United States v. Bland*, specifically included "the undertaking of any surety or guarantor for the buyer." In contrast, section 23A(c)(1) of the Act, in specifying the items which are acceptable collateral, does not mention a guaranty. It does require that acceptable collateral have ascertainable market values. A guaranty might be considered an "other debt instrument" under section 23A(c)(1)(C), in which event it would be required to have a market value equal to 120 percent of the amount of the extension of credit. A guaranty could be considered to have an ascertainable market value only if it in turn were secured by collateral with an ascertainable market value.<sup>21</sup> Here, the guaranty was not for 120 percent of the credit extended, and was not secured with collateral. Hence, it could not have met the requirements of section 23A of the Act.

[.3] Finally, the very purpose of the statutory provision would be nullified by the interpretation urged by Respondent. This was an extension of credit to a closely-held corporation controlled by Respondent. The Bank had no financial statement or other information on the corporation or on the other two owners, who failed to respond to the Bank's request for financial statements and failed to sign the notes and guarantees proffered to them, Tr. at 943-54. In other words the Bank, quite properly, considered the MGM letters of credit and loan as extensions of credit to Respondent. For Respondent to be allowed to treat his unsecured guaranty as "collateral" for extensions of credit made for all practical purposes to himself would defeat the very purpose of the statute. For similar reasons, section 23A(c)(4) provides that securities issued by an affiliate of a bank are not acceptable collateral for a loan or credit to any affiliate of that bank.

[.4] Respondent next argues that in July 1986, the Grubb Judgment was pledged as collateral for Respondent's personal guaranty. The Board is of the view that a judgment as to which appeal rights have

not expired cannot qualify as collateral with an ascertainable market value for purposes of section 23A of the Act. Moreover, as stated by the ALJ, the security interest in collateral required by section 23A must be perfected in order to protect depositors from the dangers of inadequately secured insider transactions. *Fitzpatrick v. FDIC*, 765 F. 2d 569 (6th Cir. 1985). There was never a perfected security interest in the Grubb judgment with respect to the MGM letters of credit. The principal only of the April 1988 loan to MGM, charged off as a loss in December 1988, was covered by the 1990 Assignment of the second Grubb judgment, which was perfected on December 4, 1990. Clearly, the collateral requirements of section 23A of the Act were not met for the MGM extensions of credit by the Grubb Judgment.<sup>22</sup>

2. *Overdrafts*. The Board adopts the findings of fact, conclusions of law, and analysis of the ALJ with respect to overdrafts of Respondent and his related interests, R.D. 7–9; Findings of Fact Nos. 52–73, 74 as corrected by changing the account number to 0-659-014, and 75–92, R.D. at 28–31; Conclusions of Law Nos. 39, 41–42, 44–46, 48–51, 53–57, and 59–60; and adopted Conclusions of Law Nos. 40, 43, 47, 52, and 58 after substituting the words "continued to violate" for the word "violated," R.D. at 44–46.

[.5] Respondent argues that the collateral requirements of section 23A were not violated because all of the overdrafts were secured by segregated deposits within the Bank, in accordance with 12 U.S.C. § 84(c)(6). The Board agrees with the ALJ that the right of offset arguably created by the text of the Bank's checking account signature cards does not constitute secured collateral for purposes of section 23A or for purposes of the exemption from Regulation O. See section 32.6(f)(2) & (3) of the Office of the Comptroller of the Currency ("OCC") Rules and Regulations, 12 C.F.R. § 32.6(f)(2) & (3), which the OCC has stated clarifies the fact that a bank may not merely rely on the right of set-off against the deposit in the event of non-payment. 48 Fed. Reg. 15844 (April 12, 1983). The Board has recognized the necessity for an express assignment to the bank where cash collateral is involved. *Docket No. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e*, 1 P-H FDIC Enf. Dec. ¶5049 at A-537 (1985). Respondent also argues that the prior approval requirements of section 215.4(b) were

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<sup>21</sup> The board rejects Respondent's apparent argument that a market value for the guaranty can be calculated from the market values of the items of property listed on the guarantor's personal financial statement.

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<sup>22</sup> Moreover, the posting of collateral in July 1986 for an extension of credit made in February 1986 would not eliminate the previous section 23A(c) violations. The same is true with respect to the 1990 Assignment and the 1987 and 1988 letters of credit and the April 1988 loan.

{11-30-92 p.A-2023}met because a majority of the Bank's board of directors approved the overdrafts "on an individual and daily basis." The Board agrees with the ALJ that, because the Bank's records show that such overdrafts were approved after the disbursement of funds, the burden shifts to Respondent to demonstrate that the challenged overdrafts were approved by a disinterested majority of directors prior to disbursement of funds. The very general testimony of the Bank's President, Fred Schamburg, does not meet this burden, Tr. at 988, 989. Respondent himself admitted that overdrafts may have been approved by a single disinterested director that happened to be at the Bank, Tr. at 901.

Respondent next argues that the overdrafts on his personal account fall within the exceptions of section 215.4(d) of Regulation O.<sup>23</sup> The Board agrees with the ALJ that there is no evidence of a written plan providing for the payment of interest, as required by the first exception; and that the second exception requires an actual transfer of funds between accounts upon the occurrence of an overdraft.

3. *Falcon Production Transactions*. The Board agrees with and adopts the ALJ's analysis of these transactions, R.D. at 9–13 and Findings and Fact Nos. 93–131, R.D. at 31–34; rejects Findings of Fact Nos. 132–135, R.D. at 34, 35; adopts Conclusions of Law Nos. 61–65 and 67–78; and adopts Conclusions of Law Nos. 66 and 79 after substituting the words "continued to violate" for the word "violated," R.D. at 46–47.

Respondent does not contest the violations found with respect to the extension and renewal of the \$110,000 loan to Falcon Production in December 1985 and February 1987.

With respect to the "Other Real Estate" transaction in February 1988, Enforcement Counsel argues that Respondent, as a fiduciary of the Bank, is obligated to repay to the Bank the "equity payments" to Falcon Production totalling \$83,241 because (1) Respondent allegedly received the funds in violation of state law and (2) he allegedly received them as a result of an unsafe or unsound banking practice; hence, the disbursement of the "equity" to Respondent were "extensions of credit" for purposes of section 214.3(a) (8) of Regulation O.

(a) *Violation of State Law*. The state law in question is section 414B of the Oklahoma Banking Code, 6 Okla. Stat. Ann. 414B, which allows a bank to acquire real estate in satisfaction of a previously contracted debt and requires that the acquired real estate be booked at the lower of fair market value or the bank's

"recorded investment." The section further provides that "recorded investment" shall, as relevant, consist of unpaid principal of the debt satisfied, unpaid accrued interest, and "loan acquisition costs." Respondent argues that "loan acquisition costs" is a broad enough term to include payments representing equity made in the course of a loan work-out. FDIC Enforcement Counsel argues that Respondent's interpretation would defeat the very mandate of the statute—to book the real estate at the lower of fair market value or the bank's "recorded investment" —because the debtor's "equity" in the property is the difference between those two figures. The Board agrees with the ALJ that the statutory provisions cited by Respondent as analogous fail to support Respondent's interpretation because they lack the very accounting requirements at issue here; and that the statutory interpretation urged by FDIC Enforcement Counsel is logical and supportive of the basic statutory intent to prohibit risky real estate transactions on the part of banks.<sup>24</sup>

(b) *Unsafe or Unsound Banking Practices*. Respondent argues that, far from being an unsafe or unsound banking practice, the ORE transaction was a good deal for the Bank. It allowed the Bank to "pay off" the \$110,000 loan in default and to obtain a "valuable income producing property" with an "uncontested and substantial value," Resp. Reply Brief at 5.<sup>25</sup> FDIC Enforcement Counsel argues that making substan-

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<sup>23</sup>That section provides:

No member bank may pay an overdraft of an executive officer or director of the bank, unless the payment of funds is made in accordance with (1) a written, pre-authorized, interest-bearing extension of credit plan that specifies a method of repayment or (2) a written, pre-authorized, transfer of funds from another account of the account holder at the bank.

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<sup>24</sup> The Bank Commissioner for the State of Oklahoma ("Bank Commissioner") testified that the payments violated section 414B. Tr. at 490.

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<sup>25</sup> Respondent's assertions as to the estimated and actual revenues to the Bank from the Harmon County farm were contradicted by Bank Examiner Melton, who conducted the 1990 Examination which classified the Falcon [\(Continued\)](#)

[{{11-30-92 p.A-2024}}](#)tial cash "equity" payments to a debtor when collateral security is acquired in lieu of fore-closure upon default is inherently risky and abnormal banking practice, despite the existence of an appraised value in excess of the funds paid out.

The ALJ found that the practice was neither usual nor prudent, and that it transferred the risk of further decline in property value to the Bank. He concluded that the transaction was an unsafe or unsound banking practice and therefore Respondent was not entitled to receive the funds disbursed during the ORE transaction. The Board agrees. Bank Commissioner Wayne H. Osborn testified that in his experience as an expert in banking affairs in the state of Oklahoma, he had never seen an ORE transaction handled this way, and that he would not have allowed it for the simply reason that the Bank could possible suffer some future loss, Tr. at 493.<sup>26</sup>

The Board concludes that the "equity" payments to Falcon Production, for the benefit of Respondent, violated state law and were unsafe or unsound banking practices, and Respondent is obligated to repay the Bank because these payments were made in violation of his fiduciary duty to the Bank.

As a consequence, the payments constituted extensions of credit under Regulation O, which defines an "extension of credit" to include:

(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)(8). The Board recently held that any debtor-creditor relationships is, by definition, an extension of credit at the time the obligation arises, unless specifically excepted by the regulation. *In the Matter of Ira lee Brannan, David Brannan, and Stephen L. Brannan, Freedom Bank, DeLeon, Texas*, Docket No. FDIC-91-37k, 2 P-H FDIC Enf. Dec. ¶5176, at A-1963 (1992). The "equity payments" violated the lending limits of section 215.4(c) of Regulation O; and, because made without provisions for interest and repayment, violated the comparable terms requirements of section 215.4(a)(1) of Regulation O; and, because the extensions were undocumented and made to a borrower with other loans adversely classified, violated the creditworthy requirements of section 215.4(a)(2) of Regulation O.

4. *Respondent's Personal Loans*. The Board adopts the ALJ's Findings of Fact Nos. 136–153, R.D. at 35, 36; and Conclusions of Law Nos. 80–82, 84–86, 88–90, and 92–94; and adopts Conclusions of Law

Nos. 83, 87, 89, 91 and 95, after substituting the words "continued to violate" for the word "violated," R.D. at 47, 48.

The ALJ found that each of the four loans made to Respondent during 1986 and 1987 violated the lending limits of section 215.4(c) of Regulation O.<sup>27</sup> He also concluded that because Respondent on each of the four occasions sought to borrow money from a bank which he controlled in violation of the lending limits of Regulation O, each of the loans had an "unfavorable feature" violative of section 215.4(a)(2) of Regulation O, citing *Docket No. FDIC-84-23b*, 1 P-H Enf. Dec. ¶5061 (1986). The Board concurs.

At the administrative hearing, Respondent challenged each of the Reports of Examination for adversely classifying loans made to or guaranteed by Respondent. Respondent appears to argue that the adverse classification of his loans in the 1985 Report of Examination was erroneous, and therefore the credits made to him or with his personal guaranty in late 1985 (Falcon Production) and 1986 (MGM Letter of credit, personal loans to Respondent) cannot be said to contain unfavorable features. First, as we have stated above, the 1986 loans to Re-

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<sup>25</sup> Continued: Production ORE "Substandard." He testified that he could substantiate Bank revenues from the farm of \$14,000 in 1988, \$12,400 in 1989, and \$18,000 in 1990, resulting in yields on the Bank's investment in the property (\$342,000) of 4.09% in 1988 and 3.5% in 1989.

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<sup>26</sup> President Schamburg testified that he was unaware of any similar transaction during his six year tenure with the Bank, although "I have talked with legal counsel that knows of two instances in Oklahoma that that's been done," Tr. at 1029. However, the Bank's own expert witness could recall only two similar instances in his career as a bank examiner with the OCC and the Federal Reserve Board, and both involved banks with severe regulatory problems which eventually failed, Tr. at 1141, 1142. Respondent introduced no evidence concerning similar transactions.

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<sup>27</sup> The October 29, 1986, loan to Respondent in the amount of \$100,000 exceeded the lending limits of section 215.4(c) of Regulation O even if the MGM extension of credit were not taken into account. See Findings of Fact Nos. 145–148, R.D. at 35, 36.

{11-30-92 p.A-2025} Respondent had "unfavorable features" which are unrelated to the adverse classification of Respondent's previous loans. Second, the Board has frequently held that classifications of loans and other assets made by FDIC bank examiners are entitled to deference by the Board and should not be overturned unless shown to be arbitrary or capricious, without factual basis, or outside a zone of reasonableness. See *Docket Nos. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e*, 1 P-H FDIC Enf. Dec. ¶5049 (1985), *aff'd., Sunshine State Bank v. FDIC*, 783 F. 2d 1580 (11th Cir. 1986). "Unless shown to be arbitrary or capricious or outside a zone of reasonableness, the ALJ, the Board and the courts must give significant deference to [FDIC bank examiners]," *id.*, at 1584. After careful review of the testimony of Examiner Dennis Kanter, Tr. at 145–168, the 1985 Report of Examination, FDIC Ex. 1, and the statement of financial position of Respondent and his wife as of December 31, 1983, and December 31, 1984, FDIC Ex. 284, the Board finds that the adverse classifications of Respondent's loans in the 1985 Report of Examination were reasonable and appropriate.

Respondent also argues that his personal loans were secured with collateral in the form of the Grubb Judgment and hence did not violate the creditworthy requirements of section 215.4(a)(2) of Regulation O. As noted earlier, the assignment to the Bank was not perfected until February 1989, and it was known to the Bank that at least one and possibly more other banks had prior liens on the judgment. Within days after perfection of the assignment, the value of the 1985 judgment was substantially diminished by the decision in *Grubb v. FDIC*, 868 F. 2d 1151 (10th Cir. 1989). When Respondent rejected the remittitur of some \$220,000 in July 1989, the judgment had essentially no direct recovery value. The next assignment of the Grubb Judgment to the Bank did not occur until November 1990, after Respondent's personal loans had been written off by the Bank, and that assignment was not perfected until December 1990.

Without deciding whether a judgment as to which appeal rights have not expired can ever be considered appropriate collateral for purposes of section 215.4(a)(2) of Regulation O, the Board finds that the facts here—the delay in assigning the judgment, the delay in perfecting the assignment, and the value of the judgment when assignment was perfected—preclude a determination that assignment of the Grubb Judgment with respect to Respondent's personal loans satisfied the creditworthy requirements of section 215.4(a)(2) of the Regulation O.

5. *Cease-and-Desist Order*. The ALJ found that all alleged violations of the Cease-and-Desist Order did in fact occur. Respondent contests the allegation that the Bank's loan policy was not amended to incorporate changes required by the FDIC. The Board agrees with the ALJ that the weight of the evidence shows that the required changes were not incorporated by the Bank. Respondent does not contest the two violations involving capitalizations of interest. As to the violations relating to failure to

document reasons for extensions of credit to classified borrowers and for purchasing a loan participation, Respondent argues that the failure was the responsibility of Bank President Schamburg. The Board agrees with the ALJ that Respondent, as a member of the Bank's board of directors, had an affirmative obligation to monitor and insure the Bank's compliance with the provisions of the Cease-and-Desist Order. See *Docket No. FDIC-85-303k*, 1 P-H Enf. Dec. p 5089 at 7090 (1987). This is particularly true with respect to Respondent, who was severely criticized for his lending policies and practices in the 1985 Report of Examination which engendered the Cease-and-Desist Order, who agreed to remove himself from lending activities at the Bank during the 1985 Examination, FDIC Ex. 1, and who proposed the transactions as to which the Board failed to document its reasons for approval, Jt. Stip. 184–188.

[6] The ALJ found that "none of the foregoing violations resulted in a loss to the Bank." The Board declines to adopt this finding. The only evidence in the record on this point indicates that there might well have losses associated with some of the transactions involved in these violations.<sup>28</sup> If troublesome transactions are properly discussed and documented in the minutes, they will

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<sup>28</sup> The Duke extension of credit at issue, in the amount of \$10,000, was adversely classified as "Substandard" in the 1989 Report of Examination, FDIC Ex. 4 at 2-a-1. The 1990 Report of Examination notes that of the Duke loans totalling \$350,00 in 1989, \$56,000 has been taken into ORE or Other Assets, \$83,000 paid in cash, and [\(Continued\)](#)

[{{11-30-92 p.A-2026}}](#) likely not obtain approval without strong supporting reasons, which of course is the purpose of the Cease-and-Desist Order provision in question.

The Board adopts Findings of Fact Nos. 154–157, 159–161, 163–168, and 170; adopts Findings of Fact Nos. 158 and 162 after adding at the end of each the sentence, "Respondent was responsible for the loan transaction and it was conducted at his request;" and rejects Finding the Fact No. 169, R.D. at 36–38; and adopts Conclusions of law Nos. 96–100, R.D. at 48, 49.

## B. CIVIL MONEY PENALTY

The five statutory factors the Board is required to consider are: the size of the financial resources and good faith of the person charged, the gravity of the violations, 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).<sup>29</sup>

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 Respondent and others from future violations of banking laws and regulations. See, generally, *In the Matter of \*\*\* Bank*, Docket No. FDIC-85-2k, 1 P-H FDIC Enf. Dec. ¶5063 (1986); *In the Matter of Ira Lee Brannan, David Brannan, and Stephen L. Brannan, Freedom Bank, DeLeon, Texas, supra*.

First, the Board agrees that Respondent has committed violations of laws and regulations which render him liable for the payment of a civil money penalty. The Board disagrees with certain of the findings of fact, observations, and conclusions of law of the ALJ on this subject, as discussed below.

Each of the five statutory requirements is discussed below.

1. *Financial Resources*. The Board adopts all of the ALJ's findings on financial resources, R.D. at 16, except for his final finding that, as long as Respondent continues to receive the stipulated remuneration for his activities as a banker, he will have sufficient financial resources to allow him to pay a \$50,000 civil money penalty. The substantial evidence of record is that Respondent's financial resources will allow him to pay a much larger penalty, whether or not he continues to receive banking income.<sup>30</sup> Respondent's December 31, 1987, joint financial statement, FDIC Ex. 287, showed a net worth of \$1,099,000. While assets included the \$2,750,000 Grubb Judgment, Respondent has in fact been paid \$3,717,000 as a result of that lawsuit, thereby significantly improving his asset position and reducing interest expenses. The Board finds the record supports a conclusion that Respondent has the financial resources to pay a substantial civil money penalty, even after full repayment to the Bank of the losses suffered on the transactions at issue here.

2. *Good Faith*. The Board disagrees with several of the ALJ's conclusions concerning Respondent's good faith. First, the Board disagrees that the fact that no prohibited overdrafts or violations of the Cease-and-Desist Order occurred after November 1987 demonstrates that Respondent made a successful effort to "correct" these types of violations. More to the point is the fact that numerous prohibited overdrafts occurred after the 1986 Report of Examination set forth numerous violations of law and regulations related to overdrafts of Respondent and his related interests, and the bank examiners had discussed them with Respondent.<sup>31</sup> These over-

28 Continued: \$49,000 charged against loss reserves, and \$54,000 adversely classified as "Substandard" (over the Bank's strong disagreement). FDIC Ex. 335 at 2-a-3. The Stickler loan participation of \$197,000 was adversely classified "Substandard" in the 1990 Report of Examination, FDIC Ex. 335 at 2-a-10.

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29 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 \$1,500,000 for the gross period of time that credit attributable to Respondent were in an overline position, counting the overline as only one violation of Regulation O.

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30 The Board disagrees with the ALJ's statement that the only evidence in the record concerning Respondent's "actual income" is that relating to his various salaries as a banker and hence there is no evidence to support a finding that he would have the financial ability to pay a civil money penalty if he is removed from banking, R.D. at 16, n. 39. Joint Stipulation of Fact No. 200 states that as of December 31, 1989, Respondent's total income was \$450,117.08. Joint Stipulations of Fact Nos. 201–205 state that Respondent's annual salaries from banks total \$204,000. Respondent testified that he could pay a \$50,000 civil money penalty over three years if the Grubb Judgment were paid. Tr. at 1099.

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31 The overdrafts occurring after the July 1986 Examination are not minor violations. Respondent's joint account with his wife was overdrawn from 8-26-86 to 9-1-86 by over \$11,000; the RGI account was overdrawn for two days in August 1986 by \$4,000, from September 10–27, 1986 by amounts ranging from \$12,000 to \$45,000, [\(Continued\)](#) [{{11-30-92 p.A-2027}}](#) drafts did not cease until the Bank Commissioner issued further written warnings to the Bank in October and December, 1987, FDIC Ex. 337 and 339, more than one year later. Finally, the Falcon Production ORE payment of \$48,663 to Falcon Production on February 17, 1988, was made to cover an insufficient funds item which the Bank was holding, which had been drawn by Respondent in order to pay Respondent's personal loan at the Bank's affiliate, First State Bank of Mooreland, Mooreland, Oklahoma. Tr. at 400, FDIC Ex. 335 at 6-a-1.

Second, the Board rejects the ALJ's conclusion that Respondent's failure to repay the loans in question at an earlier date, causing repeated violations because the Bank renewed the prohibited loans, is excused by Respondent's inability to repay the loans at an earlier date. There may be situations in which a respondent's financial inability to correct a violation would be a mitigating factor in determining the respondent's good faith. In this proceeding, however, it clearly is not. Respondent's ability to repay was in question at the time the improper extensions of credit at issue here were first made in 1985, 1986, 1987, and 1988, as evidenced by the fact that loans to Respondent were classified in the 1985, 1986, and 1987 Reports of Examination.<sup>32</sup> Moreover, Respondent could have attempted to liquidate certain of his property which he argues was collateral security for his defaulted loans—such as his silver bars and valuable art work, Tr. at 652, and the real estate which was purportedly mortgaged to secure Respondent's personal loans in April 1987—in order to pay off or reduce one or more of the loans, but he did not do so. In the same manner, if Respondent was entitled to "equity payments" in connection with the Falcon ORE transaction in 1988, as he argues, why was the so-called equity not at least credited to Respondent's obligations at the Bank, rather than paid to him in cash?

The Board finds that, taking into account only the real property pledged or attempted to be pledged with respect to the Falcon Production loan and Respondent's personal loans, Respondent could have corrected many of the violations involved in this case had he caused those properties to be liquidated and the proceeds applied to the reduction of outstanding loans.

The Board also rejects the ALJ's finding that there is no evidence that Respondent failed to cooperate with Petitioner or the State with respect to any matter cited in the Assessment Notice or Removal Notice. The Board finds that all of the violations of law and regulations occurring after the July 1986 Examination are evidence of Respondent's failure to cooperate with the FDIC and the State with respect to prohibited transactions—the overdrafts and the October 1986 loan of \$100,000 to Respondent, which were the same types of transactions of which Respondent had been warned in July 1986, and the Falcon Production ORE transaction.

[.7] The Board agrees with the ALJ that Respondent's attitude with respect to the Falcon Production ORE transaction is representative of his general attitude toward the Bank, that is, he has often treated the Bank's resources as if they were his personal purse which he might employ without regard to regulatory restraints, R.D. at 18. This attitude, and the transactions which demonstrate it, do not reflect well on Respondent's good faith for purposes of a civil money penalty.

3. *Gravity of the Violations.* The R.D. states that the gravity of Respondent's violations may be

measured by (1) the effect of those violations upon the Bank and (2) the extent to which Respondent benefited from the violations. As to the first measure, the ALJ found that the Bank's aggregate extensions of credit to Respondent and his related interests were continuously in excess of regulatory limits between February 1986 and December 1990, but concluded that the "weight" of this lengthy duration is less-

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<sup>31</sup> Continued: on October 26, 1986 by \$40,993, and on various occasions in April, May, June, August, September, and November, 1987, by amounts ranging from \$308 to \$13,452; the MGM account was overdrawn for a week in September 1986 by amounts ranging up to \$712, and by over \$6,000 on January 6 and 7, 1987; and Falcon Management was overdrawn by \$1,610 on October 27 and 28, 1987. The largest of these overdrafts, on the RGI account, were caused by an \$80,000 check signed by Respondent and a check for \$60,099.58 signed by Respondent 1987 Report of Examination, FDIC Ex. 3 at 6-a-2 and 6-a-3.

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<sup>32</sup> The ALJ based his finding that Respondent was unable to pay on Respondent's "uncontroverted testimony" and the expert testimony of FDIC bank examiner Adams that "as early as 1986, Respondent was unable to meet his outstanding debts except by further borrowing..." R.D. at 17, footnote 50. Examiner Adams' testimony supports the Board's conclusion rather than that reached by the ALJ. [{{11-30-92 p.A-2028}}](#)ened by Respondent's financial inability to make restitution prior to November 1991. Again, the Board rejects this conclusion because it was apparent at the time the prohibited extensions of credit were first made to him or guaranteed by him that Respondent was a credit risk, and because he did not use the resources which he testified were available to the Bank to curtail the prohibited

transactions.<sup>33</sup> The Board finds that the number, size, and the lengthy duration of the prohibited extensions of credit to Respondent and his related interests all reflect the serious gravity of the violations.

With respect to the economic benefit received by Respondent, the Recommended Decision notes that this Board has concluded as a matter of law that any receipt of credit which should not have been received is an indirect economic benefit to the recipient, citing *In re R. Wayne Lowe*, Docket No. FDIC-89-21k, 2 P-H FDIC Enf. Dec. ¶5153 (1990). However, the Recommended Decision then states that the correct method of quantifying the benefit in this case is by the amount of "actual loss" to the Bank, citing *Docket No. FDIC-85-87k*, 2 P-H FDIC Enf. Dec. ¶5119 (1988). The ALJ holds that loans to Respondent and his related interests which were written off as "loss" but subsequently "voluntarily returned to the Bank" cannot be considered in calculating the amount of benefit to the violator. The ALJ then finds that the Bank suffered "significant actual losses" because of unpaid accrued interest of \$10,895 on Respondent's personal loan and \$12,979 on the extension of credit to MGM, R.D. at 20; and concludes that the "minimum civil money penalty which can be imposed in this proceeding is \$23,874," and that the penalty actually imposed should substantially exceed that minimum.

[.8] The Board rejects the "gravity" calculations made by the ALJ in several respects. The purpose of civil money penalties is to reduce risk to financial institutions by discouraging the types of insider transactions which experience has shown to be the major cause of bank failure. To hold that prohibited transactions "don't count" for civil money penalty purposes if the insider repays them, would eliminate the major deterrent purpose of civil money penalties. As the Board held in *Docket Nos. FDIC-85-82e, FDIC-85-83k*, 2 P-H FDIC Enf. Dec. ¶5137 at A-1463-64 (1989), the fact that charged off portions of a prohibited loan are ultimately recovered does not eliminate or excuse the existence of the violation of Regulation O. Likewise, loans which have been classified "Loss" and written off can be considered losses for purposes of quantifying the gravity of violations, even if later repaid.<sup>34</sup> Repayment may be taken into account as a mitigating factor, "as justice may require." The Board also rejects the ALJ's conclusion that unpaid interest on the Falcon Production loan and the equity payments in the ORE transaction, although required by the Bank Commissioner to be written off as "Loss," should not be included in calculating loss to the Bank because the Bank "would not necessarily suffer a loss," R.D. at 20, footnotes 59 and 60, apparently because the value of the ORE will cover them. There are few transactions which demonstrate greater "gravity of violation" than the Falcon Production ORE transaction equity payments of Respondent. Those amounts, as well as the unpaid interest on the underlying loan, have been written off as losses to the Bank. The fact that such amounts may ultimately be recouped by the Bank does not detract from the gravity of the violations involved or the risk to the Bank at the time the transaction was consummated. Moreover, the loss to the Bank from the Falcon Production transactions appears to be greater than the sum of the unpaid interest and equity payments written off. The low revenue received on the ORE, as set forth in the April 27, 1990 Report of Examination, means that the Bank has suffered and continues to suffer lost opportunity on the significant funds it has invested in this transaction.

The Board concludes that the Bank incurred the following direct losses with respect to the extensions of credit to Respondent and his related interests which are the subject of this proceeding:

MGM loan	\$248,780
Falcon Production loan	14,311
Falcon Production ORE funds	83,241
Respondent's personal loans	259,701
Total	\$606,033

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<sup>33</sup> See Respondent's testimony at Tr. 652, 653.

<sup>34</sup> The case cited by the ALJ for the "actual loss" proposition, *Docket No. FDIC-85-87k*, 2 P-H FDIC Enf. Dec. ¶15110 (1988), involved loans which, as here, had been classified "Loss" by bank examiners and therefore written off.

{{11-30-92 p.A-2029}}

These amounts are in addition to the losses of opportunity resulting from the Bank's inability to utilize funds tied up in ORE and in charged off loans.

Finally, the Board is of the view that in this case the benefit to Respondent substantially exceeded the loss to the Bank. In addition to the loans charged off as "Loss", Respondent received the benefit of \$281,527 in prohibited overdrafts. While these were all repaid, Respondent had the use of funds which were obviously needed for some purpose. Moreover, all of the loans and overdrafts gave Respondent access to funds which he could not have obtained elsewhere, at least not on the same terms, on an arm'slength basis. The Board also notes that Respondent was never charged interest on the Falcon Production ORE payments he received in February 1988 or interest on the other extensions of credit at issue here after they were charged off by the Bank in 1988 and 1989. While difficult to quantify, the Board finds that the benefit to Respondent of unpaid interest on the Falcon Production ORE payments and the charge-off loans to Respondent and to MGM amounted to at least \$150,000,<sup>35</sup> and that the total benefits to Respondent resulting from the prohibited transactions amounted to at least \$200,000 in addition to the losses of \$121,426 which have not been repaid.

4. *History of Previous Violations.* The ALJ found that the 1986, 1987, and 1989 Examination Reports contain specific criticisms and discussions of numerous alleged violations of Regulation O, section 23A and the Act and the FDIC's Cease-and-Desist Order. The Board agrees.

[.9] 5. *Matters Required by Justice.* The Board declines to adopt the ALJ's finding that significant improvements in the Bank's financial condition took place under Respondent's management between 1985 and 1991. The evidence in the record is at best mixed. The condition of the Bank did improve between 1985 and 1991, moving from the CAMEL rating of 4 to a rating of 3. However, the 1985 Report of Examination noted that the Bank's condition reflected a serious deterioration from the previous examination; that loan classifications had doubled; that 53 percent of all classified loans were originated by Respondent; and recommended that Respondent completely divorce himself from the loan area. At the conclusion of the 1985 Examination, Respondent resigned as chairman of the board and removed himself from the lending area. Moreover, the November 29, 1985 Ceaseand-Desist Order, promulgated as a result of the 1985 Examination, was a very significant factor in the improvement in the Bank's condition.

Finally, the Board is of the view that rarely if ever would improvement in a bank's financial condition be a matter required by justice to be considered in determining the amount of a civil money penalty. The purpose of civil money penalties is to deter abusive insider conduct which has traditionally been a major cause of bank failures. That purpose would be substantially defeated if only those instances of conduct which ultimately result in damage to the affected bank's condition could be punished.

The Board does agree with the ALJ's conclusion that in the Falcon Production ORE transaction the Respondent misused his position to obtain additional credit denied him by law while retaining the power to reassert control over the real estate he conveyed to the Bank, in breach of his fiduciary duty to the Bank, R.D. at 21.

The Board also notes that the repayment made by Respondent in November 1991 of

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<sup>35</sup> The ORE payments totalling \$83,241 were made in February 1988. No interest has ever been charged on this extension of credit.

The MGM loan of \$235,801 was made in April 1988. Principal and accrued interest totalling \$248,780 were charged off in December 1988. No interest has accrued since that date. Respondent repaid the principal only in November 1991.

The terms of Respondent's April 1987 loan of \$250,000 were clearly more favorable than terms being offered other customers of the Bank. Respondent defaulted on the loan in August 1988. The Bank

charged off accrued but uncollected interest of \$10,895 in December 1988, and the unpaid principal of \$248,806 in June 1989. No interest was charged after December 1988. Respondent repaid the principal only in November 1991.

Without compounding interest and without including the below-market interest charged on Respondent's loan from April 1987 to December 1988, a rough but conservative calculation of interest not charged follows:

\$83,241 × 8% × 4.5 years	\$29,966
235,801 × 8% × 3.0 years	56,592
250,000 × 8% × 3.0 years	60,000
Total	\$145,458

{{11-30-92 p.A-2030}}the principal amounts of the MGM loan and his personal loans is appropriately a matter to be considered in mitigation of the size of the penalty.

Finally, the Board adopts the ALJ's conclusion that imposition of a civil money penalty in this case is supported by substantial evidence of record.

In summary, the Board finds that Respondent and his related interests received prohibited extensions of credit totalling \$606,033 that resulted in a loss to the Bank, of which amount Respondent has repaid the Bank \$484,606.98, leaving a balance of \$121,426 of loss to the Bank; that Respondent and his related interests received the additional benefit of \$281,527 in prohibited overdrafts, none of which resulted in a loss to the Bank, and additional benefits as a result of the prohibited transactions, including interest of at least \$150,000 not charged by the Bank, totalling more than \$200,000; and that Respondent is responsible for the alleged violations of the Cease-and-Desist Order. The Board concludes, on the basis of all relevant evidence in the record, that a civil money penalty of \$50,000 is clearly warranted.<sup>36</sup> The Board is certain that the Bank will take all necessary steps to recover the additional losses of \$121,426 and the interest never charged of approximately \$150,000.

The Board adopts Findings of Fact Nos. 171 through 176, 178, 179, 181, 183, 185, 190–191, and 195; rejects Findings of Fact Nos. 177, 180, 182, 184, 186–189, 192–194; and adopts Conclusions of Law Nos. 102–109.

## C. REMOVAL

### 1. *Factors Not Considered in the Recommended Decision.*

In considering the question whether Respondent should be removed from participation in the Bank's affairs and prohibited from participating in the affairs of any FDIC-insured institution, the ALJ did not review all of the statutory criteria. The ALJ did not consider Petitioner's proposed findings of fact and conclusions of law relating to Respondent's breaches of fiduciary duty and unsafe or unsound banking practices, and relating to whether Respondent's conduct caused substantial loss or damage to the Bank or could cause serious prejudice to the interests of the Bank's depositors.<sup>37</sup> This was error on the part of the ALJ. The Board has therefore carefully reviewed the record as a whole and the parties' proposed findings of fact and conclusions of law, and has made additional Findings of Fact and Conclusions of Law with respect to the statutory criteria not considered by the ALJ, which are set forth in the Appendix to this Decision. The Board's analysis of the application of these statutory criteria to the transactions in question follows.

#### (a) *Breaches of Respondent's Fiduciary Duty to the Bank.*

It is well established that bank directors and officers have a fiduciary duty to the bank to act diligently, prudently, honestly, and carefully in carrying out their responsibilities and must ensure their bank's compliance with state and federal banking laws and regulations. *Docket No. FDIC-87-61e*, 2 P-H FDIC Enf. Dec. ¶5113 at A-1243 (1988); *Docket No. FDIC-85-356e*, 2 P-H FDIC Enf. Dec. ¶5112 at A-1235 (1988). This duty requires the proper supervision of subordinates, a knowledge of state and federal banking laws, and the constant concern for the safety and soundness of the bank, *id.* at A-1235. "The greater the authority of the director or officer, the broader the range of

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<sup>36</sup> At the time of the Assessment Notice and at the time of the hearing, Respondent's financial resources were considerably smaller than they became in November 1991 with the settlement of the Grubb Lawsuit. In November 1991 FDIC Enforcement Counsel had no opportunity to amend the Assessment Notice to increase the amount of the penalty.

<sup>37</sup> An action under pre-FIRREA section 8(e)(1) requires the FDIC to prove at least one of the factors in

each of the following three numbered paragraphs:

1. That a director, officer or person participating in the conduct of the affairs of an insured bank has:
  - (a) committed any violation of law, rule or regulation or of a cease and desist order which has become final; or
  - (b) engaged or participated in any unsafe or unsound practice in connection with the bank; or
  - (c) committed or engaged in any act, omission or practice which constitutes a breach of his fiduciary duty as a director or officer; *and*
2. That as a result of such violation, practice or breach:
  - (a) the bank has suffered or will probably suffer substantial financial loss or other damage; or
  - (b) the interest of the bank's depositors could be seriously prejudiced; or
  - (c) the director or officer has received financial gain; and
3. That the violation, practice or breach of fiduciary duty is either:
  - (a) one involving personal dishonesty on the part of the director or officer; or
  - (b) one which demonstrates a willful or continuing disregard for the safety or soundness of the bank. **{{11-30-92 p.A-2031}}**his duty; the more complex the transaction, the greater the duty to investigate, verify, clarify, and explain," *id.* at A-1235.

Respondent is the consummate bank insider. He owns 94 percent of the Bank, the board of which is dominated by—at times consisting solely of—Respondent's relatives and Bank employees. When Respondent resigned as chairman of the Bank in 1985 on the advice of the FDIC, he promoted to president a young man 26 years old who had worked for the Bank since graduating from college in 1981. One of the FDIC bank examiners testified at the hearing that, "[w]hen I made mention that I wanted to discuss these items in front of the entire board, Mr. Grubb stated to me that he was the board of directors of this Bank." Tr. at 320.<sup>38</sup> Because of his degree of control, Respondent owed the Bank the highest degree of fiduciary care.

Respondent breached his fiduciary duty to the Bank. First he breached his obligation to see that the Bank operated in compliance with law and regulations, *Docket No. FDIC-85-42b*, 1 P-H FDIC Enf. Dec. ¶5062 at A-791, 792, and A-952 (1986). Moreover, he ignored a series of warnings of federal and State regulators regarding violations and unsafe and unsound practices, *Docket No. FDIC-85-215e*, 1 P-H FDIC Enf. Dec. ¶5069 at A-952 (1986); *Docket Nos. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e*, 1 P-H FDIC Enf. Dec. ¶5049 at A-582 (1985); *Docket No. FDIC-85-165k*, 1 P-H FDIC Enf. Dec. ¶5065 at A-864 (1986).

Second, he proposed and personally benefited from transactions in which his personal interests and the Bank's interests were in conflict. The Board has held such conduct to constitute a breach of an officer's or director's fiduciary duty, *Docket Nos. FDIC-87-61e, FDIC-87-62k, supra. See also Hoffman v. FDIC*, 912 F. 2d 1172 (9th Cir. 1990). As the ALJ concluded, in the Falcon Production ORE transaction, Respondent misused his position to obtain additional credit denied by law while retaining the power to reassert control over the real estate he conveyed to the Bank, in breach of his fiduciary duty, R.D. at 21. Where a conflict of interest exists, directors have a duty to take extra precautions to protect the Bank's interest, *Docket Nos. FDIC-87-61e, FDIC-87-62k, supra*, at A-1244.

[.10] Respondent's testimony reveals that he ignored or perhaps failed to understand the conflicts created by transactions which he devised for his own benefit. For example, Respondent argued that the Falcon Production ORE transaction was in the best interest of the Bank because his son Shawn, the "actual owner" of Falcon Production, would not have allowed and permitted the Bank to have foreclosed and taken that farm and lost the equity in it without some type of bankruptcy proceeding or some other litigation, Tr. at 640. In so doing, Respondent acts as if he is discussing an arm's-length transaction—despite his testimony that he transferred ownership of Falcon Production to his 20-year-old son Shawn in 1985 for "tax-planning" purposes, Tr. at 630; that the purpose of the December 31, 1985, loan of \$110,000 to Falcon Production was so that Respondent could transfer a valuable mineral lease to his son, Tr. at 630; and that he transferred the Harmon County Farm to Falcon Production, taking back a note for \$405,000, representing the value of the property above the first mortgage, Tr. at 632-35; and the fact that Respondent has been granted a power of attorney by his son to conduct the business of Falcon Production. Respondent's argument that he obtained control of MGM in exercise of rights arising out of a bona fide debt to the Bank previously contracted<sup>39</sup> is another example of his failure to distinguish between his own interests and those of the Bank. The Board concludes that Respondent failed to take even rudimentary precautions to protect the Bank's interests with respect to transactions from which he benefited.

Respondent also breached his fiduciary duty by allowing the Bank to engage in the unsafe or unsound practices which are discussed below.

- (b) *Unsafe or Unsound Banking Practices*. Unsafe or unsound practices are defined, in part, as:

. . . any action, or lack of action, which is contrary to generally accepted stand-

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<sup>38</sup>For example, when Respondent was in the process of selling BancCentral and was required to move the MGM letter of credit to another bank, he simply telephoned President Schamburg and arranged the transaction, Tr. at 943–947. The letter of credit was issued without any financial information on MGM, Tr. at 1013, and prior to approval by the directors of the Bank.

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<sup>39</sup> See n. 17, above.  
{11-30-92 p.A-2032}

ards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

*Financial Institutions Supervisory and Insurance Act of 1966: Hearing on S. 3158 Before the House Comm. on Banking and Currency, 89th Cong., 2d Sess., 49–50 (1966).*

The Board has held that it is inherently unsafe or unsound to make a loan "without regard for the borrower's ability to make repayment." *Docket No. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e*, 1 P-H FDIC Enf. Dec. ¶5049 at A-492. The improper perfection of a security in personal property has also been held by the Board to constitute an unsafe or unsound banking practice. *Docket No. FDIC-84-58e*, 1 P-H FDIC Enf. Dec. ¶5042, at A-388 (1985). Making a secured loan without proper title information, without proper appraisals, or with a cloud on the title to collateral, are also unsafe or unsound banking practices, *Docket Nos. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e*, 1 P-H FDIC Enf. Dec. ¶5049 at A-530 (1985), as are making secured loans based on inadequate collateral, and making loans which violate section 23A, also are unsafe or unsound banking practices. *Id.*, at A-492.

[.11] The transactions which are at the heart of this proceeding were unsafe and unsound banking practices. The MGM letters of credit were issued after the underlying mechanic's lien lawsuit had been lost, without collateral (which had been required by the previous bank), without any financial information on the borrowing corporation, and based on the personal guaranty of a Bank insider whose outstanding loans had been adversely classified by bank examiners. Respondent's personal loans were extended in violation of Regulation O, without collateral or with unperfected security interests in collateral, and at times when Respondent's financial condition had been found by bank examiners not to support substantial loans, at least without adequate collateral security. The Falcon Production loan was made to a corporation with a negative net worth, without a proper appraisal of the property offered as security, and at a time when the outstanding loans to Respondent, the guarantor and beneficiary of the loan, were adversely classified. The Falcon Production ORE transaction violated State law, increased the risk of loss to the Bank, and allowed Respondent to obtain additional cash funds at a time when the Bank was prohibited from extending him additional credit. The Board concludes that these were abusive insider transactions and constituted unsafe or unsound practices.

[.12] (c) *Substantial Financial Loss to the Bank*. The Board has concluded that the Bank incurred losses totalling \$606,033 on loans to Respondent and his related interests, in addition to the lost opportunities suffered by the Bank as a result of the transactions at issue here. See page 63 above. Respondent has repaid some of these losses, amounting to \$484,607, Resp. Late-filed Ex. 330. However, the Board has held that the determination whether a bank has suffered, or probably would suffer, a substantial financial loss is to be made as of the time of issuance of the Removal Notice. *Docket Nos. FDIC-83-252b&c, FDIC-84-49b, FDIC-84-50e, supra; Docket No. FDIC-85-215e, supra*. Moreover, subsequent redemptive acts are irrelevant to a removal action. Unlike the factors to be considered in determining the appropriate dollar amount of a civil money penalty, there are no mitigating criteria under the removal statute. *Docket No. FDIC-85-215e*, 1 P-H FDIC Enf. Dec. ¶5069 at A-961 (1986).

The Board concludes that as a result of Respondent's violations, breaches of fiduciary duty and unsafe or unsound banking practices, the Bank has suffered or will probably suffer substantial financial loss or other damage. The financial loss to the Bank is considered substantial even if Respondent's repayments are taken into account. See *In the Matter of William Marvin Clark, Sr.* FDIC-89-199e, 2 P-H FDIC Enf. Dec. ¶5162 (1991), where the Board held that a loss resulting in charge-offs of \$148,000 constituted "substantial financial loss."

[.13] (d) *Serious Prejudice to the Interests of Depositors*. When the Removal Notice was issued in July 1989, the Respondent's violations of law, breaches of fiduciary duty and unsafe or unsound practices had

resulted in losses to the Bank on loans to or guaranteed by Respondent totalling \$606,033. Respondent's joint financial statement with his spouse dated December 31, 1987, showed total assets of \$8,407,600 and a net worth of \$1,099,300 with contingent liabilities of \$15,726,500. Major assets listed. [{{11-30-92 p.A-2033}}](#) included the Grubb Lawsuit anticipated recovery of \$2,750,000, 1989 Report of Examination, FDIC Ex. 4, at 2-a-2. However, the U.S. Court of Appeals for the 10th Circuit had vacated the judgment in February 1989 and remanded the case for a new trial on damages unless Respondent accepted a remittitur of \$222,629.88, *Grubb v. FDIC*, 868 F.2d 1151 (10th Cir. 1989), which Respondent rejected in July 1989. The Board concludes that, as of the date the Removal Notice was issued, the interests of the Bank's depositors were subject to the risk of serious prejudice because of Respondent's violations of laws and regulations, breaches of fiduciary duty, and unsafe or unsound practices, and resulting substantial losses to the Bank. See *Docket No. FDIC-85-215e*, FDIC Enf. ¶5069 at A-951 (1986).

## 2. Factors discussed in the Recommended Decision.

The ALJ's decision to dismiss the Removal Notice is based on his conclusion that Respondent's repetitive violations of laws and regulations did not constitute a willful or continuing disregard for the safety and soundness of the Bank. In so concluding, the ALJ (1) ruled that becoming financially unable to repay a loan cannot constitute "voluntary" or "deliberate" conduct; (2) found that Respondent "willingly" pledged collateral which ultimately repaid the principal balances of the extensions of credit at issue, thus demonstrating that Respondent took positive action to insure the Bank's safety and soundness; (3) found that after receiving the report of the July 1986 Examination, Respondent was involved in eight overdrafts and five violations of the Cease and Desist Order, none of which allegedly exposed the Bank to a possibility of abnormal risk of loss; and the Falcon Production ORE, which created an abnormal "albeit ultimately unrealized" risk to the Bank but without any evidence that Respondent's imposition of that risk was deliberate; (4) found that Respondent committed no new violation after November 1987; (5) found it significant as a matter of discretion that Respondent's violations were not duplicated at the five other banks which he controlled; and (6) found it significant as a matter of discretion that Respondent possesses skills and experience which the industry can ill-afford to lose at this juncture. FDIC Enforcement Counsel excepts to all six of these findings and conclusions. For the reasons stated below, the Board disagrees with each of these findings and conclusions by the ALJ.

(a) *Financial Inability to Repay*. Respondent amplifies upon the findings and conclusion in the R.D. on this point by urging that,

Ironically, the FDIC held the purse strings and delayed payment for years until the FDIC settled [the Grubb Lawsuit]. These [renewals of earlier extensions of credit] were necessitated by those delays which relate back to purported violations ending in 1987. Likewise, the FDIC has always known that Respondent was unable to correct the violations because of his financial inability at the time to repay the loans. The so-called repeat violations were nothing more than renewals awaiting the eventual appellate process to collect on a valid judgment.

Resp. Exceptions, at 42–43.

The Board has already found that Respondent's inability to repay was in serious question at the time that the extensions of credit were first made to Respondent and his related interests in 1985 and 1986. Hence, his inability to repay is not considered a mitigating factor but an indication of Respondent's disregard for the safety and soundness of the Bank in obtaining the extensions of credit in the first instance. However, Respondent's argument that the FDIC was responsible for his inability to repay, and is treating him unfairly by seeking his removal based on his inability to repay, must be addressed.

First, the Board notes that the FDIC was not a party to nor responsible for the transactions underlying the Grubb Lawsuit. Respondent's financial difficulties were greatly increased not by the lawsuit to recoup his losses but by the substantial cash requirements of his decision to purchase the stock of Security State in 1983. Respondent chose to impose part of the burden of those case requirements on the Bank through the extensions of credit out of which the violations alleged in this proceeding arose.<sup>40</sup>

Second, the fact that the FDIC as Re-

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<sup>40</sup> Respondent also borrowed at least \$1.5 million of his cash requirements in 1983 for Security State through Hydro Bancshares, Inc., the Bank's holding company. *Grubb v. FDIC*, 868 F.2d 1151, 1157 (10th Cir. 1989). Hence, the Bank's capital deficiencies were also exacerbated by the payment of dividends to Hydro Bancshares, [\(Continued\)](#)

[{{11-30-92 p.A-2034}}](#) ceiver was involved in the Grubb Lawsuit was mere happenstance, caused by the failure of First National in July 1986. Among the functions which Congress has delegated to the FDIC are the supervision of certain financial institutions including the Bank through, *inter alia*, bank examinations

and enforcement actions such as this proceeding, and the conservation and liquidation of assets of failed banks such as First National. These functions of necessity frequently intersect. Nevertheless, Congress requires and expects that all of them be prosecuted vigorously by the Corporation, in order to minimize losses to the Bank Insurance Fund. The evidence of record in this case discloses that the FDIC as Receiver pursued its legal positions in the Grubb Lawsuit vigorously and tenaciously, as Congress expects it to do. There has been no suggestion that FDIC as Receiver engaged in overreaching or improper or unethical conduct in its handling of the Grubb Lawsuit once it became a party.<sup>41</sup>

Third, the substantial evidence of record does not support Respondent's argument that the "continuing" or "repetitive" violations on which the Removal action is based "are simply the renewals of Respondent's extensions of credit by the Bank which the Respondent became financially unable to pay" by virtue of FDIC's "holding of the purse strings." The FDIC did not become a party to the suit until sometime after the original defendant, First National, was declared insolvent in July 1986. By that time, the Falcon Production and MGM extensions of credit has been made, as well as the April and June 1986 personal loans to Respondent. The July 1986 Examination cited numerous violations of section 23A and Regulation O. Thereafter, Respondent borrowed an additional \$100,000 in October 1986, and received an additional \$83,241 in the February 1988 Falcon Production ORE transaction, as well as engaging in numerous additional prohibited overdrafts at the Bank. The Board concludes that even if all the "renewals" of prohibited extensions of credit are eliminated from consideration, and even after receiving explicit warning of statutory and regulatory violations, Respondent engaged in repetitive transactions in violation of law and regulations, in breach of his fiduciary duty, that constituted unsafe or unsound practices which caused the Bank to suffer financial loss and which financially benefited Respondent.

(b) *Willing Pledge of Collateral.* Respondent argues that when he became unable to repay loans, he made "every effort" to pledge sufficient collateral on his loans to insure that the Bank would not suffer a loss. FDIC Enforcement Counsel argues that Respondent's pledges of collateral were made only in response to actions by either the FDIC or the Oklahoma Banking Department. The Board agrees with FDIC Enforcement Counsel.

The Board finds that the 1986 Assignment of the 1985 Grubb Judgment was made during the course of the July 1986 Examination, criticizing several extensions of credit to Respondent and his related interests. Moreover, the 1986 Assignment was never perfected, and was not in the file of the Bank at the time of the 1987 Examination, Tr. at 330.

Similarly, Respondent's 1987 personal loan (a renewal and consolidation of his 1986 loans) was purportedly secured with real property only after the July 1986 Examination had criticized the unsecured (and smaller) loans to him in April and June, 1986; and moreover these collateral interests were never properly secured for the Bank. The April 1987 loan to Respondent was secured (principal only) with a perfected interest in the 1985 Grubb Judgment in February 1989, only after the loan was again adversely classified and cited for legal violations in the 1989 Examination. Respondent's personal loan (principal only) and the MGM loan (principal only) were secured with a perfected interest in the second Grubb Judgment only after the Removal Notice had been issued and the administrative hearing in this proceeding had commenced on December 3, 1990. Moreover, the deficiencies concerning the 1986 Assignment and the pledges of real property in connection with Respondent's 1987 personal loan, were so exten-

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<sup>40</sup> Continued: Inc. and bonuses to Respondent in order to service the debt created by Respondent's Security State transactions. See the 1985, 1986, 1987, and 1989 Reports of Examination, FDIC Ex. 1 at 1-a-1, FDIC Ex. 2 at 1-a, FDIC Ex. 3 at 1-a-1, and FDIC Ex. 4 at 1-a-1.

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<sup>41</sup> Indeed, in February of 1989, as a result of FDIC's arguments, the judgment of \$2.7 million in favor of Respondent was vacated by the U.S. Court of Appeals for the 10th Circuit. A second judgment in a similar amount was not obtained until November 1990. It too was appealed by the FDIC, and the case was settled in November 1991.

[[11-30-92 p.A-2035]]sive that one must question whether any security interest in the underlying assets was intended to be conveyed.

The renewal of the Falcon Production loan was secured with additional collateral—the Harmon County farm—only after the loan had been adversely classified and cited for legal violations at the 1986 Examination. This is the only property which Respondent made "every effort" to pledge when he became unable to pay which was properly pledged prior to the Assessment Notice and the Removal Notice. However, this ORE property has in essence been "warehoused" by the Bank, with no serious effort to market the property. Respondent testified that one purpose of the ORE transaction was to warehouse the property until he could repurchase it. Tr. at 870-71.

Under the circumstances described above, the Board does not consider these pledges of collateral to

constitute "positive action to insure the Bank's safety and soundness."

(c) *No Loss, or Risk or Loss Ultimately not Realized, or not Deliberately Imposed.* The Board agrees with the ALJ that the Removal Notice does not allege the Bank has suffered or will probably suffer substantial financial loss or other damage as a result of the 1987–1988 overdrafts or violations of the Cease-and-Desist Order. However, it does allege losses with respect to the MGM loan, Respondent's personal loans and the Falcon Production loan and ORE transaction. While some but not all of such amounts classified as "Loss" have been repaid by Respondent, the Board has held that the partial repayment does not "cancel" the violation even though it reduces the amount of the loss. See pages 60–62, above.

Respondent argues that the classification of Respondent's personal loan and the MGM loan as "Loss" by the FDIC bank examiners was made "without adequate explanation or reasonable investigation," and was inconsistent with the opinions of FDIC examiners at F&M and First Oklahoma Bank and Trust Company of Edmond, Edmond, Oklahoma ("First Oklahoma"), who did not classify as "Loss" Respondent's loans which were "also secured solely by the Grubb Judgment as collateral." Resp. Ex. at 44. This argument, which Respondent uses as a basis for his assertion of a prejudicial attitude against him on the part of the FDIC, is simply unsupported by record evidence. First, the MGM loan was never adversely classified by the FDIC. The loan, which originated in April 1988, was charged off by the Bank in December 1988, Tr. at 1016. There was no examination of the Bank in 1988. The March 1987 letter of credit was classified "Doubtful" in the December 31, 1987, Report of Examination, FDIC Ex. 3 at 2-a-9, with adequate explanation.<sup>42</sup> The MGM loan was not collateralized by an assignment of the Grubb Judgment until November 30, 1990, almost two years after it had been charged off as a loss. That assignment was not perfected until December 4, 1990.

Respondent's personal loan was classified "Loss" by the January 23, 1989 Report of Examination. The explanation, set forth at length in footnote 11 above, is adequate and reasonable. No further investigation by the examiner beyond what is reflected in the Report was necessary, and it is not a fair reading of the 1989 Report of Examination to say that the Grubb Judgment was determined to have "no value." Rather, the examiner noted that the Bank's assignment was not perfected and that the judgment had also been assigned to other creditors.

As to inconsistent treatment of the Grubb Judgment by other Bank examiners, Respondent cites no evidence of record. No Reports of Examination of the other banks were offered in evidence. The only evidence of record on this issue is contained in the testimony of Respondent's witness Christopher Dale Conn, senior vice president in charge of the Correspondent Bank Division at F&M. Mr. Conn testified that his bank had three "bank stock loans" related to Respondent: to Rocky Financial Corp., to Hydro Bancshares, and to Interstate Financial Corp., the holding company for First Oklahoma. In addition, his bank has personal loans to Respondent related to the stock in

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<sup>42</sup> ". . . President Schamburg also indicated that there is a reasonable expectation that the letter of credit may have to be funded, as the appeal situation indicates that MGM lost the initial lawsuit, and accordingly, could also lose the appeal. Bank Director Ronald J. Grubb has executed a blank, signed note and guaranty form to support the letter of credit in event of funding. No collateral has been pledged to secure this contingent liability. No financial information is available on MGM to determine repayment capacity, and with guarantor Grubb's weak financial condition as detailed on page 2-a-2, coupled with the letter of credit's unsecured status, a Doubtful classification is accorded." FDIC Ex. 3 at 2-a-2.

{{11-30-92 p.A-2036}}the three holding companies, and a loan related to his ownership in Leadership Bank in Oklahoma City. The principal amount of these loans totaled "just under seven and a half million dollars," Tr. at 756. F&M had a "valid first and prior security interest and lien in the Judgment Collateral," Resp. Ex. 320. Mr. Conn testified that for several years, the Grubb Lawsuit was what his bank has relied on "for our ultimate repayment and restructuring of a lot of those loans," Tr. at 757; that the lawsuit was not his only collateral, but is some additional collateral, Tr. at 757; that the judgment is "wrapped around all of our loans, cross-collateralized to all our loans," Tr. at 787; and that his bank had charged off \$400,000 in principal and \$700,000 in interest on these loans, Tr. at 786, 787. Mr. Conn testified that the FDIC had never charged off any of the principal of Respondent's loans in his bank, Tr. at 762. He stated:

I can't cite for you nor did I bring our examination reports. But I'm pretty certain if you go back and look at the FDIC's write-ups of Mr. Grubb's loans, you'll find that they probably did not charge off some of his loans in our bank because we were in the position we were in with respect to the lawsuit and the expectation that he would be successful.

Tr. at 759.

The evidence of record therefore is that the FDIC did not classify as "Loss" loans to Respondent at another bank which were (1) subject to a prior security interest in the Grubb Judgment (2) secured by

other collateral, namely stock in various banks and bank holding companies controlled by Respondent. The Board concludes on the basis of the evidence cited above that until the Bank entered into a Subordination Agreement with F&M dated November 30, 1990, it has no security interest in the Grubb Judgment of any real value. Hence, there is no support in the record for Respondent's assertion of inconsistent treatment by bank examiners or unfair or improper treatment by examiners of loans to Respondent or his related interests at the Bank.

The Board also disagrees that the risk of loss imposed in the Falcon Production ORE transaction was not deliberately imposed. This transaction was clearly imprudent and an unsafe and unsound banking practice. It was proposed and carried out by Respondent in breach of his fiduciary duty, and with the knowledge that the risk of loss to the Bank, inherent in a deed-in-lieu-of-foreclosure transaction, was significantly increased by the Bank's cash payments to Respondent of \$83,241 representing "equity".

[.144] (d) *No New Violation After November 1987*. The ALJ is in error. The Falcon Production ORE transaction, which the ALJ states "deserves censure," R.D. at 23, occurred in February 1988. More to the point, the Removal Notice alleged, and the ALJ found, dozens of section 23A and Regulation O violations, beginning in December 1985 and continuing through February 1988. Without question, all of the violations which occurred after the July 1986 Examination were done with full knowledge of their seriousness. Moreover, even if the renewals of previous extensions of credit were to be eliminated from the list of post-July 1986 violations, it includes multiple prohibited overdrafts, the \$100,000 loan to Respondent in October 1986, five violations of the Cease-and-Desist Order, and the Falcon Production ORE transaction in 1988. The Board finds that these repeated violations demonstrate a willful or continuing disregard for the safety and soundness of the Bank. The Board also finds that Respondent's personal loans and the Falcon Production loan and ORE transaction caused the Bank to suffer substantial financial loss.

(e) *Violations not Duplicated at the Five Other Banks Respondent Controlled*. This finding by the ALJ is erroneous.<sup>43</sup> Respondent testified that three other banks owned by him were subject to cease and desist orders, Tr. at 716, and the transcript also reflects that Respondent was the subject of a notice to assess civil money penalties at The State Bank of Rocky, Rocky, Oklahoma, which he owned, which was settled prior to the hearing in this matter, Tr. at 717-19. That notice of assessment alleged violations by Respondent of Regulation O and of an FDIC Cease-and-Desist Order.

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<sup>43</sup> As support for this finding, the ALJ states, "I credit the un rebutted testimony to this effect of the State Commissioner," without citation. The State Commissioner's testimony cannot be so read: "... I think that in the situation in the Bank of Hydro it's been proven, you know, based on the information contained in the Reports of Examinations, that Mr. Grubb has not upheld his responsibility to the banking community in this particular bank, laying aside all of his other banks, investments. We've had similar mild problems, but noting that's taken place in this bank." Tr. at 525.

[{{11-30-92 p.A-2037}}](#)

The Board also notes that the ALJ ruled at the October 3, 1989 prehearing conference in this proceeding that the hearing would be strictly limited to the Bank, Transcript of Prehearing Conference dated October 3, 1989, at 29.<sup>44</sup>

[.15] More to the point, the Board is of the view that Respondent's conduct at other banks should not be considered a mitigating circumstance in this case. The owner of more than one bank should not be allowed to insulate himself from penalty by focusing all his violations of law, breaches, of fiduciary duty, unsafe or unsound practices, and disregard for safety and soundness, at one bank.

(f) *Respondent's Skills and Experience*. It is evident that Respondent has many years of experience in banking in Oklahoma. However, the Board draws very different conclusions from his background. The Board concludes that the depth and scope of Respondent's experience makes his participation in prohibited activities all the more reprehensible. As the Bank Commissioner testified at the hearing:

It seems like every examination uncovers something a little bit different than has taken place in the past. And again, with Mr. Grubb's experience in the banking community, he's certainly not a novice in banking, would indicate to me that, you know, he's been given every opportunity.

Every Report of Examination, every transmittal letter that we've sent back to the Bank, that I've sent bank to the Bank, that I've sent bank to the Bank, has been pretty well descriptive of the problems in the Bank as far as violations are concerned. And they still continue; not only the same violations, but something new, a little bit different than we've encountered in the past.

Tr. at 525, 526.

The Board concludes as a matter of discretion that Respondent's banking skills and experience are not mitigating factors in the circumstances of this case.

The Board rejects the ALJ's Findings of Fact Nos. 196–198; modifies Conclusion of Law No. 110 to read, "[t]he FDIC has authority pursuant to 12 U.S.C. § 1818(e) to issue an order removing Respondent from the Bank as a director and prohibiting him from serving or acting as an institutionaffiliated party and/or from participating in the conduct of the affairs of the Bank and any other insured depository institution"; adopts Conclusion of Law No. 111; and modifies Conclusion of Law 112 by substituting the text of footnote 37 herein. The Board also adopts the Additional Findings of Fact and Additional Conclusions of Law set forth in the Appendix to this Decision.

### *CONCLUSION*

Based on the substantial evidence of record, the Board must conclude that Respondent engaged in extensive and abusive self-dealing with respect to the substantial extensions of credit by the Bank to him and his related interests, all of which were for Respondent's personal benefit, and at the Bank's expense. The Board does not doubt that Respondent was motivated to do so by the very serious financial pressures created by his investment in Security State and other financial problems. Moreover, the Board assumes that Respondent was personally confident that he would ultimately prevail in the Grubb Lawsuit, and if payment were forthcoming soon enough he would be able to repay the loans in question. Nevertheless, the Board can only conclude that Respondent deliberately engaged in the prohibited transactions as calculated risks, having decided that it was better to obtain the credit he needed to keep his operations afloat, knowing that some day he would have to deal with the consequences, than to abstain from what he certainly knew were illegal transactions.

Having found that elements of every statutory factor for removal except personal dishonesty on the part of Respondent (never alleged by the FDIC) are present in this case, the Board in its discretion has determined that it is appropriate to prohibit Respondent's participation in any manner in the conduct of the affairs of the Bank or any other FDIC-insured institution.

### *ORDER TO PAY CIVIL MONEY PENALTY*

For the reasons set forth in the above Decision, the Board of the FDIC hereby ORDERS that:

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<sup>44</sup> Given the fact that the Assessment Notice and the Removal Notice as amended did not charge Respondent with violations concerning any other bank, and neither party requested that conduct or transactions at other banks be considered, this ruling was appropriate.

[{{11-30-92 p.A-2038}}](#)

A civil money penalty in the amount of \$50,000 be, and hereby is, assessed against Respondent Ronald J. Grubb, pursuant to former section 18(j)(3) of the FDI Act, 12 U.S.C. § 1818(j)(3).

### *ORDER OF REMOVAL AND PROHIBITION FROM FURTHER PARTICIPATION*

For the reasons set forth in the above Decision, and pursuant to section 8(e) of the FDI Act, as amended by sections 903 and 904 of FIRREA, Pub. L. No. 101-73, §§ 903 and 904, 103 Stat. 183, 453, 457 (1989) (codified at 12 U.S.C. § 1818(e)), the Board of the FDIC hereby ORDERS that:

1. Ronald J. Grubb is hereby removed as a director and officer of Bank of Hydro, Hydro, Oklahoma.
2. Ronald J. Grubb is hereby prohibited from serving or acting as an institutionaffiliated party and/or from participating in any manner in the conduct of the affairs of any of the institutions or agencies listed herein, without the prior written consent of the FDIC and of the appropriate Federal financial institutions regulatory agency pursuant to the provisions of section 904(a) of FIRREA, Pub. L. No. 101-73, § 904, 103 Stat. 183, 457, (1989) (codified at 12 U.S.C. § 1818(e)(7)):
  - (i) Any insured depository institution as defined in 12 U.S.C. § 1813(c)(2),(3) and (4);
  - (ii) Any depository institution holding company as defined in 12 U.S.C. § 1813(w);
  - (iii) Any insured credit union under the Federal Credit Union Act as defined in 12 U.S.C. § 1752;
  - (iv) Any institution chartered under the Farm Credit Act of 1971;
  - (v) Any appropriate Federal banking agency as defined in 12 U.S.C. § 1813(q);
  - (vi) The Federal Housing Finance Board and any Federal home loan bank; and
  - (vii) The Resolution Trust Corporation.
3. Ronald J. Grubb is hereby prohibited from voting for a director, or soliciting, procuring, transferring,

attempting to transfer, voting, or attempting to vote any proxy, consent, or authorization with respect to any voting rights in any institution described in paragraph 2 hereof, without the prior written approval of the FDIC and the appropriate federal banking agency as that term is defined in section 3(q) of the FDI Act, 12 U.S.C. § 1813(q).

4. Ronald J. Grubb is hereby prohibited from violating any voting agreement previously approved by the appropriate Federal banking agency with regard to any institution described in paragraph 2 hereof, without the prior written approval of the FDIC and the appropriate Federal banking agency as that term is defined in section 3(q) of the FDI Act, 12 U.S.C. § 1813(q).

This ORDER shall become effective thirty (30) days after the date of its service.

This ORDER shall remain effective and enforceable except to the extent that and until such time as, any of its provisions shall have been modified, terminated, suspended or set aside by the FDIC.

IT IS FURTHER ORDERED, that the Executive Secretary, or his designee, is instructed to execute and serve copies of the Decision and Orders on counsel for both parties, the Administrative Law Judge, the Bank, and the Bank Commissioner for the State of Oklahoma.

By direction of the Board of Directors.

Dated at Washington, D.C., this 25th day of August, 1992.

/s/ Robert E. Feldman

Deputy Executive Secretary

## APPENDIX

### ADDITIONAL FINDINGS OF FACT AND CONCLUSIONS OF LAW

#### A. Findings of Fact

1. On September 17, 1985, Respondent met with the FDIC and the Oklahoma State Banking Department regarding the results of the 1985 Examination.

2. At the conclusion of the 1986 examination, FDIC Examiner-in-Charge Darwin E. Niles met with Respondent and informed him of the alleged violations of law and violations of the FDIC's Cease-and-Desist Order recited in the 1986 Report of Examination.

3. On or about November 26, 1986, Respondent received a copy of the 1986 Report of Examination from the Oklahoma State Banking Department and was notified of the alleged violations of law discovered at the 1986 Examination and recited in the 1986 Report of Examination.

4. At the conclusion of the 1987 Examination, FDIC Examiner-in-Charge Bruce C. [{{11-30-92 p.A-2039}}](#) Adams met with Respondent and informed him of the violations of law and violations of the FDIC's Cease-and-Desist Order discovered at the 1987 examination and recited in the 1987 Report of Examination.

5. At the conclusion of the 1989 Examination, FDIC Examiner-in-Charge Luther W. Hildebrand met with Respondent and informed him of the violations of law and violations of the FDIC's Cease-and-Desist Order discovered at the 1989 Examination and recited in the 1989 Report of Examination.

6. Respondent, who has owned interests in and worked in banks since 1968, has substantial knowledge and experience in the policies, operations, affairs, and business of banking.

#### B. MGM Production Company - Letters of Credit

7. Prior to March 9, 1987, Respondent received a letter from the FDIC that the issuance of the Bank's letter of credit No. 21486 on behalf of MGM violated section 23A of the Federal Reserve Act.

8. Prior to March 9, 1987, Respondent had knowledge and information that the Bank's issuance of letter of credit No. 21486 on behalf of MGM violated section 23A of the Act.

9. In March 1988, Respondent received a copy of the 1987 Report of Examination.

10. In March 1988, Respondent had knowledge and information that the Bank's issuance of letters of credit Nos. 21486 and 038809 on behalf of MGM violated section 23A of the Act.

11. When issued, the Bank's letter of credit No. 21486 was not secured with any collateral.

12. When issued, the Bank's letter of credit No. 038809 was not secured with any collateral.

13. When issued, the Bank's letter of credit No. 038809 was not secured with any collateral.

14. The Bank's loan No. 97013 was not secured with any collateral.

15. When the Bank's letter of credit No. 21486 was issued, the Bank had no financial information on MGM to determine MGM's capacity to repay the letter of credit.

16. When the Bank's letter of credit No. 21486 was issued, Respondent's financial statements reflected a steadily declining net worth and a highly leveraged position, resulting in a marked deterioration of his financial condition.

17. When the Bank's letter of credit No. 038809 was issued, the Bank had no financial information on

MGM to determine its capacity to repay the letter of credit.

18. When the Bank's letter of credit No. 038809 was issued, Respondent's financial statement reflected a steadily declining net worth and a highly leveraged position, resulting in a marked deterioration of his financial condition.

19. When the Bank's letter of credit No. 038809 was issued, Respondent's financial statements reflected a steadily declining net worth and a highly leveraged position, resulting in a marked deterioration of his financial condition.

20. On October 31, 1985, Respondent was awarded a Judgment against the First National Bank and Trust Company of Oklahoma City, Oklahoma ("1985 Judgment").

21. The Bank considered only Respondent's guaranty for payment on the Bank's letters of credit No. 21486, No. 038809, and No. 038809 and loan No. 97013 to MGM.

22. The Assignment of Judgment executed by Respondent and filed by the Bank on February 15, 1989, with the Clerk of the U.S. District Court, Western District of Oklahoma, did not assign any interest in the possible proceeds from the 1985 Judgment for the payment of the Bank's charged-off loan No. 97013 to MGM.

23. Not until F&M executed its Subordination Agreement with the Bank and Respondent on November 30, 1990, and the Bank filed its Assignment of Judgment on December 4, 1990 with the U.S. District Court Clerk (Resp. Ex. 320, 322) was the Bank provided with a purported security interest as collateral for the Bank's chargedoff loan No. 97013 to MGM.

#### *C. MGM Production Company - Overdrafts*

24. Respondent was one of two persons with signature withdrawal authority on MGM's account No. 0-781-191 at the Bank.

#### *D. Ron Grubb Investments - Overdrafts*

25. During 1986, Ron Grubb Investments periodically overdraw its account No. 0-659014 at the Bank. [{{11-30-92 p.A-2040}}](#)

#### *E. Falcon Production Company - Loans to Respondent and ORE Transaction*

26. On December 31, 1985, when the Bank extended loan No. 95198 to Falcon Production, the Bank had no title information with respect to the mineral mortgage that comprised the collateral for the loan.

27. On December 31, 1985, when the Bank extended loan No. 95198 to Falcon Production, the Bank had no appraisal on the mineral mortgage that comprised the collateral for the loan other than Respondent's handwritten appraisal which had no supporting information or documentation.

28. On December 31, 1985, when the Bank extended loan No. 95198 on Falcon Production, Falcon Production had a negative net worth of \$15,400.

29. On December 31, 1985, when the Bank extended loan No. 95198 to Falcon Production, the Bank was without any information as to the income-producing ability of the mineral mortgage as a means of payment on the loan.

30. On February 12, 1987, when the Bank extended loan No. 96282 to Falcon Production, the Bank had no title information with respect to the mineral mortgage and the real estate mortgage that comprised the collateral for the loan.

31. On February 12, 1987, when the Bank extended loan No. 96282 to Falcon Production, the Bank had no appraisals on the mineral mortgage (except for Respondent's outdated handwritten appraised described in finding of Fact No. 27 above) or the real estate mortgage that comprised the collateral for the loan.

32. On February 12, 1987, when the Bank extended loan No. 96282 to Falcon Production, the Bank did not have any current information on the financial condition of Falcon Production.

33. On February 12, 1987, when the Bank extended loan No. 96282 to Falcon Production, the Bank was without any information as to the income-producing ability of the loan's collateral as a means of payment on the loan.

34. The Bank continues to own the ORE acquired from Falcon Production in February 1988.

#### *F. Respondent's Personal Loans*

35. The Bank's loan No. 95549 to Respondent was partially comprised of a renewal of loan No. 95465 in the principal amount of \$75,000 with accrued interest of \$1,116.

36. The Bank's loan No. 95549 was, also, partially comprised of additional new funds disbursed to Respondent in the amount of \$73,884.

37. On June 5, 1986, when the Bank's loan No. 95549 was made to Respondent, Respondent was contingently liable on other transactions in the amount of \$17,580,000.

38. On October 29, 1986, pursuant to the Bank's loan No. 95866 to respondent, initial funds were disbursed in the amount of \$39,270.22 and deposited into Ron Grubb Investments' account no. 0-659-014 with the Bank.

39. The funds in the amount of \$39,270.22 that were deposited into Ron Grubb Investments' account No. 0-659-014 were for the payment of multiple overdrafts incurred by Respondent in said account.

40. On October 29, 1986, when the Bank's loan No. 95866 was made to Respondent, Respondent was contingently liable on other transactions in the amount of \$17,580,000.

41. The Bank's loan No. 96212 was secured with real estate collateral represented by two real estate mortgages.

42. On April 14, 1987, when the Bank's loan No. 96212 was made to Respondent, the loan was amortized for 36 months, with monthly payments of \$1,922 and a final balloon payment of \$243.815 to be made by Respondent.

43. On April 14, 1987, when the Bank's loan No. 96212 was made of Respondent, Respondent's contingent liabilities were \$18,358,000.

44. On April 14, 1987, when the Bank's loan No. 96212 was made to Respondent, the Bank had outstanding extensions of credit to Falcon Production in the amount of \$110,000 and to Respondent in the amount of \$150,000 that were adversely classified "Substandard" at the 1986 Examination.

45. During the 1985 Examination, Respondent's loans were classified "Substandard" because his loans were unsecured and his financial condition was steadily declining.

46. Loan No. 95465 to Respondent was unsecured.

47. Loan No. 95549 to Respondent was unsecured.

48. On October 29, 1986, when the Bank's [{{11-30-92 p.A-2041}}](#) loan No. 95866 was made to Respondent, the loan was not secured with any collateral acceptable for purposes of section 23A of the Act.

49. On October 29, 1986, when the Bank's loan No. 95866 was to Respondent, Respondent's financial statements reflected a steadily declining net worth and a highly leveraged position resulting in a marked deterioration of his personal financial condition.

50. On April 14, 1987, when the Bank's loan No. 96212 was made to Respondent, the Bank's collateral position was uncertain because of Respondent's wife's failure to sign and execute the two real estate mortgages.

51. On April 14, 1987, when the Bank's loan No. 96212 was made to Respondent, the Bank's lien positions with respect to the collateral were uncertain because the Bank had no title information on the two mortgaged properties.

52. On April 14, 1987, when the Bank's loan No. 96212 was made to Respondent, Respondent's financial statements reflected a steadily declining net worth and a highly leveraged position resulting in a marked deterioration of his personal financial condition.

53. The Security Agreement concerning the 1985 Judgment, as executed by Respondent on July 23, 1986, was not perfected by the Bank through proper filing of the Assignment of Judgment with the U.S. District Court Clerk until February 15, 1989.

54. The Bank's security interest in the 1985 Judgment was subordinated to multiple prior security interests of Respondent's creditors such that any receipt by Respondent of the total proceeds of the Judgment would only result in the payment of the principal amount of \$250,000 due on loan No. 96212 and no other debt obligations of Respondent's or his related interests to the Bank would be paid.

55. The Assignment of Judgment executed by Respondent and filed by the Bank on February 15, 1989, only assigned any interest in the possible proceeds from the 1985 Judgment for the sole payment of the principal due on Respondent's personal loan No. 96212 and not for the payment of the uncollected interest on the loan or any other extensions of credit to Respondent and his related interests.

56. The 1985 Judgment was affirmed in part, reversed in part, and remanded on February 16, 1989, by the U.S. Court of Appeals for the Tenth Circuit, *Rob Grubb, Weatherford Interstate Holding Co. v. FDIC*, 868 F.2d 1151 (10th Cir. 1989), with a Court proffered option for Respondent to accept a remittitur of the 1985 Judgment to the sum of \$222,629.88.

57. On July 21, 1989, Respondent rejected the remittitur in the amount of \$222,629.88 as proffered by the U.S. Court of Appeals and sought a new trial on the issue of damages.

58. Pursuant to a second trial, on October 26, 1990, Respondent was awarded a second judgment against the FDIC in its corporate capacity and as receiver for the failed First National Bank and Trust Company of Oklahoma City, Oklahoma ("1990 Judgment").

59. On November 30, 1990, Respondent granted the Bank a security interest in the 1990 Judgment and tendered the Bank an assignment of Judgment.

60. On December 4, 1990, the Bank's security interest in the 1990 Judgment was perfected when Respondent's Assignment of Judgment, dated November 30, 1990, was filed with the Clerk of the U.S.

District court, Western District of Oklahoma.

#### *G. Respondent's Lack of Good Faith*

61. At the conclusion of the 1986 Examination, Respondent was expressly informed of and warned about the numerous violations of law and violations of the FDIC's Cease-and-Desist Order, and he took no action to correct the numerous violations, except to make an assignment of the 1985 Judgment which was never perfected and subordinate to assignments at other banks.

62. Approximately 30 days after the conclusion of the 1986 Examination, Respondent and his related interests overdrew their accounts at the Bank in violation of the same provisions of Regulation O which Respondent had been expressly informed of and warned about at the conclusion of the 1986 Examination.

63. Approximately 90 days after the conclusion of the 1986 Examination, Respondent received additional funds from the Bank for the purpose of paying Respondent's overdrafts at the Bank in violation of the same provisions of Regulation O which Respond-  
{{11-30-92 p.A-2042}}ent had been informed and warned at the conclusion of the 1986 Examination.

64. Prior to the 1987 Examination, Respondent was, again, informed by Bank Commissioner Osborn that Respondent's continued overdrafts at the Bank violated the same provisions of which Respondent had been previously informed and warned about at the conclusion of the 1986 Examination.

65. At the conclusion of the 1987 Examination, Respondent was, again, expressly informed of and warned about the numerous new violations of law and violations of the FDIC's Cease-and-Desist Order, many of which were repeat violations of the same provisions of Regulation O and section 23A and provisions of the Order recited and criticized during the 1986 Examination, and he took no action to correct the same.

66. Approximately 21 days after the conclusion of the 1987 Examination, Respondent received additional funds as a defaulting borrower at the Bank through the Falcon Production ORE transaction in violation of the same provisions of Regulation O of which Respondent had been informed and warned at the conclusion of the 1987 Examination.

67. At the conclusion of the 1989 Examination, Respondent was, again, expressly informed of the numerous new violations of law and of the FDIC Cease-and-Desist Order; and he took no action to correct the same.

68. Respondent was not "too concerned" for several years, until he realized that the FDIC was serious about pursuing them, about the violations of Regulation O and section 23A with respect to the MGM letters of credit transactions that occurred in 1986, 1987, 1988, and that resulted in a loss to the Bank.

#### *H. Gravity of Respondent's Violations of Law*

69. All of the numerous and repetitive violations of Regulation O and section 23A criticized at the 1986 Examination, 1987 Examination, and 1989 Examination, concerned and involved Respondent and his related interests.

#### *I. Respondent's Unsafe or Unsound Practices*

70. Respondent and his related interests were criticized during the 1986 Examination, 1987 Examination, and 1989 Examination for their participation in numerous violations of law, including Regulation O and section 23A.

71. Respondent and his related interests engaged in numerous overdrafts at the Bank during 1986 and 1987.

72. Respondent's related interest, MGM, obtained unsecured letters of credit in 1986, 1987, and 1988, and a loan 1988, guaranteed by Respondent whose financial condition was deteriorating.

73. Respondent received additional funds from the Bank through the Falcon Production ORE transaction that he was not entitled to receive in violation of section 414B of the Oklahoma Banking Code, and Regulation O and in violation of prudent, safe and sound banking.

#### *J. Respondent's Breach of his Fiduciary Duty*

74. Respondent and his related interests received funds from the Bank pursuant to transactions that were in violation of Regulation O and section 23A.

75. Respondent and his related interest received funds from the Bank that resulted in adversely classified extensions of credit at the Bank.

76. Respondent and his related interests repeatedly received funds from the Bank that exceeded the lending limits provided by Regulation O and section 23A.

77. Respondent received from the Bank initial funds on October 29, 1986 in the amount of \$39,270, through loan No. 95866, to pay off overdrafts in his Ron Grubb Investments account at the Bank.

78. Respondent and his related interests engaged in numerous continuous overdrafts at the Bank.

79. Respondent received additional funds from the Bank through the Falcon Production ORE transaction that he was not entitled to receive in violation of section 414B of the Oklahoma Banking Code.

*K. Respondent's Benefit and Financial Gain and Bank's Loss*

80. Respondent and his related interests received the tangible economic benefit of proceeds from the Bank in the total amount of \$708,241 with respect to the following extensions of credit:

MGM letter of credit	\$265,000
Falcon Production loan	\$110,000
Falcon Production ORE funds	\$83,241
Respondent's personal loans	\$250,000
Total	\$708,241.

{{11-30-92 p.A-2043}}

81. Respondent and his related interest received tangible economic benefit in the total amount of \$281,527 with respect to the numerous overdrafts paid by the Bank during 1986 and 1987.

82. Respondent and his related interests have caused the Bank to incur loss in the total amount of \$606,033 with respect to the following extensions of credit:

MGM loan	\$248,780
Falcon Production loan	\$14,311
Falcon Production ORE funds	\$ 83,241
Respondent's personal loans	\$259,702
Total	\$606,033.

83. In December 1988, the Bank charged off as loss loan No. 97013 to MGM in the amount of \$235,801 for the unpaid principal loan balance and \$12,979 for the uncollected interest for a total of \$248,780.

84. Pursuant to the 1989 Examination, the Bank was required to charge off as loss \$14,311 representing accrued, but uncollected, interest with respect to loan No. 96282 to Falcon Production.

85. Pursuant to the 1989 Examination, the Bank was required to charge off as loss \$48,553, representing the entire amount of funds disbursed to Falcon Production on February 17, 1988, pursuant to the Bank's ORE transaction with Falcon Production.

86. Pursuant to the 1989 Examination, the Bank was required to charge off as loss \$34,688, representing the entire amount of the funds disbursed to Falcon Production on February 22, 1988, pursuant to the Bank's ORE transaction with Falcon Production.

87. In December 1988, with respect to loan No. 96212 to Respondent, the Bank charged off as loss the accrued, but uncollected, interest on the loan in the amount of \$10,895.

88. Subsequent to the 1989 Examination, with respect to loan No. 96212 to Respondent, the Bank charged off as loss \$248,806 representing the unpaid principal balance of the loan.

89. When aggregating the total extensions of credit to Respondent and his related interests, MGM, Falcon Production, Falcon Management, and Ron Grubb Investments, in the forms of letters of credit, direct loans, and overdrafts, Respondent has received financial gain in the total aggregate amount of \$887,560 as follows:

\$606,033 for the funds extended to Respondent and his related interests that resulted in loss to the Bank, and

\$281,527 in total overdraft items paid on behalf of Respondent and his related interests and of which Respondent directly or indirectly received the benefit.

*L. Respondent's Willful or Continuing Disregard for the Bank*

90. Respondent, as the principal shareholder of the Bank, exercised a controlling and dominant role in the management and policies of the Bank so as to obtain the extensions of credit to him and his related

interests.

91. On the transactions at issue, Respondent considered himself as sole authority for the Bank's affairs.

92. Respondent used the Bank to finance the operations of his other businesses.

93. At the conclusion of the 1986 Examination and 1987 Examination, Respondent was repeatedly informed by the FDIC and the Oklahoma Banking Department about the numerous violations of Regulation O and section 23A caused by him and his related interests and was warned to discontinue such violations.

94. Notwithstanding the notice and warnings to Respondent by the FDIC and the Oklahoma Banking Department regarding his numerous, repetitive violations of Regulation O and section 23A, Respondent continued to receive funds from the Bank in violation of Regulation O and section 23A, as well as in violation of safe and sound banking practices.

95. The Bank Commissioner is of the opinion that the Respondent should not remain as a director and person participating in the affairs of the Bank.

#### ADDITIONAL CONCLUSIONS OF LAW

##### A. Introduction

1. Respondent is an "institution-affiliated party" as that term is defined in section 3(u) of the FDI Act, 12 U.S.C. § 1818(a) (1989).

2. At all times pertinent to the alleged charges, the Bank was subject to section 414B of the Oklahoma Banking Code ("section 414B"), 6 Okla. Stat. Ann. § 414B (Supp. 1991).

3. At all times pertinent to the alleged charges, Respondent "violated", as that term is defined in section 3(v) of the FDI Act, 12

[{{11-30-92 p.A-2044}}](#) U.S.C. § 1813(v) (1989), former section 8(i)(2)(i) of the FDI Act, 12 U.S.C. § 1813(i)(2)(i), section 8(k) of the FDI Act, 12 U.S.C. § 1818(k), section 18(j)(4)(A) of the FDI Act, 12 U.S.C. § 1828(j)(4)(A), sections 23A and 22(h) of the Act, 12 U.S.C. § 371c and 375b, section 414B of the Oklahoma Banking Code, 6 Okla. Stat. Ann. 414B, and the FDIC Cease-and-Desist Order to the Bank by, without any limitation, acting (alone or with another or others) for or toward causing, bringing about, participating in counseling, or aiding or abetting one or more violations of Regulation O, section 23A and the FDIC Cease-and-Desist Order.

4. The opinions and conclusions of FDIC Examiners are entitled to great weight and considerable deference in accordance with *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

##### B. MGM Production Company - Letter of Credit

5. Because on March 9, 1988, the Bank's letter of credit No. 038909 exceeded 10 percent of the Bank's capital and surplus, Respondent continued to violate section 23A(a)(1)(A).

6. Because the funding of the Bank's loan No. 97013 to MGM involved more than the normal risk of repayment or presented other unfavorable features, Respondent continued to violate section 215.4(a)(2) of Regulation O, 12 C.F.R. § 215.4(a)(2).

7. On February 14, 1986, the Bank's "lending limit," pursuant to section 215.2(f) of Regulation O, 12 C.F.R. § 215.2(f), was \$340,950.

8. Because on April 14, 1988, the Bank's loan No. 97013 to MGM exceeded 10 percent of the Bank's capital and surplus, Respondent continued to violate section 23A(a) (1)(A) of the Act.

##### C. Falcon Production Company - Loans to Respondent and ORE Transaction

9. The fair market value of the real estate acquired by the Bank from Falcon Production exceeded the Bank's "recorded investment" in Falcon Production's defaulted loan.

10. At the time the Bank acquired the real estate from Falcon Production in February 1988, Falcon Production was a defaulting borrower whose borrowing, as a related interest of Respondent, already had exceeded the lending limit prohibition of Regulation.

11. Because the Falcon Production ORE transaction resulted in Respondent's receiving additional funds on February 17, 1988, in the amount of \$48,553 to which he was not lawfully entitled pursuant to Respondent's unsafe or unsound practices concerning the disbursement of such funds, Respondent was obligated to repay the funds to the Bank.

12. Because the Falcon Production ORE transaction resulted in Respondent's receiving additional funds on February 22, 1988, in the amount of \$34,688 to which he was not lawfully entitled pursuant to Respondent's unsafe or unsound practices concerning the disbursement of such funds, Respondent was obligated to repay the funds to the Bank.

#### D. Statutory Grounds for Respondent's Removal and Prohibition

13. Pursuant to former section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1), Respondent's acts, omissions, and practices have caused him to violate laws, rules, and regulations; in particular Regulation O, section 23A, and section 414B.

14. An unsafe or unsound practice involves any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk of loss or damage to an institution, its shareholders, or the agencies administering the insurance funds and encompasses all practices contrary to accepted standards of prudent banking operation that might result in abnormal risk or loss to a bank.

15. Pursuant to former section 8(e)(1) of the Act, 12 U.S.C. § 1818(e)(1), Respondent's acts, omissions, and practices related to the letters of credit for and loan to MGM; related to the loans and disbursed ORE funds to Falcon Production; related to the personal loans to Respondent; and related to the overdrafts in Respondent's personal account and the accounts of MGM, Ron Grubb Investments, and Falcon Management, constitute unsafe or unsound practices by Respondent in connection with the Bank.

16. Respondent's acts, omissions, and practices that resulted in violations of Regulation O, section 23A, and section 414B, are deemed to be unsafe or unsound practices.

17. Respondent engaged in an unsafe or unsound practices as a result of his selfdealing with the Bank pursuant to the vari-

[{{11-30-92 p.A-2045}}](#)ous, numerous extensions of credit (letters of credit, loans, ORE funds, and overdrafts) to Respondent and his related interests that allowed him to receive a personal financial benefit as a direct consequence of his insider position at the Bank as principal shareholder and director.

18. Respondent breached his fiduciary duty to the Bank by engaging and participating in transactions with the Bank that caused violations of Regulation O, section 23A, and section 414B.

19. Respondent breached his fiduciary duty to the Bank as a result of his self-dealing with the Bank pursuant to the various numerous extensions of credit (letters of credit, loans, ORE funds, and overdrafts) to Respondent and his related interests that allowed him to receive a personal benefit as a direct consequence of his insider position at the Bank as principal shareholder and director.

20. Respondent breached his fiduciary duty to the Bank by failing to heed the numerous repeated warnings from the FDIC and the Oklahoma Banking Department concerning the numerous, continuing violations of Regulation O and section 23A.

21. Given Respondent's extensive experience in the banking industry and his actual knowledge of the facts and voluntary and intentional participation in the transactions involving the MGM letter of credit and loan, the Falcon Production loans and ORE funds, Respondent's personal loans, and the overdrafts that occurred in the accounts of Respondent, MGM, Ron Grubb Investments and Falcon Management; Respondent's intentional and deliberate conduct throughout 1986, 1987, and 1988 evidences his willful or continuing disregard for the safety or soundness of the Bank pursuant to former section 8(e)(1) of the Act, 12 U.S.C. § 1818(e)(1).

22. The fact that Respondent's acts, omissions, and practices, constituting violations of Regulation O and section 23A, unsafe or unsound practices, and breaches of his fiduciary duty, continued after repeated notices and warnings by the FDIC and the Oklahoma State Banking Department during the three year period of 1986, 1987, and 1988, further demonstrates Respondent's willful or continuing disregard for the safety or soundness of the Bank, pursuant to former section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1).

23. Respondent's willful or continuing disregard for the safety or soundness of the Bank is further evidenced by the extensions of credit to Respondent and his related interests resulting in continuous lending limit violations at the Bank from on or about February 14, 1986 when the MGM letter of credit No. 21486 was first issued to November 14, 1991.

24. As a result of Respondent's acts, omissions, and practices that have resulted in his violating Regulation O, section 23A, and section 414B; that have resulted in his engaging and participating in unsafe or unsound practices with regard to the Bank; and that have resulted in the breaching of his fiduciary duty to the Bank, the Bank has suffered substantial financial duty to the Bank, the Bank has suffered substantial financial loss or other damage in the total amount of \$606,033, pursuant to former section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1), of which amount Respondent repaid \$484,606.98 on November 14, 1991.

25. Recovery of a charge-off loan does not eliminate or void the existence of a violation of Regulation O or section 23A.

26. Respondent's repayment of some of the losses caused by the extensions of credit to Respondent and his related interests, are not relevant or material to the statutory factor of "substantial financial loss" set forth in former section 8(e)(1) of the FDI Act, 12 U.S.C. § 1818(e)(1).

27. The fact that the substantial financial loss from Respondent's violations, practices, and breaches did

not result in such critical harm to the Bank as the cause possible insolvency and failure, is not a basis for Respondent not being subject to a removal and prohibition Order pursuant to former section 8(e) of the Act, 12 U.S.C. § 1818(e) (1989).

28. As result of Respondent's violations, practices, and breaches, Respondent has received financial gain in the total aggregate amount of \$887,560 pursuant to former section 8(e)(1) of the Act, 12 U.S.C. § 1818(e)(1), including \$606,033 in funds loaned to him and his related interests that resulted in substantial financial loss to the Bank.

29. Respondent also received benefit from [{{11-30-92 p.A-2046}}](#) the \$281,527 in overdrafts extended to him and his related interest, in violation of section 23A and Regulation O.

FEDERAL DEPOSIT INSURANCE  
CORPORATION

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CERTIFIED COPY OF RESOLUTION  
OF BOARD OF DIRECTORS

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I, Robert E. Feldman, Deputy Executive Secretary of the Federal Deposit Insurance Corporation, do hereby certify that the attached is a true and correct copy of a resolution duly adopted at a meeting of the Board of Directors of said Corporation, regularly called and held on the 25th day of August, 1992, at which a quorum was present, and that the same has not been amended or rescinded and is now in full force and effect.

IN WITNESS WHEREOF, I have hereunto subscribed my name and caused the seal of the Corporation to be affixed hereto, in the City of (SEAL) Washington and District of Columbia, this 25th day of August, 1992.

/s/ Robert E. Feldman  
Deputy Executive Secretary  
FEDERAL DEPOSIT INSURANCE CORPORATION

*RESOLUTIONS*

In the Matter of

RONALD J. GRUBB,

individually and as a director and/or

person

participating in the conduct of the affairs

of

BANK OF HYDRO

HYDRO, OKLAHOMA

FDIC-88-282k

FDIC-89-111e

WHEREAS, on December 22, 1988, a Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay and notice of Hearing ("Assessment Notice") was filed against Ronald J. Grubb for \$50,000, issued pursuant to former sections 18(j)(3) and 18(j)(4) of the Federal Deposit Insurance Act ("Act"), 12 U.S.C. §§ 1828(j)(3) and 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.

WHEREAS, the Assessment Notice as amended alleges the following violations with respect to Bank of Hydro, Hydro, Oklahoma ("Bank"): (1) violations of the lending limits and collateral security requirements of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c ("section 23A"), and the creditworthy requirements and lending limits of sections 215.4(a)(2) and 215.4(c) respectively of Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. § 215, with respect to the issuance and subsequent renewals of a letter of credit on behalf of MGM Production Company, an "affiliate" of the Bank and "related interest" of Respondent, as those terms are defined in section 23A and section 215.2(k) of Regulation O, respectively; (2) violations of the creditworthy requirements of section 215.4(a)(2), the lending limits of section 215.4(c), and the prior approval requirements of section 215.4(b), all of Regulation O, with respect to overdrafts on checking accounts maintained at the Bank on behalf of Respondent and certain of his "related interests," namely MGM, Falcon Management Company ("Falcon Management"), and Ron Grubb Investments ("RGI"); (3) violations of section 215.4(d) of Regulation O with respect to overdrafts on Respondent's personal account; (4) violations of the collateral requirements of section 23A(c)(1) with respect to the overdrafts of MGM and Falcon Management; (5) violations of the creditworthy requirements of section 215.4(a)(2) of Regulation O with respect to the issuance and renewal of a loan to Falcon Production Company ("Falcon Production"), an alleged "related interest" of Respondent, and violation of the lending limits of section 215.4(c) of Regulation O with respect to the renewal of that loan; (6) violations of sections 215.4(a)(2) and 215.4(c) of Regulation O with respect to certain payments to Respondent in connection with the so-called Falcon Production ORE transaction; (7) violations of sections 215.4(c) and 215.4(a)(2) of Regulation O with respect to four extensions of credit made to Respondent during 1986 and 1987; (8) violations of the November 29, 1985 Cease-and-Desist Order issued by the FDIC to the Bank by (a) capitalizing uncollected interest on two occasions, (b) twice failing to document the reasons for extensions of credit to classified borrowers, (c) failing to document the reasons for purchasing a loan participation, and (d) failing to [\[11-30-92 p.A-2047\]](#) amend the loan policy to reflect changes required by the FDIC.

WHEREAS, on July 13, 1989, the FDIC issued a Notice of Intention to Remove and/or Prohibit from Further Participation ("Removal Notice") to Respondent pursuant to former section 8(e)(1) of the Act, 12 U.S.C. § 1818(e)(1), and Part 308 of the FDIC Rules of Practice and Procedure, 12 C.F.R. § 308.69-.73.

WHEREAS, the Removal Notice as amended realleges that Respondent violated section 23A of the Act and various provisions of Regulation O as described above; and further alleges that Respondent's illegal conduct resulted in Respondent's engaging or participating in unsafe or unsound banking practices and breaches of his fiduciary duty to the Bank, and demonstrated his willful or continuing disregard for the safety or soundness of the Bank; and that as a result of Respondent's acts, omissions and/or practices, the Bank has suffered or will probably suffer substantial financial loss or other damage in the amount of approximately \$606,033, and resulted in Respondent's receiving financial gain amounting to \$887,560; and seeks to permanently prohibit Respondent from further participation in the conduct of the affairs of the Bank or any other FDIC-insured institution as an institution-affiliated party.

WHEREAS, in December 1989, the civil money penalty and removal actions were consolidated for hearing and decision.

WHEREAS, an evidentiary hearing was held December 3-6, 1990, in Oklahoma City, Oklahoma before Administrative Law Judge Steven M. Charno ("ALJ").

WHEREAS, on March 25, 1992, the ALJ found that Respondent had committed the violations of section 23A and Regulation O alleged in the Assessment Notice and the Removal Notice.

WHEREAS, the ALJ found that Respondent had acted in good faith for purposes of a civil money penalty.

WHEREAS, the ALJ found that the Bank had suffered "actual losses" of \$23,874 as a result of the transactions complained of and that such loss was the proper measure of the financial gain or other benefit to Respondent for purposes of determining the gravity of the violations.

WHEREAS, the ALJ found that Respondent had breached his fiduciary duty to the Bank in connection with the Falcon Production ORE transaction and that such breach justifies a penalty approximately twice as great as the economic benefit which Respondent received as a result of his violations; and concluded that a civil money penalty of \$50,000 was supported by substantial evidence of record.

WHEREAS, the ALJ found that Respondent had committed violations of law but also found that the repetitions of violations were the result of Respondent's financial inability to repay the prohibited extensions of credit, and held that financial inability to repay prohibited extensions of credit cannot constitute "deliberate" or "voluntary" conduct and hence does not demonstrate a willful or continuing disregard by respondent for the safety or soundness of the Bank.

WHEREAS, the ALJ failed to make findings of fact as to whether the transactions at issue constituted breaches of Respondent's fiduciary duty to the Bank, constituted unsafe or unsound practices, caused substantial loss or damage to the Bank, or could cause serious prejudice to the interests of the Bank's

depositors.

WHEREAS, the ALJ recommended that the Removal Notice by dismissed.

WHEREAS, Respondent and FDIC Enforcement Counsel filed exceptions to the ALJ's Recommended Decision.

NOW, THEREFORE, BE IT RESOLVED, that the Board of Directors ("Board") of the FDIC, 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, adopts the ALJ's Findings of Fact Nos. 1–50, No. 51 after substituting the figure \$250,000 for the figure \$484,606, 52–72, 74 after correcting the account number to read "0-659-014," 75–131, 136–157, 158 after adding the sentence, "Respondent was responsible for this loan transaction and it was conducted at his request," 163–168, 170–176, 179, 181, 183, 185, 190–191, and 195; rejects the ALJ's Finding of Fact 132–135, 169, 177, 180, 182, 184, 186–189, 192–194, and 196–198; adopts Conclusions of Law Nos. 1–25, 28, 31, 33, 37, 39, 41–42, 44–46, 48–51, 53–57, 59–65, 67–78, 80–82, 84–86, 88–90, 92–94, 96–100, 102–109, and 111; adopts Conclusions of Law Nos. 26, 27, 29, 30, 32, 34, [{{11-30-92 p.A-2048}}](#)46, 38, 40, 43, 47, 52, 58, 66, 79, 83, 87, 89, 91, and 95, after substituting the words "continued to violate" for the word "violated" in each such Conclusion; adopts Conclusion of Law No. 110 after modifying it to read, "The FDIC has authority pursuant to 12 U.S.C. § 1818(e) to issue an order removing Respondent from the Bank as a director and prohibiting him from serving or acting as an institution-affiliated party and/or from participating in the conduct of the affairs of the Bank and any other insured depository institution;" and adopts Conclusion of Law 112 after modifying it to read as follows:

An action under pre-FIRREA section 8(e)(1) requires the FDIC to prove at least one of the factors in *each* of the following three numbered paragraphs:

1. That a director, officer or person participating in the conduct of the affairs of an insured bank has:
  - (a) committed any violation of law, rule or regulation or of a cease and desist order which has become final; or
  - (b) engaged or participated in any unsafe or unsound practice in connection with the bank; or
  - (c) committed or engaged in any act, omission or practice which constitutes a breach of his fiduciary duty as a director or officer; and
2. That as a result of such violation, practice or breach:
  - (a) the bank has suffered or will probably suffer substantial financial loss or other damage; or
  - (b) the interest of the bank's depositors could be seriously prejudiced; or
  - (c) the director or officer has received financial gain; and
3. That the violation, practice or breach of fiduciary duty is either:
  - (a) one involving personal dishonesty on the part of the director or officer; or
  - (b) one which demonstrates a willful or continuing disregard for the safety or soundness of the bank;

and rejects Conclusion of Law No. 101 and the proposed Order.

BE IT FURTHER RESOLVED, that the Board adopts the additional Findings of Fact and Additional Conclusions of Law set forth in the Appendix to the Decision.

BE IT FURTHER RESOLVED, that the Board finds that Respondent's conduct does not reflect good faith for purposes of a civil money penalty.

BE IT FURTHER RESOLVED, that the Board finds that Respondent's violations of section 23A and Regulation O caused the Bank to suffer substantial financial losses of \$606,033, of which Respondent subsequently repaid \$484,607, while Respondent personally benefited from the multiple violations of law he committed, including the amount of losses on loans to Respondent and his related interests have not repaid and the Bank's failure to charge and collect interest on credits to Respondent and his related interests, amounting to at least \$150,000.

BE IT FURTHER RESOLVED, that the Board concludes that Respondent's alleged inability to repay prohibited extensions of credit to him and his related interests does not preclude a finding and conclusion that his repeated violations were deliberate and voluntary and that he demonstrated willful or continuing disregard for the safety or soundness of the Bank.

BE IT FURTHER RESOLVED, that the Board finds that Respondent's violations of section 23A and Regulation O constituted breaches of his fiduciary duty of the Bank and unsafe or unsound practices, that his violations, breaches, and practices caused the Bank to suffer substantial financial loss, and could have caused the interests of the Bank's depositors to be seriously prejudiced; and demonstrates willful or continuing disregard by Respondent for the safety or soundness of the Bank.

BE IT FURTHER RESOLVED, that by reason of the violations set forth above, a civil money penalty of \$50,000 be, and hereby is, assessed against Respondent Ronald J. Grubb pursuant to former sections 18(j)(3) and 18(j)(4) of the Act, 12 U.S.C. §§ 1828(j)(3) and 1828(j)(4).

BE IT FURTHER RESOLVED, that pursuant to section 8(e) of the Act, as amended by sections 903 and 904 of FIRREA, Pub. L. No. 101-73, §§ 903 and 904, 103 Stat. 183, 453, 457 (1989) (codified at 12 U.S.C. § 1818(e):

1. Respondent Ronald J. Grubb be, and hereby is, removed as a director of Bank of Hydro, Hydro, Oklahoma.

2. Respondent Ronald J. Grubb be, and hereby is, prohibited from serving or acting as an institution-affiliated party and/or from [{{11-30-92 p.A-2049}}](#) participating in any manner in the conduct of the affairs of any of the institutions or agencies listed herein, without the prior written consent of the FDIC and of the appropriate Federal financial institutions regulatory agency pursuant to the provisions of section 904(a) of FIRREA, Pub. L. No. 101-73, § 904, 103 Stat. 183, 457, (1989) (codified at 12 U.S.C. § 1818(e)(7):

- (i) Any insured depository institution as defined in 12 U.S.C. § 1813(c)(2), (3) and (4);
- (ii) Any depository institution holding company as defined in 12 U.S.C. § 1813(w);
- (iii) Any insured credit union under the Federal Credit Union Act as defined in 12 U.S.C. § 1752;
- (iv) Any institution chartered under the Farm Credit Act of 1971;
- (v) Any appropriate Federal banking agency as defined in 12 U.S.C. § 1813(q);
- (vi) The Federal Housing Finance Board and any Federal home loan bank; and
- (vii) The Resolution Trust Corporation.

3. Respondent Ronald J. Grubb be, and hereby is, prohibited from voting for a director, or soliciting, procuring, transferring, attempting to transfer, voting, or attempting to vote any proxy, consent, or authorization with respect to any voting rights in any institution described in paragraph 2 hereof, without the prior written approval of the FDIC and the appropriate federal banking agency as that term is defined in section 3(q) of the Act, 12 U.S.C. § 1813(q).

4. Respondent Ronald J. Grubb be, and hereby is, prohibited from violating any voting agreement previously approved by the appropriate Federal banking agency with regard to any institution described in paragraph 2 hereof, without the prior written approval of the FDIC and the appropriate Federal banking agency as that term is defined in section 3(q) of the Act, 12 U.S.C. § 1813(q).

BE IT FURTHER RESOLVED, that the Executive Secretary, or his designee, is instructed to execute and serve copies of the attached Decision and Orders on counsel for both parties, the ALJ, the Bank, and the Bank Commissioner for the State of Oklahoma.

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### RECOMMENDED DECISION

**In the Matter of  
RONALD J. GRUBB, individually and  
as a director and/or person  
participating in the conduct  
of the affairs of  
BANK OF HYDRO  
HYDRO, OKLAHOMA  
(Insured State Nonmember Bank)**

*Carey R. DeMoss, Esquire, Katherine C. Hall, Esquire and David W. Lynch, Esquire of Dallas, Texas for the Petitioner.*

*Terry W. Tippens, Esquire and Greg A. Castro, Esquire (Fellers, Snider, Blankenship, Bailey & Tippens) of Oklahoma City, Oklahoma for the Respondent.*

**Docket Nos. FDIC-88-282k  
and FDIC-89-111e**

**Steven M. Charno, Administrative Law Judge:**

On December 22, 1988, the Federal Deposit Insurance Corporation ("Petitioner" or "FDIC") issued a Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay and Notice of Hearing ("Penalty Notice") to Ronald J. Grubb ("Respondent"), individually and as a director of the Bank of Hydro, Hydro, Oklahoma ("Bank").<sup>1</sup> The Penalty Notice alleged that Respondent had violated Section 23A of the Federal Reserve Act ("Act"), 12 U.S.C. § 371c, Section 22(h) of the Act, 12 U.S.C. § 375b, Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. Pt. 215, and a Cease and Desist Order issued by Petitioner. By Answer filed February 20, 1989, Respondent denied the propriety of any civil money penalty.

On July 13, 1989, Petitioner issued a Notice of Intention to remove and/or to Prohibit from Further Participation ("Removal Notice") to Respondent, realleging the violations first cited in the Penalty Notice. By Answer of August 28, 1989, Respondent opposed the remedy sought by Petitioner. During a December 28, 1989 prehearing conference, the penalty and removal actions were consolidated for hearing and decision.

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<sup>1</sup> The Penalty Notice named four additional individuals as Respondents in this proceeding. All four were dismissed from the action as a result of negotiated settlements with Petitioner. [{{11-30-92 p.A-2050}}](#)

Hearing was held before me in Oklahoma City, Oklahoma on April 10–11 and December 3–6, 1990.<sup>2</sup> Initial post-hearing briefs, together with proposed findings of fact and conclusions of law, were submitted by Petitioner and Respondent under extended due date of June 24, 1991. Simultaneous reply briefs were filed by the parties under extended due date of July 12, 1991. By motion filed November 26, 1991, Respondent sought to have the record reopened in order to offer three late-filed exhibits. Petitioner's December 9, 1991 response opposed the motion on the ground of relevance. Under due date of December 20, 1991, Respondent filed supplemental proposed findings of fact and conclusions of law based on the late-filed exhibits. Petitioner simultaneously filed a brief opposing receipt of the exhibits. Upon consideration, I find Respondent's late-filed exhibits 329, 330 and 331 to be relevant, at the very least, to the issue of Respondent's good faith.<sup>3</sup> I therefore receive these exhibits in evidence.

## DISCUSSION

### I. Alleged Violations

#### A. Letters of Credit

MGM Production Company ("MGM") is an Oklahoma corporation which is one-third owned by Respondent. On February 14, 1986, the Bank issued a standby letter of credit on MGM's behalf to Travelers Insurance Company ("Travelers") in the amount of \$265,000. The weight of the evidence does not establish that this letter was issued pursuant to a 1983 agreement between the Bank, on the one hand, and MGM or its principals, on the other hand.<sup>4</sup> The letter was guaranteed by Respondent, but neither the letter nor the guaranty were secured by a pledge of collateral. At the time Respondent gave his guaranty, one of his loans from the Bank had been adversely classified "substandard." The standby letter of credit became effective on March 10, 1986.

On March 9 of 1987 and of 1988, the Bank renewed the letter of credit. On both occasions, the renewed letter was guaranteed by Respondent but the Bank did not have a perfected security interest in an pledged collateral.<sup>5</sup> At the time of the first renewal, other loans by the Bank to Respondent and Falcon Production Company, Inc. ("Falcon Production")<sup>6</sup> had been adversely classified "substandard;" at the time of the 1989 renewal, other outstanding loan to Respondent and Falcon Production had been adversely classified "doubtful." On April 14, 1988, the Bank disbursed \$235,801 pursuant to the letter of credit and booked the transaction as a loan in that amount to MGM. At the time the letter was funded Respondent guaranteed the resulting loan but the Bank did not have a perfected security interest in any pledged collateral. In December of 1988, the Bank charged off the MGM loan as a "loss."

Petitioner maintains that the three letters of credit and the loan violate the lending limits of Section 23A of the Act, which prohibits an extension of credit to or on behalf of an "affiliate" which exceeds 10 percent of a bank's capital and surplus. Respondent, relying upon Section 23A(b)(2)(E) of the Act, argues that MGM is not an "affiliate"

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<sup>2</sup> The unopposed transcript corrections proposed by Petitioner are hereby adopted.

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<sup>3</sup> In this context, Petitioner has requested a finding that two of Respondent's loans from the Bank were news repaid. See Petitioner's proposed finding of fact 257. That finding is directly controverted by the proffered exhibits.

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<sup>4</sup> Respondent contends without controversion that he "assured MGM" in 1983 that the Bank would, under certain circumstances, "issue a letter of credit ..." See Respondent's proposed finding of fact 53. Although Respondent testified to this effect, there is no evidence that (1) Respondent had authority to bind the Bank in this manner or (2) the Bank's Board of Directors authorized such a commitment. Absent a demonstration that the Bank as opposed to Respondent, agreed to issue the letter of credit, I find Respondent's assurances to be immaterial. In addition, there is no documentary evidence of a

"preexisting obligation" to issue the letter, and the Bank President, whose tenure in various capacities commenced in 1981, credibly testified that he was unaware of any such agreement. For the foregoing reasons, I have made the finding set forth in text.

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<sup>5</sup> Respondent contends that, on July 23, 1986, he executed a security agreement pledging a \$2.7 million judgment in his favor to secure the letter of credit. See Respondent's proposed finding of fact 67. In addition to showing that no such agreement was in the Bank's files during the 1987 bank examination, Petitioner contends that the pledge did not provide sufficient protection since the "bank did not have a perfected security interest in the judgment until February 15, 1989." Reply Brief of the Federal Deposit Insurance Corporation at 40. The record establishes that the judgment in question had been pledged to at least one other financial institution, and there is no indication that the latter institution knew of Respondent's pledge to the Bank. Because the Bank's unperfected security interest would not be valid against another institution in the absence of knowledge, I accept Petitioner's contention which is factually supported by the admission of the Bank's President, the report of a 1989 examination of the Bank and the 1989 Assignment of Judgment.

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<sup>6</sup> Respondent's relationship to Falcon Production is discussed at page 9, *infra*. [{{11-30-92 p.A-2051}}](#) of the Bank. "Affiliate" is defined by Section 23A(b)(2)(E) so as to exclude "any company where control results from the exercise of rights arising out of a bona fide debt previously contracted..." Petitioner, citing an Interpretive Letter of the Federal Reserve Board,<sup>7</sup> contends that the statutory exemption applies only to companies the control of which was acquired through foreclosure or otherwise in satisfaction of a previously contracted debt. While the statute is less than clear on its face, it would appear that the construction advanced by Petitioner is both reasoned and based in fact, while the interpretation advanced by Respondent is without logical or factual support.<sup>8</sup> Accordingly, I conclude that the exemption is inapplicable, that MGM is an "affiliate" of the Bank and that the letters of credit and loan are subject to the lending limits of Section 23A of the Act. In view of the parties' stipulation that the letters of credit for \$265,000 exceeded 10 percent of the Bank's capital and surplus on February 14, 1986 and March 9, 1987,<sup>9</sup> I conclude that the letters issued on those dates violated Section 23A(a)(1)(A) of the Act. Because the Bank's April 14, 1988 loan for \$235,801 was less than 10 percent of the Bank's stipulated capital and surplus of \$2,506,000 on that date, I conclude that the loan to MGM did not violate the Act.

Petitioner next contends that the letters of credit and the resulting loan violate the collateral requirements of Section 23A(c)(1) of the Act. Respondent maintains that his guaranty constitutes sufficient collateral to meet the statutory requirement. Petitioner argues that the "personal guaranty of an individual, standing alone, does not provide sufficient protection for purposes of Section 23A."<sup>10</sup> Section 23A(c)(1) provides that an extension of credit to or on behalf of an affiliate "shall be secured at the time of the transaction by collateral" and enumerates various acceptable forms of collateral, all of which are tangible assets readily subjected to hypothecation. Indeed, it has been held that the security interest in collateral required by Section 23A must be perfected in order to protect depositors from the dangers of inadequately secured insider transactions. *Fitzpatrick v. FDIC*, 765 F.2d 569, 573-74 (6th Cir. 1985). Because a perfected security interest in collateral did not exist at the time the three letters of credit were issued or when the loan to MGM was made, I find all four transactions to be violative of Section 23A(c)(1) of the Act.

Petitioner also contends that the three letters of credit and the loan violate the lending limit prohibitions and the creditworthy requirements of Regulation O. Respondent demurs, arguing that the transactions are exempt from Regulation O because they represent "indebtedness to a bank for the purpose of protecting the bank against loss ..." See 12 C.F.R. § 215.3(b)(4). Given my earlier finding that there is insufficient evidence to establish that the Bank committed itself in 1983 to the subsequent issuance of a letter of credit in exchange for the payment in 1983 of a then-outstanding debt to the Bank, I must find that the Bank was not being protected against any identifiable loss when the first letter of credit was issued. I therefore reject Respondent's argument for want of factual support.

Respondent also appears to argue that extensions of credit to or on behalf of MGM were not within the purview of Regulation O because MGM was not a "related interest" of Respondent. Section 215.2(k) of Regulation O defines a "related interest" as "a company that is controlled by a person."<sup>11</sup> "Control" is presumed to exist when a person owns more than 10 percent of a company's voting securities. 12 C.F.R. § 215.2(b)(2). Given Respondent's stipulated ownership of one-third of MGM, I conclude that MGM is Respondent's related interest.

Petitioner alleges that the first two letters

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<sup>7</sup> 1 Fed. Res. Serv. 3-1126 (1941).

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<sup>8</sup> In any event, Respondent's contention that a 1983 "commitment to issue a letter of credit ... represents a substitute credit for a `bona fide debt previously contracted'" must be rejected in view of my finding that no such commitment was shown to have existed. See note 4 and accompanying text, *supra*.

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<sup>9</sup> Petitioner did not enter a stipulation nor propose a finding of fact concerning the amount of the Bank's capital and surplus on March 9, 1988. Absent such a finding, I cannot conclude that the issuance of a letter of credit on that date violated Section 23A(a)(1)(A) of the Act.

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<sup>10</sup> Proposed Findings of Fact, Proposed Conclusions of Law, and Brief of the Federal Deposit Insurance Corporation ("Petitioner's Brief") at 107.

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<sup>11</sup> It is immaterial that MGM was originally organized as a partnership, since the term "company" includes a partnership. 12 C.F.R. § 215.2(a).

{{11-30-92 p.A-2052}}of credit and the loan to MGM,<sup>12</sup> when aggregated with the Bank's other loans to Respondent and his related interests, violate the lending limits of Section 215.4(c) of Regulation O, which prohibit an aggregation of loans by a bank to or on behalf of an insider or his related interests which exceeds 15 percent of the bank's capital and surplus. Based on the stipulated loans outstanding to Respondent and his related interests and the Bank's stipulated capital and surplus of the dates in question, I find that the issuance of the first two letters of credit, as well as the funding of the loan to MGM, caused the Bank to exceed the 15 percent lending limit. Accordingly, I conclude that Respondent violated Section 215.4(c) of Regulation O on all three occasions.

Finally, Petitioner contends that the letters and the loan were extensions of credit which involved more than normal risk of repayment or presented other unfavorable features in violation of Section 215.4(a)(2) of Regulation O. The parties stipulated that, at the time each letter of credit was issued, the Bank had adversely classified loans outstanding to Respondent and his related interests. Because the adverse classification of an outstanding loan to a borrower is an "unfavorable feature" of a new loan to or on behalf of that borrower, I must conclude that issuance of all three letters of credit was violative of Section 215.4(a)(2) of Regulation O.<sup>13</sup> See *Docket No. FDIC-89-229b*, 1991 F.D.I.C. Enf. Dec. (P-H) ¶5164.<sup>14</sup>

#### B. Overdrafts

During 1986 and 1987, the Bank maintained checking accounts on behalf of Respondent and certain of his related interests: MGM, Falcon Management Company ("Falcon Management"), a corporate wholly owned by Respondent, and Ron Grubb Investments ("RGI"), Respondent's sole proprietorship. It is uncontested that all of these accounts were overdrawn at various times between July 1, 1986 and November 30, 1987.

Petitioner contends that each of these overdrafts violated three provisions of Regulation O: the creditworthy requirements of Section 215.4(a)(2), the lending limits of Section 215.4(c) and the requirement of Section 215.4(b) that certain loans be given prior approval by a disinterested majority of a bank's board of directors. Petitioner further contends that the Bank's payment of overdrafts on Respondent's personal account violated the overdraft prohibition of Section 215.4(d) of Regulation O. Finally, Petitioner contends that the overdrafts of MGM and Falcon Management violated the collateral requirements of Section 23A of the Act.

In response, Respondent argues that the lending limits of Regulation O and the collateral requirements of Section 23A were not violated because all of the overdrafts `were secured by segregated deposits within the Bank ..."<sup>15</sup> Any extension of credit which is, in fact, secured by collateral consisting of a segregated, earmarked deposit account is not subject to the lending limits of Regulation O<sup>16</sup> and does not violate the collateral requirements of Section 23A.<sup>17</sup> Petitioner argues that the right of offset arguably created by the text of the Bank's checking account signature cards does not constitute secured collateral. I agree, See 6 Okla. Stat. Ann. § 802B(16); Okla. St. Banking Bd. Rule IV-11(c)(2). Because Section 23A and the exemption from Regulation O both explicitly require that extensions of credit be secured by collateral,<sup>18</sup> I conclude that a right of offset does not provide the required security interest. See *Docket No. FDIC-83252b&c*, 1985 F.D.I.C. Enf. Dec. (P-H) ¶5049 at 6172; 12 C.F.R. § 32.6(f); 48

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<sup>12</sup> Petitioner did not enter a stipulation or request a finding of fact concerning (1) the Bank's capital and surplus on the date of issuance of the third letter of credit or (2) the total credit or (2) the total credit extended by the Bank to Respondent and his related interests on that date. Absent such findings, I cannot conclude that issuance of the final letter of credit violated Section 215.4(c) of Regulation O.

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<sup>13</sup> Petitioner has argued that the issuance of each letter of credit violated Section 215.4(a)(2) for several

reasons in addition to the one discussed above. Given my conclusion that the regulation was violated, Petitioner's additional reasons are moot. I have adopted a similar approach throughout this Decision. Thus, whenever I conclude that a violation exists and base that conclusion on one of several alternative rationales advanced by Petitioner, I make no findings with respect to those rationales which I did use as a basis for my conclusion.

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<sup>14</sup> While it requested a conclusion of law that the loan to MGM violated Section 215.4(a)(2) of Regulation O, the FDIC did not enter stipulations or request findings of fact concerning any factors adversely affecting the risk of repayment or otherwise representing unfavorable features at the time the loan to MGM was funded. Absent such findings, Petitioner's requested conclusion must be rejected.

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<sup>15</sup> Respondent's proposed finding of fact 101.

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<sup>16</sup> 12 C.F.R. §§ 215.2(f) & 215.4(c); 18 U.S.C. § 84.

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<sup>17</sup> 12 U.S.C. § 371c(d)(4)(C).

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<sup>18</sup> See 12 U.S.C. § 371c(c)(1); 12 U.S.C. § 84(a)(6).

[{{11-30-92 p.A-2053}}](#)

Fed. Reg. 15844 (April 12, 1983). Accordingly, I conclude that the overdrafts of MGM and Falcon Management were not secured by acceptable collateral and that those extensions of credit were therefore violative of Section 23A of the Act. Based on the foregoing discussion and on the parties' stipulations concerning the volume of loans outstanding to Respondent and his related interests during 1986 and 1987, I further conclude that the overdrafts of Respondent, MGM, Falcon Management and RGI violated the lending limits of Section 215.4(c) of Regulation O.

Respondent also argues that the prior approval requirements of Section 215.4(b) were met because "a majority" of the Bank's Board of Directors "approved the overdrafts on an individual and daily basis."<sup>19</sup> The Bank's records show that the overdrafts in question were approved after, rather than before, the disbursement of funds.<sup>20</sup> Testimony that one or more unnamed directors informally approved overdrafts on a daily basis does not meet Respondent's shifted burden of demonstrating that each of the challenged overdrafts was given approval by a disinterested majority of the Board prior to any disbursement of funds. I therefore find that the probative evidence of record does not establish the presence of prior approval. Accordingly, I conclude that the overdrafts by Respondent, MGM, Falcon Management and RGI violate the prior approval requirement of Section 215.4(b) of Regulation O.

The parties' stipulations establish that the Bank had loans outstanding to Respondent and his related interests between July 1, 1986 and November 30, 1987 which had previously been classified "substandard." Because the adverse classification of an outstanding loan constitutes an "unfavorable feature" of any new loan to the same borrower, I conclude that the overdrafts by Respondent, MGM, Falcon Management and RGI violated the creditworthy requirements of Section 215.4(a)(2) of Regulation O. See *Docket No. FDIC-89-229b, supra*.

The final question relating to overdrafts<sup>21</sup> concerns the interpretation of Section 215.4(d) of Regulation O which provides:

No member bank may pay an overdraft of an executive officer or director of the bank, unless the payment of funds is made in accordance with (1) a written, pre-authorized, interest-bearing extension of credit plan that specifies a method of repayment or (2) a written, pre-authorized transfer of funds from another account of the account holder at the bank.

Respondent appears to contend that the overdrafts on his personal account fall within the quoted exceptions because a written agreement provided for repayment and pledged his other accounts to repay any particular overdraft.<sup>22</sup> Because there is no evidence of the existence of a written plan which provided for the payment of interest, I conclude that the first exception of Section 215.4(d) is inapplicable. Although interpretation of the second exception appears to present a question of first impression,<sup>23</sup> the provision's wording seems intended to prevent risk to a bank by requiring an actual transfer of funds between accounts upon the occurrence of an overdraft. This reading is fully consonant with the general purpose underlying the remaining provisions of Section 215.4 of Regulation O. Because no transfer of funds took place pursuant to any agreement identified by Respondent,<sup>24</sup> I conclude that Respondent's agreement did not meet the requirements of the second exception. For the foregoing reasons, I conclude that the overdrafts on Respondent's personal account violated Section 215.4(d) as charged.

### C. Dealing With Falcon Production

It is uncontested that Respondent was one of the original incorporators of Falcon Production and that he thereafter served as its President and one of its directors. In addition, the parties stipulated that Respondent "exercised controlling influence over the management and policies of Falcon Production." The power to exercise such an influence constitutes control of the company so influenced. 12 C.F.R. § 215.2(b)(2). Be-

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<sup>19</sup> Respondent's proposed finding of fact 97.

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<sup>20</sup> Petitioner's examiner credibly so testified without controversion.

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<sup>21</sup> Respondent's argument that various overdrafts occurred pursuant to an agreement to honor overdrafts while deposits were in transit is without relevance to the question of whether Respondent violated Regulation O and Section 23A.

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<sup>22</sup> See Respondent's proposed finding of fact 248.

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<sup>23</sup> Neither of the parties identified any legal authority concerning this question.

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<sup>24</sup> Respondent's accountant so testified.

{{11-30-92 p.A-2054}} cause a company controlled by a person is a "related interest" of that person within the meaning of Regulation O, I find that Falcon Production was related interest of Respondent. See 12 C.F.R. § 215.2(k).

#### 1. Loans

The parties stipulated that the Bank loaned \$110,000 to Falcon Production on December 31, 1985 for a one year term and that the Bank renewed that loan on February 12, 1987. Respondent personally guaranteed the loan and the renewal. It is uncontested that the proceeds of the initial loan were transferred to Respondent and used for his tangible economic benefit. When the loan was made and when it was renewed, Respondent had outstanding loans from the Bank which had previously been classified "substandard."

Petitioner contends that the loan and renewal both violated the creditworthy requirements of Regulation O. As discussed above, the adverse classification of an outstanding loan is an "unfavorable feature" of a new extension of credit to the same borrower. See *Docket No. FDIC-89-229b, supra*. I therefore conclude that the loan and the renewal violated Section 215.4(a)(2) of Regulation O.

Petitioner further contends that the renewal exceeded the aggregate lending limits established by Regulation O. Because it is uncontested that the Bank's aggregate extensions of credit to Respondent and his related interests on February 12, 1987 exceeded 15 percent of the Bank's capital and surplus on that date, I conclude that the Bank's renewal of the Falcon Production loan violated Section 215.4(c) of Regulation O.

#### 2. Other Real Estate

The following facts concerning this matter are not in dispute. On February 2, 1988, Falcon Production failed to pay principal or interest on the renewal loan. Because the loan was past due, the Bank on February 22, 1988<sup>25</sup> accepted a deed to the real estate collateral in lieu of foreclosure. At that time, the past due principal and accrued interest on the loan amounted to \$124,311. Also on February 22, the Bank paid off a superior outstanding lien on the collateral in the amount of \$134,447. Recognizing that the property's appraised value<sup>26</sup> exceeded the total expenditures set out above, the Bank disbursed additional funds purportedly representing the borrower's equity to Falcon Production: \$48,553 on February 17 and \$34,688 on February 22, 1988. The \$83,241 received by Falcon Production was transferred to Respondent who economically benefitted therefrom. In order to reflect the entire transaction on its books, the Bank removed the principal and interest due on the renewal from its accounts and booked the deeded property as "Other Real Estate" ("ORE") with a value of \$342,000, a figure which represented 90 percent of the property's appraised value.

Petitioner presents another legal issue of first impression with its contention that the disbursements to Falcon Production on February 17 and 22 constitute "extensions of credit" within the meaning of Regulation O. Section 215.3(a)(8) of Regulation O provides as follows:

An extension of credit. . . includes. . . [a]ny 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.

The determinative conclusion to be reached is, therefore, whether Respondent was "obligated to pay money" to the Bank as a result of the ORE transaction. Petitioner contends that Respondent was not entitled to receive the \$83,241 and was obligated to repay it to the Bank for two reasons: (1) Respondent allegedly received the funds in violation of state law and (2) he allegedly received them as a result of an unsafe or unsound banking practice.

The statutory framework in which to evaluate the Falcon Production ORE transaction is found in Section 414B of the Oklahoma Banking Code, 6 Okla. Stat. Ann. § 414B, which allows a bank to acquire real estate in satisfaction of a previously contracted debt and requires that the acquired real estate be booked at the lower of fair market value or the bank's "recorded investment." Section 414B further provides that "recorded investment" shall, as relevant, consist of unpaid principal of the debt satisfied, unpaid accrued interest and "loan acquisition costs."

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<sup>25</sup> My modification of the stipulated date "February 24, 1988" is based on the credited, uncontroverted correction of the parties' stipulations found in Examiner Hildebrand's testimony.

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<sup>26</sup> The parties stipulated that there was an outstanding \$380,000 appraisal on the property at the time of transfer.

[{{11-30-92 p.A-2055}}](#)

The parties agree that payment of a first mortgage may properly be designated an "acquisition cost," but they differ as to the propriety of so designating a payment representing a defaulting borrower's equity in the acquired property. The statute does not explicitly address this question, and there appears to be no dispositive decisional authority.

Petitioner argues that a statutory mandate to book the lesser of value or the acquirer's investment by implication requires one to ignore any outstanding equity when determining "acquisition cost," since equity is by definition the difference between value, on the one hand, and acquisition costs in the form of liens and fees, on the other hand. See *Black's Law Dictionary* 484 (5th ed. 1979). This argument is consonant with the manifest statutory intent underlying Section 414B, that is, to lessen a bank's risk by requiring it to adopt a conservative accounting methodology when booking ORE transactions. Citing statutory schemes which do not contain a mandate similar to the accounting prescription of Section 414B, Respondent argues that the term "acquisition cost" is "clearly ... broad enough" to include payments representing equity made in the course of a loan workout.<sup>27</sup> While the issue is far from clear, I believe that Petitioner has presented a logical basis for acceptance of the statutory construction which it advocates. Accordingly, I conclude that (1) the disbursement of funds representing Falcon Production's equity was not an appropriate "acquisition cost" within the meaning of Section 414B, (2) the Bank's payment of \$83,241 to Falcon Production pursuant to the ORE transaction violated the requirements of Section 414B and (3) Respondent was not entitled to receive these funds.

In evaluating the allegation that the Falcon Production ORE transaction was an unsafe or unsound practice, I shall employ the definition set forth in *Gulf Fed. S. & L. v. Fed. Home Loan Bank B.*, 651 F.2d 259, 264 (5th Cir. 1981), quoting 112 Cong. Rec. 26474 (1966):

an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

The weight of the evidence establishes that it is neither usual nor prudent for a bank to pay equity to a defaulting borrower when accepting a deed in lieu of foreclosure in satisfaction of the borrower's debt.<sup>28</sup> Whether this practice was unsafe or unsound therefore turns on whether it created a possibility of abnormal risk or loss to the Bank. Respondent arranged the ORE transaction in order to allow the Bank to hold the real estate until he could reacquire it and to obtain additional funds<sup>29</sup> during a period when any further loan to him by the Bank was proscribed by the lending limits of Regulation O.<sup>30</sup> The probative evidence of record establishes that the ORE transaction transferred the risk of any decline in the value of the deeded property from Respondent to the Bank.<sup>31</sup> Thus, the Bank's risk of loss was magnified by the fact that the payments to Falcon Production caused the Bank to decrease its "cushion" against falling property values by \$83,241. The possibility that property values would rise after the ORE transaction, thereby preventing an actual loss to the Bank, could not have been foreseen or rationally relied upon at the time of the transaction and such a possibility is therefore irrelevant to the question of whether the trans-

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<sup>27</sup> Respondent's proposed conclusion of law 99.

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<sup>28</sup> The credited expert testimony to this effect of Petitioner's examiner and the Bank Commissioner for the State of Oklahoma ("State Commissioner") are supported by (1) the admission of Respondent's President that he was unaware of any similar transaction during his six year tenure with the Bank and (2) the testimony of Respondent's expert that the only similar transactions of which he was aware involved failed financial institutions.

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<sup>29</sup> Initially, Respondent candidly admitted that these ends were among his purposes in arranging the transaction. I credit that testimony, which was corroborated by Examiner Hildebrand's credited recitation of hearsay concerning information received from the Bank's employees, over Respondent's subsequent, self-serving denial. The question of whether a higher price could have been obtained from a public sale of the property is without relevance in view of Respondent's intention to warehouse the property for subsequent repurchase.

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<sup>30</sup> Examiner Hildebrand testified credibly and without controversy that the total amount of Respondent's loans from the Bank was in excess of the Regulation O lending limit from February 14, 1986 through the time at which the Falcon Production ORE transaction took place.

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<sup>31</sup> The credited testimony of the State Commissioner to this effect was corroborated by the admission of the Bank's President.

[{{11-30-92 p.A-2056}}](#) action posed an abnormal risk to the Bank. For the foregoing reasons, I conclude that the Falcon Production ORE transaction was an unsafe or unsound banking practice and that Respondent was therefore not entitled to receive the funds disbursed during that transaction.

Because Respondent received funds to which he was not entitled as a result of a transaction which was both an unsafe or unsound banking practice and a violation of law,<sup>32</sup> Respondent, as a fiduciary of the Bank, was obliged to repay those funds.<sup>33</sup> Accordingly, I conclude that the disbursement of funds to Respondent pursuant to the Falcon Production ORE transaction were "extensions of credit" within the meaning of Section 214.3(a)(8) of Regulation O.

Petitioner contends that both extensions of credit were violative of Regulation O. I agree. Because Respondent's obligation to repay these extensions of credit was wholly undocumented, I conclude that the disbursement of \$83,241 created a more than normal risk of repayment in violation of the creditworthiness requirements of Section 215.4(a) (2) of Regulation O. Finally, given the fact that the Bank's extensions of credit to Respondent prior to February 17, 1988 already exceeded Regulation O's lending limits,<sup>34</sup> I must conclude that the additional extensions of credit to Respondent on February 17 and 22, 1988 violated the lending limits of Section 215.4(c) of Regulation O.

#### D. Respondent's Personal Loans

During a 1985 examination of the Bank, Respondent's personal loans were classified "substandard" because they were unsecured and because his financial net worth had been steadily declining.<sup>35</sup> It is uncontested that all of those loans were paid off by April of 1986.

The parties agree that the Bank made four extensions of credit to Respondent during 1986 and 1987. On April 25, 1986, the Bank made a \$75,000 loan to Respondent. On June 5, 1986, the Bank made a \$150,000 loan to Respondent, which was used to renew the principal and unpaid interest of the April 25 loan and to provide Respondent with \$73,884 in new funds. On October 29, 1986, the Bank made a loan for \$100,000 to Respondent, approximately \$39,000 of which was used to pay Respondent's overdrafts on another account with the Bank. On April 14, 1987, the Bank made a \$250,000 loan to Respondent for a term of three years. This extension of credit represented a consolidation of the loans of June 5 and October 29, 1986.

Petitioner contends that these four loans violated both the lending limit restrictions and the creditworthiness requirements of Regulation O. Based on the parties' stipulations as to the Bank's aggregate extensions of credit to Respondent and his related interests when the four loans were made, as well as the Bank's aggregate lending limits on those days, I conclude that each of the Bank's four personal loans to Respondent violated Section 215.4(c) of Regulation O.

An "unfavorable feature" exists within the meaning of the creditworthiness requirements of Regulation O where a borrower with a controlling interest in a bank creates a conflict of interest by seeking money for himself and his related interests in violation of law. *Docket No. FDIC-84-23b*, 1986 F.D.I.C. Enf. Dec. (P-H) ¶15061 at 6531-32. Because Respondent on four occasion sought money from a bank which he controlled in violation of the lending limits of Regulation O, I conclude that each of the four loans had an "unfavorable feature" violative of Section 215.4(a)(2) of Regulation O.

#### E. Order to Cease and Desist

In 1985, the FDIC issued a Cease and Desist Order to the Bank. Petitioner alleges that the Bank's Board of Directors violated various provisions of the Order by (1) capitalizing uncollected interest on two occasions, (2) twice failing to document the reasons for extensions of credit to classified borrowers, (3) failing to document the reasons for purchasing a loan participation and (4) failing to amend the loan policy to reflect changes required by the FDIC.

Existence of the two violations involving capitalization of interest is uncontested. Re-

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<sup>32</sup> The fact that the Bank may have received value in exchange for the sums it disbursed in no way alters the illegality or unsafe or unsound nature of the transaction.

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<sup>33</sup> Subsequent to the transaction here at issue, Congress codified the FDIC's authority to remedy unsafe or unsound practices and statutory violations by requiring restitution by an unjustly enriched insider. See 12 U.S.C. § 1818(b)(6).

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<sup>34</sup> See note 30, *supra*.

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<sup>35</sup> This fact does not appear to be in dispute. See Petitioner's proposed finding of fact 225 and Respondent proposed finding of fact 163. [{{11-30-92 p.A-2057}}](#) Respondent established that the two loans and the loan participation at issue were discussed by the Board of Directors but conceded that they were not properly documented due to oversights by the Bank's President. The weight of the evidence establishes that the Bank did not amend its loan policy so as to incorporate changes required by the FDIC.<sup>36</sup> Respondent, as a member of the Bank's Board of Directors, had an affirmative obligation to monitor and insure the Bank's compliance with the provisions of the Cease and Desist Order. See *Docket No. FDIC-85-303k*, 1987 F.D.I.C. Enf. Dec. (P-H) ¶5089 at 7090; *Docket No. FDIC-80-34k*, 1981 F.D.I.C. Enf. Dec. (P-H) ¶5004 at 5050. Accordingly, I conclude that Respondent bears responsibility for the demonstrated violations of the Order. It is uncontested that none of the foregoing violations resulted in a loss to the Bank.

#### II. Civil Money Penalty

Civil money penalties may be assessed whenever there is a violation of the statutory or regulatory promulgations which govern the relationship between a bank, on the one hand, and its insiders and their related interests, on the other hand. See 12 U.S.C. §§ 1818(i)(2) and 1828(j)(4). Respondent is concededly one of the Bank's insiders by virtue of his positions as the Bank's principal shareholder and a member of its Board of Directors. As discussed above, many of the Bank's extensions of credit to Respondent and his related interests violated the provisions of Section 23A, Regulation O or state law. In addition, Respondent has been found responsible for the Bank's violations of an outstanding Cease and Desist Order.

Because Respondent committed violations which render him liable for the payment of a civil money penalty, the size of that penalty must be determined. Petitioner contends that it should be \$50,000. In setting the amount of a penalty, Congress has mandated that:

the Corporation shall take into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of the member bank or person charged, the gravity of the violation, the history of previous violations, and such other matters as justice may require. 12 U.S.C. § 18(j)(4)(B).

The relative weight to be given each of these statutory factors is within the FDIC's discretion, which cannot be exercised arbitrarily and must be based on reasoned analysis and substantial evidence. See *Butz v. Glover Livestock Co.*, 411 U.S. 182, 185 (1973).

The Board of Directors of the FDIC has adopted the Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies ("Interagency Policy") which provides:

In determining the amount of a civil money penalty, the agencies believe that a significant consideration should be the financial or economic benefit the Respondent obtained from the violation.... The removal of economic benefit will, however, usually be insufficient by itself to promote compliance with the statutory provisions. The penalty may, therefore, in appropriate circumstances reflect some additional amount beyond the economic benefit derived to provide a deterrent to future conduct. 45 Fed. Reg. 59423 (1980).

This emphasis on deterrence accurately reflects the legislative history of the statutory scheme which

authorizes the imposition of civil money penalties. See S. Rep. No. 95-323, 95th Cong., 1st Sess. 9 (1977); H. Rep. No. 95-1383, 95th Cong., 2d Sess. 17 (1978). The removal of any economic benefit received by Respondent may appropriately be considered in the context of the statutory factor concerning the gravity of Respondent's offenses, while the deterrent aspect of the penalty is clearly relevant as a matter which "justice may require."

The Interagency Policy also lists 13 elements which an agency should consider in determining whether to initiate a civil money penalty assessment proceeding. Since these elements explicitly relate only to the decision to initiate a proceeding, they cannot be concluded to control the amount of the penalty ultimately set. As relevant, these elements will be considered in the context of the five statutorily mandated factors set out above.

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<sup>36</sup> Examiner Niles credibly so testified. The testimony of the Bank's President that the loan policy was amended on a number of occasions does not controvert Niles' account. Indeed, the Bank's President could not even recall receiving the loan policy changes requested by the FDIC.

{{11-30-92 p.A-2058}}

#### A. Financial Resources

The parties have stipulated that Respondent's "total income" as of December 31, 1989 exceeded \$450,000 and that he annually receives salaries from various banks which total more than \$200,000. Although Respondent uses his salaries to service outstanding debt, he conceded that he could pay a \$50,000 penalty over a three year period.<sup>37</sup> In addition, Respondent's debt service obligations and overall net worth were substantially improved by his recent receipt of \$3,250,000 as a result of settling his lawsuit against the FDIC.<sup>38</sup> I therefore find that, as long as respondent continues to receive the stipulated remuneration for his activities as a banker, he will have sufficient financial resources to allow him to pay a \$50,000 civil money penalty.<sup>39</sup>

#### B. Good Faith

Petitioner has requested a series of findings concerning Respondent's remedial efforts.<sup>40</sup> Some of these proposals lack factual support and others tend to distort the actual facts of record. More specifically, Petitioner has proposed findings that correctly note that Respondent was informed of his alleged violations at the conclusion of bank examinations conducted in 1986, 1987 and 1989 but incorrectly state that he "took no action to correct" these violations or to repay the extensions of credit which were criticized in reports of the various examinations.

As is apparent from the foregoing discussion of the merits of this proceeding, the violations in this case were caused by (1) an extension of credit on behalf of MGM and the renewals and funding thereof,<sup>41</sup> (2) the sequence of loans to Respondent,<sup>42</sup> (3) overdrafts by Respondent, MGM, Falcon Management and RGI,<sup>43</sup> (4) an extension and renewal of credit to and the resulting ORE transaction involving Falcon Production<sup>44</sup> and (5) various violations of the Cease and Desist Order.<sup>45</sup> It is uncontested that no prohibited overdrafts or violations of paragraphs 6(c), 6(d) or 7(b) of the Cease and Desist Order took place after the 1987 examination of the Bank.<sup>46</sup> It would therefore seem that Respondent did make a successful effort, albeit belatedly, to "correct" these types of violations.

The principal balances of the Bank's loans to Respondent and MGM were ultimately repaid on November 14, 1991,<sup>47</sup> thereby at least partially "correcting"<sup>48</sup> the violations caused by these loans.<sup>49</sup> Unlike Petitioner, I am not inclined to make much of Respondent's failure to repay these loans at an earlier date. The record is clear that Respondent was without the financial resources to retire these debts until his lawsuit against the FDIC came to fruition.<sup>50</sup> It is uncontested that settlement of the lawsuit resulted in the FDIC's paying Respondent \$3,250,000 on November 13, 1991 and Respondent's repaying the principal balance of his and MGM's loans the following day. Because Respondent paid these debts at the earliest practical moment, I find that his delay in so doing was not demonstrative of bad faith.

The remaining transactions as to which Petitioner has requested findings involve the Bank's dealings with Falcon Production. The Bank's loan to Falcon Production and the renewal of that loan, both of which were criticized in the report of the December 31, 1987 examination of the Bank, were "cor-

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<sup>37</sup> Respondent so testified.

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<sup>38</sup> The settlement agreement is of record.

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<sup>39</sup> The only evidence in the record concerning Respondent's actual income is that relating to his various salaries as a banker. Accordingly, there is no evidence to support a finding that he would have the

financial ability to pay a civil money penalty if he was removed from banking.

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<sup>40</sup> Petitioner's proposed findings of fact 249-57.

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<sup>41</sup> These extensions caused 12 violations.

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<sup>42</sup> These loans resulted in eight violations.

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<sup>43</sup> These overdrafts provided the basis for 15 conclusions that violations occurred.

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<sup>44</sup> This series of transactions resulted in six violations.

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<sup>45</sup> Failures to comply with the Order comprised six violations.

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<sup>46</sup> Petitioner has not sought a finding nor otherwise explained what efforts to remedy violations of the Order were expected or appropriate.

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<sup>47</sup> The veracity of the Bank President's memorandum to this effect is unchallenged, and I credit the document.

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<sup>48</sup> In the credited, uncontroverted expert opinion of the State Commissioner, "a violation can totally be corrected ... by paying off ... the debt."

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<sup>49</sup> I presume it to be beyond dispute that the existence of a recovery does not excuse an associated violation.

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<sup>50</sup> I credit Respondent's uncontroverted testimony to this effect, which was supported by the expert opinions of (1) Examiner Adams that, as early as 1986, Respondent was unable to meet his outstanding debts except by further borrowing and he had cash-flow problems which rendered highly suspect his ability to continue to service his debts and (2) Examiner Hildebrand that respondent "basically was insolvent" as of January 23, 1989 if one did not consider the then-pending judgment against the FDIC. [{{11-30-92 p.A-2059}}](#)rected"<sup>51</sup> on February 22, 1988 when Respondent deeded to the Bank real estate collateral appraised at an amount well in excess of the amount of the underlying debt. That ORE transaction also resulted in new, unlawful extensions of credit to Respondent, and those extensions have never been repaid. Respondent's attitude with respect to this transaction is representative of his general attitude toward the Bank. While he does not appear ever to have engaged in a transaction with the intention of securing a profit which would cause a loss to the Bank, he has often treated the Bank's resources as if they were his personal purse which he might employ without regard to regulatory constraints.<sup>52</sup>

In summary, I find that (1) Respondent took belated action to remedy overdraft and Cease and Desist Order violations, (2) he repaid the principal balances of the extensions of credit made to him and MGM, (3) his personal honesty has not been called into question, (4) he did not attempt to conceal his activities or otherwise deceive either regulators or the Bank's management, (5) he cooperated with the inquiries of Petitioner and the Oklahoma State Banking Department ("State") and (6) he acted with disregard for the requirements of the law in connection with the Falcon Production ORE transaction. While the degree of good faith demonstrated by Respondent would tend to preclude the imposition of a penalty in excess of \$50,000, I find a penalty in that amount to be reasonable.

#### C. Gravity of the Violation

As relevant to this proceeding, the gravity of Respondent's violations may be measured in two ways: (1) the effect of these violations upon the Bank and (2) the extent to which Respondent benefitted from the violations. The first of these measures is the subject of Petitioner's proposed finding that the Bank's aggregate extensions of credit to Respondent and his related interests between February 1986 and December 1990 were at all times in excess of regulatory lending limits.<sup>53</sup> This fact is uncontested, and I so find. The weight which may be accorded the lengthy duration of Respondent's violations is lessened by his financial inability to make restitution prior to November of 1991.<sup>54</sup>

In contrast, the economic benefit enjoyed by Respondent is a wholly appropriate measure of the gravity of his violations, and removal of that benefit is a central injunction of the Interagency Policy. The FDIC has concluded that, as a matter of law, any receipt of credit which should not have been received is an indirect economic benefit to the recipient. *E.g., In re. R. Wayne Lowe*, 1990 F.D.I.C. Enf. Dec. (P-H)

¶5153.<sup>55</sup> However, in order to comply with the dictates of the Interagency Policy and remove the benefit flowing from a violation, that benefit must be quantified. Relying upon its expertise, the FDIC has measured benefit to the violator by the amount of actual loss suffered by a bank as a result of the violation. *E.g., Docket No. FDIC-85-87k*, 1988 F.D.I.C. Enf. Dec. (P-H) ¶5119.<sup>56</sup> Neither the prohibited overdrafts nor violations of the Cease and Desist Order were shown to have resulted in actual loss to the Bank.<sup>57</sup> Based on my earlier determination that Respondent repaid the principal balances of both his personal loan and the extension of credit to MGM, I find that these amounts do not constitute actual loss to the Bank.<sup>58</sup> Similarly, the principal balance of the extension

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<sup>51</sup> See note 48, *supra*.

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<sup>52</sup> In reaching this determination, I have relied upon the credited testimony of Messrs. Adams, Hildebrand, Osborn and Schamburg, as well as upon the factual detail of the transactions in question.

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<sup>53</sup> Petitioner's related proposed findings of fact 258-74 are substantially duplicative of findings previously adopted and are therefore rejected.

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<sup>54</sup> See note 50 and accompanying text, *supra*.

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<sup>55</sup> Slip opinion filed April 16, 1990 at 18. The FDIC's reported decisions and orders supplied to those administrative law judges of the National Labor Relations Board who decide cases for the FDIC end with 1988 F.D.I.C. Enf. Dec. (P-H) ¶5114. Requests for supplementation have been unavailing.

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<sup>56</sup> Slip opinions filed May 12, 1988 at 13 and September 13, 1988 at 14. See note 55, *supra*.

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<sup>57</sup> It is uncontested that Respondent repaid the overdrafts in question and that he paid the Bank's regular charges related to those overdrafts.

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<sup>58</sup> Petitioner appears to contend that any amount which it has classified "loss" should be considered an actual loss to the Bank for purposes of establishing the amount of a civil money penalty. Based both on the expert opinion of the State Commissioner and upon the demands of logic, I disagree. The concept of loss is meaningful only insofar as it serves to measure the amount of benefit which must be taken away from a malefactor. If an amount classified "loss" has been voluntarily returned to a bank, that amount is no longer in the malefactor's possession and is, therefore, not an appropriate measure of the benefit which must be taken from him.

{11-30-92 p.A-2060} of credit to Falcon Production was concededly repaid by the debtor's transfer of collateral in lieu of foreclosure, and that loan does not therefore constitute an actual loss to the Bank. Finally, the weight of the evidence does not demonstrate that the Bank suffered an actual loss in connection with the Falcon Production ORE transaction.<sup>59</sup>

The foregoing findings notwithstanding, the Bank has suffered significant actual losses in certain of its dealings with Respondent and his related interests. Specifically, Respondent failed to pay accrued interest of \$10,895 on his personal loan and \$12,979 on the extension of credit to MGM.<sup>60</sup> Accordingly, I find that the Bank's quantifiable loss attributable to Respondent's violations, which appropriately measures the benefit Respondent received from those violations, is \$23,874. For the foregoing reasons, I find that (1) the minimum civil money penalty which can be imposed in this proceeding is \$23,874 and (2) based on the existence of unquantifiable economic benefit to Respondent resulting from his access to funds not lawfully available to him, the penalty actually imposed should substantially exceed that minimum.

#### D. History of Previous Violations

Petitioner has requested a single finding of fact concerning criticisms of Respondent in reports of the 1986, 1987 and 1989 examinations of the Bank. In the absence of any opposition to that finding, it is adopted.

#### E. Matters Required By Justice

Several additional elements identified in the Interagency Policy may appropriately be considered at this juncture. As discussed above, Respondent made restitution to the Bank of more than \$484,000. In addition, Respondent's violations were not shown to have created an unsafe or unsound condition at the Bank. Indeed, probative evidence of record establishes that significant improvements in the Bank's financial condition took place under Respondent's management between 1985 and 1991.<sup>61</sup>

The final factor<sup>62</sup> requiring consideration is the deterrent emphasis of the legislative policy which underlies the statutory authorization of civil money penalties. The totality of facts surrounding the Falcon Production ORE transaction convinces me that Respondent's transgressions are not confined to technical defaults or violations caused by his inability to repay extensions of credit. In the ORE transaction, Respondent misused his position to obtain additional credit denied him by law while retaining the power to reassert control over the real estate he conveyed to the Bank. This breach of fiduciary duty justifies a penalty approximately twice as great as the economic benefit which Respondent received as a result of his violations.

For the reasons set out above, I find that imposition of a \$50,000 civil money penalty in this case is supported by substantial evidence of record.

### III. Removal

Petitioner seeks an order removing Respondent from participation in the Bank's affairs and prohibiting him from participating in the affairs of any insured depository institution. When an institution-affiliated party, such as Respondent, has been shown, as is the case here, to have engaged in violations of law and regulation<sup>63</sup> which have economically benefitted the party,<sup>64</sup> the FDIC is entitled to an order removing that party

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<sup>59</sup> A March 9, 1990 independent appraisal using a comparative sales technique credibly valued the ORE property at \$396,000. The parties have stipulated that the total amount expended by the Bank when it acquired the property, including the \$83,241 disbursed to Falcon Production, was \$341,999. Under these circumstances, it was the credited expert opinion of the State Commissioner that the Bank would not necessarily suffer a loss even though the \$83,241 extensions of credit violated the law. The fact that these extensions were classified "loss" by Petitioner does not alter this conclusion. See note 58, *supra*.

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<sup>60</sup> I credit Examiner Hildebrand's unrefuted testimony which enumerated the accrued unpaid interest on these loans. Petitioner's proposed finding that the Bank suffered an actual \$14,311 loss based on accrued unpaid interest on the renewed Falcon Production loan is refuted by the report of the examination of the Bank as of January 23 1989, as well as by Petitioner's stipulation that the account in question was credited for \$14,311 in accrued interest as a result of the Falcon Production ORE transaction. Compare Petitioner's proposed finding of fact 96 with 279

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<sup>61</sup> This finding is based on the credited testimony of the Bank's President and the unchallenged expert opinions of Msrs. Adams, Niles and Osborn.

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<sup>62</sup> I have employed the allegations set forth in Petitioner's proposed findings of fact 281-83 in making the determination set forth in the text accompanying note 52, *supra*.

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<sup>63</sup> Because Petitioner has established that Respondent engaged in violations of law and regulation, I find Petitioner's contentions concerning the alternative statutory criteria for removal to be moot. Accordingly, I need make no findings or conclusions on the questions of whether Respondent's activities also constituted (1) breaches of fiduciary duty or (2) unsafe or unsound banking practices.

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<sup>64</sup> Because Petitioner has demonstrated that Respondent received financial gain from violations of laws and [\(Continued\)](#)

[{{11-30-92 p.A-2061}}](#)from banking if the violation "demonstrates willful or continuing disregard by such party for the safety and soundness of such insured depository institution..."<sup>65</sup> 12 U.S.C. § 1818(e)(1).

Petitioner contends that, "[a]s a result of Respondent's repetitive violations, the FDIC has established that Respondent demonstrated a willful or continuing disregard for the safety and soundness of the Bank."<sup>66</sup> "Willful" disregard has been defined by the FDIC as "conduct which is practiced deliberately in contemplation of the results," while "continuing" disregard has been held to be "that conduct which is voluntarily engaged in over a period of time with heedless indifference to the prospective consequences." *Docket No. FDIC-85-215e*, 1986 F.D.I.C. Enf. Dec. (P-H) ¶5069 at 6741. The question for determination is therefore whether "Respondent's repetitive violations" were shown to have been made either (1) deliberately with intended consequences or (2) voluntarily and without regard to consequence.

Petitioner asserts that the type of continuing conduct which best exemplifies Respondent's disregard for the Bank's safety and soundness is the repeated extension of credit to him and his related interests in violation of regulatory lending limits.<sup>67</sup> As discussed above, the repetitive nature of these violations came into being when the Bank renewed extensions of credit which Respondent has become financially unable

to repay.<sup>68</sup> Becoming financially unable to repay a loan cannot constitute "deliberate" or even "voluntary" conduct of any sort and does not demonstrate a lack of regard for the Bank's safety or soundness. Indeed, the record establishes that Respondent willingly pledged collateral which proved sufficient to insure the ultimate repayment of the principal balances of all of the extensions of credit challenged in this proceeding. Thus, the principal balances of the MGM and Respondent's personal extensions of credit were secured by the then-pending judgment against the FDIC,<sup>69</sup> while the Falcon Production loan was collateralized by real estate which had an admitted value well in excess of the outstanding loan balance.<sup>70</sup> These hypothecations demonstrate that Respondent, even though unable to prevent the continuing lending limit violations found herein, took positive action to insure the Bank's safety and soundness in connection with those loans which gave rise to the lending limit violations.

A similar pattern emerges upon examination of those of Respondent's violations which were not caused by the extensions of credit discussed above. After receiving the report of the July 18, 1986 examination, Respondent and his related interests committed the following new violations: (1) overdrawing accounts on eight occasions,<sup>71</sup> each of which was "corrected"<sup>72</sup> by voluntary repayment within one week of the overdraft and none of which was shown to have exposed the Bank to a possibility of "abnormal risk or loss,"<sup>73</sup> (2) failing by virtue of inaction to insure the Bank's compliance with the Cease and Desist Order on five occasions, none of which was alleged to have exposed the Bank to a possibility of "abnormal risk or loss," and (3) the Falcon Production ORE transactions. As discussed above, the latter transaction corrected two

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<sup>64</sup> Continued: regulations, I find Petitioner's contentions concerning the alternative statutory grounds for removal to be moot. I therefore decline to make additional findings or conclusions as to whether Respondent's conduct (1) caused loss or damage to the Bank or (2) prejudiced the interests of the Bank's depositors.

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<sup>65</sup> Alternatively, the statute provides that a removal order may be issued when the demonstrated violation "involves personal dishonesty ..." 12 U.S.C. § 1818(e)(1)(C)(i). Petitioner has made no allegations nor requested any findings concerning Respondent's honesty.

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<sup>66</sup> Petitioner's Brief at 15.

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<sup>67</sup> "[I]t is perhaps the continuous lending limit violations of Regulation O and Section 23A that are the most egregious and exhibit most clearly Respondent's total disregard for the law and the adverse consequences for the Bank." Petitioner's Brief at 172.

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<sup>68</sup> See note 50 and accompanying text, *supra*.

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<sup>69</sup> While the Bank failed to perfect its collateral position with respect to Respondent's other creditors, there is no question that its claim to the collateral was good against Respondent.

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<sup>70</sup> See note 26 and accompanying text, *supra*.

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<sup>71</sup> Falcon Management overdrew its account in the amount of \$1,610 for a one day period in October 1987; MGM overdrew its account for \$6,112 for the period of one day in January 1987 and RGI overdrew its account in amounts ranging from \$3,064 to \$13,452 on six occasions with a total duration of 18 days between April and November of 1987.

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<sup>72</sup> See note 48, *supra*.

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<sup>73</sup> *Gulf Fed. S. & L. v. Fed. Home Loan Bank Bd.*, *supra*.

{{11-30-92 p.A-2062}}violations while creating three more. More significantly, the transaction created an abnormal, albeit ultimately unrealized, risk to the Bank. While this transaction deserves censure and is a principal basis for the size of the penalty assessed herein, there is no evidence that Respondent's imposition of such a risk on the Bank was deliberate. Moreover, the record does not demonstrate that this heedless imposition of risk was one of a series of voluntary acts over time.

Finally, I find significant the fact that neither Respondent nor his related interests was alleged to have committed any type of new violation after November of 1987. Accordingly, I find that Respondent was not shown to have demonstrated a willful or continuing disregard for the safety or soundness of the Bank.

Because the issuance of a removal order is a discretionary act on the part of the FDIC,<sup>74</sup> two additional facts merit consideration. First, the violations engendered in significant part by the deterioration in Respondent's financial condition were not duplicated at the five other banks which he controlled.<sup>75</sup> Second, Respondent brings to banking an unquestioned array of aptitudes, skills and experience which the industry can ill-afford to lose at this juncture.<sup>76</sup>

For the foregoing reasons, I believe that the Removal Notice should be dismissed.

#### FINDINGS OF FACT<sup>77</sup>

1. At all times pertinent hereto, the Bank was a corporation existing and doing business under the laws of Oklahoma with its principal place of business in Hydro, Oklahoma.
2. At all times pertinent hereto, the Bank was a state nonmember bank insured by the FDIC.
3. At all times pertinent hereto, Respondent was a director and person participating in the affairs of the Bank.
4. At all times pertinent hereto, Respondent owned 1,433.5 shares of the 1,483.5 shares of outstanding stock of Hydro Bancshares, Inc. ("Bancshares"), a one-bank holding company that owned 4,885 shares of the 5,000 shares of the outstanding stock of the Bank. As a result, Respondent owned 96.63 percent of the outstanding stock of Bancshares, and Bancshares owned 97.70 percent of the outstanding stock of the Bank.
5. At all times pertinent hereto, MGM was a corporation existing and doing business under the laws of Oklahoma.
6. At all times pertinent hereto, Respondent owned 33.33 percent of MGM.
7. At all times pertinent hereto, Falcon Production was a corporation existing and doing business under the laws of Oklahoma.
8. Respondent was one of the original incorporators of Falcon Production on August 30, 1978.
9. At all times pertinent hereto, Respondent (a) was President and a director of Falcon Production, (b) had the authority to borrow on the account of Falcon Production and (c) held a power of attorney allowing him to conduct the business of Falcon Production.
10. At all times pertinent hereto, Respondent exercised controlling influence over the management and policies of Falcon Production.
11. On January 1, 1987, Falcon Production issued to Respondent 5,000 shares of preferred stock valued at \$411,191.02.
12. At all times pertinent hereto, RGI was a sole proprietorship wholly owned by Respondent.
13. At all times pertinent hereto, Falcon Management was a corporation existing and doing business under the laws of Oklahoma.
14. At all times pertinent hereto, Falcon Management was 100 percent owned by Respondent.
15. The Bank was examined jointly by examiners from the FDIC and the State as of the close of business on May 10, 1985 ("1985 Examination"), and a joint report of exam-

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<sup>74</sup>12 U.S.C. § 1818(e)(1).

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<sup>75</sup> I credit the un rebutted testimony to this effect of the State Commissioner.

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<sup>76</sup> "The fact that [Respondent] has managed to operate several banks on such an apparently stable and profitable basis speaks well for his business acumen and management abilities. This is particularly true in light of the devastation of the economies of the States of Oklahoma and Texas where his banks are located." Petitioner's Brief at 146.

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<sup>77</sup> Proposed findings and conclusions not set forth below or treated in the foregoing discussion are found to be moot in light of the findings and conclusions which were adopted, to be immaterial to any matter properly before me or to be statements of general principle which lack probative value in the absence of a specific factual context. Findings and conclusions appearing below but not previously discussed are based on the parties' stipulations or upon admissions contained in post-hearing pleadings. {{11-30-92 p.A-2063}}ination was later prepared ("1985 Examination Report").

16. The Bank received a copy of the 1985 Examination Report on or before September 17, 1985.

17. The Bank was examined jointly by examiners from the FDIC and the State as of the close of business on July 18, 1986 ("1986 Examination"), and a joint report of examination ("1986 Examination Report") was later prepared, which recited certain alleged violations of law and of the FDIC's Cease and Desist Order.

18. On or about November 21, 1986, the FDIC's Dallas Regional Office notified Respondent of the violations of law and of the FDIC's Cease and Desist Order alleged in the 1986 Examination Report.

19. On or about November 26, 1986, Respondent received a copy of the 1986 Examination Report from the State.

20. The Bank was examined jointly by examiners from the FDIC and the State as of the close of business on December 31, 1987 ("1987 Examination"), and a joint report of examination ("1987 Examination Report") was later prepared, which recited certain alleged violations of law and of the FDIC's Cease and Desist Order.

21. On or about March 4, 1988, the FDIC's Dallas Regional Office notified Respondent of the violations of law and of the FDIC's Cease and Desist Order alleged in the 1987 Examination Report.

22. On or about March 16, 1988, Respondent received a copy of the 1987 Examination Report from the State.

23. The Bank was examined jointly by examiners from the FDIC and the State as of the close of business on January 23, 1989 ("1989 Examination"), and a joint report of examination ("1989 Examination Report") was later prepared, which recited certain alleged violations of law and of the FDIC's Cease and Desist Order.

24. On or about March 27, 1989, the FDIC's Dallas Regional Office notified Respondent of the violations of law and of the FDIC's Cease and Desist Order alleged in the 1989 Examination Report.

25. On or about April 6, 1989, Respondent received a copy of the 1989 Examination Report from the State.

26. The Bank was examined jointly by the examiners from the FDIC and the State as of the close of business on April 27, 1990 ("1990 Examination"), and a joint report of examination ("1990 Examination Report") was later prepared, which recited certain alleged violations of law and of the FDIC's Cease and Desist Order.

27. On or about June 19, 1990, Respondent received a copy of the 1990 Examination Report from the State.

28. Prior to February 14, 1986, MGM was involved in a materialman's lien lawsuit which it had lost in state district court in March 1984.

29. MGM posted a bond with respect to the lawsuit, said bond being provided by Travelers.

30. Prior to February 14, 1986, Travelers was secured by a standby letter of credit issued by BancCentral, Amarillo, Texas ("BancCentral"), with security being a pledged certificate of deposit owned by Respondent.

31. On February 14, 1986, the Bank issued a standby, irrevocable letter of credit no. 21486, effective March 10, 1986, for \$265,000 on behalf of MGM and for the benefit of Travelers.

32. Letter of credit no. 21486 was guaranteed by Respondent, who signed a "blank" promissory note and a "blank" guaranty agreement, but the extension of credit was not secured by a pledge of collateral.

33. At the time of the issuance of letter of credit no. 21486, the Bank had a loan outstanding to Respondent which had been adversely classified "substandard" during the 1985 Examination.

34. On February 14, 1986, the Bank's capital and surplus was \$2,273,000; 10 percent of this amount was \$227,300 and 15 percent was \$340,950.

35. At the time of issuance, letter of credit no. 21486 in the amount of \$265,000 (a) exceeded 10 percent of the Bank's capital and surplus by \$37,700 and (b) when aggregated with the Bank's \$110,000 loan to Falcon Production, exceeded 15 percent of the Bank's capital and surplus by \$34,050.

36. The 1986 Examination Report recited that the Bank's issuance of letter of credit no. 21486 was a violation of section 23A of the Act.

37. When letter of credit no. 21486 expired on March 9, 1987, the Bank issued a replacement, standby, irrevocable letter of

[{{11-30-92 p.A-2064}}](#) credit no. 038809 for \$265,000 on behalf of MGM and for the benefit of Travelers.

38. Letter of credit no. 038809 was guaranteed by Respondent, who signed a "blank" promissory note and a "blank" guaranty agreement, but the Bank did not have a perfected security interest in any pledged collateral.

39. At the time of the issuance of letter of credit no. 038809, the Bank has loans outstanding to Respondent and Falcon Production which had been adversely classified "substandard" at the 1986 Examination.

40. On March 9, 1987, the Bank's capital and surplus was \$2,394,000; 10 percent of this amount was \$239,400 and 15 percent was \$359,100.

41. At the time of issuance, letter of credit no. 038809 for \$265,000 (a) exceeded 10 percent of the Bank's capital and surplus by \$25,600 and (b) when aggregated with the Bank's loans of \$110,000 to Falcon Production and \$250,000 to Respondent, exceeded 15 percent of the Bank's capital and surplus by \$265,900.

42. The 1987 Examination Report recited that the Bank's issuance of letter of credit no. 038809 was a violation of Section 23A of the Act.

43. When letter of credit no. 038809 expired on March 9, 1988, the Bank issued a replacement, standby, irrevocable letter of credit no. 038909 for \$265,000 on behalf of MGM and for the benefit of Travelers.

44. At the time of its issuance, letter of credit no. 038909 was guaranteed by Respondent, who signed a "blank" promissory note and a "blank" guaranty agreement, but the Bank did not have a perfected security interest in any pledged collateral.

45. At the time of the issuance of the Bank's letter of credit no. 038909, the Bank had loans outstanding to Respondent and Falcon Production which had been adversely classified "doubtful" at the 1987 Examination.

46. On April 14, 1988, the Bank disbursed funds pursuant to its letter of credit no. 038909 in the amount of \$235,801 and designated the transaction as loan no. 97013 to MGM.

47. Loan no. 97013 to MGM was guaranteed by Respondent, who signed a "blank" promissory note and a "blank" guaranty agreement, but the Bank did not have a perfected security interest in any pledged collateral.

48. On April 14, 1988, the Bank's capital and surplus was \$2,506,000; 10 percent of this amount was \$250,600 and 15 percent was \$375,900.

49. On April 14, 1988, the Bank had extensions of credit to Falcon Production for \$48,553 and \$34,688, to Respondent for \$248,883 and to MGM for \$235,801.

50. On April 14, 1988, the Bank's aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's capital and surplus by \$192,025.

51. On February 15, 1989, the Bank for the first time acquired a perfected security interest in a 1985 judgment for \$484,606 in favor of Respondent.

52. Prior to September 9, 1986, the FDIC informed Respondent of the alleged existence of multiple overdrafts by Respondent and his related interests in violation of the law.

53. Prior to January 6, 1987, Respondent received a copy of the 1986 Examination Report which alleged that Respondent and his related interests had engaged in multiple overdraft transactions in violation of the law.

54. MGM had deposit account no. 0-781191 at the Bank.

55. During the period September 9-16, 1986, account no. 0-781-191 was continuously overdrawn in amounts ranging from \$55.26 to \$711.99.

56. During the period From January 6-7, 1987, account no. 0-781-191 was continuously overdrawn in amounts ranging from \$6,109.29 to \$6,112.64.

57. During the period September 9-16, 1986, the Bank's capital and surplus was \$3,378,000, and 15 percent of this amount was \$356,700.

58. During the period September 9-16, 1986, the Bank had extensions of credit outstanding to Falcon Production for \$110,000, to MGM for \$265,000 and to Respondent for \$150,000, for a total of \$525,000.

59. During the period January 6-7, 1987, the Bank's capital and surplus was \$2,394,000, and 15 percent of this amount was \$359,100.

60. During the period January 6-7, 1987, the Bank had extensions of credit outstanding to Falcon Production for \$110,000, to

[\[11-30-92 p.A-2065\]](#) MGM for \$265,000 and to Respondent for \$250,000, for a total of \$625,000.

61. A disinterested majority of the Bank's Board of Directors failed to give prior approval to the overdrafts on account no. 0-781191 during the periods September 9-16, 1986 and January 6-7, 1987.

62. The overdrafts on account no. 0-781-191 during the periods September 9-16, 1986 and January 6-7, 1987 were not secured by acceptable collateral.

63. Account no. 0-781-191 was changed and paid the Bank's standard overdraft fee of \$7.00 in connection with each of the overdrafts during the periods September 9-16, 1986 and January 6-7, 1987.

64. During the periods September 9-16, 1986 and January 6-7, 1987, MGM paid \$392.00 in overdraft charges while the Bank forewent the collection of market rate interest of \$339.07 on the extensions of credit represented by the overdrafts.

65. RGI had deposit account no. 0-659-014 at the Bank.

66. During the period September 9-15, 1986, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$12,160.79 to \$15,003.48.

67. During the period October 15-21, 1986, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$41,456.86 to \$43,217.13.

68. During the period October 24-28, 1986, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$40,993.33 to \$45,129.71.

69. During the period April 9-13, 1987, account no. 0-659-914 was continuously overdrawn in amounts

ranging from \$1,542.21 to \$9,864.82.

70. During the period May 13–20, 1987, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$2,873.76 to \$10,064.98.

71. During the period June 22–23, 1987, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$2,992.93 to \$3,102.95.

72. During the period August 5–7, 1987, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$1,067.95 to \$13,452.12.

73. During the period September 15–16, 1987, account no. 0-659-014 was continuously overdrawn in amounts ranging from \$1,782.01 to \$3,064.75.

74. During the period November 5–8, 1987, account no. 0-659-914 was continuously overdrawn in amounts ranging from \$308.45 to \$12,751.39.

75. During the period September 9–15, 1986, the Bank's capital and surplus was \$2,378,000, and 15 percent of this amount is \$356,700.

76. During the period October 5–28, 1986, the Bank's capital and surplus was \$2,292,000, and 15 percent of this amount is \$343,800.

77. During the period April 9 through June 23, 1987, the Bank's capital and surplus was \$2,449,000, and 15 percent of this amount is \$367,350.

78. During the period August 5 through September 16, 1987, the Bank's capital and surplus was \$2,522,000, and 15 percent of this amount is \$378,300.

79. During the period November 5–8, 1987, the Bank's capital and surplus was \$2,593,000, and 15 percent of this amount is \$388,950.

80. A disinterested majority of the Bank's Board of Directors failed to give prior approval to the overdrafts on account no. 0-659-014 during 1986 and 1987.

81. Falcon Management had deposit account no. 0-622-109 at the Bank.

82. During the period October 27–28, 1987, account no. 0-622-109 was continuously overdrawn in the amount of \$1,610.55.

83. During the period October 27–28, 1987, the Bank's capital and surplus was \$2,593,000, and 15 percent of this amount is \$388,950.

84. A disinterested majority of the Bank's Board of Directors failed to give prior approval to the overdraft on account no. 0-622-109 during the period October 27–28, 1987.

85. The overdraft on account no. 0-622-109 during the period October 27–28, 1987 was not secured by acceptable collateral.

86. Respondent had deposit account no. 0-659-058 at the Bank.

87. During the period July 15–20, 1986, account no. 0-659-058 was continuously overdrawn in amounts ranging from \$1,560.63 to \$25,567.19.

88. During the period August 26 through September 1, 1986, account no. 0-659-058 [{{11-30-92 p.A-2066}}](#) was continuously overdrawn in amounts ranging from \$11,381.44 to \$11,996.41.

89. During the period July 1 through August 30, 1986, the Bank's capital and surplus was \$2,378,000, and 15 percent of this amount is \$356,700.

90. A disinterested majority of the Bank's Board of Directors failed to give prior approval to the overdrafts on account no. 0-659-058 during the periods July 15–20 and August 26 through September 1, 1986.

91. At all times from July 1, 1986 through November 30, 1987, the Bank had loans outstanding to Respondent and his related interests which had been adversely classified "substandard" during the 1986 Examination.

92. The Bank did not suffer a loss on the overdrafts on the accounts of Respondent and his related interests.

93. On December 31, 1985, the Bank extended credit in the form of loan no. 95198 to Falcon Production in the amount \$110,000 for a term of one year, single payment, for the stated purpose of purchasing a mineral lease.

94. Respondent signed the Promissory Note and Security Agreement that comprised loan no. 95198.

95. Respondent personally guaranteed payment of loan no. 95198.

96. Loan no. 95198 was secured with collateral represented by a mineral mortgage.

97. On December 31, 1985, proceeds of loan no. 95198 were deposited into Falcon Production's account no. 0-622-043 with the Bank.

98. Later that day, Respondent drew a check on account no. 0-622-043 made payable to himself in the amount of \$110,000 and deposited the same in account no. 0-659-014, a demand deposit account at the Bank owned by RGI.

99. Still later the same day, Respondent drew a check on account no. 0-659-014 made payable to the Bank in the amount of \$110,000, the proceeds of which were used as payment on Respondent's personal

loan no. 94525 at the Bank.

100. Prior to February 12, 1987, Respondent received a copy of the 1986 Examination Report which alleged that loan no. 95198 violated Section 22(h) of the Act and Regulation O.

101. On February 12, 1987, the Bank renewed the \$110,000 extension of credit to Falcon Production by issuing a renewal loan no. 96282 for a term of one year, single payment.

102. The Promissory Note and Security Agreement that comprised loan no. 96282 were both signed by Respondent.

103. Respondent personally guaranteed payment of loan no. 96282.

104. Loan no. 96282 was secured with collateral represented by a mineral mortgage and a real estate mortgage as to which the Bank had a subordinated lien position.

105. On February 2, 1988, Falcon Production failed to make the principal and interest payment due on loan no. 96282.

106. Because of the past due status of loan no. 96282, the Bank accepted a real estate deed in lieu of foreclosure from Falcon Production on February 22, 1988.

107. On or about February 22, 1988, the Bank paid off the outstanding superior lien held by the Equitable Life Assurance Society of the United States in the amount of \$134,447.

108. In order to reflect the Falcon Production ORE transaction on its books, the Bank on February 22, 1988 removed \$124,311 in past due principal and accrued interest on loan no. 96282 from its accounts.

109. In order to further reflect the Falcon Production ORE transaction on its books, the Bank on February 22, 1988 added to its financial statements the real estate acquired from Falcon Production as ORE in the amount of \$342,000.

110. At the time of the Falcon Production ORE transaction, there was an outstanding appraisal of the real estate in the amount of \$380,000.

111. On or about February 17, 1988 and pursuant to the Falcon Production ORE transaction, the Bank disbursed funds to Falcon Production in the amount of \$48,553 by depositing such funds into Falcon Production's account no. 0-622-043 at the Bank.

112. The \$48,553 deposited into account no. 0-622-043 were used by Falcon Production to pay an insufficient funds item drawn by Respondent.

113. On or about February 22, 1988 and pursuant to the Falcon Production ORE transaction, the Bank disbursed additional funds to Falcon Production in the amount of [{{11-30-92 p.A-2067}}](#)\$34,688 by depositing the same into account no. 0-622-043 at the Bank.

114. On or about February 24, 1988, immediately after the deposit of \$34,688 into account no. 0-622-043 at the Bank, \$34,000 was transferred into RGI's account no. 0-659-014 at the Bank.

115. When the Bank extended loan no. 95198 to Falcon Production on December 31, 1985, the Bank had a loan outstanding to Respondent which had been adversely classified "substandard" at the 1985 Examination.

116. When the Bank extended loan no. 96282 to Falcon Production on February 12, 1987, the Bank had a loan outstanding to Respondent which had been adversely classified "substandard" at the 1986 Examination.

117. On February 17 and 22, 1988, when the Bank disbursed funds to Falcon Production in the respective amounts of \$48,553 and \$34,688, the Bank was without any contractual means for obtaining repayment from Falcon Production.

118. On February 12, 1987, the Bank's unimpaired capital and surplus was \$2,394,000, and 15 percent of this amount is \$359,100.

119. On February 12, 1987, the Bank had extensions of credit to MGM in the amount of \$265,000, to Respondent in the amount of \$250,000 and to Falcon Production in the amount of \$110,000, for a total of \$625,000.

120. On February 12, 1987, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by the sum of \$265,900.

121. On February 17, 1988, the Bank's unimpaired capital and surplus was \$2,451,000, and 15 percent of this amount is \$367,650.

122. On February 17, 1988, the Bank had extensions of credit to MGM in the amount of \$265,000, to Respondent in the amount of \$249,154 and to Falcon Production in the amount of \$48,553, for a total of \$562,707.

123. On February 17, 1988, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$195,057.

124. On February 22, 1988, the Bank's unimpaired capital and surplus was \$2,451,000, and 15 percent of this amount is \$367,650.

125. On February 22, 1988, the Bank had extensions of credit to MGM in the amount of \$265,000, to

Respondent in the amount of \$249,079 and to Falcon Production in amounts of \$34,688 and \$48,553, for a total of \$597,320.

126. On February 22, 1988, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$229,670.

127. The Falcon Production transaction is the only ORE transaction at the Bank since 1985 whereby a defaulting borrower received additional funds for deeding the Bank real estate in consideration for the Bank's forgiveness of a loan debt.

128. Respondent arranged the Falcon Production ORE transaction to allow the Bank to warehouse the real estate until he could repurchase it and to permit him to obtain additional funds.

129. The Bank's disbursement of \$83,241 pursuant to the Falcon Production ORE transaction (a) was contrary to ordinary standards of prudent operation and (b) created a possibility of abnormal risk or loss to the Bank.

130. As of April 27, 1990, the Bank continued to own the Falcon Production ORE.

131. As of April 27, 1990, the Bank had received and rejected purchase offers for the Falcon Production ORE property for amounts which were less than the property's independently appraised value but were marginally sufficient to repay the funds expended by the Bank in connection with the transaction.

132. On March 8, 1990, an independent appraisal of the Falcon Production ORE real estate credibly valued the property at \$396,200 by using a comparable sales technique.

133. There is no probative evidence that the fair market value of the Falcon Production ORE property was ever less than the \$341,952 expended by the Bank in connection with its acquisition of the deed to that property.

134. The Bank was not shown to have suffered an actual loss with respect to its loan nos. 95198 or 96282 or with respect to the Falcon Production ORE transaction.

135. The FDIC has not alleged that Respondent is guilty of any personal dishonesty with respect to loan nos. 95198 or 96282 or with respect to the Falcon Production ORE transaction.

136. On April 25, 1986, the Bank extended loan no. 95465 to Respondent in the principal amount of \$75,000.

137. On April 30, 1986, the Bank's unimpaired capital and surplus was \$2,373,000, and 15 percent of this amount is \$355,950.

138. On April 25, 1986, the Bank had outstanding extensions of credit to Falcon Production in the amount of \$110,000, to MGM in the amount of \$265,000 and to Respondent in the amount of \$75,000, for a total of \$450,000.

139. On April 25, 1986, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$94,050.

140. On June 5, 1986, the Bank extended loan no. 95549 to Respondent in the principal amount of \$150,000 for a one year term, single payment.

141. On June 5, 1986, the Bank's unimpaired capital and surplus was \$2,373,000, and 15 percent of this amount is \$355,950.

142. On June 5, 1986, the Bank had outstanding extensions of credit to Falcon Production in the amount of \$110,000, to MGM in the amount of \$265,000 and to Respondent in the amount of \$150,000, for a total of \$525,000.

143. On June 5, 1986, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$169,050.

144. At the conclusion of the 1986 Examination, Respondent was informed by the FDIC that the Bank's loan no. 95549 was (a) a violation of Regulation O and (b) in such a condition as to merit a "substandard" classification.

145. On October 29, 1986, the Bank extended loan no. 95866 to Respondent in the principal amount of \$100,000 for a six month term, single payment.

146. On October 29, 1986, the Bank's unimpaired capital and surplus was \$2,292,000, and 15 percent of this amount is \$343,800.

147. On October 29, 1986, the Bank had outstanding extensions of credit to Falcon Production in the amount of \$110,000, to MGM in the amount of \$265,000 and to Respondent in the amount of \$250,000, for a total of \$625,000.

148. On October 29, 1986, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$281,200.

149. On April 14, 1987, loan nos. 95549 and 95866 were consolidated by the Bank, at the direction of Respondent, into a single loan no. 96212 in the amount of \$250,000 for a term of three years with monthly payments.

150. On April 14, 1987, the Bank's unimpaired capital and surplus was \$2,449,000, and 15 percent of this amount is \$367,350.

151. On April 14, 1987, the Bank had outstanding extensions of credit to Falcon Production in the amount of \$110,000, to MGM in the amount of \$265,000 and to Respondent in the amount of \$250,000, for a total of \$625,000.

152. On April 14, 1987, the Bank's total aggregate extensions of credit to Respondent and his related interests exceeded 15 percent of the Bank's unimpaired capital and surplus by \$257,650.

153. The FDIC has not alleged that Respondent is guilty of any personal dishonesty with respect to any of the personal loans made to him by the Bank during 1986 and 1987.

154. The FDIC issued a Cease and Desist Order to the Bank, which became effective on November 29, 1985.

155. Paragraph 6(c) of the Cease and Desist Order provides as follows:

Following the effective date of this ORDER, the Bank shall not extend, directly or indirectly, any additional credit to, or for the benefit of, any borrower whose loan or other credit has been classified "Substandard" and is uncollected unless the Bank's Board of Directors has signed a detailed written statement giving reasons why failure to extend such credit would be detrimental to the best interests of the Bank. The statement shall be placed in the appropriate loan file and included in the minutes of the applicable board of director's meeting.

156. On December 30, 1985, the Bank extended credit in the amount of \$97,000 to Jimmie Schimmel for the purpose of providing additional funds to pay uncollected [{{11-30-92 p.A-2069}}](#) interest that was past due on two of his outstanding loans from the Bank, both of which had been adversely classified "substandard" during the 1985 Examination.

157. With respect to the Bank's loan in the amount of \$97,000 to Jimmie Schimmel on December 30, 1985, Respondent, as a director of the Bank, failed to detail the reasons that would justify this loan and failed to take action to insure that such reasons were included in the minutes of the Bank's Board of Directors.

158. On September 10, 1987, the Bank extended credit in the amount of \$30,000 to D.D. Duke so as to provide funds to pay for income taxes resulting from the sale of real estate in 1986.

159. At the time that the Bank made its loan in the amount of \$30,000 to D.D. Duke on September 10, 1987, D.D. Duke had outstanding extensions of credit which had been adversely classified "substandard" during the 1985 and 1986 Examinations.

160. With respect to the Bank's loan in the amount of \$30,000 to D.D. Duke on September 10, 1987, Respondent, as a director of the Bank, failed to detail the reasons that would justify this loan and failed to take action to insure that such reasons were included in the minutes of the Bank's Board of Directors.

161. Paragraph 6(d) of the Cease and Desist Order provides as follows:

Following the effective date of this ORDER, the Bank shall not extend, directly or indirectly, any additional credit through purchasing participations in loans unless prior to their purchase the Bank's Board of Directors receives and reviews (i) adequate financial information, (ii) proper collateral documents (if applicable), (iii) adequate evidence of the obligor's demonstrated paying capacity, and an affirmative determination is made that the credit conforms to the Bank's existing loan policy. Written approval, citing complete reasons for the extensions of credit, shall be prepared by the Bank's Board of Directors and placed in the appropriate credit file.

162. On August 1, 1987, the Bank purchased a participation in the amount of \$200,000 in a loan to Harry Stickler from the Bank of the Northwest, Woodward, Oklahoma.

163. With respect to the Bank's purchase of a participation in the loan to Harry Stickler on August 1, 1987, Respondent, as a director of the Bank, failed to provide written approval for the participation and failed to take action to insure that such approval was included in the appropriate loan file.

164. Paragraph 7(b) of the Cease and Desist Order provides as follows:

Within 60 days from the effective date of this ORDER, the Bank shall review its current written loan policies and procedures, and adopt any changes thereto that are necessary or appropriate. The Bank's lending policy shall include:

- (i) a requirement that extensions of credit to an obligor must receive the prior review and approval of the Loan and Discount Committee if the total obligations of the obligor, after the extensions of credit, will exceed 50 percent of the limitation on maximum indebtedness to the Bank as set forth in Section 802 of the Oklahoma State Banking Code.
- (ii) a prohibition against credit to income until actually collected from the borrower of any

interest added to the unpaid balance of any loan on which interest is due, interest included in a separate note accepted for uncollected interest due on any loan unless such advances are supported by additional tangible collateral which adequately and completely secures the loan, or uncollected interest booked by any means that essentially avoids recognition of overdue loans and/or artificially inflates the income of the Bank.

165. The Bank capitalized uncollected interest due on loan nos. 95508 and 95830 to Verlin Long by extending loan no. 96048 to Mr. Long on January 21, 1987.

166. The Bank capitalized uncollected interest due on loan nos. 96181 and 96603 to Travis Hagy by extending loan no. 96800 to Mr. Hagy on December 16, 1987.

167. Paragraph 7(c) of the Cease and Desist Order provides as follows:

The written loan policies and procedures described in paragraph 7(b) and any amendments shall be presented to the Regional Director and the Commissioner for

{{11-30-92 p.A-2070}}

their review; within 30 days from their response, the amended written loan policies and procedures shall be adopted by the Board of Directors of the Bank.

168. The Bank did not amend and approve the proposed loan policy after receiving the responses and recommendations of the FDIC's Regional Director on or about March 10, 1986.

169. There is no evidence that any of the violations of the Cease and Desist Order resulted in a loss to the Bank.

170. The FDIC has not alleged that Respondent is guilty of personal dishonesty with respect to any of the violations of the Cease and Desist Order.

171. As of December 31, 1989, Respondent's total income was \$450,117.

172. The Bank pays Respondent an annual salary of \$60,000.

173. The Bank pays Respondent a director's fee of \$100 for attending each board meeting.

174. Leadership Bank, N.A., Oklahoma City, Oklahoma, pays Respondent an annual salary of \$60,000.

175. The State Bank of Rocky, Rocky, Oklahoma, pays Respondent an annual salary of \$24,000.

176. First Oklahoma Bank and Trust Company, Edmond, Oklahoma, pays Respondent an annual salary of \$60,000.

177. As long as Respondent is employed as a banker, he will have sufficient financial resources to allow him to pay a civil money penalty in the amount of \$50,000.

178. Prohibited overdrafts on the accounts of Respondent and his related interests and violations of paragraphs 6(c), 6(d) and 7(b) of the Cease and Desist Order were cited in the 1987 Examination Report and did not recur after the dissemination of that Report.

179. The principal balances of the Bank's extensions of credit to Respondent and MGM were repaid in cash on November 14, 1991.

180. Respondent's failure to repay the Bank's extensions of credit to him and MGM prior to November 14, 1991 does not demonstrate bad faith on his part.

181. There is no evidence that Respondent attempted to conceal any fact relating to any matter cited in the Penalty or Removal Notices or that he otherwise attempted to deceive Petitioner or the State with respect to such matters.

182. There is no evidence that Respondent failed to cooperate with Petitioner or the State with respect to any matter cited in the Penalty or Removal Notices.

183. Respondent acted with disregard for the requirements of the law when he accepted extensions of credit amounting to \$83,241 from the Bank in connection with his tender of a deed in lieu of foreclosure on February 22, 1988.

184. Respondent's demonstrated good faith is not inconsistent with the imposition of a \$50,000 civil money penalty.

185. From February 14, 1986 through the commencement of the hearing on December 3, 1990, the Bank's aggregate extensions of credit to Respondent and his related interests continuously exceeded 15 percent of the Bank's unimpaired capital and surplus.

186. The extent to which Respondent received economic benefit from his violations is appropriately measured by the actual loss suffered by the Bank as a result of those violations.

187. The Bank was not shown to have suffered an actual loss with respect to (a) Respondent's violation of the Cease and Desist Order, (b) the overdrafts drawn on the accounts of Respondent and his related interests, (c) the Bank's extensions of credit to Falcon Production or (d) the principal balance of the Bank's loans to Respondent or MGM.

188. The Bank suffered actual losses in the amount of \$23,874 due to Respondent's failure to pay the interest accrued on extensions of credit to him and MGM.

189. Respondent received direct financial benefit of \$23,874 from his violations.

190. The 1986, 1987 and 1989 Examination Reports contain specific criticisms and discussions of numerous alleged violations of Regulation O, Section 23A of the Act and the FDIC's Cease and Desist Order.

191. Respondent made restitution to the Bank of more than \$484,000.

192. Respondent's violations were not shown to have created an unsafe or unsound condition at the Bank.

193. Significant improvements in the Bank's financial condition took place under Respondent's management between 1985 and 1991.

[{{11-30-92 p.A-2071}}](#) 194. The need to deter future unlawful conduct by Respondent requires the imposition of a civil money penalty which is approximately twice the size of the actual economic benefit received by Respondent as a result of his violations.

195. The imposition of a \$50,000 civil money penalty on Respondent is not arbitrary and is supported by substantial evidence.

196. Respondent was not shown to have demonstrated a willful or continuing disregard for the safety or soundness of the Bank.

197. Respondent's violations involving the Bank were not repeated at any of the other five banks controlled by Respondent.

198. Respondent has demonstrated the possession of aptitudes, skills and experience which should not be lost to banking.

#### CONCLUSIONS OF LAW

1. At all times pertinent hereto, the Bank was subject to the provisions of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1831d, the Rules and Regulations of the FDIC, 12 C.F.R. Ch. III, and the laws of Oklahoma.

2. The Bank is an "insured depository institution" within the meaning of 12 U.S.C. § 1813(c)(2).

3. The FDIC is the "appropriate Federal Banking Agency" within the meaning of 12 U.S.C. § 1813(q).

4. At all times pertinent hereto, Respondent was a "director" of the Bank within the meaning of 12 U.S.C. §§ 1818(e)(1), 1818(i)(2) and 1828(j)(3).

5. At all times pertinent hereto, the Bank and Respondent were subject to Section 23A of the Act, as made applicable to insured state nonmember banks by 12 U.S.C. § 1828(j)(1).

6. At all times pertinent hereto, the Bank and Respondents were subject to Section 22(h) of the Act and Regulation O, as promulgated thereunder and made applicable to insured state nonmember banks of 12 U.S.C. § 1828(j)(2) and Section 337.3 of the FDIC's Rules and Regulations, 12 C.F.R. § 337.3.

7. As of November 29, 1985, Respondent and the Bank were subject to a final Cease and Desist Order issued by the FDIC.

8. The FDIC has jurisdiction over the Bank, Respondent and the subject matter of this proceeding.

9. The FDIC has the burden of proof by a preponderance of the evidence.

10. At all times pertinent hereto, Respondent was a "director" and a "principal shareholder" of the Bank as those terms are defined in Sections 215.2(c) and (j) of Regulation O.

11. At all times pertinent hereto, MGM was an "affiliate" of the Bank as that term is defined in Section 23A(b)(1) of the Act.

12. At all times pertinent hereto, MGM was a "related interest" of Respondent as that term is defined in Section 215.2(k) of Regulation O.

13. At all times pertinent hereto, Falcon Production was controlled by Respondent within the meaning of Section 215.2(b)(1)(iii) of Regulation O.

14. At all times pertinent hereto, Falcon Production was a "related interest" of Respondent as that term is defined in Section 215.2(k) of Regulation O.

15. At all times pertinent hereto, RGI was a "related interest" of Respondent as that term is defined in Section 215.2(k) of Regulation O.

16. At all times pertinent hereto, Falcon Management was an "affiliate" of the Bank as that term is defined in Section 23A(b)(1) of the Act.

17. At all times pertinent hereto, Falcon Management was a "related interest" of Respondent as that term is defined in Section 215.2(k) of Regulation O.

18. The Bank's issuance of letter of credit no. 21486 was a "covered transaction" within the meaning of Section 23A(b)(7)(E) of the Act.

19. Because letter of credit no. 21486 at the time of issuance exceeded 10 percent of the Bank's capital and surplus, Respondent violated Section 23A(a)(1)(A) of the Act.

20. An individual's unsecured personal guaranty is not acceptable collateral to secure an extension of credit from a bank to its affiliate pursuant to the collateral requirements of Section 23A(c)(1) of the Act.

21. Because letter of credit no. 21486 at the time of issuance was not secured with acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

22. The issuance of letter of credit no. 21486 was an "extension of credit" within [{{11-30-92 p.A-2072}}](#)the meaning of Sections 215.3(a)(3) and (4) of Regulation O.

23. Because the issuance of letter of credit no. 21486 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

24. Because the issuance of letter of credit no. 21486 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

25. The Bank's issuance of letter of credit no. 038809 was a "covered transaction" within the meaning of Section 23A(b)(7)(E) of the Act.

26. Because letter of credit no. 038809 at the time of issuance exceeded 10 percent of the Bank's capital and surplus, Respondent violated Section 23A(a)(1)(A) of the Act.

27. Because letter of credit no. 038809 at the time of issuance was not secured with acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

28. The issuance of letter of credit no. 038809 was an "extension of credit" within the meaning of Sections 215.3(a)(3) and (4) of Regulation O.

29. Because the issuance of letter of credit no. 038809 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

30. Because the issuance of letter of credit no. 038809 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

31. The Bank's issuance of letter of credit no. 038909 was a "covered transaction" within the meaning of Section 23A(b)(7)(E) of the Act.

32. Because letter of credit no. 038909 at the time of issuance was not secured with acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

33. The issuance of letter of credit no. 038909 was an "extension of credit" within the meaning of Sections 215.3(a)(3) and (4) of Regulation O.

34. Because the issuance of letter of credit no. 038909 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

35. The Bank's funding of loan no. 97013 was a "covered transaction" within the meaning of Section 23A(b)(7)(E) of the Act.

36. Because loan no. 97013 at the time of funding was not secured with acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

37. The funding of loan no. 97013 was an "extension of credit" within the meaning of Sections 215.3(a)(3) and (4) of Regulation O.

38. Because funding of loan no. 97013 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

39. Each overdraft by MGM on account no. 0-781-191 during the periods September 9–16, 1986 and January 6–7, 1987 was an "extension of credit" within the meaning of Section 215.3(a)(2) of Regulation O.

40. Because each overdraft on account no. 0-781-191 during the periods September 9–16, 1986 and January 6–7, 1987 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

41. Because each overdraft on account no. 0-781-191 during the periods September 9–16, 1986 and January 6–7, 1987 resulted in the Bank continuing to exceed its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

42. Because of disinterested majority of the Bank's Board of Directors failed to give prior approval to each overdraft on account no. 0-781-191 during the periods September 9–16, 1986 and January 6–7, 1987, Respondent violated Section 215.4(b) of Regulation O and Section 337.3(b) of the FDIC's Rules and Regulations.

43. Because each overdraft on account no. 0-781-191 during the periods September 9–16, 1986 and January 6–7, 1987 was not secured by acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

44. Each overdraft by RGI on account no. 0-659-014 during 1986 and 1987 was an "extension of credit" within the meaning of Section 215.3(a)(2) of Regulation O.

45. Because each overdraft on account no. 0-659-014 during 1986 and 1987 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

46. On every occasion when RGI overdrew account no. 0-659-014 during 1986 and 1987, the Bank's aggregate extensions of credit to Respondent and his related interests exceeded either \$500,000 or 5 percent of the Bank's "capital and unimpaired surplus" within the meaning of Section 215.2(f) of Regulation O.

47. Because each overdraft on account no. 0-659-014 during 1986 and 1987 resulted in the Bank continuing to exceed its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

48. Because a disinterested majority of the Bank's Board of Directors failed to give prior approval to each overdraft on account no. 0-659-014 during 1986 and 1987, Respondent violated Section 215.4(b) of Regulation O and Section 337.3(b) of the FDIC's Rules and Regulations.

49. The overdraft by Falcon Management on account no. 0-622-109 during the period October 27–28, 1986 was an extension of credit within the meaning of Section 215.3(a)(2) of Regulation O.

50. Because the overdraft on account no. 0-622-109 during the period October 27–28, 1986 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

51. When Falcon Management overdrew account no. 0-622-109 during the period October 27–28, 1986, the Bank's aggregate extensions of credit to Respondent and his related interests exceeded either \$500,000 or 5 percent of the Bank's "capital and unimpaired surplus" within the meaning of Section 215.2(f) of Regulation O.

52. Because the overdraft on account no. 0-622-109 during the period October 27–28, 1986 resulted in the Bank continuing to exceed its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

53. Because a disinterested majority of the Bank's Board of Directors failed to give prior approval to the overdraft on account no. 0-622-109 during the period October 27–28, 1986, Respondent violated Section 215.4(b) of Regulation O and Section 337.3(b) of the FDIC's Rules and Regulations.

54. Because the overdraft on account no. 0-622-109 during the period October 27–28, 1986 was not secured by acceptable collateral, Respondent violated Section 23A(c)(1) of the Act.

55. Each overdraft by Respondent on account no. 0-659-058 during 1985 and 1986 was an extension of credit within the meaning of Section 215.3(a)(2) of Regulation O.

56. Because the Bank paid each overdraft on account no. 0-659-058 during 1985 and 1986, Respondent violated Section 215.4(d) of Regulation O, 12 C.F.R. § 215.4(d).

57. Because each overdraft on account no. 0-659-058 during 1985 and 1986 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

58. Because each overdraft on account no. 0-659-058 during 1985 and 1986 resulted in the Bank continuing to exceed its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

59. On every occasion when Respondent overdrew account no. 0-659-058 during 1985 and 1986, the Bank's aggregate extensions of credit to Respondent and his related interests exceeded either \$500,000 or 5 percent of the Bank's "capital and unimpaired surplus" within the meaning of Section 215.2(f) of Regulation O.

60. Because of disinterested majority of the Bank's Board of Directors failed to give prior approval to each overdraft on account no. 0-659-058 during 1985 and 1986, Respondent violated Section 215.4(b) of Regulation O and Section 337.3(b) of the FDIC's Rules and Regulations.

61. The Bank's loan no. 95198 was an "extension of credit" to Respondent and his related interest, Falcon Production, within the meaning of Sections 215.3(a) and 215.3(f) of Regulation O.

62. Because loan no. 95198 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

63. The Bank's loan no. 96282 was an "extension of credit" to Respondent and his related interest, Falcon Production, within the meaning of Sections 215.3(a) and 215.3(f) of Regulation O.

64. Because loan no. 96282 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

65. On February 12, 1987, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$359,100.

66. Because loan no. 96282 exceeded the Bank's aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

67. Section 414B of the Oklahoma Banking Code allows a bank to acquire real estate conveyed to it in satisfaction of debts previously contracted.

68. Section 414B requires that real estate acquired in satisfaction of a borrower's previous debt be accounted for at the lower of a bank's "recorded investment" in the loan being satisfied or at the real estate's fair market value on the date of acquisition.

69. The Bank's "recorded investment" of \$258,711 in the Falcon Production ORE property was comprised of the following elements: (a) \$110,000 from the "unpaid original balance" of loan no. 96282, (b) \$14,311 from the "accrued and uncollected interest" on that loan and (c) \$134,400 from the "loan acquisition cost" of paying the first mortgage.

70. Payments representing a defaulting borrower's equity in real estate conveyed in satisfaction of a debt previously contracted do not constitute "loan acquisition costs" within the meaning of Section 414B.

71. Because the Falcon Production ORE transaction allowed Respondent to receive funds in excess of the Bank's "recorded investment," he caused the Bank to violate Section 414B.

72. An unsafe or unsound practice embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders or the agencies administering the insurance funds.

73. The Bank's disbursement of \$83,241 in connection with the Falcon Production ORE transaction was an unsafe and unsound banking practice.

74. During the period February 17–22, 1988, neither Falcon Production nor Respondent was entitled to receive funds from the Bank in contravention of Section 414B or the principles of safe and sound banking.

75. Because the Falcon Production ORE transaction resulted in Respondent receiving \$83,241 during the period February 17–22, 1988 to which he was not lawfully entitled, he was obligated to repay such funds to the Bank.

76. The disbursements of funds by the Bank pursuant to the Falcon Production ORE transaction in amounts of \$48,553 and \$34,668 were "extensions of credit" to Respondent and his related interest, Falcon Production, within the meaning of Sections 215.3(a) and 215.3(f) of Regulation O.

77. Because the disbursements of funds by the Bank in amounts of \$48,553 and \$34,688 pursuant to the Falcon Production ORE transaction involved more than a normal risk of repayment, Respondent violated Section 215.4(a)(2) of Regulation O.

78. On February 17 and 22, 1987, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$367,650.

79. Because the disbursement of funds by the Bank in amounts of \$48,553 and \$34,688 pursuant to the Falcon Production ORE transaction resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

80. The Bank's loan no. 95465 to Respondent was an "extension of credit" within the meaning of Section 215.3(a) of Regulation O.

81. Because the Bank's loan no. 85465 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

82. On April 25, 1986, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$355,950.

83. Because loan no. 95465 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interest, Respondent violated Section 215.4(c) of Regulation O.

84. The Bank's loan no. 95549 to Respondent was an "extension of credit" within the meaning of Section 215.3(a) of Regulation O.

85. Because loan no. 95549 involved more [{{11-30-92 p.A-2075}}](#) than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

86. On June 5, 1986, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$355,950.

87. Because loan no. 95549 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

88. The Bank's loan no. 95866 to Respondent was an "extension of credit" within the meaning of Section 215.3(a) of Regulation O.

89. Because loan no. 95866 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

90. On October 29, 1986, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$343,800.

91. Because loan no. 95866 resulted in the Bank exceeding its aggregate lending limit to Respondent

and his related interests, Respondent violated Section 215.4(c) of Regulation O.

92. The Bank's consolidated loan no. 96212 to Respondent was an "extension of credit" within the meaning of Section 215.3(a) of Regulation O.

93. Because loan no. 96212 involved more than the normal risk of repayment or presented other unfavorable features, Respondent violated Section 215.4(a)(2) of Regulation O.

94. On April 14, 1987, the Bank's "lending limit" within the meaning of Section 215.2(f) of Regulation O was \$367,350.

95. Because loan no. 96212 resulted in the Bank exceeding its aggregate lending limit to Respondent and his related interests, Respondent violated Section 215.4(c) of Regulation O.

96. Every member of a bank's board of directors is legally responsible to take any action necessary to insure that the bank is in compliance with all orders issued by the FDIC.

97. Respondent caused the Bank to violate the FDIC Cease and Desist Order by failing to monitor and insure the Bank's compliance with paragraph 6(c) of the Order in connection with the Bank's loans to Jimmie Schimmel on December 30, 1985 and D.D. Duke on September 10, 1987.

98. Respondent caused the Bank to violate the FDIC Cease and Desist Order by failing to monitor and insure the Bank's compliance with paragraph 6(d) of the Order in connection with the Bank's purchase of a participation in the Harry Stickler loan on August 1, 1987.

99. Respondent caused the Bank to violate the FDIC Cease and Desist Order by failing to monitor and insure the Bank's compliance with paragraph 7(b) of the Order in connection with the Bank's capitalization of uncollected interest in connection with loans to Verlin Long on January 21, 1987 and Travis Hagy on December 16, 1987.

100. Respondent caused the Bank to violate the FDIC Cease and Desist Order by failing to monitor and insure the Bank's compliance with paragraph 7(c) of the Order in connection with the Bank's failure to adopt changes in its loan policy required by the FDIC.

101. Except as concluded herein, Respondent was not shown to have violated any law, regulation or order.

102. Because Respondent violated Section 23A of the Act and Regulation O, he is subject to the assessment of a civil money penalty pursuant to 12 U.S.C. § 1828(j)(4).

103. Because Respondent violated the FDIC's Cease and Desist Order, he is subject to the assessment of a civil money penalty pursuant to 12 U.S.C. § 1818(i)(2).

104. In any action for the assessment of a civil money penalty pursuant to 12 U.S.C. §§ 1818(i)(2)(ii) and 1828(j)(4)(B), the determination of the amount of the penalty must take into account: (a) the size of the offender's financial resources, (b) the good faith of the offender, (c) the gravity of the offender's violations, (d) any history of previous violations and (e) any other matter which justice may require.

105. The relative weight to be given each of the five statutory factors is within the FDIC's discretion, which cannot be exercised arbitrarily and must be based on reasoned analysis and substantial evidence.

106. A central statutory purpose of the enabling legislation authorizing the imposition of civil money penalties pursuant to 12 U.S.C. §§ 1818(i)(2)(ii) and 1828(j)(4)(B) is the deterrence of abusive and self-serving practices which are harmful to banks.

107. In assessing a civil money penalty pursuant to 12 U.S.C. §§ 1818(i)(2)(ii) and 1828(j)(4)(B), significant consideration should be given to the financial or economic benefit which Respondent received as a result of his violations.

108. The receipt of credit which should not have been received is of indirect economic benefit to the recipient.

109. In assessing a civil money penalty pursuant to 12 U.S.C. §§ 1818(i)(2)(ii) and 1828(j)(4)(B), the penalty amount may reflect some additional amount beyond the economic benefit derived in order to provide a deterrent to future unlawful conduct.

110. The FDIC has authority pursuant to 12 U.S.C. § 1818(e) to issue an order removing Respondent from the Bank as a director and prohibiting him from participating in the affairs of the Bank or any other insured depository institution.

111. The issuance of an order removing Respondent from banking is discretionary of the part of the FDIC.

112. In order to issue an order removing Respondent from banking in this case, Petitioner must demonstrate that Respondent's conduct simultaneously (a) violated laws and regulations, (b) economically benefitted Respondent and (c) demonstrated Respondent's willful or continuing disregard for the Bank's safety or soundness.

Based on the foregoing findings of fact and conclusions of law and upon the entire record in this proceeding, I hereby make the following recommended:

ORDER

It is ORDERED that:

1. By reason of his violations of law, regulation and order, Ronald J. Grubb is assessed a civil money penalty in the amount of \$50,000 pursuant to Sections 8(i)(2) and 18(j)(4) of the Federal Deposit Insurance Act, 12 U.S.C. §§ 1818(i)(2) and 1828(j)(4).

2. This Order shall be effective and the ordered penalty shall be final and payable twenty (20) days from its date of issuance by the Board of Directors of the Federal Deposit Insurance Corporation.

3. The Notice of Intention to Remove and/or to Prohibit from Further Participation is dismissed.

Done at Arlington, Virginia, this 25th day of March, 1992.