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{{1-31-93 p.A-2106}} **[¶5187] In the Matter of James C. Amberg, Robert Ray Carroll, W.M. Causey, Billy Ray Whitehead and Benny Zeagler, The Olla State Bank, Olla, Louisiana, Docket No. FDIC-89-144k (10-27-92).**

Board adopts ALJ's recommendation to assess civil money penalties against five outside directors for participating in extensions of credit to bank's executive officer and principal shareholder in violation of Regulation O; they failed in their responsibility to police insider transactions and to protect the bank from unsafe or unsound practices. Amount of penalty was $10,000 for one director, $20,000 for each of the other four.

[.1] Regulation O — Statutory Exceptions — For Bank's Protection
Exception for acquisition of a note "for the protection of the bank" requires an objective determination. It is irrelevant that respondent directors sincerely believed the acquisition would protect the bank; the proper standard is whether reasonably prudent directors in the exercise of their fiduciary duties would so conclude.

[.2] Regulation O — Definition — Extension of Credit
Reaffirmation of an executive's existing line of credit is an extension of credit under Regulation O, and violates the regulation if it exceeds lending limits or presents more than a normal degree of risk to the bank.

{{1-31-93 p.A-2107}} **[.3] Regulation O — Defenses — Reasonable Reliance**
Although directors may rely on the technical expertise of the bank's executive officers when making decisions, insider transactions are so serious that board members are charged with having independent knowledge of the restrictions on insider lending.

[.4] Civil Money Penalty — Amount of Penalty — Good Faith
Although respondents derived no personal benefit from approving insider transactions and said they had no desire to aid the executive, they were completely derelict in their duty to be vigilant concerning insider transactions. Whatever good faith credit they are entitled to is fully accounted for in the initial assessment of penalties.

[.5] Civil Money Penalty — Amount of Penalty — Matters of Justice
The fact that another insider, one who was an active supporter of the policies and practices of the executive, was separately assessed a much smaller penalty for his role in the same transactions does not require that as a matter of justice the penalties against the respondents be reduced. The only question is whether the penalties assessed here are appropriate.

In the Matter of
JAMES C. AMBERG,ROBERT RAY CARROLL,
W.M. CAUSEY,BILLY RAY WHITEHEAD andBENNY ZEAGLER,
individually and as directors of
THE OLLA STATE BANK
OLLA, LOUISIANA
(Insured State Nonmember Bank)
DECISION AND ORDER
FDIC-89-144k

INTRODUCTION

This proceeding is an action brought by the Federal Deposit Insurance Corporation ("FDIC" or "Petitioner") against James C. Amberg, Robert Ray Carroll, W.M. Causey, Billy Ray Whitehead, and Benny Zeagler (collectively "Respondents"), individually and as directors of The Olla State Bank, Olla, Louisiana ("Bank"), seeking civil money penalties pursuant to former section 18(j)(4) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1828(j)(4),[1] and Part 308 of the FDIC Rules of Practice

and Procedure, 12 C.F.R. Part 308. Respondents are charged with violations of section 22(h) of the Federal Reserve Act ("Act"), 12 U.S.C. § 375b, and sections 215.2(f), 215.4(a) and 215.4(c) of Regulation O of the Board of Governors of the Federal Reserve System ("Regulation O"), 12 C.F.R. Part 215, as promulgated thereunder and made applicable to insured State nonmember banks by section 18(j)(2) of the FDI Act, 12 U.S.C. § 1828(j)(2).

After careful review of the entire record in this matter, including the transcripts of testimony, the parties' exhibits and briefs, the Recommended Decision of the Administrative Law Judge, and the exceptions thereto urged by the parties, the Board of Directors of the FDIC ("Board") adopts the Recommended Decision of the Administrative Law Judge except as modified herein.

The Board finds and concludes that at meetings of the board of directors of the Bank held on January 13, 1988, and (except for Respondent Causey) on March 15, 1988, Respondents participated in extensions of credit to W. Scott Maxwell, a director and an executive officer of the Bank, in violation of the creditworthiness requirements of section 215.4(a), and the lending limits of 215.4(c), of Regulation O, 12 C.F.R. §§ 215.4(a) and 215.4(c). In so doing, Respondents completely failed in their responsibilities to police insider transactions and to exercise due diligence to protect the Bank against unsafe or unsound banking practices. The Board orders Respondents Amberg, Carroll, Whitehead, and Zeagler to

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[1] Section 18(j)(4) of the FDI Act was amended by section 907(c) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 1032 Stat. 183, 466 (1989). The amendments are prospective and do not affect application of the civil money penalties assessed here based on pre-FIRREA activity. References herein are to the pre-FIRREA section.

{{1-31-93 p.A-2108}}pay civil money penalties of $20,000 each; and Respondent Causey to pay a civil money penalty of $10,000.

I. STATEMENT OF THE CASE

A. SUMMARY OF PROCEEDINGS

On September 28, 1989, the FDIC issued a Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing ("Notice of Assessment") against Respondents and W. Scott Maxwell ("Maxwell"), Dan W. Bowker, Roscoe P. Steen, and J.J. Silagy, for the alleged violations of Regulation O cited above. The cases against Messrs. Maxwell, Bowker, Steen, and Silagy have been resolved.[2] The Notice of Assessment charged that a January 18, 1988, extension of credit to Maxwell in the amount of $557,464.85 exceeded the Bank's existing lending limit under sections 215.2(f) and 215.4(c) of Regulation O, 12 C.F.R. §§ 215.2(f) and 215.4(c), and involved more than the normal risk of repayment in violation of section 215.4(a) of Regulation O, 12 C.F.R. § 215.4(a); and that on March 15, 1988, Respondents caused or allowed the Bank to extend credit of $875,000 to Maxwell, exceeding the lending limit under sections 215.2(f) and 215.4(c) of Regulation O, and violating the creditworthiness requirements of section 215.4(a) of Regulation O. The Notice of Assessment assessed a $10,000 civil money penalty against Respondent Causey, and civil money penalties of $20,000 each against Respondents Amberg, Carroll, Whitehead, and Zeagler.

Respondents filed a Request for Hearing and an Answer in October 1989, and Administrative Law Judge James L. Rose ("ALJ") was appointed to hear the case. Following an interlocutory appeal, the entry of a default order for failure to file a timely answer, the denial of a motion for reconsideration, the reversal of the default order by the United States Court of Appeals for the Fifth Circuit, and an order remanding the proceeding to the ALJ for hearing,[3] an administrative hearing was held on March 16–18, 1992, in New Orleans, Louisiana. The parties entered into a Joint Stipulation as to certain pertinent facts. Petitioner presented three witnesses: FDIC Examiners Denton and Birdsell, and Review Appraiser Walker, FDIC Division of Liquidation. Respondents called nine witnesses, including Respondents Amberg, Carroll, and Whitehead, and FDIC Examiners Adams and Payne. The parties introduced into evidence numerous exhibits, including the transcript of the February 14, 1990, deposition to perpetuate testimony of Dan M. Bowker, former president of the Bank. Both parties filed post-hearing Proposed Findings of Fact, Conclusions of Law, Order and Brief, and a Reply Brief. ALJ Rose's Recommended Decision ("R.D.") is dated June 16, 1992. Thereafter, both Petitioner and Respondents filed Exceptions to the R.D.

B. BACKGROUND

Controlling interest in the now-closed Bank (approximately 56 percent) was owned by M.W. Maxwell ("Maxwell Sr."), FDIC Ex. 18; Tr. at 409,[4] who served as chairman of

[2] On January 15, 1991, the Board held Maxwell in default after he failed to respond to an Order requiring him to submit evidence that he had filed and served an answer to the Notice of Assessment, and ordered him to pay a civil money penalty of $150,000. *In the Matter of W. Scott Maxwell*, Docket No. FDIC-89-144k, 2 P-H FDIC Enf. Dec. ¶5161 (1991).

On February 14, 1991, Mr. Bowker entered into a Stipulation and Agreement to Pay a civil money penalty in the amount of $1,500. *In the Matter of Dan W. Bowker*, Docket No. FDIC-89-144k, 3 P-H FDIC Enf. Dec. ¶10,180 (1991).

On October 22, 1991, after a separate adjudication, the Board ordered Mr. Silagy to pay a civil money penalty in the amount of $10,000. *In the Matter of J.J. Silagy*, Docket No. FDIC-89-144k, 2 P-H FDIC Enf. Dec. ¶5170 (1991).

Respondent Steen died on January 6, 1991. The action against him was dismissed by the Administrative Law Judge on March 16, 1992.

[3] Respectively, *In the Matter of W. Scott Maxwell, et al.*, Docket No. FDIC-89-144k, 2 P-H FDIC Dec. ¶8007 (1990) [Interlocutory Appeal]; 2 P-H FDIC Dec. ¶5154B (1990) [Default Order]; 2 P-H FDIC Dec. ¶5155A (1990) [Motion for Reconsideration and for Stay denied]; *Amberg v. FDIC*, 934 F.2d 681 (5th Cir. 1991); *In the Matter of W. Scott Maxwell et al.*, Docket No. FDIC-89-144k, 2 P-H FDIC Dec. ¶5172 (1992) [Order remanding to the ALJ for further proceedings].

[4] Citations in this Decision shall be as follows:
Recommended Decision — "R.D. at ____."
Transcript — "Tr. at ____."
Exhibits — "FDIC Ex. ____" or "Resp. Ex. ____."
Joint Stipulation of the Parties — "Jt. Stip. No. ____."
Dan W. Bowker Deposition Transcript — "Bowker Tr. at ____."
Exceptions of the parties — "FDIC Excep. at ____"; "Resp. Excep. at ____".
{{1-31-93 p.A-2109}}the board of the Bank until 1987, and during 1987 and 1988 was a director of the Bank as well as president and a director of Olla Bancshares, Inc. ("Bancshares"), a one bank holding company formed in 1982 which owned 92.8 percent of the Bank's voting stock. Resp. Ex. 24. However, he rarely, if ever, attended Bank directors' meetings during 1987 and 1988, apparently due to poor health. His son, Maxwell, was a director of the Bank until May 1988 and its legal counsel, as well as a vice president and director of Bancshares. Respondents Amberg, Carroll, Causey, Whitehead, and Zeagler served as directors of the Bank from 1977, 1972, 1975, 1975, and 1954, respectively. They were also directors of Bancshares. FDIC Ex. 20.

Following an examination of the Bank by the State of Louisiana Office of Financial Institutions ("State Office") in July, 1986, the Bank entered into a Memorandum of Understanding with the State Office. The FDIC conducted examinations in October 1986, October 1987, and August 1988, issuing Reports of Examination dated October 20, 1986, FDIC Ex. 18; October 23, 1987, FDIC Ex. 19; and August 19, 1988, FDIC Ex. 20, respectively.

The October 1986 Report of Examination notes that the board of directors "has neglected to provide adequate policies and effective supervision," and states:

> It is imperative that the board review all areas of criticism noted at this examination, the requirements of the Memorandum of Understanding and adopt policies and procedures to correct deficiencies and meet requirements for corrective actions as specified in the Memorandum.

FDIC Ex. 18 at 1. The 1986 Report also notes numerous deficiencies in the Bank's credit administration procedures, including incomplete, missing, or outdated financial information, requiring little or no reduction of debt on renewals, failure to move promptly on distressed loans, and failure to reappraise collateral in a period of economic downturn. FDIC Ex. 18 at 1-a.

The 1986 Report also notes apparent violations of section 215.4(b) of Regulation O with respect to approving lines of credit to four directors, stating that under certain conditions violations of Regulation O may be subject to fines of $1,000 per day. FDIC Ex. 18 at 1-a. The Report describes these apparent violations as occurring at the February 4, 1986, directors meeting at which the Board approved a line of credit for each director in name and amount only. The Report states in some detail the requirements for approval of "insiders" debt by the Board. FDIC Ex. 18 at 6-b. During the examination, the FDIC and State Office examiners conducted a meeting, attended by all directors, to discuss the findings in detail. The Bank was assigned a CAMEL rating of 4. FDIC Ex. 18 at 1-a-1.

The October 1987 Report of Examination repeats the admonition that the directors are not exercising adequate supervision of the Bank's affairs:

> The board of directors is responsible for the bank's present condition, which is considered unsatisfactory. These problems were brought to management's attention at the prior Corporation examination, dated October 20, 1986 and at the previous State Examination, dated July 11, 1986. To date, these problems remain uncorrected. It is imperative that the board formulate sound policies and provide effective supervision over the bank.

FDIC Ex. 19 at 1-a-1.

The 1987 Report also notes that a substantial percentage of loans classified Doubtful are debts of Maxwell and Maxwell Sr.:

> These debts have been steadily increasing and are inadequately collaterized [sic]. While these borrowers have obtained appraisals on the pledged real estate [sic] to justify this volume of debt, the assumptions contained therein are totally unrealistic. At present the bank holds liens on speculative real estate, with its present fair market value unknown. It is recommended that the Board obtain an outside MAI appraisal to determine the bank's equity position and seek additional collateral to protect the bank from loss.

FDIC Ex. 19 at 1-a-2.

The description of adverse assets in the October 1987 Report lists total loans to Maxwell of $312,000, of which $255,000 is classified Doubtful. The balance of $51,000 represented a loan originated after the examination date which exceeded the board's preapproved line for Maxwell by $15,000. The October 1987 Report states that new loans to Maxwell and Maxwell Sr. vastly exceed the nominal reductions on their debts, that the appraisal on several tracts of land pledged {{1-31-93 p.A-2110}}is unrealistic, and that the lien on the largest parcel was junior to a $500,000 lien, in violation of the Bank's loan policy. The Report concludes that the borrowers do not appear to have the cash flow to properly service the debts or to amortize the loans, and the collateral is of questionable value with equity position uncertain. FDIC Ex. 19 at 2-a-4 to 2-a-6.

The October 1987 Report also notes apparent violations of Regulation O, namely preferential interest rate terms for loans to Maxwell and Maxwell Sr. in violation of section 215.4(a) of Regulation O, preferential terms for Maxwell on the purchase of a Bank-owned automobile in violation of the same provision, and improper prior board approval of lines of credit to directors Maxwell, Maxwell Sr., and Terral, in violation of section 215.4(b) of Regulation O. A reminder is included that civil money penalties could be imposed for Regulation O violations. FDIC Ex. 19 at 1-a-3, 6-a, 6-a-1.

A meeting was held by the FDIC and State examiners with the directors of the Bank on December 16, 1987. All directors were present except Maxwell Sr. FDIC Ex. 19 at 1-a-4; FDIC Ex. 7. Major findings of the examination were discussed with special emphasis on the lack of improvement in the Bank's asset condition. FDIC Ex. 19 at 1-a-4. The minutes of this directors meeting, signed by Respondent Zeagler, state that the examiners discussed poor loan policies and procedures, "highlighted the Classified and Loss Categories...reported on the apparent Reg. O violation, in particular, Section 215.4(a)...He also discussed Sec. 215.4(b) ...Mr. Adams discussed possible conflicts of interest involving Chairman Maxwell... Mr. Dent [Commissioner of Financial Institutions for the State of Louisiana] then spoke of the Board's responsibility to the bank..." FDIC Ex. 7.

At a directors meeting held on December 9, 1987, the directors approved an increase in Maxwell's line by $10,000 to cover the overline noted by the examiners, on condition that he pay 10 percent per year principal, plus interest, and that he not borrow any more money until he had reduced his debt for 2 years or 20 percent. Maxwell also agreed to put up additional collateral. FDIC Ex. 6.

The minutes of a meeting of the Loan Committee on January 5, 1988 attended by Maxwell, Respondents Carroll and Whitehead, Director Terral, and President Bowker, state:

> Mr. W.S. Maxwell said he was getting off the note he was on with his daddy. He in turn needs approximately $50,000 to pay Central Bank until his loan package was put together. He was reminded he must be approved by the Board.

Resp. Ex. 1.

The Bank entered into a Cease-and-Desist Order with the State Office and the FDIC effective March 31, 1988. The board of directors consented to the entry of the Order on March 9, 1988. FDIC Ex. 45.

C. THE TRANSACTIONS AT ISSUE

The transactions at issue here occurred in January and march 1988 and must be viewed in the context of the prior events summarized above.

1. *The January 1988 Transaction*.

As set forth in the minutes of the January 13, 1988, meeting of directors, Maxwell requested a loan of approximately $560,000:

> to pay off Central Bank on his home loan and 95 acres around the Country Club in Winnfield...This loan would be for 180 days then be moved to a long term loan being prepared by Mr. Jim Adams [legal counsel to Maxwell and the Bank]. Mr. Maxwell reduced his debt by over 20% since the last meeting by removing his obligation on a note he endorsed with his father in the amount of $143,000.00. This will also cause an increase in his line to $875,000.00...Mr. Maxwell left the room following questions by the directors. Mr. Whitehead then asked [Bank President] Bowker what the bank's lending limit was. Mr. Bowker replied his understanding is 50% of the bank's capital and surplus, which in our case, is $900,000 ...Mr. Silagy then made a motion to pay off Central Bank on Mr. Maxwell's home and 95 acres taking a first mortgage on both pieces and to raise Mr. Maxwell's line to $875,000.00...All in favor, since it would increase the Bank's collateral position.

The minutes are signed by Respondent Zeagler as secretary and Maxwell as vice chairman. FDIC Ex. 8. The Bank's lending limit on January 13, 1988, under sections 215.2(f) and 215.4(c) of Regulation O was $403,000. Jt. Stip. 28. On January 13, 1988, Maxwell was a "director" and an "executive officer" of the Bank for purposes of Regulation O.
{{1-31-93 p.A-2111}}Jt. Stip. 9–11. Respondents Amberg, Carroll, Causey, Whitehead, and Zeagler attended the January 13, 1988 directors meeting. Jt. Stip. 19.

2. *The March 1988 Transaction*.

At the March 15, 1988, meeting of the directors, attended by Maxwell, Respondents Whitehead, Carroll, Zeagler, and Amberg, directors Steen and Terral, and President Bowker, the first order of business was the reading and signing of a letter from the FDIC concerning the October 23, 1987, examination of the Bank. Thereafter, the directors acted upon "the directors Line of Credit which was brought up by Mr. Bowker that should be passed at this meeting," approving lines of credit for Directors Amberg, Carroll, Maxwell Sr., Maxwell, Silagy, Steen, Whitehead, Zeagler, and Terral, and President Bowker. In each case, the minutes carefully note that the director in question left the room before the vote. In the case of Maxwell:

> Line of credit for Mr. W.S. Maxwell was set at $875,000.00 on real estate. Maturity to be 6 months and the rate would be determined at the time of the loan determined by the Profitability Analysis formula.

Resp. Ex. 10.

At the same meeting, the directors approved the renewal of two of Maxwell's notes with the Bank:

> Mr. W.S. Maxwell had loans coming due that need to be renewed. One in the amount of $42,387.36, and one for $212,046.61. Mr. Maxwell excused himself from the room for the discussion. It was asked if Mr. Maxwell would be making a 5% reduction, plus his interest. This was affirmative that this was Mr. Maxwell's intentions. The loan will be for 6 months and will be collateralized by real estate and maturity 6 months and at a rate to be determined by the Profitability Analysis at the time of the loan. This loan at the present time is classified, but has no effect on renewal. On a motion by Mr. Terral, seconded by Mr. Whitehead, the loan was approved.

On March 15, 1988, the Bank's lending limit under section 215.2(f) and 215.4(c) of Regulation O was $403,000. Jt. Stip. 31. On March 15, 1988, Maxwell was a "director" and an "executive officer" of the Bank for purposes of Regulation O. Jt. Stip. 9–11. Respondents Amberg, Carroll, Whitehead, and Zeagler attended the March 15, 1988, meeting. Jt. Stip. 20.

The August 1988 Report of Examination notes that the January 1988 loan to Maxwell violated the lending limits of section 215.4(c) and 215.2(f) of Regulation O, and the creditworthiness requirements of section 215.4(a) (2). No mention is made of the March 15, 1988, meeting. FDIC Ex. 20 at 6-b.

D. THE ALJ'S RECOMMENDED DECISION

1. *The Alleged Regulation O Violations*.

a. *The January 13, 1988 Transaction*.

The ALJ concluded that the January 13, 1988, transaction was an extension of credit to Maxwell which violated the lending limits of section 215.4(a) of Regulation O and the creditworthiness requirements of section 215.4(c) of Regulation O. In so doing he rejected Respondent's primary argument that by

purchasing the credit of Central Bank, Monroe, Louisiana, the Bank simply sought to enhance the collateral for its $305,000 outstanding credit to Maxwell, and hence the transaction was exempt from the extension of credit limitations of Regulation O by application either of section 215.3(b)(3), which exempts "any indebtedness to a bank for the purpose of protecting the bank against loss or giving financial assistance to it," or section 215.3(a)(6) of Regulation O as an increase in indebtedness "advanced by the bank for its own protection for...(ii) taxes, insurance, or other expenses incidental to the existing indebtedness." R.D. at 5–10.[5]

The ALJ also rejected Respondents' argument that they relied on then President Dan Bowker's advice that the purchase of the Central Bank credit would not violate lending limits, stating that the "misinformation from Bowker" does not protect Respondents from imposition of civil money penalties. R.D. at 11.

The ALJ also concluded that the January

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[5] The R.D. cites section 215.3(b)(4)(ii), which also exempts certain indebtedness "for the purpose of protecting the bank against loss." However, Respondents rely upon section 215.3(b)(3), and the Board is of the view that the transaction in question properly falls within the transactions to which the latter provision applies.

{{1-31-93 p.A-2112}}1988 transaction involved more than normal risk of repayment within the meaning of section 215.4(a)(1) of Regulation O, noting that Bowker testified that he did not believe Maxwell could service all his debt, that the October 1987 Report so concludes, and that FDIC Examiners Denton and Birdsell so testified. R.D. at 13.

b. *The March 1988 Transaction*.

While stating that, "whether the March 15 action is, or is not, a violation of Regulation O makes little difference in this matter," the ALJ concludes that "the Respondents did violate Regulation O on March 15, 1988, by setting a line of credit for Maxwell in excess of the prescribed limit." R.D. at 16. The ALJ rejected Respondents' argument that the FDIC should be estopped from alleging the March 15 action as a violation of Regulation O since no "fifteen day letter" was sent to them and hence they had no opportunity to defend their position at the administrative level and before litigation. R.D. at 16.

The ALJ declined to conclude that the March 15, 1988, action violated the creditworthiness requirements of section 215.4(a) of Regulation O, on the grounds that the FDIC's allegations were based upon the renewal at the March 15 meeting of two Maxwell notes which had been classified Doubtful at the October 1987 examination, and that there was no evidence that the two classified credits were in fact ever renewed as approved at the March 15 meeting. R.D. at 15.

2. *Assessment of Civil Money Penalties*.

The R.D. states that in determining the size of penalties, the FDIC is to consider five factors: size of the financial resources of the person charged, his good faith, gravity of the violation, history of previous violations, and such other matters as justice may require. R.D. at 17.

a. *Financial Resources*.

The ALJ found that the parties stipulated that they have sufficient resources to pay an assessment of $20,000, or $10,000 in the case of Respondent Causey. R.D. at 17.

b. *Good Faith*.

The ALJ rejected the Respondents' argument that they relied on Bowker's advise at the January 13 meeting that there was no lending limit problem, stating that Respondents must have known that any extension of credit to Maxwell was an insider transaction, that the transaction benefitted Maxwell, the collateral was questionable, and Maxwell was a credit risk. He concluded that on these facts, Respondents are not entitled to mitigation of a penalty based on good faith. R.D. at 18.

c. *Gravity of the Violation*.

The ALJ concluded that the "overextension of credit to Maxwell, one of its executive officers, caused substantial loss." The R.D. states that at the August 1988 examination, $127,000 of Maxwell's debt had been charged off on June 24, $513,000 was classified Substandard, and $207,000 was classified Loss. "This amount of loss to the Bank, much of which resulted directly from the Central Bank credit, made the violation here grave." R.D. at 19.

d. *History of Previous Violations*.

The ALJ found that Regulation O violations as to Maxwell and Maxwell Sr. were noted in the October 1987 Report and discussed at the December 16, 1987 meeting of the directors and the FDIC. "That there was a history, and it was recent, tends to operate against the Respondents." R.D. at 19.

e. *Other Factors as Justice may Require*.

The ALJ stated there are no additional factors which would tend to lower the amount assessed in the Notice.

The ALJ concluded that the assessment of $20,000 for each Respondent (including Causey) is

appropriate; and that although Respondent Causey did not participate in the March 15 meeting, the action taken then was less serious than that taken at the January 13 meeting, which he did attend. Nevertheless, the ALJ concluded it would be inappropriate to increase the civil money penalty of $10,000 assessed against Respondent Causey in the Notice of Assessment. R.D. at 19.

E. EXCEPTIONS TO THE RECOMMENDED DECISION

Respondents take a number of exceptions to the ALJ's findings and conclusions that the January 13 and March 15 transactions constitute extensions of credit, as well as various findings and conclusions made with respect to the five statutory factors to be considered in determining the amount of the penalties. FDIC Enforcement Counsel has taken exception to the ALJ's failure to conclude that the March 15 approval of a line of credit for Maxwell violated the creditwor-
{{1-31-93 p.A-2113}}thiness requirements of Regulation O. The exceptions of the parties which, after careful review, the Board considers to merit discussion are included in the analysis set forth below.

II. DISCUSSION

A. THE JANUARY 1988 TRANSACTION

The transaction approved by the directors at the January 13, 1988, meeting is an extension of credit to Maxwell unless it falls within the exception provided in section 215.3(a)(6),[6] or the exception provided in section 215.3(b)(3),[7] of Regulation O. The Board has previously held that statutory exceptions to insider lending limitations must be strictly construed. *In the Matter of*****, Docket No. FDIC-85-82e, 2 P-H Enf. Dec. ¶5137 (1989); *In the Matter of Ronald J. Grubb*, Docket Nos. FDIC-88-282k and FDIC-89-111e (8-25-92). That principle is applicable here.

The Board concludes that the additional funds here were not advanced by the Bank for "expenses incidental to the existing indebtedness". Hence, the transaction does not fall within the exception provided in section 215.3(a)(6) of Regulation O.

[.1**]** As to the exception provided in section 215.3(b)(3), the Board concludes that the Central Bank note could be considered to have been acquired by the Bank "through foreclosure or similar proceedings," since Central Bank had either instituted or was on the brink of instituting foreclosure proceedings.[8] Hence, the question is whether the acquisition was "for the protection of the bank," as provided in section 215.3(b)(3). That determination must be objective, not subjective. That is, the question is not whether Respondents sincerely, albeit erroneously, believed that the acquisition would protect the Bank; but rather, whether reasonably prudent directors in the exercise of their fiduciary and statutory duties would conclude that the acquisition would protect the Bank.

Respondents, in their evidence, briefs, and Exceptions, present the following facts and circumstances in support of their argument that the Central Bank note was acquired to shore up the collateral securing Maxwell's existing debts to the Bank, and was a prudent decision to prevent losses to the Bank: On January 8, 1988, Maxwell had asked the loan committee for an additional $50,000 "to pay Central Bank until his loan package was put together," Resp. Ex. 1, and was told to seek approval from the board. Either at or immediately prior to the January 13, 1988, board meeting, Maxwell informed the directors that Central Bank was about to foreclose on a 96-acre tract of undeveloped land owned by Maxwell, and that the Bank's lien on the same property securing Maxwell's indebtedness of approximately $300,000 was junior to that of Central Bank.[9]

James L. Adams, an attorney experienced in banking regulation and enforcement matters, and who had represented both Maxwell and the Bank on various matters, also attended the January 13 meeting. He and Maxwell told President Bowker that it was advisable to buy the note from Central Bank rather than let the property go to foreclosure, Bowker Tr. at 37. Adams described his plans to obtain a consolidated loan within 6 months for the Maxwell and Maxwell Sr. debt, which would result in their present debts at the Bank and elsewhere being paid off and moved to one larger bank. FDIC Ex. 8; Tr. at 418–422.

The directors were presented with apprais-

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[6] Section 215.3(a)(6) provides that an extension of credit includes:

> (6) An increase of an existing indebtedness, but not if the additional funds are advanced by the Bank for its own protection for (i) accrued interest or (ii) taxes, insurance, or other expenses incidental to the existing indebtedness.

[7] Section 215.3(b)(3) provides in pertinent part that an extension of credit does not include:

> (3) An acquisition of a note, draft, bill of exchange, or other evidence of indebtedness through...
> (ii) foreclosure on collateral or similar proceeding for the protection of the bank.

[8] Central Bank's attorney had notified Maxwell by letter dated December 29, 1987, Resp. Ex. 21, that the enclosed copy of the suit to commence foreclosure proceedings, Resp. Ex. 20, would be mailed to the Clerk of Court on January 6, 1988, "unless all the requirements which we discussed in your office are perfected prior to that date."

[9] During the October 1987 examination, FDIC Ex. 19 at 2-a-4, it was discovered that the Bank's position was junior to the $500,000 lien of Central Bank, rather than a first lien as Respondents had previously thought. Tr. at 176.

The Bank did in fact have a first lien, dated February 14, 1984, which Maxwell cancelled on June 9, 1986, the day the Central Bank mortgage was recorded. The following day he recorded a mortgage to the Bank, which was junior to the Central Bank lien. Tr. at 382.

{{1-31-93 p.A-2114}}als dated November 19, 1987, on the 96-acre tract and on Maxwell's resident (the latter secured the Central Bank loan but not that of the Bank) prepared by H.D. Burlew, Jr., Resp. Ex. 2 ("Burlew Appraisals"). Burlew often appraised property for the Bank and other banks in the area.[10] Respondents Whitehead, Carroll, and Amberg all testified that they relied on the appraisals and considered the values stated therein to be reasonable. Tr. at 178–180; 261; 298. President Bowker testified that he considered the loan to be adequately collateralized. Bowker Tr. at 113. Respondent Whitehead testified that attorney Adams "assured us they had a loan package practically wrapped up, that [Maxwell] was...going to buy his daddy's stock and then remove his entire debt package from our bank; that they had financing available somewhere." Tr. at 185.

In summary, the directors were confronted with a situation of apparent immediate foreclosure on collateral by Central Bank which would wipe out the Bank's security for $305,000 in adversely classified debt. They were presented appraisals showing that the property to be foreclosed was values at over $1 million, and advised that the Central Bank note could be purchased for approximately $560,000.[11] Respondents argue that the apparent choices presented to the board were, either (1) purchase the Central Bank note for approximately $560,000 and obtain a first lien on property worth approximately $1 million for a combined debt of approximately $860,000, or (2) purchase the property at foreclosure sale for approximately $140,000 more to cover the fees and costs of foreclosure, or (3) let the property go to foreclosure and lose the Bank's collateral for the $300,000 in existing debt. In essence, Respondents argue that given the assurances that refinancing of all Maxwell debt was a matter of months from fruition, and given the values set forth in the Burlew appraisals, it was reasonable for the directors to purchase the Central Bank note rather than allow the foreclosure to go forward.[12]

Despite Respondent's argument, the Board agrees with the ALJ's conclusion that the directors' action was highly risky and imprudent. As the R.D. states, Respondent's argument rests in substantial part on the Burlew appraisals. Respondent Whitehead testified that whether the transaction was beneficial to the Bank or not depended entirely on the value of the collateral, Tr. at 232, and this is consistent with the testimony of Respondents' expert witness Dorroh. The Board adopts the ALJ's finding that the FDIC examiner criticisms of the appraisal values [contained in the October 1987 Report] were not known to the Respondents at the time of the January 13 meeting, R.D. at 23, Finding of Fact No. 16. However, as Finding of Fact No. 16 also correctly notes, the Respondents did not question the values assigned in the Burlew Appraisals, which under the circumstances the Board concludes was unreasonable and imprudent. The Burlew Appraisal for the Maxwell residence states on its face that the trend is "upward," which no prudent director of a bank in the northern Louisiana area could reasonably have believed in January 1988.[13] The residence appraisal uses the cost, rather than market value, approach — which should have alerted anyone familiar with real estate loans that the appraisal should not be accepted at face value. The Burlew Appraisal for the undeveloped tract is based on the market value approach, but the list of comparable sales is so out-dated (7 sales between 1978 and March 6, 1980; 1 sale in 1984) and so lacking in analysis that no reasonably prudent person would accept it at face value. Moreover, the tract appraisal contains no market survey or analysis of absorption rate of lots for expensive residential construction, al-

[10] Walter Evans Dorroh, the attorney who handled the later foreclosure proceedings against Maxwell, so testified. Tr. at 380.

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[11] Respondents argue in their Exceptions that the ALJ was in error in using the $560,000 figure because it contains $23,000 in future interest to be charged by the Bank on the Central Bank note after purchase. However, Maxwell requested a $560,000 loan at the January 13 meeting, and the directors approved it.

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[12] Attorney Dorroh, who was qualified as an expert in foreclosure and similar matters, testified that:

[B]ased on what you are telling me, there was approximately $800,000 of debt owed against this property:

500,000 to Central...300,000 to the Olla State Bank...I haven't seen the appraisals, but if the property

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[13] The October 1986 Report, FDIC Ex. 18, states that the area was in a period of "economic downturn." FDIC review examiner John Walker testified that, "I think anybody in the Winfield area, and knowledgeable about what was going on in the economy of north Louisiana...at that time, realized that we had a softening market in real estate. We had suffered a great cut-back in the...oil patch, which is all over north Louisiana.

"It would be difficult for me to understand or accept that anyone reading this report would say that there was an increase in values, that trends were upward, and that everything was positive for the development of a subdivision of the magnitude of 100 lots." Tr. at 440, 441.

{{1-31-93 p.A-2115}}though the value per acre is based on a projected retail, not wholesale, liquidation of the property. In addition, there is no analysis of development costs.[14]

In summary, the Burlew Appraisals on their faces raise many questions in the minds of a prudent reader.[15] Moreover, when these appraisals were reviewed by the directors in January 1988 for the purpose of analyzing a proposal to purchase a $530,000 overdue note which was collateralized by the property, the directors also knew that the Bank had a composite rating of 4, and that the cash to be expended to purchase the note represented approximately 20 percent of the Bank's unimpaired capital and surplus. To plunge ahead with the purchase of the Central Bank note under those circumstances without further investigation and analysis was not reasonably calculated to protect the Bank but rather to further weaken the Bank.

But, the Respondents counter, they were assured by counsel that the troublesome Maxwell loans would soon be refinanced with another bank, if the Central Bank foreclosure could be averted. On this point, the Board rejects the ALJ's finding that there are no facts of record to support the Respondents' faith in attorney Adams' assurance of refinancing, R.D. at 9. Instead, the Board assumes that Respondents' reliance on the assurances concerning refinancing was not unreasonable,[16] and that the Central Bank foreclosure would have made refinancing impossible and probably would have caused Maxwell to default on his debt to the Bank.[17] Nevertheless, the Board is of the view that under the circumstances the purchase of the Central Bank note was risky and imprudent.

Instead of buying the Central Bank note for $530,000, the Bank could have loaned Maxwell the $50,000 necessary to bring Central Bank current (as proposed on January 5, 1988), stopped the foreclosure, and not have exceeded the 15 percent lending limit. This course would have resulted in the bank having significantly less of its assets at risk while efforts were under way to refinance Maxwell's debt and/or investigate why the Bank held a junior lien rather than a first lien as the directors believed. There was simply no need to expose more than $530,000 of the Bank's scant capital to the risks of nonperformance (no earnings) or non-payment (loss) in order to protect the Bank.

Respondents Whitehead and Carroll attended the January 5 Loan Committee meeting at which the $50,000 advance was proposed. The directors should have explored this option further at the January 13 meeting rather than plunging ahead with the purchase of a non-performing note requiring the expenditure of cash equal to approximately 20 percent of the Bank's unimpaired capital and surplus. It may well be that upon further investigation of the possibility of refinancing, the directors would have concluded that such an additional advance was not prudent. In that event, the purchase of the Central Bank note would clearly have been even less prudent.

Finally, the Respondents themselves have pointed out that the Bank had other collateral besides the junior lien on the 96-acre tract securing Maxwell's debt. Resp. Excep. at 10. The directors should have investigated the liquidation of this security rather than purchasing additional collateral.

The ALJ concluded that in purchasing the Central Bank note, the directors were hoping that the collateral had sufficient value and liquidity for the Bank to recover

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[14] While the appraisal states that the tracts of land "have available to them all public utilities," and a

"blacktop road surrounding the south and west areas of this property," there is no indication of the costs of making these amenities available to individual homesites or of the impact of such costs on projected market values.

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[15] The Board does not adopt the ALJ's finding that the appraisals were prepared "for Maxwell, which suggests, at a minimum, that any doubts as to value would be resolved in Maxwell's favor." R.D. at 10. The record evidence on this point is mixed at best.

The Board also declines to adopt the ALJ's argument that the Respondents should have questioned why Burlew appraised the land at $6,500 per acre on March 24, 1986, and then raised the value to $7,500 on November 19, 1987, without any intervening sales and at a time when the economy was in a downturn. R.D. at 10. Despite the fact that both the Respondents' and the FDIC's versions of the Burlew Appraisals, Resp. Ex. 2, FDIC Ex. 55, contain the March 24, 1986 appraisal as part of the Burlew Appraisal package, Respondents correctly argue in their Exceptions that there is no evidence that the directors had the 1986 appraisal before them at the January 13 meeting.

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[16] Attorney Adams testified that it would be easier to refinance the entire family-related debt — that is, oil and

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[17] The Board declines to adopt the ALJ's assumption that in the event of foreclosure, since Maxwell would have no longer had the $534,000 obligation to service, he would have had an easier time making payments to the Bank. R.D. at 9. The Board also rejects the ALJ's assumption that the refinancing could have gone forward in the face of foreclosure. R.D. at 9.

{{1-31-93 p.A-2116}}$557,000 to cover the Central Bank principal and unpaid interest, plus fees and costs of about $140,000 plus $305,000 to cover Maxwell's existing debt to the Bank, thus requiring that the collateral be liquid and have a market value of at least $1,000,000. "On this hope the Respondents voted to put at risk about 20 percent of the Bank's capital. I find this so unreasonable, with such a remote chance of success, that it cannot qualify as an indebtedness to protect the Bank." R.D. at 8. Respondents correctly argue in their Exceptions that the ALJ misinterpreted expert Dorroh's testimony in finding that the Bank would incur fees and costs of $140,000 if the Bank (not Central Bank) instituted foreclosure proceedings. The Board is of the view that the amount the Bank would have had to recover on the collateral to break even — assuming a quick sale, without having to incur holding costs and additional unpaid interest on the debt — would be closer to $800,000 than $1 million. Nevertheless, the Board agrees with and adopts the ALJ's ultimate conclusion that the hope of the Bank's breaking even on the purchase of the Central Bank note, based on the information before the directors at the January 13 meeting, was so unreasonable that the transaction cannot qualify as an indebtedness to protect the Bank. R.D. at 8. Consequently, the transaction is an extension of credit under Regulation O.

There is no question that the extension of credit, even standing alone, exceeded the lending limits of section 215.2(f) of Regulation O; and that Maxwell as vice president of Bancshares was an executive officer of the Bank as defined in section 215.2(d) of Regulation O. Hence, the transaction violated the lending limit restrictions of section 215.4(c) of Regulation O. Respondents argue that at the January 13 meeting, the directors were advised by President Bowker that the lending limits would not be violated by the transaction. However, the defense of reasonable reliance is not available under section 18(j)(4) of the FDI Act, 12 U.S.C. § 1828(j)(4). *Lowe v. FDIC*, 958 F.2d 1526 at 1535 (11th Cir., 1992). The argument of reasonable reliance is relevant to the question of good faith in determining the appropriate amount of the penalty. *See* page 32, below.

The Board also adopts the ALJ's conclusion that the January 1988 extension of credit to Maxwell violated the creditworthiness requirements of section 215.4(a)(2) of Regulation O because it involved more than normal risk of repayment. R.D. at 14. The Central Bank credit was overdue, the Respondents knew that Maxwell did not have the cash to bring it current. Respondents also knew that Maxwell's debt at the Bank had been adversely classified by the FDIC examiners during the October 1987 examination. FDIC Ex. 7. Moreover, FDIC Examiners Denton and Birdsell testified that the transaction "involved more than a normal degree of risk," Tr. at 46, and "considerably more than the normal risk of repayment," Tr. at 84. As stated by the ALJ, in making predictive judgments concerning the weakness in a credit, the opinion of an examiner for the FDIC must be given deference. *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

B. THE MARCH 1988 TRANSACTION

At the March 15, 1988, meeting, the directors set a "Line of Credit" for each director, at the suggestion of President Bowker. Maxwell's line was set at $875,000, "the [interest] rate could be determined at the time of the loan determined by the Profitability Analysis formula." The directors also approved renewal of

two Maxwell "loans coming due that need to be renewed," one in the amount of $42,387.36, and one in the amount of $212,046.61. The minutes note that, "[t]his loan at the present time is classified, but has no effect on renewal."

As to the line of credit, the Board agrees with the ALJ that the directors' action is "in the nature of affirming his past extensions of credit," and that, "Respondents did violate Regulation O on March 15, 1988, by setting a line of credit for Maxwell in excess of the prescribed limit." R.D. at 16.[18] However, the Board disagrees with the ALJ's conclusion that whether or not the March 15 action violates Regulation O is unimportant, and disagrees with the ALJ's failure to adopt appropriate conclusions of law with respect to the March 15 transaction.

[.2**]** The re-affirmation at the March 15 meeting of an $875,000 line of credit to Maxwell — established at the January 13 meeting — is no mere technicality without

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[18] While the action of the directors as described in the minutes of the meeting, Resp. Ex. 10, is somewhat confusing, President Bowker's testimony makes it clear that the directors were setting lines of credit to comply with the provisions of section 215.4(b)(2) of Regulation O. Tr. at 68–69.

{{1-31-93 p.A-2117}}consequences for the Bank. By this approval, the Board relinquished supervision and control over Maxwell's debt and allowed the Bank's officers to continue a "do nothing" policy with respect to Maxwell's loans, at a time when the Bank should have been taking aggressive action to achieve at least some repayment. This approval occurred at a time when the directors knew the refinancing assured them in January by attorney Adams was unlikely to happen.[19] They reapproved Maxwell's credit without ever looking at his financial statement (Respondent Whitehead testified that he never saw Maxwell's financial statement: "I don't think I ever saw a financial statement on anybody on that board, because it was considered confidential information," Tr. at 210). They reapproved Maxwell's credit without requiring additional collateral, or even knowing whether Maxwell had additional property to pledge as collateral, and without imposing any conditions with respect to reduction of outstanding debt. The Board holds that approval of a director's credit line to comply with the provisions of section 215.4(b)(2) of Regulation O constitutes an extension of credit. The Board concludes that the action of the directors at the March 15 meeting violated the lending limit restrictions of section 215.4(c) of Regulation O, and the creditworthiness requirements of section 215.4(a) (2) of Regulation O.

With respect to the two March 15 loan renewals, the Board disagrees with the ALJ's conclusion that despite the directors' approval there is no evidence that renewals were ever executed and hence no violation of Regulation O has been proved. The Board has previously held that a violation of Regulation O occurs upon issuance of the commitment, whether or not any funds are actually advanced. *In the Matter of* ****, Docket No. FDIC-85-165k, 1 P-H Enf. Dec. § 5065. However, FDIC Enforcement Counsel determined not to take exception to the ALJ's conclusion on this issue because the renewals were not cited specifically as violations of Regulation O in the Notice of Assessment. FDIC Excep. at 4. Hence, the Board will not adopt conclusions of law with respect to the renewals.

C. ASSESSMENT OF CIVIL MONEY PENALTIES

Pursuant to former section 18(j)(4)(A) of the FDI Act, 12 U.S.C. § 1828(j)(4)(A), the FDIC is entitled to assess civil money penalties of up to $1,000 per day for each day the violation occurred. The ALJ correctly stated that in determining the amount of penalty to be assessed, the FDIC must consider five factors: size of the financial resources of the person charged, his good faith, gravity of the violation, history of previous violations, and such other matters as justice may require. 12 U.S.C. § 1818(i) (2)(G), formerly 12 U.S.C. § 1828(j)(3)(B).

1. *Financial Resources*.

Each Respondent stipulated that he had sufficient resources to pay the amount assessed against him in the Notice of Assessment, and the ALJ so found. The Board adopts that finding.[20]

2. *Good Faith*.

Respondents argue that in considering the purchase of the Central Bank note at the January 13 meeting they reasonably relied on President Bowker's understanding that the Bank's lending limit "is 50% of the bank's capital and surplus, which in our case is $900,000.00" Resp. Ex. 8.

The Board adopts the ALJ's findings that the 50 percent figure used by Bowker is correct under state law, and that Bowker, being new to the Bank, may not have known at the time that Maxwell was an officer of Bancshares (Maxwell was not an officer of the Bank) and hence an "executive officer" pursuant to section 215.2(d) of Regulation O.

The Board also notes that attorney Adams, who testified that he was experienced in banking regulation matters, and that he was representing the Bank with respect to certain matters during the period in

question, Tr. at 405–422, attended the January 13 meeting and spoke in support of the transaction.[21]

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[19] Respondent Carroll so testified. Tr. at 317.

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[20] Respondent Whitehead testified at the administrative hearing that his net worth had declined by 25 to 30 percent, to approximately $85,000. Respondents argued in their Brief that as a consequence the $20,000 penalty assessed against him would be an extreme hardship. The point is not mentioned in Respondents' Exceptions. The Board concludes that Respondent Whitehead is financially able to pay a penalty of $20,000.

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[21] Shockingly, attorney Adams testified that, although in January 1988 he "had done work, at that point in time, for Olla Bank and for the Maxwells," Tr. at 421, "I did not give [Olla Bank directors] any opinions about [the (Continued)

[.3**]** Nevertheless, the Board adopts the ALJ's conclusion that the directors did not reasonably rely on the actual and implied advice received from the Bank's officers and advisers at the January 13 meeting. As the R.D. states, although directors are entitled to rely on the technical expertise of the executive officers of the bank when making decisions, *Briggs v. Spaulding*, 141 U.S. 132 (1891), insider transactions are so serious and have had such a devastating effect on the banking industry, that board members are charged with having independent knowledge of the restriction on insider lending. R.D. at 11, 12.

Respondents argue in their Exceptions that,

> Maxwell's status as an active participant in the Bank's affairs does not subject him to more stringent lending limits. It was the position as the executive officer of the Holding Company which triggered the fifteen (15%) percent Regulation O limit... Respondents' knowledge, or lack thereof, of [Maxwell's] insider status did not cause any violation of law.

The Board rejects this argument. Maxwell was clearly an "executive officer" of the Bank, as defined in section 215.2(d), because he was a person "who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions" of the Bank, whether or not he had an official title or served without salary or other compensation. Maxwell Sr., who controlled the Bank, had stepped down as chairman of the board in 1986 and his son, Maxwell, was appointed in his place. FDIC Ex. 18. While Maxwell Sr. was redesignated chairman of the board in early 1987, FDIC Ex. 19, he rarely if ever attended director meetings. According to the October 1987 Report, Maxwell "remains the dominant force within the bank," and "appears to have taken control of the bank, and is actively guiding the bank in its daily transactions." FDIC Ex. 19.

Finally, the Board notes that Respondents Whitehead and Carroll professed almost total ignorance of Regulation O. Whitehead said that the first he ever heard of it was the December 16, 1987, meeting with the examiners. Tr. at 169. Carroll testified that the directors did not know what Regulation O was. Tr. at 295. This is a shocking admission of total disregard for the duties to be exercised by directors of a Bank insured by the Bank Insurance Fund. Moreover, the directors had previously been furnished copies of the October 1986 Report which discussed Regulation O violations involving four directors, including Regulation O violations involving four directors, including Maxwell and Maxwell Sr., as well as admonishing that the directors had neglected to provide effective supervision. In the Board's view, Respondents' ignorance in the circumstances makes reliance on the Bank's consultants even less reasonable as grounds for mitigation of civil money penalties.

The Board adopts the ALJ's finding that Respondents knew or should have known that Maxwell was subject to the lending restrictions of section 215.4(c) of Regulation O, and did not reasonably rely on advise to the contrary at the January 13 meeting.

[.4**]** For purposes of the good faith analysis, the Board accepts Respondents' assertions that they had no desire, and were not attempting, to help Maxwell in approving the January 1988 transaction, and rejects the ALJ's findings to the contrary. Moreover, the Board accepts the ALJ's findings that Respondents did not benefit from the transactions at issue. Nevertheless, Respondents were completely derelict in their duty to be vigilant concerning insider transactions. Whatever good faith credit they are entitled to for the fact that they were misled by the Bank's advisers was fully accounted for in the initial assessment of penalties.

3. *Gravity of the Violation*.

The Board adopts the ALJ's finding that the overextension of credit to Maxwell caused substantial loss to the Bank, and his conclusion that such loss makes the violations here grave. R.D. at 18, 19. The August 1988 Report notes that the Bank had charged off in June 1988 over $127,000 of Maxwell credits, and that of the remaining amounts, $513,000 was classified "Substandard" and $207,000 "Loss." FDIC Review Examiner H. Lee Birdsell testified that as of August 1988 the Bank had suffered an additional

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21 Continued: Central Bank note]. I felt like, at that time, that I had a conflict of interest, in terms of their relationship with their borrower." Tr. at 423. Instead, he discussed his proposed refinancing of the Maxwell debt in order to persuade the directors in purchase the Central Bank note, even though he must have been aware that the transaction would violate Regulation O. The Board considers Mr. Adams' conduct in this regard to be clearly unethical and misleading to the directors.

{{1-31-93 p.A-2119}}$94,000 of loss because of the January 1988 transaction; and that the Maxwell transactions were a significant factor in the Bank's composite rating dropping from 4 in 1987 to 5 in 1988. Tr. at 94, 95.

Respondents in their Exceptions dispute the $94,000 loss figure because it is "based on unsupported valuation of the real estate," and dispute that the Maxwell credits were a significant factor in the Bank's failure. However, both FDIC Examiner Larry Denton, who participated in the August 1988 examination and prepared the analysis of classified loans for the August 1988 Report, and Review Examiner Birdsell, testified as to the bases for the loan classification numbers, Tr. at 37–103. The Board finds the Examiners' judgments reasonably flowed from the facts of record, and to be well within the zone of reasonableness. *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986).

4. *History of Previous Violations*.

The October 1986 Report notes that four credit lines to directors, including Maxwell and Maxwell Sr., were not properly approved in advance, in violation of Regulation O. FDIC Ex. 18 at 1-a, 6-b.

The October 1987 Report describes Regulation O violations involving Maxwell and Maxwell Sr., FDIC Ex. 19 at 1-a-3, 6-a, 6-a-1. These violations were discussed at the December 16, 1987, meeting with FDIC and State Office examiners attended by Respondents. FDIC Ex. 7. Less than one month later, Respondents approved a major transaction involving Maxwell in violation of Regulation O.[22]

The Board has previously held that the meaning of "prior violations" is not restricted to "violations of the same type." *In the Matter of R. Wayne Lowe and Jimmy A. Spivey*, Docket No. FDIC-89-21k, 2 P-H ¶5153 (1990), *aff'd, Lowe v. FDIC*, 958 F.2d 1526 (11th Cir. 1992).

By the time of the March 15, 1988 meeting, Respondents had been presented with copies of the October 1987 Report, detailing the Regulation O violations, and stating that "several transactions involving [Maxwell and Maxwell Sr.] were disclosed which reflect poorly on the Board of Directors," FDIC Ex. 19 at 1-a-4. The Board adopts the ALJ's conclusion: "That there was a history, and it was recent, tends to operate against the Respondents." R.D. at 19.

5. *Other Factors as Justice May Require*.

The Board is mindful that several other matters were raised by Respondents at the hearing and in briefs as bearing on the culpability of Respondents. The Board has considered these factors, not raised by Respondents in their Exceptions, and determined that they are not factors which would tend to lower the amount assessed in the Notice.[23]

The Board is also aware of the fact that the penalties assessed against Respondents Amberg, Carroll, Whitehead, and Zeagler are double that assessed against their fellow director J.J. Silagy. *See, In the Matter of J.J. Silagy, supra*.[24]The record in this proceeding discloses that Mr. Silagy was a paid consultant to the Bank as well as a director. He urged the directors to approve the Maxwell transaction at the January 13 meeting. Moreover, President Bowker, who prepared the minutes of that meeting, testified that Silagy "ramrodded" the Maxwell transaction through the board, Bowker Tr. at 95; and that only Maxwell and Silagy voted in favor of the transaction (the other directors remaining silent) and he was directed by Maxwell and Silagy to "put it in the minutes as unanimous." Bowker Tr. at 102.

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[22]As the Board has previously held, section 18(j)(4) of the FDI Act does not restrict the meaning of "prior violations" to violations of the "same type." *In the Matter of R. Wayne Lowe and Jimmy A. Spivey*, Docket No. FDIC-89-21k, 2 P-H FDIC Enf. Dec. ¶5153 (1990), *aff'd, Lowe v. FDIC*, 958 F.2d 1526 (11th Cir. 1992).

[23]The Board considered the facts that the August 1988 Report, FDIC Ex. 20, does not mention the March 15 approvals and, with respect to the January 1988 transaction states: The apparent violations of Regulation O are not considered deliberate or overly serious and civil money penalties are not recommended. The more pronounced violations in this area cited at the last examination regarding the Maxwells were appropriately addressed and proper restitution made. FDIC Ex. 20 at A-1. The Board also took note of the fact that the FDIC examiners did not disclose to the directors, following the October 1987 examination, that five Reports of Criminal Irregularity were prepared and submitted to the Regional Office of the FDIC concerning Maxwell; and agrees with the ALJ that this fact has no bearing on the culpability of the Respondents.

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[24]The Notice of Assessment assessed penalties against directors Silagy and Causey of $10,000 each rather than $20,000 as assessed against directors Amberg, Carroll, Whitehead, and Zeagler—apparently because the former two did not attend the March 15, 1988 meeting at which additional Regulation O violations occurred.

{{1-31-93 p.A-2120}}Respondent Whitehead testified that the Maxwells and Silagy were a "clique," Tr. at 181, and that in January 1987, the other directors had gone to Maxwell Sr. and "begged Mr. Maxwell to get Scotty and Silagy off that board," Tr. at 182. As a result, "they were just a little more entrenched. We took verbal abuse from them . . . and I think right after that, Mr. Scotty Maxwell became chairman of the board." Tr. at 183.

Finally, attorney Adams testified that he had been approached by Silagy in 1987, "to find out what they could do about the President of the bank," Tr. at 417, 418. Thereafter, President James resigned and was replaced by Mr. Bowker. Respondent Whitehead testified that the Maxwells fired James, because he "wasn't just rubberstamping everything that they wanted." Tr. at 171. The October 1986 Report states:

> President James is considered a capable and qualified executive officer. During the examination he expressed a growing concern over the bank's problems and criticized both Maxwell's conduct concerning the bank's affairs. He appeared to be willing to initiate stronger preventive measures, if a majority of the board would support him. He is, however, dependent upon the Maxwells for his position here, and may be limited by such.

FDIC Ex. 8, at Supervisory Section.

[.5**]** The Board is troubled by the fact that Respondent Silagy, a paid consultant to the Bank and an active supporter of the policies and initiatives of the Maxwells, was assessed so light a penalty in relation to other directors, for his role in the transactions at issue. Nevertheless, the Board concludes that this imbalance of penalties does not require as a matter of justice that the penalties assessed against these Respondents be reduced. Rather, the question is whether the penalties assessed here are appropriate under the factors set forth in 12 U.S.C. §1818(i)(2)(G). A major purpose of civil money penalties under the FDI Act is to deter bank directors and insiders from initiating and/or approving improper insider transactions. While the penalty against Mr. Silagy may have been too light, the Board concludes that the size of the penalties against these Respondents appropriately reflects their almost total abdication of responsibility as directors at the January 13 and March 15 meetings, thereby allowing the improper use of Bank assets by the Maxwells to continue.

The extent of abdication of responsibility by these directors is perhaps best illustrated by the letter dated April 2, 1988, from Respondent Whitehead to the Regional Director (Supervision) of the FDIC's Memphis Regional Office, responding to the latter's February 23, 1988 letter concerning the Regulation O violations disclosed in the October 1987 examination:

> You asked for any possible reasons for our negligence. I must go back to the beginning of my tenure (11 years) to explain . . . the lack of scrutiny exercised on my part . . . [W]hen asked . . . to serve on the Board, it was explained "the meetings would be short, there was very little responsibility, and the actual decision making was an internal matter performed by Management . . . During the latter years, the outside members . . . raised objections . . . These were routinely discounted as to their worthiness. If we countered "the examiners requested such," we were told "No. We were misinterpreting what they said." When we asked if we were in compliance with the Memorandum, we were assured everything was in order.
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> Now after reading subject matter on "Duties and Responsibilities of Bank Directors", this seems stupid, which is how I feel . . . [F]or the first time I realize . . . the entire Board is to be held accountable.

FDIC Ex. 62.

Respondent Whitehead is to be commended for his sincerity and forthrightness. However, the "lack of scrutiny" he and the other Respondents exercised as directors of a small, closely-held bank is exactly the negligent conduct which, repeated at hundreds of banks, has been a primary factor in the number of bank failures in this country. The Congress has directed the regulatory agencies to impose civil money penalties for lax director supervision of this nature, sufficient in size to serve as warnings and deterrents to other such directors and to insiders. The Board is of the view that the penalties imposed in this proceeding are appropriate, and adopts the findings and conclusions of the ALJ in this regard.

The Findings of Fact and Conclusions of {{1-31-93 p.A-2121}}Law set forth in the R.D. are adopted with the following modifications:

1. Finding of Fact No. 3 is modified to read as follows:

> 3. At all times material to this matter, Respondents Amberg, Carroll, Steen, Whitehead, and Zeagler were members of the board of directors of the Bank. Respondent Causey was a member until his resignation on January 28, 1988. (Jt. Stip. Nos. 14 and 15).

2. Conclusions of Law Nos. 11 and 12 are renumbered 12 and 13, and a new Conclusion of Law No. 11 is added as follows:

> 11. The March 15, 1988, renewal of W. Scott Maxwell's line of credit constitutes an "extension of credit" to W. Scott Maxwell within the meaning of section 215.3 of Regulation O, 12 C.F.R. §215.3. This extension of credit exceeded the Bank's lending limits and involved more than normal risk of repayment, all in violation of section 22(h) of the Federal Reserve Act, 12 U.S.C. §375(b) and sections 215.2(f), 215.4(a) and 215.4(c) of Regulation O, 12 U.S.C. §215.2(f), 215.4(a) and 215.4(c).

III. CONCLUSION

Respondents, all outside directors of the Bank, approved the highly risky purchase of the $500,000 Central Bank note of insider Maxwell in January 1988, based upon real estate appraisals which were questionable on their face and at a time when the Bank had a composite rating of 4. This transaction alone exceeded the Regulation O lending limit by more than $100,000. When added to the Maxwell credits already outstanding, most of which had been classified Doubtful, the lending limit was exceeded by $470,000. The directors took this action without any investigation of the real estate appraisal values or other relevant factors, in total derogation of their obligations to exercise due diligence on behalf of the Bank and to protect it from unsafe or unsound practices; and in spite of the fact that less than 30 days earlier, they had been warned by the FDIC examiners of previous Regulation O violations involving Maxwell and Maxwell Sr.

On the basis of the entire record, the Board finds that Respondents improperly and illegally approved extensions of credit to W. Scott Maxwell, a director and executive officer of the Bank, which exceeded the insider lending limit established by section 215.4(c) of Regulation O by $468,200 at a Bank board meeting on January 13, 1988, and by $471,200 at a board meeting on March 15, 1988; and involved more than the normal risk of repayment. The Board finds that these were serious violations of Regulation O, that the Bank had a recent history of Regulation O violations of which the Respondents were or should have been aware, and that the Respondents have sufficient financial resources to pay the civil money penalties sought. Finally, the Board finds that the imposition of civil money penalties of $20,000 against each Respondent ($10,000 in the case of Respondent Causey) is more than justified on the basis of the record in this proceeding.

ORDER TO PAY CIVIL MONEY PENALTY

Based upon substantial evidence in the record of this proceeding, and for the reasons set forth in the above Decision and the Recommended Decision of the ALJ, the Board of the FDIC hereby ORDERS that:

1. A civil money penalty of $20,000 each be, and the same hereby is, assessed against James C. Amberg, Robert Ray Carroll, Billy Ray Whitehead, and Benny Zeagler, and a civil money penalty of $10,000 is hereby assessed against W.M. Causey, pursuant to former section 18(j)(4) of the FDI Act, 12 U.S.C. §1828(j)(4) (1988).

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

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

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

By direction of the Board.

Dated Washington, D.C., this 27th day of October, 1992.

/s/ Hoyle L. Robinson
Executive Secretary

{{1-31-93 p.A-2122}}

RECOMMENDED DECISION

In the Matter of
James C. Amberg, Robert Ray CarrollY,
W.M. Causey, Billy Ray
Whitehead, and Benny Zeagler,
individually and as directors of
The Olla State Bank
Olla, Louisiana
(Insured State Nonmember Bank)
James. L. Rose, Administrative Law
Judge:

Statement of the Case

This matter was tried before me at New Orleans, Louisiana, on March 16, 17 and 18, 1992, upon a Notice of Assessment of Civil Money Penalties against W. Scott Maxwell and others. This proceeding involves only James C. Amberg, Robert Ray Carroll, W.M. Causey, Billy Ray Whitehead and Benny Zeagler, cases involving the other Respondents having been resolved.[1] Following the hearing, Counsel for the FDIC and the Respondent submitted extensive briefs, and reply briefs.

Upon the record as a while, including my observation of the witnesses and briefs and arguments of counsel, I hereby issue the following findings of fact, conclusions of law and recommended order:

I. The Facts

The Respondents had been members of the Board of Directors of the Olla State Bank (herein the Bank) for some years and all were members of the Board of Directors of Olla Bancshares, Inc. —a one-bank holding company which owned 92.8 percent of the Bank's voting stock.[2] Along with the other directors, they were assessed civil money penalties in connection with the Bank's purchase of a credit to the Central Bank of Louisiana from W. Scott Maxwell, approved by a unanimous vote of the Board of Directors on January 13, 1988, and originating on January 18, in the amount of $557,464.85 (which included the principal of about $534,000 and accrued interest).

At the time the Board approved the purchase of this credit, Maxwell was the Vice-President of the Bank's holding company in which position he was an executive officer of the Bank within the meaning of 12 C.F.R. §215.2(d). He also was a member of the Bank's board of directors, served as counsel for the Bank, and in February became the Bank's vice-chairman, which is also an executive officer position.

In essence, the FDIC contends that by purchasing the Central bank credit, the Bank extended Maxwell's aggregate debt to more than $1 million and far in excess of the Bank's legal lending limit as set forth in 12 C.F.R. §§215.2(f) and 215.4(c), which as the material time was approximately $403,800.

At the January 13 Board meeting, it was discussed that Central Bank was about to foreclose on the collateral securing Maxwell's note, on which the Bank had a second mortgage securing Maxwell's various credits with the Bank of about $305,000, which, for purposes of this decision, will be treated as a single credit. This collateral was 96 acres of land to be developed as part of a residential tract subdivided in 2-acre lots. (Collateral securing the Central Bank credit also included Maxwell's residence.)

On March 15, 1988, the Board, and these Respondents, voted a line of credit for Maxwell in the amount of $875,000, which the FDIC charges additionally violated Regulation O. The Respondents contend this was just as authorization. There was no extension of credit until the line was funded, which it never was.

II. Analysis and Concluding Findings

In pertinent part, 12 U.S.C. §375b reads:

(1) No member bank shall make any loan or extension of credit in any manner to any of its executive officers . . . where the amount of such loan or extension of credit, when aggregated with the amount of all other loans or extensions of credit then outstanding by such bank to such executive officer or person . . . would exceed the limits on loans to a single borrower established by section 84 of this title. For purposes of this paragraph, the

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[1]The penalty against J.J. Silagy was tried separately on January 28 and 29, 1991. My recommended decision assessing a penalty was adopted by the FDIC Board. *In the Matter of J.J. Silagy*, FDIC-89-144k, 2 P-H FDIC Enf. Dec. ¶ 5170 (1991). Though the facts found in that case are not binding on these Respondents, the government's proof was essentially the same as here and is for the most part uncontested. Though additional facts were presented by the Respondents which have been considered, much of my decision in *Silagy* is applicable here and, where appropriate, is repeated without citation.

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[2]Causey resigned his positions on January 28, 1988.

{{1-31-93 p.A-2123}}provisions of section 84 of this title shall be deemed to apply to a State member bank as if such State member bank were a national banking association.

(3) No member bank shall make any loan or extension of credit in any manner to any of its executive officers or directors . . . unless such loan or extension of credit is made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons and does not involve more than the normal risk of repayment or present other unfavorable features.

These provisions of the Federal Reserve Act are implemented by Regulation O, 12 C.F.R. Part 215. Further, 12 U.S.C. §1818(j)(4)[3]provides for imposition of a civil money penalty where a bank director has been involved in violating Section 375b and Regulation O.

The FDIC alleged in its civil money penalty assessment that the purchase of Maxwell's Central Bank note was an extension of credit to an executive officer in excess of the limits allowed by Regulation O, in that adding this $557,000 to his existing debt at the Bank brought the aggregate to more than one million dollars (which included a continuing guarantee on a debt of his father of about $195,000 (given as $143,000 in FDIC Ex. 8) which he subsequently relinquished, reducing the aggregate to about $860,000). The Bank's lending limit under Regulation O was about $405,000 at the time.

In addition, the FDIC alleged that this extension of credit involved more than normal risk of repayment in violation of Section 375b(3) and Section 215.4(a)(1). Therefore, the Respondents should be assessed civil money penalties due to their active participation in the transaction.

The Respondents' principal argument is that by purchasing this credit the Bank simply sought to enhance the collateral for its $305,000 outstanding credit to Maxwell. Therefore, the transaction was not an extension of credit by application of Section 215.3(b)(4)(ii) which exempts "any indebtedness to a bank for the purpose of protecting the bank against loss or giving financial assistance to it." Alternatively, the Respondents argue this transaction comes within Section 215.3(a)(6) since it was an increase in indebtedness "advanced by the bank for its own protection for * * * (ii) taxes, insurance, or other expenses incidental to the existing indebtedness."

Noting that Maxwell's debt to the Bank was classified doubtful at the October 1987 examination (about which they were informed in December though the final report was not sent until February 1988) and Central was about to foreclose, Counsel states: "the directors were faced with a critical decision; whether to purchase the Maxwell note at Central bank, to purchase the property at the sheriff's sale, or let the real estate go leaving them with an unsecured note on their books." (Respondents' Reply Brief at 11)

In sum, the Respondents contend than under the facts as known to them, purchase of the note was not an extension of credit, was made to prevent losses to the Bank and was a prudent decision: Maxwell had a note for about $534,000 which was nine months past due and Central Bank was about to foreclose, the Bank Board's Loan Committee having refused to loan Maxwell $50,000 to make a payment. The effect of foreclosure would be to force a sale of the collateral on which the Bank had a second position securing $305,000 in credits which had been classified as doubtful. Thus to protect its collateral position, the Respondents determined to purchase the Central Bank note. Though the $305,000 credit had been classified and Maxwell's financial condition was known by the Respondents to be precarious, he was, apparently, current with the Bank.

The way foreclosure works in Louisiana was testified to by Walter Evans Dorroh, Jr., an attorney who

practices law near Olla, Louisiana, and who testified as an expert witness for the Respondents. Where a creditor seeks to foreclose on real estate collateral, the property is auctioned at a sheriff's sale. The bidding must begin at two-thirds of the appraised value of the collateral, and is typically sold for that amount with the creditor being the only bidder, although any one can enter the bidding. The successful creditor pays the costs of the sale (attorney and sheriff fees) and becomes the owner of

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[3]Section 18(j)(4) of the Act was amended by section 907(c) of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 1032 State. 183,446 (1989). The amendments are prospective and do not affect application of the civil money penalties assessed here based on pre-FIRREA activity.

{{1-31-93 p.A-2124}}the property, which has the effect of extinguishing subordinate liens. It is theoretically possible for another to be the successful bidder, in which case the amount bid plus costs must be paid. The first lien holder is paid off, and if there is any money left the subordinate lienholders are paid.

Thus assuming the facts here (setting aside for the moment the question of whether the appraisal was accurate), Dorroh testified that the bidding would start at about $660,000 and Central Bank would probably have been the only bidder. Central Bank would then have paid the costs of about $140,000 and become the owner of the collateral. The Bank would have received nothing and its second lien would have been extinguished.

Since it was unrealistic to assume a third party would have entered the auction, the Respondents contend that by buying the credit, the Bank got a first position on the collateral and saved the sale costs of $140,000.

The flaw in this argument is the Bank was not required to bid on the property if it had gone to a sheriff's sale. True the Bank would have lost its second mortgage on the $305,000 credit, but this was questionable security in any event, and the Bank still had the credit. Further, in buying the Central Bank note, if Maxwell failed to perform (which was a reasonably good prospect given his record) the Bank would have to have foreclosed, and ultimately pay the foreclosure costs.

Thus I conclude that the Bank did not save $140,000 by purchasing the note. Rather, it expended $557,000 on the dubious premise that Maxwell would pay his now almost $875,000 debt to the Bank. Even assuming that the value of the collateral was about $1,000,000, I have difficulty understanding how the Bank was better off after spending $557,000 to get a non-performing Maxwell credit.

The Respondents knew that Central Bank had a credit from Maxwell for $534,000 which was non-performing and on which he owed about $23,000 in interest. Their hope was the collateral securing this credit had sufficient value and liquidity such that in the event of foreclosure the Bank would recover the $557,000 after costs and fees (of about $140,000) and there would be enough left to pay the $305,000 credit. In order to accomplish this the collateral would have to have been liquid and have a market value of at least $1,000,000.

On this hope the Respondents voted to put at risk about 20 percent of the Bank's capital. I find this so unreasonable, with such a remote chance of success, that it cannot qualify as an indebtedness to protect the Bank.

Further, it does not follow, as the Respondents argue, that the Bank would have been worse off had Central foreclosed on its credit. The Respondents argue that in such event, the Bank would have been left with an unsecured credit for $305,000. However, since Maxwell would have no longer had the $534,000 obligation to service, it would seem he would have had an easier time making payments to the Bank. Although Maxwell was a credit risk, I am unpersuaded that buying the Central Bank credit improved the Bank's position.

The Respondents also argue that Maxwell's attorney gave them assurances "that refinancing would have all Maxwell debt out of the Bank within six (6) months." (Respondents' Reply Brief at 12) They testified they did not believe that Maxwell would pay his debt of $305,000, but they did believe his attorney would be able to refinance and payoff about $860,000. (T. 297) There are no facts of record to support faith in such an assurance by Maxwell's attorney. But even if the Respondents could rely on this assurance of refinancing, such would seem to have lessened the reasonableness of advancing an extra $557,000 to protect the $305,000 credit. The Bank would have this credit unsecured for just six months.

Finally, the Respondents' argument rests in substantial part on the appraisal of the collateral — Maxwell's resident and 96 acres of adjacent land to be developed as two acre home sites. The appraisal, as updated in 1987, gave a value of the residence to be $271,000 and the undeveloped land to be $7,500 per acre (up from $6,500 the year before). The Respondents all testified that these figures were reasonable. Various witnesses for the FDIC testified that land value was outlandish and a $371,000 home in Winnfield, Louisiana, is not readily marketable. There are few buyers at such a price and those who exist would more likely build rather than buy an existing structure.

The appraiser, H.D. Burlew, is known in the area and does appraisals for all the local banks.

Nevertheless, he did the appraisal in question for Maxwell, which suggests, at a {{1-31-93 p.A-2125}}minimum, that any doubts as to value would be resolved in Maxwell's favor. I note also that recent comparables were nonexistent. The appraiser listed eight sales of the tract, one in 1978, three in 1979, three in 1980 and one in 1984. Such not only makes the appraised value dubious, but suggests a minimal market for the property. At least the Respondents should have questioned why Burlew appraised the land at $6,500 per acre on March 24, 1986, and then raised the value to $7,500 on November 19, 1987, without any intervening sales and at a time when the economy was in a downturn. Presumably the Respondents were aware of this, since the value of the collateral was the asserted reason they voted to expend $557,000. Yet they apparently accepted the November 1987 appraisal without question.

But even if the land was worth $7,500 an acre, the Bank would have to hold it a very long time before all of it could be sold. (T. 438) Even Amberg testified that due to the economy, the Bank would have to have held the property a few years. (T. 261)

Though the appraisal is certainly some evidence of the land's value, on its face the appraisal contained information which would suggest that buying note for $557,000 in order to acquire a first mortgage on this collateral was not sound.

The Board members were advised by then President Dan Bowker that the purchase of this credit would not be violative of any of the federal or state lending limit statutes. The lending limit issue was raised at the January 13 Board meeting and they were told there was no lending limit problem. Bowker is reported to have said he "understood" the lending limit was 50 percent of capital and surplus which made it about $900,000 and purchase of the Central Bank credit would bring Maxwell's aggregate to $875,000. (FDIC Ex. 8) The 15 percent limit applies only because Maxwell was a executive officer. Thus there is an issue as to whether the misinformation from Bowker protects the Respondents from imposition of civil money penalties. I conclude it does not.

Although members of a board of directors are charged with knowing a reasonable amount about banking proscriptions, directors are entitled to rely on the technical expertise of the executive officers of the bank when making decisions. *E.g., Briggs v. Spaulding*, 141 U.S. 132 (1891). *Lowe v. FDIC*, No. 90–8471 (11th Cir. April 22, 1992) relied on by Counsel for the FDIC is inapposite on this issue because the respondent made no effort to learn what he should have known. Here the Respondents did ask Bowker whether there was a lending limit problem.

Nevertheless, insider transactions are so serious and have had such a devastating effect on the banking industry, I conclude that board members should have independent knowledge that Section 375b and Regulation O limits the amount which can be loaned to an executive officer. If the Respondents did not know that the limit was an aggregate amount in excess of 15 percent of the Bank's unimpaired capital and surplus, they were charged with finding out. Further, they were charged with knowing that Maxwell, by virtue of his positions, was an executive officer. Indeed Whitehead testified that "I would know better than 50 percent (as the lending limit)." (T. 227)

While the matter of who is an executive officer can be technical, Maxwell was not a technical insider. He and his father owned the holding company which owned the Bank. He was vice-chairman of the holding company and a member of the boards of both the holding company and the Bank. Further, he was legal counsel for the Bank. He had a great deal of involvement in the operations of the Bank. Thus the Respondents knew, or should have known, that Maxwell was one covered by insider proscriptions.

Indeed the Respondents testified that they petitioned Maxwell senior to remove his son from his various positions of authority, which Maxwell senior declined to do. Implicit in their testimony was a concern about Maxwell's financial dealings.

Therefore, I conclude that the Respondents were on notice about Maxwell's insider status and they should have been guarded in the Bank to make extensions of credit to him, regardless of the form such took. Further, I conclude that Bowker's statement was insufficient to shield the Respondents from liability.

If Bowker had simply miscalculated the lending limit, such would have been a technical matter on which board members could reasonably rely. However, the percentage which Bowker is reported to have thought could be lent to an executive officer was {{1-31-93 p.A-2126}}not, nor was his statement reported in such a way that a reasonable person would rely on it, since at best it was equivocal. See, *Fitzpatrick v. FDIC*, 765 F. 2d 569 (6th Cir. 1985) for a director's duty to investigate the propriety of an insider transaction such as the one here. (Bowker in fact did misstate the Bank's capital and surplus, but putting it lower than reported as of December 31, 1987. FDIC Ex. 41)

Further, Bowker testified in his deposition (Jt. Ex. 4 at 109) that he did not believe Maxwell could service all his debt, a conclusion also set forth in the examination report presented to all directors on December 16, 1987.

Therefore, in addition to the lending limit excess, purchase of the Central Bank credit clearly involved more than normal risk of repayment within the meaning of Section 215.4(a)(1). The credit was nonperforming. At a minimum Maxwell was known to be having cash flow problems. Under such

circumstances, buying a credit for $557,000 was certainly risky.

Examiner Larry Denton testified that the transaction in issue here "involved more than a normal degree of risk." (T. 46) Review Examiner H. Lee Birdsell had the same opinion. (T. 84)

In making predictive judgments concerning the weakness in a credit, the opinion of an examiner for the FDIC must be given deference. *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986). The facts on which such an opinion is based can be tested for accuracy. And the opinion must reasonably flow from the facts. But unless it is shown that an examiner's predictive judgment is outside the "zone of reasonableness", it must be accepted.

The opinions of Denton and Birdsell are reasonable and based on facts which I accept concerning Maxwell's general inability to service his debt.

I conclude that buying Maxwell's Central Bank credit involved more than the normal amount of risk of repayment, and therefore was violative of Section 375b(3) and Section 215.4(a)(2).

The Respondents deny their vote to purchase the Central Bank credit was an attempt to help Maxwell, though they also testified that his attorney persuaded them that within six months all of Maxwell's debt would be moved out of the Bank. Buying the Central Bank credit certainly had effect of helping Maxwell. And he was an insider. Such precisely the type of risk to a bank's assets which 12 U.S.C. §375b and Regulation O seek to prevent.

The FDIC also alleges that the Board's action of March 15, 1988, in approving a line of credit for Maxwell of $875,000 was an extension of credit in violation of Regulation O. (D Ex. 18) The Respondents argue that it was not —that a) setting a line of credit is not an extension of credit until funded or b) the Board's action did not constitute a new line of credit but simply memorialized Maxwell's already existing debt to the Bank of about $875,000.

In addition, at the March 15 meeting the Respondents voted to renew two of Maxwell's notes —one for $42,387.36 and one for $212,046.61. Both had been classified doubtful at the October 1987 examination, thus the FDIC argues they necessarily involved more than the normal risk of repayment. The Respondents argue that neither credit was actually renewed, therefore regardless of their expressed intent, there was no extension of credit.

The FDIC apparently does not disagree with the Respondents' fact contention, arguing that "failure to complete the appropriate paperwork in conjunction with this action (the two renewals) will not circumvent the applicability of Regulation O to the board's actions." (FDIC Reply Brief at 26, n. 10)

I disagree. The allegation is that two classified credits were renewed. There is no evidence they were. Notwithstanding the Respondents' intentions as voiced at the March 15 meeting, the FDIC did not prove that in fact the credits were renewed. Therefore, this allegation cannot be a basis for assessing a civil money penalty.

As for setting the line of credit, the facts of record seem to support the Respondents' contention that the Board's action was not approval of an additional line for Maxwell. Although establishing a line of credit, without more, is an extension of credit under 12 C.F.R. §215.3(a), the Board's action here is more in the nature of affirming its past extensions of credit. However, whether the March 15 action is, or is not, a violation of Regulation O makes little difference in this matter. I have concluded that in buying the Central Bank note, the Bank did extend credit to Maxwell in excess of the limits set by Regulation O for executive officers, and had {{1-31-93 p.A-2127}}more than the normal risk of repayment. That the Board's violation of Regulation O was affirmed later would add nothing to the recommended penalty to be assessed. Nevertheless, I conclude, in agreement with Counsel for the FDIC, that the Respondents did violate Regulation O on March 15, 1988, by setting a line of credit for Maxwell in excess of the prescribed limit.

Finally, Counsel for the Respondents argue that the FDIC should be estopped from alleging the March 15 action as a violation of Regulation O since no "fifteen day letter" was sent to them. Therefore, they had no opportunity to defend their position at the administrative level and before litigation.

Counsel cite no authority to the effect that a "fifteen day letter" is required as precedent to bringing an administrative action. There is no claim that any Respondent relied to his detriment on some representation by agents of the FDIC. Further, as a general rule, an agency cannot be estopped from performing its regulatory functions by acts (or omissions) of its employees. *Office of Personnel Management v. Richmond*, ____ U.S. ____, 110 S.Ct. 2465 (1990). I therefore reject the Respondent's estoppel argument.

III. Assessment

As applicable at the time of the events in this matter, 12 U.S.C. §1828(j)(4) (for nonmember state banks) provided that a civil money penalty assessment could be levied against one violating Section 375b of not more than $1,000 for each day the violation occurred. In determining how much of an assessment to levy, the FDIC is to consider five factors: size of the financial resources of the person charged, his good faith, gravity of the violation, history of previous violations, and such other matters as

justice may require.

A. Financial Resources

The parties stipulated that the financial resources of each Respondent is not an issue here—that they have sufficient resources to pay an assessment of $20,000, or $10,000 in the case of Causey. (Jt. Ex. 1)

B. Good Faith

In support of their good faith argument, the Respondents testified that they did not know of the Regulation O limit and that Bowker told at the January 13 meeting there was no problem with lending limits. The minutes states that Bowker gave his understanding of the lending limit to Maxwell to 50 percent of capital (which is correct under state law, but not under Regulation O for an executive officer). And Bowker may not have known that Maxwell was an executive officer.

However, Bowker was new to the Bank, and these Respondents would be expected to know much more about Maxwell's relationship to the Bank than he. They must have known that any extension of credit of Maxwell was an insider transaction. The Bank was going to put out $557,000 so that Maxwell would not have his house foreclosed. The collateral was questionable and the argument that somehow the Bank's collateral position would be improved was dubious. And even if Maxwell was not a executive officer, he was admittedly an insider and a credit risk. On these facts I conclude that the Respondents are not entitled mitigation of a penalty based on good faith.

C. Gravity of the Violation

"Problem banks and insider abuses have been virtually synonymous. Nothing appears more often on the fever charts of sick financial institutions than self-dealing ailments." H.R. Rep. No. 1383, 95th Cong., 2d Sess. 10–12, reprinted in 1978 U.S. Code Cong. & Ad.News 9273.

The Bank's overextension of credit to Maxwell, one of its executive officers, caused substantial loss. Thus, at the examination as of August 18, 1988, $127,000 of Maxwell's debt had been charged off on June 24. of the remaining, the Examiner found $513,000 was substandard and $207,000 a loss. This amount of loss to the Bank, much of which resulted directly from the Central Bank credit, made the violation here grave.

D. History of Previous Violations

At the examination as of October 23, 1987 (FDIC Ex. 19), Regulation O violations as to Maxwell and his father were noted. At the FDIC meeting with the board on December 16, 1987, this was discussed. Yet less than a month later, the Respondents embarked on a course of action which would again violate the insider lending proscriptions, albeit in a different way. That there was a history, and it was recent, tends to operate against the Respondents.

E. Other Factors as Justice May Require

There are no additional factors which I {{1-31-93 p.A-2128}}believe would tend to lower the amount assessed in the Notice.

With due consideration to the five statutory factors, and the entire record in this matter, I conclude that the assessment of $20,000 for each Respondent is appropriate and will so recommend to the FDIC Board.

No reason was given why the assessment against Causey was administratively set at $10,000. Though he did not participate in the March 15 meeting, having previously resigned as a board member, the action taken then was much less serious than buying the Central Bank credit. Nevertheless, I conclude it would be inappropriate to raise the amount asked for by the FDIC. Accordingly, I will recommend an assessment against him of $10,000.

Upon the foregoing I hereby recommend adoption of the following:

FINDINGS OF FACT

1. At all times material the Bank was a corporation existing and doing business under the laws of the State of Louisiana, having its principal place of business in Olla, Louisiana. It was insured by the FDIC and not a member of the Federal Reserve. (Jt Ex 1, No. 8)

2. The Bank was a subsidiary of Olla Bancshares, Inc., Olla, Louisiana ("Bancshares"), a one-bank holding company which owned 92.8 percent of its voting stock. (Jt Ex 1, No. 8, 17)

3. Since 1974 and at all time material, the Respondent was a member of the board of directors of the Bank. (T. 139, 141; Jt Ex 1, No. 15)

4. At all times material W. Scott Maxwell was a member of the board of directors of the Bank and was Vice-President of Bancshares. (Jt Ex 1, Nos. 9 and 10)

5. At all times material W. Scott Maxwell served on the loan committee, executive committee and retirement committee of the Bank. Between February 2, 1988 and May 1, 1988, he was vice-chairman of the board of directors of the Bank. (Jt Ex 1, No. 10; FDIC-3; FDIC-4)

6. At the October 1987 examination, $255,000 of W. Scott Maxwell's $312,000 outstanding direct debt was classified "Doubtful" due to its more than normal risk of repayment. (Jt Ex 1; No. 18; FDIC-19, p. 6-a)

7. Collateral for W. Scott Maxwell's classified debt included a second mortgage covering a 96-acre tract of undeveloped land. The first mortgage on this property was held by Central Bank, Monroe, Louisiana ("Central Bank"), as collateral for a note in the amount of $500,000 dated May 15, 1986. (FDIC Ex. 39, 40)

8. The 1987 examination disclosed that W. Scott Maxwell had a high volume of debt at various financial institutions and did not appear to have the cash flow to service his debt at the Bank. Additionally, his assets were over-valued, appraisals on the real estate securing his debt contained unrealistic assumptions and the collateral was of questionable value with the Bank's equity position uncertain. (FDIC-19, pp. 1-a-2, 2-a-4 through 2-a-6)

9. The 1987 examination cited three violations of Regulation O involving W. Scott Maxwell, including loans to W. Scott Maxwell and his father containing preferential terms in violation of Section 215.4(a) Regulation O based on the rate of interest charged and the collateral taken. The examination noted that the loans were apparently made due to the Maxwell's positions at the Bank without regard to his repayment ability or collateral values. A separate violation of Section 215.4(a) of Regulation O was also cited in connection with W. Scott Maxwell's purchase of a bank-owned automobile for less than half of its market value. In connection with these violations, it was noted that civil money penalties of up to $1,000 for every day the violation continues could be assessed for violation of Regulation O. (FDIC-19, pp. 6-a through 6-a-2)

10. Following the 1987 examination, the Bank's board of directors made provisions to increase the interest rates on the loans to W. Scott Maxwell and his father which had been cited as preferential and in violation of Section 215.4(a) of Regulation O. The directors also required W. Scott Maxwell to make additional payments on the automobile which he had purchased from the Bank for less than market value. (T. 90, 91)

11. At this meeting of December 9, 1987, the Bank's board of directors approved a $10,000 overline for W. Scott Maxwell on the condition that he pay 10 percent per year principal and interest and that he not borrow any more until he had reduced his debt for two years or by 20 percent. W. Scott Maxwell also agreed to put up additional collateral but never did. (FDIC-6)

{{1-31-93 p.A-2129}}12. The Respondents attended a December 16, 1987, board meeting which was held at the Commissioner's Office in Baton Rouge, Louisiana, with representatives of the State and the FDIC for the purpose of discussing the findings of the 1987 examination of the Bank. The apparent violations of Regulation O, problems and criticisms with the extensions of credit of W. Scott Maxwell cited in the 1987 Report of Examination, and the possibility of civil money penalties were subjects of discussion at this meeting. (FDIC Ex. 7)

13. On January 5, 1988, the Bank's loan committee considered a request by W. Scott Maxwell for a $50,000 loan to pay interest on his loan at Central Bank. The loan committee told Maxwell that the loan would have to be presented to the Bank's board of directors. (Ex. D-1)

14. At a January 13, 1988, meeting of the Bank's board of directors, the Respondents voted in favor of purchasing W. Scott Maxwell's note with Central Bank by paying the amount of the note plus accrued interest. (FDIC Ex. 8)

15. The only inquiry made concerning a possible lending limit violation associated with the Bank's purchase of the Central Bank note was a question directed to President Bowker, who stated the lending limit was 50 percent of capital and surplus, or about $900,000. (FDIC Ex. 8)

16. At the board meeting of January 13, 1988, the Respondents reviewed the 1987 appraisals on the collateral pledged to W. Scott Maxwell's debt and relied on them. The Respondents did not question the values assigned in the appraisal. FDIC examiner criticisms of the appraisal values were not known to the Respondents until the report of the October 1987 examination was received some time later.

17. On January 18, 1988, the Bank purchased W. Scott Maxwell's note from Central Bank and received an assignment of the collateral. As further evidence of the debt owed the Bank by W. Scott Maxwell, the Bank's documentation in conjunction with the transaction included a "Combination Disclosure Statement and Negotiable Paper" dated January 18, 1988, and signed by W. Scott Maxwell, for the loan amount of $557,464.85 (principal and accrued interest plus a $5 notary fee). (FDIC-21)

18. By January 13, 1988, the total of all extensions of credit to W. Scott Maxwell by the Bank was $305,063. Since the previous Board meeting, he had been removed from a continuing guaranty on the

line of credit to his father, M.W. Maxwell, in the amount of $143,000. (FDIC Ex. 8)

19. As a result of the Bank's purchase of his note from Central Bank, outstanding extensions of credit by the Bank to W. Scott Maxwell was approximately $875,000. This amount represented 32 percent of the Bank's capital and surplus and undivided profits based on the Consolidated Report of Condition as of December 31, 1987. (FDIC Ex 41)

20. The Respondents did not personally benefit from the Bank's purchase of the Central Bank note.

21. At the examination as of August 1988, $207,000 of the loans to W. Scott Maxwell were classified as "Loss", which did not include over $100,000 of his debt which the Bank had charged off on June 24, 1988. (FDIC-20, pp. 1-a-6, 2-a-14)

22. In purchasing the Central Bank credit the Bank made an extension of credit to W. Scott Maxwell in an amount which together with his other obligations to the Bank exceeded 15 percent of the Bank's unimpaired capital and surplus and which resulted in a substantial loss to the Bank.

23. The Bank did not adequately protect itself by purchasing W. Scott Maxwell's note from Central Bank and in fact, the Bank increased its exposure and incurred additional loss. At the time of the January transaction, W. Scott Maxwell had no repayment ability.

24. The January transaction involved more than the normal risk of repayment because at the time of the January transaction, W. Scott Maxwell's financial condition was deteriorating and the value of the collateral was much less than the amount of the transaction.

25. The Bank suffered an additional $94,000 loss as a result of the January transaction. (T. 94)

26. Based upon the Bank's total equity capital and reserves of $2,692,000, as reported in the Bank's Consolidated Report of Condition as of December 31, 1987, the Bank's Regulation O lending limit, as of January 18, 1988, was $403,800. (FDIC Ex. 41)

{{1-31-93 p.A-2130}}27. Apparent violations of Regulation O cited in the 1986 and 1987 reports of examination constitute a history of previous violations, which had been transmitted to the Board as recently as December 1987.

28. The January 1988 transaction represented about 20 percent of the Bank's unimpaired capital and surplus, and the amount of the Bank's total debt outstanding to W. Scott Maxwell after the January transaction, was 32 percent of the Bank's unimpaired capital and surplus, and exposed the Bank to more loss and was a contributing factor to the Bank's failure.

CONCLUSIONS OF LAW

1. At all times material, the Bank was an insured state nonmember bank subject to the Act, 12 U.S.C. §§1811, et seq., the Rules and Regulations of the FDIC, 12 C.F.R. Chapter III and the laws of the state of Louisiana.

2. The FDIC has jurisdiction over the Bank, the Respondent and the subject matter of this proceeding.

3. Under Section 18(j) of the Federal Deposit Insurance Act, 12 U.S.C. §1828(j), the FDIC has authority to impose civil money penalties for violations of Section 22(h) of the Federal Reserve Act, 12 U.S.C. §375b, and Regulation O of the Board of Governors of the Federal Reserve System, 12 C.F.R. Part 215.

4. At all times material, W. Scott Maxwell was a "director" of the Bank within the meaning of 12 C.F.R. §215.2(c) and was an "executive officer" of the Bank within the meaning of 12 C.F.R. §§215.2(c) and 215.2(d).

5. The January 1988 transaction constitutes an "extension of credit" to W. Scott Maxwell within the meaning of 12 C.F.R. §215.3.

6. The January 1988 transaction was made in violation of Section 22(h) of the Federal Reserve Act, 12 U.S.C. §375b, and in violation of 12 C.F.R. §§215.2(f) and 215.4(c) in that it was an extension of credit which exceeded the Bank's lending limit.

7. The January transaction was made in violation of Section 22(h) of the Federal Reserve Act, 12 U.S.C. §375b, and in violation of 12 C.F.R. §215.4(a), in that it was an extension of credit involving more than the normal risk of repayment.

8. The Respondents caused, brought about, participated in, counseled, or aided or abetted violations of section 22(h) of the Federal Reserve Act, 12 U.S.C. §375b, and 12 C.F.R. §215.4(a).

9. The Respondents caused, brought about, participated in, counseled, or aided or abetted violations of Section 22(h) of the Federal Reserve Act, 12 U.S.C. §375b, and 12 C.F.R. §§215.4(c) and 215.2(f).

10. By purchasing the Central Bank note and acquiring its collateral, the Bank did not increase W. Scott Maxwell's indebtedness for its own protection within the meaning of 12 C.F.R. §215.3 (a)(6) or protect itself against loss within the meaning of 12 C.F.R. §(b)(4)(i).

11. A civil money penalty is warranted against Respondents considering the size of their financial resources, good faith, history of previous violations, gravity of the violations and such other matters as justice may require as set forth in 12 U.S.C. §1828(j)(4).

12. A civil money penalty of $20,000 ($10,000 for Causey) is appropriate for the Respondents

participation in violations of Section 22(h) of the Federal Reserve Act and Regulation O.

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

ORDER TO PAY CIVIL MONEY PENALTIES

IT IS HEREBY ORDERED THAT a civil money penalty of $20,000 be, and the same hereby is, assessed James C. Amberg, Robert Ray Carroll, Billy Ray Whitehead and Benny Zeagler and a of $10,000 against W.M. Causey, pursuant to section 18(j)(4) of the Federal Deposit Insurance Act, 12 U.S.C. §1828(j)(4).

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

Dated at Arlington, Virginia, this of June 16, 1992.

/s/ James L. Rose
Administrative Law Judge