

1 DEPARTMENT OF CONSUMER AND BUSINESS SERVICES
2 DIVISION OF FINANCE AND CORPORATE SECURITIES
3 ENFORCEMENT SECTION
BEFORE THE DIRECTOR OF THE DEPARTMENT OF CONSUMER AND
BUSINESS SERVICES

4 In the Matter of:) No. B-08-0007
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COMMUNITY BANK, a state chartered
financial institution,

Respondent.

ORDER TO CEASE AND DESIST AND
CONSENT TO ENTRY OF ORDER

11 WHEREAS, the Director of the Department of Consumer and Business Services for the
12 State of Oregon (hereafter the "Director"), acting by and pursuant to the authority of the Oregon
13 Bank Act, ORS 706.005 *et. seq.*, has conducted an investigation into the activities of
14 COMMUNITY BANK, a state chartered financial institution (hereafter "COMMUNITY
15 BANK");

16 WHEREAS, COMMUNITY BANK wishes to avoid the additional costs and expenses
17 resulting from an action by the Director, does not desire to expend further time on this matter,
18 and seeks to obtain finality without invoking its right to a hearing;

19 NOW THEREFORE, the Director hereby issues the following Findings of Fact,
20 Conclusions of Law, and Order, to which COMMUNITY BANK has consented, as evidenced
21 by the signature of the Chief Executive Officer of COMMUNITY BANK, Bruce Penoske, on
22 the Consent to Entry of Order attached hereto:
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350 Winter Street, Suite 410
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1 **FINDINGS OF FACT**

2 The Director **FINDS** that:

3 **Part One: Community Bank**

4 1. **COMMUNITY BANK** is a state chartered financial institution (Division of Finance
5 and Corporate Securities Bank Charter #323). Community Bank, originally chartered as “Bank
6 of Wallowa County” on April 6, 1955, has branches throughout eastern Oregon. The bank
7 conducts business from 609 North Main Street, Joseph, Oregon 97846.

8 2. **COMMUNITY BANK** is a wholly owned subsidiary of Community Bancshares,
9 Inc. Community Bancshares, Inc. is a for-profit Oregon corporation (Secretary of State Business
10 Registry #693202-82). Community Bancshares, Inc. conducts business from 609 North Main
11 Street, Joseph, Oregon 97846.

12 3. Bruce Penoske (hereafter “Penoske”) was, during all times material herein, the
13 President and Chief Executive Officer of **COMMUNITY BANK**. The Chief Executive Officer
14 of the bank is, for purposes of the Oregon Bank Act, an “officer” of the bank. During all times
15 material herein Penoske, who also served on the bank’s board of directors, conducted business
16 from 609 North Main Street, Joseph, Oregon 97846.

17 4. D. Rahn Hostetter (hereafter “Hostetter”) was, during all times material herein,
18 outside general counsel to **COMMUNITY BANK**. Hostetter, admitted to practice in Oregon in
19 1978, is a shareholder of D. Rahn Hostetter, P.C., and conducts business from 203 E. Main
20 Street, Enterprise, Oregon 97828.

21 5. **COMMUNITY BANK** had a customer (hereafter “Community Bank customer” or
22 “customer”) who conducted, among other business ventures, logging activities in eastern
23 Oregon.

24 **Part Two: Community Bank Reaches its Lending Limit with its Customer**

25 6. **COMMUNITY BANK** is authorized to make loans for commercial or personal
26 purposes without obtaining prior regulatory consent. However, to ensure the continuing safety

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1 and soundness of state chartered financial institutions, Oregon law limits the percentage of a
2 bank's capital that may be lent for the benefit of a single borrower, commonly referred to as the
3 institution's "aggregate lending limit."

4 7. **COMMUNITY BANK** first established a lending relationship with its customer in
5 January 2001, when it lent the customer and his wife money for the customer's business
6 ventures. Community Bank continued to have outstanding loans with its customer as of March
7 2003.

8 8. On December 11, 2002 the customer and his wife executed a real estate purchase and
9 sale agreement (hereafter "REPSA") that granted them the right to buy a large parcel of timber
10 land in eastern Oregon (hereafter the "property"). The REPSA called for an immediate \$200,000
11 earnest money payment, with an additional \$300,000 earnest money payment due on the date the
12 REPSA became irrevocable, January 31, 2003.

13 9. On January 31, 2003 **COMMUNITY BANK** loaned \$270,000 to its customer for the
14 express purpose of making the REPSA's second earnest money payment. This loan did not cause
15 Community Bank to exceed its aggregate lending limit.

16 10. On February 27, 2003 the parties to the December 11, 2002 REPSA executed an
17 addendum, reducing the sale price slightly and setting a March 21, 2003 closing date for the
18 transaction.

19 11. The customer originally approached **COMMUNITY BANK** about borrowing the
20 funds required to consummate the entire property transaction in early January 2003. The loan
21 request was reported to the Community Bank board of directors at its January 10, 2003 meeting.
22 Community Bank hired an appraiser to assess the value of the property in question on January
23 15, 2003.

24 12. In January 2003 the bank's CEO determined that granting the large loan the customer
25 and his wife had applied for would, in combination with sums already lent to these borrowers,
26 place **COMMUNITY BANK** in violation of its aggregate lending limit. However, the CEO told

1 the customer that Community Bank would attempt to use alternative approaches in an attempt to
2 fund the loan.

3 **Part Three: Community Bank Facilitates The Use of a Nominee Borrower**

4 13. The bank's CEO initially suggested to the customer that a relative of the customer
5 should apply to **COMMUNITY BANK** for the loan, for the customer's benefit. Initially
6 agreeable, a relative soon withdrew himself from consideration for this purpose.

7 14. The bank's CEO later suggested to the customer that a specific businessperson from
8 the local community should act as the nominee borrower, for the customer's benefit. This
9 proposal did not meet with success.

10 15. **COMMUNITY BANK** also engaged in preliminary efforts to garner the
11 participation of other state chartered financial institutions in the transaction, with the goal of
12 having two banks jointly render a loan to the customer.

13 16. Approximately two weeks before the scheduled March 21, 2003 closing of the
14 property transaction, the bank's CEO informed the customer that **COMMUNITY BANK** had
15 not been able to secure the participation of other financial institutions for the loan in question.
16 Instead, the CEO suggested to the customer that Hostetter – the bank's outside general counsel -
17 apply for the loan, for the customers' benefit. During the conversation, the CEO strongly inferred
18 that Community Bank would approve such an arrangement. With the customer's consent, the
19 CEO introduced Hostetter to the customer by telephone.

20 17. On or about March 14, 2003, the customer met with Hostetter at Hostetter's law
21 office to discuss Hostetter's prospective role in a **COMMUNITY BANK** funded loan. (The
22 bank's CEO did not attend or participate in this meeting.) Although the parties initially discussed
23 the payment of a substantial "flat fee" by the customer to Hostetter for the use of the latter's
24 name on loan documents, their talks soon expanded to encompass a more involved role by
25 Hostetter.
26

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1 18. In a March 17, 2003 letter, **COMMUNITY BANK** informed a real estate broker
2 involved in the property transaction that Community Bank was prepared to grant a loan to
3 Hostetter to facilitate the property purchase.

4 19. On March 19, 2003 the customer and his wife and the Hostetters (Mrs. Hostetter was
5 a party to this transaction) entered into a signed contract with respect to the property, which
6 Hostetter drafted. Under its terms, the customer and his wife were to assign their interest in the
7 REPSA to the Hostetters, who would be named as borrowers on the **COMMUNITY BANK**
8 loan. The Hostetters were to pay \$3,900,000 toward purchase of the property, with Community
9 Bank lending the Hostetters \$3,725,000 for this purpose. The customer and his wife agreed to
10 pay the entirety of the sum Community Bank lent the Hostetters on their behalf from the
11 proceeds of logging efforts on the property. Furthermore, the customer and his wife agreed to
12 pay the Hostetters an additional \$200,000 in compensation for involvement in the transaction.
13 The Hostetters agreed to re-convey a portion of the property to the customer and his wife once
14 the Community Bank loan was paid off, with the remainder of the acreage being divided equally
15 by the customer and his wife and the Hostetters.

16 20. On March 19, 2003 Penoske, without obtaining a copy of the agreement between the
17 customer and his wife and the Hostetters, formally approved a loan in the amount of \$3,725,227
18 to the Hostetters from **COMMUNITY BANK**. The bank assessed a loan fee in the amount of
19 \$100,000, a sum paid to it by the customer. Community Bank deemed the primary source of
20 repayment to be "income from timber liquidation" harvested from the property acquired with
21 loan proceeds, with a secondary source of repayment being "liquidation of collateral, assets of
22 signers." The bank required no guarantees for the loan.

23 21. The March 19, 2003 loan caused **COMMUNITY BANK** to exceed the Oregon Bank
24 Act's aggregate lending limit to, or for the benefit of, a single borrower.

25 22. The property closing took place as scheduled on March 21, 2003.
26

1 **Part Four: Concerns About the March 19, 2003 Loan From Community Bank Officers**

2 23. Several **COMMUNITY BANK** officers had serious concerns about the bank's
3 March 19, 2003 loan. On March 24, 2003, five days after the loan was formally granted, a bank
4 assistant vice president ("AVP") sent an electronic communication to the bank's then Chief
5 Financial Officer ("CFO") with respect to the aggregate lending limit issue, observing that a
6 comparison of the loan amounts made for the benefit of the customer against the bank's capital
7 evidenced a violation of legal lending limits. In response, the CFO offered his view that
8 regulatory agencies would not be concerned about lending limit violations unless the subject
9 transaction approached 45% of the bank's capital.

10 24. On March 24, 2003 the AVP sent another e-mail to the CFO reiterating and
11 emphasizing his concern about the bank's March 19, 2003 loan and implicitly conveying that
12 **COMMUNITY BANK** looked to the customer, and not Hostetter, for repayment of the loan.

13 25. Despite their respective reservations about the propriety of this transaction, neither
14 the AVP nor the CFO communicated their concerns to regulators with the Federal Deposit
15 Insurance Corporation (hereafter "FDIC") or the Oregon Division of Finance and Corporate
16 Securities (hereafter the "Division") in March 2003, or, for that matter, at any point in time
17 during 2003 or 2004.

18 26. **COMMUNITY BANK** did not have in place and/or implement a written policy that
19 advised officers of the bank of the circumstances under which they were to report possible
20 violations of law, or other issues of substantial concern, to the bank's board of directors (a so
21 called "whistleblower" policy). Nevertheless, despite enunciated reservations about the propriety
22 of the March 19, 2003 transaction, neither the AVP nor the CFO communicated their concerns to
23 the bank's board of directors in March, 2003 or, for that matter, at any point in time during 2003
24 or 2004.

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1 27. Between March 2003 and July 2003 all loan payments tendered to **COMMUNITY**
2 **BANK** for the property loan, nominally extended by the bank to the Hostetters, were made
3 directly by the customer.

4 28. On July 21, 2003, the AVP sent electronic correspondence to the CFO and other
5 senior bank officers regarding the March 19, 2003 loan, expressing concern that the customer
6 was making payments on a loan made to Hostetter using checks drawn against the customer's
7 account, and that the appraisals obtained by the bank in support of the loan to Hostetter named
8 the customer and his wife as the actual borrowers of record. Moreover, the AVP noted his
9 concern that the FDIC would link the March 19, 2003 loan to Hostetter with and to the
10 interconnected transactions between the customer and Hostetter, and conclude from this linkage
11 that the bank was blatantly circumventing legal lending limit restrictions.

12 29. On July 23, 2003 the CFO responded to the AVP via email, observing that a meeting
13 of senior bank officers should be called to discuss the March 19, 2003 loan to Hostetter,
14 expressing concerns that the FDIC would be highly critical of Community Bank concerning the
15 subject loan, and that the professional consequences to the CEO on account of the March 19,
16 2003 loan to Hostetter could be "dire."

17 30. Despite the multiple email communications and follow-up telephone conversations
18 among various **COMMUNITY BANK** officers, none of the bank's officers with knowledge of
19 the March 19, 2003 loan to Hostetter, and the related transactions between him and the bank's
20 customer, communicated their concerns about the subject loan, possible violations of legal
21 lending limits, or the bank's operations to the Division, the FDIC, or the bank's Board of
22 Directors in July 2003 or, for that matter, at any point in time during 2003 or 2004.

23 31. The Division and the FDIC commenced a joint examination of the books and records
24 of **COMMUNITY BANK** on August 23, 2004. On or about September 10, 2004, the bank's
25 CEO expressly represented to the Division's Examiner In Charge and the FDIC's representative
26 that the loan in question did not raise aggregate lending limit issues for the bank.

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1 **Part Five: Lending Limit Violation Is Cured; Bank Admits Violation**

2 32. Between March 19, 2003 and June 30, 2004 the bank's customer made payments to
3 **COMMUNITY BANK** on the various loans that he, or Hostetter on his behalf, had outstanding
4 with the bank.

5 33. On or about June 30, 2004 the total sum outstanding on **COMMUNITY BANK's**
6 loans to its customer fell below the bank's aggregate lending limit.

7 34. In a July 26, 2005 letter, **COMMUNITY BANK** advised the Division that "*the bank*
8 *violated of (sic) the bank's legal lending limit in connection with certain loan transactions*"
9 involving the bank's customer. The correspondence stated that "*these transactions appear to*
10 *have involved joint ventures by the... [customer] with the other participating borrowers,*
11 *including the bank's then outside general counsel.*"

12 **Part Six: Community Bank Implements Remedial Actions**

13 35. Subsequent to the events set forth above, by action of its Board of Directors,
14 **COMMUNITY BANK** has approved, implemented, and distributed to each of its directors,
15 officers, and employees a written and comprehensive policy addressing the types of matters,
16 including violations of law that shall be immediately reported to the bank's Board of Directors
17 via a reporting process that is rapid and protective of the person reporting alleged violations of
18 law.

19 36. Subsequent to the events set forth above, by action of its Board of Directors,
20 **COMMUNITY BANK** has approved and instituted a policy requiring Board approval for loans
21 exceeding certain specified monetary limits.

22 37. Subsequent to the events set forth above, **COMMUNITY BANK** has hired
23 individuals previously unaffiliated with the institution to serve in the posts of Chief Financial
24 Officer and Chief Lending Officer.

1 CONCLUSIONS OF LAW

2 The Director **CONCLUDES** that:

3 38. **COMMUNITY BANK**, as a state chartered financial institution, is subject to the
4 mandates of the Oregon Bank Act, ORS 706.005, *et. seq.*

5 39. In connection with a March 19, 2003 loan, **COMMUNITY BANK** exceeded the
6 aggregate loan limit it was authorized to lend to a single borrower, in violation of ORS
7 708A.295, because the loan it nominally made to the Hostetters was made for the actual benefit
8 of and use by another customer, one with then outstanding loans from the bank.

9 40. In connection with a March 19, 2003 loan, **COMMUNITY BANK** had at least one
10 officer or director willfully do an act which is expressly forbidden by the Bank Act, in violation
11 of ORS 707.720, by authorizing a loan which exceeded the bank's permissible aggregate loan
12 limit.

13 41. Prior to a March 19, 2003 loan, **COMMUNITY BANK** failed to develop written
14 policies regarding the types of matters that shall be reported to the institution's board of directors
15 by an employee, officer, or director, in violation of ORS 708A.635, by not mandating that its
16 officers immediately report violations of the Bank Act they are cognizant of to the board of
17 directors.

18 42. In connection with a March 19, 2003 loan, **COMMUNITY BANK** had at least one
19 officer or director knowingly make a false statement or report to the Director, in violation of
20 ORS 706.725, by expressly representing to the Division's Examiner In Charge on or about
21 September 10, 2004 that the loan to Hostetter did not raise aggregate lending limit issues for the
22 bank.

23 43. **COMMUNITY BANK**, by authorizing a loan in excess of its aggregate lending
24 limits, violated a banking law and conducted its business in an unsafe or unauthorized manner,
25 and is therefore subject to sanction as described in ORS 706.580 (2) (a).
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ORDER

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Therefore, the Director **ORDERS** that:

44. **COMMUNITY BANK** shall, pursuant to the authority contained in ORS 706.580 (2) (a) (A), **CEASE AND DESIST** from engaging in **ILLEGAL, UNSAFE, OR UNAUTHORIZED BANKING PRACTICES** in violation of the Oregon Bank Act, ORS 706.005 *et. seq.*

45. **COMMUNITY BANK** shall, pursuant to the authority contained in ORS 706.580 (2) (a) (B), develop, or amend, a written policy regarding the types of matters, including violations of law, that shall be immediately reported to the institution's board of directors by employees, officers, and directors, and shall submit same to the Director's designee within thirty (30) days of the entry of this Order. Furthermore, Community Bank shall develop, or amend, a plan for disseminating the contents of said policy to employees, officers, and directors to the Director, who shall approve said plan or require additional or different actions to ensure that Community Bank fulfills its obligations under the Oregon Bank Act.

46. **COMMUNITY BANK** shall, pursuant to the authority contained in ORS 706.580 (2) (a) (B), nominate or re-nominate individuals to serve in the posts of Chief Financial Officer and Chief Lending Officer within thirty (30) days of the entry of this Order. The Director shall investigate each such nominee to determine the individual's character, honesty, financial responsibility, competence, and professional experience. The Director shall approve the nomination, disapprove the nomination, or request additional information with respect to the nomination in a writing addressed to the bank's board of directors.

47. **COMMUNITY BANK** shall, pursuant to the authority contained in ORS 706.980 (1), pay the sum of **TWO THOUSAND DOLLARS** (\$2,000) for each violation of ORS 707.720, ORS 708A.295, and ORS 708A.635, for a total civil penalty of **SIX THOUSAND DOLLARS** (\$6,000).

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1 **CONSENT TO ENTRY OF ORDER**

2 Respondent **COMMUNITY BANK** states: that it has read the foregoing Order and fully
3 understands the contents thereof; that it has been advised of the right to a hearing and of the right
4 to be represented by counsel in this matter; that it, voluntarily, and without any force or duress,
5 consents to the entry of this Order, expressly waiving any right to a hearing in this matter; that
6 the Order contains the complete agreement of the parties, and that no additional promises or
7 assurances have been made to Respondent by the Division with respect to matters covered by the
8 Order; that it understands that the Director reserves the right to take further actions to enforce
9 this Order or to take appropriate action upon discovery of other violations of the Oregon Bank
10 Act; and that it will fully comply with the terms and conditions stated herein.

11 Respondent further understands that this Consent Order is a public document.

12 Dated this 29th day of April, 2008.

13
14 For Community Bank:

15 I, Bruce Penoske, represent that I am the Chief Executive Officer of Community Bank and that, as
16 such, I have been authorized by Community Bank to enter into this Order for and on behalf of
17 Community Bank.

18 Dated this 29th day of April, 2008.

19 Community Bank
20 *[Signature]*

21 By: Bruce Penoske

22 Title: Chief Executive Officer

23 *MARYANNE HAWKRIDGE*
24 *Maryanne Hawkridge*
(Printed Name of Notary Public)

25 Notary Public
for the State of *Washington*
26 My commission expires: *6-13-2011*

MARY ANNE HAWKRIDGE
NOTARY PUBLIC
STATE OF WASHINGTON
COMMISSION EXPIRES
JUNE 13, 2011

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1 For Community Bancshares, Inc.:

2 L. Bruce Tenoske represent that I am Chairman of
3
4 Community Bancshares, Inc. I have advised the board of directors of Community Bancshares,
5 Inc. that Community Bank consents to the entry of this Order.

6 Dated this 29th day of April, 2008.

7 Community Bancshares, Inc.

8 By: L. Bruce Tenoske

9 Title: Chairman

10 MARY ANNE HAWKRIDGE
11 NOTARY PUBLIC
12 STATE OF WASHINGTON
13 COMMISSION EXPIRES
14 JUNE 13, 2011

15 MARY ANNE HAWKRIDGE
16 Mary Anne Hawkrig
17 (Printed Name of Notary Public)

18 Notary Public
19 for the State of: Washington
20 My commission expires: 6-13-2011

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