

{{10-31-02 p.A-3241}}

[¶5267] In the Matter of Charles F. Watts, Farmers Bank of Vine Grove, Vine Grove, Kentucky,
Docket Nos. 98-046e, 98-044k (8-6-02).

The FDIC Board adopted the conclusion of the administrative law judge and assesses both a Civil Money Penalty in the amount of \$304,000, and an Order to Prohibit based on evidence that the Respondent had willfully committed unsafe or unsound practices and breach of fiduciary duty and violated laws or regulations.

[.1] Regulation O—Extension of Credit—Related Interest

Respondent authorized unsecured extensions of credit to related interests to cover overdraft activity.

[.2] Cease and Desist Order—Insider Abuse

A Cease and Desist Order was issued based on findings of insider abuse through liberal and improper use of overdrafts, many violations of law and regulation, an unacceptable level of classified assets, lax underwriting standards, weak credit administration, and a decreasing level of capital.

[.3] Fund Manipulations and diversion of Loan Proceeds

Respondent concealed the use of loan proceeds for his own personal benefit resulting in losses to Bank.

[.4] Prohibition, Removal or Suspension—Misconduct

Respondent had numerous Regulation O violations as well as multiple violations of the Cease and Desist Order.

[.5] Prohibition, Removal or Suspension—Effects test, loss to Bank

The charge offs required because of misconduct resulted in a loss to the Bank.

[.6] Prohibition, Removal or Suspension—Culpability Requirement

The Board found that the Respondent had engaged in personal dishonesty and willful disregard to abnormal risk of loss or harm.

[.7] Civil Money Penalties (CMP)—Statutory Threshold

The statutory requirements for a CMP have been proven.

[.8] Civil Money Penalties (CMP)—Ability to Pay—Evidence of Wealth

Determination the CMP required consideration of the size of financial resources of the person charged. Respondent has refused to provide any information whatsoever regarding his financial condition. Since the Respondent refused to produce pertinent materials he is barred from challenging the assessment.

[.9, .13] Civil Money Penalties (CMP)—Punishment and Deterrent

The CMP of \$304,000 issued by the ALJ and upheld by the Board serves to both adequately punish the Respondent and create a deterrent to others, achieving the goals of the statute.

[.10] Admissions—Failure to Respond to Proceedings

All of the underlying factual allegations supporting the charges have been admitted by virtue of Respondent's failure to respond. Moreover, a default judgment would be appropriate because as a practical matter, the proceeding was uncontested.

[\[.11\]](#) Prohibition, Removal or Suspension—Bank Affairs, Conduct of Denied

[\[.12\]](#) Prohibition, Removal or Suspension—Voting rights, Exercise Denied
{10-31-02 p.A-3242}

In the Matter of
CHARLES F. WATTS,
individually, and as an institution-affiliated party of
FARMERS BANK OF VINE GROVE
VINE GROVE, KENTUCKY
(Insured State Nonmember Bank)
DECISION AND ORDER
TO PROHIBIT FROM
FURTHER PARTICIPATION
AND ASSESSMENT OF
CIVIL MONEY PENALTY

FDIC-98-046e

FDIC-98-044k

I. INTRODUCTION

This matter is before the Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC") following the issuance on May 1, 2002, of a Recommended Decision and Order by Administrative Law Judge Ann Z. Cook ("ALJ") ("Recommended Decision") granting FDIC Legal Division Enforcement Counsel's ("Enforcement Counsel") Motion for Summary Disposition and Assessment of Civil Money Penalty. For the reasons discussed below, the Board affirms the Recommended Decision, as supplemented, and issues an Order of Prohibition and Assessment of a Civil Money Penalty against Charles F. Watts ("Respondent" or "Watts").

II. PROCEDURAL BACKGROUND

The FDIC initiated this action on February 13, 2001, pursuant to sections 8(e) and 8(i)(2) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. §§ 1818(e) and (i)(2). A Notice of Intention to Prohibit From Further Participation, Notice of Assessment of Civil Money Penalty, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing ("Notice") was issued against Respondent, individually, and as an institution-affiliated party of Farmers Bank of Vine Grove, Vine Grove, Kentucky ("Bank").

Respondent in his role as president and a member of the Bank's board of directors, is charged with engaging in unsafe or unsound banking practices, breaches of fiduciary duty, and violations of laws, rules, and regulations, and a cease and desist order. The Notice cites many violations of Regulation O of the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), 12 C.F.R. part 215, violations of a 1998 cease and desist order ("Cease and Desist Order"), and unsafe or unsound banking practices including improper fund manipulations, failing to record or perfect security interests, renewing or restructuring loans in contravention of the Bank's policies and unauthorized withdrawal and diversion of borrower funds. Enforcement Counsel alleged that this conduct resulted in a gain to Respondent and a loss to the Bank and evidenced Respondent's continuing or willful disregard for the safety and soundness of the Bank.

Following the issuance of the Notice, the Respondent, in a March 7, 2001, letter to FDIC Associate Director John L. Lane, requested a hearing and submitted the following general denial of the charges outlined in the Notice: "I Charles F. Watts deny any wrong doings in the above mentioned matters." Two weeks later, on March 21, 2001, Enforcement Counsel, pursuant to sections 308.10, 308.11 and 308.19(b) of the FDIC Rules of Practice and Procedure ("Rules"), 12 C.F.R. §§ 308.10, 308.11 and 308.19(b), filed a Motion for Specific Responses to the Allegations of Fact in the Above-Captioned Cases, and that Respondent's Answers be Properly Served and Filed in Accordance with FDIC Rules of Practice and Procedure.

On April 3, 2001, the ALJ granted Enforcement Counsel's motion and issued an order ("April 3, 2001 Order") directing Respondent to respond specifically to the facts contained in the Notice as required under §308.19(b). The ALJ further ordered Respondent to properly file and serve his responses within 20 days from the issuance of the April 3, 2001 Order, in accordance with §§ 308.10–11.

In an April 20, 2001, letter to the ALJ, Respondent repeated his general denial but once again failed to provide specific responses as required by the Rules and the ALJ's April 3, 2001 Order. As was the case with his first general denial, Watts's April 20 letter was not filed and served in accordance with the Rules.

On May 3, 2001, Enforcement Counsel filed, pursuant to §308.19(b), a Motion to Declare as Admitted All Undenied Allegations of Fact in FDIC's Notice. Thereafter, on June 6, 2001, the ALJ issued an Order to Show Cause notifying Respondent that unless he showed good cause for not filing specific responses and filed such responses within 20 working days, the allegations in [{{10-31-02 p.A-3243}}](#)

the Notice would be deemed admitted. Watts replied by letter dated June 30, 2001, in which he generally denied the allegations but provided neither specific responses nor good cause. On July 13, 2001, the ALJ issued an Order Declaring as Admitted All Undenied Allegations of Fact ("July 13, 2001 Order").

On October 16, 2001, Enforcement Counsel, pursuant to section 308.25 of the FDIC Rules of Practice and Procedure, 12 C.F.R. §308.25, served on Respondent FDIC's First Request For Production of Documents To Respondent Charles F. Watts ("Document Request") to obtain for the civil penalty phase of this case information regarding Respondent's financial condition. On November 11, 2001, Enforcement Counsel received a one-page letter from Respondent stating that he had none of the documents that Enforcement Counsel had requested regarding certain corporate entities, that the FDIC already had his tax returns,¹ that he would agree to sign a prohibition order but not pay a civil penalty, and that he had been advised by legal counsel not to provide the requested information due to other matters involving the U.S. Department of Justice. Respondent's letter was not served and filed in accordance with §§ 308.10–11.

On November 27, 2001, Enforcement Counsel, pursuant to §308.25(f)(1), filed a Motion to Compel Production of Documents by Issuance of a Subpoena Compelling Production ("Motion to Compel"). Respondent did not respond to Enforcement Counsel's Motion to Compel. On December 10, 2001, the ALJ issued an Order Granting Motion to Compel ("Order to Produce") and a Subpoena Duces Tecum ordering Respondent to produce to Enforcement Counsel on December 20, 2001, documents responsive to the Document Request. Respondent produced no documents in response to the subpoena and Order to Produce.

Enforcement Counsel, on March 5, 2002, filed, pursuant to section 308.29(b) of the FDIC Rules of Practice and Procedure, 12 C.F.R. §308.29(b), a Notice of Motion and Motion for Summary Disposition and Assessment of Civil Money Penalty ("Motion for Summary Disposition"). In support of its Motion for Summary Disposition, Enforcement Counsel submitted a Memorandum of Points and Authorities, a Statement of Material Facts as to Which There is No Genuine Issue, and a sworn Affidavit of FDIC Examiner-in-Charge Donald K. Buford ("Buford Affidavit") and exhibits thereto. The same day, Enforcement Counsel also filed a Motion for Sanctions seeking an order prohibiting Respondent from offering evidence in opposition to the assessment of a civil money penalty ("CMP") or contesting a finding that he should be assessed a CMP in the amount of \$304,000.

In response, Respondent submitted a one-page letter dated March 6, 2002 ("March 6, 2002 Letter"), opposing the motions generally and requesting that the FDIC proceedings against him be suspended pending the resolution of a related criminal proceeding.² Respondent also stated in the letter that he was unable to pay a \$304,000 judgment and that he had been advised not to submit any information in this matter. Respondent's March 6, 2002 letter was not filed and served in accordance with §308.10–11.

On March 8, 2002, the ALJ issued an Order Accepting Letter as Motion to Stay ("March 8, 2002 Order") which stated that Enforcement Counsel could respond in accordance with section 308.23 of the FDIC Rules of Practice and Procedure, 12 C.F.R. §308.23. Pending resolution of Respondent's Motion to Stay, the ALJ lifted the deadline for Respondent to respond to Enforcement Counsel's Motion for Summary Disposition. On March 13, 2002, because Enforcement Counsel had not received a copy of Respondent's March 6, 2002 letter until March 11,³ ALJ Cook issued a related Order on Deadline for Response to Motion which provided that for purposes of responding to Respondent's March 6th letter, March 11th would be the effective date of service on Enforcement Counsel.

¹ The record in this proceeding does not include any of Respondent's tax returns or related documents.

² On February 4, 2002, in a six-count indictment in the United States District Court for the Western District of Kentucky, Respondent—in his role as president of the Bank—was charged with misapplication of bank funds and making false entries in bank records in violation of 18 U.S.C §§ 656 and 1005. A copy of the indictment is attached as Exhibit 4 to Enforcement Counsel's Response in Opposition to Motion to Stay.

³ Respondent did not serve the March 6, 2002 letter on Enforcement Counsel in accordance with §308.11. After receiving the ALJ's March 8, 2002 Order, Enforcement Counsel obtained a copy of the letter from the Office of Financial Institution Adjudication. [{{10-31-02 p.A-3244}}](#)

On March 21, 2002, Enforcement Counsel filed a Response in Opposition to Respondent's Motion for Stay of Proceedings. On March 25, 2002, the ALJ issued an Order Denying Stay and directing the Respondent to respond by April 12, 2002 to the pending motion for summary disposition. Respondent submitted nothing further in this matter.

On May 1, 2002, the ALJ issued the Recommended Decision and Order in which the ALJ concluded that Respondent's conduct warranted a prohibition order and a CMP in the amount of \$304,000. The ALJ found that Respondent had willfully committed unsafe or unsound practices and breaches of fiduciary duty and violated laws or regulations. R.D. at 4.⁴ In addition, the ALJ concluded that Respondent's misconduct had caused the Bank to suffer losses and prejudiced depositors' interests. *Id.* The ALJ further found Respondent's pattern of misconduct warranted a second tier CMP. *Id.* at 4–5. The ALJ also ruled that, based on Respondent's failure to produce documents in response to the Order and subpoena, sanctions were appropriate. *Id.* at 2–3. The ALJ included an Order granting sanctions ("Order on Sanctions") in the Recommended Decision. R.D. at 5. The ALJ also concluded that Enforcement Counsel was entitled to summary judgment because (1) no genuine issues of material fact were in dispute as all allegations of fact were deemed admitted by the July 13, 2001 Order, and (2) Enforcement Counsel had demonstrated through its points and authorities in support of Motion for Summary Disposition, the Buford Affidavit and other supporting materials, that a prohibition and second tier CMP were warranted. *Id.* at 3–4.

Neither party filed exceptions to the ALJ's Recommended Decision.

III. DISCUSSION

For the reasons set forth, the Board finds that the record contains substantial evidence supporting both an Order to Prohibit pursuant to section 8(e) of the FDI Act and the assessment of a CMP in the amount of \$304,000 pursuant to section 8(i) of the FDI Act. The Board, therefore, affirms and adopts the ALJ's Recommended Decision and agrees with the ALJ's determination that the facts alleged in the Notice and deemed admitted by the ALJ's July 13, 2001 Order form sufficient legal bases to impose a prohibition and to assess a CMP. R.D. at 4. The Recommended Decision is supplemented below by discussion of several matters.

A. Factual Summary and Conclusions of Law

Respondent was employed at the Bank and served as president, chief executive officer, and a member of the Bank's board of the directors from November 1, 1992, until he resigned on November 12, 1998. As such, Respondent was an "institution-affiliated party" of the Bank as defined in section 3(u) of the FDI Act, 12 U.S.C. §1813(u), and for purposes of sections 8(e)(7), 8(i) and 8(j) of the Act, 12 U.S.C. §§ 1818(e)(7), 1818(i) and 1818(j). S.F. ¶ 3, 4. During the relevant time period, the Bank was a corporation, existing and doing business under the laws of the Commonwealth of Kentucky, with its principal place of business at Vine Grove, Kentucky. The Bank is and was during the pertinent time period an insured state nonmember bank. S.F. ¶ 1.

This proceeding involves Respondent's activities at the Bank in the nearly two-year period between December 1996 and November 1998. During that time Respondent intentionally engaged in a series of transactions that constituted violations of Regulation O of the Federal Reserve Board, violations of the 1998 Cease and Desist Order, and other unsafe or unsound practices including fund manipulations and unauthorized diversions of loan proceeds.

[.1]1. Regulation O Violations

Respondent and his wife, Carolyn Watts, engaged in a number of business deals with Steven and Karen Welch ("Welches"). Their business interests included Westport Food Mart, Inc. ("Westport"), WE WA, Inc. ("WE WA") and W & W Rentals, Inc. ("WW"). S.F. ¶ 8. Respondent, his wife and the Welches were makers and guarantors of, and therefore personally liable for, nine extensions of credit to WE WA and WW at four other financial institutions located in Kentucky: ⁴ Citations to the record shall be as follows:

Recommended Decision — "R.D. at —"

Statement of Material Facts As To Which There Is No Genuine Issue — "S.F. ¶ —"

Affidavit of FDIC Examiner Donald K. Buford — "Buford Affidavit ¶ —" or "Buford Affidavit Exhibit at —" (referring to Bates stamped page numbers).

[{{10-31-02 p.A-3245}}](#)

First Citizens Bank, The Cecilian Bank, Republic Bank & Trust Company, and PNC Bank. S.F. ¶ 9a-d. To make payments on those loans Respondent authorized overdrafts on the Westport and WW demand deposit accounts ("DDA") at the Bank. S.F. ¶ 10a-d.

Regulation O governs the permissible lending relationships between a financial institution and its executive officers, directors, principal shareholders and their related interests. Regulation O prohibits a bank from making an extension of credit to one of the above-described categories of persons and related interests unless the extension of credit falls within limits permitted by the regulations. As an officer and director of the Bank, Respondent was an insider under Regulation O. 12 C.F.R. §215.2(h). For purposes of Regulation O, any transaction whereby an insider becomes obligated either directly or indirectly to pay money to his or her bank is an extension of credit to that insider. Regulation O provides that an extension of credit is considered to be made to an insider to the extent that the proceeds are transferred to the insider or are used for the tangible economic benefit of the insider. 12 C.F.R. §215.3(f). S.F. ¶ 10d.

Between December 30, 1996 and January 12, 1998, Respondent—to make payments on the above loans—authorized the final payment of 38 overdrafts on the Westport and WW DDA accounts. S.f. ¶ 10. The overdrafts were extensions of credit under 12 C.F.R. §215.3(a)(2). Because these overdrafts were used to amortize the debt that Respondent had personally guaranteed at the four other financial institutions, Respondent received an extension of credit subject to Regulation O. S.F. ¶ 9-10, 12.

To cover the overdraft activity in the Westport DDA, Respondent caused the Bank to extend credit to Westport and WE WA. On April 26, 1996, he caused the Bank to extend \$145,000 in credit to WE WA. S.F. ¶ 11. Of that amount, \$135,000 was used to pay down outstanding overdrafts in the Westport DDA. S.F. ¶ 11. The WE WA loan was to be secured by a third lien on the Westport collateral, but Respondent did not perfect the lien. S.F. ¶ 11. On June 27, 1997, Respondent caused the Bank to extend \$185,000 in unsecured credit to Westport once again for the purpose of reducing overdrafts in the Westport DDA. S.F. ¶ 12. Both of these loans were for Respondent's tangible economic benefit as the proceeds were used to pay off the overdrafts that funded payments on the loans guaranteed by Respondent at the four other institutions. S.F. ¶ 11-12. Respondent's unsecured extensions of credit to Westport and WE WA, which were not documented in a manner consistent with the Bank's loan policies and did not specify adequate repayment terms, violated one of the primary restrictions of Regulation O which prohibits loans on terms and conditions more favorable to insiders than to non-covered parties. 12 C.F.R. §215.4(a). S.F. ¶ 13.

Because of Respondent's conduct in connection with the Westport and WE WA extensions of credit, the Bank suffered a direct loss in the amount of \$303,777 in the following manner: \$184,777 of the \$185,000 loan to Westport was classified as a loss and charged off by the Bank during its January 1998 examination. Of the \$145,000 loan to WE WA, \$87,000 was adversely classified and written off as a loss during the bank's 1999 examination. S.F. ¶ 14. After the 1999 FDIC examination of the Bank, additional overdrafts of \$32,000 were uncovered in the Westport DDA and charged off as a loss. S.F. ¶ 15.

[.2].2 Violations of the 1998 Cease and Desist Order

Commencing on January 26, 1998, the FDIC conducted an examination of the Bank as of September 30, 1997 ("1998 Examination"). Buford Affidavit ¶ 5, Buford Affidavit, Exhibit 4. As a result of findings of the 1998 Examination, the Bank's board of directors stipulated to and the FDIC issued the Cease and Desist Order pursuant to section 8(b) of the FDI Act, 12 U.S.C. §1818(b), which became effective on

August 31, 1998. Buford Affidavit Exhibits 1 and 2. The Cease and Desist Order was based on findings at the 1998 Examination of insider abuse through liberal and improper use of overdrafts, many violations of law and regulation, an unacceptable level of classified assets, lax underwriting standards, weak credit administration, and a decreasing level of capital. The terms of the Cease and Desist Order precluded the Bank from permitting final payment on any demand item for any customer account which when aggregated with all other overdrafts of that customer would exceed \$5,000 unless such payment received

{{10-31-02 p.A-3246}}

prior approval of the Bank's board of directors. The Cease and Desist Order also prohibited the Bank from extending credit for the purpose of eliminating overdrafts. S.F. ¶ 16.

On July 29, 1998, Respondent opened a demand deposit account in the name of Joe and Gina Saltsman ("Saltsman DDA"). By September 9, 1998, the Saltsman DDA had a negative balance of \$3,084.58. S.F. ¶ 17. Between September 10 and October 5, 1998, Respondent, without the Bank board's prior approval and in direct contravention of the Cease and Desist Order, authorized the payment of 12 separate overdrafts on the Saltsman DDA which ultimately resulted in a negative account balance of \$36,865. As a result of Respondent's violation of the Cease and Desist Order and other fund manipulations associated with the Saltsman DDA, as detailed in paragraphs 30 through 38 of the Notice, the Bank was required to charge \$19,002 to its loan loss reserve. S.F. ¶ 17a-h. These transactions were discovered by the FDIC during an October 26, 1998 visitation to the Bank to assess compliance with the Cease and Desist Order. Buford Affidavit ¶ 5. On November 12, 1998, after Watts was confronted with the FDIC's findings, he resigned from the Bank. S.F. ¶ 3; Buford Affidavit ¶ 13(2).

[.3].3 Fund Manipulations and Diversion of Loan Proceeds

Respondent deceived Bank customers and manipulated their accounts by misappropriating loan payments and deposits; making unauthorized draws on lines of credit and then diverting those proceeds to various deposit and loan accounts; extending nominee loans and then redirecting those funds to other accounts, and otherwise concealing the use of loan proceeds for his own personal benefit. S.F. ¶ 19-51. Including the Nitschke loan conversion described by the ALJ in the Recommended Decision, R.D. at 4, three other customer relationships—the Cain, Saltsman and Casey DDAs and loans—which were directly linked to Respondent's misconduct, resulted in losses to the Bank totaling \$84,626. Each of the facts in connection with these activities, which are briefly described below, has been admitted. S.F. ¶ 19-47.

Cain Loan Proceeds Diversion: Between April 3 and August 3, 1998, Respondent engaged in a series of transactions among accounts in the names of David L. Cain, D.L. Cain Construction, Richard and Donna Pearman, Richard Pearman d/b/a Richie Built, and Georgia P. Furgeson. The transactions included fund manipulations and extensions of credit, which resulted in a \$44,837 loss to the Bank. S.F. ¶ 19-25.

Saltsman Funds Conversion and Repayment: From July 29 through November 12, 1998, Respondent engaged in a series of improper transactions involving the Saltsman DDA and two loan accounts at the Bank. The transactions involved a conversion of funds by Respondent combined with an unorthodox and suspicious repayment to the accounts, which caused a loss to the Bank in the amount of \$19,002.68. S.F. ¶ 30-38.

Casey's Plumbing & Pipe Funds Manipulation and Diversion: Between August 3 and November 12, 1998, Respondent manipulated and diverted funds from Casey's Plumbing & Pipe DDA which resulted in the loss of \$6,718 to the Bank. S.F. ¶ 39-47.

B. A Section 8(e) Prohibition is Warranted

As noted in the Recommended Decision, Enforcement Counsel—to meet its burden in a prohibition action—must show that Respondent engaged in prohibited conduct (misconduct), the effect of which was to cause the Bank to suffer financial loss or damage, to prejudice or potentially prejudice the Bank's depositors, or to provide financial gain or other benefit to the Respondent (effects). Enforcement Counsel must also demonstrate that such misconduct evidences personal dishonesty or a willful or continuing disregard for the safety and soundness of the Bank (culpability). 12 U.S.C. §1818(e)(1); R.D. at 3; *See In the Matter of Ramon M. Candelaria*, 1 FDIC Enforcement Decisions and Orders ¶ 5242, A-2837, A-2839 (1997); *In the Matter of Leuthe*, 1 FDIC Enforcement Decisions and Orders, ¶ 5249, A-2915, A-2961-2963 (1998), *aff'd*, 194 F.3d 174 (D.C. Cir. 1999). As discussed below, the Board finds that Respondent's

activities during the period from December 1996 through November 1998 overwhelmingly satisfy the three standards necessary to impose a prohibition.

[.4]1. **Misconduct**

First, Respondent's misconduct—multiple violations of Regulation O and the Cease and Desist Order, and unsafe or unsound practices and breaches of fiduciary duty—is well established by the record. The FDIC has interpreted "violations of law" as including violations of state lending or credit concentration restrictions as well as credit extended in violation of Regulation O. *In the Matter of Richard Robertson*, FDIC Enforcement Decision and Orders, ¶ 5211, A-2394, A-2399 (1994). In addition to the numerous Regulation O violations, Respondent's multiple violations of the Cease and Desist Order are well documented. S.F. ¶ 17a-h.

and Desist Order, and unsafe or unsound practices and breaches of fiduciary duty—is well established by the record. The FDIC has interpreted "violations of law" as including violations of state lending or credit concentration restrictions as well as credit extended in violation of Regulation O. *In the Matter of Richard Robertson*, FDIC Enforcement Decision and Orders, ¶ 5211, A-2394, A-2399 (1994). In addition to the numerous Regulation O violations, Respondent's multiple violations of the Cease and Desist Order are well documented. S.F. ¶ 17a-h.

The Board also finds that Respondent's activities in connection with the Regulation O violations, the violations of the Cease and Desist Order and the account manipulations and diversion of loan proceeds demonstrates unsafe or unsound conduct contrary to prudent practice which exposed the Bank to an abnormal risk or loss or harm. See *Landry v. FDIC*, 204 F.3d 1125, 1138 (D.C. Cir. 2000), *cert denied*, 531 U.S. 924 (2000); *VanDyke v. Board of Governors of the Fed. Reserve Sys.*, 876 F.2d 1377, 1380 (8th Cir. 1989). Respondent personally benefited from the transactions at the expense of the Bank's interests. In so doing, he committed a serious breach of his fiduciary duty to the Bank and its depositors. See *In the Matter of Ronald J. Grubb*, FDIC Enforcement Decisions and Orders, ¶ 5181, A-2006, A-2008 (1992), *aff'd on other grounds*, *Grubb v. FDIC*, 34 F.3d 956 (10th Cir. 1994); *Candelaria* ¶ 5242, A-2847.

[.5]2. **Effects**

The record also establishes satisfaction of the "effects" test. As a direct result of Respondent's activities, the Bank had to charge-off hundreds of thousands of dollars, including the \$304,000 in personal gain to Respondent as a result of the Regulation O violations. Moreover, the Bank suffered "other damage" within the meaning of 12 U.S.C. §1818(e)(1) in that a large part of Respondent's misconduct was a direct attempt by him to conceal from the Bank's board the financially troubled condition of Westport and WE WA. See *In the Matter of Tim M. Lane*, FDIC Enforcement Decisions and Orders, ¶ 5205, A-2333, A-2342 (1993). In addition, because a substantial portion of Respondent's misconduct involved the manipulation, conversion and diversion of funds from four Bank customer accounts, Respondent's conduct seriously prejudiced the interests of the Bank's depositors. See *Lane* ¶ 5205, A-2334 n.6; *In the Matter of Henry P. Massey*, FDIC Enforcement Decisions and Orders, ¶ 5204, A-2313 (1993).

As noted, Respondent received a direct benefit in the amount of \$304,000 attributable to the Westport and WE WA extensions of credit. *Buford Affidavit* ¶ 13(7). Moreover, a loan made in violation of law to an institution-affiliated party or his related interest, like those to Respondent, has been held to be a benefit in and of itself. See *Leuthe* ¶ 5249, A-2929; *In the Matter of Wayne Lowe*, FDIC Enforcement Decisions and Orders, ¶ 5153, A-1537 (1990), *aff'd*, 958 F.2d 1526 (11th Cir. 1992).

[.6]3. **Culpability**

The term "personal dishonesty" as it is used in 12 U.S.C. §1818(e)(1) has been held to mean "a disposition to lie, cheat, defraud, misrepresent, or deceive. It also includes a lack of straightforwardness and a lack of integrity." *In the Matter of Allan Hutensky*, 1 FDIC Enforcement Decisions and Orders, ¶ 5204, A-2566 (1995), *aff'd*, *Hutensky v. FDIC*, 82 F.3d 1234 (2nd Cir. 1996). The Board finds the record laden with instances of Respondent's deceitful behavior. His repeated Regulation O violations from which he received a direct personal gain and his many self-dealing and deceptive acts at the Bank including the authorization of overdrafts, fund manipulations and diversion of proceeds make Respondent's a symbol of personal dishonesty.

"Willful disregard" refers to that conduct which is practiced deliberately with full knowledge of the facts and risks, and which potentially exposes a bank to abnormal risk of loss or harm. "Continuing disregard" refers to that conduct which is voluntarily engaged in over time, with heedless indifference to the possible consequences. *Massey* ¶ 5204, A-2330; *In the Matter of Constance C. Cirino*, 1 FDIC Enforcement Decisions and Orders, ¶ 5261, A-3166 (2000). The Board finds that Respondent's conduct exemplifies

the "willful or continuing disregard" standard. He deliberately violated Regulation O and the Cease and Desist Order. Moreover, he manipulated, converted and diverted Bank funds that exposed the Bank to abnormal risk of harm and was contrary
{{10-31-02 p.A-3248}}

to prudent banking practices. Respondent's misconduct involves at least 80 incidents occurring over a period of nearly two years. S.F. ¶ 8-46. See, e.g., *Candelaria* ¶ 5242, A-2842 ("continuing disregard" found by two nominee loans over a period of six months); *In the Matter of Frank E. Jameson*, FDIC Enforcement Decisions and Orders, ¶ 5154A, A-1541, A-1542-1542.1, 1542.6, *aff'd*, *Jameson v. FDIC*, 931 F.2d 290 (5th Cir. 1991) (two incidents of falsifying loan records to hide self-serving transactions occurring within three months held to be "continuing disregard").

C. Assessment of a CMP Pursuant to Section 8(i) is Warranted

The Board finds, based on Respondent's undisputed misconduct described above, that a \$304,000 CMP is appropriate. The pertinent factors are briefly analyzed below.

[.7]1. Statutory Threshold

The FDIC sought a second tier CMP against Respondent which, as noted in *Leuthe*, is a remedy which requires two elements of proof: first, "misconduct," *i.e.*, either a violation of any law or regulation or final order, or breach of a fiduciary duty, or recklessly engaging in an unsafe or unsound practice in connection with the Bank, 12 U.S.C. §1818(i)(2)(B)(i); and second, "effects," *i.e.*, either a pattern of misconduct, or conduct which caused or was likely to cause more than minimal loss to the institution, or which resulted in a gain or benefit to the Respondent. 12 U.S.C. §1818(i)(2)(B)(ii). *Leuthe* ¶ 5249, A-2930. As set forth in the Recommended Decision, and in the discussion above related to the Order to Prohibit, the statutory requirements for a CMP have been proven.

[.8]2. Calculation of CMP

Because the statutory requirements authorizing the assessment of a CMP have been met, the appropriate amount of the penalty can be calculated. *Leuthe* ¶ 5249, A-2965. Using a straightforward analysis of Respondent's improper extensions of credit to Westport and WE WA, Examiner-in-Charge Buford determined that a Tier II CMP of \$304,000 should be assessed. Buford Affidavit ¶ 13-15. He arrived at this figure based on the amount the Bank suffered due to the charge-offs and the direct personal gain to Respondent⁵ as a result of these transactions as well as Respondent's ability to pay based on available materials. *Id.*⁶

As is evident from the record in this case, Examiner-in-Charge Buford considered the statutory mitigating factors found at 12 U.S.C. §1818(i)(2)(G), the 13-factor analysis found in the interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies, 45 *Fed. Reg.* 59,423 (Sept. 9, 1980) ("Interagency Policy"), and the financial gains and other benefits that accrued to Respondent as a result of his actions. R.D. 3-4; Buford Affidavit ¶ 12, 13. The Board notes, as a preliminary matter, that the Interagency Policy cited by Examiner Buford in his affidavit was updated in 1998, 63 *Fed. Reg.* 30,226 (June 3, 1998). The Board finds, however, that Examiner Buford's reliance on the earlier Interagency Policy is inconsequential because the 13 factors cited for consideration in determining a CMP assessment are virtually identical in both versions of the Interagency Policy. For purposes of this review, however, the Board applies the 1998 Interagency Policy.

In determining the amount of any penalty, section 8(i)(2)(G) of the FDI Act, 12 U.S.C. §1818(i)(2)(G), and section 308.132(b) of the FDIC Rules of Practice and Procedure, 12 C.F.R. §308.132(b), require consideration of the size of financial resources and good faith of the person charged; the gravity of the violations; the history of previous violations; and such other matters as justice may require.

As to the first mitigating factor, Respondent has steadfastly refused to provide any information whatsoever regarding his financial condition. He failed to respond to the ⁵ Rounded off to nearest thousand from losses totaling \$303,777.

⁶ Examiner-in-Charge Buford also found that a much higher CMP could have been assessed. The FDI Act authorizes a second tier CMP in the amount of \$27,500 per day for each day the violations, unsafe practices or breaches exist. Taking into consideration only the Regulation O violations with respect to the

Westport and WW DDAs, the Respondent authorized payment of 38 overdrafts during a 379-day period between December 30, 1996 and January 12, 1998. During a 26-day period between September 10, and October 5, 1998, Respondent authorized additional overdrafts in violation of the Cease and Desist Order. Based upon these violations, the FDIC would be entitled to assess a CMP of \$10,422,500 (379 days x \$27,500) for the first set of overdrafts and an additional \$715,000 penalty for violations of the Order (26 days x \$27,500) for a total of \$11,137,500. Buford Affidavit ¶ 11; See *Leuthe* ¶ 5249, A-2965. {{10-31-02 p.A-3249}}

FDIC's Motion to Compel, and he ignored the ALJ's subsequent Order to Produce and Subpoena for production of documents regarding his financial resources. R.D. 2; Buford Affidavit ¶ 15.

The FDIC has in its possession three self-certified financial statements for Respondent. One was included in the 1998 examination report and two he filed as a debtor with other financial institutions. According to those records, Respondent was born in July 1952 and had a stated net worth of \$737,919 as of February 4, 1997 (Buford Affidavit Exhibit 5), \$721,000 as of January 29, 1998 (Buford Affidavit Exhibit 4 at 02294) and \$152,305 as of May 18, 1999 (Buford Affidavit Exhibit 6). Buford Affidavit ¶ 14.

The Board finds that, given the age of these records, they are of limited probative value regarding his current financial condition. The Board notes, however, that Respondent has been made fully aware from the time that the Notice was issued in February 2001, that the FDIC was seeking the imposition of a \$304,000 CMP. Yet other than a general statement in his March 6, 2002 letter the ALJ claiming that he was unable to pay the assessed amount, Respondent has provided no evidence supporting his contention. Respondent ignore Enforcement Counsel's Document Request and the ALJ's Order to Produce and Subpoena directing him to provide materials relating to his current financial condition. Indeed, Respondent's continuing failure to produce any evidence regarding his ability to pay was the basis for the ALJ's Order on Sanctions issued in conjunction with the Recommended Decision which prohibited Respondent from contesting the CMP or challenging evidence offered by Enforcement Counsel in support of the assessed CMP. The Board finds that in view of Respondent's persistent refusal to produce pertinent materials, the ALJ was correct in issuing the Order on Sanctions. As such, the Respondent is barred from challenging the \$304,000 assessment.⁷

As for the "good faith" factor above, the continued violations and repeated misconduct by Respondent as well as his subsequent blatant disregard for the FDIC Rules and the ALJ's Orders, preclude a finding that Respondent acted in good faith. With respect to the gravity of the offenses, as is clear from the record, the violations not only resulted in losses to the Bank of hundreds of thousands of dollars, but also contributed largely to the Bank's significantly undercapitalized position. Buford Affidavit ¶ 9–10.⁸

Respondent's repeated history of misconduct is evident in the record. He has demonstrated a pattern of noncompliance with law and regulation and—by paying no attention to the Cease and Desist Order—an obvious disregard for the regulator's concerns. S.F. §8-59; Buford Affidavit §5, 9, 10, 13(2), 13(9), 13(13).

The last mitigating factor allows the consideration of other matters as justice may require in assessing a CMP. In this case, even after regulators identified Respondent's misconduct and the Cease and Desist Order was implemented, Respondent devised alternative schemes to conceal his self-dealing. For instance, Respondent used the Saltsman DDA to convert funds for his use and benefit. S.F. ¶ 16–18; Buford Affidavit ¶ 13(3), 30–38.⁹ Because Respondent failed to file exceptions to the Recommended Decision, he is now barred from challenging any aspect of the ALJ's Recommended Decision including the CMP assessment. *In the Matter of Chul Song*, FDIC Enforcement Decisions and Orders, ¶ 5214, A-2445 (1994); *In the Matter of Kevin L. Jensen*, 1 FDIC Enforcement Decisions and Orders, ¶ 5240, A-2808 (1996); *In the Matter of Raymond M. Phillips*, 1 FDIC Enforcement Decisions and Orders, ¶ 5232, A-2759 (1996) (Respondents' failure to file exceptions to the Recommended Decision pursuant to 12 C.F.R. §308.39 must be deemed a waiver of any objection to the ALJ's Recommended Decision). Thus, at this point in the proceeding, the ALJ's Order on Sanctions is subsumed by the Recommended Decision and this Final Decision and Order.

⁸ According to the report from the 1998 and 1999 FDIC Examinations, Respondent essentially controlled the Bank's board. His unchecked powers—particularly with respect to his lending practices—contributed significantly to the Bank's deterioration. Buford Exhibit 3 at 02103, 02126-02127, 02130, 02140; Buford Exhibit 4 at 02226-02228, 02232-02235.

⁹ In addition to the statutory mitigating factors, Examiner-in Charge Buford also considered the 13

factors contained in the Interagency Policy which are:

1. Whether the violation was committed with a disregard for the law or the consequences to the institution;
2. The frequency or recurrence of the violations and the length of time the violation has been outstanding;
3. The continuation of the violation after the Respondent became aware of it;
4. Failure to cooperate with the agency in affecting an early resolution of the problem;
5. Evidence of concealment of the violation or its voluntary disclosure;
6. Threat of or actual loss or other harm to the institution;
7. Evidence that participants or their associates received financial or other gain; or benefit or preferential treatment as a result of the violation;
8. Evidence of restitution by the participants in the violation;
9. A history of similar violations;
10. Previous criticism of the institution for a similar violation;
11. The presence or absence of a compliance program and its effectiveness;
12. The tendency to create unsafe or unsound banking practices or a breach of fiduciary duty; and
13. The existence of agreements, commitments or orders intended to prevent the subject violations.

Examiner-in-Charge Buford found that none of the 13 factors favored the Respondent and, as such, saw no reason to justify any reduction in the assessment sought. Buford Affidavit ¶ 13. See *Leuthe* ¶ 5249, A-2966. [{{10-31-02 p.A-3250}}](#)

[.9]3. *The Amount Assessed is Appropriate and Consistent with Policy Goals*

A CMP serves two basic policy goals—(1) to adequately sanction an offender, and (2) to create a deterrent to others who may consider engaging in improper activities. See Interagency Policy; *Leuthe* ¶ 5249, A-2931. The Interagency Policy also advises that in cases where the wrongdoer has financially benefited from his misconduct, removal of the economic gain may be insufficient by itself to promote the statutory goals behind CMP assessments.

In this case, where the amount of the CMP assessed is essentially equal to the amount of Respondent's gain, the Board concludes that a civil penalty in excess of \$304,000 would have been justified. However, Enforcement Counsel did not file an exception to the amount assessed and has, in fact, from the inception of this proceeding sought a \$304,000 CMP. Thus, after considering the complete record herein, the Board declines to increase the CMP assessment. Likewise, in light of Respondent's failure to cooperate with the regulators in discontinuing his violations, and the benefit he derived from his wrongdoing, the Board finds no mitigating factors that would warrant a lower assessment. As such, the Board finds that the CMP imposed will adequately achieve the goals of the statute.¹⁰

In addition, the Board agrees with the ALJ that the factors raised in Respondent's March 6, 2002 letter are wholly without merit. Respondent has openly disregarded the ALJ's clear requirements for participation in this proceeding. Under the circumstances, it appears that Respondent has consciously opted not to take part in this action even after he has been given numerous opportunities to do so. Thus, his claim, in the March 6, 2002 letter that "there are numerous allegations which can be proven not to be the total facts" is unsustainable because all of the facts alleged in the Notice were deemed true by the ALJ's July 13, 2001 Order. R.D. at 4. Similarly, Respondent was barred by the ALJ's Order on Sanctions from raising issues regarding the CMP assessment. R.D. at 4. Thus, for the reasons discussed above and because Respondent has produced no evidence demonstrating that he is unable to pay the amount

sought, the Board finds no reason to disturb the ALJ's \$304,000 CMP assessment.¹¹

IV. CONCLUSION

[.10] After a thorough review of the record in this proceeding, and for the reasons set forth above, the Board finds that an Order of Prohibition and the Assessment of a CMP in the amount of \$304,000 are warranted against the Respondent. A hearing in this case is not necessary to render a decision on the merits.¹² All of the underlying factual allegations¹⁰ The Board notes too that Respondent will likely be subject to criminal penalties as a result of his indictment in the Western District of Kentucky. See n. 2.

¹¹ The Board notes too that Respondent's ability to pay a CMP is not limited by his present financial condition. See *Leuthe* ¶ 5249, A-2931. Moreover, given Respondent's current age of 50, there is no reason to believe that his future earning potential will not support the CMP assessed. See *Id.*; *Raney v. Honeywell*, 540 F.2d 932, 936 (8th Cir. 1976).

¹² The Board does not have to reach this issue but the record also supports a conclusion that a default judgment would be appropriate in this case because, as a practical matter, this is an uncontested proceeding. Although Respondent had, at several points during the course of this proceeding, written letters to ALJ Cook in response to the Notice and the pleadings filed by Enforcement Counsel, he repeatedly and inexcusably failed to respond to the charges against him in accordance with the FDIC Rules of Practice and Procedure. Significantly even though the ALJ directed him to do so and provided him with additional time to respond, Respondent did not, as required by FDIC Rule 19(b), respond with specificity to the charges in the Notice. He also failed, in flagrant disregard of the ALJ's repeated Orders, to file and serve his answer and other responsive pleadings in accordance with FDIC Rules 10 and 11. Respondent's conduct clearly demonstrates an intentional disregard of, or willful failure to follow, the FDIC's procedural requirements. As such, a default judgment would be warranted. *In the Matter of Raymond M. Phillips* ¶ 5232, A-2759 (1996); *In the Matter of Hiram L. Fong*, 1 FDIC Enforcement Decisions and Orders, ¶ 5230, at A-2749 (1995), *Cirino* ¶ 5261, A-3127. Such defaults constitute a consent to entry of an order of prohibition as well a CMP assessment. *Id.*; *In the Matter of Kevin L. Jensen* ¶ 5240, A-2807, A-2808 (1996).
{{10-31-02 p.A-3251}}

supporting the charges in the Notice have been admitted by virtue of Respondent's failure to respond and the ALJ's July 13, 2001 Order. In addition, the fully admitted charges are sufficient to sustain an Order of Prohibition and the Assessment of a \$304,000 CMP. Thus, the ALJ properly found that summary disposition is appropriate. 12 C.F.R. §308.29(a); R.D. at 5.

In this case, the record plainly shows that, time and again, Respondent ignored the law and regulatory directives with respect to his operation of the Bank. Instead, in a clear abuse of his role as president and a member of the Bank's board of directors and in violation of federal law and regulation and the Cease and Desist Order, Respondent defrauded the Bank and its customers to prop up his own failing business interests. In fact, Respondent took his scheme as far as he could go with it and only stopped when he was compelled to resign from the Bank. Moreover, Respondent has further signaled a general disdain for the FDIC's regulatory authority by his intransigence in the face of the ALJ's Orders. In view of Respondent's repeated transgressions and his propensity for disregarding the regulators, the Board is persuaded that he should be permanently barred from the banking industry. Moreover, in light of the entire record, the Board finds the CMP imposed to be an appropriate amount and one which is consistent with the statute's intended effects.

Based on the foregoing, the Board concurs in and adopts by reference the findings of fact and conclusions of law in the Notice, the FDIC's Statement of Material Facts as to Which There is no Genuine Issue and the Buford Affidavit; affirms the Recommended Decision of the ALJ as supplemented; and issues the following Orders implementing its Decision.

ORDER TO PROHIBIT

The Board of the FDIC, having considered the entire record of the proceeding and finding that Respondent, Charles f. Watts, an officer and director of the Bank, violated laws and regulations, engaged in unsafe or unsound banking practices, violated a cease and desist order, and breached his fiduciary duty, causing financial loss to the Bank and resulting in personal benefit to him, and that said actions involved personal dishonesty and willful and continuing disregard for the safety and soundness of the

Bank, it is hereby ORDERED and DECREED that:

[.11]1. Charles F. Watts shall not participate in any manner in any conduct of the affairs of any insured depository institution, agency or organization enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. §1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate federal financial institutions regulatory agency as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. §1818(e)(7)(D).

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

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

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

5. This ORDER shall be effective thirty (30) days from the date of its issuance.
[{{10-31-02 p.A-3252}}](#)

ORDER TO PAY CIVIL MONEY PENALTY

The Board, having considered the entire record in this proceeding, taking into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of Respondent, the gravity of the violations and such other matters as justice may require, it is hereby ORDERED and DECREED that:

[.13]1. A civil money penalty is assessed against Respondent Charles F. Watts in the amount of \$304,000 pursuant to 12 U.S.C. §1818(i).

2. This ORDER shall be effective and the penalty shall be final and payable thirty (30) days from the date of its issuance.

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

IT IS FURTHER ORDERED that a copy of this Decision and Order to Prohibit From Further Participation and Assessment of Civil Money Penalty shall be served on Charles F. Watts, Enforcement Counsel, the ALJ, and the Commissioner, Department of Financial Institutions for the Commonwealth of Kentucky.

By the direction of the Board of Directors.

Dated at Washington, D.C., this 6th day of August, 2002.