UNITED STATES OF AMERICA
Before The
OFFICE OF THRIFT SUPERVISION
DEPARTMENT OF THE TREASURY

In the Matter of	
JOHN W. JOHNSON, JR. President and Chairman of the Board of Directors,	Case No. OTS AP 93-53 Dated: June 18, 1993 OTS Order No. AP 95-17 Dated: March 16, 1995
ROBERT L. JOHNSON, Director, Vice President and Chief Financial Officer,	
and R. TERRY TAUNTON, Director, of	
Charter Federal Savings and Loan Association, West Point, Georgia	

DECISION AND ORDER

TABLE OF CONTENTS

DECISION

I. INTRODUCTION AND SUMMARY OF CONCLUSIONS

This case presents the question of when a director may pursue a transaction in the name of the savings association but for the personal benefit of the director. In this case, the three Respondents -- John W. Johnson, Jr. ("Johnson"), Robert L. Johnson (Johnson's son) and R. Terry Taunton (collectively, Respondents) -- and other directors (who have since settled claims against them) decided to pursue an appeal and other means of relief after the Federal Home Loan Bank Board (the "Bank Board" or "FHLBB")[1] denied Charter Federal Savings and Loan Association's, West Point, Georgia ("Charter") application to engage in a voluntary supervisory conversion. Because the appeal (which Charter's attorneys advised against) and other activities intended to reverse the Bank Board's decision would have been of benefit to Respondents and other insiders and not to Charter or its depositors, the Acting Director concludes that the decision to pursue post-denial relief at the institution's expense was an unsafe and unsound practice, a breach of fiduciary duty, and a violation of 12 C.F.R. § 563b.31. The Acting Director orders Respondents to make restitution to Charter in the amount of $139,039. The Acting Director has determined not to impose any civil money penalties in this proceeding.

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[1] The Bank Board is the predecessor agency to the Office of Thrift Supervision ("OTS"). The OTS is the "appropriate Federal banking agency" with regard to Charter and Respondents. 12 U.S.C. § 1813(q), 1818(i)(3).

II. BACKGROUND

A. Description of the Charges and Summary of Administrative Proceedings

On June 18, 1993, pursuant to sections 8(b) and (i) of the Federal Deposit Insurance Act ("FDIA"), as amended by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 ("FIRREA") (12 U.S.C. § 1818(b) and (i) (1988 & Supp. II 1990), OTS Enforcement ("Enforcement") filed a Notice of Charges and Hearing for an Order to Cease and Desist and to Direct Restitution against Respondents and Notice of Assessment of Civil Money Penalty against Johnson ("Notice"). The Notice alleged that the three Respondents violated 12 C.F.R. § 563b.31 and engaged in an unsafe and unsound practice when they authorized Charter's continuing payment of expenses to seek a reversal of the Bank Board's denial of Charter's application for a voluntary supervisory conversion. The Notice also alleged that Respondents' conduct constituted a breach of fiduciary duty and a conflict of interest. The Notice sought a cease and desist order against Respondents, as well as restitution to or reimbursement of Charter. Respondent Johnson also was assessed a civil money penalty in the amount of $306,000.

Respondents filed a timely answer to the Notice and requested a hearing. On January 19, 1994, through January 26, 1994, an administrative hearing was held in LaGrange, Georgia before an Administrative Law Judge ("ALJ"). The parties filed post-hearing proposed findings of fact, conclusions of law, memoranda of law, and reply briefs.

The ALJ issued a Recommended Decision and Order on September 15, 1994. Both parties filed exceptions thereto as well as additional memoranda and replies. On December 9, 1994, the parties were notified that the ALJ's Recommended Decision had been submitted to the Acting Director for final decision. On March 9, 1995, the Acting Director extended the deadline for issuing the Final Decision and Order to March 17, 1995. OTS Order No. AP 95-12.

B. Summary of the ALJ's Recommended Decision

The ALJ concluded that Respondents should be subject to a cease and desist order, and make restitution in the amount of $139,039. In addition, the ALJ found that Johnson should be assessed a civil money penalty in the amount of $133,920.

The ALJ concluded that Respondents committed unsafe or unsound banking practices, breaches of fiduciary duty and a violation of 12 C.F.R. § 563b.31 in approving Charter's expenditure of funds to appeal the denial of the voluntary supervisory conversion, which the ALJ characterized as "an attempt by Respondents to gain control of the bank and to harvest huge personal benefits at the bank's expense." Recommended Decision at 3. The ALJ determined that Respondents had been advised by the regulators that it was unlikely that Charter qualified for a voluntary supervisory conversion and advised by counsel and others that the likelihood of success on appeal of the Bank Board's denial of Charter's voluntary supervisory conversion application was remote at best. Coupled with evidence indicating that Respondents were seeking control of

the Association, and that Respondents would personally benefit substantially from a voluntary supervisory conversion, the ALJ concluded that Respondents had both committed an unsafe or unsound practice and breached their fiduciary duties to Charter.

The ALJ further determined that Respondents violated the expense provision of the voluntary supervisory conversion regulation codified at 12 C.F.R. § 563b.31, which requires that expenses incurred by a savings association in connection with a voluntary supervisory conversion be "reasonable." During Charter's conversion attempt, Bank Board supervisory personnel expressed concerns over the amount of Charter's voluntary supervisory conversion expenses in general because the institution's operating income was low. The ALJ determined that the ability of an association to incur conversion expenses without potential or actual injury is a factor to consider in determining prudent costs, as well as whether the acquirors defrayed the costs or, alternatively, forced the institution to bear the burden. The ALJ concluded that the expenses incurred by Charter at Respondents' direction were unreasonable and thus Respondents violated 12 C.F.R. § 563b.31. Accordingly, the ALJ determined that the requirements for a cease and desist order had been satisfied.

In assessing whether the OTS was entitled to affirmative relief under 12 U.S.C. § 1818(b)(6), the ALJ found that Respondents were unjustly enriched by requiring Charter to bear virtually all of the expense of the voluntary supervisory conversion, where it was Respondents -- instead of Charter -- who would have benefitted

significantly from the voluntary supervisory conversion. For the same reasons, the ALJ also concluded that Respondents acted with reckless disregard of the expense regulation. He thus determined that restitution was appropriate in the amount of $139,039. The ALJ arrived at the restitutional amount by calculating the difference between total post-conversion expenses of $258,715 (the amount offered by Charter's expert, which the ALJ concluded was unrefuted by the OTS) and money paid to Charter via settlement of charges against other directors pursuant to settlement agreements (totalling $119,676).[2]

The ALJ also recommended assessment of a second tier civil money penalty based on his conclusion that Respondent Johnson caused a violation of law and breached his fiduciary duty by causing the institution to pursue and bear the cost of the post-denial expenses. He calculated 372 days of violation at $1000 for a total of $372,000, prior to adjustments. After taking into account adjustments and mitigating factors, the ALJ determined the appropriate net civil money penalty should be $133,920.

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[2] While the ALJ opined that the costs of litigating an administrative proceeding might be appropriately assessed in some cases, he decided that Enforcement's litigation costs should not be assessed against the Respondents in this proceeding. The ALJ suggested that these matters be addressed through public rulemaking. Enforcement has not excepted to this portion of the Recommended Decision, and the Acting Director accepts the recommendation of the ALJ not to assess litigation costs herein.

C. Exceptions to the Recommended Decision

Respondents excepted to virtually all of the ALJ's findings and conclusions. In particular, they charge: (1) that the ALJ's conclusion that Respondents would have obtained a "windfall" upon consummation of a voluntary supervisory conversion was in error, as evidenced by, among other things, the ALJ's failure to make a valuation finding based on the market value of the converting association's stock, as well as his refusal to admit certain of Respondents' evidence on valuation; (2) that the right to appeal necessarily encompasses the payment of the costs of the appeal; (3) numerous factual and legal arguments including, among other things, mootness, reliance on advice of counsel, ratification, and full or partial release; and (4) constitutional and statutory violations in connection with the assessment of the civil money penalty, OTS witness testimony and alleged ex parte communications between Enforcement and the ALJ's attorney advisor.

Enforcement excepted to the ALJ's reduction of the civil money penalty assessed against Johnson, arguing that it should be increased in accordance with the guidelines established in In the Matter of Rapp, OTS Order No. AP 92-148 (December 4, 1992). Specifically, Enforcement takes exception to the per day starting amount used by the ALJ, and the ALJ's netting of the aggravating factors to reduce the starting amount of the civil money penalty. In addition, Enforcement argues that the ALJ made an arithmetic error in his own calculations in the amount of $111,600.

III. FINDINGS OF FACT

A. Background

Charter is a federally chartered mutual savings association that maintains its principal place of business in West Point, Georgia. Johnson was the Chairman of the Board of Directors, President and General Counsel, Robert Johnson was a Vice President and Director, and Taunton was a director of Charter at all relevant times.[3]

In December 1984, Charter sold a substantial loan portfolio -- consisting of low-yielding, fixed rate mortgages -- which caused Charter to record a loss in excess of $5 million. Under Generally Accepted Accounting Principles ("GAAP"), Charter was rendered insolvent by $3.5 million. Despite this insolvency, Charter was able to meet its regulatory capital requirements except for the fiscal year ending September 30, 1985.[4]

From 1984 through 1988, Charter acquired a substantial position in stock of the Federal Home Loan Mortgage Corporation ("FHLMC"), commencing with an initial dividend from the Federal Home Loan Bank of Atlanta ("FHLB-Atlanta") of 3580 shares. Thereafter, Charter began accumulating FHLMC stock in significant amounts and by January 1, 1988, Charter held 150,000 shares.

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[3] Respondents are institution-affiliated parties. 12 U.S.C. § 1813(u).

[4] Charter was GAAP insolvent from at least December 28, 1988 through August 3, 1989. On or about September 1989, Charter corrected its GAAP insolvency.

At that time, the trading restrictions on FHLMC stock were such that thrifts were the primary entities permitted to own FHLMC stock. During or about the summer of 1988, Johnson, Robert Johnson and others worked actively to have the trading restrictions on the Freddie Mac stock lifted.

On July 13, 1988, the Bank Board, sitting as the board of directors of the FHLMC, approved a resolution that lifted certain trading restrictions on FHLMC stock, so that effective January 1, 1989, any interested investor could acquire FHLMC stock. To that end, on August 30, 1988, the FHLMC authorized an exchange offer under which FHLMC stockholders were offered four shares of a new class of freely transferable senior participating preferred stock ("Freddie Mac stock") in exchange for each share of existing FHLMC stock and a cash contribution of $7 per share of existing FHLMC stock.[5] Pursuant to the four-for-one stock split, Charter exchanged its FHLMC stock for the new Freddie Mac stock. Afterwards, Charter held approximately one million shares of Freddie Mac stock, at an average cost basis of approximately $20 per share. As a result of the removal of the trading restrictions, the value of Charter's FHLMC stock holdings increased to a level which, if the FHLMC stock had been liquidated, Charter no longer would have been insolvent on a GAAP basis.

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[5] By August 30, 1988, Charter held approximately 250,000 shares of FHLMC stock.

B. Charter's conversion application

In early 1988, while Respondents were seeking to eliminate the trading restrictions on the Freddie Mac stock, Respondents were also considering a voluntary supervisory conversion of Charter.[6] Charter hired the law firm of Huggins and Associates to provide advice and representation in connection with a proposed voluntary supervisory conversion of Charter, including preparation of the necessary application materials.

Immediately before the trading restriction was lifted, Charter's counsel requested that FHLB-Atlanta permit Charter to convert by means of a voluntary supervisory conversion, proposing that the institution be purchased by Johnson "and others" for an amount to be determined upon the results of an appraisal of the association.[7] FHLB-Atlanta responded on August 2, 1988, that Charter did not qualify for a voluntary supervisory conversion because: (1) the institution was not actually insolvent, and (2) taken as a whole, the conversion would not be in the best interests of Charter's members. Because the Freddie Mac stock then had a market value in excess of $9 million, and a voluntary supervisory conversion would deprive the account holders of their interest in the association, the FHLB-Atlanta concluded that a voluntary supervisory conversion would be inequitable. By letter dated

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[6] The requirements for a voluntary supervisory conversion are set forth below at section V. A. Such a transaction, which is designed to infuse capital into a failing institution, requires no appraisal of the institution.

[7] The record does not reflect that such appraisal was performed.

August 24, 1988, after their services had been terminated, the Huggins firm informed Johnson that it believed Charter had other conversion options which would be "much more palatable to the regulatory authorities and will enjoy much quicker approval and processing." (GX 3).

In or about August 1988, Johnson retained Ronald Snider ("Snider") of the law firm Miller, Hamilton, Snider & Odom of Mobile, Alabama to advise whether Charter should continue to pursue a voluntary supervisory conversion. The Miller firm advised Charter that they believed that the FHLB-Atlanta's position was incorrect. On September 15, 1988, Respondents and Charter's other directors authorized Snider to pursue a voluntary supervisory conversion and file an application thereto on Charter's behalf.[8]

On December 28, 1988, Charter filed an application with the Bank Board in Washington to convert via a voluntary supervisory conversion. The application proposed that Charter would sell 90,000 shares to insiders, including Respondents, at $50 per share for a total purchase price of $4.5 million. At that time, Charter's Freddie Mac stock was worth approximately $48 million.

Respondents and the other insiders intended to sell the appreciated Freddie Mac stock if the conversion application was

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[8] Around this time Snider and his firm became involved in an effort to have legislation passed by Congress to enable Charter to convert by means of a voluntary supervisory conversion without consideration of Charter's large FHLMC portfolio. On October 22, 1988, the U.S. Senate issued Senate Resolution 514 that expressed the view that a GAAP insolvent institution should be permitted to convert by means of a voluntary supervisory conversion "without regard to any factors relating to the appreciation in market value" of FHLMC stock.

approved, and replace the stock with "higher yielding loans, investments and mortgage-backed securities." (SX 3 at 5256). Respondents and Charter's other insiders had arranged for Colonial Bank to finance their purchase of Charter's stock, using Charter's stock as collateral.

After the application was filed, the Bank Board issued three comment letters to Charter expressing serious concerns about the propriety of the proposed voluntary supervisory conversion. Charter filed five separate amendments to the voluntary supervisory conversion application; amendment no. 4 made substantive changes to the original conversion proposal which effectively incorporated some of the protections afforded in a standard conversion. Shortly before the fourth amendment was filed, Johnson explained his purpose in a letter:

> Let me make it clear. I am not interested in a conversion merely for the sake of a conversion. **We must maintain control of the Association.** My family's contribution to Charter must be fairly recognized. If a conversion is on such basis that we would be better off to remain a mutual, we will remain a mutual. The proposal outlined in the attached memo is our final step. There is no room left for compromise. If this doesn't work, we will either sue the Board or remain a mutual.

(GX 8 at 4106)(emphasis added). Pursuant to the amended conversion plan, Charter proposed to raise the offering price to $7.5 million (for a total of 150,000 shares) and, although the voluntary supervisory conversion regulations did not so require, proposed to

open up the offering to all of Charter's members.[9] Under the amended plan, 35% of the stock would be offered to the directors, and 65% would be offered to the other depositors.

However, individual depositor purchases were to be constrained in several respects. Under the amended plan, no individual depositor could purchase more than 3.25% of the total offering, and each member wishing to purchase shares had to buy at least 20 shares, for an aggregate price of $1000.[10] Moreover, the offering would only remain open for 20 days, which was functionally shortened by the fact that checks in payment for subscriptions must have cleared prior to the expiration of the 20 day period; and no provision was made to allow depositors to withdraw funds from their accounts without penalty to pay for their stock purchases.

In contrast, of the 35% of the stock to be offered first to the directors, Johnson and Robert Johnson would each purchase 9.9% of the total stock to be offered; and Taunton would be permitted to acquire approximately 2.5% of the total stock to be offered. The amended conversion plan also provided that the insiders would be able to purchase all unsubscribed shares. If there were still unsubscribed shares remaining, 10% of such shares would be purchased by an ESOP.

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[9] This revision was apparently undertaken in response to Bank Board staff's concerns that given the unrealized value of the Freddie Mac stock, it would have been inequitable to exclude the depositors from participation in the conversion.

[10] This provision was later revised by Amendment No. 5 to permit each depositor to acquire only 10 shares for minimum of $500, and be allowed to purchase up to 5% of the total offering.

If shares continued to be available, Johnson family members (John W. Johnson III and Curti M. Johnson -- sons of Respondent Johnson) would be permitted to each purchase up to 7.1% of the total shares offered. Thereafter, Johnson and Robert Johnson would each be allowed to purchase 28.29% of the remaining shares; Taunton and five of the remaining directors could purchase 7.14% of the remaining shares, and the other director and a Charter employee each would be entitled to purchase .29% of the remaining shares.

On June 30, 1989, the date that Charter filed its final amendment to the voluntary supervisory conversion application, Freddie Mac stock opened the day trading at $71.50 per share. Because of this increase, there was a substantial unrealized gain that did not appear on Charter's balance sheet.

On August 3, 1989, the Bank Board issued Resolution No. 89-2215 denying Charter's voluntary supervisory conversion application on the grounds that: Charter had a positive equity; the transaction was not in the best interests of, and presented the possibility of injury to, the institution, its account holders and the FSLIC; the Bank Board was unable to issue a tax certification on the proposed transaction; and the financial condition and integrity of the acquirors was such that the proposed transaction might jeopardize Charter's financial stability and was not in the best financial interest of Charter, its depositors, the public or the FSLIC.

On August 24, 1989, the Miller firm prepared a memorandum that concluded, for a number of reasons, that should Charter seek review of the Bank Board's decision in the Eleventh Circuit, the

likelihood of success would be remote. On August 30, 1989, the Miller firm recommended that Charter not pursue an appeal.

On September 5, Charter's directors held a special meeting of the board to discuss options in light of the denial of the voluntary supervisory conversion. Respondents and Charter's other directors were provided with and reviewed a copy of the August 24 memo.[11] Charter's board resolved that Johnson be delegated authority as Charter's general counsel to determine whether an appeal should be pursued and that the board would support him if he decided to pursue an appeal.

On September 11, 1989, Johnson filed the petition for review. On the same day, Charter's outside counsel filed a request for reconsideration with the OTS. OTS later denied the reconsideration request.

At that time, Respondents believed Charter's appraised value substantially exceeded $7.5 million. In a memorandum documenting a telephone conversation with OTS staff in October 1989, Johnson notes that he informed OTS staff that:

> a standard conversion simply did not conform, was not practical for our situation. I then ran through the scenario where if we had an appraisal the appraisal would be at least some $35 to $40 million. We would then have to raise another $35 to $40 million and that was just completely out of the question in this area.

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[11] Johnson also concluded in a memorandum dated September 5, 1989, that the prospects for a successful appeal were "very limited." (SX 28).

(SX-33 at 7013). Following the Bank Board's denial of the application, Snider (by letter dated November 10, 1989) proposed that Charter agree to acquire an insolvent institution in exchange for the OTS's approval of the voluntary supervisory conversion. By letter dated December 11, 1989, the Chief Counsel of the OTS responded that the agency would be unable to recommend approval of the voluntary supervisory conversion under the proposed terms.

On December 26, Charter's directors, as individual petitioners and on behalf of Charter, filed their brief in the Eleventh Circuit appeal.

On February 8 and 9, 1990, approximately one year after Charter filed the voluntary supervisory conversion application, Charter held a vote of the depositors on the voluntary supervisory conversion. The proxy statement filed in connection therewith states that "Charter Federal is requesting that its members vote on two issues at the Special Meeting: (1) to direct the Board of Directors regarding whether Charter Federal should continue to pursue the voluntary supervisory conversion (the "Conversion") which it first undertook approximately 18 months ago, and (2) to approve the expenses incurred by Charter Federal to date in the pursuit of the Conversion." (SX 39 at 2). The depositor vote was not tabulated until May 25, 1990. Approximately ninety-seven per cent of the votes were cast in favor of approving pursuit of the

voluntary supervisory conversion as well as Charter's payment of expenses incurred therewith.[12]

On October 2, 1990, the Eleventh Circuit upheld the Bank Board's denial of Charter's conversion application on the grounds that the proposed conversion would not be in the best interests of, and presented potential injury to, Charter, its members and the FSLIC. Charter Fed. Sav. and Loan Ass'n v. OTS, 912 F.2d 1569 (11th Cir. 1990). The Court concluded that if the Bank Board had approved the voluntary supervisory conversion, Charter would have received only $7.5 million in exchange for an institution with assets worth more than $50 million, and Charter would have faced the likely post-conversion depletion of its assets. The Court also determined that the structure of the proposed conversion discouraged depositor participation in the conversion, to the benefit of the insiders. The Court further found that the financial condition of the Respondents and the other insiders might jeopardize Charter's stability as the proposed acquisition was to be consummated with borrowed money, to be repaid through expected profits.

C. Post-Denial Expenses

On more than one occasion in 1989, OTS supervisory personnel raised questions concerning the expenses Charter incurred in

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[12] The OTS reviewed Charter's proxy statement before it was disseminated but did not attend the meeting. The proxy statement did not reflect that Charter's counsel had advised against appealing the denial of the voluntary supervisory conversion application. Nor did the proxy statement separately identify the expenses incurred to seek a reversal of the Bank Board's denial of the application.

connection with the conversion attempt and the appeal. By letter to Charter dated May 31, 1989, Supervisory Agent Deborah Beals expressed her concerns over the increase in conversion related expenses and its negative effect on the association's operating income. The letter reports that the Bank Board believed that the cost of the voluntary supervisory conversion should be shared by the acquiring group.

These concerns were repeated in both the 1989 and 1990 reports of examination. The 1989 Report of Examination, dated May 31, 1989, states that: "[f]or the 12 months ended May 31, 1989, the institution incurred $427,277 in expenses related to the VSC. Supervisory Agent Deborah Beals has informed the board that these expenses should be shared by the acquiring group." (SX-10 at 2708). The 1990 Report of Examination repeats these points and notes Johnson's agreement, rendered in response to the OTS's concerns about the conversion costs, that the "expenses incurred in pursuing the appeal had gotten out of hand." (GX 26 at 12-13).[13]

Charter's year-end audit for the period September 30, 1989 and September 30, 1990, prepared and certified by the accounting firm of King, Ninas and Company, of which Respondents' accountant Russell Ninas ("Ninas") was a principal, reflects that Charter

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[13] Since that time, Charter has recouped some of these expenses. Payments received by Charter from other directors pursuant to settlement agreements with OTS in this case total $119,676. The only evidence of a payment by Respondents reflected in the record is a payment by Johnson in the amount of $12,400 for an amicus brief filed with the Eleventh Circuit, although this expense is not included in the various calculations of the conversion-related expenses paid by Charter.

incurred $320,971 in conversion expenses after the denial of the voluntary supervisory conversion application. At Charter's request, Ninas prepared a breakdown of the conversion-related expenses. See RX 52. From August 1, 1989 through September 30, 1990, Ninas calculated the conversion-related expenses for the period August 1, 1989 through September 30, 1990 in the amount of $333,472. Enforcement's expert calculated the post-denial conversion costs in the amount of $297,931. Some services included in this calculation appear to reflect expenses incurred before but paid after the Bank Board's denial of Charter's voluntary supervisory conversion application. These expenses total $39,216.

IV. DISCUSSION

A. Regulatory Background

A savings association may convert from a mutual form to a stock form only in accordance with regulations issued by the OTS. 12 U.S.C. § 1464(i)(1) and (2). The OTS's conversion regulations, codified at 12 C.F.R. Part 563b et seq., require all mutual savings associations to obtain the OTS's written consent prior to effecting conversion. The purpose of the regulations is to "ensure that conversions will benefit the converting association, its members and the general public." Charter Fed. Sav. and Loan Ass'n, 912 F.2d at 1571 (citations omitted).

Subpart A addresses standard conversions.[14] Among other things, these regulations specifically address the interests of the account holders. For example, the regulations require that after the OTS approves the conversion plan, it shall be submitted to a special meeting of the members. If a majority of the total outstanding votes of the association's members approve the plan, it can be implemented. See 12 C.F.R. § 563b.6(e) (1989). The account holders are also given preferential participation in the institution's conversion to stock form. See 12 C.F.R. § 563b.3 (1989). Under the conversion plan, each eligible account holder is required to receive non-transferrable subscription rights to purchase the association's newly issued capital stock before it is offered to the general public. See 12 C.F.R § 563b.3(c)(2) (1989). Further, each savings association upon conversion must provide for a liquidation account equal to its pre-conversion net worth for the benefit of eligible account holders. See 12 C.F.R. § 563b.3(f)(1) and (2) (1989).[15]

The OTS regulations also impose value restrictions on the sales price of the newly issued stock and the amount of stock that

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[14] This proceeding involves the regulations in effect at the time Charter completed its application for a voluntary supervisory conversion. The conversion rules have been amended since then but not in any way that would gain Charter's application a more favorable response.

[15] The purpose of the liquidation account is to provide former mutual account holders with a priority claim equal to the institution's pre-conversion liquidation value on the association's assets if, after conversion, the institution should be liquidated. 12 C.F.R. § 563b.3(f)(2) (1989).

any one person or group of persons can acquire. Specifically, the regulations require that the converting association will issue and sell capital stock in an amount equal to its estimated pro forma market value as determined by an independent valuation. See 12 C.F.R. § 563b.3(c)(1) (1989); 12 C.F.R. § 563b.7 (1989). In addition, the regulations provide generally that no person or associate or group of persons acting in concert may subscribe for or purchase more than five percent of the total offering of shares. See 12 C.F.R. § 563b.3(c)(7). (1989).[16]

A voluntary supervisory conversion, by contrast, does not provide comparable benefits and protections to accountholders because it is based on the premise that the institution has no real worth.[17] Thus, the accountholders own nothing of value which must

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[16] For this purpose, members of the converting association's board of directors are not deemed to be associates or a group acting in concert solely as a result of their board membership. 12 C.F.R. § 563b.3(c)(8)(1989). Purchases by directors and officers and their associates are subject to an aggregate limitation of between twenty-five percent and thirty-five percent of the total number of shares being issued in the conversion, depending on the size of the association. Id.

[17] There is also a middle ground of conversions, known as modified conversions. Subpart D of the regulations provide guidelines for modified conversions. A modified conversion generally is available to an institution that fails to meet its regulatory capital requirements. 12 C.F.R. § 563b.35 (1989). In a modified conversion, the substantive and procedural rights granted to members in mutual insured institutions converting under Subpart A may be restricted in order to meet the needs of an insured institution whose financial condition has deteriorated such that a standard conversion which would raise sufficient capital to enable the institution to achieve a solid capital base is not feasible. Id. Modified conversions may be effected without the approval of members, sales of conversion stock must be at an aggregate price in excess of the pro forma market value of the institution as determined by an independent appraiser, and members' preemptive rights are limited. Id.

be protected; the only value is the capital to be infused by persons willing to buy stock in the institution. Accordingly, in order for a FSLIC-insured institution to qualify for a voluntary supervisory conversion, both (1) the institution's liabilities must exceed its assets under GAAP on a going concern basis and (2) the converted institution must be a viable entity under § 563b.26. See 12 C.F.R. § 563b.24 (1989). Under § 563b.26, a converting FSLIC-insured institution is a "viable entity" if the prospective acquiror infuses sufficient capital, as defined by the regulation, and the transaction taken as a whole is in the best interests of, and does not present the potential of injury to, the converting institution, its depositors and the FSLIC. The members of the institution "have no rights of approval or participation in the voluntary supervisory conversion, or to the continuance of any legal or beneficial ownership interest in the converted institution or savings bank," 12 C.F.R. § 563b.21 (1989), unlike depositors participating in a standard conversion. No appraisal of the institution is required.

B. Statutory Background

Under 12 U.S.C. § 1818(b)(1), the OTS may issue a cease-and-desist order if an institution-affiliated party has engaged in proscribed conduct including: engaging in an unsafe or unsound practice in conducting the business of the association; or violating a law, rule or regulation, or conditions imposed in writing or written agreements with the agency. The OTS may require

the institution-affiliated party to cease and desist from the violation or practice and to take affirmative action to correct the conditions resulting from the violation or practice. 12 U.S.C. §1818(b)(1) and (6). The OTS may order an institution-affiliated party to make restitution or provide reimbursement, indemnification, or guarantee against loss, if certain standards, discussed below, are met. 12 U.S.C. §1818(b)(6)(A). The OTS may also take such other action as it deems appropriate. 12 U.S.C. §1818(b)(6)(F).

C. Grounds for a Cease and Desist Order

1. Unsafe or Unsound Banking Practice

The Acting Director finds that Respondents' actions in directing the Association to fund the post-denial pursuit of Charter's voluntary supervisory conversion constitute an unsafe or unsound banking practice. An unsafe or unsound practice is understood to have:

> a central meaning which can and must be applied to constantly changing factual circumstances. Generally speaking, an "unsafe or unsound practice" embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance fund.

Financial Institutions Supervisory Act of 1966: Hearings on S. 3158 Before the House Committee on Banking and Currency, 89th Cong., 2d Sess. 49-50 (1966)(statement of Chairman Horne), cited in First Nat'l Bank of Eden v. Dept. of Treasury, 568 F.2d 610, 611 (8th Cir. 1978)(per curiam). See also In the matter of Lopez and

Saldise, OTS Order No. AP 94-23 at 29 n.47 (May 17, 1994) appeal pending sub nom. Lopez v. OTS, No. 94-1449 (D.C. Cir.); In the matter of Keating, OTS Order No. AP 93-85 at 34-35 (October 22, 1993), aff'd, Keating v. OTS, No. 93-70902, slip op. (9th Cir. Jan. 18, 1995).

The courts of appeals generally have adopted this articulation, although they appear to differ to some degree, over the extent to which an imprudent activity must be shown to have affected the financial condition of a savings association. The U.S. Court of Appeals for the Fifth Circuit has required "a reasonably direct effect on an association's financial soundness." Gulf Federal Sav. & Loan Ass'n v. Federal Home Loan Bank Board, 651 F.2d 259, 264 (5th Cir. 1981), cert. denied, 458 U.S. 1121 (1982). Elsewhere, "an abnormal risk to the financial stability" of the institution is considered. Seidman v. OTS, 37 F. 3d 911, 928 (3d Cir. 1994).

Accordingly, in determining the safety and soundness of an action, the Acting Director considers, first, whether the action was prudent and then, if it was not, whether an abnormal risk of loss followed.

First, "generally accepted standards of prudent operation" require, among other things, that directors take reasonable steps, in light of all the circumstances then known, to protect the capital of the institution. See, e.g., Northwest Nat'l Bank v. United States, 917 F.2d 1111, 1115 (8th Cir. 1990) (inadequate loan documentation and poor capital was unsafe and unsound condition);

First Nat'l Bank of Gordon v. Department of Treasury, 911 F.2d 57, 64 (8th Cir. 1990 (unsafe and unsound practice to maintain lending policies that permitted classified loans to rise to 261% of capital); Sunshine State Bank v. Federal Deposit Ins. Corp., 783 F.2d 1580, 1581 (11th Cir. 1986) (unsafe and unsound to permit classified loans to rise above 581% of total equity capital and reserves); First Nat'l Bank of Eden, 568 F.2d at 611 (excessive compensation and other practices that diminished capital were unsafe and unsound). Indeed, simply making a loan that is improper or illegal, regardless of the probability of repayment, is imprudent. See Seidman, 37 F.3d at 928-29.

In this case, the question facing Respondents after the Bank Board's denial of the voluntary supervisory conversion application was whether to continue to pursue the voluntary supervisory conversion, in light of the facts then known. There were two issues facing Respondents: the prospects for an appeal and the overall value to Charter of a voluntary supervisory conversion. At the time, Respondents were aware of several facts as to the appeal and as to the value of a voluntary supervisory conversion versus other forms of conversion.

With regard specifically to the appeal, Charter's attorney had advised against the appeal because its chance of success was remote. Johnson also knew that the prospects were "very limited." In addition, the directors had been warned that the costs of the conversion were excessive if borne by the institution alone.

The voluntary supervisory conversion was not the only or the optimal means of infusing capital into Charter.[18] It can reasonably be inferred from Johnson's letter (GX 8), his memorandum (SX 33) and other evidence of the directors' consideration of the voluntary supervisory conversion that Respondents knew that a voluntary supervisory conversion would not entail the detailed regulatory requirements, such as those limiting stock purchase preferences and an appraisal requirement, that would apply to other forms of conversion.

The Bank Board had denied the voluntary supervisory conversion application for several reasons, including the fact that it was not in the best interests of Charter or its accountholders. While the Bank Board's decision was of course not dispositive of the question whether to pursue reversal of that decision, Respondents should have considered at that point whether there was some evidence to support the view that a voluntary supervisory conversion was in the best interest of Charter and its depositors.

The record is, however, devoid of any evidence that Respondents could reasonably have believed at the time they determined to support an appeal and other post-denial activities that those activities were in the best interests of the institution and its accountholders. One of two pieces of information would have been sufficient: an informed opinion that there was a reasonable prospect of success on appeal or evidence presented to

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[18] Before Charter filed its brief on appeal, Johnson was advised (and told the other directors) that the regulators were more likely to approve a standard conversion.

the board that from the perspective of the institution and its depositors, a voluntary supervisory conversion was superior to the other forms of conversion. Neither was present here. There is no record evidence that the directors considered why a voluntary supervisory conversion remained the preferred form of conversion from the institution's point of view. To the contrary, the record indicates that Respondents were aware of information that indicated that the institution was worth approximately $35 to $40 million, but would be offered for $7.5 million in the voluntary supervisory conversion.

Respondents have argued that: (1) the proposed conversion provided a good investment opportunity for depositors; 2) the conversion was in the best interests of the association because it would be beneficial for the institution to operate in stock form, and new capital would be invested in the association; (3) the capital investment allegedly would also inure to the benefit of the FSLIC; and (4) the conversion would not be detrimental to depositors because the depositors could purchase 65% of the shares issued in the conversion. While it is true that the voluntary supervisory conversion would have resulted in some new capital coming into Charter (the second and third arguments) and that the depositors would have had some limited opportunity to participate in the voluntary supervisory conversion (the first and fourth arguments), neither of these factors offer any support for the notion that expenditure of Charter's capital on continued attempts to pursue a voluntary supervisory conversion was prudent.

Respondents knew that the chances of success on appeal were remote, that the regulators believed that conversion expenditures already had been excessive, and that alternative forms of conversion -- providing comparable, and probably superior benefits to Charter -- were available. Respondents' conduct might have been prudent if, at the time the Bank Board denied Charter's application, there were some factual basis to believe either that Respondents' efforts would lead to a reversal of the Bank Board's decision or that a voluntary supervisory conversion was a superior means of conversion for the institution. No such factual material is in the record, however.[19]

Second, as to whether there was an abnormal risk of loss arising from Respondents' imprudent decision to continue seeking a voluntary supervisory conversion, the facts are that the probability of success on appeal was remote and that Charter's earnings position was poor. Expenditures on the appeal came directly out of Charter's capital. A loss actually occurred as a result of Respondents' imprudent decision; a fortiori, an abnormal risk of loss was present.

2. Breach of Fiduciary Duty

As the OTS explained nearly four years ago,

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[19] The Acting Director notes that Respondents attempted to offer ex post evidence in the form of a 1994 report from Donald Kaplan (and related testimony) that the voluntary supervisory conversion was appropriate. Although the Acting Director believes it may have been error to exclude this evidence on the issue of fiduciary breach, see note 21 infra, such ex post evidence is irrelevant to the issue of whether Respondents exercised prudence in directing Charter to continue pursuit of a voluntary supervisory conversion.

> [a] fundamental component of the fiduciary duties of directors in every jurisdiction . . . is that directors owe a duty of loyalty to the institution they serve. This duty prohibits directors from engaging in transactions that involve conflicts of interest with the institution. When faced with divided loyalties, directors must demonstrate both their good faith and the inherent fairness to the corporation of transactions in which they have a financial, business or other personal interest.

In re Bush, No. ERC-90-30, at 13-14 (April 18, 1991) (footnote omitted).

In this case, the decision to pursue post-denial relief involves divided loyalty.[20] Respondents stood to gain a substantial benefit from purchasing unappraised stock, under a system of preferences not otherwise available. Thus having Charter foot the bill for hundreds of thousands of dollars in post-denial expenses was an immediate benefit to them.

The evidence as to the institution, however, is that it stood to gain nothing from a voluntary supervisory conversion that could not be derived from a different method of conversion. Indeed, other forms of conversion were more likely to receive regulatory approval and to produce a greater benefit for the institution and its depositors. Since these other forms of conversion required an appraisal and given (at the very least) Johnson's judgment that Charter was worth close to $30 million, it is reasonable to infer that these other forms of conversion

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[20] The ALJ's Recommended Decision discusses the breach of fiduciary duty issue in terms of Respondents' self-interest superseding their concern for the best interests of the association. In substance, that issue involves the duty of loyalty, and the discussion of breach of fiduciary duty herein is limited to the duty of loyalty.

would have generated a greater capital infusion to Charter. This scenario was, of course, not attractive to Respondents, since it would have required them to invest more capital in order to maintain their desired control.

Where, as here, there is divided loyalty, Respondents bear the burden of proving both the good faith of their decision and the ultimate fairness to the institution of that decision. See Pepper v. Litton, 308 U.S. 295, 306, 310-11 (1939); Garner v. Pearson, 545 F. Supp. 549, 558 (M.D. Fla. 1982); Bush, supra. Respondents have not done so; the record evidence is that their decision was not in good faith. Charter's attorney advised Charter's board against the appeal. Respondents nevertheless went forward on that and other fronts, believing that the voluntary supervisory conversion was necessary for them to maintain control. They pursued this course though, if successful, it would have resulted in a $7.5 million offering for an unappraised institution holding tens of millions of dollars of Freddie Mac stock that Respondent Johnson believed had an appraised value of "at least some $35 to $40 million." Accordingly, the Acting Director concludes that Respondents' decision to have Charter expend its capital to obtain approval for a voluntary supervisory conversion that would benefit Respondents personally but not Charter represented a breach of their duty of loyalty.[21]

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[21] On the issue of the fairness to Charter, the Acting Director notes that it probably was error to exclude the report and related testimony of Respondent's expert witness, Donald Kaplan.

3. Violation of the Reasonable Expense Provision of the Voluntary Supervisory Conversion Regulation

The expense provision of the voluntary supervisory conversion regulation, codified at 12 C.F.R. § 563b.31 (1989),[22] requires in part that expenses incurred in connection with a voluntary supervisory conversion be "reasonable." The provision does not define "reasonableness;" accordingly, "reasonableness" must be assessed with reference to the surrounding facts and circumstances.

As the preceding discussion of unsafe and unsound practices and breach of fiduciary duty shows, Respondents caused Charter to devote part of its capital to activities that had no identifiable benefit for the institution. Such expenditures cannot be justified as a reasonable expense. As discussed more fully below, Charter spent approximately $258,000 in post-denial conversion-related expenses. This expenditure is particularly disturbing in light of the fact that as of the year-end June 30, 1990, Charter had an operating loss of $1,497,000.[23] Given the

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It is arguable that such evidence may have been relevant to the issue of fairness to the institution. But see Federal Deposit Ins. Corp. v. Stanley, 770 F. Supp. 1281, 1311 (N.D. Ind. 1991) ("evidence on the issue of whether a particular transaction was fair and reasonable to the bank must be viewed in the time frame in which the directors were making their decisions"). Because the record is plain that Respondents acted in bad faith, it is unnecessary to reach the fairness issue.

[22] This provision is currently codified at 12 C.F.R. § 563b.32.

[23] This amount did not include gains realized from Charter's intermittent sale of Freddie Mac stock to maintain its capital levels.

absence of any benefit to Charter arising uniquely from the voluntary supervisory conversion (as opposed to other types of conversion), as well as Charter's weak operating performance, the Acting Director concludes that the institution's expenditures were unreasonable.

4. Respondents' Additional Defenses

Respondents excepted to virtually all of the ALJ's findings and conclusions. In addition to their claim that Respondents would not have enjoyed a windfall,[24] they have also charged, among other things, that: (1) Charter's right to appeal necessarily encompasses the right to have Charter pay costs of the appeal; (2) constitutional and statutory violations in connection with alleged ex parte communications and preparation of this Final Decision; and (3) the depositor vote in February, 1990 ratified Respondents' decision to pursue a voluntary supervisory conversion and Charter's expenses incurred therewith.

a. Payment of Appeal Costs

Respondents claim that Charter is deprived of its First Amendment right to appeal if the OTS will not permit Charter to bear the costs thereof. In support thereof, Respondents rely solely on a line of cases decided under the Noerr-Pennington doctrine. These cases stand at most for the proposition that

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[24] Whether the ALJ correctly found a "windfall" is not dispositive here. What is clear is that the voluntary supervisory conversion afforded unique benefits to Respondents -- which they understood at the time -- but no corresponding benefit to Charter.

petitions to the government may not be challenged on antitrust grounds. This case, of course, presents no antitrust issues so Respondents' authority is irrelevant here. Moreover, it is unclear that Respondents personally may assert a right that belongs to Charter. Further, even assuming that Respondents have a colorable First Amendment claim -- and their failure to cite to relevant authority suggests that they do not -- all petitions to the government are subject to reasonable time, place and manner restrictions. In this case, the appeal might have been appropriate had the directors acted prudently -- i.e., if there were some factual basis for believing either that the appeal might have been successful or that the voluntary supervisory conversion, rather than another form of conversion, was in Charter's best interests -- or if they had been willing to pay for the appeal themselves. These constraints are entirely reasonable given the OTS's Congressionally-mandated duty to protect the safety and soundness of savings associations.

b. Administrative Procedure Act/Due Process Claims

Respondents claim that it is error for either the Chief Counsel, or any one who works under her, to participate in the drafting of the Acting Director's final decision. The separation of adjudicatory and advocacy functions is mandated by § 5(c) of the Administrative Procedure Act ("APA"), which provides in part:

> (d) . . . An employee or agent engaged in the performance of investigative or prosecuting functions for an agency in a case may not, in that or a factually related case, participate or advise in the decision, recommended decision, or agency

> review pursuant to section 557 of this title, except as witness or counsel in public proceedings. This subsection does not apply --
>
> > (A) in determining applications for initial licenses;
> > (B) to proceedings involving the validity or application of rates, facilities, or practices of public utilities or carriers; or
> > (C) to the agency or a member or members of the body comprising the agency. . . .

5 U.S.C. § 554(d). Thus, agency employees, other than the Acting Director[25], may not participate in the adjudication of a formal enforcement proceeding if they have participated in investigating or prosecuting that case or a factually related case.[26] That standard has been met in this case and Respondents' exceptions are thus denied.[27] None of the lawyers involved in

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[25] By express exception, the prohibition does not apply to the head of the agency who must oversee and administer all functions of the agency. See 5 U.S.C. § 554(d)(C); see also Federal Trade Comm'n v. Cinderella Career & Finishing Schools, Inc., 404 F.2d 1308, 1315 (D.C. Cir. 1968).

[26] Following the plain language of this provision, the prohibition extends only to the combination of functions in the same person in the same or a factually related case. See Au Yi Lau v. United States INS, 555 F.2d 1036, 1043 (D.C. Cir. 1977); Grolier, Inc. v. Federal Trade Comm'n, 615 F.2d 1215, 1220 (9th Cir. 1980), on remand, 699 F.2d 989 (9th Cir. 1983), cert. denied, 464 U.S. 891 (1983).

[27] The separation of functions doctrine has due process implications as well. See Withrow v. Larkin, 421 U.S. 35 (1975). The standard for establishing a due process violation is high, however. There must be a demonstration that the particular facts and circumstances "foreclose fair and effective consideration at a subsequent adversary hearing," or "that the risk of unfairness is intolerably high." Withrow, 421 U.S. at 58. Respondents have made no such showing here.

advising the Acting Director on the Final Decision had participated in any manner in the investigation or prosecution of this case.

Respondents also raise a similar objection concerning an alleged ex parte communication between Enforcement and the ALJ's attorney advisor. After review of the papers filed by the parties, it appears that the communication in question involved the timing of Enforcement's compliance with document requests. The record does not indicate, however, that such requests were not ultimately satisfied or that there was any delay that prejudiced Respondents. The communication does not appear to go to the merits of the adjudicatory proceeding. See 12 C.F.R. § 509.9. Nevertheless, the Acting Director disfavors such unilateral oral communications and notes that Enforcement should have made its request either in writing or in a telephone conference call with Respondents.

c. Ratification

Respondents have argued that the depositor votes on February 8 and 9, 1990, constitute a ratification of the decision to appeal. The OTS has not previously had occasion to consider whether the accountholders of a mutual association may ratify decisions of its board of directors. The Acting Director notes that under general corporate law principles, a ratification is permissible provided that full disclosure has been made to the

shareholders[28] and provided that the decision is not one contrary to law or public policy.[29] Neither condition has been met here. The proxy statement fails to disclose substantive information concerning the appeal or other post-denial activities, including such material facts as Charter's counsel's legal advice that the appeal had only a remote possibility of success. Moreover, the Acting Director does not believe that shareholders or accountholders ever may be permitted to ratify an unsafe or unsound practice.[30]

D. Grounds for Restitution

Restitution is an available remedy either when a respondent acts in reckless disregard for the law, applicable regulation or an agency order, or when there has been unjust enrichment. See 18 U.S.C. §1818(b)(6)(A).

Reckless disregard exists when: (1) a party acts with clear neglect for or plain indifference to the requirements of the law, applicable regulations or agency order of which the party was, or with reasonable diligence, should have been aware; and (2) there is a risk of loss or harm or other damage arising

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[28] See First Trust Savings Bank v. Iowa-Wisconsin Bridge Co., 98 F.2d 416, 427 (8th Cir.), cert. denied, 305 U.S. 650 (1938).

[29] See Loft, Inc. v. Guth, 2 A.2d 225, 245-46 (Del. Ct. Ch. 1938), aff'd, 5 A.2d 503 (Del. 1939).

[30] The statutory grant of authority to the Director to provide by regulation for the organization, operation and regulation of federal savings associations, in accordance with principles of safety and soundness, see 12 U.S.C. § 1464(a), overrides any argument that there might be a common law ability by depositors to approve unsafe or unsound practices.

from the conduct such that the party knows it, or it is so obvious that the party should have been aware of it. 12 U.S.C. § 1818(b)(6)(A); In the matter of Keating, OTS Order No. AP 93-85 at 34-35 (October 22, 1993), aff'd, Keating v. OTS, No. 93-70902, slip op. (9th Cir. Jan. 18, 1995); In re Simpson, OTS Order No. AP 92-123 (Nov. 18, 1992), order aff'd, Simpson v. OTS, 29 F.3d 1418 (9th Cir. 1994), petition for cert. filed, 63 U.S.L.W. 3462 (Nov. 23, 1994)(No. 94-953).

Although unjust enrichment has not been discussed as frequently in OTS cases, the agency's cases do make clear that breaching a legal obligation in order to obtain a personal benefit at the expense of an institution's capital constitutes unjust enrichment. See In re Christo, OTS Order No. AP 95-06 at 14 (Jan. 26, 1995); In re Rapaport, OTS Order No. AP 93-95 (1993), appeal pending sub nom. Rapaport v. OTS, No. 93-1811 (D.C. Cir.)(argued January 31, 1995); In re Akin, OTS Order No. 90-4009 at 27, aff'd sub nom. Akin v. OTS, 950 F.2d 1180 (5th Cir. 1992).

The facts in this case demonstrate both reckless disregard and unjust enrichment. Unjust enrichment occurred because, as a result of the violations of safety and soundness, the duty of loyalty and the expense regulation, the Respondents received a benefit: free legal services in pursuing an appeal and other post-denial relief that would benefit themselves but not necessarily the institution. The institution bore virtually all

of the costs of Respondents' conduct; thus, Respondents were unjustly enriched.

In addition, Respondents' unsafe and unsound practice and breach of the duty of loyalty (both reflecting disregard of the law) were reckless because it was fundamental for them, as directors, to know that their primary obligation in considering whether to convert was to preserve the health and capital position of Charter. It is equally fundamental knowledge that a director may not place his interests ahead of the institution. Respondents' doing so was particularly egregious, or reckless, because, as the evidence reflects, they were aware of the other forms of conversion and of the fact that these other forms would bring a greater benefit to Charter. The risk of loss arising from this recklessness was obvious: the post-denial expenses depleted Charter's capital and were not likely ever to be recovered.

Similarly, violation of the expense regulation represented clear neglect because Respondents had been warned expressly about excessive conversion costs. The risk of this violation was also obvious, since the costs of the post-denial activities had to be paid by Charter. Respondents claim that they could not have known what amount of expense was "reasonable" under these circumstances. While "reasonableness" may be difficult to delineate in the abstract, it is not difficult to understand that substantial expenses, when not mitigated by at least the potential for benefit, must be considered unreasonable.

The evidence further demonstrates that Respondents acted with neglect for and indifference to the "reasonableness" requirement of the expense regulation. Respondents had adequate notice of this issue, insofar as Charter was warned in May, 1989 by OTS supervisory personnel that OTS considered the expenses excessive if borne by the institution alone. Moreover, Respondents cannot plausibly assert they did not know or could not have known that Charter's expenses were unreasonable, in light of the admission made by Johnson in response to supervisory concerns that the appeal expenses had "gotten out of hand." Once Respondents had been put on notice that the OTS thought the expenses were improper for Charter to bear alone, they had, at the least, an obligation to justify those expenses. The record does not demonstrate that they did or ever attempted to do so.

Respondents claim they relied on the advice of counsel for comfort that they could not personally be charged with post-denial conversion expenses. The Acting Director rejects this defense to the extent that Respondents seek to rely on a lawyer's opinion (without legal reasoning or citation) that OTS was unlikely to bring an enforcement action to recoup such losses. Moreover, counsel's opinion explicitly is qualified on this point:

> [W]e believe it is doubtful that the OTS would be successful in holding you or the other directors personally responsible for fees paid by the institution. However, we have not and could not give you an unqualified opinion that that result could not occur.

(RX 33).

All other exceptions not otherwise addressed herein are denied.

1. Calculation of Amount of Restitution

The evidence of expenditures by Charter on its appeal and other post-denial activities is conflicting and somewhat sparse. Enforcement's expert witness calculated all of Charter's post-denial legal expenses, arriving at a total of $297,931. (GX 15.) Respondents' expert witness determined that total post-denial expenses actually were higher -- $333,472. He also produced an exhibit showing expenses broken down by several categories of activities. (RX 52.) This witness did not actually perform the classifications, however. (Tr. 1125-28.) That task was performed by Robert Johnson (Tr. 1127), and the only evidence of his work is a memorandum dated September 4, 1992, from Robert Johnson to Paula Emmerson, located among the Respondents' expert's work papers (RX 53, pp. 3-4). The memorandum is cursory and does not explain the meaning of the classifications or how they were made, nor does Robert Johnson's testimony offer any further explanation.

The ALJ resolved this issue by selecting the lower total offered by an expert, i.e., the $258,715 (after adjustment offered by Enforcement's expert). Recommended Decision at 43-44.[31] Based on the evidence available, this is the most

[31] This amount is derived from OTS's total of $297,931, minus expenses incurred prior to but paid after the Bank Board's denial of Charter's application. See RX 58. The Acting Director accepts the ALJ's recommendation to subtract this amount from the OTS's calculation, for a total of $258,715.

reasonable approach, and the Acting Director will adopt it.[32]

E. Civil money penalty against Johnson

In his discretion, the Acting Director declines to order the assessment of a civil money penalty in this proceeding. Based on the facts presented, it is the Acting Director's purpose to have Charter reimbursed for the expenses that Respondents wrongfully caused the institution to incur. Any funds received pursuant to the assessment of a civil money penalty would not go

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[32] The Acting Director considered an alternative approach, adopting what might be considered the most reliable parts of Robert Johnson's September 4 memorandum, cursory and unsworn as it is. However, this approach would have resulted in an even greater restitution amount.

Specifically, the September 4 memorandum suggests that certain expenditures were not related to the imprudent pursuit of the voluntary supervisory conversion after denial by the Bank Board. The Acting Director would have been willing to credit those categories if it seemed clear that the expenditure did not relate to the voluntary supervisory conversion and to deduct those items from the total presented by Respondents' expert. Categories whose meaning was uncertain -- and as to which Respondents chose to offer no explanatory evidence -- would not have been so credited. Accordingly, the Acting Director would not have required reimbursement for four categories: "Wash Sales," which appears to deal with a separate issue about the recording of gains from sales of FHLMC stock; "Resolution/FOIA," since this category appears to be a legitimate inquiry about how the Bank Board reached its decision; "Appeal Memo" because the directors were entitled to legal advice on whether to appeal (indeed, they imprudently ignored this advice); and "Mutual Holding Company," since this appears to be a transaction suggested by the regulator. As to all other categories in RX 52, however, there is no evidentiary basis on which to conclude that these expenditures were not related to the imprudent effort to overturn the Bank Board's denial of the voluntary supervisory conversion application.

The total of the four credited categories is $36,486, and deducted from the total of $333,472 in RX 52, this would produce a total of $296,986. Subtracting the restitution already paid, $119,676, this approach would result in a restitution award of $177,310, almost $40,000 more than what the Acting Director orders today.

to Charter but to the U.S. Treasury. 12 U.S.C. §1818(i)(2)(J). The Acting Director believes that it is unnecessary from a supervisory standpoint to impose a penalty that would not further the goal in this case of making Charter whole.

F. Respondents' Request for Oral Argument

Respondents have also requested oral argument before the Director. Under Rule 40(b) of the Rules of Practice and Procedure, the Director has the discretion to order and hear oral argument.

A party seeking oral argument has the burden of demonstrating good cause for such argument and establishing that arguments cannot be adequately presented in writing. Upon consideration of Respondents' request for oral argument, the Acting Director finds that: (1) the factual and legal arguments are fully set forth in the parties' written submissions; (2) the Acting Director will not be aided in deciding this matter by oral argument; (3) Respondents will not be prejudiced by the lack of oral argument; and (4) Respondents have not shown good cause for oral argument. Therefore, the Acting Director declines to exercise his discretion under Rule 40(b) and denies Respondents' request for oral argument.

VI. CONCLUSION

For the reasons set forth above, the Acting Director will issue an order directing Respondents to cease and desist from statutory and regulatory violations, and to pay restitution to Charter in the amount of $139,039.

ORDER

Upon consideration of the entire record in this matter, including the Recommended Decision of the Administrative Law Judge, the exceptions and replies to exceptions filed by the parties, and for the reasons set forth in the accompanying Decision:

The Acting Director, pursuant to his authority under 12 U.S.C. § 1818(b) (1988 & Supp. II 1990), finds that John W. Johnson, Jr., Robert L. Johnson, and R. Terry Taunton (collectively, Respondents), in their capacities respectively as President and Chairman of the Board of Directors, as Director and Vice President, and as Director, of Charter Federal Savings and Loan Association of West Point, Georgia, ("Charter") a federal savings association, were institution-affiliated parties of Charter who violated laws and regulations, engaged in unsafe and unsound practices, and committed acts and practices which constitute breaches of fiduciary duty to Charter, in conjunction with which they were each unjustly enriched and Charter suffered financial loss in connection with these violations and practices, and the violations and practices involved reckless disregard for the law and applicable regulations. Accordingly, grounds exist to issue a cease and desist order requiring affirmative action to correct or remedy conditions resulting from these violation or practices.

Upon consideration of Respondents' request for oral argument, the Acting Director finds that: (1) the factual and

legal arguments are fully set forth in the parties' written submissions; (2) the Acting Director will not be aided in deciding this matter by oral argument; (3) Respondents will not be prejudiced by the lack of oral argument; and (4) Respondents have not established good cause for oral argument.

IT IS THEREFORE HEREBY ORDERED:

1. Respondents shall cease and desist from engaging in any acts, omissions, or practices involving unsafe or unsound practices, and of violations of law or regulations;

2. Within ten (10) business days after the effective date of this Order Respondents shall jointly and severally pay restitution to Charter in the amount of $139,039, plus interest for each day after ten (10) business days hereafter;

3. The provisions of paragraphs 1 and 2 of this Order apply separately to each of the named Respondents and are effective as to each individual upon the expiration of thirty (30) days after the date of service of this Order upon Respondents and shall remain effective and enforceable, except as to the extent that, and until such time as, any provisions of this Order shall have been stayed, modified, terminated or set aside by action of the Acting Director or a reviewing court, or in accordance with 12 U.S.C. §1818(e)(7)(B). Respondents are hereby notified that they have the right to appeal this Decision and Order within thirty (30) days after service of such Decision and Order under 12 U.S.C. § 1818(h); and

4. Respondents' request for oral argument is denied.

DATED: March 16, 1995

THE OFFICE OF THRIFT SUPERVISION

By: Jonathan L. Fiechter
Jonathan L. Fiechter
Acting Director

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of March, 1995, a copy of the foregoing OTS Order No. AP 95-17 was served by hand delivery and first class mail on the following:

By Hand Delivery

Stephen E. Hart, Esquire
Charles H. Fitzpatrick, Esquire
Timothy P. Leary, Esquire
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Melba H. McCannon

Melba H. McCannon For the Secretary
Office of Thrift Supervision