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{{3-31-03 p.A-2915}}

[¶5249] In the Matter of James L. Leuthe, individually, and as an Institution-affiliated Party of First Lehigh Bank, Walnutport, Pennsylvania, FDIC Docket No. 95-15e and 95-16k (6-26-98)

FDIC adopted the conclusion of the administrative law judge that the controlling shareholder and chairman of the board of directors of a small, community bank engaged in unsafe and unsound banking practices by making loans to himself and others without adequate procedures and safeguards. The Board found that loans were made without thought to lending limit restrictions, approval, collateral or reporting requirements, as well as other statutory and regulatory requirements created to protect depositors, and that nearly all of the unsafe practices previously litigated were found in this one bank's practices. The Board found substantial and usually uncontroverted evidence to support an Order to Prohibit and an assessment of a civil money penalty in the amount of $250,000. *(The United States Court of Appeal for the D.C. Circuit denied a petition for review of the order, 194 F.3d 174)*

{{3-31-03 p.A-2916}}

[.1] Oral Arguments—Discretionary authority of FDIC

Oral argument denied within FDIC discretion on finding that no benefit would be derived from oral argument and Respondent would not be prejudiced by the lack of oral argument.

[.2] Statute of Limitations—New or continuing violations

Sufficient new or continuing violations occurred within the uncontested period, within the meaning of 28 USC 2462, to support sanctions without determining whether the statute of limitations provided in section 1818(i)(3) of the FDI Act, or in 28 USC 2462 applies.

[.3] Rules of Evidence—FDIC admissibility

Evidence admissible under the Federal Rules of Evidence is admissible under the FDIC's Rules and Regulations, Rule 36(a)(2), allowing public reports, documents, statements or data compilations created by public officials admissible as an exception to the hearsay rule.

[.4] Burden of Proof—Respondent's burden regarding Reports of Examination

In the absence of rebuttal evidence by Respondent showing the ROEs were without rational basis, the ALJ correctly concluded that factual matters set forth in the ROEs were admissible as evidence of underlying unsafe practices.

[.5] Notice—Not made invalid by previous settlement of state action alleging different problems

Corrective action taken by Respondent to settle a State action for capital insufficiency does not preclude issuance of a notice by FDIC for mismanagement

[.6] Constitutional Law—Creation of Office of Thrift Supervision and Office of Financial Institutions Adjudication lawful

Neither the Administrative Procedures Act, nor the Financial Institutions Reform, Recovery and Enforcement Act of 1989, nor any provision of the Constitution is violated by the use of ALJs.

[.7] Unsafe and Unsound Practices—Frequency

Virtually all unsafe and unsound practices identified in previous decisions and case law were found in this case, creating no doubt that there were numerous violations of laws and regulations, and breaches of fiduciary duty, resulting in such unsafe and unsound practices for years.

[.8] Fiduciary Responsibilities—as Chairman

Respondent's duties as chairman are "unequivocal." In addition, he was given clear and express direction regarding his duties in several orders following bank examinations and cannot claim ignorance.

[.9] Prohibition—Misconduct

Respondent's loan to himself violated previous Orders, breached his fiduciary duty and violated inside lending laws sufficient to show misconduct for a prohibition order. Additionally multiple violations of orders and breaches of fiduciary duties are evident.

[.10] Prohibition—Effects test gain

The loans made to the Respondent resulted in gains to him in violation of law, satisfying the effects test

necessary for an order of prohibition.

[.11] Prohibition—Effects test, loss to bank
The charge offs required because of improper bank procedures resulted in a loss to the Bank.

{{8-31-98 p.A-2917}}
[.12] Prohibition—Culpability prong satisfied by one of three elements
Respondent's continuing and willful disregard for the safety and soundness of the bank justified an order of prohibition by satisfying two of the three elements, creating no need to find the third element of personal dishonesty.

[.13] Civil Money Penalty—Second Tier CMP requires two elements of proof
The FDIC proved misconduct on the part of Respondent, as well as a gain or benefit to Respondent and loss to the Bank, satisfying the effects element of proof.

[.14] Civil Money Penalty—Punishment and deterrent
The CMP of $250,000 reduced from a possible $9 million penalty serves to both adequately punish the Respondent and create a deterrent to others, achieving the goals of the statute.

In the Matter of
JAMES L. LEUTHE,
Individually, and as an
Institution-affiliated Party of
FIRST LEHIGH BANK
WALNUTPORT,PENNSYLVANIA
(Insured State Nonmember Bank)
FDIC-95-15e
FDIC-95-16k
Decision and Order To Prohibit From
Further Participation and Assessment of
Civil Money Penalty

Procedural Background

The Federal Deposit Insurance Corporation (the "FDIC") initiated this action on June 23, 1995, pursuant to sections 8(e) and 8(i) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e) and (i)(3). A Notice of Intention to Prohibit From Further Participation in the affairs of any federally insured financial institution and a Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing (the "Notices") in the amount of $500,000 was issued against James L. Leuthe ("Respondent" or "Leuthe"), individually, and as a former director and institution-affiliated party of First Lehigh Bank, Walnutport, Pennsylvania (the "Bank").[1]

Respondent is charged with engaging in unsafe or unsound banking practices, breaches of fiduciary duty, and violations of law, rule, regulation and cease-and-desist orders in his roles as controlling shareholder and chairman of the Bank's board of directors. The Notices cite numerous violations of section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, and Regulation O of the Board of Governors of the Federal Reserve Board ("Federal Reserve Board"), 12 C.F.R. § 215,[2] violations of final cease-and-desist orders, and unsafe or unsound lending practices, including the making of loans without regard to the borrowers' ability to repay, failing to maintain adequate information on borrowers, making secured loans with inadequate collateral, failing to obtain adequate appraisals, making loans without establishing or enforcing repayment programs, renewing or restructuring loans without collection in cash of interest due, failing to maintain adequate information on collateral, and failing to obtain or perfect security interests. FDIC Enforcement Counsel allege that this conduct resulted in gain to the Respondent, prejudice to depositors, or loss to the Bank and that it evidenced Respondent's continuing or willful disregard for the safety and soundness of the Bank.

The parties engaged in protracted discovery and pre-hearing motions culminating in a hearing which commenced in Philadelphia, Pennsylvania on July 8, 1996. With two periods of recess, the hearing continued until February 11, 1997. Briefs and Reply

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[1] The FDIC also sought an order of prohibition and a civil money penalty ("CMP") (in the amount of $300,000) against Harold R. Marvin, Jr. ("Marvin"), the Bank's president. At the commencement of the hearing, Marvin stipulated to an Order of Prohibition, and the CMP against him was subsequently

dismissed. The hearing proceeded solely against Leuthe.

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[2] Sections 23A and 22(h) of the Federal Reserve Act, 12 U.S.C. §§ 371c, 375B and Regulation O, 12 C.F.R. Part 215, are made applicable to insured State nonmember banks by section 18(j) of the FDI Act, 12 U.S.C. § 1828(j), and section 337.3(a) of the FDIC's Rules of Practice and Procedure ("Rules"). {{8-31-98 p.A-2918}}Briefs were filed by the parties, and the Administrative Law Judge Walter J. Alprin (the "ALJ"), issued a Recommended Decision on February 13, 1998. Respondent filed Exceptions and a Request for Oral Argument on March 13, 1998.[3]

Request for Oral Argument

[.1**]** After considering the Respondent's Request, Enforcement Counsel's Opposition, and the entire record in this matter, the Board of Directors of the FDIC ("Board") finds that the (1) the factual and legal arguments are fully set forth in the parties' voluminous submissions, (2) no benefit will be derived from oral argument, and (3) Respondent will not be prejudiced by the lack of oral arguments. Therefore, the Board declines to exercise its discretion under section 308.40 of the FDIC's Rules (12 C.F.R. § 308.40) and denies Respondent's Request for Oral Argument.

Factual Summary

On February 1, 1983, the Bank's predecessor, Walnutport State Bank, was merged into, and became known as, First Lehigh Bank, a wholly-owned subsidiary of First Lehigh Corporation ("FLC"), a one bank holding corporation. Respondent, together with his related interests and family members, owned a controlling interest in FLC, the Bank's sole shareholder.[4] The Bank had total assets of approximately $141 million as of March 31, 1992. From October 15, 1982 through 1992, Respondent was chairman of the board of directors of FLC. On February 18, 1981, Respondent was elected chairman of the board of the Bank, and he served in that capacity until May 1, 1993, when he resigned from the board in connection with the settlement of an enforcement proceeding brought against the Bank by the Department of Banking for the Commonwealth of Pennsylvania ("State DOB).

The FDIC (and the State DOB) conducted regular examinations of the Bank from 1987 through 1993 for the purpose of determining the Bank's compliance with applicable laws, rules, regulations and the Bank's safety and soundness. The Bank was repeatedly criticized for unsafe and unsound practices in each Report of Examination (("ROE") of the Bank from 1987 through 1992. In addition, the Bank was repeatedly criticized for:

- violations of law involving insider transactions,
- violations of final cease-and-desist orders,
- inadequate lending and collection policies and practices,
- unwarranted extension or renewal of credits past their original maturity dates,
- funding interest reserves to keep real estate development loans current,
- permitting borrowers to use the proceeds of new loans to pay delinquent interest on overdue loans,
- concentrations of credit,
- out-of-territory lending,
- inadequate loan documentation,
- inadequate recordkeeping and reporting practices.

See, ROEs 1987-1992, FDIC Ex. Nos. 12, 16, 22, 29, 30, 32. At all pertinent times the Bank was under the direction of Respondent as chairman of the board. Respondent's alleged failure to address these problems over the years resulted in a depletion of the Bank's equity capital and threatened its future viability.

During this period of time, the Bank was subject to numerous State and Federal enforcement actions, intended to improve the condition of the Bank.[5] The most significant was the 1987 Cease-and-Desist Order ("1987 Order") between the FDIC and the Bank, to which

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[3] Citations to the record shall be as follows:
Recommended Decision — "R.D. at ____"
Transcript — "Tr. at ____"
Respondent's Exceptions — "Except at ____"
Exhibits — "Resp/FDIC Ex. No. ____"

[4] Respondent's 63 percent control of FLC is significant. The next largest shareholder controls 6.25 percent. Resp. Memorandum of Law in Opposition to FDIC's Motion to Strike Affirmative Defenses.

[5] FDIC October 29, 1987, Cease-and-Desist Order (FDIC Ex. No. 14), Commonwealth of Pennsylvania 1991 Cease-and-Desist Order (Resp. Ex. No. 7), Commonwealth of Pennsylvania May 11, 1992 Cease-and-Desist Order (FDIC Ex. No. 33), FDIC June 10, 1992, Cease-and-Desist Order (FDIC Ex. No. 34), Commonwealth of Pennsylvania September 15, 1992, Capital Directive (FDIC Ex. No. 40), FDIC November 16, 1992, Prompt Corrective Action Notification (FDIC Ex. No. 41), FDIC December 9, 1992, Notice of Intent To Terminate Deposit Insurance (Resp. Ex. No. 192), December 11, 1992, State Seizure Proceedings (FDIC Ex. No. 60), FDIC June 23, 1995, Notice of Intent to Prohibit from Further Participation and FDIC June 12, 1995, Notice of Assessment of Civil Money Penalty. {{8-31-98 p.A-2919}}Respondent specifically consented. Failure to adhere to the requirements of these enforcement actions led to an increasingly unsafe and unsound operation of the Bank. As of January 31, 1989, total adversely classified assets at the Bank equaled 129.2 percent of the Bank's adjusted primary capital. FDIC Ex. No. 22, p. 1–1. As of March 31, 1990, total adversely classified assets equaled 165.2 percent of adjusted primary capital. This figure grew to in excess of 200 percent by the May 28, 1991 examination. FDIC Ex. No. 29, p. 1–1. The severity of the problem became enormous in 1992. As of the 1992 examination, over 28 percent of the Bank's total assets were adversely classified, representing *842.12 percent* of the Bank's equity capital. FDIC Ex. No. 32, p. 2-1; Tr. 1760. By that time the Bank's capital was nearly extinguished, representing only two-tenths of one percent of total assets. *Id* at pp. 1–1, 1-3.

By 1992, although some minimal compliance with the 1987 Order had been achieved, the condition of the Bank had deteriorated significantly, and major aspects of the 1987 Order were still being violated. To address the issues that had arisen between 1987 and 1992, a Cease-and-Desist Order was issued by the FDIC to which the Bank consented ("1992 Order"). FDIC Ex. No. 34.

Respondent asserts that he played no role in any of the Bank's lending decisions or day-to-day operations and, therefore, he was not responsible for the problems cited in the ROEs. He points instead to his role in infusing $1 million of his personal funds into the Bank and arranging for others to invest $1 million to recapitalize the Bank in 1992 in order to settle charges related to capital insufficiency brought by the State DOB.[6]

Significantly, Respondent's theory of the case involves an alleged "conspiracy" between the FDIC and State DOB to seize the Bank. The ALJ rejected this notion of a conspiracy and ruled that the State proceedings are not relevant to the instant proceeding. Those decisions are affirmed. This description summarizes Respondent's theory:

> The FDIC, in collusion with the State DOB, has covertly schemed an illicit strategy extending back to 1980. This strategy is charged to be the result of personal animosity apparently in both agencies, against Respondent. The scheme charged is to falsely and adversely classify loans at the Bank as being in violation of Regulation O, dealing with excessive loans to bank insiders and their affiliated interests, and/or being improper in other respects; that this caused the bank's stated capital to falsely be declared as having declined to the point of being so impaired as to be insufficient to support maintenance of Federal deposit insurance, so that the bank would be seized and its assets sold at steeply discounted value. Respondent charges that the FDIC caused the State to institute such action as a means of avoiding the due process requirements of hearing to which FDIC is bound. Respondent charges that in furtherance of this scheme, the FDIC controlled the proceeding instituted by the Bank against the State. Respondent further charges that the State seizure of the bank was thwarted through the Bank's exercise of its due process rights in the institution of the proceeding in The Commonwealth Court [of Pennsylvania], and achieved a settlement with the State DOB by agreement to accept a plan of capital infusion. The settlement included prophylactic provisions that Marvin would resign from the Bank and that Respondent, for a period of two years or until the capital deficiency was completely cured, would not act as an officer of the Bank in day-to-day operations and would place his stock in a voting trust. From this, Respondent charges the FDIC is in violation of his right to justice, fairness, and due process of law, by now seeking to prohibit him from further participation in the affairs of insured depository institutions and also by assessing unlawful civil money penalties.

See Order on Motions Pending At Time of Commencement of Hearing, Regarding Subpoenas, Evidence Regarding Affirmative Defenses, and For Summary Disposition (issued July 15, 1996) at 17–18.

The ALJ made extensive and careful findings of fact after combing through a large

[6] In December 1992, the State DOB began an action under its emergency powers to take control of the Bank. The Bank sought an injunction in state court, and, after a full hearing a settlement was entered into between the Bank and the State DOB. Under this settlement, Leuthe agreed to resign as chairman of the Bank for a period of two years or until the capital deficiency was cured. He was also required to put his FLC stock in a voting trust and to obtain FDIC approval before he could serve as a director again.

{{8-31-98 p.A-2920}}and complicated record. He recommended the issuance of an Order of Prohibition against Respondent and the issuance of a civil money penalty ("CMP") against Respondent in the amount of $250,000.[7] In support of his conclusions, the ALJ specifically found that the FDIC had established by substantial evidence each of the elements of an action pursuant to section 8(e) of the FDI Act and the elements necessary to impose a CMP under section 8(i) of the FDI Act.

The Board has reviewed the record in its entirety, including the lengthy Exceptions and Memoranda of Law in Support of Exceptions filed by Respondent. The Board generally affirms the recommendation of the ALJ and adopts his Recommended Decision and Findings of Fact, except as modified herein. In addition, minor factual and typographical corrections to the Recommended Decision are made in an appendix to this Decision and Order.

Exceptions and Affirmative Defenses

Respondent filed two hundred and ninety-one (291) Exceptions challenging every legal conclusion, many evidentiary rulings, and virtually every factual finding made by the ALJ. Discussed below are the major affirmative defenses raised by Respondent throughout the proceeding and repeated as Exceptions to the Recommended Decision. The Board concludes that the Exceptions are generally frivolous, repetitious and most merely reargue matters raised below which were adequately addressed by the ALJ. For clarity, some Exceptions are discussed in other sections of this Decision and Order. Those Exceptions not discussed are denied.[8]

A. The Statute of Limitations Defense

On January 24, 1997, Respondent filed an amended Answer which set forth the statute of limitations as an affirmative defense. Respondent takes the position that (1) the five-year limitations period under 28 U.S.C. § 2462 applies to both the prohibition and CMP actions herein, thus barring evidence of violations occurring prior to June 23, 1990;[9] and (2) with respect to the loans and transactions which are not time-barred, there is insufficient proof of the elements necessary to sustain these actions against Respondent.

FDIC Enforcement Counsel argue that: (1) violations prior to June 1988 are not timebarred because 12 U.S.C. § 1818(i)(3) sets forth the applicable limitations period, a six-year period commencing at the time Respondent resigned from his position at the Bank in 1993; (2) the violations are in large part "continuing violations," which, although involving misconduct which commenced more than five years before the charges were brought, continued into the viable period under section 2462; (3) section 2462 is inapplicable in any event because it applies only to a civil fine, penalty or forfeiture, pecuniary or otherwise, and does not pertain to the prohibition action against Respondent; (4) sufficient violative transactions originally arose within the five year period asserted by Respondent to support the relief sought; and (5) both the imposition of a CMP and a prohibition order require the Board to take into consideration offenses, prior violations, and the willful and/or continuing nature of the offenses, whether within or beyond any statute of limitations.

The ALJ found that section 1818(i)(3) is a specific statute "otherwise provided by Act of Congress," thus falling within the exception to the applicability of 12 U.S.C. § 2462. It provides the time frame (six years) in which the banking agencies may initiate an action against a party who resigns from a Federally insured institution. The ALJ also found that,

[7] The Notices requested that a CMP in the amount of $500,000 be issued. Because FDIC Enforcement Counsel did not file Exceptions to the Recommended Decision, they are deemed to have waived any objection to it. 12 C.F.R. § 308.39(b).

[8] In addition to the Exceptions and affirmative defenses discussed below, Respondent has raised numerous additional Exceptions and/or affirmative defenses that do not merit discussion. These include: laches, waiver, estoppel, speedy trial, double jeopardy, demurrer, *res judicata*, equal access to justice; and arbitrary enforcement (separate and distinct from arbitrary and capricious action). Each of these was discussed and rejected by the ALJ either in his Order Denying Respondent's Motion for Summary

Disposition (issued January 10, 1997), or his Order on Motions Pending At Time of Commencement of Hearing, Regarding Subpoenas, Evidence Regarding Affirmative Defenses, and for Summary Disposition (issued July 15, 1996). The Board agrees with and adopts the ALJ's disposition of those exceptions and defenses not discussed herein.

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[9] 28 U.S.C. § 2462 provides as follows: "Except as otherwise provided by Act of congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same period, the offender or the property is found within the United States in order that proper service may be made thereon."

{{8-31-98 p.A-2921}}even if the five year limitation of section 2462 were applicable, it would be limited to the CMP portion of the proceeding only. He found that a prohibition order is remedial, not a "punishment," and, therefore, it lies outside the parameters of 12 U.S.C. § 2462. R. D. at 11. He also found that, because the calculation of the CMP was based only on the number of days the violations of the 1987 Order continued *after* the 1992 ROE, the five-year limitations period was not exceeded in any event. R. D. at 97. In addition, the ALJ found that "in view of the continuing nature of the violations in this matter, whether governed by section 1818(i)(3) or section 2462, all of the allegations against Respondent are properly before [the ALJ] for review and are not time-barred." R. D. at 11.

[.2**]** The Board concludes that, since it finds sufficient violations occurred within the five-year limitations period of section 2462 to support the relief sought, it is not necessary to determine whether that statute of limitations is applicable in this case, and, therefore, Respondent's Exception is denied. Accordingly, the Board finds that there are sufficient violations to support the prohibition order and the CMP occurring after June 23, 1990—within the "viable" time period as defined by either party—the issue of which, if any, statute of limitations is applicable need not be reached. Moreover, the United States Court of Appeals for the Fifth Circuit recently held that for violations which "continue," a new claim accrues each day the violation is extant. *InterAmericas v. Board of Governors of the Federal Reserve System*, 111 F.3d 376 (5th Cir. 1997). Sufficient new and/or continuing violations occurred within the period not contested by Respondent to support both the prohibition and the CMP actions.[10]

Finally, in determining the amount of a CMP, 12 U.S.C. § 1818(i)(2)(G) requires the Board to consider the following mitigating factors: (1) the size of financial resources and good faith of the person charged: (2) the gravity of the violations: (3) *the history of previous violations*; and (4) such other matters as justice may require (emphasis added).

The ALJ is correct in stating that, regardless of the applicability of a statute of limitations, evidence of previous violations[11] is properly admissible, and indeed must be considered, in determining the amount of a CMP. Nevertheless, for purposes of this case we have considered only the new and/or continuing violations that occurred after June 23, 1990. The Board is cognizant of Respondent's prior history of violations, and does not perceive anything which benefits Respondent in the way of mitigation. Nor has the Board augmented the sanctions imposed because of Respondent's prior history. The evidence of violations after June 23, 1990, is quite sufficient standing alone to support the sanctions.

B. Findings Based on Alleged Uncorroborated Hearsay

Respondent asserts that the ALJ's decision is fundamentally flawed because it "relies entirely on the `multiple-hearsay-laden' FDIC ROEs." Respondent objects to the admissibility of the ROEs without sponsorship by any witnesses, even though all such reports were admitted into evidence with the testimony of FDIC examiners. He further objects to the ALJ's ruling that factual statements in such reports constituted evidence of those matters without supporting documentation or testimony. Except. at 2-3.

[.3**]**As found by the ALJ, Rule 36(c)(2) of the FDIC's Rules and Regulations provides for the admissibility of such records without a sponsoring witness, and Rule 36(a)(2) of the FDIC's Rules and Regulations makes admissible evidence that would be admissible under the Federal Rules of Evidence ("FRE"). The ROEs are admissible under Rule 803(8) of the Federal Rules of Evidence, which provides for a number of exceptions to the hearsay rule even though the "declarant" is available as a witness:

> Records, reports, statements, or data compilations, in any form of public offices or agencies, setting forth...(B) matters observed pursuant to duty imposed by law as to which there was a duty to report... (C) in civil actions and proceedings and against the Government in criminal cases,

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[10] These violations are listed on Schedules B and C to FDIC's Response to Respondent's Post Hearing Brief, Findings of Fact and Conclusions of Law. The lists set forth violations of the 1987

> Order and the repeated classifications of loans made in violation of safe and sound lending practices which continued after June 23, 1990.

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[11] These "violations," although not adjudicated, were the basis for the 1987 Order and 1992 Order to which Respondent consented.

{{8-31-98 p.A-2922}}factual findings resulting from an investigation pursuant to authority granted by law, unless the sources of information or other circumstances indicate lack of trustworthiness.

Public reports, documents, statements or data compilations that are created by public officials are "presumed admissible" pursuant to the hearsay exception in FRE 803(8). *See Nautilus Motor Tanker Co. v. M/T BT Nautilus,* 85 F.3d 105, 112 (3rd Cir. 1996); and *Clark v. Clabaugh*, 20 F.3d 1290, 1294 (3rd Cir. 1994). Such documents are presumed reliable and trustworthy because they are prepared pursuant to a duty imposed by law. *Melville v. American Home Assurance Company*, 584 F.2d 1306 (3rd Cir. 1978). The scope of these reports includes opinions and conclusions by the agency as long as the report is based on a factual investigation and the report is sufficiently trustworthy. *Beech Aircraft Corp. v. Rainey*, 488 U.S. 153 (1988). The party opposing their introduction has the burden of providing "some evidence that would impugn its trustworthiness." *Melville* at 1316. In addition, there is no requirement that the author of the report have "first hand knowledge of the facts upon which his findings are based." *Zenith Radio Corp. v. Matsushita Electric Industrial Co.*, 505 F. Supp. 1125, 1148 (E.D. Pa. 1980).

The ALJ correctly found that the ROEs were properly admitted and constituted evidence of the matters observed without sponsoring witness or other documentary or testimonial support. Respondent did not challenge the trustworthiness of the FDIC examiners who, in fact, testified regarding the ROEs. Significantly, the ALJ found that Respondent had the burden of going forward to contradict the ROEs through documentary or testimonial evidence, which, as the ALJ found, "he failed to do." R. D. at 12. Indeed, Respondent did not seriously contest the FDIC's factual proof of cease-and-desist violations, violations of law, unsafe and unsound practices or breaches of fiduciary duty.

The admissibility and weight of examination reports was directly addressed by the United States Court of Appeals for the Eleventh Circuit in *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (1986):

> [T]he unique experience of the bank examiners involved in this examination leads to the conclusion that their classifications were entitled to deference and could not be overturned unless they were shown to be arbitrary and capricious or outside a "zone of reasonableness."
>
> ...
>
> [T]he board correctly determined the weight that should be given to the recommendations of expert bank examiners. There are few decisions that instruct on the point. We set forth here verbatim the reasoning of the FDIC board and adopt it as our own:
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> ...
>
> After extensive training, lengthy apprenticeship and careful evaluation, FDIC examiners are appointed as `commissioned examiners,' and thereby vested with authority to make informed predictions about the risk inherent in a bank's assets. This exercise of informed *judgment* on the part of commissioned examiners is entitled to deference, and *should not be disregarded in the absence of compelling evidence that it is without rational basis*.

783 F.2d at 1581–1583 (emphasis added).

[.4**]** Respondent did not prove that the classifications in the numerous ROEs to which he objects were "without rational basis." In support of his assertions that the ROEs were unreliable, Respondent could have tried to establish their unreliability on cross-examination, but he did not do so. In the absence of rebuttal evidence, the ALJ correctly concluded that the factual matters set forth in the ROEs represented admissible evidence of the underlying loan transactions and violations associated with them. R.D. at 12.

C. FDIC's Action is Arbitrary and Capricious

Respondent makes much of the ALJ's finding that Respondent had not engaged in any acts of personal dishonesty and that FDIC witnesses testified that "they have never in numerous years of experience with the agency seen an action for prohibition commenced where the person charged had not engaged in acts of personal dishonesty." Resp. Br. at 48–53; Except. at 3–4. He asserts that FDIC's actions in this matter therefore "demonstrate selective prosecution, coupled with personal animus and an attempt to deprive Respondent of his constitutional right to due process of law." Resp. Br. at 64–67; Except. at 4.

To impose an Order of Prohibition, one or more of the following elements must be proven to satisfy the

"culpability prong" of
{{8-31-98 p.A-2923}}the statute: 1) personal dishonesty; 2) willful disregard; or 3) continuing disregard. The statute is written in the alternative, making it clear that proof of only one of these elements will be sufficient. Thus, even without a finding of personal dishonesty, the ALJ correctly found that the culpability prong was satisfied here by his finding that Respondent acted with willful and continuing disregard for the safety and soundness of the Bank. R.D. at 93-95. 12 U.S.C. § 1818(e)(1). With respect to Respondent's claim of "selective prosecution," the Board directs attention to the following cases in which Orders of Prohibition have been entered where no personal dishonesty was found: *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986); *Grubb v. FDIC*, 1 P-H FDIC Enf. Dec ¶ 5181 at A-2030, 2031 (1992), *aff'd*, 34 F.3d 956 (10th Cir. 1994); *In the Matter of Billy Gene Humphrey, Jr.*, Bay City Bank & Trust Co., Bay City, Texas, FDIC-93-55e, 2 P-H FDIC Enf. Dec. ¶ 5207 at A-2347 (1993); *In the Matter of George W. Glover*, Bay City Bank & Trust Co., Bay City, Texas, FDIC-93-54e, 2 P-H FDIC Enf. Dec. ¶ 5206 at A-2345 (1993); *In the Matter of James G. Welk*, County Bank of Merced, Merced, California, FDIC-91-201e, 2 P-H FDIC Enf. Dec. ¶ 5186 at A-2096 (1992). Accordingly, the decision to proceed with this matter was an appropriate exercise of the FDIC's discretion and wholly consistent with the legal requirements for the remedies applied.

D. Failure of the FDIC to Follow Its Manual and Procedures

Respondent asserts that the FDIC's action must be dismissed because it failed to follow its manuals and procedures. In particular, he points to a provision in the Division of Supervision Manual of Examination Policies to the effect that decisions to proceed with prohibition actions should be made while the examiner is still in the bank. Since the Bank underwent examinations from 1987 through 1992, Respondent complains because charges were not brought until 1995.

The foreword to the Examination Manual is particularly relevant:

> The emphasis is on policies as opposed to procedures. The Division has long held the view that detailed, highly structured, step-by-step guidance on the "How-To's" of performing an examination function is frequently unnecessary, often inefficient and, in fact, may unduly inhibit the development and exercise of good judgment and common sense on the part of an examiner. Consequently, considerable flexibility is available to tailor examination procedures and methods to the particular requirements and circumstances of the bank being examined.

Manual at page 2-1. The Examination Manual provides general guidance and advice. It does not constitute a rule or regulation, and it does not provide any binding procedural rules which Respondent can invoke. *See Schweiker v. Hansen*, 450 U.S. 785, 789 (1981).

The flexibility provided by the foreword to the manual is intended to insure that common sense will dictate the agency's actions. In this case, Respondent disregarded Federal and State warnings over at least six years and disregarded the requirements of laws, regulations, cease and desist orders, fiduciary duty and safe and sound lending practices. Six consecutive examiners-in-charge testified about their own personal observations regarding Leuthe at six consecutive examinations. The ALJ gave credence to this testimony. Rec. Dec. at 83. Although charges could have been brought against Respondent after each of the examinations, the FDIC delayed taking any action for many years in reliance upon the promises made by Respondent to mend his ways and improve the compliance of the Bank. Tr. at 3281, 3286, 3293. When asked why he had finally decided to commence the section 8(e) proceeding after the 1992 ROE, Assistant Regional Director Michael J. Piracci responded: "I had never seen such deterioration in a financial institution as I had witnessed in First Lehigh Bank." Tr. at 3294. Indeed, the fact that charges might have been brought earlier shows an absence of personal animus, contrary to Respondent's assertions. The delay of which Respondent now complains is an indication that the FDIC tried to work with the institution to achieve safe and sound conditions, rather than rush to judgment. Tr. at 3286.

E. Action Allegedly Barred by Section 8(m)

Respondent claims that the ALJ erred as a matter of law by failing to adopt Respondent's argument that these prohibition and {{8-31-98 p.A-292424}}CMP proceedings are barred by section 8(m) of the FDI Act, 12 U.S.C. § 1818(m).[12] Except. at 4. Although not specifically addressed in the Recommended Decision, Respondent's defense and argument was fully addressed by the ALJ in his Order on Motions Pending at Time of Commencement of Hearing Regarding Subpoenas, Evidence Regarding Affirmative Defenses and for Summary Disposition, issued July 15, 1996. In that Order, the ALJ determined that section 8(m) of the FDI Act does not preclude the instant action. Upon review, the Board concurs with the ALJ's findings and conclusions of law. Nothing in section 8(m) precludes this action.[13]

Respondent argues that section 8(m) "represents congressional direction and intent that when a primary state regulator, such as [the State DOB] takes action with respect to a prohibition proceeding, FDIC is precluded from taking the same action." Thus, he asserts the FDIC is precluded from bringing the instant charges against him because he engaged in satisfactory corrective action pursuant to charges brought by the State DOB.

Respondent is incorrect for several reasons. As noted by Respondent in his brief, section 8(m) specifically provides:

> No bank or other party who is the subject of any notice or order issued by the agency under this section shall have standing to raise the requirements of this subsection as ground for attacking the validity of any such notice or order.

Thus, the Respondent clearly lacks standing to raise the requirements of this section as a ground for attacking the validity of the Notices. *See Investment Co. Institute v. Federal Deposit Ins. Corp.*, 728 F.2d 518 (D.C. Cir. 1984). Respondent argues that he is not challenging the "validity of the Notice," but rather, it is his position that the proceeding itself "is barred by virtue of the satisfactory corrective action effectuated by the [State DOB]." Resp. Findings of Fact, Conclusions of Law, and Memorandum of Law at 105. The Notices in this case were brought two years *after* the conclusion of the State DOB settlement with the Bank. Thus the "corrective action" to which Respondent refers is outside the scope of section 8(m) which addresses corrective action in response to or prompted by an impending notice of charges.

[.5**]** The issue between the *Bank* and the State DOB was one of capital insufficiency, not mismanagement, on which the prohibition and assessment of a CMP are based. Thus, even if the FDIC had been a party to that proceeding, assent to the settlement by the FDIC would not have precluded the issuance of the Notices herein against Respondent.[14]

F. Amendment to Pleadings

Respondent argues that his due process rights were violated by FDIC Enforcement Counsel's amendments to the Prohibition Notice.[15] The Original Prohibition Notice stated that, since 1987, Respondent had been repeatedly criticized for, *inter alia*, unsafe and unsound practices including inadequate lending and collection practices, such as "the unwarranted extension or renewal of credits past their original maturity dates, funding interest reserves to keep real estate development loans current notwithstanding the borrowers' inability to pay, using the proceeds of new loans to pay delinquent interest on other loans notwithstanding the borrowers' inability to pay, concentrations of credit, out-of-territory lending, and inadequate loan documentation...." Prohibition Notice at 6, 7.

The original Prohibition Notice pointed to unsafe and unsound practices reported in ROEs between 1987 and 1992, but it only specified by date and transaction the most

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[12] Section 8(m) provides: "In connection with any proceeding under subsection (b), (c)(1), or (e) of this section involving an insured State bank or any institution-affiliated party, the appropriate Federal banking agency shall provide the appropriate State supervisory authority with notice of the agency's intent to institute such a proceeding and the grounds therefor. Unless within such time as the Federal banking agency deems appropriate in the light of the circumstances of the case...satisfactory corrective action is effectuated by action of the State supervisory authority, the agency may proceed as provided in this section. No bank or other party who is the subject of any notice or order issued by the agency under this section shall have standing to raise the requirements of this subsection as grounds for attacking the validity of any such notice or order."

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[13] In response to the FDIC's notification, it is noteworthy that the State DOB did not take any action to effectuate corrective action under section 8(m), nor did it notify the FDIC that it intended to take such action.

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[14] Notwithstanding Leuthe's contrary assertions, the FDIC was not a party to this action and it did not participate in the court proceedings other than to represent FDIC employees who were called as witnesses.

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[15] Although Respondent refers to amendments to the Notices, only the Prohibition Notice was amended. The CMP Notice was not amended.

egregious violations. At hearing, Respondent objected to the submission of evidence

on transactions that were not specifically enumerated in the original Prohibition Notice. The ALJ permitted FDIC Enforcement Counsel to amend the Prohibition Notice, pursuant to 12 C.F.R. § 308.20,[16] "to specify allegations not fully described to aid Respondent in a meaningful defense." Order, January 10, 1997 at 4. In addition, the ALJ delayed the hearing for four months to allow sufficient time for Respondent to conduct additional discovery on the amended charges and even provided that, after the additional discovery, Respondent could re-call FDIC Enforcement Counsel's witnesses to conduct further cross examination as to those specific additional allegations introduced during their direct testimony.

The original Prohibition Notice was sufficient to notify Respondent that evidence would be presented regarding a rather lengthy list of unsafe and unsound lending practices between 1987 and 1992. As stated by the ALJ on the record:

> For the purpose of showing what Mr. Leuthe was faced with, which is the argument we are going to get into, [the issue is] what notice did Mr. Leuthe have of the charges that were being placed against him, not what evidence the agency had, but what notice had been given.

Tr. at 3215; Resp. Brief at 117, fn.20. The amendment served to provide additional detail of the charges that were already set forth in the original Prohibition Notice, to all of which charges Respondent was offered an adequate opportunity to respond. His due process rights were not violated.

In connection with this Exception, it is noteworthy that Respondent was subsequently permitted to amend his Answer— after the close of FDIC Enforcement Counsel's case-in-chief—to include the statute of limitations affirmative defense, originally omitted from his pleadings.

G. Respondent Not Dominant

Respondent objects to the FDIC's characterization of him as the "dominant force in the Bank," and he objects to the testimony of FDIC examiners and a representative of the Burbidge Group, qualified as an expert in bank management, to that effect. Except. at 59. His objection is without merit. Respondent's dominance is obvious. He is the majority and controlling shareholder. He is the only non-officer director to have an office in the Bank, and in 1991, when no other non-officer director received any compensation, Leuthe's compensation was $155,000. FDIC Ex. No. 32, p. B; R. D. at 83.[17]

Indeed, no one outside the Bank had any doubt about Respondent's position. The Burbidge Report Management Study of the Bank (FDIC Ex. No. 49) indicates that "most staff members are of the conviction that Chairman Leuthe makes every decision, clearly running the Bank." *Id*. at 20. It also noted that "the board members seem to be comforted by [Leuthe's] personal knowledge of borrowers, especially when there are ambiguous circumstances...." The Report concluded that "to have such dependence on the contribution of one board member [Leuthe] is not considered a prudent situation." *Id*. at 6. The author of the report specifically identified Respondent as the person in control and able to dominate the entire board of directors, *Id*. at 20, 23; Tr. at 5428-29. In addition, Examiners-in-Charge of six successive reports of examination testified that, from what they perceived, heard and observed, Respondent was the dominant influence in the Bank.[18] Leuthe presented no credible evidence to show the dominance or even a significant role of anyone else.[19]

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[16] 12 C.F.V. § 308.20 provides: (a) Amendments. The notice or answer may be amended or supplemented at any stage of the proceeding.

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[17] In 1987 Leuthe's compensation was four times greater than any other non-officer director; in 1988, it was six times greater; in 1989 it was seven times greater. In 1992, one other non-officer director received $1,000 in compensation; Leuthe received $120,000. FDIC Ex. No. 12, pp. B, B-1, No. 16, pp. B, B-1, No. 22, p. B and 32, P. B.

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[18] One Examiner-in-Charge noted that Respondent frequently provided missing credit file documents by removing them from his suit pockets. FDIC Ex. No. 12, p. B; Tr. at 301-302.

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[19] The issue of whether Respondent dominated the board of directors, though filling many pages of Respondent's Brief, is not determinative. His fiduciary responsibilities and other obligations arise from his position as director and majority shareholder. If proven, he would be liable for the actions alleged herein if he were simply a director and not chairman of the board, and if there were no evidence of his dominant role in the Bank's activities. Of course, the evidence introduced of his dominant role supports the FDIC's allegations.

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H. Lack of Proper Jurisdiction—Constitutional and Statutory Violations Regarding Creation of OFIA and Appointment of Administrative Law Judges

Respondent asserts for the first time in his Exceptions, at 75-78, that the ALJ and the Board lack standing to conduct these proceedings, or to render a decision because of the involvement of the "unlawfully- and illegally-created Office of Financial Institution Adjudication, and the corresponding illegal hiring and employment of administrative law judges," including ALJ Alprin. He seeks a determination by the Board that these proceedings have been initiated and conducted pursuant to and by an unlawful and unconstitutional procedure, and therefore, the Recommended Decision must be dismissed.

[.6**]** Respondent raised each of these issues in a lawsuit he brought in the United States District Court for the Eastern District of Pennsylvania against the Office of Financial Institution Adjudication ("OFIA"), FDIC, Office of the Comptroller of the Currency, Office of Thrift Supervision ("OTS"), Federal Reserve Board, and National Credit Union Administration. The defendant agencies took the position that OFIA was created in response to instructions from Congress to establish a pool of ALJs who would handle their enforcement actions.[20] As is set forth in an interagency agreement, the ALJs are employed by OTS and are available for assignments by all of the banking agencies. This arrangement fully satisfies section 916 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (1989) ("FIRREA"), the statute directing the agencies to create the pool, and does not run afoul of either the Administrative Procedure Act or any provision of the Constitution. *See* Corrected Brief of Appellees, *James L. Leuthe v. OFIA et. al*, (Case No. 97-1826, 3rd Cir., filed February 27, 1998).

The District Court dismissed Leuthe's complaint for lack of jurisdiction and did not reach Leuthe's constitutional claims. Leuthe appealed, and the United States Court of Appeals for the Third Circuit issued its decision affirming the District Court's dismissal of the case for lack of subject matter jurisdiction (No. 97-1826, June 8, 1998, unpublished). The Court of Appeals found that meaningful judicial review of his constitutional challenge will be available to Leuthe after completion of this administrative proceeding.[21]

The merits of Respondent's claim are not well taken in the Board's view. Accordingly, Respondent's Exception is denied.[22]

ANALYSIS

A. Order to Prohibit

To meet its burden in a prohibition action, FDIC Enforcement Counsel must show that the Respondent has engaged in prohibited conduct, the effect of which was to cause the Bank to suffer financial loss or damage, to prejudice or potentially prejudice the Bank's depositors, or to provide financial gain or other benefit to Respondent. FDIC Enforcement Counsel must also prove that such misconduct evidences personal dishonesty or demonstrates a willful or continuing disregard for the safety and soundness of the Bank. R. D. at 85–95. 12 U.S.C. § 1818(e)(1).

Because the ALJ's Findings of Fact are so detailed, the Board need not discuss the multiple violations of laws, regulations, and the cease-and-desist orders, or the numerous breaches of fiduciary duty which occurred after June 23, 1990. Significantly, Respondent has presented virtually no evidence contradicting the factual assertions set forth in the ROEs and the examiner testimony relating thereto.

This case is in many ways similar to *Sunshine State Bank*, 783 F.2d 1580, in which, like the instant case, challenges were made to the quality of the FDIC's examinations, the independence of the examiners, the re-

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[20] In section 916 of FIRREA Congress mandated that the banking agencies "jointly...establish their own pool of administrative law judges." 108 Stat. 486, 12 U.S.C. § 1818 note.

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[21] *See also Spiegel, Inc. v. Federal Trade Commission*, 540 F.2d 187, 294 (7th Cir. 1976); *Buckeye Industries v. Secretary of Labor*, 587 F.2d 231 (5th Cir. 1979).

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[22] Respondent also challenges these proceedings on the ground that they violate his due process right to a disinterested decision-maker. He claims that the Board has an "irrevocable and inherent bias." Except. at 89. This issue was recently addressed and rejected by the U.S. Court of Appeals in *Doolin Sec. Sav.*

Bank, F.S.B. v. FDIC, 53 F.3d 1395, 1407 (4th Cir. 1995), *cert. denied*, 516 U.S. 973 (1995). The Court held that the presumed level of inherent institutional bias "does not render all agencies incapable of adjudicating disputes within their own proceedings given the strong public interest in effective, efficient and expert decision making in the administrative setting." *See Schweiker v. McClure*, 456 U.S. 188, 195 (1982); *Winthrow v. Larkin*, 421 U.S. 35, 47 (1975).
{{8-31-98 p.A-2927}}liability of the underlying facts and testimony, and the nexus between the respondents and the losses. The Board's decision, affirmed by the Eleventh Circuit in *Sunshine State Bank* is instructive:

> Maintenance of such a large number of classified assets and extending further credit to borrowers with adversely classified loans constitute unsafe or unsound banking practices and breach of fiduciary duty by the officers and directors responsible. Further, the unlawful overlines and other unsafe or unsound practices pose additional risks to the [bank] which will probably result in losses. These extensions of credit and other unsafe or unsound practices for which the [respondents] are responsible are sufficiently related to the [b]ank's losses and probable losses to provide an adequate nexus.
> Nor do other factors, such as economic decline in South America, which allegedly affected certain borrowers' ability to repay, excuse the respondent's mismanagement of the [bank]. A sound lending policy aims to spread and limit the risk of loss. Prudent bank management and a sound lending policy would not have permitted the [bank] to accumulate so many poor-quality assets.

See In the Matter of Sunshine, 1 P-H FDIC Enf. Dec. (Bound) at A-583

[.7**]** In the course of this Board's decisions and the decisions of other federal banking agencies over the years, all sustained by court of appeals, certain practices which are inherently unsafe and unsound have been identified. Virtually all of these practices may be found in this case. Included in such practices have been the accumulation of an excessively high volume of adversely classified loans and other assets, *First National Bank of Eden v. The Department of Treasury*, 568 F.2d 610, 611 n. 1 (8th Cir. 1978) (unsafe assets in the amount of 37 percent of the bank's gross capital funds); *Groos National Bank v. Comptroller of Currency*, 573 F.2d 889, 892, 896 (high percentage of `highrisk' loans);[23] making secured loans based on inadequate collateral, *Bank of Dixie v. FDIC*, 766 F.2d 175 (5th Cir. 1985);[24] making loans without establishing and/or enforcing repayment programs, *id*; renewing loans without collection, in cash, of interest due, *id*; maintaining an inadequate reserve for loan losses in view of the volume of adversely classified loans, *id*; maintaining an inadequate level of equity capital and surplus, *Id*; making loans without regard for the borrower's ability to make repayment, *Gulf Federal Savings & Loan v. The Federal Home Loan Bank Board*, 651 F.2d 259, 264 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982); and maintaining inadequate liquidity, *Id; Bank of Dixie*, 766 F.2d at 178. Thus, it is abundantly clear upon this record that violations of law, violations of regulations, breaches of fiduciary duty, and unsafe and unsound practices were rampant at the Bank for many years.

Respondent failed to present any convincing evidence that these violations and unsafe and unsound practices did not occur, and he cannot excuse himself by arguing that he had no connection to any of these activities since he was "merely the Chairman of the board of directors," without any role, input or involvement in day-to-day operations. Except. at 10, 12. Looking beyond the selfcontradictory phrase "mere chairman of the board," it is apparent that the vast evidence in this case is quite to the contrary.

[.8**]** The duty of Respondent as chairman of the board of the bank is unequivocal. That duty includes: (1) the duty to oversee the Bank's affairs in a responsible manner, and (2) the duty to investigate, verify, clarify and explain when put on notice of unsafe and unsound practices, *Grubb v. FDIC*, 2-PH FDIC Enf. Dec., (Bound) ¶ 5181 at A-2030, 2031 (1992) *aff'd*, 34 F3d 956 (10th Cir. 1994). Respondent was given express, clear direction in the 1987 Order to which he consented. Any argument that he was ignorant of his duties (notwithstanding his many prior years of banking experience, including an informal enforcement action against him, *see* FDIC Ex. No.6) disappeared with the issuance of the 1987 Order which required that the board of directors approve every loan in

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[23] *See* FDIC Ex. No. 22, p. 1–1; FDIC Ex. No. 29, p. 1–1; FDIC Ex. No. 32, p. 2-1; Tr. at 1760.

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[24] Numerous extensions of credit to affiliates of the Bank or its insiders were not secured by collateral meeting the requirements for insider transactions set forth in section 23A of the Federal Reserve Act, 12 U.S.C. § 371c. 7 Pa. Stat. Ann. 1415(a)(ii); FDIC Ex. No. 12, pp. 6-a-2, 6-a-3, 6-a-7, 6-a-13. Some extensions of credit to Respondent's affiliates were not secured at all, such as loans to Bethlehem Freight

and First Lehigh Corporation (FDIC Ex. No. 12, p. 6-a-6.)
{{8-31-98 p.A-2928}}excess of $250,000. The Bank's own loan policy contained the same provision, as required by the 1987 Order. Thus, at least after the issuance of the 1987 Order, Respondent was directly tied to every loan greater than $250,000, of which there were many. If the unsafe and unsound loans as found by the ALJ in excess of $250,000 were approved by Leuthe as required by the 1987 Order, then he is linked to the loans so approved. If the loans were not so approved, then Leuthe participated by allowing the resulting violations of the 1987 Order and Bank loan policy, and he breached his fiduciary duty as well.

Respondent's failure to recognize his fiduciary duty is demonstrated in his own Brief. Footnote 4 to the chart at page 68 attempts to make the point that, because the FDIC failed to introduce evidence directly linking Leuthe to a loan, the loan cannot be used as evidence of his unsafe and unsound banking practices. Respondent states:

> [I]t is clear from the 1991 ROE that...this loan was never approved by the loan committee nor the board. (FDIC Ex. 30, p. 2-a-21.) In other words, this loan was made by bank employees—most likely Harold Marvin, the acting president— with board members, including Mr. Leuthe, having nothing to do with initiation or approving it. In fact, there is not one scintilla of evidence that he even knew the loan had been made.

See Resp. Brief at 69. As stated above, at the time this $322,000 loan to a classified borrower was made, every member of the board, and particularly Respondent as chairman, was obligated by both the 1987 Order and the Bank's loan policy to approve every loan over $250,000. While a director may delegate responsibility to operating management, he may not abdicate his fiduciary duty. As previously stated by this Board:

> 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*, and knowledge of state and federal banking laws, and the constant concern of 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 his duties; the more complex the transaction, the greater the duty to investigate, verify, clarify, and explain." *Id.* at A-1235.

Grubb v. FDIC, 2 P-H FDIC Enf. Dec. (Bound) at A-2031 (emphasis added).

Respondent's repeated assertions that he "never approved a single loan, lacked any involvement whatsoever in the vast majority of loans and transactions which were the subject of this proceeding," Except. at 3, and his foisting of blame on Marvin[25] are quite remarkable in light of the numerous warnings given him by both the State DOB and the FDIC. As the United States Supreme Court clearly admonished in *Briggs v. Spaulding*:

> [W]e hold that the directors must exercise ordinary care and prudence in the administration of the affairs of a bank, and that this includes something more than officiating as figureheads. They are entitled under the law to commit the banking business, as defined, to their duly-authorized officers, but this does not absolve them from the duty of *responsible supervision*, nor are they to be permitted to be shielded from liability because of want of knowledge of wrongdoing, if that ignorance is the result of gross inattention....

141 U.S. 132, 166 (emphasis added).[26]

The suggestion that Leuthe was not a par-

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[25] Leuthe seems to claim that be acted no differently than the other directors and, therefore, the fact that the FDIC filed charges only against him (and Marvin) indicates improper prosecution of some sort. That the FDIC might have brought charges against others is irrelevant to the issue of whether it has supported by substantial evidence the charges brought against Leuthe, which is the only issue in this proceeding. In exercising its judgment to proceed against one or more possible respondents, many factors are appropriately weighed by the FDIC.

Respondent's testimony blaming Marvin does not help Leuthe. It is clear that abdication of duty by directors is not a defense. *In the Matter of Sunshine*, 1 P-H (Bound) FDIC Enf. Dec. at A-581-2. Moreover, if Marvin was incompetent, it was Respondent's obligation to replace him. Respondent failed to

ensure compliance with laws, regulations, cease-and-desist orders and the Bank's own policies, and either condoned management's practices or completely failed to stop them. In either case, disregard of safe and sound banking is evident.

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[26] In administrative enforcement proceedings under section 8 of the FDI Act, the fiduciary duties owed by directors to federally insured financial institutions have been well established. *See Briggs v. Spaulding, Geddes v. Anaconda Mining Co.*, 254 U.S. 590, 599 (1921) and *Pepper v. Litton*, 308 U.S. 295, 306 (1939). This standard is
(Continued)

{{8-31-98 p.A-2929}}ticipant in the Bank's policies, procedures and operations is, however, easily belied by the record. As of April 1, 1987, Leuthe was a member of the Executive, Finance, Audit and Loan Committees. As of January 31, 1989, Leuthe was a member of the Executive, Finance and Audit Committees. As of May 28, 1991, he was a member of the Audit Committee, and he returned to the Loan Committee in 1992. FDIC Ex. No. 16, pp. B-B-2; No. 22, pp. B-B-2; No. 30, p. B-1; No. 32, p. B-1; Tr. 4515, 4518.[27] The ALJ found that "unlike any other director, Respondent had daily meetings with the president of the Bank, made all the investment and securities decisions, and was always the person at the Bank who met with examiners as the Bank's spokesman." FDIC Ex. No. 12, p. A-1; FDIC Ex. No. 16, p. A-1; FDIC Ex. No. 22, p. A-1; FDIC Ex. No. 29, p. A-1; FDIC Ex. No. 30, p. A-1; FDIC Ex. No. 32, p. A-1; R. D. at 82. Two of the Bank's loan officers testified that they had never been told about the requirements of the 1987 Order, or that, as the Bank's loan officers, they were bound by the detailed mandates of the 1987 Order including safe and sound lending. Tr. at 4485, 4568.

Significantly, Respondent's Ex. No. 378, introduced by the FDIC (FDIC Ex. No. 80), shows Respondent's course of conduct directly involving himself in the loan approval process. This exhibit contains the board of directors' minutes regarding a $1,720,000 loan to Riverfront Concepts (classified in 1991: $1,720,000 "substandard"; and in 1992: $525,000 "substandard," $770,000 "doubtful," $425,000 "loss"). The minutes indicate that Respondent personally inspected the premises and told the board that the property was a valuable property and that the borrower had a strong financial statement. In fact, the loan was classified at its first examination, was a nominee loan for another long-time classified borrower, and the financial statement was stale. FDIC Ex. No. 32, pp. 6-a-3, 2-a-51.

Furthermore, it is impossible for Respondent to distance himself from the loans made to him.[28] The loan of $400,000 made to Leuthe personally, on October 10, 1990, violated the 1987 Order, caused a breach of fiduciary duty, and violated insider lending laws. This single loan, by itself, could serve to justify the issuance of an order of prohibition and a CMP against Respondent.

After Leuthe resigned from his position as a consequence of the settlement with the State DOB on May 1, 1993, he continued to provide background, historical and personal information pertaining to classified borrowers, to act as the intermediary between certain large problem borrowers and the Bank, and to make investment decisions for the Bank. In February 1994, Respondent called the New York Regional Office of the FDIC on behalf of the Bank to discuss a possible branch sale and branch acquisition.

[.9**]** Leuthe's misconduct—violations of law, violations of final cease-and-desist orders, and unsafe and unsound practices and breaches of fiduciary duty—is well established by the record. And, as stated by the ALJ, "[r]espondent's multiple breaches of his fiduciary duties would, alone, constitute sufficient evidence to satisfy the misconduct element." R. D. at 31–81, 86–90.

[.10**]** The record also establishes satisfaction of the "effects" test. A loan made in violation of law to an institution-affiliated party or his related interests, like those to Leuthe, has been held to be a benefit in and of itself. *In the Matter of R. Wayne Lowe*, FDIC-89-21k, 2-P-H FDIC Enf.Dec. ¶ 5153 at A-1537 (1990), aff'd 958 F.2d 1526 (11th Cir. 1992); *In the Matter of Stoller*, Coolidge Corner Co-operative Bank, Brookline, Massachusetts, FDIC-90-115e, 2 P-H FDIC Enf. Dec. ¶ 5174 at A-1881 (1992); *In the Matter of Donohoo*, Capital Bank, St. Paul, Minnesota, FDIC-250e, 252k 2 P-H FDIC Enf. Dec. ¶ 5225 at A-2584-86, *aff'd* in relevant part, 103 F.3d 1409 (1997), *cert.* denied. Therefore, all loans to Respondent or his

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26 Continued different from the gross-negligence standard of care set by Congress as a floor to govern civil suits against directors and officers brought by the FDIC as receiver for failed institutions. *See Atherton v. FDIC*, 519 U.S. 213 (1997).

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[27] Leuthe contends in his Exceptions that the ALJ failed to "recognize that [he] was not a member of the Compliance Committee established by the board to monitor compliance with the 1987 Cease-and-Desist

Order,... to ensure impartiality in evaluating loans and other transactions which might have affected or pertained to his `related interests.'" Except. at 58. Whether he was on the Compliance Committee or not, there were hundreds of transactions between the 1987 Order and 1992 for which Respondent had at least oversight responsibility as chairman of the board of a bank subject to a cease and desist order.

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[28] Respondent concedes at footnote 2, p. 6, of his Post-Hearing Reply Memorandum that he had knowledge of and consented to any loans or other transactions involving him and/or any of his related interests.

{{8-31-98 p.A-2930}}related interests in violation of law, including the October 10, 1990, personal loan to Leuthe in the amount of $400,000, and the March 3, 1992, Standby Letter of Credit to Midland Farms, a related interest (FDIC Ex. No. 32, p. 6-a), resulted in gain or other benefit to Respondent for purposes of section 8(e).

[.11**]** The 1987 Order required the Bank to charge off its loans classified "Loss" or "Doubtful." Successive examiners testified that when a bank is required to charge off one hundred percent of a loan classified "Loss" or fifty percent of a loan classified "Doubtful," it results in a loss to the bank, Tr. at 155–156. The charge-off requirement has been held as a matter of law to result in a loss to the Bank. *In the Matter of Sunshine*, 1 P-H FDIC Enf.Dec. (Bound) at A-581-2.[29]

[.12**]** Finally, the FDIC must show Respondent's culpability. As pointed out above, it does not matter that the ALJ found that Respondent did not act with personal dishonesty. As found by the ALJ, findings which the Board adopts, the record fully supports the conclusion that Respondent acted with both willful and continuing disregard for the safety or soundness of the Bank. R. D. at 93-5. A finding of either one would be sufficient to satisfy the culpability prong of the statute. *Brickner v. Federal Deposit Insurance Corporation*, 747 F.2d 1198, 1202-3 (8th Cir. 1984).

Thus, there is substantial evidence for each of the elements necessary for the Board to issue a prohibition order.

B. Civil Money Penalty

[.13**]** The FDIC sought a second tier CMP against Respondent, a remedy which requires two elements of proof: first, "misconduct," i.e., either a violation of any law or regulation or final order, or breach of a fiduciary duty, or recklessly engaging in an unsafe or unsound practice in connection with the Bank, 12 U.S.C. § 1818(i)(2)(B)(i); and second, "effects," i.e., either a pattern of misconduct, or conduct which caused or was likely to cause more than minimal loss to the institution, or which resulted in a gain or benefit to the Respondent, 12 U.S.C. § 1818(i)(2(B)(ii). As set forth in the Recommended Decision, and in the discussion above related to the order to prohibit, the statutory requirements for a CMP have been proven. The FDI Act authorizes a second tier CMP in the amount of $25,000 per day for each day the violations, unsafe practices or breaches exist. In determining the amount of the CMP, FDIC Examiner Pavlick calculated the number of days the violations of the 1987 Order continued *after* the 1992 ROE, and suggested an assessment in the range of $9 million. FDIC Ex. No. 85A; Tr. at 2852–2950. After considering Respondent's financial statements, FDIC Ex. No. 62, examiner Pavlick reduced the proposed assessment to $500,000, the amount sought in the CMP Notice.[30]

[.14**]** In his Recommended Decision, the ALJ discussed at length the mitigating factors required to be considered, 12 U.S.C. § 1818(i)(2)(G), and each of the elements of the Interagency Policy on CMP Assessments.[31] R. D. 97–103. He found that none of the mitigating factors in the statute favored the Respondent and that only one of the thirteen factors in the Interagency Policy favored Respondent:

> In light of respondent's failure to cooperate with the regulators in discontinuing his violations, and the benefit he derived from his wrongdoing, the undersigned finds only one factor in the Interagency Policy that justifies any reduction in the assessment sought...the general lack of attempt to hide the existence of the violations, virtually all of which are clearly evidenced by the Bank records, in the opinion of the undersigned warrants a

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[29] The Board does not have to reach this issue, but the record also supports a finding of possible prejudice to the depositors. Mr. Leuthe admits that if the Bank had been closed by the State, as it nearly was, the FDIC would have sustained a loss of approximately $25 million, and uninsured depositors would have suffered a $6 million loss. Resp. Br. at 100-01. The last minute infusion of capital Leuthe was hardly altruistic, since it was clearly necessary to save Leuthe's significant investment in FLC and the Bank. The

record contains substantial evidence of financial gain to Respondent, loss to the Bank or prejudice to depositors to satisfy the "effects" test.

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[30] Initially, Respondent failed to submit a financial statement as requested in the FDIC's 15-day letter. Eventually one was provided indicating a total net worth of approximately $9 million. At that time the proposed assessment was reduced to $500,000, which equates to a $25,000 penalty for 20 days. This is extremely lenient given the long history of violations established on this record.

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[31] *See Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies*, 45 Fed. Reg. 59, 423 (Sept. 9, 1980). This document sets forth thirteen factors as additional guidance in assessing a CMP.

{{8-31-98 p.A-2931}}reduction of the proposed assessment to $250,000.

Id. at 102-3. The Board does not necessarily agree that the mere absence of deviousness is sufficient basis to reduce by one-half the assessment of an already lenient CMP, particularly in a case, such as this one, in which the wrongdoing was so egregious. The courts have held that the establishment of the amount of a CMP should be left to the judgment and expertise of the agency. A CMP serves two basic policy goals—(1) to adequately punish an offender, and (2) to create a deterrent to others who may consider engaging in improper activities. In this case, it is the judgment of the Board that a CMP of $250,000 will adequately achieve the goals of the statute. Furthermore, as stated in footnote 7 *supra*, FDIC Enforcement Counsel did not file an Exception to this finding. After considering the complete record herein, the Board declines to overturn the ALJ on this point.

Respondent nevertheless contends that in setting the reduced amount of the CMP, the ALJ failed to consider the effect of the Order of Prohibition on his finances. He claims that he will be forced to sell his shares in FLC, or be left "holding non-voting, non-dividend-paying, essentially worthless" shares in FLC, thereby significantly reducing his net worth. Resp. Post-Hearing Reply Memorandum at 15; Except. at 71. Respondent argues that it is "flawed as a matter of law" for the FDIC to "base its request for CMP on the Respondent owning an asset which does not belong to him, or as to which he has no financial use or benefit." Resp. Supplemental Memorandum of Law Submitted in Support of Exceptions at 13.

Respondent's argument is without basis in law or fact. There is no reason to assume that Respondent will have no financial use or benefit from the Bank in the future. Respondent will not be prohibited from owning shares, only from voting them. If he decides to sell his shares, he will reap fair market value on the sale. With good management the Bank may begin to pay dividends. In any event, it is not for the Board to speculate regarding the future of the Bank or about what Respondent may do in the future regarding his shares.

The record is quite clear that Respondent is a sophisticated, well-diversified and successful businessman.[32] Respondent's ability to pay a CMP is not limited by his net worth. *See* 1 P-H FDIC Enf. Dec (Bound) ¶ 5063 (1986). Regardless of what Respondent does with his FLC shares, his independent future earning potential is sufficient to support the $250,000 CMP assessed herein. *See Raney v. Honeywell, Inc.*, 540 F.2d 932, 936 (8th Cir. 1976); 1 P-H FDIC Enf. Dec. (Bound), ¶ 5082 (1987). Moreover, in light of the entire record, the Board finds this to be an appropriate amount and one which is consistent with the statute's intended deterrent effect. *See* S. Rep. No. 95-323, 95th Cong., 1st Sess. 9 (1977); H. Rep. No. 95-1382, 95th Cong., 2d Sess. 17 (1978).

CONCLUSION

In the Board's view, this case represents a clearcut example of a controlling shareholder who used a small, community bank as his personal piggy bank. It requires nearly twenty pages of the Recommended Decision (*see* pp. 33-52) to detail the violative loans to Respondent and his related interests. Respondent's retort, that all loans to him and his related interests were repaid in full, is largely irrelevant. This Board has held that repayment of insider loans is entitled to slight, if any, mitigating weight. *See FDIC v. Grubb*, 1 P-H FDIC Enf. Dec. ¶ 5181 at A-2031, *aff'd*, 34 F.3d 956 (10th Cir. 1994). The focus of this proceeding is the Bank's practice, under the leadership of Respondent, of making these loans in the first place. It is the risk associated with the initiation of loans such as those itemized here, that has led the Board to hold that such loans, when classified "Loss" or "Doubtful," result in loss to a bank. Notwithstanding Respondent's apparent financial ability to repay the Bank's loans in the current good economic times, there is no guarantee that this ability will continue into the future, especially if the economy were to suffer a downturn. In addition, it has been a substantial benefit to the Respondent to be able to go repeatedly to the till for funds, without ever giving a thought to lending limit restrictions, ap-

[32] The list of businesses in which Respondent has had an interest includes; textile manufacturing and distribution companies, real estate holding companies, machinery manufacturing, clothing manufacturing, real estate, leasing, housing projects, bond investments and others. *See* FDIC Prehearing Submissions at 25–29; R. D. at 33.

{{8-31-98 p.A-2932}}proval requirements, collateral requirements, reporting requirements and other statutory and regulatory requirements created to protect depositors from just these abuses.

For the reasons set forth, the Board finds that the record contains substantial evidence supporting both an Order to Prohibit pursuant to section 8(e) of the FDI Act and the assessment of a CMP in the amount of $250,000 pursuant to section 8(i) of the FDI Act.

ORDER TO PROHIBIT

For the reasons set forth above, and pursuant to section 8(e) of the Federal Deposit Insurance Act, 12 U.S.C. § 1818(e), it is hereby ORDERED that:

1. James L. Leuthe shall not participate in any manner in the conduct of the affairs of any insured depository institution, agency or organization enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D);

2. James L. Leuthe shall not solicit, procure, transfer, attempt to transfer, vote, or attempt to vote any proxy, consent or authorization with respect to any voting rights in any financial institution, agency, or organization enumerated in § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D);

3. James L. Leuthe shall not violate any voting agreement with respect to any insured depository institution, agency, or organization enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D);

4. James L. Leuthe shall not vote for a director, or serve or act as an institutionaffiliated party, as that term is defined in section 3(u) of the FDI Act, 12 U.S.C. § 1813(u) of any insured depository institution, agency or organization enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

This ORDER will become effective thirty (30) days from the date of its issuance.

ORDER TO PAY CIVIL MONEY PENALTY

The Board, having considered the entire record in this proceeding, taking into account the appropriateness of the penalty with respect to the size of financial resources and good faith of Respondent, the gravity of the violations, and such other matters as justice may require, pursuant to section 8(i) of the FDI Act, 12 U.S.C. § 1818(i), it is hereby

ORDERED that a civil money penalty is assessed against Respondent James L. Leuthe in the amount of $250,000.00. IT IS FURTHER ORDERED, that this ORDER shall be effective and the penalty shall be final and payable thirty (30) days from the date of this ORDER.

The provisions of these ORDERS will remain effective and in force except to the extent that, and until such time as, any provision of these ORDERS shall have been modified, terminated, suspended, or set aside by the FDIC.

By direction of the Board of Directors.

Dated at Washington, D.C. this 26th day of June, 1998.

RECOMMENDED DECISION

In the Matter of
JAMES L. LEUTHE
individually, and as an
institution-affiliated
party of
FIRST LEHIGH BANK
WALNUTPORT,PENNSYLVANIA
Docket Nos.

FDIC-95-15e,and
FDIC-95-16k

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I. STATEMENT OF THE CASE

This proceeding was instituted through Notices filed on June 23, 1995, by the Federal Deposit Insurance Corporation ("FDIC" or "Petitioner") against James E. Leuthe ("Respondent" or "Leuthe") and Harold R. Marvin, Jr. ("Marvin"), individually, and as institution-affiliated parties of First Lehigh Bank ("the Bank"), of Walnutport, Pennsylvania, seeking an Order prohibiting Leuthe and Marvin from further participation in the affairs of any Federally insured depository institution, and assessing a civil money penalty of $500,000 against Leuthe, former executive officer, chairman of the board of directors, and principal shareholder.[1]

Enforcement Counsel allege that Respondent has demonstrated a pattern of noncompliance despite repeated warnings from regulators over the years. He is alleged to have dominated the bank by controlling the policies and decision-making processes and by controlling ownership of the bank's parent company.

In part, the FDIC charges Respondent with violating Federal Reserve Board's Regulation O by receiving preferential treatment; engineering the Bank's extensions of credit to himself or his related interests above the permissible statutory limits and without the approval of a majority of the board of directors; and presenting more than the normal risk of repayment. He is charged with making or approving extensions of credit/ loans involving real estate in which proper appraisals are wholly lacking.

In short, Respondent Leuthe is charged with violations of law involving insider transactions, violations of final cease and desist orders, engaging in inadequate lending and collection policies and practices including unwarranted extension of renewal of credits past due. Respondent's alleged failure to address these problems over the years has resulted in a depletion of the Bank's equity capital and threatened its future viability.

The hearing herein commenced in Philadelphia, Pennsylvania, on July 8, 1996, and with two periods of recess, continued until February 11th, 1997. Briefs and Reply Briefs of the parties were thereafter filed on April 15, 1997 and May 15, 1997 respectively.

II. SUMMARY OF RECOMMENDATIONS

After careful review of the entire record and the testimony of witnesses at hearing, the undersigned recommends prohibiting Respondent from the future participation in the affairs of the federal financial institutions pursuant to section 8(e), 12 U.S.C. § 1818(e) of the Federal Deposit Insurance Corpora-

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[1] At the opening of the hearing it was announced that Respondent Marvin had submitted an offer in settlement in a form acceptable to Enforcement Counsel, and the portion of the proceeding relating to Respondent Marvin was severed. The offer was thereafter formally accepted, and this Recommended Decision relates solely to Respondent Leuthe.

{{8-31-98 p.A-2934}}tion Act ("Act"). However, the undersigned finds that Respondent did not disguise the operations in which he was involved through nominee transactions, but permitted them to be shown on Bank records where they were easily detected upon examination. Accordingly, the undersigned recommends that an Order issue assessing a civil money penalty in the sum of $250,000 against Respondent, rather than the requested amount of $500,000 pursuant to 8(i), 12 U.S.C. § 1818(i).

III. STATUTE OF LIMITATIONS

Enforcement counsel sought to introduce evidence of violations dating back to the 1970s, but primarily from the early to mid1980s and continuing to the FDIC's 1987 Report of Examination ("Roe") and later reports. Respondent relies on 28 U.S.C. § 2462, which establishes a five year statute of limitations, to assert that violations prior to June 23, 1988 are out of time. 28 U.S.C. § 2462 provides the following:

> Except as otherwise provided by Act of congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued if, within the same

> period, the offender or the property is found within the United States in order that proper service may be made thereon.

Enforcement Counsel argue that violations prior to June 1988 are not time-barred. Enforcement Counsel rely on 12 U.S.C. § 1818(i)(3), a six rather than a five year period, beginning not at the date of the violation, but at the time Respondent resigned from his position at the Bank in 1993 and ceased being an "institution-affiliated person." (IAP) pursuant to 12 U.S.C. § 1813(u). Thus, violations occurring in 1987 or even before maybe included in the charges. Enforcement Counsel secondly argue that the violations charged are in the most part "continuing violations," which, though originating more than five years ago, continued into a viable time period under Section 2462. Third, Enforcement Counsel argue that Section 2462 only applies to a civil fine, penalty, or forfeiture, pecuniary or otherwise, and does not pertain to that portion of this proceeding that seeks to prohibit Respondent. Fourth, it is noted that both the imposition of prohibition, and the assessment of civil money penalties, take into consideration the gravity of the offenses, prior violations, and the willful and/or continuing nature of the offenses, whether within or beyond any statute of limitations. Finally, Enforcement Counsel charge that sufficient transactions alleged originally arose within the period of limitations even utilizing Respondent's calendar to support the relief sought.

A. SECTION 2462 APPLIES TO ADMINISTRATIVE PROCEEDINGS

On its face, Title 28 covers "Judiciary and Judicial Procedure" and is a statute of general applicability. However, 28 U.S.C. § 2462 has recently been applied to administrative proceedings such as in *3M Co. v. Browner*, 17 F.3d 1453 (D.C. Cir. 1994) and *Johnson v. SEC*, 87 F.3d 484 (D.C. Cir. 1996). In *3M*, the Court held that the five year statute of limitations for an action, suit or proceeding for enforcement of a civil fine, penalty or forfeiture applied to administrative proceedings brought by the Environmental Protection Agency to impose civil penalties against a company for its violations. In *Johnson*, the Court held that an SEC disciplinary proceeding to suspend a managing securities broker constituted a penal action and was subject to a five year statute of limitations. However, in both these instances **no other statute existed** on point which provided for a longer limitation period. (See FN 15 in *Johnson*, Congress provided for longer limitations periods elsewhere in the Exchange Act at 15 U.S.C. § 780(b)(4)(B), allowing SEC to sanction a broker who has been convicted by a foreign court of a securities violation within the past ten years.) The general statute applied in the above cases involving those agencies only because Congress failed to provide a specific exception to the five year limitation period.

As stated above, there is a six year provision in Title 12, "Banks and Banking," that specifically provides for the time frame in which an agency may initiate an action against a party after resigning from a federally insured institution. This six year provision precisely fits the case at hand and the agency has initiated this matter in compliance with that time period.

B. STATUTORY LANGUAGE AND LEGISLATIVE HISTORY OF 12 U.S.C. § 1818(i)(3)

A careful review of section 1818(i)(3) reveals that the statute refers to "the jurisdiction *and authority*," not just the jurisdiction {{8-31-98 p.A-2935}}alone. The statute thus provides the *authority* to institute the proceeding within the stated time, and not beyond, and is thus a limitation differing from Title 28. The banking agency is specifically given "*authority to issue any notice and proceed*." With such explicit language showing a clear intent it is not possible to consider Section 1818(i)(3) as anything but a clear and forceful provision of a time period different than that of Title 28.

The legislative history of this section reveals the purpose and intent of the statute and in this matter, what is generally referred to as "The Stoddard Fix." The decision in *Stoddard v. Board of Governors of the Federal Reserve System*, 868 F.2d 1308 (D.C. Cir. 1989), held that an individual who resigns or otherwise departs from an insured depository institution is beyond the jurisdiction of the banking agencies, regardless of culpability. Section 905 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, provided a Congressional "fix" to the disturbing court decision which had established a five year period to take action against a former IAP. The House Report provides:

> This section explicitly authorizes the banking agencies to take enforcement actions, including prohibition orders and civil money penalties ("CMPs") against culpable insiders who resign or otherwise depart from an institution within 5 years after they leave the institution.... This provision does not create a new offense, but clarifies *when the banking agencies may initiate enforcement actions against individuals....*

House Report No. 101-54(I) at 393, reprinted in 1989 U.S. Code Cong. & Admin. News 189, emphasis added. *See, Abercrombie v. Clarke*, 920 F.2d 1351, 1359-60 (7th Cir. 1990), and House Report No. 111-

54(I) at 468-69, reprinted in 1989 U.S. Code Cong. & Admin. News 264-65. The section was later amended to increase the period from five, to six years. House Conf. Rep. No. 101-222 at 440, reprinted in U.S. Code Cong. & Admin. News 479 states that:

> For example, assuming that the legislation is enacted on August 26, 1989, a banking agency could initiate and pursue enforcement action against any institution-affiliated party who departed an institution in the previous six years dating back to August 26, 1983.

Thus, it is obvious that Congress was clearly concerned about the possibility that is not changed by statute, *Stoddard* would permit future IAPs to avoid enforcement action by resigning from the depository institution before the action is filed. The change was made by enacting Section 1818(i)(3), as recognized by several circuits. In *Stanley v. Board of Governors of the Federal Reserve System*, 940 F.2d 267, 271 (7th Cir. 1991), the court ruled that:

> [Section 905 of FIRREA, codified at 12 U.S.C. § 1818(i)(3)] affects only the timing according to which the Board may initiate proceedings against a director, permitting it to proceed against a director even when the financial institution has closed or the director has resigned, *so long as the Board initiated proceedings within a six year period beginning when the director severs his ties with the institution*. (Bracket and emphasis added.)

To the same effect, *Ryan v. Bonar*, 1992 U.S. DIST. LEX. 18086 (N.D. Ill. 1992), provides:

> Bonar argues that the [Office of Thrift Supervision] is time-barred from proceeding against him. We conclude, however, that the OTS is not time-barred in bringing this action against Bonar. Under section 1818(i)(3), the OTS is required to proceed against a party who has resigned or terminated his employment with a depository institution within the six-year period following his resignation or termination.... *Other than this limitation under section 1818(i)(3), the OTS faces no other time limitations on its ability to bring suit against Bonar. This comports with Congress' intent to provide an efficient and effective mechanism by which financial regulatory agencies may act to ensure the safety and soundness of the national banking system. Parker v. Ryan*, 760 F.Supp 1189, 1193 (N.D. Miss. 1991). (Emphasis added.)

C. THE FIVE YEAR STATUTE IS NOT APPLICABLE TO A PROHIBITION PROCEEDING UNDER 12 U.S.C. § 1818(e)

Assuming arguendo that the five-year statute applies, such application would be limited to the portion of the proceeding assess- {{8-31-98 p.A-2936}}ing a "civil fine, penalty, or forfeiture, pecuniary or otherwise," as within the clear words of the statute.

The Board of Governors of the Federal Reserve Board also ruled in its Final Decision in *In the Matter of Donald Hedrick and John K. Snyder*, Docket OCC-AA-EC-92-176 and -93-94, regarding the prohibition sought, as stated below:

> The Board believes that the remedy of prohibition, which is designed to protect the banking industry against individuals found to have engaged in misconduct of a certain sort, is not a "fine, penalty or forfeiture" within the meaning of the statute. *U.S. v. Stoller*, 78 F.3d 710 (1st Cir. 1996) (prohibition order is remedial and not a "punishment" within the meaning of the double jeopardy clause); *Federal Election Commission v. Nat'l Republican Senatorial Committee*, 877 F. Supp. 154, 21 (D.D.C. 1995) (injunction actions outside the scope of Section 2462; *but cf. Johnson v. S.E.C., 87 F.3d 484*, D.C. Cir. 1996) (S.E.C. broker suspension constitutes punishment and thus is subject to Section 2462). (Footnote 16).

D. "CONTINUING" VIOLATIONS

As a general rule, the statute of limitations begins to run when a claim exists or "when the factual and legal prerequisites for filing suit are in place." *3M*, 17 F.3d at 1460. Once a continuing violation is discovered and for as long as at least one act falls within the applicable limitation period, the statute runs from the last of the continuing violations, not each individual act, and all acts are properly the subject of the action. As stated by the Fifth Circuit in *Interamericas*, 111 F.3d 376, 382 (5th Cir. 1997):

> A continuing violation applies where the conduct is ongoing, rather than a single event. *See Tousie v. United States*, 397 U.S. 112, 136, 90 S.Ct. 858, 871, 25 L.Ed.2d 156 (1990) (continuing violations "set on foot by a single impulse and operated by an unintermittent force.") Along that

> line, statutes of limitations in the civil context are to be strictly construed in favor of the government against repose. *Badaracco v. Commissioner of Internal Revenue*, 464 U.S. 386, 104 S.Ct. 756, 78 L.Ed.2d 459 (1984); *E.E. Dupont de Nemours & Co. v. Davis*, 264 US. 456, 462, 44 S.Ct. 364, 366, 68 L.Ed. 788 (1924).

In view of the continuing nature of the violations in this matter, whether governed by Section 1818(i)(3) or Section 2462, all of the allegations against Respondent are properly before the undersigned for review and are not time-barred.

I.V. RULINGS ON THE ADMISSIBILITY OF EVIDENCE

Throughout the hearing, Respondent continually objected to the undersigned's rulings regarding the entering of Reports of Examination into evidence without sponsorship by any witnesses, even though all the reports actually were sponsored by examiners. In addition, Respondent objected to the undersigned's ruling that factual statements in such Reports constituted evidence of those matters without supporting documentation or testimony.

Rule 36(c)(2) of the Rules of Practice and Procedure applicable herein, 12 C.F.R. 308.36(c)(2) provides that:

> Subject to the requirements of paragraph (a) of this Section, any document, including a report of examination, supervisory activity, inspection or visitation, prepared by an appropriate Federal financial institution regulatory agency, or state regulatory agency, is admissible either with or without a sponsoring witness.

Rule 36(a)(2) provides further that:

> Evidence that would be admissible under the Federal Rules of Evidence is admissible in a proceeding conduct pursuant to this subpart.

Rule 803(8) of the Federal Rules of Evidence, *Hearsay Exceptions; Availability of Declarant Immaterial, Public records and reports*, provides as follows:

> Records, reports, statements, or data compilations, in any form of public offices or agencies, setting forth...(B) matters there was a duty to report, excluding, however, in criminal cases matters observed by police officers and other law enforcement personnel, of (C) in civil actions and proceedings and against the Government in criminal cases, factual finding resulting from an investigation pursuant to authority granted by law, unless the sources of information or other circumstances indicate lack of trustworthiness.

Pursuant to the above, there is no doubt that the Reports of Examination were properly admitted, and constituted evidence of the {{8-31-98 p.A-2937}}matters observed without sponsoring witness or other documentary or testimonial support. Respondent had the burden of going forward to contradict the Reports of Examination through documentary or testimonial evidence, which he failed to do. The factual matters in the Reports represent not only a preponderance of the evidence, which is the burden to be borne by Enforcement Counsel, but go beyond that needed here and demonstrate substantial evidence.

V. FINDINGS OF FACT, DISCUSSION AND CONCLUSIONS OF LAW[2]

A. JURISDICTION

F/1. The Bank was and is a corporation existing and doing business under the laws of the Commonwealth of Pennsylvania, with its principal place of business at Walnutport. As an insured State nonmember bank, it was and is subject to the laws of the Commonwealth of Pennsylvania and of the United States of America, particularly the Federal Deposit Insurance Act, 12 U.S.C. §§ 18111831t, and Regulations thereunder, 12 C.F.F., Chapter III. Through the Bank's predecessor in interest, Walnutport State Bank, the Bank became a wholly-owned subsidiary of the First Lehigh Corporation, of Walnutport, Pennsylvania, a one-bank holding corporation. (Admitted, R. Answer, ¶¶1 and 2)[3]

F/2. Respondent joined the Bank's predecessor in 1972, and was elected Chairman of the Bank's Board of Directors on February 18, 1981 FDIC Exh. 7, p. B; Admitted, R. Answer, ¶¶4, 5. He remained in that position during the entire period covered by the matters in this proceeding, until May 1, 1993, when he temporarily resigned his position as part of a settlement with the Pennsylvania Department of Banking

as a condition of settlement of a State administrative proceeding. Respondent is the Bank's majority stockholder. (R. Answer, ¶2)

Supervision of the Bank, as an insured State nonmember bank, is within the jurisdiction of the FDIC. An institution-affiliated party is defined, at 12 U.S.C. 1813(u)(1), as including among others "any director, officer, employee, or controlling stockholder ...of...an insured depository institution." The Bank is supervised by the Federal Deposit Insurance Corporation. Respondent's personal responsibility for violations is hereinafter separately discussed.

Respondent is an institution-affiliated party of a depository institution within the jurisdiction of the Federal Deposit Insurance Corporation.

B. VIOLATIONS OF CEASE AND DESIST ORDERS

1. The 1987 Cease and Desist Order

F/3. Respondent consented to the issuance of a cease-and-desist order by the FDIC against the Bank on October 29, 1987 ("Order I"). FDIC Exh. 14; FDIC Exh. 15, p. 3. Tr. 994, 1133. Among other specific matters, the Order required the Bank's Board of Directors, of which Leuthe was Chairman, to correct and cease all violations of Regulation "O", to correct the unsafe or unsound practices cited in the Order, and to specially give prior approval to all loans equal to or greater than $250,000.

2. Provisions and Violations by Year, 1987-1993

F/4. In order to meet requirements of the relationship between the Bank's adjusted total assets and its primary capital, **Paragraph 1(a) of the 1987 Order** required the Bank to increase its primary capital by a minimum of $3,500,000 within 120 days of the effective date of the Order.[4] Subsequently, the Bank was required to maintain adjusted primary capital of at least seven percent of the Bank's adjusted total assets until such time as the 1987 Order was removed. FDIC Exh. 14, pp. 3–4.

F/5. 1988 Lack of Compliance: As of the February 19, 1988 date of the FDIC's 1988 examination of the Bank, the Bank's adjusted primary capital to adjusted total as-

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[2]For ease of reference, all findings of fact and conclusions are numbered consecutively preceded with "F/", as in "F/1", within the otherwise indicated topic headings.

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[3]Abbreviations used throughout are as follows:
R. Answer — Respondent's Answer paragraph.
FDIC Exh. — Enforcement Counsels' Exhibit number.
R Exh. — Respondent's Exhibit number.
Tr. — Transcript page number.

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[4]The 1987 Order became effective ten days following its issuance on October 29, 1987, making the effective date November 9, 1987.

{{8-31-98 p.A-2938}}sets ratio ("adjusted primary capital ratio") was 6.03 percent and its consolidated adjusted primary capital ratio was 6.94 percent, both of which were below the 1987 capital ratio requirement of seven percent. FDIC Exh. 16, p. 3. However, during the examination, as of March 7, 1988, albeit 120 days beyond the compliance date, the Bank increased its capital ratio to 7.33 percent, to put it in compliance. The 1988 ROE does not mention the unconsolidated ratio as of that date. FDIC Exh. 16, pp. 3, 3-1.

F/6. 1989 Failure to Comply: In 1989, the Bank's adjusted primary capital ratio was 6.21 percent, and hence not in compliance, requiring either an increase in capital or a decrease in assets. FDIC Exh. 22, pp. 3, 3-1.

F/7. 1990 Failure to Comply: In 1990, the Bank's adjusted primary capital ratio was 6.59 percent, again not in compliance. FDIC Exh. 29, pp. 3, 3-1.

F/8. 1991 Compliance: In 1991, the Bank's adjusted primary capital ratio reached a nominal compliance rate of 7.33 percent. FDIC Exh. 30, pp. 3, 3-1.

F/9. 1992 Failure to Comply: In 1992, the Bank was below the required capital ratio required by the 1987 Order, maintaining a dangerously low ratio of only .2 percent, indicating the Bank's adjusted capital

was virtually nil. FDIC Exh. 32, p. 3-1. FDIC Exh. 32, p. 3-1

F/10. Paragraph 2(a) of the 1987 Order required that the Bank, within 10 days of the November 9, 1987 effective date of the 1987 Order, charge off or collect all assets classified Loss and fifty percent of all assets classified Doubtful, if not previously collected or charged off. This requirement remained in effect for all assets classified Loss or. Doubtful at any subsequent examination, with the only difference being that the Bank was permitted to take the required action within 30 days after the examination report was received. FDIC Exh. 14, pp. 6–7.

F/11. Failure to Comply: The 1991 FDIC Report of Examination ("ROE") revealed that, as to at least two assets, the Bank failed to charge off the required amount classified Loss within the time period required by the 1987 Order. FDIC Exh. 30, pp. 1–4, 1–5; Respondent Exh. 164 (unpaginated). As of May 28, 1992, FDIC examiners identified additional loans and securities with amounts that were required to be charged off following the 1991 examination, but were not charged off, including loans to **Perkiomen Bridge Hotel, Aurora Cellulose and Michael Falieski**. FDIC Exh. 32, p. 1–7

F/12. Paragraph 2(b) of the 1987 Order required the Bank to increase the reserve for loan losses, as of February 30, 1987, by a minimum of $1,000,000 and thereafter to maintain an adequate reserve. The Order specified the means by which to accomplish this requirement, and also directed the Bank's Board of Directors to conduct a quarterly re-evaluation of the reserve and make any necessary adjustments to maintain its adequacy. The re-evaluations were to be memorialized in the minutes of the Board, along with the methodology followed in calculating the level of the reserve. FDIC Exh. 14, p. 7.

F/13. 1988 through 1992 Failure to Comply: For each year from 1988 through 1992, FDIC examiners found and reported violations of paragraph 2(b) due to inadequacies in the Bank's reserve for loan losses during those years and the Bank's failure to properly document its procedures as required under the 1987 Order to evaluate and review of the reserve. FDIC Exh. 16, p. 1-2; FDIC Exh. 22, p. 1–1; FDIC Exh. 29, 1; FDIC Exh. 30, p. 1–5; FDIC Exh. 32, p. 1-7. In further violation, the minutes of the Bank's Board of Directors contained little of the information and few references to the reserve as required by the 1987 Order. *Id.* Until late 1991, the Board failed to indicate its methodology in calculating the reserve, and did not provide any supporting information. *Id.* The bank's own external auditors, in a February, 1992 letter to management, criticized its procedures in evaluating the reserve.

F/14. Paragraph 3(a) of the 1987 Order prohibited the Bank from directly or indirectly extending any new or additional credit to any borrower obligated on any loan that had been charged off in whole or in part, as long as the balance owing remained outstanding or uncollected. FDIC Exh. 14, p. 8.

F/15. 1990 through 1992 Failures to Comply: Even though the Bank on various dates charged off approximately $200,000 in connection with loan losses on extensions of credit to **Fountain Hill Millwork**, one of Respondent's related interests in ownership with Donald J. Ronca, it nevertheless, extended additional credit to Ronca entities. In one instance, on October 18, 1991, nearly two years after amounts had been charged off on loans to Mr. Ronca's Fountain Hill {{8-31-98 p.A-2939}}Millwork, the Bank loaned $828,000 to BiRan Development Corporation, an entity owned by Maryanne Ronca, his wife. This credit was almost immediately classified Substandard at the next examination. FDIC Exh. 32, p. 2-a-1. In addition, the Bank extended credit to Bi-Ran Development Corporation on April 10, 1992 in the amount of $450,000, part of the proceeds of which were used to reduce the balance of existing, classified debt of Fountain Hill Millwork and Donald Ronca. FDIC Exh. 32, p. 2-a-1. This loan was also immediately classified, receiving a Doubtful classification at the May 1992 FDIC Examination. FDIC Exh. 32, p. 2-a-1. As to Fountain Hill Millwork, following the February 27, 1990 charge off of $59,359 of debt owed, the Bank made an additional loan of $55,000 only three months later on May 18, 1990. FDIC Exh. 32, p. 2-a-29.

F/16. Paragraph 3(d) of the 1987 Order required the Bank to reduce remaining classified assets to $4,000,000 or less within 60 days of the effective date of the Order, and to an amount representing less than fifty percent of primary capital or less within 360 days of the Order's effective date.

F/17. Failures to Comply: As of January 31, 1989, the total adversely classified assets equaled not less than 50 percent, but a full 129.2 percent of adjusted primary capital. FDIC Exh. 14, p. 9; FDIC Exh. 22, p. 1–1. As of March 31, 1990, the total adversely classified assets equaled not less than 50 percent, but an even fuller 165.2 percent of adjusted primary capital. FDIC Exh. 29, p. 1–1. By the next examination as of May 28, 1991, this figure had grown to be in excess of 200 percent. Furthermore, while the Bank did develop a written program to address the FDIC's criticism of Bank assets, examiner

comments in 1988 and 1992 indicate that the form of the program did not meet all the requirements of the 1987 Order. FDIC Exh. 16, p. 1–3; FDIC Exh. 32, p. 1–7.

F/18. Paragraph 3(d) of the 1987 Order required the Bank, within 60 days, to take all reasonable steps to eliminate all deficiencies in assets scheduled as "Special Mention" in the 1987 ROE. FDIC Exh. 14, p. 9.

F/19. Failure to Comply: The Bank had assets scheduled as Special Mention for the years 1989, 1991 and 1992. FDIC Exh. 22, p. 2-c; FDIC Exh. 30, pp. 2-c, 2-c-1; FDIC Exh. 32, pp. 2-c, 2-c-1. Furthermore, the 1993 ROE contained twelve (12) pages of assets identified for Special Mention. FDIC Exh. 81, p. 2-c. No reasonable explanation has ever been offered.

F/20. Paragraph 3(f) of the 1987 Order required the Bank, within 60 days from the effective date of the Order, to take and document all reasonable steps to eliminate and/or correct all Technical Exceptions on loans and leases held by the Bank as of February 20, 1987 and noted in the 1987 ROE. FDIC Exh. 14, p. 10.

F/21. Failure to Comply: The years subsequent to 1988 through and including 1992, showed violations of this provision of the Order. Technical Exceptions did not improve, but became worse. FDIC Exh. 16, pp. 1–3, 2-e; FDIC Exh. 22, pp. 1–1, 2-e; FDIC Exh. 29, pp. 1–1, 2-e; FDIC Exh. 30, pp. 1–5, 2-e; FDIC Exh. 32, pp. 1–7, 2-e. By the **1992** examination, the loans identified as having Technical Exceptions represented 39 percent of the total dollar volume of all of the loans reviewed by FDIC examiners at the **1992** examination. FDIC Exh. 32, p. 2-3-1. In **1993**, FDIC examiners noted that numerous technical exceptions continued to be identified in the Bank's asset portfolio. FDIC Exh. 81, p. 6-3.

F/22. Paragraph 4 of the 1987 Order required the Bank to reduce each concentration of credit specified in the 1987 ROE, within 60 days from the Order's effective date, to an amount less than 25 percent of the Bank's total equity capital and reserves, and immediately upon the effective date of the Order, prohibited the Bank from extending any new credit which would cause any further concentrations of credit equal to 25 percent of the Bank's total equity capital and reserves. FDIC Exh. 14, p. 10.

F/23. Partial Compliance and Partial Failure to Comply: By the 1988 FDIC Examination, the Bank had complied with the requirement to reduce concentrations of credit which had existed as of February 20, 1987. However, the Bank violated the prohibition against new concentrations of credit, permitting concentrations consisting of its own equity investments **in various banks and bank holding Companies**, obligations of **Meridian Bank Corp. and its affiliates, and loans to William Thayer and his interests**. The Bank and bank holding company equity investments comprised 61.98 percent of total equity capital and reserves, the Meridian concentration was 49.64 percent of equity capi {{8-31-98 p.A-2940}}tal and reserves, and the William Thayer concentration was 26.21 percent of the Bank's total equity capital and reserves. FDIC Exh. 16, p. 2-b. By the **1990** FDIC examination, the Bank had reduced the William Thayer concentration listed in the 1998 ROE to less than 25 percent of total equity capital and reserves. However, other violations continued in that the Bank and bank holding company investment concentration and Meridian concentration were still on the Bank's books as reflected in the 1990 ROE. FDIC Exh. 29, p. 2-b. In 1990, violations of these provisions included the Bank and bank holding company investment concentration, and were 30.89 percent of total equity capital and reserves, while the Meridian concentration represented 54.58 percent of the Bank's total equity capital and reserves. FDIC Exh. 29, p. 2-b. Violations continued, and at the time of the examination, conducted as of May 28, **1991**, the Bank and bank holding company investment still represented a concentration on the Bank's book equaled to 57.97 percent of total equity capital and reserves, more than double the amount required by the limitation of the Order. FDIC Exh. 30, pp. 2-b, 2-b-2.

F/24. Paragraph 5 of the 1987 Order required the Bank, within 60 days from the Order's effective date to eliminate and/or correct all violations of law and regulation described in the 1987 ROE.[5] FDIC Exh. 14, pp. 10–11. In addition, within 30 days from the effective date of the Order, and at 15-day intervals thereafter, the Bank was required to provide the FDIC with progress reports detailing the actions being taken and the results of those actions, including documentation supporting the Bank's actions. The Order further provided that the Bank would do all necessary to prevent the recurrence of such violations and to ensure future compliance with applicable laws and regulations. *Id.*

F/25. Failure to Comply: In 1988, FDIC examiners indicated that management of the Bank had taken steps to correct certain violations of law and regulations, but while management represented to the FDIC

that outstanding violations had been corrected, the documentation required under paragraph 5 of the 1987 Order was not provided to the FDIC, and no details were provided explaining the Bank's actions taken to correct violations, reflecting a failure to comply. FDIC Exh. 16, pp. 1–4. The **1989** ROE indicates ongoing violations caused by the Bank's continued failure to provide the Regional Director of the FDIC with the required 15-day reports detailing the actions taken to correct violations listed in the 1987 Report and to ensure future compliance on an ongoing basis. Furthermore, the 1989 ROE listed numerous new violations of law and regulations, demonstrating that the Bank was still violating paragraph 5 of the 1987 Order. FDIC Exh. 22, pp. 1–2, 6, 6-1. In **1991**, while no new types of violations of Federal law or regulations were cited, numerous violations of Pennsylvania State laws and regulations were noted, as discussed in another section hereof. FDIC Exh. 30, pp. 6-a, 6-a-1. FDIC examiners noted an increase in violations of laws and regulations in **1992**, involving both State and Federal laws and regulations. Many of these violations involved insider transactions prohibited by Regulation "O" of the Regulations of the Board of Governors of the Federal Reserve System, 12 C.F.R., Part 215, which had been repeatedly violated during the period covered by the 1987 through 1992 examinations. In addition, the Bank appeared to have been wholly ignoring FDIC regulations requiring appraisals, as there were more than forty appraisals in the Bank's files which did not conform with the requirements of such regulations. FDIC Exh. 32, pp. 6-a-4 through 6-a-7. In total, the violations of State and Federal laws and regulations covered eight full pages of the 1992 ROE. *See*, FDIC Exh. 32, 6-a through 6-a-7. Examiners at the **1993** joint State and Federal examination indicated that Bank's management had still not taken all necessary steps to prevent future violations of applicable laws and regulations. Specifically, apparent violations of Part 362 of the FDIC's Rules and Regulations were cited at the 1993 examination. In addition, the FDIC's Compliance Report of Examination as October 13, 1993 also cited numerous apparent violations. FDIC Exh. 81, p. 6-3.

F/26. Paragraph 6 of the 1987 Order required the Bank's Board of Directors to develop and implement procedures for the detailing in a certified statement by each director and officer of all entities and ventures in which any was financial related or interested, and set forth various information

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[5]Paragraph 5 excepted violations of Part 325 of the FDIC's Rules and Regulations, 12 C.F.R. Part 325, which was dealt with in Paragraph 1 of the Order regarding capital.

{{8-31-98 p.A-2941}}which such statement was required to contain. In addition, Paragraph 6 required any material changes in the information reflected in the certified statement to be updated to reflect the change. Finally, the certified statements were required to be reviewed by the entire Board every year, and a copy of the first set of these statements was to be provided to the Regional Director within 40 days from Order I's effective date. FDIC Exh. 14, pp. 11–12.

F/27. Failure to Comply: Although it appears that the Bank submitted statements in November, 1987 and February, 1988 on behalf of each director, the **1988** examination showed that the Board of Directors had failed to develop any of the procedures required under Paragraph 6 so that the information would be reported on a regular and meaningful basis. Furthermore, no affiliate information or statements appeared in the reports submitted by the Board concerning the interests of non-director officers at the time of the 1988 examination. FDIC Exh. 16, p. 1–4. In **1989**, FDIC examiners found that the Board still had not developed any specific procedures as required by Paragraph 6 concerning the statements of financial interests. The last submission of directors' statements of interests was February, 1988, with no indication of whether any circumstances had occurred requiring the filing of new statements. As at the previous examination, there was still no record of any submissions on behalf of non-director officers concerning their related interests. Although Paragraph 6 of the 1987 Order required that the Board review each of the certified statements, no mention was made in the minutes of the Board that any such review had occurred since February, 1988. FDIC examiners at the 1989 examination did find individual statements submitted on behalf of directors and officers listing affiliations, again with no record that the Board had reviewed them, and noted that statements of interests submitted on behalf of Respondent did not include **Lehigh Engineering Associates, Inc.**, which was one of his related interests. FDIC Exh. 22, p. 1-2.

F/28. Paragraph 7(a) of the 1987 Order required the Bank's Board to establish a committee of independent, outside directors to ensure that the Bank complied with the provisions of the Order, and required that the committee report monthly to the entire Board and include a copy of such report and any related discussions in the Board's minutes, a copy of which would be forwarded to the FDIC. While setting forth the requirement of establishing this committee to ensure compliance with the 1987 Order. Paragraph 7(a) also reaffirmed the responsibility of the entire Board of compliance with the Order's provisions. FDIC Exh. 14, p. 12. **Paragraph 7(b) of the 1987 Order required** the Bank to use its best efforts to add two new independent, outside directors to the Board, and to ensure that at least two-thirds

of the Board consisted of independent, outside directors at all times in the future. FDIC Exh. 14, pp. 12–13.

F/29. The **1988** ROE indicated that although two potential new independent, outside directors had been identified, the Bank was unwilling to add them to the Board while the 1987 Order was in effect. FDIC Exh. 16, p. 1–5. At each subsequent examination from **1989 through 1992**, FDIC examiners found that the Bank had not added the two additional qualifying directors as required. FDIC Exh. 22, p. 1–2; FDIC Exh. 29, p. 1–1; FDIC Exh. 30, p. 1–6; and FDIC Exh. 32, p. 1–8. Although the **1993** report of examination indicated that a compliance committee had been appointed and references were found to the reports of such committee, the FDIC's Regional Director found that the two additional board members proposed by the Bank for the compliance committee were not independent, outside directors as required by the 1987 Order.

F/30. Paragraph 8 of the 1987 Order required the Bank, within sixty days from the Order's effective date, to revise, adopt and implement written lending and collection policies and procedures to provide affective guidance and control over the Bank's lending function and its leasing subsidiary. Paragraph 8 further set forth a comprehensive list of requirements which the lending policy was required to meet in order to be adequate under the Order, and required a copy of the policy to be provided to the FDIC for review. FDIC Exh. 14, pp. 14–16. **Paragraph 8(d)** of the 1987 Order set forth a specific requirement that the Bank's loan policy require all loans in excess of $250,000 to be reviewed by and receive the prior approval of the Bank's Board of Directors. FDIC Exh. 14, p. 14; FDIC Exh. 16, pp. 1–5, 1–6.
{{8-31-98 p.A-2942}}

F/31. Failure to Comply: The **1988** ROE shows that the Bank's Board adopted a new lending policy on January 4, 1988 and forwarded a copy to the Regional Director. However, the policy contained substantially less than the comprehensive lists of specifications required under Paragraph 8. FDIC Exh. 14, p. 14; FDIC Exh. 16, pp. 1–5, 1–6. At the **1989, 1990, 1991 and 1992** examinations, examiners noted that while the Bank's Board of Directors had approved a lending and collection policy meeting the requirements of Paragraph 8 of the 1987 Order, the policies had been ineffective in controlling the lending function because the Bank was failing to adhere to the lending and collection policy it had approved, an obviously necessary concomitant of establishing the policy. FDIC Exh. 22, p. 1–2; FDIC Exh. 29, p. 1–2; FDIC Exh. 30, p. 1–6; FDIC Exh. 32, p. 1–8.

F/32. Paragraph 9 of the 1987 Order required, within sixty days from the Order's effective date, the Bank to revise, adopt and implement a written investment policy to provide effective guidance and control over the Bank's investment function. FDIC Exh. 14, p. 16. Paragraph 9 also set forth minimum requirements for the policy. *Id*.

F/33. Failure to Fully Comply: FDIC Examiners found at the **1988** examination that the Bank's Board approved an investment policy on November 5, 1987. However, the policy did not contain all the required guidelines under Paragraph 9, and did not meet the terms of the Order. FDIC Exh. 16, p. 1–6. FDIC examiners at the **1991** examination commented that the Bank's investment policy, which had last been reviewed and approved by the Board on August 27, 1990, while appearing adequate, did not provide steps to be taken when a security became subinvestment grade quality. FDIC Exh. 30, p. 1–6. At the time of the **1992** FDIC examination, the investment policy was determined to be adequate for the Bank's needs. However, it did not set forth percentages of the investment portfolio allocated to any particular type of investment, a violation of Paragraph 9(d) of the 1987 Order, which required the policy to set forth limitations on any one type of instrument or obligor. FDIC Exh. 32, p. 1–8. It was noted at the **1993** joint State and Federal examination that although an investment policy was in existence, the policy still did not fully provide effective guidance and control over the Bank's investment function. FDIC Exh. 81, p. 6–4.

F/34. Paragraph 10 of the 1987 Order requires the Bank, within 90 days from the Order's effective date, to adopt a written funds management policy acceptable to the FDIC, including certain minimum requirements, and to thereafter immediately initiate the measures detailed in the policy if they had not already been implemented. FDIC Exh. 14, pp. 16–17.

F/35. Failure to Comply: The **1988** ROE indicated that the Bank's Board approved a funds management policy on January 28, 1988, but that the policy did not consider any asset/liability management strategy, volatile liability dependence or liquidity record keeping systems and procedures, all of which were required by Paragraph 10 of the 1987 Order. FDIC Exh. 16, p. 1–6. In **1989**, FDIC examiners indicated that the funds management and liquidity policy approved by the Bank's Board on October 17, 1988 had not been adequately implemented. FDIC Exh. 22, p. 1–3. At the **1991** examination,

FDIC examiners found that the Bank's management was conducting funds management and liquidity operations in contravention of the Bank's own policies. FDIC Exh. 30, p. 1–7. In **1992**, FDIC examiners found that the Bank again violated Paragraph 10 of the 1987 Order, as the funds management policy in effect did not address the management of volatile liabilities as a source of funds. FDIC Exh. 32, p. 1–8. As of the **1993** examination, the Bank's funds management policy did not meet the requirements of Paragraph 10 of the 1987 Order. FDIC Exh. 81, p. 6–4.

F/36. Paragraph 11 of the 1987 Order prohibits the Bank from declaring or paying cash dividends in any amount out of the capital stock of the Bank unless certain conditions were met. FDIC Exh. 14, p. 17.

F/37. Failure to Comply: At the **1989** FDIC examination, the Bank's Board declared two cash dividends each in the amount of $120,000, without providing written notification to the FDIC at least 15 days prior to each declaration, which was one of the conditions required in Paragraph 11. FDIC Exh. 22, p. 1–3.

F/38. Paragraph 15 of the 1987 Order required the Bank, within 60 days from the Order's effective date, to institute a training program to ensure that all officers and employees were fully trained and knowledgeable as to their duties and responsibilities, {{8-31-98 p.A-2943}}and further required a staffing table setting forth management's responsibilities and designations to be approved by the Bank's Board and submitted to the FDIC. In addition, Paragraph 15 required the Board to conduct a complete review of all operating procedures and controls to ensure full compliance with all applicable laws and regulations. FDIC Exh. 14, p. 18.

F/39. Failure to Comply: While examiners at the **1988** FDIC examination noted that various Bank personnel held periodic meetings during the 1988 examination for training purposes, no written documentation appeared in the Bank's file indicating the existence of any training program as required by Paragraph 15 of the 1987 Order. Training manuals for employees were noted, as was a management training program for various departments. In addition, the Board approved an organizational chart reflecting management's responsibilities, which was submitted to the Regional Director. However, no record documenting the complete review by the Board of all operating procedures and controls to ensure compliance with laws and regulations was found in the Bank's files. FDIC Exh. 16, p. 1–7. In **1989**, the Bank's records still did not document the required training program, although the Bank's management continued to maintain that an adequate method of training existed. Again, as found at the 1988 examination, there was no record that the Bank's Board had conducted a complete review of the Bank's operating procedures and control to ensure full compliance applicable laws and regulations. Despite the expressions of the Bank's Board and management that it desired to correct all deficiencies noted in the 1988 examination, FDIC examiners determined that management had failed to follow the framework provided by the 1987 Order to accomplish effective oversight of the Bank's operations, resulting in numerous and serious deficiencies. FDIC Exh. 16, p. 1–7. At the **1990** FDIC examination, it was found that the Bank had belatedly instituted the training program required by Paragraph 15 of the 1987 Order, although management had not yet documented review of that program in the Board's minutes. FDIC Exh. 29, p. 1–3. It appears that the Bank never documented or demonstrated that the complete review of all operating procedures and controls to ensure full compliance with laws and regulations was ever conducted by the Board. FDIC Exh. 32, p. 1–9. Examiners at the **1993** joint State and Federal examination found no evidence that the Bank's Board had undertaken a complete review of all operating procedures and controls to ensure compliance with applicable Federal and state laws and regulations. In addition, neither compliance nor CRA training appeared to have been conducted by the Bank. Furthermore, the Compliance Report of Examination as of October 13, 1993 cited numerous apparent violations of rules and regulations. FDIC Exh. 81, p. 6–5. Accordingly, the Bank continued to be in violation of Paragraph 15 of the 1987 Order.

In toto, for the period of 1988 into 1993, as Chairman of the Board, as President, as principal and controlling stockholder, and as the individual exercising the most direct control over the Bank's operations, the Respondent on numerous occasions and in numerous manners failed and participated in the Bank's failure to comply with the requirements of the 1987 Order to Cease and Desist.

3. The 1993 Cease and Desist Order

F/40. Respondent consented to the issuance of a cease and desist order issued by the FDIC against the Bank on June 10, 1992 ("Order II"). FDIC Exh. 35, p. 3. Tr. 1751–1752. The 1993 Report of Examination, as of October 18, 1993, shows that many of the requirements had been met, and the others had at least been substantially improved, but that compliance had not been achieved.

C. UNSAFE AND UNSOUND OPERATIONS

F/41. As of February 20, 1987, the date of Respondent's Report of Examination of the Bank, Respondent's related interests included the following entities:

Barry Manor, Inc.
Bethlehem Corporation
Bethlehem Freight Consolidating, Inc.
Deeville Blouse Co., Inc.
D.J. Partners
D.J. Properties
First Lehigh Corporation
Garrett Manufacturing Co.
James L. Leuthe, Personal
L.U.R.R.S. (A Partnership)
{{8-31-98 p.A-2944}}
Midland Farms
Nikki, Inc.
Westside Warehouse Co.

A history of loan transactions during the period involved for each of these entities is here set forth. Each of these loans were cited in the 1987 and later ROEs as constituting violations due to their relationship with Respondent, and as affiliates of the Bank.

Barry Manor, Inc.

F/42. Respondent held a 50% partnership interest with **Donald Ronca** in Barry Manor. There were five loans outstanding as of February 20, 1987. The first, of August 12, 1986, was originally for $60,000 and due August 12, 1988, and was collateralized by real estate. The full amount of the original loan remained an outstanding balance due as of February 20, 1987, to wit, $60,000. The second loan, of December 30, 1986, originally for $300,000 was collateralized by real estate. It had a current balance due on February 20, 1987 of $29,393. The third loan, of December 31, 1986, was originally for $200,000 and collateralized by real estate, had a current balance due on February 20, 1997, of $199,595. The fourth loan, of January 21, 1987, was originally for $60,000, was due on January 21, 1988, and was collateralized by real estate. It had a current balance due on February 20, 1987, of $60,000. The fifth loan, of January 30, 1987, was originally for $60,000 and due on February 28, 1988, and was collateralized by real estate. It had a current balance due on February 20, 1987, of $60,000. The total balance due from this related entity on February 20, 1987, was $408,988. FDIC Exh. 7, 6-a-8. At the time of the December 30, 1986 extensions of credit, Barry Manor, Inc. was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. 215.2(m), and the aggregate amount of covered transactions between the Bank and all affiliates exceeded 20 percent of the Bank's capital and assets, resulting in violations of that statute and regulations at 121 C.F.R. 215.4. FDIC Exh. 12, p. 6-a-1 and -2, Exh. 44, Tr. 198-199.

Bethlehem Corporation

F/43. This entity was a machinery manufacturer and a corporate owner of **Bethlehem Freight Consolidating, Inc.**, a freight consolidator, which in turn was the owner of **G.T.S., Inc.**, a textile distribution company. As of the 1987 Report of Examination, Respondent was Chairman, CEO, and 20% stockholder of Bethlehem Corporation, and also was President, Secretary, and Chairman of the Board of Directors of Bethlehem Freight.

F/44. There were thirteen lease loans outstanding to Bethlehem Corp. as of February 20, 1987, originating from August of 1983 to December 12, 1986, collateralized by leased property and with various monthly payments due, representing maturities of from 24 to 60 months from origination. The total current balance on these loans as of February 20, 1987, was $334,105. FDIC Exh. 7, 6-a-7 through 9.

F/45. On September 4, 1986, the Bank extended credit to Bethlehem Corp. in the amount of $75,000. On September 12, 1986, the Bank extended additional credit to Bethlehem Corp. in the amount of $48,000. In October, 1986, the Bank extended additional credit to Bethlehem Corp. in the amount of $25,600. On December 3, 1986, the Bank extended additional credit to Bethlehem Corp. in the amount of $31,150. On December 15, 1986, the Bank extended further credit to Bethlehem Freight in the amount of $475,000. On December 18, 1986, the Bank extended further credits to Bethlehem Corp. in the amounts

of $27,000 and of $10,000. On March 30, 1987, the Bank extended credit to Bethlehem Freight Consolidating in the amount of $693,839. On April 8, 1987, the Bank extended credit to Bethlehem Corporation in the amount of $26,512. On December 12, 1988, **after the 1987 Cease and Desist Order**, the Bank extended credit to Bethlehem Corporation in the amount of $14,480. FDIC Exh. 12, p. B, 6-a-2 through -10; Tr. 206, 207, 445, 628635. At all times, both Bethlehem Corp. and Bethlehem Freight were affiliates of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and related interests of Respondent within the meaning of 12 C.F.R. § 215.2(m) and the aggregate of such transactions with all af- filiates exceeded 20 percent of the Bank's capital and surplus, resulting in violations of said statute and regulations at 12 C.F.R. 215.4. FDIC Exh. 12, p. 6-a-1 and -3, Exh. 44, Tr. 198-199.

F/46. G.T.S., Inc. was a subsidiary of the Bank through affiliation with Bethlehem Freight Consolidating, and Respondent was president and a 3% stock owner. On Decem {{8-31-98 p.A-2945}}ber 31, 1986, the Bank extended credit to G.T.S., Inc. in the sum of $30,490. FDIC Exh. 12, p. 6-a-1. At that time, G.T.S., Inc. was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1), and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m), while the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus, resulting in the violation of that state and regulation. FDIC Exh. 12, p. 6-a-1- and -2, Exh. 44, Tr. 198-199. Further, on January 21, 1987, the Bank, with Respondent as its chief stockholder and chairman, extended Credit to G.T.S., Inc. in the sum of $60,000 under the same conditions as set forth in this paragraph, resulting in similar violations.

F/47. As of the March 30, 1987 extension of credit to Bethlehem Freight Consolidating, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 16, p. 6-a-8. Tr. 628-633. This extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 16, p. 6-a-8. Tr. 628–633. This extension of credit constituted a violation of section 215.4(b) of Regulation O as a result of the March 30, 1987 extension of credit to Bethlehem Freight Cons. FDIC Exh. 44.

F/48. At the time of the March 30, 1987 extension of credit to Bethlehem Freight, Bethlehem Freight was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 16, p. 6-a-10. Tr. 633–635. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded the lending limit of the Bank specified in 12 C.F.R. § 215.2(i). FDIC Exh. 16, p. 6-a-10. Tr. 633–635. The Bank failed to prevent the violation arising from section 215.4(c) of Regulation O as a result of the March 30, 1987 extension of credit to Bethlehem Freight. FDIC Exh. 44.

F/49. At the time of the April 8, 1987 extension of credit to Bethlehem Corporation, Bethlehem Corporation was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 16, p. 6-a-10. Tr. 633-635, at that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded the lending limit of the Bank specified in 12 C.F.R. § 215.2(i). FDIC Exh. 16, p. 6-a-10. Tr. 633–635.

F/50. From July 1983 through July 1986, the Bank extended credit to Bethlehem Corporation in the amount of $12,048. FDIC Exh. 12, p. 6-a-2. These extensions of credit were not secured by collateral meeting the requirements of 12 U.S.C. § 371c(c). FDIC Exh. 12, p. 6-a-2.

F/51, At the time of the December 12, 1985 extension of credit to Bethlehem Corporation, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. The extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/52. At the time of the January 1986 extensions of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a11. Further, the January, 1986 extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/53. At the time of the May 16, 1986 extension of credit to Bethlehem Corpora- tion, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. The aggregate amount of credit outstanding to Respondent and his related interests then exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. The extension of credit

was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/54. At the time of the July 14, 1986 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. The aggregate amount of credit outstanding at that time to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired {{8-31-98 p.A-2946}}surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. This extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/55. At the time of the September 4, 1986 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. The aggregate amount of credit outstanding to Respondent and his related interests at that time exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. This extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/56. At the time of the September 12, 1986 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, pp. 6-a-10 through 6-a-11. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. The credit was extended without advance approval by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/57. At the time of the October 1986 extensions of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a11. The credit was extended without the advance approval by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/58. At the time of the December 3, 1986 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. The credit was extended without advance approval of a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

F/59. At the time of the April 8, 1987 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, within the meaning of 12 C.F.R. § 215.2(m). FDIC Exh. 16, p. 6-a-8. Tr. 628–633. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 16, p. 6-a-8. Tr. 628–633. The credit was extended without the advance approval by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 16, p. 6-a-8. Tr. 628–633.

F/60. At the time of the December 12, 1988 extension of credit to Bethlehem Corporation, it was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 22, p. 6-2. Tr. 885. At that time, the aggregate amount of credit outstanding to Respondent and his related interests exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 22, p. 6-2. The credit was extended without the advance approval by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 22, p. 6-2.

Deeville Blouse Co., Inc.

F/61. As of the 1987 ROE, Respondent was the President and 83% stockholder of this textile company. There were two extensions of credit outstanding as of February 20, 1987. The first was a loan originating on October 22, 1986, with a demand note for the original amount of $224,488, collateralized by two vehicles with a ready market value of $3,825, on which the current balance due as of February 20, 1987 was $194,488. The second was a loan originating on December 31, 1984, for an original amount of $34,800, collateralized by lease on equipment, payable over 36 months at $1,058 per month. As of February 20, 1987, the current balance due on the second loan was $12,180. Total current balance due from this entity as of February 20, 1987 was $207,268. FDIC Exh. 7, 6-a-8.

F/62. As of the time of these loans, Deeville Blouse was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m), FDIC Exh. 12, p. 6-a-1. At that time the aggregate {{8-31-98 p.A-2947}}amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus. FDIC Exh. 12, pp. 6-a-1 through 6-a-2. Tr. 198-199. The Bank violated section 23A(a) (1)(B) of the Federal Reserve Act as a result of the extension of credit to Deeville Blouse. FDIC Exh. 44.

F/63. On December 31, 1984, the Bank extended additional credit to Deeville Blouse in the amount of $34,800. FDIC Exh. 12, p. 6-a-2. This extension of credit was not secured by collateral meeting the requirements of 12 U.S.C. § 371c(c). FDIC Exh. 12, p. 6-a-2.

F/64. On October 22, 1986, the Bank extended credit to Deeville Blouse in the amount of $224,488. FDIC Exh. 12, p. 6-a-3. This extension of credit to Deeville Blouse was not secured by collateral meeting the requirements of 12 U.S.C. § 371c(c). FDIC Exh. 12, p. 6-a-3. At this time Deeville Blouse was a related interest of Respondent, as defined in 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-9a, and this extension of credit exceeded 5 percent of the Bank's capital and unimpaired surplus. FDIC Exh. 12, pp. 6-a-10 through 6-a-11. Further, the extension of credit was not approved in advance by a majority of disinterested members of the Bank's board of directors. FDIC Exh. 12, pp. 6-a-10 through 6-a-11.

D.J. Partners

F/65. This entity was a partnership jointly owned by Respondent and Donald J. Ronca. As of April 20, 1987, there was one unsecured loan outstanding from the Bank to D.J., originating on November 5, 1986, in the amount of $75,000, due November 5, 1987. FDIC Exh. 7, 6-a-7. As of February 22, 1988, the full amount of the loan, $75,000, remained outstanding and due. FDIC Exh. 8, 6-a-1, showing that the loan had been renewed without payment of principal.

D.J. Properties

F/66. Respondent held an 83% stock ownership in this entity. There were two loans outstanding as of February 20, 1986. The first loan was made on December 5, 1985, in the amount of $500,000, collateralized by real estate and due on June 6, 1987. The balance due as of February 20, 1987, was $200,000. The second loan was made on December 31, 1986, in the amount of $300,000, on a real estate mortgage, and payable at the monthly rate of $3,410. The balance due as of February 20, 1987 was $299,393, indicating that payments were already in default. The balance due on both loans as of February 20, 1987, was $499,393. FDIC Exh. 7, 6-a-8.

First Lehigh Corporation

F/67. This entity was a bank holding company and the parent holding all of the Bank's stock. Respondent was president and chairman, held 55.3% and had voting rights over 59.2% of its stock.

F/68. On July 28, 1986, the Bank extended credit to First Lehigh Corporation in the amount of $650,000. On that date, 10 percent of the Bank's capital stock and surplus was an amount less that $650,000. FDIC Exh. 12, p. 6-a. The aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation exceeded 10 percent of the Bank's capital stock and surplus, and exceeded 20 percent of the Bank's capital stock and surplus, in violation of 12 U.S.C. 371c(a) FDIC Exhs. 12, p. 6-a-1, Exh. 44; Tr. 198-199, 449.

F/69. On August 29, 1986, the Bank extended further credit to First Lehigh Corporation in the amount of $1,500,000. At that time, FDIC Exh. 12, p.6-a-6. Tr. 449. On that date, 10 percent of the Bank's capital stock and surplus was an amount less than $1,500,000, and the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus and exceeded 20 percent of the Bank's capital stock and surplus, in violation of 12 U.S.C. 371c(a), and Section 23A(1)(b) of the Federal Reserve Act. FDIC Exh. 12, p. 6-a; Tr. 198199, 449.

F/70. On March 14, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $95,167. As of that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c (b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, and constituted a violation of section 23A(a)(1)(A) of the Federal Reserve Act.

FDIC Exh. 12, p. 6; Exh. 44.
{{8-31-98 p.A-2948}}

F/71. On April 7, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $76,360. As that time the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c (b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, and resulted in a violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exhs. 12, p. 6-a; Exh. 44; Tr 198.

F/72. On May 14, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $55,922. As of that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c (b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, resulting in a violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exhs. 6-a; Exh. 44.

F/73. On June 13, 1986, the Bank extended credit to First Lehigh Corporation in the amount of $180,006. On that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, in violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exh. 12, p. 6-a, Exh. 44, Tr. 198.

F/74. On July 1, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $644,558. As of that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c (b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, resulting in the violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exh. 12, p. 6-a, Exh. 44, Tr 198.

F/75. On August 4, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $181,995. As of that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, resulting in a violation arising from section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exh. 12, p. 6-1, Exh. 44, Tr 452.

F/76. On December 10, 1986, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $253,561. On that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, resulting in a violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exh. 12, p. 6-a, Exh. 44, Tr 198.

F/77. On January 15, 1987, the Bank extended credit by an overdraft to First Lehigh Corporation in the amount of $181,099. As of that date, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and First Lehigh Corporation, exceeded 10 percent of the Bank's capital stock and surplus, resulting in a violation of section 23A(a)(1)(A) of the Federal Reserve Act. FDIC Exh. 12, p. 6-a, Exh. 44, Tr 198.

F/78. The total outstanding balance due from this entity as of February 20, 1987, was $2,083,312. FDIC Exh. 7, p. 6-a-8.

Garrett Manufacturing Co.

F/79. Respondent was President and owner of a 34% interest in this entity. On October 22, 1986, the Bank extended credit to Garrett Mfg. in the amount of $75,000. FDIC Exh. 12, p. 6-a-1. At that time, Garrett Manufacturing was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-1. At that time the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371(b)(7), between the Bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus, FDIC Exh. 12, pp. 6-a-1 through 6-a-2; Tr. 198-199, resulting also in a violation of section 23A(a)(1)(B) of the Federal Reserve Act as a FDIC Exh. 44.

James L. Leuthe, Personal

F/80. As of February 20, 1987, Respondent had one personal loan outstanding, originated August 25, 1986, in the amount of $286,769, collateralized by readily marketable stocks ($45,692), certificates of

deposit ($180,000), and various mortgages and equipment, to be repaid with 11 monthly install- {{8-31-98 p.A-2949}}ments of $2,031.[6] The amount of $273,026 was outstanding and due, with an obvious default or recapitalization of interest as of February 20, 1987. FDIC Exh. 7, 6-a-7.

F/81. On November 16, 1986, an additional loan was made in the amount of $182,688. The proceeds of this loan, together with the proceeds of a mirror loan to **Donald J. Ronca**, were disbursed to payment of the loan to **D.J. Properties**, of $304,074, and to payment of the loan to **Barry Manor, Inc.** of $61,302, in each of which entities Respondent and Ronca held a one-half interest. At the time of these extensions of credit the aggregate amount of the covered transactions as defined in 12 U.S.C. § 371(c)(b)(7), between the Bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus, resulting in violations of the statute and the Regulation. FDIC Exh. 12, pp. 6-a-1 and -2, Tr. 198-199. Each of these entities were affiliates of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-1. As of February 22, 1987, the amount outstanding and due from Respondent on this second loan was $152,188. The total due from Respondent on the two loans as of February 22, 1988, was $393,727. Additional extensions of credit to Respondent include one for $400,000 on October 10, 1990, without appraisal on the collateral pledged. FDIC Exh. 32, p. 6-a.

James Leuthe Leasing Co.

F/82. Respondent was sole owner, President and Director of this entity, which had one loan outstanding as of February 20, 1987, originated December 31, 1986 in the amount of $14,806, for the lease of a 1987 Ford, repayable in 48 monthly payments of $297. As of February 20, 1987, the outstanding balance due was $14,414. FDIC Exhs. 16, page B; 22, page B; 30, page B; 32, p. B; and 63.

L.U.R.R.S.

F/83. Respondent held a 25% interest in L.U.R.R.S. On December 9, 1986, the Bank extended credit to L.U.R.R.S. in the amount of $66,053. FDIC Exh. 12, p. 6-a-1. At that time, L.U.R.R.S. was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-1. Also at the time, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus. FDIC Exh. 12, pp. 6-a-1 through 6-a-2. Tr. 198-199. This resulted in the violation of section 23A(a)(1)(B) of the Federal Reserve Act. FDIC Exh. 44.

Midland Farms, Inc.

F/84. Respondent was President and held a 34% stock interest of this textile company, which had two loans outstanding as of February 20, 1987. On December 5, 1986, the Bank extended credit to Midland Farms, Inc. in the amount of $18,537. FDIC Exh. 12, p. 6-a-1. At that time, Midland Farms, Inc. was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m). FDIC Exh. 12, p. 6-a-1. Also at the time, the aggregate amount of covered transactions, as defined in 12 U.S.C. § 371c(b)(7), between the Bank and all affiliates of the Bank, exceeded 20 percent of the Bank's capital and surplus. FDIC Exh. 12, pp. 6-a-1 through 6-a-2. Tr. 198-199. FDIC Exh. 44. The first loan originated December 18, 1986, in the original amount of $35,299, payable in 60 monthly installments of $693, for lease of tractor loader and backhoe. As of February 20, 1987, the outstanding balance due was $25,813. The second loan originated December 5, 1986, in the original amount of $18,537, payable in 48 monthly payments of $400, for lease of a 1987 Ford Bronco. As of February 20, 1987, the outstanding balance due was $18,000. The total balance due from this entity as of February 20, 1987, was $43,813. FDIC Exh. 7, 6-a-9. Another extension of credit, in the sum of $278,744, was made March 9, 1992, by standby letter of credit, without appraisal of the renewal estate collateral pledged. FDIC Exh. 32, pp. 6-a, 6-a-1.

Nikki, Inc.

F/85. This entity was a textile company of which Respondent was President and virtu-

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[6]The repayment schedule obviously does not match the terms of the loan, and it must be assumed that a balloon payment was due on the twelfth month.

{{8-31-98 p.A-2950}}ally if not entirely the sole stockholder. This entity had one loan outstanding as of February 20, 1987, originated on August 8, 1980 in the amount of $76,000, secured by a 1979 Lincoln,

and by stocks of a not readily available marketability, to be repaid with monthly payments of $1,004. The amount due as of April 20, 1987, was $59,000, indicating that the loan was in default. FDIC Exh. 7, 6-a-8.

Westside Warehouse Co.

F/86. Respondent held a one-third partnership interest in this entity, which had one loan, originated on December 3, 1986, outstanding as of February 20, 1987, and then was in the amount of $555,500, collateralized by real estate and payable on demand. As of February 20, 1987, the amount currently due was the full amount, $555,500. FDIC Exh. 7, 6-a-8. At the time of the extension of credit, Westside Warehouse was an affiliate of the Bank within the meaning of 12 U.S.C. § 371c(b)(1) and a related interest of Respondent within the meaning of 12 C.F.R. § 215.2(m), and the aggregate amount of covered transactions between the Bank and all affiliates of the Bank exceeded 20 percent of the Bank's capital and surplus, resulting in violations of the statute and regulations. FDIC Exh. 12, p. 6-a-1 and -2, Exh. 44, TR 198-199.

C. EXCESSIVE CLASSIFIED LOANS

F/87. The sum of $215,000 of a $220,000 loan made to John Akin and Maniac Parker on December 14, 1988 was classified Substandard in the **1991 ROE**. In the **1992 ROE**, the total credit outstanding to the borrowers was $213,000, the entire balance of which was classified Substandard. The adverse classifications in the 1991 and 1992 ROEs resulted from the loan being made without regard to the borrowers' ability to repay from earnings or liquid assets and the failure of the Bank to maintain adequate information on the borrowers. FDIC Exh. 30, p. 2-a; FDIC Exh. 32, p. 2-a.

F/88. The sum of $571,000 of a $611,000 loan made to Aurora Cellulose Corporation on **September 19, 1990** was classified Doubtful in the **1991 ROE** resulting from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; failure of the Bank to maintain adequate information on the borrower; making of a secured loan based on inadequate collateral; failure of the Bank to obtain an adequate appraisal on the collateral; and failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 30, p. 2-a-1.

F/89. Several loans were made to Adman M. Barber and Related Interests during the period **between December, 1985 and November, 1988**, i.e., $25,000 on December 11, 1985, $15,000 on February 4, 1986, $111,630 on April 7, 1987, $200,000 on September 1, 1987, and $1,054,000 on November 30, 1988. Of the $1,255,000 in credit outstanding to Adman M. Barber and Related Interests at the time of the 1989 ROE, $893,000 was classified Substandard and $328,000 was classified Doubtful. In the 1990 ROE, the total credit outstanding to the borrowers was $1,053,000, the entire balance of which was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrowers was $163,000, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $163,000 and $73,000 was classified Substandard. The adverse classifications were the result of the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; making of the loans without establishing and/or enforcing repayment programs; and the failure of the Bank to renew or restructure the loans without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 22, pp. 2-a through 2-a-2.

F/90. The sum of $209,000 of a $210,000 loan made to Frank A. Banco on **July 25, 1990** was classified Substandard in the **1991 ROE** as a result of the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; and the making of a secured loan based on inadequate collateral. FDIC Exh. 30, p. 2-a-2.

F/91. The sum of $370,000 on a $390,000 loan made to CBS Enterprises on April 13, 1988 was classified Substandard in the **1992 ROE** due to the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; and failure of the Bank to maintain adequate information on the borrower. FDIC Exh. 32, p. 2-a.

F/92. The full amount of a $500,000 loan to Andrew J. Called in November, 1988 was classified Substandard in the 1990 ROE and $79,000 of a $79,000 loan made to Andrew J. Called on **February 28, 1990** was classi- {{8-31-98 p.A-2951}}fied Loss in the **1990 ROE**. The 1990 loan was granted for carrying costs, including interest on the original loan of $500,000. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; renewing or restructuring the

loans without collection, in cash, of interest due (capitalization of interest); the failure of the Bank to maintain adequate information on the collateral securing the extensions of credit; and the fact that the extensions of credit were made outside of the Bank's territory. FDIC Exh. 29, p. 2-a-2.

F/93. The sum of $160,000 was loaned to Charles and Ann Crivellaro and Anthony and Rose Crivellaro on March 28, **1990** and $70,000 was loaned to Charles and Ann Crivellaro and Anthony and Rose Crivellaro on April 20, **1990**. Of the total amount loaned in March and April, 1990, $200,000 was classified Substandard in the **1991 ROE** and $230,000 was classified Substandard in the **1992 ROE** due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; making of secured loans based on inadequate collateral; and renewing or restructuring the loans without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 30, p. 2-a-5.

F/94. Loans totaling $1,366,000 were made to Dalessio and Rocco and Related Interests during the period **between 1985 and May, 1992**. Specifically, $200,000 was loaned in 1985; $300,000 was loaned on January 25, 1988; $300,000 was loaned on **December 18, 1990**; $300,000 was loaned on **September 30, 1991**; $335,000 was loaned on **November 21, 1991**; and $29,000 was loaned on **May 21, 1992**. Of the total amount loaned, i.e., $1,366,000, $654,000 was classified Substandard and $712,000 was classified Doubtful in the **1992 ROE** due to the fact that loans were made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals; renewing or restructuring the loans without collection, in cash, of interest due (capitalization of interest); and the failure of the Bank to obtain and/or perfect security interest in the collateral securing the extensions of credit. FDIC Exh. 32, pp. 2-a-4 and 2-a-5.

F/95. The entire amount of the loans, $387,000, granted **between 1983 and 1986** to Fred R. Davis and Related Interests were classified Loss in the 1987 ROE due to the fact that loans were made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; and the failure of the Bank to obtain and/or perfect security interest in the collateral. FDIC Exh. 12, p. 2-a-3.

F/96. Loans totaling $1,296,000 were made to Edward Doran **between March, 1987 and May, 1991**. Specifically, $396,000 was loaned on March 4, 1987; $100,000 was loaned on July 21, 1988; $700,000 was loaned on **February 21, 1991**; and $100,000 was loaned on **May 3, 1991**. Of the total amount loaned to Edward Doran between March, 1987 and May, 1991, i.e., $1,296,000, $1,179,000 was classified Substandard in the **1992 ROE** due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower, the making of secured loans based on inadequate collateral; and the failure of the Bank to obtain adequate appraisals on the collateral. FDIC Exh. 32, p. 2-a-8.

F/97. The sum of $250,000 was loaned to Michael Faliski on **March 3, 1988 and $50,000 was loaned to him on July 6, 1989**. Of the total amount loaned to Michael Falieski in 1988 and 1989, i.e., $300,000, $253,000 was classified Substandard in the **1991 ROE** resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 30, p. 2-a-6.

F/98. The sum of $760,000 was loaned to Carl A. and Martha Forss and Related Interests **between September, 1989 and November, 1990**. Specifically, $100,000 was loaned on September 12, 1989; $60,000 was loaned on December 29, 1989; $50,000 was loaned {{8-31-98 p.A-2952}}on March 3, 1990; $350,000 was loaned on March 30, 1990; and $200,000 was loaned on **November 1, 1990**. In the **1991 ROE**, the total credit outstanding to the borrowers was $309,000 and $276,000 was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $343,000, the entire balance of which was classified Doubtful. The 1991 and 1992 adverse classifications were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of secured loans based on inadequate collateral; and making of the loans without establishing and/or enforcing repayment programs. FDIC Exh. 30, p. 2-a-7; FDIC Exh 32, p. 2-a-8.

F/99. The sum of $249,000 of a $250,000 loan made to Nicholas Fotopoulos on **August 6, 1987** was classified Substandard in the 1988 ROE resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate

information on the borrower; the making of secured loans based on inadequate collateral; the Bank's failure to obtain an adequate appraisal of the collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect its security interest in the collateral. FDIC Exh. 16, p. 2-a-1.

F/100. The sum of $295,000 was loaned to Louis A. and Olga C. Gerlette on February 13, **1984**. In the **1992** ROE, the total credit outstanding to the borrowers was $218,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the failure of the Bank to obtain adequate appraisal on the collateral; the making of the loan without establishing and/or enforcing repayment programs; and renewing or restructuring the loan without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 32, p. 2-a-9.

F/101. The sum of $175,000 was loaned to Biagio Guiliano on August 1, 1987. In the **1991 ROE**, the total credit outstanding to the borrower was $174,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 32, p. 2-a-9.

F/102. The sum of $175,000 of a $175,000 loan made to Robert and Patricia Heim on September 23, **1987** was classified Substandard in both the **1991 and 1992 ROEs** result from the loan having been made without regard to the borrowers' ability to repay from earnings or liquid assets; and the Bank's failure to obtain adequate appraisal of the collateral. FDIC Exh. 39, p. 2-a-10; FDIC Exh. 32, p. 2-a-10.

F/103. A number of credits totaling $278,000 were extended to J & J Leasing and Rentals, Inc. between **May and December, 1986**. Of the total amount extended to J & J Leasing and Rentals, Inc. between **May and December 1986**, i.e., $278,000, $114,000 was classified Doubtful and $144,000 was classified Substandard in the **1987** ROE due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; and failure of the Bank to obtain an adequate appraisal of the collateral. FDIC Exh. 12, pp. 2-a-23 and 2-a-24.

F/104. The sum of $3,277,000 was extended to K & R Properties between **September, 1989 and December, 1991**. Specifically, $575,000 was extended on September 22, **1989**; another $937,000 was also extended on September 22, **1989**; $283,000 was extended on January 4, **1990**; $50,000 was extended on **October 25, 1990**; $1,155,000 was extended on **November 8, 1991**; and $277,000 was extended on **December 31, 1991**. In the **1990 ROE**, the total credit outstanding to the borrower was $1,776,000 and $920,000 was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrower was $1,264,000, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrower was $2,042,000, of which $1,113,000 was classified Substandard, $277,000 was classified Doubtful, and $594,000 was classified Loss. All of the adverse classifications were due to the loans having been made without re- {{8-31-98 p.A-2953}}gard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain an adequate appraisal of the collateral; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 29, p. 2-a-3; FDIC Exh. 30, p. 2-a-11; FDIC Exh. 32, pp. 2-a-11 and 2-a-12.

F/105. Loans were made to Kenneth Kucharz and Joseph Ranzini, d/b/a Katie Company in 1986 and 1988. On December 31, 1986, a loan in the amount of $1,650,000 was extended to Katie Company and on March 31, **1988** a loan in the amount of $750,000 was also extended to Katie Company. In the 1989 ROE, the credit outstanding to the borrower was $1,366,000, the entire balance of which was classified Substandard. In the **1990 ROE**, the total outstanding credit to the borrowers was $869,000, the entire balance of which was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrowers was $1,034,000, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $1,745,000, the entire balance of which was classified Substandard. The adverse classifications were due to the fact that loans were made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of secured loans based on inadequate collateral; making of the loans without establishing and/or enforcing repayment programs; renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest); and the loans having been made outside the Bank's market territory. This loan was also discovered to be a Reg O violation because a portion of the

proceeds were received by James L. Leuthe through his related interests, D.J. Properties, the seller of the property and Lehigh Engineering, an undisclosed engineering company owned by Respondent. FDIC Exh. 22, p. 2-a-7; FDIC Exh. 29, p. 2-a-6; FDIC Exh. 30, p 2-a-11; and FDIC Exh. 32, p. 2-a-13.

F/106. The sum of $300,000 was loaned to Paul F. Laubner on February 12, **1990**. In the **1992 ROE**, the total credit outstanding to the borrower was $249,000, the entire balance of which was classified Substandard due to the fact that the loan was made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the failure of the Bank to obtain an adequate appraisal of the collateral; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 32, p. 2-a-14.

F/107. Loans in the amounts of $182,000 and $186,000 were made to Leonard Lines, Inc. on December 20 and 31, **1986**, respectively. In the **1987 ROE**, the total credit outstanding to the borrower was $341,000, the entire balance of which was classified Substandard as the loans had been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower. FDIC Exh. 12, p. 2-a-22.

F/108. The sum of $400,000 was loaned to Joseph and Kathleen Lippert on July 22, **1987**. In the **1991 ROE**, the total credit outstanding to the borrowers was $381,000, the entire balance of which was classified Substandard due to the fact that the loan was made without regard to the borrowers' ability to repay from earnings and liquid assets; and the failure of the Bank to maintain adequate information on the borrowers. FDIC Exh. 30, p. 2-a-11.

F/109. Loans were made to Thomas J. Maloney between May 1987 and **June 1991**. Specifically, $26,000 was loaned on May 1, **1987**; $17,000 on **September 7, 1990**; another $25,000 was loaned on **September 7, 1990**; $975,000 was loaned on **October 25, 1990**; $125,000 on **November 1, 1990**; and $1,075,000 was loaned on **June 17, 1991**. In the **1991 ROE**, the total credit outstanding to the borrower was $1,158,000 and $1,033,000 was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrower was $1,218,000 and $968,000 was classified Substandard. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings and liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure {{8-31-98 p.A-2954}}of the Bank to obtain and/or perfect its security interest in the collateral; FDIC Exh. 30, p. 2-a-12; FDIC Exh. 32, p. 2-a-15.

F/100. Loans in the amount of $333,500 and $325,000 were extended to Patrick and Carmen Mangan on **March 31, 1988 and March 22, 1989**, respectively. In the **1992 ROE**, the total credit outstanding to the borrowers was $339,000, the entire balance of which was classified Substandard. The adverse classification was due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; and the failure of the Bank to maintain adequate information on the borrowers. FDIC Exh. 32, p. 2-a-14.

F/111. Loans were made to Edward G. Martin and Related Interests **between August, 1986 and January, 1989**. Specifically, $285,000 was loaned on August 26, **1986**; $10,500 was loaned on January 12, **1987**; $90,000 was loaned on November 3, **1987**; $99,612 was loaned May 4, **1988**; $25,000 was loaned on October 12, **1988**; $135,000 was loaned on December 2, **1988**; and $25,000 was loaned on January 6, **1989**. In the **1989 ROE**, the total credit outstanding to the borrower was $655,000, and the entire balance was classified Substandard. The adverse classification was due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; the making of the loans without establishing and/or enforcing repayment programs; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect a security interest in the collateral. FDIC Exh. 22, 2-a-3 and 2-a-4.

F/112. Loans in the amount of $320,000 and $125,000 were extended to Daniel and Ruth Martino on December 19 and 22, **1986**, respectively. In the **1990 ROE**, the total credit outstanding to the borrowers was $417,000 and $375,000 was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrowers was $407,000 and $375,000 was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $400,000, and the entire balance was classified Substandard. The adverse classifications were due to the fact that loans were made without regard to the borrowers' ability

to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of loans without establishing and/or enforcing repayment programs; and the renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 29, p. 2-a-3; FDIC Exh. 30, p. 2-a-14; and FDIC Exh. 32, p. 2-a-17.

F/113. Loans were made to John and Donna Marushok **between July, 1985 and april, 1987**. Specifically, $225,000 was loaned on July 10, **1985**; $75,000 was loaned July 10, **1986**; and $20,000 was loaned on April 3, **1987**. In the **1987 ROE**, the total credit extended to the borrowers was $294,000, the entire balance of which was classified Substandard. In the **1988 ROE**, the total credit extended to the borrowers was $314,000, the entire balance of which was classified Substandard. In the **1989 ROE**, the total credit outstanding to the borrowers was $310,000, the entire balance of which was classified Substandard. The adverse classifications were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; and the making of secured loans based on inadequate collateral. FDIC Exh. 12, p. 2-a-7; FDIC Exh. 16, p. 2-a-3; FDIC Exh. 22, p. 2-a-5.

F/114. Loans in the amount of $370,000 and $260,000 were made to Matlee, Inc. on August 31, **1989** and November 29, **1989**, respectively. In the **1990 ROE**, the total credit extended to the borrower was $366,000, the entire balance of which was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrower was $359,000, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrower was $604,000, the entire balance of which was classified Substandard in the 1992 ROE. All of the adverse classifications were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of the loans based on inadequate collateral; the making of loans without establishing and/or enforcing repayment programs; and renewing or restructuring loans without collection, in cash, or in- {{8-31-98 p.A-2955}}terest due. FDIC Exh. 29, p. 2-a-4; FDIC Exh. 30, p. 2-a-14; FDIC Exh. 32, p. 2-a-17.

F/115. Loans were made to John and Gayle McGeeghan **between March, 1988 and March, 1990**. A $252,000 loan was made on March 2, 1988; a $61,000 loan was made on May 12, 1988; a $108,000 was made on March 2, 1989; and a $90,000 loan was made on March 30, 1990. Of the $247,000 outstanding credit at the time of the **1992 ROE**, $161,000 was classified Substandard due to the loans having been made without regard to the borrowers' inability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; and making of the loans without establishing and/or enforcing repayment programs. FDIC Exh. 32, p. 2-a-18.

F/116. Loans in the amount of $154,000 and $10,000 were made to Douglas W. Mehrens on April 10 and August 4, **1986**, respectively. Of the $164,000 outstanding at the time of the **1989 ROE**, the entire balance was classified Substandard due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the failure of the Bank to obtain an adequate appraisal of the collateral; making loans without establishing and/or enforcing repayment programs; the failure of the Bank to obtain and/or perfect security interest in the collateral; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 22, p. 2-a-5.

F/117. Loans were made to Mikabe Sportsware, Ltd. **between October, 1983 and January, 1987**. A loan of $250,000 was made on October 18, **1983**; another loan of $250,000 was made on December 6, **1983**; a loan of $50,000 was made on March 28, **1984**; a loan of $70,000 was made on May 23, **1985; and** a loan of $84,455 was made between December, **1986** and January, **1987**. At the time of the **1987 ROE**, the total credit extended to the borrower was $445,431, and $220,000 was classified Substandard and $225,000 was classified Loss in the 1987 ROE. In the **1988 ROE**, the total credit extended to the borrower was $225,000, the entire balance of which was classified Substandard. In the **1989 ROE**, the total credit extended to the borrower was $225,000 and $135,000 was classified Loss. All of the adverse classifications were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; making of secured loans based on inadequate collateral; the failure of the Bank to obtain and/or perfect security interests in the collateral; and the fact that the extensions of credit were made outside the Bank's market territory. FDIC Exh. 12, p. 2-a-8; FDIC Exh. 16, p. 2-a-3; FDIC Exh. 22, p. 2-a-6.

F/118. A loan in the amount of $251,500 was made to Barry L. and ann Miller on March 8, **1988**, of which $180,000 was classified Substandard and another $71,000 was classified Loss in the **1989 ROE**

resulted from the loan having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of the secured loan based on inadequate collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect security interests in the collateral. FDIC Exh. 22, p. 2-a-6.

F/119. Loans were made to Thomas A. Mirth between **February, 1990 and January, 1992**. Specifically, $500,000 was loaned on February 8, **1990**; $1,118,000 was loaned on **June 3, 1991** and $70,000 was loaned on **January 2, 1992**. The proceeds of the 1991 loan **included refinancing** of the February 8, 1990 loan noted above. In the **1991 ROE**, the total credit extended to the borrower was $440,000, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit extended to the borrower was $1,109,000, and $1,102,000 was classified Substandard. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; and the failure of the Bank to obtain adequate appraisals of the collateral. FDIC Exh. 30, p. 2-a-15; FDIC Exh. 32, p. 2-a-20.

F/120. The sum of $330,000 was loaned to Joseph C. Posh on June 22, **1988** and $269,000 was outstanding at the time of the **1992 ROE**. The amount of $219,000 was {{8-31-98 p.A-2956}}classified Substandard in the **1992 ROE** resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; and the failure of the Bank to obtain an adequate appraisal of the collateral. FDIC Exh. 32, p. 2-a-22.

F/121. Loans were made to Joseph T. Posh and Related Interests between **April, 1991** and **December, 1992**. Specifically, $290,000 was loaned on **April 17, 1991**; $733,000 was loaned on **April 30, 1991**; another $350,000 was loaned on **April 30, 1991**; $47,000 was loaned on **March 31, 1992**; another $131,000 was loaned on **March 31, 1992**; $131,000 was loaned on **August 5, 1992**; $54,000 was loaned on **October 25, 1992**; and $173,000 was loaned on **December 30, 1992**. Of the $1,871,000 extended to Joseph T. Posh and Related Interests between April, 1991 and December, 1992, $878,000 was classified Substandard and $635,000 was classified Doubtful in the **1992 ROE** due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the making of the secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect its security interest in the collateral. FDIC Exh. 32, p. 2-a-22.

F/122, A loan was made to Eugene and Gail Rader in the amount of $180,000 on **October 22, 1991**. In the **1992** ROE, the total amount of credit outstanding to the borrowers was $176,000 and $76,000 was classified Substandard and $100,000 was classified Doubtful due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of a secured loan based on inadequate collateral; and the fact that the extension of credit was made outside of the Bank's market territory. FDIC Exh. 32, p. 2-a-24.

F/123. The sum of $100,000 was loaned to Charles J. Rader on July 2, **1984**; $75,000 was loaned to him on December 27, **1985**; and $300,000 was loaned to him on November 11, **1988**. Of the $178,000 loaned to Charles J. Rader in 1984 and 1985, the entire balance was classified Substandard in the **1987 ROE**. As of May 28, 1991, the total credit outstanding to Charles J. Rader was $402,000; of that amount, $236,000 was classified Substandard in the **1991 ROE**. The adverse classifications in the 1987 and 1991 ROEs were due to the loans having ben made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of a secured loan based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; the making of the loan without establishing and/or enforcing repayment programs; and renewing or restructuring the loan without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 12, p. 2-a-11; FDIC Exh. 30, p. 2-a-16.

F/124. Loans were made to Barry R. Rauhauser between **March, 1991** and the end of **1992**. Specifically, $500,000 was loaned on **March 7, 1991**; another $150,000 was loaned on **March 7, 1991**; #386,000 was loaned on May 28, 1991; and the sums of $373,000 and $248,000 were loaned on various dates during **1991 and 1992**. In the **1992 ROE**, the total credit outstanding to the borrower was $1,704,000, of which $360,000 was classified Substandard, $522,000 was classified Doubtful, and $352,000 was classified Loss due to the loans having been made without regard to the borrower's ability

to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the failure of the Bank to obtain adequate appraisals of the collateral; the failure of the Bank to maintain adequate information on the collateral; and the fact that the extensions of credit were made outside the Bank's market territory. FDIC Exh. 32, p. 2-a-25.

F/125. The sums of $950,000 and $770,000 were loaned to Riverfront Concepts, Inc. on January 31, **1989**, respectively. The total amount of the loans to Riverfront Concepts, Inc., **$1,720,000** was classified Substandard in the **1990 and the 1991 ROEs**. In the **1992 ROE**, the total credit outstanding to the borrower was $1,720,000 and $525,000 was classified Substandard; $770,000 was classified Doubtful and $425,000 was classified Loss. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; failure of the Bank to maintain adequate information on the borrower; the mak- {{8-31-98 p.A-2957}}ing of the loans without establishing and/or enforcing repayment programs; and renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 29, p. 2-a-5.

F/126. Loans were made to Frank Romano and Related Interests **between May, 1985 and October, 1987**. Specifically, $200,000 was loaned on May 6, **1985**; $75,000 was loaned on July 18, **1985**; $79,883 was loaned on December 8, **1986**; $5,000 was loaned on September 7, 1986; $119,724 was loaned on January 5, **1987**; $20,000 was loaned on April 2, **1987**; $140,000 was loaned on April 8, **1987**; $600,700 was loaned on May 14, **1987**; $200,000 was loaned also on May 14, **1987; and $220,000 was loaned between June, 1987 and October, 1987**. In the **1988 ROE**, the total credit outstanding to the borrower was $1,477,000 and $1,492,00 was classified Substandard. In the **1989 ROE**, the total credit outstanding to the borrower was $1,848,000 and $579,000 was classified Substandard. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals on the collateral; and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 16, p. 2-a-4; FDIC Exh. p. 2-a-8.

F/127. The sum of $1,544,784 in loans were made **between June, 1984 and May, 1990** to Donald J. Ronca and Related Interests (including Fountain Hill Millwork, Inc.). The loans were adversely classified in the **1989, 1990, 1991 and 1992 ROEs**. In the **1989 ROE**, the total credit outstanding to the borrower was **$1,466,000** and $1,205,000 was classified Substandard. In the **1990 ROE**, the total credit outstanding to the borrower was **$1,660,000** and $1,198,000 was classified Substandard and $462,000 was classified Doubtful. In the **1991 ROE**, the total credit extended to the borrower was **$866,000**, the entire balance of which was classified Substandard. In the **1992 ROE**, the total credit extended to the borrower was **$754,000**, and $230,000 was classified Substandard, $339,000 was classified Doubtful; and $185,000 was classified Loss. The adverse classifications were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of a secured loan based on inadequate collateral; the failure of the Bank to obtain adequate appraisals of the collateral; the making of the loan without establishing and/or enforcing repayment programs; renewing or restructuring the loan without collection, in cash, of interest due (capitalization of interest); the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect its security interest in the collateral. FDIC Exh. 22, p. 2-a-8; FDIC Exh. 29, p. 2-a-6; FDIC Exh. 30, p. 2-a-17; and FDIC Exh. 32, p. 2-a-26.

F/128. The sum of $350,000 was loaned to Jane and Stewart Schooley on February 15, **1989** and $25,000 was loaned to them on **April 17, 1992**. In the **1991 ROE**, the total credit outstanding to the borrowers was $231,000 and the entire amount was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $225,000 and the entire amount was classified Substandard. The adverse classifications in both the 1991 and 1992 ROEs were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the making of secured loans based on inadequate collateral; the making of loans without establishing and/or enforcing repayment programs; and renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest). FDIC Exh. 30, p. 2-a-18; FDIC Exh. 32, p. 2-a-29.

F/129. The sums of **$1,325,000 and $190,000** were loaned to Stone Row Development on November 1, **1988**. In the **1989 ROE**, the total credit outstanding to the borrower was approximately $1,325,000 of which $1,140,000 was classified Substandard due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate

information on the borrowers; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals on the collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect security interest in the collateral. FDIC Exh. 22. p. 2-a-10.
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F/130. Several loans were made to William H. Thayer and Related Interests **between September, 1986 and September, 1988**. Specifically, $140,000 was loaned on September 8, **1986**; $685,000 was loaned on November 21, **1986**; $180,000 was loaned on December 2, **1987; $820,000** was loaned on May 9, **1988**; and $35,553 was loaned on September 27, **1988**. In the **1989 ROE**, the total credit outstanding to the borrower was approximately **$2,612,000** and $1,469,000 was classified Substandard. In the **1990 ROE**, the total credit outstanding to the borrower was approximately **$2,067,000** and the entire balance was classified Substandard. In the **1991 ROE**, the total credit outstanding to the borrower was **$1,650,000** and $1,581,000 was classified Substandard. The adverse classifications in the 1989, 1990, and 1991 ROEs were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; the failure of the Bank to obtain adequate appraisals on the collateral; renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest); and the failure of the Bank to obtain and/or perfect security interest in the collateral. FDIC Exh. 22, p. 2-a-11; FDIC Exh. 29, p. 2-a-6; FDIC Exh. 30, p. 2-a-18.

F/131. The sum of $189,000 was loaned to Donald and Markley Troyano on October 25, **1988**. In the **1991 ROE**, the total credit outstanding to the borrowers was $187,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the failure of the Bank to obtain an adequate appraisal on the collateral; and making of a loan without establishing and/or enforcing repayment programs. FDIC Exh. 30, p. 2-a-19.

F/132. Several loans were made to Salvatore and Rose Venezia **between April, 1984 and August, 1991**. Specifically, $120,000 was loaned on April 17, 1984; $105,000 was loaned on January 29, 1986; $60,000 was loaned on January 26, 1987; and **$260,000 was loaned on August 22, 1991**. In the **1987 ROE**, the total credit extended to the borrowers was $271,121, virtually all of which was classified Substandard. In the **1992 ROE**, the total credit outstanding to the borrowers was $256,000 and the entire amount, i.e., $256,000, was classified Substandard. The adverse classifications in the 1987 and 1992 ROEs were due to the loans having been made without regard to the borrowers' ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrowers; the making of secured loans based on inadequate collateral; and failure of the Bank to obtain adequate appraisals on the collateral. FDIC Exh. 12, p. 2-a-14; FDIC Exh. 32, p. 2-a-30.

F/133. The sum of **$300,000** was loaned to William Werpehowski on **October 12, 1990**. Of the $300,000 loaned to the borrower on October 12, 1990, the total amount, $300,000, was classified Substandard in the **1991 ROE**. In the **1992 ROE**, the total credit outstanding to the borrower was $149,000, the entire balance of which was classified Substandard. The adverse classifications in both the 1991 and 1992 ROEs were due to the loans having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the failure of the Bank to obtain an adequate appraisal on the collateral; renewing or restructuring the loan without collection, in cash, of interest due (capitalization of interest); and the failure of the Bank to obtain and/or perfect security interest in the collateral. FDIC Exh. 30, p. 2-a-20; FDIC Exh. 32, p. 2-a-30.

F/134. The sum of $210,000 was loaned to White Lion Inn, Inc. on August 29, **1986**. In the **1991 ROE**, the total credit outstanding to the borrower was $192,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to obtain an adequate appraisal on the collateral; and the making of a loan without establishing or enforcing a repayment program. FDIC Exh. 30, p. 2-a21.

F/135. Loans in the amount of $500,000 and $50,000 were made to Whitetail Golf Club Associates on **October 31, 1990** and **October 4, 1991**, respectively. The total amount loaned to Whitetail Golf Club Associates in 1990 and 1991 was outstanding at the time of the **1992 ROE** and $500,000 was classified Substandard due to the loans {{8-31-98 p.A-2959}}having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of secured loans based on inadequate collateral; and the failure of the Bank to

obtain an adequate appraisal on the collateral. FDIC Exh. 32, p. 2-a-31.

F/136. The sum of **$713,000** was loaned to Woodside Associates Partnership on September 20, **1988**. In the **1991 ROE**, the total credit outstanding to the borrower was $607,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of a secured loan based on inadequate collateral; the making of a loan without establishing and/or enforcing a repayment program; renewing or restructuring loans without collection, in cash, of interest due (capitalization of interest); and the failure of the Bank to maintain adequate information on the collateral. FDIC Exh. 30, p. 2-a-9.

F/137. Loans in the amount of **$200,000 and $315,000** were extended to Bob Young on **November 12, 1986 and April 19, 1988**, respectively. In the **1989 ROE**, the total credit outstanding to the borrower was $501,000 and $476,000 was classified Substandard resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; and the failure of the Bank to maintain adequate information on the borrower. FDIC Exh. 22, pp. 2-a-12 and 2-a-13.

F/138. The entire balance of a **$1,250,000** loan made to Prosperity Center Partnership on May 19, **1989** was classified Substandard in the **1990** ROE. In the **1991 ROE**, the total credit outstanding to the borrower was $1,246,000, the entire balance of which was classified Substandard. The adverse classifications in the 1990 and 1991 ROEs were resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets and the making of a secured loan based on inadequate collateral. FDIC Exh. 29, p. 2-a-4; FDIC Exh. 30, 2-a-8.

F/139. Loans of **$767,000 of $1,289,000** made to March Development Company in May and July, **1990** were classified Substandard in the **1991** ROE. The adverse classification in the 1991 ROE was resulted from the loan having been made without regard to the borrower's ability to repay from earnings and liquid assets and the making of a secured loan based on inadequate collateral. FDIC Exh. 30, p. 2-a-13.

F/140. The sum of **$322,000** was loaned to Napa Transportation on October 24, **1991**. In the **1992 ROE**, the total credit outstanding to the borrower was $293,000, the entire balance of which was classified Substandard resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the making of a secured loan based on inadequate collateral; the failure of the Bank to maintain adequate information on the collateral; and the failure of the Bank to obtain and/or perfect security interest in the collateral. FDIC Exh, 32, p, 2-a-21.

F/141. The sum of **$450,000** was loaned to Bi-Ran Development Corp. on April 10, **1992**. In the **1992 ROE**, the total credit outstanding to the borrower was $449,000, the entire balance of which was classified Doubtful resulted from the loan having been made without regard to the borrower's ability to repay from earnings or liquid assets; the failure of the Bank to maintain adequate information on the borrower; the making of a secured loan based on inadequate collateral; and the failure of the Bank to obtain adequate appraisal of the collateral. FDIC Exh. 32, pp. 2-a-1 through 2-a-3.

D. VIOLATION OF STATUTES[7]

F/142. The 1987 joint state and federal ROE cites six different violations of the Pennsylvania banking laws, including Section 1415(a) of Chapter 7 requiring either prior board approval or adequate security, 7 P.S. § 1415(a), FDIC Ex. 12, p. 6-a-13, six violations of Section 1415(b) regarding lending limits, 7 P.S. § 1415(b), FDIC Ex. 12, p. 6-a-13, two violations of section 306(a) regarding adequate collateral and lending lim-

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[7] The Pennsylvania statutes involved are basically the same as the federal statutes violated. It might also be noted that some of the state statutes provide that a violator must be given a reasonable opportunity to correct the violations before a sanction can be imposed, but in these circumstances the undersigned considers the violative act to constitute violation of the statute whether or not later corrected, and whether or not sanction is imposed.

{{8-31-98 p.A-2960}}its, 7 P.S. § 306(a), FDIC Ex. 12, pp. 6-a-14, 6-a-15; and fourteen violations of Section 311 regarding unauthorized investments, 7 P.S. § 311 FDIC Ex. 12, p. 6-a-16.

F/143. The joint state and federal 1988 ROE cites two state law violations of Section 307 regarding excessive securities investments, 7 P.S. § 307, FDIC Ex. 16, p. 6-a-11, five violations of Section 311(a)

regarding unauthorized investments in partnerships, 7 P.S. § 311(a), FDIC Ex. 16, p. 6-a-11, and one violation of Section 311(d) of the Pennsylvania banking law regarding excessive stock investments, 7 P.S. § 311(d), FDIC Ex. 16, p. 6-a-12. These violations of law also evidence unsafe or unsound practices as well as breaches of fiduciary duty. Their repeated nature, even after clear and unequivocal warnings, further evidences a pattern of unsafe and unsound practices.

F/144. The joint state and federal 1991 ROE cites 24 violations of state law, including a Pennsylvania Banking Law Section 306(a) lending limit violation, 7 P.S. § 306(a), FDIC Ex. 29, p. 6-a, 21 Pennsylvania insider overdraft violations, 7 P.S. § 1413(a)(ii), FDIC Ex. 29, p. 6-a, and two Title 10 of the Pennsylvania Banking Law, violations of section 13.31 requiring reappraisals of liened property, FDIC Ex. 29, p. 6-a-1. The adversely classified asset ratio had now skyrocketed to 215.43 percent of capital. FDIC Ex. 30, p. 3.

F/145. The 1992 ROE cites three violations of the State lending limit, 7 P.S. § 306(a), FDIC Ex. 32, p. 6-a-1.

E. RESPONDENT'S PERSONAL RESPONSIBILITY

F/146. The Respondent was not only the owner of controlling stock ownership of the Bank, but was also the only non-officer director on the executive, finance, audit and loan committees when such committees were constituted. FDIC Exh. 12, p. B; FDIC Exh. 16, p. B; FDIC Exh. 22, p. B; FDIC Exh. 29, p. B; FDIC Exh. 30, p. B; FDIC Exh. 32, p. B. Respondent was the only director who received loans in violation of law, having in fact been granted extensions of credit of millions of dollars personally and through associated interests in violation of law. FDIC Exh. 12, p. 6; FDIC Exh. 16, p. 6; FDIC Exh. 22, p. 6; FDIC Exh. 29, p. 6; FDIC Exh. 30, p. 6; FDIC Exh. 32, p. 6. The record shows that other board members looked to Respondent for leadership, for advice, and for approval of the quality of loans presented for approval. FDIC Exh. 49.

F/147. Unlike any other director, Respondent had daily meetings with the president of the Bank, FDIC Exh. 49, made all the investment and securities decisions, and was always the person at the bank who met with examiners as the Bank's spokesman, FDIC Exh. 12, p.A-1; FDIC Exh. 16, p.A-1; FDIC Exh. 22, p. A-1; FDIC Exh. 29, A-1; FDIC Exh. 30, A-1; FDIC Exh. 32, p. A-1. Respondent was the individual promising future improvement, and renewing commitments to observe the law and observe safe and sound banking practices. FDIC Exh. 12, p. A-1; FDIC Exh. 16, p. A-1; FDIC Exh. 22, p. A-1; FDIC Exh. 29, A-1; FDIC Exh. 30, A-1; FDIC Exh. 32, p. A-1; Resp. Exh. 30; Resp. Exh. 42.

F/148. The record shows that Respondent's total compensation from the Bank was by far greater than any other non-officer directors. In 1987 it was four times greater. FDIC Exh. 12, pp. B, B-1. In 1988, it was six times greater. FDIC Exh. 16, pp. B, B-1. In 1989, Respondent received $113,000 in compensation as chairman of the board, seven times the next highest paid director. FDIC Exh. 22, p. B. Likewise, in 1991, while no other non-officer directors received any compensation, Respondent received $155,000. In 1992, one other non-officer director received $1,000 in compensation, while Respondent received one hundred twenty times that amount, to wit, $120,000. FDIC Exh. 32, p. B.

F/149. Based on their own perceptions and personal observations, six successive Examiners-in-Charge of Bank examinations testified that Respondent was the dominant force in the Bank. FDIC Exh. 12, p. A-1; FDIC Exh. 16, p. A-1; FDIC Exh. 22, p. A-1; FDIC Exh. 29, p. A-1; FDIC Exh. 30, p. A-1; FDIC Exh. 32, p. A-1. The Burbidge Report, a management study of the Bank conducted by a banking management consultant qualified as an expert in the area, FDIC Exh. 49, confirmed what six successive examinersin-charge had found, i.e., that Respondent controlled the management of a bank that consistently engaged in unsafe and unsound lending practices and violations of statute and Regulation, notwithstanding years of warnings and prodding by regulators, both state and federal.

F/150. The bank's attorney, Jack May, recognized that violations occurred in 1987, {{8-31-98 p.A-2961}}1988 and 1989, and that such violations constituted a pattern following warnings. Tr. 4258 and 4260.

F/151. Two of the Bank's loan officers, Messrs Carroll and Ziegenfuss, admitted that they had not been told of the requirements of the 1987 Order at all, let alone that as the Bank's loan officers they were also bound by the detailed mandates of the 1987 Order including safe and sound lending. Tr. 4485, 4568. They each testified that they were not told at all about the importance of appropriate documentation, adequate collateral and appraisals as required by the 1987 Order. Pavlick, an experienced FDIC Examiner, testified that without a financial statement and appraisal, a bank has no ability at all to

determine the risk inherent in any extension of credit. Examiner Pavlick's opinion in this regard conforms to the court ruling in *Sunshine, supra*, at p. 502.

F/152. Each extension of credit of $250,000 or greater was required by the 1987 Order to be approved by the board of directors. FDIC Exh. 14. In addition, the Bank's own loan policy required that loans of $250,000 or greater be approved by the Bank's board of directors.

F/153. Testimony was introduced by Respondent that all of the violations, breaches and unsafe and unsound practices were caused by the Bank's former president, Harold Marvin. However, it is clear that abdication of duty by directors to officers is not a defense. *Sunshine, supra*, at p. 581, 2. Respondent's duty as a board member, and particularly as Chairman of the Board, was to monitor the activities of bank management, to ensure compliance with laws, regulations, cease and desist orders and the Bank's own loan policy. Respondent failed to ensure compliance with these matters, and either condoned management's practices or completely failed to stop them. In either case, disregard of safe and sound banking is evident.

In short, Respondent's defense comes down to a claim that he shirked his obligations, but he is now required to take responsibility for his actions and inactions.

VI. PROHIBITION ACTION

A. STATUTORY OVERVIEW

Banking regulatory agencies are authorized pursuant to 12 U.S.C. § 1818(e) to remove an IAP from office and prohibit his future participation in the affairs of federally insured depository institutions if the IAP has:

> (1) violated any law *or* final cease and desist order *or* engaged in an unsafe or unsound practice *or* breached a fiduciary duty;
> *and*
> (2) the violation, breach, or practice caused the bank to suffer financial loss[8] or damage, *or* the interests of the bank's depositors have been or could be prejudiced, *or* the IAP has received financial gain or other benefit from the misconduct;
> *and*
> (3) the IAP's misconduct evidences personal dishonesty, *or* demonstrates a willful, or a continuing disregard for the safety and soundness of the bank.

Accordingly, before imposing a prohibition, the Petitioner must establish each of the following three criteria: "misconduct," the "effect" of such misconduct, and the "culpability" of Respondent.[9]

B. MISCONDUCT

1. Violation of Law, Rule or Regulation Or Final Cease and Desist Orders

The facts show that Respondent was the principal stockholder, executive officer, Chairman of the Board, most active nonofficer in the management of the Bank, and the individual with unquestionable control over the Bank and its functions. (F/2; F/146-149) The record is replete with instances of excessive loans to Respondent and his related interests involving more than the normal risk of repayment. (F/41-86) The record also overwhelmingly supports a finding of violations of the 1987 Cease and Desist Order (F3-39) and 1992 Cease-and-Desist Order (F/40), as well as many instances of violations of state law (F/143-150).

More specifically, Respondent participated in violations of the Pennsylvania banking laws, including Section 1415(a) of Chapter 7 requiring either prior board approval or

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[8]For conduct existing prior to the passage of FIRREA on August 9, 1989, the loss to the institution resulting from such conduct must be a "substantial loss."

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[9]*Obserstar v. FDIC*, 987 F.2d 494 (8th Cir. 1993).
{{8-31-98 p.A-2962}}adequate security, 7 P.S. § 1415(a), (FDIC Ex. 12, p. 6-a-13); section 1415(b) regarding lending limits, 7 P.S. § 1415(b), (FDIC Ex. 12, p. 6-a-13); section 306(a) regarding adequate collateral and lending limits, 7 P.S. § 306(a), (FDIC Ex. 12, pp. 6-a-14. 7-a-15); and section 311 regarding unauthorized investments, 7 P.S. § 311 FDIC Ex. 12, p. 6-a-16. Respondent also participated in

violations of state law involving section 307 regarding excessive securities investments, 7 P.S. § 307, (FDIC Ex. 16, p. 6-a-11); section 311(a) regarding unauthorized investments in partnerships, 7 P.S. § 311(a), (FDIC Ex. 16, p. 6-a-11); and section 311(d) of the Pennsylvania banking law regarding excessive stock investments, 7 P.S. § 311(d), (FDIC Ex. 16, p. 6-a-12).

In addition to the numerous state law violations stated above, Respondent also violated 12 U.S.C. § 371(c), and 12 C.F.R. § 215, both prior to and after the 1987 ROE, as has been set forth in the findings of fact. As previously stated, the Respondent failed to comply with the terms of the 1987 Cease-and-Desist Order as detailed in the findings of fact. Any one of these activities alone is sufficient to meet the requirements of the "misconduct" prong of the statute.

2. Unsafe or Unsound Practice

"Unsafe or unsound practice" is a broadbased concept that reaches the entire spectrum of banking operations. The phrase is not defined in the statute but is commonly understood to mean the following:

> ... [T]he term `unsafe or unsound practices' has a central meaning which can and must be applied to constantly changing factual circumstances. *Generally speaking, 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 of loss or damage to an institution, its shareholders, or the agencies administering the insurance fund*.

(Underscoring added.) *Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Committee on Banking and Currency*, 89th Congress, 2d Sess., at 49–50 (1966). The phrase "unsafe or unsound practice" is a deliberately flexible concept designed to give the agencies "the ability to adapt to changing business problems and practices." *In re Seidman*, 37 F.3d 911, 927 (3d Cir. 1994).

In the instant case, the record is fraught with examples of loans classified as doubtful as a result of borrowers' inability to repay; inadequate collateral and appraisals; failure to renew or restructure loans without collecting, in cash, the interest due (capitalization of interest); and failure to obtain and/or perfect security interests in the collateral securing the extensions of credit as detailed in the findings of fact. (FDIC Exhs. 30, 32-pp. 2-a-4 and 2-a-5). Accordingly, Respondent's participation in the above-referenced unsafe or unsound practices satisfy the misconduct prong of the statute.

3. Respondent's Breach of Fiduciary Duty

It is well established that officers and directors of depository institutions are held by a strict fiduciary duty to act in the best interests of the institution, its shareholders and its depositors. *In the Matter of Bush*, OTS AP 91-16 (1991), 1991 WL 540753, 1991 OTS DD LEXIS 2 (April 18, 1991). It has been ruled that:

> In general corporate matters, the Supreme Court has held, when Directors and officers place their personal interests above those of the corporation or utilize corporate resources for personal gain, they have committed a serious breach of their common law fiduciary duty.... The standards are even higher in banking, where the officers and Directors are charged with looking after other people's money. Indeed, given the paramount importance of a credible and safe and sound banking system, there can be no question that officers and Directors of banks are held to the very highest standard of fiduciary duty.

In the Matter of Stoller, FDIC 90–115e, I Prenctice-Hall Enforcement Decisions, ¶5174, page A-1865, February 18, 1992; *Pepper v. Litton*, 308 U.s. 295, 311 (1939); *Gadd v. Pearson*, 351 F. Supp. 895, 903 (M.D. Fla. 1972); *accord, First National Bank of LaMarque v. Smith*, 436 F.Supp. 824, 831 (S.D. Texas 1977), *aff'd in part and vacated in part*, 610 F.2d 1258 (5th Cir. 1980).

Case law also provides that:

> [B]ank Directors and officers have a fiduciary duty to the bank to act diligently, prudently, honestly, and carefully in carrying out their responsibilities and must {{8-31-98 p.A-2963}}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 his duty; the more complex the transaction, the greater the duty to investigate, verify, clarify, and explain." id.* at A-1235.

Underscoring added. *In the Matter of Ronald J. Grubb, Band of Hydro, Hydro, Oklahoma*, FDIC-89-111e, 1 FDIC Enforcement Decisions and Orders (P-H) ¶5181 at A-2030, 2031 (August 25, 1992), aff'd *Grubb v. FDIC*, 34 F.3d 956 (10th Cir. 1994).

In the matter at hand, the evidence supports a finding that Respondent benefitted from the numerous extensions of credit to himself and his related interests to the detriment of Bank.

Respondent clearly has placed his personal interest before that of the Bank. Respondent's multiple breaches of his fiduciary duties would, alone, constitute sufficient evidence to satisfy the misconduct element.

C. Effects

As stated above, the "effects" element requires that Respondent either received a financial gain, or that his actions caused the financial institution to suffer financial loss or other damage, or that depositors' interests could have been seriously prejudiced.

1. Financial Gain to Respondent

The record establishes that the loans made to Respondent and to his related interests resulted in gain to him. Loans to insiders, like those to Respondent Leuthe, have been held to evidence financial gain or other benefit to such insiders. *See, In the Matter of Stoller*, FDIC-90-115e, Bound Vol. 2 FDIC Enf. Dec. & Orders (P-H) ¶5174 at A-1881; *In the Matter of Donohoo*, FDIC-250e (1992), 252k, FDIC Enf. Dec. & Orders (P-H) ¶5225 at pp. A-2584-86 (1995), aff'd *sub nom*. Here, the loans made to Lehigh Engineering and D.J. Properties resulted in gain to Respondent in that he or his related interests received a portion of the proceeds of those loans. (FDIC Exh. 32, p. 2-a-52. Tr. 796, 2698). Such gain would, by itself, be sufficient to meet the "effects" test.

2. Loss or Other Damage to the Institution, And Serious Prejudice to Depositors

Successive examiners testified that when a bank is required to charge off a loan classified loss, that results in a loss to the bank. (Tr. 155–156) When the bank has to charge off 50 percent of a doubtful loan, that results in loss to the bank. (FDIC Exh. 73(2), section A, p. 12). The loss to Bank as a consequence of the charge-offs of these loans year after year resulted in an inadequate allowance for loan and lease losses. (FDIC Exh. 22, p. 1-6; FDIC Exh. 29, p. 1–4; FDIC Exh. 30, p. 1–1, 1-2; FDIC Exh. 32, p. 1–5.) Further, charge-offs have been held as a matter of law to constitute loss to the Bank. *See, Sunshine, supra*, at p. A-557, Fn. 103. Loss to the financial institution alone is sufficient to meet the "effects" test.

The records supports not only a finding of loss to the financial institution, but also possible prejudice to the depositors. If the Bank had been closed by the State of Pennsylvania, as it nearly was, $6,000,000 in uninsured deposits would have resulted in $6,000,000 of prejudice to depositors. The closure was avoided only by the reduction of delinquent assets, forced sale by the bank of two of its branches, and the infusion of $2,000,000 into capital. Even recompense from the Financial Deposit Insurance Fund, which is not considered in determining possible loss to depositors' interests, would not protect individual depositors from losses in excess of insurance limits.

Thus, either the loss to the financial institution, or the prejudice to depositors, would separately be sufficient to meet the "effects" test.

D. Culpability

The final issue is whether Respondent has the necessary culpability to satisfy the third prong of the prohibition statute. A showing that Respondent's misconduct evidences either personal dishonesty or a willful or continuing disregard for the safety or soundness of the Bank is necessary.

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1. Personal Dishonesty

Personal dishonesty has been defined to include a disposition to lie, cheat, defraud, misrepresent or deceive, as well as, a lack of integrity, fairness, straightforwardness, and trust-worthiness. *Van Dyke v. Board of Governors of the Federal Reserve System*, 876 F.2d 1377 (8th Cir. 1989).

Here, it can be said that Respondent acted in his own best interest to the detriment of Bank but, it cannot be said that he is blameworthy of defrauding or deceiving anyone, or not being straightforward in his transactions. His conduct was overt and he did not stoop to the use of sham loans or nominees. Neither did he attempt in any manner to falsify the Bank's records, which were open for review by examiners. The undersigned finds that Respondent did not act with personal dishonesty as contemplated by case law.

2. Willful or Continuing Disregard for the Safety or Soundness of the Institution

A showing of either willful or continuing disregard for the safety and soundness of the bank is sufficient to satisfy the culpability element of the statute. *Brickner v. Federal Deposit Insurance Corporation*, 747 F.2d 1198, 1202-03 (8th Cir. 1984). Unlike "personal dishonesty," willful or continuing disregard must relate directly to the safety or soundness of the institution. *Cousin v. OTS*, 73 F.3d 1242, 1252 (2nd Cir. 1996).

(i) Willful

"Willful disregard" has been defined as deliberate conduct which exposed the bank to abnormal risk of loss or harm contrary to prudent banking practices. *Grubb v. FDIC*, 34 F.3d 956, 961–962 (10th Cir.

1994). The term has also been defined as intentional conduct constituting an unsafe or unsound banking practice. *In re Magee*, 78 Federal Reserve Bulletin 969, 974 (1992).

In the present case, beginning in 1987, the Bank was criticized for its failure to comply with laws and regulations and observe safe and sound lending. In 1987, 1988 and 1989 these warnings were ignored. In 1990, some corrections were made by a new management employee, whose departure, however, led to a resumption of violations and unsafe and unsound practices in 1991 and in 1992. Respondent, as the person with control over the Bank and its functions, accordingly, is responsible for the intentional conduct constituting unsafe or unsound practices. The undersigned finds that Respondent acted with willful disregard for the safety or soundness of the institution.

The drastic measures of state and federal actions against the Bank involving terminating deposit insurance and seizing the institution, led to Respondent's departure from control for a two year period; the sale of two branches; and the recapitalization of the Bank which permitted its return to safe and sound practices.

(ii) Continuing

"Continuing disregard" is defined as voluntary conduct which has been engaged in over a period of time with heedless indifference to the prospective consequences. *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994). The evidence overwhelmingly supports a finding that the Bank and Respondent failed to correct violations and defects cited by examiners in 1987, 1988 and 1989. As primary decision-maker for Bank and as a result of his personal gain and of the risk of and actual loss to the institution, the undersigned finds that Respondent engaged in a continuing disregard for Bank. Accordingly, the culpability prong has been satisfied twiceover.

For the reasons above, the undersigned recommends the issuance of a Prohibition Order against Respondent.

VII. CIVIL MONEY PENALTY

Enforcement Counsel seek the assessment against Respondent of a second tier CMP, in the amount of $500,000. The FDI Act enacts a three-tiered approach to the assessment of CMPs. 12 U.S.C. § 1818(i)(2). Under a second tier penalty sought here, the FDIC may assess CMPs up to $25,000 for each day a violation, practice, or breach continues. 12 U.S.C. § 1818(i)(2)(B).

A. STATUTORY OVERVIEW

Second-tier CMPs require proof of two elements; first, the "misconduct" element, (violation, breach, or practice), 12 U.S.C. § 1818(i)(B)(i), and second, the "effects" element (violation, breach, or practice resulting in *either* first a pattern of misconduct; or secondly, more than minimal loss to institution; or thirdly a gain/benefit to party), 12 U.S.C. § 1818(i)(2)(B)(ii). Specifically, the misconduct element requires proof of *either* {{8-31-98 p.A-2965}}first a violation of any law or regulation or final order; or secondly, breach of a fiduciary duty; or thirdly, recklessly engaging in an unsafe or unsound practice in connection with the Bank. 12 U.S.C. §§ 1818(i)(2) (B)(i)(I), (II) or (III).

In this case, each and every alternative element has been previously analyzed and supported in the above section dealing with the prohibition action.

The second element of the CMP action requires proof that the violative practices were *either* first, a part of a pattern of misconduct; or secondly, caused or were likely to cause more than a minimal loss to the Bank; or *thirdly*, resulted in gain or other benefit to Respondent. 12 U.S.C. §§ 1818(i) (2)(B)(ii)(I), (II), or (III). Again, these prongs have been fully satisfied and discussed in the section of this Recommendation immediately above dealing with prohibition. Accordingly, since the statutory requirements authorizing the assessment of a CMP have been met, it is now necessary to calculate the appropriate amount of the fine.

B. CALCULATION OF CMP

The statute authorizes a civil money penalty in the amount of $25,000 per day for each day the violations, unsafe practices or breaches exist. The supervising agency, here the FDIC, prepares a proposed assessment based on a "matrix." With respect to the matrix, case law provides:

> ... An internal staff-level guideline, the matrix cautions that "because the facts and circumstances of each penalty case are different, the assessment of a civil money fine cannot be completely reduced by the mechanical application of a formula or purely numerical index. The exercise of judgment based on expertise and experience is important and necessary." Because the matrix does not constrain the Board's discretion, the agency had no obligation to explain any departure from it. *See, Vietnam Veterans of Am. v. Secretary of the Navy*, 843 F.2d 528, 539 (D.C. Cir. 1988) (where no indication that agency intended to bind itself by staff memorandum, document not

binding.).

Ghaith Pharaon v. Board of Governors of the Federal Reserve System, —F.3d—(D.C. Cir. 1998), decided and issued in slip form February 10, 1998, slip page 12.

The matrix, prepared by Examiner Pavlick, was limited to a calculation of the number of days the violations of the 1987 Order continued *after* the 1992 ROE, resulting in an assessment in the range of $9,000,000.[10] FDIC Exh. 85A; Tr. 2852–2950. This limitation of violations makes moot the statute of limitations argument and is extremely lenient to Respondent. Furthermore, in view of the fact that these proceedings encompass a time frame spanning from 1987 through 1992, during all of which the Respondent engaged, directly or indirectly, in unsafe and unsound practices, breaches of fiduciary duty and violations of law, rule, regulation, or cease and desist orders, Enforcement Counsel argue that their assessment is minimal, but necessary to serve the deterrent effect intended by the statutory scheme authorizing 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).

1. Mitigating Factors

In determining the amount of any penalty, 12 U.S.C. § 1818(i)(2)(G) requires consideration of the following mitigating factors:

> (1) the size of financial resources and good faith of the person charged;
> (2) the gravity of the violation;
> (3) the history of previous violations;and
> (4) such other matters as justice may require.

Respondent provided a financial statement, as of July 31, 1993, indicating a total net worth of approximately $9,000,000. FDIC Exh. 62. The Respondent's financial situation will support an assessment of the $500,000 requested by Enforcement Counsel. As for the "good faith" factor above, the continued violations and defects by Bank year after year and the continued criticism by examiners, precludes a finding that Respondent acted in good faith. With respect to the gravity of the offenses, the violations resulted in the real threat of closure of Bank which would have caused a $6,000,000 prejudice to depositors. Although, the closure was narrowly avoided, this does not vitiate the

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[10] After considering Respondent's financial statements, FDIC Ex. 62., the examiner reduced the proposed assessment to $500,000.

{{8-31-98 p.A-2966}}gravity and potential harm of the continuing offenses.

The record evidences the continuing nature of the violations. The Respondent has demonstrated a pattern of noncompliance with the examiners' repeated warnings in 1987, 1988, 1989 and even prior to and after these dates. As previously stated, the record supports a finding that Respondent dominated Bank and therefore, bears responsibility or participated in the history of the violations.

The last mitigating factor allows the undersigned to review other matters as justice may require in assessing a CMP. The undersigned finds the use of the interagency policy below useful guidance in determining the CMP.

2. Interagency Policy

The Federal Financial Institutions Examinations Council has provided thirteen factors as additional guidance in assessing an appropriate CMP. *See Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies*, 45 Fed. Reg. 59,423 (Sept. 9, 1980). The factors of the Interagency Policy and corresponding findings in this matter are stated below:

> (1) Whether the violation was committed with a disregard for the law or the consequences to the institution.

The facts found above clearly show that the violation was committed with a disregard for the law, as well as the consequences to the institution.

> (2) The frequency or recurrence of the violations and the length of time the violation has been outstanding and,
> (3) The continuation of the violation after the Respondent became aware of it.

In the instant case, the violations covered a number of years despite specific warnings from the supervisory banking regulators to the Board of Directors and to Respondent personally.

> (4) Failure to cooperate with the agency in effecting an early resolution of the problem, and
> (5) Evidence of concealment of the violation or its voluntary disclosure.

Here, it is safe to say that Respondent did not facilitate an early resolution to the violations. However, it is important to note that the record in no way indicates that Respondent concealed the violations.

(6) Threat of or actual loss or other harm to the institution.

The record clearly evidences adverse classification of numerous loans, both to insiders, affiliates, and non-connected parties, constituted a very serious threat of cancellation of deposit insurance, resulted in a requirement for a period of time that the Bank discontinue virtually all lending activity, as well as actual loss to the Bank.

(7) Evidence that participants or their associates received financial or other gain or benefit or preferential treatment as a result of the violation.

As noted above, Respondent obtained the personal benefit of literally millions of dollars in illegal and improper extensions of credit to himself and to affiliated interests.

(8) Evidence of restitution by the participants in the violation.

This does not include "repayment" of loans. The only "restitution," if it can be called that, came through $1,000,000 of capital infusion by Respondent, and another $1,000,000 from parties whom he solicited. These infusions were required to save the Bank from failure, and in reality, had the primary purpose and effect of staving off Respondent's loss of the value of his stock in and control of the Bank.

(9) A history of similar violations, and
(10) Previous criticism of the institution for a similar violation.

There is as indicated a long history of continued violations and warnings to Respondent and the entire Board of Directors which were ignored and never corrected.

(11) The presence or absence of a compliance program and its effectiveness.

Though some attempts were made, the compliance programs eventually adopted pursuant to the Cease and Desist Orders were, in many instances, inadequate, and implementation was never accomplished.

(12) The tendency to create unsafe or unsound banking practices or a breach of fiduciary duty.

In the instant case, the record supports a finding of a knowing and willful failure to comply with the law, and to even violate new laws despite formal notice after each examination. The undersigned finds that such {{9-30-98 p.A-2967}}conduct constitutes aggravating circumstances.

(13) The existence of agreements, commitments or orders intended to prevent the subject violations.

Such agreements, commitments and orders existed but as shown previously failed to end the existing violations, and even failed to deter entering into new violations.

In light of Respondent's failure to cooperate with the regulators in discontinuing his violations, and the benefit he derived from his wrongdoing, the undersigned finds only one factor in the Interagency Policy, that justifies any reduction in the assessment sought. As noted previously, the general lack of attempt to hide the existence of the violations, virtually all of which were clearly evidenced by the bank records, in the opinion of the undersigned warrants a reduction of the proposed assessment to $250,000.

VIII. CONCLUSION

For all of the reasons above, the undersigned recommends the issuance of an order prohibiting Respondent from further participation in the affairs of federally insured depository institutions, and recommends an order assessing a civil money penalty against Respondent in the sum of $250,000. Forms of draft orders are attached hereto.

PROPOSED ORDER OF PROHIBITION

On June 23, 1995, pursuant to 12 U.S.C. § 1818(e), the Federal Deposit Insurance Corporation issued a Notice of Intention to Prohibit James E. Leuthe ("Respondent") from further participation in the affairs of

Federally insured financial institutions.

NOW, THEREFORE, for the reasons set forth in the accompanying Decision, and based upon the record of the hearing,

IT IS HEREBY ORDERED THAT Respondent Leuthe shall be and is prohibited from future participation in the affairs of a Federally insured financial institution pursuant to 12 U.S.C. §§ 1818(e)(6) and (7).

This Order shall become effective upon the expiration of thirty days after service is made upon Respondent or his counsel, and shall remain in effect until such time as it is stayed, modified, terminated, or set aside by the Federal Deposit Insurance Corporation or a reviewing court.

PROPOSED ORDER ASSESSING CIVIL MONEY PENALTIES

On June 23, 1995, pursuant to 12 U.S.C. § 1818(i), the Federal Deposit Insurance Corporation issued a Notice of Assessment of a Civil Money Penalty against James E. Leuthe.

NOW, THEREFORE, for the reasons set forth in the accompanying Recommended Decision and based upon the record of the hearing,

IT IS HEREBY ORDERED, That, within thirty (30) days hereof, Respondent shall pay a civil money penalty in the amount of $250,000 by certified or bank check payable to the United States Department of the Treasury, delivered to the Federal Deposit Insurance Corporation for deposit into the Treasury pursuant to 12 U.S.C. § 1786(j).

This Order shall become effective at the expiration of thirty days after service thereof upon Respondent or his counsel, and shall remain in effect until such time as it is stayed, modified, terminated, or set aside by the Federal Deposit Insurance Corporation or a reviewing Court.