MCDOUGAL - MADISON

(REVISED MAY 31, 1995, SUPERSEDES APRIL 6 MEMO)

Prosecution Memo

(Confidential--Contains Grand Jury Information)

read

To: OIC Attorneys

From: Stephen P. Learned

Re: James B. McDougal

Date: May 31, 1995

Brad says no intent to have bank

FOIA(b)(3) - Fed. R. Crim. Pro. 6(e) - Grand Jury

I. Introduction

This memo sets forth the evidence in support of a multi-count indictment of James McDougal. It supersedes our April 6 memo on the subject. The memo takes into account comments received from the April draft and discusses more recent information. To be as comprehensive as possible this memo repeats most, but not all, of what was stated in our April memo. It also discusses revisions to our proposed indictment.

McDougal was the chairman of Madison Financial Corporation, a wholly owned subsidiary of Madison Guaranty Savings and Loan Association, a state chartered, federally insured savings and loan association. McDougal and his wife, formerly Susan Henley, owned 77 per cent of the stock of Madison Guaranty.

The proposed charges against McDougal stem from specific acts of insider abuse beginning in October 1984 and ending in March 1986, when the Federal Home Loan Bank Board commenced its 1986 examination which resulted in McDougal's removal.[1] The insider abuse outlined below and encompassed in the proposed indictment cost the institution approximately $100,000 in losses. The proposed indictment involves five individuals: Lisa Aunspaugh, a 21 year old interior decorator from Little Rock; Eric Sorensen, a Danish national married at the time to Paula Henley, Susan McDougal's sister; Bill Henley, a former state

[1]McDougal was effectively removed from any influence over Madison Guaranty and Madison Financial when the Bank Board, under threat of a lawsuit, forced Madison to sign an all encompassing cease and desist order in the summer of 1986 which dramatically changed Madison's operations.

senator and brother of Susan; Seth Ward, a wealthy Arkansas businessman; and Robert Palmer, a Little Rock appraiser who pleaded guilty to backdating Madison Guaranty appraisals. The ten year statute of limitations has already run with respect to three misapplication counts involving Eric Sorensen, one false statement count involving Lisa Aunspaugh, and one false statement count involving Seth Ward.

In a nutshell the proposed indictment alleges that, from October 1984 until February 1986, James McDougal enriched himself and his wife and provided unearned funds to other family members at the expense of the institution. In order to conceal this pattern of self-dealing from the Federal Home Loan Bank Board, McDougal created false and misleading documents, material omissions, a false financial statement, a nominee loan, an accommodation real estate sale, and a bogus lease.

Also mentioned in this memo are two officers of Madison Guaranty: John Latham and Greg Young. Both were young when they started at Madison. McDougal made Latham the Chief Executive Officer of Madison Guaranty when Latham was 29. Greg Young became the Chief Financial Officer when he was 25. Young and Latham are different personalities.

McDougal, who had been Madison Guaranty's chief executive officer, resigned from Madison Guaranty's Board in 1984 when Latham was appointed CEO. But McDougal remained as the CEO of Madison Financial Corporation, the institution's wholly owned subsidiary. Despite this change, McDougal and Latham never

switched offices. McDougal kept the prominent office in the upper half of Madison's split foyer entrance area. Latham kept his office in the back, away from customers and near the operations area where cashiers processed checks. In 1985 Latham hired Pat Heritage to be his executive assistant. Heritage met with Latham every morning to take orders. Latham remained in his office with his door closed while Pat Heritage worked with the staff and carried messages to and from Latham's office.[2]

II. The Approach Taken To A Prosecution Of McDougal

The proposed indictment attempts to follow the four basic principles set forth below:

Avoid any conceivable collateral estoppel argument that might give rise to an interlocutory appeal under United States v. Abney, 431 U.S. 651 (1977).

In the 1989 indictment, McDougal was charged with defrauding Madison Guaranty with respect to two transactions: (1) the Levi Strauss transaction and (2) the Master Developers transaction. The thrust of the government's case was that McDougal, who was entitled to ten per cent of the annual net profit of Madison Financial had fraudulently enriched himself by booking artificial profit from the sale of two portions of the 145th Street property

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[2]In 1989 Latham pleaded guilty to one false entry count. He admitted that he had changed the terms on a note (from "non-recourse" to "recourse") on the Davis Fitzhugh loan, a loan that was prominently covered in the first McDougal trial. Latham admitted that he did this unilaterally to deceive the examiners but claimed as well (and this is typical of Latham) that he thought that the original terms of the Davis Fitzhugh note were consistent with the change he made to the note. Although he had signed a plea agreement with the government, he testified as a defense witness in McDougal's 1990 trial.

that Madison Financial had purchased in October 1985. The property later became known as Castle Grande Estates. The profit was artificial, according to the government, because the two sales in question were "sham" sales. The sales were financed by Madison Guaranty with nonrecourse notes. Hastily arranged commissions paid to the purchasers served as the purchasers' downpayments. In the case of Master Developers, there were arguably false financial statements.

Nothing in the proposed indictment resembles this 1989-90 case.[3] There is no mention of Castle Grande, nonrecourse notes, ad hoc commissions, McDougal's ten per cent bonus, or the six per cent investment limitation imposed on Madison Financial. The proposed indictment, however, does involve a nominee loan and an accommodation real estate transaction involving Lisa Aunspaugh. But this transaction is fraudulent not because it allows Madison Financial to book artificial profit but because it involves undisclosed self-dealing at the expense of Madison Guaranty.

Highlight those instances in which McDougal or family members, through deception or false documents, gain at the expense of the institution.

In the 1989 case the government sought to tarnish McDougal by pointing out that he received a ten per cent bonus on the annual net profit of Madison Financial and therefore was motivated to artificially inflate Madison Financial's profit.

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[3]Sam Heuer, McDougal's lawyer, succinctly summarized the 1989-90 case in his Rule 29 argument when he told the Judge: "Their whole case is based on the theory that a 6% limitation was imposed on the savings and loan's investment and they had to shed assets and that created these two sham transactions." (T. 708).

There are two weaknesses to this approach: (i) the ten per cent bonus was a normal fully disclosed basis of compensation and (ii) McDougal's gain is, on the short term at least, tied to the gain of the institution. While McDougal gains in the short term by taking his bonus, the institution loses in the long term only if real estate prices stabilize or crash. This is what happened. In early 1986 the Bank Board "wrote down" the value of Madison Financial's real estate investments. Since a large portion of Madison Guaranty's loans were tied to these investments or other declining Arkansas real estate, the Bank Board classified a large portion of the loans. The severe write down of Madison's assets resulted in a negative net worth.

The proposed indictment eliminates the "declining real estate prices" defense. It focuses on discrete transactions in which McDougal or some family member, through deception and false documents, personally gained at the expense of the institution regardless of any economic scenario.

Emphasize McDougal's intent and motivation to deceive the Bank Board examiners.

In the 1989 case, the government practically ignored the role of the examiners and McDougal's intent to deceive them. With the bank fraud and misapplication statutes, the entire focus was on McDougal's intent to defraud Madison.[4] But this presented

[4]There are two counts in the 1989 indictment which charge a violation of 18 U.S.C. 1014 (submitting false financial statements). These counts allege among other things that the false financial statements were submitted "for the purpose of influencing the Federal Home Loan Bank Board." But the indictment fails to explain how they might have influenced the

problems for the prosecution. Why would McDougal want to defraud and injure the institution that he and his wife owned? At trial, McDougal's lawyer produced a CPA witness who attempted to explain that, with McDougal's 10 per cent bonus and the extent of his and his wife's stock ownership, it made no economic sense for McDougal to fraudulently book profit from Madison Financial when the entire financing for the transaction came from Madison Guaranty.[5]

One way to counter McDougal's defense is to fashion an indictment which emphasizes that Madison is not just any corporation. Its liabilities are insured by the federal government and for that reason its activities are strictly regulated. Since we will show economic loss to the institution, the proposed indictment does indeed charge McDougal with defrauding an institution in which he is the majority shareholder. But eight of the eleven counts of the proposed indictment charge McDougal with deceiving the examiners or defrauding the Bank Board (by deceiving its examiners). The benefit of this dual victim approach (both Madison and the examiners were defrauded) is that it shifts the focus away from an institution McDougal owns to an institution that the public

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Bank Board. In fact, the 1989 indictment never alleges that McDougal intended to deceive the bank examiners. Moreover, there was no testimony at trial from an examiner who might have explained the examination function and the materiality of various false statements.

[5]The testimony of defense witness Milton Halford at trial is difficult to follow and may not be correct. But the government was unable to counter it.

(including the depositors and members of the jury) have a stake in.

Capitalize on the fact that McDougal was placed on notice with the 1984 Supervisory Agreement.

The 1984 Supervisory Agreement, signed by McDougal, never surfaced in the 1990 trial. Nor was it disclosed that McDougal signed a cease and desist consent order in 1983 regarding Madison Bank and Trust, in Kingston, Arkansas, a small (FDIC insured) bank which he also controlled. By highlighting the 1984 agreement and by making the Bank Board one of the two victims (Madison Guaranty being the other), we will be able to prove that by 1985 McDougal was acutely aware of bank examiners and that he was motivated to deceive them.

III. The Proposed Indictment And The Statutes

The proposed indictment utilizes two statutes: 18 U.S.C. §§657 (misapplication) and 1006. Two different clauses of section 1006 are used, namely, the false entry clause and the fraudulent participation clause. To keep the matter simple for the jury, we have used section 657 only when we allege an intent to defraud Madison Guaranty. In contrast, the false entry clause of section 1006 is used only when we allege an intent to deceive the examiners. We have used the fraudulent participation clause where we allege both an intent to defraud Madison Guaranty and an intent to defraud the Bank Board (by deceiving its examiners).

18 U.S.C. § 657 provides in pertinent part:

> Whoever, being an officer, agent or employee of or connected in any capacity with...any savings and loan corporation or association...the accounts of which are

> insured by the Federal Savings and Loan Insurance Corporation...embezzles, abstracts, purloins or willfully misapplies any moneys, funds, credits, securities or other things of value belonging to such institution...shall be [guilty of an offense].
>
> 18 U.S.C. §1006 provides in pertinent part:
>
> Whoever, being an officer, agent or employee of or connected in any capacity with...any savings and loan corporation or association...the accounts of which are insured by the Federal Savings and Loan Insurance Corporation...
>
> [false entry clause]
>
> ...with intent to defraud any such institution or any other company, body politic or corporate, or any individual, or to deceive any officer, auditor, examiner or agent of any such institution or of department or agency of the United States, makes any false entry in any book, report or statement of or to any such institution,...or...
>
> [fraudulent participation clause]
>
> ...with intent to defraud the United States or any agency thereof, or any corporation, institution, or association referred to in this section, participates or shares in or receives directly or indirectly any money, profit, property, or benefits through any transaction, loan, commission, contract, or any other act of any such corporation, institution, or association, shall be [guilty of an offense].

The indictment uses the misapplication statute three times: (i) the $64,000 nominee loan to Lisa Aunspaugh; (ii) McDougal's December 1985 payment of Madison Financial funds to Eric Sorensen; and (iii) McDougal's February 1986 payment of $18,000 to Bill Henley as a lease payment, covering months in which Henley never owned the building.

The false entry clause of section 1006 is used five times. In each use of the false entry statute the indictment alleges only an intent to deceive the examiners. The five uses are as follows: (i) the June 1985 Lisa Aunspaugh loan application; (ii) the December 1985 entry in the books of Madison Financial

regarding a payment to Eric Sorensen; (iii) the backdated Madison Financial lease on 1308 Main from Bill Henley; (iv) the consulting fee invoice submitted by Robert Palmer in March 1986; and (v) the March 1986 Management Questionnaire submitted to the examiners.

The fraudulent participation clause of section 1006 is used three times. The fraudulent participation clause is essentially a conflict of interest prohibition. The three uses are as follows: (i) the receipt of the June 1985 loan proceeds to the Designers Construction account on July 3, 1985 [an account to which McDougal owed money], (ii) the receipt of the $25,000 from Designers Construction in July 1985; (ii) and the July 1985 receipt of the $25,000 for the airplane.

In our April memo we proposed charging McDougal for his interest free use of Designers Construction funds, an account that was almost always in overdraft status. Based upon our more conservative calculation of the amount of interest lost that could be traced directly to McDougal, and other factors discussed below, we do not recommend any specific charges relating to the overdraft status of the Designers Construction account. Nonetheless, we will still expose for the jury McDougal's use of the Designers Construction account in order to show that he received the Aunspaugh loan proceeds through the account.

IV. Lisa Aunspaugh And Designers Construction (Counts 1-4)

A. The Events Of 1984

Except for choosing paint colors, fixtures, carpeting, or wallpaper, Lisa Aunspaugh was inexperienced and naive. She lived at home with her parents and drove a 1981 Datsun. According to her mother, Lisa was sincere, religious, and trusting. One of her favorite TV channels was (and still is) Pat Robertson's Christian Broadcast Network. After high school she spent a year studying interior decorating at South Central Career College. In 1984 Susan McDougal met Lisa when Lisa was working at the Walls and All Design store. Susan had gone to the store seeking decorating advice, furniture and accessories for the Madison offices. After numerous contacts, Lisa confided in Susan that she did not trust her employer.[6] Susan then offered Lisa a job. Susan told Lisa that Madison needed someone to help with the renovation of Madison's main office at 1501 Main St. and to assist the builders at Maple Creek Farms or at other development sites.[7]

Lisa placed so much trust in Susan that she agreed to work for Susan without knowing what her compensation would be. She had just turned 20 and was too shy to raise the topic. She started working for Susan in February 1984. Her pay was irregular. She recalls that she had worked for Susan for

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[6]Lisa told Susan that her employer was cheating Madison when various orders were placed.

[7]Maple Creek Farms was a 1300 acre development owned by Madison Financial approximately 20 minutes from Little Rock.

approximately three months before Susan asked her, "Have we paid you?" Lisa said no. It was mid-May and Lisa was finally paid.[8]

Throughout the rest of 1984 she worked under Susan's supervision. She worked with contractors and builders, selecting interior and exterior colors, carpeting, wallpaper and fixtures. She also did miscellaneous chores helping Susan run Madison Marketing, a company Susan owned which purchased advertizing time and space for Madison Guaranty and Madison Financial.

In January 1985 Jim McDougal asked her if she wanted a new Mercedes. He explained that Madison was going into the car leasing business and that Madison would give her 100 per cent financing. Lisa accepted the offer. She sold her Datsun and signed a $20,000 note without submitting a loan application. The Mercedes loan was all the more attractive since she never had to make periodic payments on the car loan. She only made payments when Jim McDougal told her it was necessary. According to the terms of the note, the full amount was due in one year with only one semi-annual interest payment. Ex. 0.5.

B. The Formation Of Designers Construction

In January 1985 Jim McDougal called Lisa to his office. He told her that they were going to consolidate all the construction and renovation work in one company and that she was going to continue her decorating work through this company. Either Jim or Susan came up with the name Designers Construction. Jim McDougal

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[8]She was paid $3000 in the form of two identical $1500 checks. It appears from her 1984 tax return that Lisa received $7500 in payments over the eleven month time period.

told her to go downstairs and open a bank account for the company. It was not clear to Lisa what her role was but she was reluctant to ask questions. At some point in early 1985, Jim McDougal explained that Designers Construction would bill the customer whatever its costs were plus eight per cent. In most cases the customer would be Madison or individuals or companies connected to Madison. The eight per cent markup could then be used to pay Lisa.

Lisa kept the checkbook and collected the bills when they arrived. Jim McDougal would periodically tell her when it was time to pay the bills and who should be paid. Occasionally, a contractor would come to Lisa and say that Jim had approved payment of an invoice.

In April 1985 Jim McDougal told Lisa that he was making Designers Construction a corporation and that she should go to Steve Cuffman's office to pick up papers.[9] The papers she picked up were standard incorporation papers. Ex. 1. But Lisa does not know of any stock issued for Designers Construction or any Board of Directors meetings.

C. The Maple Creek Home And The $64,000 Nominee Loan (Counts 1-4)

In approximately March 1985 McDougal called Lisa to his office and told her that he and Susan had a modular home in Kingston that they were unable to sell. He told her that they

[9]Steve Cuffman recalls that somebody at Madison (he does not recall who) asked him to incorporate Designers Construction. Thereafter he had no further dealings.

planned to move the home to a Maple Creek lot and then sell it. He told her that he and Susan could not sell it in their name and wanted to use Lisa's name. Typically, McDougal gave no further explanation. Lisa, in turn, was too shy to ask questions.

Lisa signed an Offer and Acceptance for an $8000 lot (Lot 747) which was dated March 20, 1985.[10] Ex. 2. She never read it and does not recall when she actually signed it. She does recall going downstairs to the Quapaw Title Office and attending the closing on April 5, 1985, where she signed (without reading) a $7200 Promissory Note and Mortgage. Exs. 3-4. At the closing, she wrote an $800 check from her own account for downpayment on the lot. Ex. 5. Jim McDougal had told her that she would be reimbursed. A few days later she deposited a $1000 Flowerwood Farms check (apparently signed by Susan) in her personal account.[11] Ex. 6.

The $7200 Promissory Note contains a material false statement. Typed in the space designated for the purpose of the

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[10]Pat Harris signed the Offer and Acceptance on behalf of Madison Financial. In 1985 Harris was selling Maple Creek lots on commission. As a recent college graduate, Harris had worked on McDougal's 1982 congressional race.

Harris is currently a public defender in Nashville and was a 1993 graduate of the University of Michigan Law School. In a bizarre twist of events, Harris, who continues for the most part to cooperate with the investigation, is currently engaged to Susan McDougal.

[11]Flowerwood Farms was a company owned exclusively by the McDougals. Although the $1000 check was signed by "S McDougal," Lisa could not be sure that Susan signed the check.

loan is the statement "purchase lot for personal residence."

[redacted]

Lisa had nothing to do with moving the house from Kingston to Maple Creek and does not know when it happened.[12] She does remember signing additional papers in June 1985. On June 28, 1985, she signed a $64,000 Promissory Note and Mortgage. Ex. 7-8. These funds (the stated purpose of the loan was "personal") were used to "buy" Jim and Susan's modular home.[13]

Like the earlier lot loan for $7200, Lisa never considered this to be her loan. She never noticed that by signing the loan she was committed to a monthly payment of $658. It was an

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[12]Sue Strayhorn, McDougal's secretary, routinely screened McDougal's calls. She recalls talking to individuals involved in moving Jim and Susan's home from Kingston to Maple Creek. The individuals had questions directed to McDougal. Only after Jim and Susan were removed from the bank did Strayhorn learn of Lisa's involvement with the house.

[13]According to Robert Palmer, his partner Bennie Beard did a legitimate appraisal on lot 747 (without the house) dated April 1, 1985. The value of the lot was $8000. Palmer himself actually signed the appraisal. Later in July, according to Palmer, Beard did a second appraisal of the lot (with the house attached). Beard valued the lot at $69,250. Palmer can not say that there is anything wrong with this appraisal. However, Beard dated the second appraisal March 1, 1985. Palmer believes from other documents in the file, i.e., the certification sheet signed by Mariann Richards (using Palmer's name) dated 7-1-85 that Beard's 3-1-85 date is a typographical error and should have been 7-1-85. Beard's photographs show leaves on the trees which would not have been possible on 3-1-85. Exs. 9-10.

obligation that Jim would handle for her and so Lisa paid no attention to the details. Whereas Lisa clearly recognized that the Mercedes loan was her loan.

The settlement statement for the $64,000 loan shows that part of the proceeds were used to pay off Lisa's earlier $7200 lot loan. Ex. 11. After the closing costs were deducted, Quapaw Title paid Lisa $56,087.79. McDougal told her to deposit these funds into the Designers Construction account which she did.

The $64,000 loan is accompanied by an undated "Residential Loan Application" which Lisa signed but did not read. Her only recollection of this loan application is that Jim McDougal telephoned her and asked her for her credit card balances. A few days later he handed her the loan application and she signed it. Other than her credit card information, Lisa claims to have had no input in the loan application.

The application contains a number of material false statements. Ex. 12. (Attached) For example, on the income side it overstates her income ($3,682 a month) by more than 50 per cent. The application lists her monthly salary as $3000 and states that she receives $682 a month in rent. [redacted] Her bank account indicates that in 1985 she was receiving regularly $1000 a month from Madison Marketing. There is also some additional deposits to her account from Madison Marketing in 1985 (approximately $4000) that appear to be income. Her 1985 income tax return (prepared almost a year after the $64,000 loan)

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indicates that she received $35,825 in gross profit from Designers Construction but had $24,445 in expenses leaving her with a net profit of $11,380. Her 1985 return also listed $15,000 in contract fees. As a result her 1985 1040 listed a total income of $26,508.[14] Ex. 13. This was a big jump from 1984. Her 1984 income tax return reported less than $10,000 in total income. Ex. 14.

The loan application also contains a misleading statement of net worth. Just three years out of high school, Lisa, according to the application, had a net worth of $101,000. Three fourths of her purported net worth was attributable to a listed "$135,500" equity in 1308 Main, a building that Lisa did not at the time understand to be hers.[15] Nor did she have any idea of the building's value. The application also lists her furniture and other personal property at $16,000--a figure Lisa claims is grossly inflated.[16]

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[14]Contrast the $26,508 with the $44,184 (12 x $3682) listed on her financial statement.

[15]According to the documents, Lisa assumed Jim Guy Tucker's $47,000 mortgage on 1308 Main--a building Lisa remembers as Sues Barbershop--on March 22, 1985. On March 25, 1985, at McDougal's direction she wrote and delivered a $12,000 check to Jim Guy Tucker. Sometime later Tucker deeded 1308 Main to Lisa. Although she signed various documents, Lisa never understood that her name was being used on this property until Jim had her borrow $125,000 on 1308 Main to finance its renovation. Unlike her Mercedes, 1308 Main was something she understood she was holding for either Jim or Madison. In any event, Lisa had only "paid" $59,000 ($47,000 assumption and $12,000 in cash) for 1308 Main only three months earlier.

[16]A month or two earlier, Lisa had moved out of her parents' home and moved into West Side Creek Apartments. According to Lisa's mother, Bessie Aunspaugh, Lisa had taken some of her

D. The Acquisition Of 1308 Main St. And The October 1985 Loan

In early 1985 Jim Guy Tucker owned 1308 Main St, a run down two story building both Lisa and McDougal referred to at times as "Sues Barbershop."[17] Tucker had borrowed $45,000 from Madison to purchase the building. On March 25, 1985, McDougal told Lisa to write a $12,000 check from the Designers Construction account and to deliver it to Tucker. Ex. 15. McDougal also had Lisa sign an Assumption Agreement in which she personally assumed Tucker's $45,000 mortgage on the building. Ex. 16. The Assumption Agreement is dated March 22, 1985, although Lisa does not know that she actually signed it on that date.[18] Tucker also executed a deed of the property to Lisa that is dated March 22, 1985.[19]

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furniture from home. She bought a sofa and a bed. The bed was purchased, according to Lisa, at a garage sale. Lisa's parents bought her a TV. According to Bessie, Lisa never had any personal property, including clothing and jewelry, that could have been valued at $16,000.

[17]Sues Barbershop at one time had been a tenant but Lisa recalls that in 1985, before renovation began, homeless people were living in 1308 Main St.

[18]Lisa does recall that the $12,000 check to Tucker was properly dated (March 25, 1985).

[19]Although the Deed is ostensibly executed March 22, 1985, we know that it was executed in October 1985. We have a letter dated October 9, 1985, from McDougal to Tucker in which McDougal tells Tucker that he "should execute the enclosed Warranty Deed to complete the assumption of the 1308 Main St property." The letter goes on to say that if Tucker "will just return it to me, I will take care of having it notarized and recorded." Ex. 16.5. Sue Strayhorn has told us that she sent the letter and deed to Tucker in October 1985 and that she later notarized it in accordance with McDougal's instructions. In the lower left corner of the deed is the statement "prepared by John Latham, attorney at law." This statement, according to Strayhorn, was placed on nearly every deed utilized by Madison and it does not

Ex. 17. Accordingly, on paper at least, Tucker sold Lisa 1308 Main for $12,000 and her assumption of his mortgage. Lisa, on the other hand, recalls that she never connected in her mind the Tucker check and the Assumption Agreement with her "ownership" of 1308 Main. Unlike the Maple Creek house, McDougal had not told her that he was using her name to hold the building. Only later (in October 1985) when Lisa signed documents for a $125,000 loan to renovate 1308 Main, did she understand that her name was being used in connection with the building. Like the Maple Creek transaction, Lisa considered 1308 Main as something she has holding for Jim or Madison.

Lisa remembers that the October loan came up when McDougal told her that they were going to renovate 1308 Main and that they needed the funds to pay for it. When he gave her loan papers to sign she realized that her name was being used. The $125,000 loan was closed at Beach Abstract and Title Company on October 15, 1985. Lisa signed a promissory note and mortgage. Exs. 18-19. The file contains no loan application.[20] The stated purpose of the loan was "business investment." $49,000 of the loan proceeds were used to pay off Tucker's Madison loan on 1308 Main that Lisa had assumed. Ex. 21. The remainder,

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mean that John Latham, Madison Guaranty's 30 year old CEO, actually prepared the deed or ever saw it. Latham confirms this.

[20]There is a Robert Palmer appraisal, dated October 2, 1985, with a value of $247,000. This is not an "as is" appraisal. Instead it appraised the value of 1308 Main contingent upon a host of renovation plans which specifically included increasing the square footage (rental space) of the building. Ex. 20.

approximately $74,000, was deposited into the Designers Construction account.

In short, at a time when Lisa recalls earning roughly $2,000 a month before taxes, the October loan obligated her to a $1,286 monthly payment. Like the Maple Creek house loan, Lisa never considered the $125,000 loan to be her obligation, but rather an obligation that Jim would handle for her in some manner or fashion.[21]

E. The Relationship Between Jim, Susan, and Lisa

By late 1985, Lisa wanted to end her relationship with Jim and Susan McDougal. Two things bothered her. First, Jim had made sexual advances to her and seemed to "play mental games with her." She felt uncomfortable about this and told no one about it, including her mother, Bessie, who was working at the bank. Jim seemed to be aware that Susan was interested in Pat Harris and he put pressure on Lisa when Susan was not around. Despite this fact, she agreed to go to California with Jim in the summer of 1985. She expected to have her own room but Jim had made arrangements for them to share a single room with twin beds. She knew the risks of going with him but she had never been to

[21]Lisa is corroborated by her mother, Bessie Aunspaugh, who worked as a Madison receptionist in 1985-1986. Bessie Aunspaugh was shocked when we showed her the loan application which listed Lisa's net worth in June 1985 at $101,000. According to Bessie, Lisa was so trusting of Jim and Susan that she would sign anything they placed in front of her. Bessie has told us that Lisa never told her that she was buying a Maple Creek house or that she owned 1308 Main--a building that Bessie knew was being renovated two blocks from the Madison Guaranty office. But as we discuss below in our section on Bessie Aunspaugh, Lisa did not keep her mother informed on some important matters.

California and wanted to see it. At our most recent interview of Lisa, we pressed her on whether or not she ever succumbed to Jim's advances and she told us that, despite the pressure, she had not.[22]

Secondly, Lisa was tired of lying for Susan who was romantically preoccupied with Pat Harris. Susan always had Lisa lie to Jim about her (Susan's) whereabouts. In March 1985, Susan took Lisa to Aruba for a vacation. Jim did not know that Pat Harris met Lisa and Susan in Dallas and flew with them to Aruba.

In January 1986, Lisa responded to a telephone solicitation from Fort Worth regarding a company selling leadership franchises. The company provided books, tapes, and training materials whereby a franchisee would solicit corporations to conduct leadership seminars and training sessions. She visited Fort Worth more than once and was impressed by the promoters. Lisa saw this franchise as a new line of work--something that would enable her to leave Madison and the McDougals. At some point Lisa told Jim that she was purchasing this franchise.

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[22]John Latham, who was married, also made at least one unwelcome advance to her. Lisa, on the other hand, was interested in Larry Kuca. But Kuca already had a girlfriend. Both Kuca and Denton recall Lisa dressing, on occasions, like Susan (i.e. with the low cut blouse). Kuca found this somewhat out of character for Lisa. Denton, who had very little to do with Lisa, recalls that she simply followed Susan around serving no "economic purpose to Madison." Kuca recalls that Lisa "had no business sense." Sue Strayhorn, McDougal's secretary, has described Lisa and Susan as two "peas in a pod" who often dressed alike. Strayhorn has described Lisa as nice but "immature."

F. The Sale Of 1308 Main To Bill Henley

A review of the Designers Construction account shows that periodic work was done on 1308 Main even before Tucker conveyed it to Lisa. The bulk of the Designers Construction expenditures, however, were not made until the last five months of 1985 when renovation began in earnest. This renovation was complete in approximately January 1986 when she, Davis Fitzhugh, Vernon Dutton and other Madison Financial employees moved in.[23]

Sometime in January 1986 McDougal told Lisa that he was ready to sell the building to Bill Henley. Lisa was casually acquainted with Henley because he was Susan's brother. Lisa played no role in the sale and was unaware of the $190,000 sales price. At McDougal's request, Lisa executed a deed conveying the building to Bill Henley on January 15, 1986. Ex. 23. Henley borrowed the $190,000 from Madison Guaranty. Ex. 24. McDougal told Greg Young to put $130,000 of Henley's loan proceeds into the Designers Construction account and the remaining $60,000 of the proceeds into Lisa's personal account. Exs. 25-26. Lisa recalls that, when she returned to work after a few days off, Jim McDougal called her to his office and told her that he had placed $60,000 in her account to pay her for her Designers Construction work, particularly on the 1308 Main renovation. He told her as

[23]Lisa can estimate the time when renovation was complete based upon some of the checks written to various contractors. For example, Lisa recalls that the Designers Construction check to "Business Communications of Arkansas," dated January 7, 1986, paid for the installation of the telephone system. Ex. 22.

well that she had to pay off her Mercedes loan which she promptly did.

A review of bank records shows, however, that Lisa was not on vacation when the $60,000 hit her bank account. She was writing Designers Construction checks virtually every day around mid January. When this was pointed out to her, she told us that she recalled being away from the bank for several days and thought she had been away on vacation. We know that Lisa spent time away from the bank working at various development sites and we assume that this occurred around January 15, 1986.

A review of the bank records and our April 27 interview of Lisa shows the following. On January 15, 1986, 1308 Main was sold and the $60,000 was deposited into her personal account. Sometime between Wednesday, January 15, and Saturday, January 18, McDougal told her about the money in her account and ordered her to pay off her car loan. On Sunday January 19, she wrote a personal check of $10,000 to Pat Robertson's Christian Broadcast Network. She has told us that she responded to a fundraising telecast on CBN. Monday was the Martin Luther King holiday. On Tuesday, January 21, she wrote a check in the amount of $21,337.39 to pay off her car loan.

On Wednesday January 29, Lisa wrote a $15,000 personal check to her mother, Bessie Aunspaugh. Lisa has explained that she was planning to purchase a franchise from Leadership Management Incorporated and that she wanted to transfer the money to her mother's account before McDougal could ask her to return some of

the $60,000 to Designers Construction or to use the remainder of the money for some other purpose.

Lisa's fear that McDougal would try to retrieve some of the $60,000 proved to be valid. On Friday January 31, Lisa returned $20,000 of the funds to the Designers Construction account because McDougal told her that he needed the money to close out the Designers Construction account. Lisa authorized her mother to sign Lisa's name on Lisa's personal check in the amount of $20,000 payable to Designers Construction.

But Lisa had already overextended herself. With the $10,000 contribution to Pat Robertson, the $21,000 pay off of the car loan, and the $15,000 temporary transfer to her mother's account (for a total of $46,000), there was insufficient funds in her personal account to cover her $20,000 payment on Friday, January 31, to Designers Construction. As a result on Monday, February 3, Lisa transferred back to her personal account $10,000 of the $15,000 she had temporarily parked in her mother's account. But this meant that she would not have enough funds to buy the leadership franchise which she realized would cost her $18,000.

Two weeks later, acting behind McDougal's back, Lisa decided to take $15,000 from the Designers Construction account in order to enable her to purchase the leadership franchise. This was her way of undoing what McDougal had her do only a few days earlier, namely, returning $20,000 of the $60,000 to Designers Construction--something Lisa did not like doing since she had planned to use the remainder of the $60,000 to buy the franchise.

Lisa had her mother sign Lisa's name to a $15,000 Designers Construction check payable to Lisa Aunspaugh which was then deposited into Lisa's personal account. Lisa also had her mother return to Lisa's account $3,000 of the original $15,000 Lisa had transferred to her mother's account. This enabled Lisa to write an $18,000 check to purchase the leadership franchise. She needed her mother to sign the $15,000 Designers Construction check and make the necessary deposits at the bank since Lisa was in Fort Worth on February 18 to buy the franchise. She needed to make sure that her personal $18,000 check would clear her account (which it did on February 20).

G. Lisa's Mother, Bessie Aunspaugh

Bessie Aunspaugh was laid off from her Timex job in 1983. Sometime in late 1984 or early 1985, while Lisa was still living at home, Lisa told her mother that she and Susan needed part time help at Madison. Bessie came to work on a part time basis, doing odd jobs and answering the telephone for Susan and Lisa in the Madison Marketing office in the back of the Madison Guaranty office at 1501 Main. She also temporarily relieved Kirby Randolph who worked as a receptionist at the bank's main entrance.

Susan also gave Bessie the job of keeping the check register for Jim and Susan's private accounts, such as Flowerwood Farms, Tucker-Smith-McDougal, and Pembrook Manor (but not White Water Development Co.). According to Bessie, Jim would move money from one account to another and Bessie would prepare a check for Jim

to sign. Bessie recorded the checks in the register but did not reconcile the accounts when the monthly statements were delivered to her.

Bessie also wrote a number of Designer Construction checks and signed Lisa's name to the checks. Bessie explained that Lisa was often out of the office doing decorating work at some location and that Jim, Susan, or Lisa would want a check to be written to some contractor. Since the Designers Construction checkbook was kept in the Madison Marketing office in the back of the bank, Bessie would write the check. She is sure that Jim directed her to write at least some Designers Construction checks. Bessie regarded Designers Construction as Jim or Susan's company through which Lisa did most of the interior decorating work. Bessie was aware of the sizeable overdrafts in the Designers Construction account but was not concerned about it because of Jim and Susan's involvement with the company. She never regarded Designers Construction as Lisa's company although she knew that Lisa had signatory authority over the account.

Amazingly, Bessie could not remember that Lisa had parked $15,000 into her (Bessie and her husband's) checking account on January 29, 1986, and that Lisa had returned at least $13,000 of those funds to Lisa's account within a few weeks. Nor could she recall writing a $15,000 Designers Construction check to Lisa on February 18, 1986, which enabled Lisa to buy the leadership franchise. Indeed, Bessie has no recollection of Lisa's purchase of the leadership franchise. Bessie does not contradict Lisa.

She corroborates Lisa to the extent that Bessie acknowledges her signature on the checks and agrees that she wrote the checks at the direction of either Lisa, Susan, or Jim. She simply can not remember the circumstances in which she wrote the checks. Bessie also corroborates Lisa on the question of who appeared to run Designers Construction and the reason why the overdrafts never appeared to be a problem.

It appears, however, that Lisa did not confide in her mother to the degree that we had originally thought. Lisa recently told us that she never told her mother that she was unhappy with Jim and Susan and that Jim had made advances to her. Bessie told us that Lisa appeared to be happy in her relationship with Jim and Susan. Bessie did not even know that Lisa had made a trip to California, much less a trip with Jim. Bessie did say that Lisa probably would not have told her about matters that might have upset her (Bessie).

H. McDougals' Use of Designers Construction Funds

Designers Construction directed the renovation or home improvement of a number of properties besides those owned by Madison Guaranty or Madison Financial. For example, it ordered work done on properties owned by Pat Harris, Jim Henley, and Larry Kuca. According to Lisa, after the work was done, the contractors submitted their bills to Designers Construction. Jim McDougal would approve payment and Lisa would write the necessary

checks.[24] With an eight per cent markup, Designers Construction would then bill the owners of the properties (including Madison Guaranty and Madison Financial) for the work performed. But the owners were slow to pay Designers Construction. As a result the Designers Construction account was almost always in an overdraft status.

For example, the Designers Construction account had a negative balance for its first six months, reaching a high negative balance of $146,000 on May 31, 1985.[25] Ex. 28. The account was in existence for 417 days, during which it had a negative balance for 363 days. Over those 363 days, it had an average negative balance of $36,123. Ex. 30.

Jim and Susan McDougal were also using the Designers Construction account for their own renovation work. On February

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[24]We have a memo, dated June 3, 1985, typed by Sue Strayhorn, in which McDougal tells Pat Harris to "pay Designers" and "list lot 747." Ex. 29. The memo is significant because it shows McDougal's direct involvement in the business of Designers Construction and the fact that he is trying to sell his modular home in Maple Creek (lot 747) that Lisa was about to "purchase" from Jim and Susan with the June $64,000 loan. Harris has no memory of the memo. But Harris does remember that Lisa and Susan had spent substantial funds from Designers Construction renovating his house in the Quapaw quarter in Little Rock. When shown the memo, Harris concluded that he was probably late paying Designers Construction and Jim McDougal wanted him to pay up. Bank records confirm this. On the same date as the memo, Designers Construction records show a $66,350 deposit from Pat Harris.

22, 1985, Jim and Susan borrowed from Madison $360,000 to purchase and "renovate" #4 Bettswood. Ex. 31. The loan was supported by a Robert Palmer appraisal which assumed that major renovation would be done to the house.[26] Ex. 32. At the direction of Jim and Susan, Lisa became involved in the Bettswood renovation by paying the architect and the contractors with Designers Construction funds. Payments to the architect began in February 1985. The bulk of the expenditures occurred during the summer months of 1985, although some work was done as late as January 1986. In all, Designers Construction made payments of $150,792 for work done on #4 Bettswood.[27]

At times McDougal was making payments to the Designers Construction account of his own money to compensate for these expenditures. But McDougal's payments always lagged behind the expenditures, thereby aggravating the overdraft status of the account. For example, on June 21, 1985, McDougal deposited $10,000 of his own funds into the Designers Construction account. But by this time (June), Designers Construction had already spent over $40,000 on #4 Bettswood. Ex. 28.

To pay for the Bettswood expenditures, McDougal turned to the June 28th $64,000 nominee loan to Lisa Aunspaugh. This money turned out to be the largest source of funds to pay for the #4 Bettswood renovation. These funds amounted to a deposit of

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[26]Not all of the loan proceeds were used, however, for the renovation. Nearly $100,000 of the loan proceeds were used to pay off five other loans that Jim or Susan or both had.

[27]We have this figure from Lisa's ledger. Ex. 28.5.

$56,087--a deposit so substantial that it took the Designers Construction account out of overdraft status.[28] It also created a temporary surplus vis-a-vis the amount coming from the McDougals versus the amount going to the McDougals. In other words, just before Jim McDougal contributed $56,087 in nominee loan proceeds to the Designers Construction account, the account had spent $30,000 more on Bettswood than either Jim or Susan had contributed to the account. But once the $56,087 was deposited to the account, the account had received more from Jim and Susan McDougal (albeit in the form of nominee loan proceeds) than it had spent on Bettswood by the amount of $25,000. Ex. 33. But that $25,000 surplus was temporary. Within two weeks Designers Construction spent an additional $24,000 on #4 Bettswood and $4,701 on McDougal's personal American Express Card.

From that point on, until February 26, 1986, the day before McDougal had Lisa close out the Designers Construction account, Jim and Susan McDougal had received more from the Designers Construction account than what they put into the account. By February 26, 1986, McDougal owed Designers Construction approximately $30,917. The account balance itself stood at a negative $31,026. McDougal ordered Lisa to write a refund check to Campobello Co. for $6,983,03.[29] McDougal then borrowed

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[28]Not all of the $64,000 was available since it was necessary to retire Lisa's April loan which purchased lot 747 in the first place.

[29]According to Lisa, Campobello had made a prepayment to Designers Construction of $10,200 for renovation work, not all of which was needed. Her final payment to Campobello of $6,983.03

$40,000 from Madison Guaranty and deposited $38,000 to Designers Construction. This brought the account to a negative $39.31. $39.31 (from Madison Guaranty) was then credited to the account as the account's final entry on February 27, 1986.[30]

As a result of McDougal's last minute $38,000 deposit, he ended up paying approximately $7,000 more into Designers Construction than what he and Susan received. In our April memo, however, we had calculated the opposite, namely, that Jim McDougal received more from the Designers Construction account than what he deposited into the account--$9,400 more. But this earlier $9,400 figure assumed that the $16,367 Designers Construction spent on the Maple Creek lot (Lot 747 with McDougal's home) was for McDougal's (not Lisa's) benefit.[31] We have reconsidered this issue. Taking a more conservative position, we no longer assume that the Lot 747 improvements and loan payments were for the McDougals' benefit.

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was a return of the remainder of those proceeds.

[30]We have a memo signed by Bessie Aunspaugh (Lisa's mother) on Designers Construction letterhead addressed to Madison Guaranty telling Madison to close the account "when all my checks are in." Bessie does not remember this memo. We have been unable to determine from bank microfilm who signed off on the debit memo that transferred the $39.31 needed to zero out the account. The Madison Guaranty general ledger shows on the date in question that its overdraft income account was debited $39.31.

[31]According to Lisa, McDougal directed Lisa to make two payments on her $64,000 loan from the Designers Construction account. These payments add up to $3,649. The remainder of the $16,367 was spent on improvements to the property, such as landscaping and septic and interior decorating improvements that Jim had Lisa order.

I. The Indirect $25,000 Payment To McDougal And The California Trip

On July 26, 1985, three weeks after the $56,087 deposit was made, Jim McDougal told Lisa to write a $25,000 check to herself from the Designers Construction account. He then told her to deposit the funds into her personal account and to write him a $25,000 check from her personal account.[32] All of this was done to disguise from the examiners a direct payment from Designers Construction (a negative balance account) to an affiliated party, namely, James McDougal. Exs. 34-35.

This $25,000 indirect payment to McDougal on July 26, 1985, brought the Designers Construction account to an $11,000 negative balance. It also meant that by July 26, 1985, Jim and Susan McDougal had received either directly or indirectly $28,744 more from the account than what they had put into the account. Ex. 33.

And so it went. More payments were made on #4 Bettswood or for other benefits to Jim McDougal. Occasionally Jim or Susan made a deposit.[33] But their deposits into the Designers Construction account always lagged behind what they were

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[32]The examiners eventually discovered this $25,000 payment to McDougal in their 1986 examination. But according to Jim Clark, the examiner in charge, the examiners never realized that the source of these funds came from the $64,000 loan to "buy" Jim McDougal's Kingston house.

[33]At times Susan or Jim used Madison Marketing funds (over $51,000) to pay Designers Construction for its expenditures on #4 Bettswood. Madison Marketing was a sole proprietorship of Susan McDougal through which she ordered advertising for Madison Guaranty or Madison Financial.

receiving from the account. This created for them an interest free loan since the account was almost always in an overdraft status. From February 1985, when Designers Construction first spent money on #4 Bettswood, until February 1986, when McDougal deposited $38,000 into the Designers account, the McDougals effectively borrowed interest free for a year an average of $18,000.[34] This is an undisclosed use of Madison's assets by an affiliated party.

There were other ways in which Jim McDougal personally gained from the use of Designers Construction money. In June 1985 Jim McDougal asked Lisa to take a trip with him to California. He told her he wanted to look at properties. She had never seen California and agreed to go. They were in San Diego four or five days.

A month later McDougal

[34]We have been able to calculate that, by failing to make timely payments to Designers Construction, McDougal caused an interest lost to Madison of $2,282. The overall interest lost to Madison from the Designers Construction overdraft status was $4,481. We have calculated this interest loss by assuming that Designers Construction had a 12.5 per cent line of credit with the bank. Overdrafts under this theory were treated as extensions of credit. We used the 12.5 per cent figure since this is the rate McDougal paid on his own commercial loan with Madison Guaranty that he obtained in May 1985. The $18,000 figure is arrived at by backing in the principle value of a loan for a year at 12.5 per cent interest that cost the borrower in interest $2,282.

[35]Sue Strayhorn recalls that she discovered the trip when the airlines had called about the reservations. Strayhorn thought that the trip was to Atlanta not California. Strayhorn recalls that Lisa was embarrassed and told her "You weren't supposed to know about that." According to Strayhorn, Jim and

told Lisa that his American Express bill had arrived and that he had to pay for the California trip. At his direction she wrote out a Designers Construction check to American Express for $4701.91. She gave him the check and in the memo portion of the check McDougal wrote his American Express card number.[36] Ex. 36.

J. The Events Of 1986

In February 1986, McDougal told Lisa that he was closing out the Designers Construction account and that she would be needed for some decorating work at the lodge and sales office on Campobello Island. Lisa went to the island with Larry Kuca and Paula Sorensen.[37] Two months later, Susan called her and told her to return to Little Rock because she was needed to gather the Designers Construction invoices and checks. Lisa returned and at Susan's direction prepared a spread sheet itemizing each expenditure. She gave the records to Susan and returned to Campobello.

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Susan had respect for each other but had different friends and were not compatible with each other.

[36]American Express no longer has records of the statement in question. But we do have copies of checks Jim or Susan wrote to American Express which reference the same American Express card number. These checks were written out of Jim and Susan's "424" personal account. Exs. 37-38.

[37]Paula Sorensen was Susan's sister and Eric Sorensen's wife. She was separated from Eric at the time and eventually divorced him.

With the decorating work completed a month later, Lisa returned to Little Rock. Jim and Susan were no longer around and Lisa sensed that things had changed at Madison. It was now tax time and Lisa went looking for Susan to see what she should do. Susan took Lisa and various Designers Construction documents to a Little Rock accountant who prepared Lisa's 1985 return.[38]

In December 1986, Lisa received a call from someone telling her that she needed to be interviewed by a lawyer. Lisa did not know it at the time but the lawyer was Jeff Gerrish of Borod and Huggins. Lisa was contacted by Susan who met with her before the interview. Susan told her that Jim wanted the two of them to get together to decide what to say about Designers Construction. Based on what Susan told her to say, Lisa made a number of inaccurate or misleading statements to Gerrish. According to Gerrish's interview memorandum, Lisa appeared to act on her own initiative when she "bought" 1308 Main, renovated it and sold it to Bill Henley. When asked about the $64,000 Maple Creek home loan, Lisa told Gerrish that she had purchased it as an investment. When asked how she could carry so much debt on a "$12,000 a year income," Lisa gave the misleading response that

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[38]The 1985 return lists Designers Construction as a Schedule C business of Lisa Aunspaugh with gross receipts of $35,825. After deductions and depreciation, Lisa reported a Designers Construction net profit of only $11,380. In addition to the $11,380, she reported an additional $15,000 in "contract fees." According to Lisa, the $15,000 consisted of her irregular 1985 "pay checks" from Madison.

she had other customers besides Madison.[39] Lisa has explained that she gave these misleading responses at the behest of Susan.

In November 1986 Lisa married Mike Thompson, an industrial air conditioning and heating specialist, whom she had met at the Lake Faircrest sales office in late 1985. Shortly thereafter she received some bad news. She was notified by Sue Strayhorn that "her" Maple Creek house loan was in default. Lisa responded with the statement that both the loan and house belonged to Jim and Susan.[40] Neither Jim nor Susan could be located. Lisa's husband contacted McDaniel Realty which still had the Maple Creek house listed. He continued to have it listed. The property never sold. In May 1989 Lisa was sued by the FDIC. In March 1990 a judgment was entered against her for $81,000. Ex. 39. In a foreclosure sale in May 1990 the RTC bought the house for $34,500. Ex. 40.

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[39]Technically Lisa did have other clients but they were all tied to Madison and Jim McDougal.

[40]Sue Strayhorn recalls calling Lisa and telling her that her loan was due. According to Strayhorn, Lisa said that Jim had given her the house. Lisa claims that Strayhorn is mistaken about her response. She recalls telling Strayhorn that the loan belonged to Jim and Susan. Under either interpretation, Lisa never told Strayhorn that she purchased the house and that the loan was hers--which is what any examiner would assume from a review of the documents. In other words, if you believe Strayhorn's version of the conversation, Lisa did not tell Strayhorn, yes, I know, I need to pay it off, how can I arrange payments, etc.

V. The $18,000 Rent Payment To Bill Henley (Counts 8-9)

A. Henley Takes An Investment Tax Credit

We have recently discovered that Greg Young, at McDougal's request, prepared Bill Henley's 1985 income tax return. Young recalled that sometime in late 1985 or early 1986, while he was in McDougal's office, McDougal told him that Henley was going to take an investment tax credit on 1308 Main (renovating an historic building) and that Henley owned the building even though it was in Lisa's name. Young did not know what arrangements, if any, there were between Henley and Lisa. McDougal, who Young described to us as his "ultimate boss," assured Young that Henley was "liable" for the building to satisfy the investment tax credit. Young's notes indicate that McDougal told Young that the building was placed in service in August 1985, that the purchase price was $60,000 with $130,000 in renovations. With these figures, Young prepared Henley's 1985 return in which Henley claimed an investment tax credit.[41]

Records show that on January 15, 1986, Lisa Aunspaugh signed a deed conveying 1308 Main St. to Bill Henley. Ex. 23. Records

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[redacted]

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also show that on the same date, Henley borrowed $190,000 from Madison Guaranty. On the same date, January 15, 1986, under directions from Jim McDougal, Greg Young, the chief financial officer for both Madison Guaranty and Madison Financial, placed $130,000 of the Henley loan proceeds into the Designers Construction account and the remaining $60,000 in Lisa Aunspaugh's personal account. Records show that the $130,000 placed in the Designers Construction account was used to pay off Lisa's October $125,000 renovation loan. Exs. 41-43.

B. The $18,000 Payment To Henley

A month later on February 18, 1986, McDougal told Greg Young that six months' back rent (at $3000 a month) was owed to Bill Henley. Young knew at the time that 1308 Main had been under renovation for some time, that Henley was taking a tax credit for the building, and that the property was being leased to Madison Financial. Acting at McDougal's direction and without reviewing any documents, Young had an $18,000 check issued to Henley and deposited into Henley's account. Ex. 44.

On the same day, February 18, 1986, at McDougal's direction Young transferred $12,840 from Henley's account to the Designers Construction account. Ex. 45. McDougal told Young that the $12,840 was Henley's payment for renovations at 1308 Main. Shortly thereafter, Young recalls seeing the lease dated August 1, 1985, with McDougal's and Henley's signatures. Ex. 46. The

lease provides that Henley owns 1308 Main and for a period of four years will lease the building to Madison Financial. The lease was maintained in Madison's accounting department to justify periodic lease payments to Henley.

Lisa Aunspaugh remembers being in McDougal's office about the time that Henley bought the property in early 1986. McDougal had a document at his desk and she believes that Henley was also present. Lisa heard McDougal say something about having to backdate a document because Henley needed money to pay his taxes.[42] Lisa does not know what the document was that was backdated. The only explanation for McDougal's statement is that he backdated the August 1985 lease which justified an $18,000 payment to Henley and further substantiated Henley's claim for an investment tax credit in 1985.

The August 1985 lease is false because it states that the lessor, Henley, owns the property as of August 1, 1985. But Henley could not have leased the property to Madison Financial sooner than January 15, 1986. Why did McDougal give this $18,000 windfall to Henley?

The $18,000 payment to Henley also served McDougal's purpose. McDougal had told Lisa that he wanted to close out the Designers Construction account which still had a negative balance. He had Greg Young draw $12,840 from Henley's account

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[42]It makes sense that Henley would need to worry about his 1985 taxes. Madison Financial records show that in 1985 Henley was paid at least $198,000 in commissions.

and deposit it to the Designers Construction account.[43] This brought the Designers Construction account from a negative $44,856 balance to a negative $32,016. Ex. 28. Eight days later McDougal borrowed $40,000 from Madison Guaranty and deposited $38,000 into the Designers Construction account. This deposit coupled with a few more payments from the Designers Construction account brought the account to a zero balance. The account had its last activity on February 27, 1986, one week before Bank Board examiners commenced their examination. Ex. 28.

According to Lisa Aunspaugh, Madison Financial did not move into 1308 Main until December 1985 or early January 1986 within a few weeks of when Henley bought the property. She can estimate the time of the move based upon the date of the Designers Construction checks with which she paid certain contractors who were doing the final renovation of 1308 Main.

Lisa Aunspaugh also explained that Larry Kuca and Campobello Properties moved into 1308 Main as a separate tenant at approximately the same time that Madison Financial moved in. The

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[43]We have been unable to figure out how the $12,840 was arrived at. [redacted] After the Tucker mortgage and its accrued interest was paid off out of Lisa's $125,000 October loan, $74,677 was left over. This $74,677 was deposited into Designers Construction, according to Lisa, to pay for the 1308 renovation. But by February 1986 Designers Construction spent $88,608 on 1308 renovation. Ex. 28. This is a difference of $13,931. McDougal then had Henley pay $12,840 of this amount. This left an extra $1000 that had to be paid by somebody. When McDougal closed out the account, he deposited $38,000 of his own funds. This $38,000 covered not only what McDougal owed personally to Designers Construction but also the extra $1000 needed to cover 1308 Main.

earliest rent check Bill Henley has from Campobello Properties is in February 1986.

In mid-1986 the examiners ordered Madison Financial to stop paying rent to Bill Henley.[44] The examiners disallowed it because Henley was a stockholder of Madison Guaranty. He could not rent property to the institution (or its subsidiary) without supervisory approval. Henley then defaulted on his $190,000 Madison Guaranty loan. When he was sued on the note he counterclaimed for back rent on 1308 Main Street.

In his deposition on February 24, 1988, Henley was asked about the August lease and the fact that he did not own the property until January 1986. Henley admitted that he negotiated exclusively with McDougal for the sale of the property and had nothing to do with Lisa Aunspaugh. When asked why he was entitled to rental payments back to August 1985 when he did not own the building until January 1986, Henley explained that in August 1985 he discussed with McDougal his decision to buy the building and to lease it back to Madison Financial. McDougal agreed to Henley's proposal but the purchase and lease got delayed. From this fact alone, Henley drew the feeble conclusion that he was entitled to receive back rent even though he did not

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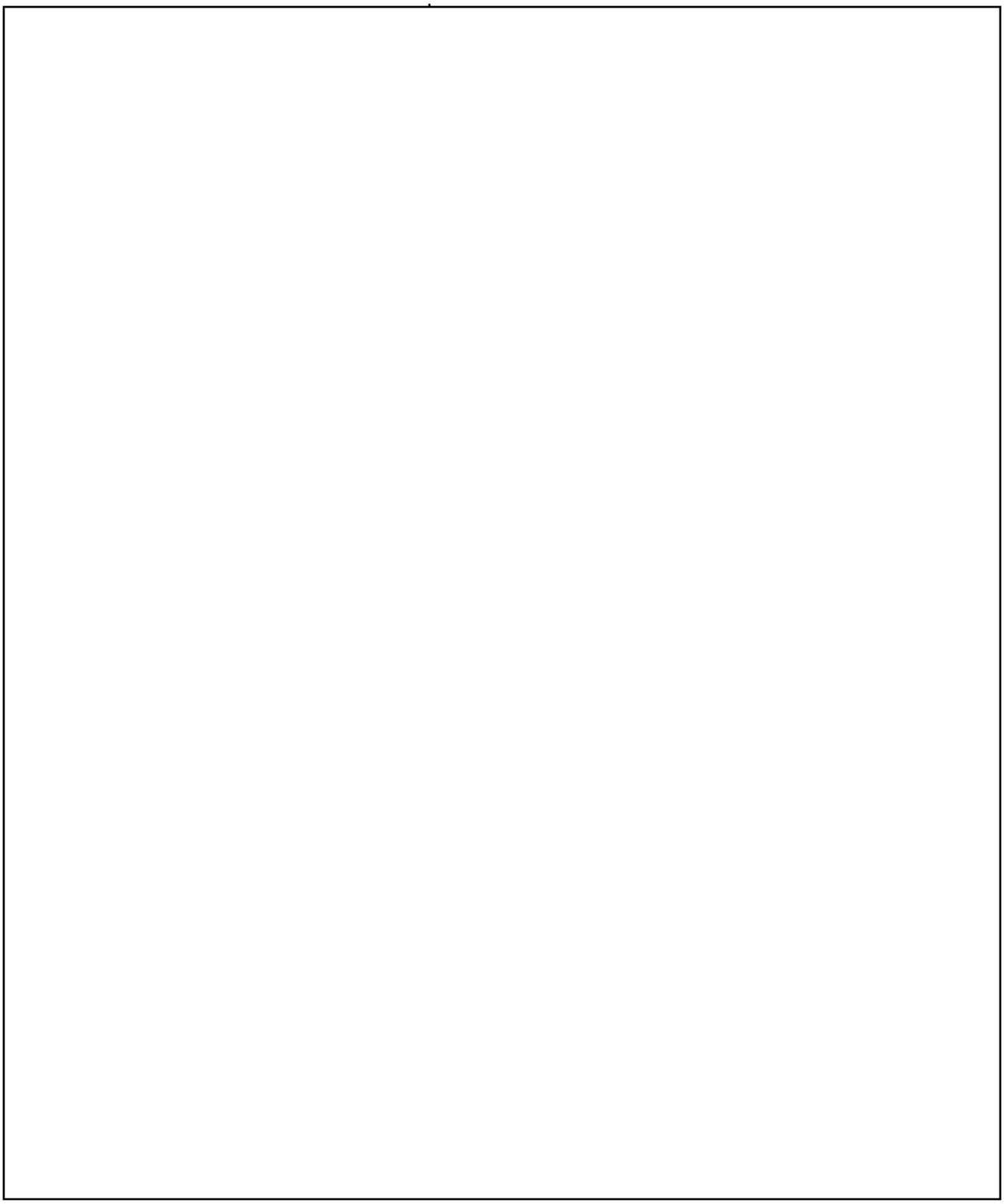
[44]The loan to Henley and the lease back to Madison Financial was a highly suspect transaction. McDougal negotiated a lease which enabled Henley to receive $3,000 a month from Madison Financial. But Henley's monthly payment on his $190,000 loan to buy the building was only $1,900. As a result, with no down payment, Henley walked into a transaction which guaranteed him a positive cash flow of $1,100 per month for the life of the four year lease.

buy the building until January, had not made a deposit, and had not spent any money on it until that time.



[redacted] Henley was clearly worried about his taxes. He had received at least $198,000 in commissions in 1985. He wanted to be in a position to substantiate or document his claim for a 1985 investment tax credit.

With the examiners coming in a few days, McDougal, on the other hand, wanted additional funds to bring down the negative balance in the Designers Construction account. The $18,000 payment helped both Henley and McDougal.

We are reluctant to use Henley as a government witness at trial. He is hostile to the investigation and contradicts Eric Sorensen (discussed below). We can prove the $18,000 misapplication from the documents and the testimony of Young and Aunspaugh. If Henley is used as a defense witness, we will be able to use him to our advantage on the $18,000 payment.

VI. Seth Ward And The Piper Seminole (Count 5)

74 year old Seth Ward sees mostly with one eye and relies on a hearing aid. Erect and dignified, Ward walks slowly with a cane, having recovered from a fall from the second story window at his daughter's (and Webster Hubbell's) house in 1989. He fell to the ground on his back when he slipped from a ledge trying to attach a downspout to a gutter. He was hospitalized for months. Although he is physically slow, he is mentally alert with an

unfailing memory, particularly when it comes to recalling his unhappy experiences with Jim McDougal or the RTC.

Ward earned his pilot's license in 1936 when he was 16 years old. While a student, he worked part time flying crop dusters. After Pearl Harbor he was commissioned in the Marine Corps and spent most of the war as a flight instructor. Toward the end of the war he flew some missions out of the Philippines and Okinawa. After the war, Ward remained in the Marine Corps, eventually flying numerous combat missions in Korea.

After Korea, Ward joined the reserves and returned to Arkansas. After working for a metal fabricating supply warehouse, Ward went into the metal fabricating business for himself. By the 1970's his company was doing $50 to $60 million in sales a year. His company merged with National Steel Corporation, and in 1975 he retired, a wealthy man.

Ward then owned a Datsun dealership for five years. After he sold the dealership he purchased a parking meter company in Russellville. After he was injured in 1989 he transferred the parking meter company to his son.

In 1985 Ward was playing gin rummy at the Little Rock country club when Don Denton approached him. It was a fateful meeting, one that Ward always refers to as the opening episode of his unhappy McDougal saga. Ward had known Denton for a number of years when Denton had been the chief lending officer at Union National Bank. Denton was Madison's newly hired senior loan officer. Denton encouraged Ward to work for Madison Financial.

Denton told him that McDougal wanted somebody to help locate properties for development. Ward had a real estate license and agreed to work for Madison. Ward told McDougal that he was not going "to punch a clock" and that he wanted a 10 per cent commission and $25,000 per year salary. McDougal agreed.

A. The May 5th Letter: Ward Agrees To Buy The Airplane

Sometime in early May 1985, shortly after Ward agreed to work for McDougal, McDougal told Ward that he had purchased an airplane. Ward asked him what kind of airplane had he purchased. McDougal told him that he had purchased a Piper Seminole.[47] Ward responded that he hoped that McDougal had not paid too much for it. McDougal said that he had swapped some property for it. McDougal told Ward "that he would like for the company to have an airplane but that he was very reluctant for the company or himself to own the airplane because he thought it would be like waving a red flag to the regulators, the same as owning an airplane might attract the attention of an IRS agent." McDougal knew that Ward was a pilot. Ward had just taken McDougal to

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[47]In April 1985, McDougal came to Chris Wade and told him that he was "tired of messing with Whitewater...[and wanted] to get rid of the rest of the lots." Wade and his friend Dr. Russell Webb agreed to buy the rest of the lots in exchange for the assumption of a $35,000 portion of a $100,000 Whitewater loan. As an additional payment, they also transferred to Whitewater a Piper Seminole that they valued at nearly $35,000. They wanted to get rid of the airplane and McDougal agreed to take it. Wade thought that they were conveying the aircraft to Whitewater Development. Wade flew the aircraft to Central Flying Service and personally gave McDougal a blank bill of sale signed by Russell Webb. McDougal told Wade to fill in McDougal's name on the bill of sale which Wade did. Ex. 47.

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Camden and El Dorado on his (Ward's) airplane. McDougal asked Ward what he should do with the Piper Seminole. Ward told him that he would think about it.

The next day Ward told McDougal that there was no law prohibiting his company from owning an airplane. But McDougal again replied that "he didn't want to attract the attention of the regulators." Ward then told McDougal that McDougal could give Ward a letter stating that Ward was directed to buy an airplane but that all costs would be covered by McDougal's company and that, if the airplane was later sold, all profit or loss would go to the company. To make the sale indirect and less noticeable, Ward and McDougal agreed that McDougal should sell the airplane to Central Flying Service and that Ward in turn would buy it from Central Flying Service for the same price. McDougal liked the idea of selling the aircraft to Central Flying Service because Ward was working for Madison. They agreed that the sales price would be $25,000.

On May 5, 1985, McDougal delivered a one page letter to Ward. Ex. 48. The letter sets forth the conditions that Ward and McDougal had agreed upon. The letter authorizes Ward to buy a small airplane in the $25,000 to $50,000 price range. The letter provides that Madison Financial will cover all expenses and guarantee Ward's purchase price if the airplane is sold. Conspicuously absent from the May 5 letter is any reference to the fact that Ward was going to buy the aircraft of James McDougal, an affiliated party and chairman of the board of the

very corporation that was guaranteeing Ward's purchase price in the event of a later sale.

B. McDougal Receives $25,000 For An Airplane In Need Of Repair

When he examined the airplane, Ward recognized that it needed a one hundred hour inspection. On June 6, 1985, Ward obtained a bill of sale for the aircraft from Central Flying Service even though he had not yet paid for it. A few days later, Ward flew the aircraft to Starke Aviation in Russellville where the mechanic, Harvey Starke, discovered that the right engine needed to be replaced. Ward told McDougal that it would be an expensive proposition to replace the engine.

On July 15, 1985, while the aircraft was waiting in Russellville for repair, Ward borrowed $25,000 from Madison for a "business" purpose. Ex. 49. He obtained a cashiers check, endorsed it, and delivered it to Central Flying Service the same day. On July 15, 1985, Richard Holbert of Central Flying Service wrote a $25,000 check to Jim McDougal.[48] Ex. 50. McDougal endorsed the $25,000 check to Henry Hamilton to partially repay a $28,000 personal loan Hamilton extended to McDougal. McDougal

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[redacted]

[48] Since Holbert was a tenant at the Little Rock airport and Ward was one of the Little Rock airport commissioners, Holbert did not want to turn Ward down. Holbert wrote out a $25,000 check to McDougal the same day Ward delivered a $25,000 check to Central Flying Service. Holbert had no dealings with McDougal and believes that he gave his $25,000 McDougal check to Ward.

had used the $28,000 to make a payment on his Worthen Bank loan for Madison Guaranty stock.

The next day, July 16, 1985, Ward obtained an additional loan from Madison. He borrowed $10,000 for a "business" purpose and immediately prepaid $10,000 to Harvey Starke for anticipated repairs to the Piper Seminole. Exs. 51-52.

When the aircraft was being repaired in Russellville, McDougal told Ward that he planned to use it to fly to Campobello Island in Canada. Ward was amused. He told McDougal that the Piper Seminole was a short distance "puddle jumper" and that he could get to Campobello faster on a Greyhound bus. McDougal was surprised. "What should I do?" he asked. Ward told him to sell the airplane. McDougal agreed.

The aircraft was not ready to fly until September 1985. On October 25, 1985, Ward borrowed an additional $5,000 from Madison. Ex. 53. From these proceeds he made a final payment to Harvey Starke of $2,951. Ex. 54. He then flew the aircraft back to Central Flying Service in Little Rock. For several months Ward tried to find a buyer. On one occasion he flew the aircraft to Fort Scott, Kansas, to show it to a family he knew. Finally, in December 1985, a couple he knew from Atlanta agreed to buy the aircraft for $28,500. Ex. 55.

The aircraft had made only two trips the entire time that Ward owned it--back and forth to Russellville for repair and one trip to and from Ft Scott, Kansas, for the purpose of selling it.

At no point in time had the aircraft been used for any Madison Financial purpose.

C. Ward Settles With Madison Financial

The agreement with McDougal since May had been that Ward would not suffer any out of pocket expense for the aircraft. As a result, on December 18, 1985, a week after he sold the Piper Seminole to the Atlanta couple for $28,500, Ward prepared a letter to McDougal detailing his costs of owning and maintaining the aircraft. Ex. 56. A part of these costs was $1,904 that Ward owed in accrued interest based on the three loans (totalling $40,000) that he had taken out at Madison to either purchase or repair the aircraft. He kept the $28,500 in sales proceeds to help pay off the three loans. When the costs and credits were added up in the December 18 letter, Ward claimed that Madison Financial owed him $12,827.

A week later on December 24, 1985, when Ward paid off all three Madison loans, Lisa McIntyer, at Greg Young's instruction wrote out a $13,000 check to Seth Ward.[49] Ex. 57.

McDougal ordered Young to book the $13,000 as a travel expense of Madison Financial even though McDougal knew that the aircraft had never been used for any Madison Financial purpose and that the reason why the $13,000

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[49]Ward was slightly overpaid but had agreed with McDougal that this overpayment was proper in light of the fact that Ward had flown McDougal to Camden in Ward's own airplane and had never been compensated for it.

payment to Ward was so high was because the airplane (with a costly repair) had been overvalued (at $25,000) in the first place. Ex. 58. McDougal knew that a substantial portion of the $13,000 expense would have been borne by McDougal personally had he not passed the aircraft on to Ward who in turn was covered by Madison Financial.

Don Denton was the loan officer who approved Ward's airplane related loans. Through conversations with Ward, Denton was aware of all the material facts of the transaction except for the most significant fact, namely, that McDougal personally received the initial $25,000 used to buy the airplane.[50] Denton knew that Chris Wade was involved and that McDougal had arranged for the sale through Central Flying Service. But Denton thought that Chris Wade or someone connected to Chris Wade was selling the airplane and thus Wade or some other person was receiving the $25,000. Denton thought that McDougal wanted Madison Financial to use (or indirectly "own") an airplane but was afraid of what the examiners might think if it was on the Madison Financial books as an asset.[51] When Ward settled up with Madison Financial in December 1985 at the time the aircraft was sold, Denton

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[50]We confirmed this with an interview of Denton on April 25, 1995.

calculated the amount of interest due on Ward's airplane related loans so that Ward could add the interest figure as a cost of owning the airplane.

VII. Eric Sorensen And The Inflated Invoices (Counts 6-7)

A Danish national, Eric Sorensen was 34 years old when he visited Arkansas in August 1982. He came to Camden, Arkansas, because he had a high school friend who had a business there. In Camden he met 25 year old Paula Henley. By the end of the year the two had gone to Denmark to get married. Since Sorensen spoke English and Paula was hopeless in Danish, the two decided to return to Arkansas to live.

For a few months Sorensen helped run a small hardware store owned by Bill Henley, Paula's brother. Bill Henley had been elected to the Arkansas state senate and was away from Camden when the legislature was in session. Sorensen then worked for Brunswick Defense in East Camden. In September 1983 he quit his job with Brunswick when he was told that he would have to work a night shift. Sorensen then decided that he wanted to be self-employed. He worked for a few months doing remodelling work and building meter bases for the Maple Creek Farms subdivision where Bill Henley was selling lots.[52]

In late 1983 Sorensen had discussions with Jim and Susan McDougal. Jim McDougal wanted to build a modular home factory near Pine Bluff where homes could be manufactured and then sold

[52]A meter base is a kind of utility pole that the utility company uses to direct switches to various mobile homes within an area.

to Maple Creek purchasers. Sorensen had operated a factory in Denmark for eight years prior to coming to the United States. Jim and Susan McDougal wanted Sorensen to determine what it would take to build and operate a factory that could produce one modular home per day. Although he had considerable experience at remodeling, Sorensen responded that he could not determine the investment and operational costs of such a factory until he had experienced the building of a house from start to finish. It was then decided that Sorensen would hire the builders and observe them build a Maple Creek house. With this knowledge of materials and labor costs, Sorensen would then submit a feasibility study to Jim McDougal.

Citing regulations, Jim McDougal explained that Sorensen would have to "own" the property since Madison was not in the "house building business." McDougal explained further that Madison would make a construction loan to Sorensen, the proceeds of which would be used to buy the lot and build the house. Sales agents at Maple Creek would then sell the house. Sorensen planned to use the proceeds of the sale to pay off his construction loan.

A. The Two Maple Creek Homes

Jim McDougal selected lot 206 in an area allocated for mobile homes. The actual plans for the house were given to Sorensen by either Jim or Susan McDougal. Although the house was built conventionally, it resembled a "modular" house, what Sorensen called a "shoebox" house.

On December 16, 1983, Sorensen took out a $48,000 construction loan for lot 206. Ex. 59. Sorensen observed the building of the house and paid the builders out of the loan proceeds. When the house was finished in February 1984, Sorensen submitted a feasibility study to McDougal and was paid $2,000 or $3,000. The house was then put on the market for sale.

Immediately after completing the house on lot 206, McDougal told Sorensen to build another house on a nicer Maple Creek lot. Lot 313, a residential lot, was chosen. On February 13, 1984, Sorensen borrowed $55,200 and purchased lot 313. Ex. 60. McDougal gave Sorensen the plans for this more elaborate house. Again, Sorensen observed the building of the house and paid the builders from the construction loan proceeds. By April 1984, this more elaborate house was near completion.

But as the lot 313 house was nearing completion, it became evident to Sorensen that he was spending more money than what he had borrowed. The problem was that the construction loans to lot 206 and lot 313 were not sufficient to build the kind of houses that Sorensen had been told to build. Spending more on the two houses was not an immediate problem for Sorensen since he was permitted to overdraft his Madison checking account.[53] But the negative balance in Sorensen's checking account kept growing. By the time he was finished with the lot 313 house, he had a $27,000 negative balance.

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[53]This account (700111) was under the name of Sorensen Enterprises. All of Sorensen's construction business was conducted out of this account.

B. The Need To Borrow $27,000

Sorensen discussed this negative balance problem with McDougal who told him not to worry and that Madison would make him a personal loan to cover the overdraft. Accordingly, Sorensen borrowed $27,000 on April 13, 1984, which balanced his checking account. Ex. 61. McDougal told Sorensen that he would not have to pay back the $27,000 personal loan.

In the meantime neither of the two houses (lots 206 and 313) were selling. It bothered Sorensen to think that the two houses might not sell for enough to clear the two outstanding construction loans plus the $27,000 personal loan plus the accrued interest on all three loans. He voiced this concern to his brother-in-law Bill Henley and to Jim McDougal and was told not to worry.

C. The Two 1984 Inflated Invoices

One hundred miles from Maple Creek, Madison Financial opened a new development outside Camden, called Greentree Farms Subdivision. In September 1984 Sorensen did some remodelling at Bill Henley's request. Henley was working at Greentree Farms as the sales manager. Sorensen converted a farm building into a sales office and garage. When he completed the work, Sorensen submitted a $4,109.90 invoice to Madison Financial, dated October 6, 1984. The $4,109 invoice consisted of Sorensen's out-of pocket

costs plus a 10 per cent markup for his own fee. When he handed the invoice to Bill Henley, Henley told him that "Jim wants you to add $10,000 to this bill." Although Henley did not say it, Sorensen immediately realized that McDougal and Henley were trying to help Sorensen with his $27,000 personal loan and the two construction loans on the two Maple Creek homes which had not yet sold. Sorensen then inflated the invoice by $10,000. Ex. 62.

A few days later, Sorensen's Madison checking account was credited with a payment of $14,109.90. Ex. 63. With these extra funds Sorensen immediately wrote a $10,000 check and sent it to McDougal to apply to Sorensen's two construction loans or his personal $27,000 loan. Ex. 64. In his checkbook ledger, Sorensen wrote "Jim's discretion," meaning that he left it to McDougal's discretion to apportion the $10,000 among the three loans. Ex. 65.

A few weeks later, Bill Henley asked Sorensen to build a sales office in the form of a log cabin at Madison Financial's Fair Oaks Subdivision southwest of Camden. Sorensen built the log cabin on two huge beams which enabled Madison to move the log cabin to another subdivision. When he was finished with the log cabin, he gave a $9,592 bill to Bill Henley.[54] Again, Bill Henley told Sorensen, "Jim wants you to add $10,000 to this bill." As a result, on December 31, 1984, Sorensen submitted a

[54]Sorensen had actually billed Madison Financial $19,952 for the project. But since he had earlier received an advance of $10,000 on the log cabin project, his final bill was for $9,592.

$19,592.89 bill to Madison Financial. Ex. 66. A few weeks later, Sorensen's checking account was credited with a $19,592.89 payment. Ex. 67.

Sorensen wrote a $10,000 check to Madison Guaranty and sent it to McDougal. In the memo section of the check Sorensen wrote "apply toward loans." Ex. 68. A few days later Sorensen telephoned Madison and found out how the $10,000 payment was apportioned among his loans.

D. The Sale Of Sorensen's Maple Creek Homes

While Sorensen was working on the log cabin sales office for Fair Oaks, sales agents at Maple Creek succeeded in finding a buyer for the second of the two homes Sorensen built and owned at Maple Creek (lot 313). On the same day (December 31, 1984) that Sorensen submitted the inflated $19,592 invoice to Bill Henley for the Fair Oaks log cabin sales office, Madison Financial closed on lot 313 on Sorensen's behalf. Sorensen recalled that the sales price obtained from the buyer was sufficient to pay off Sorensen's $55,000 construction loan that encumbered the property.[55]

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[55]Sorensen did not attend the closing but (at somebody's direction) signed a quitclaim deed to the property to the purchasers on January 2, 1985. Exs. 69, 70. The closing statement actually records the seller, not as Sorensen, but as Madison Financial. The December 31 closing documents include a December 31 Madison Financial deed to the purchasers signed by McDougal. According to the closing statement, after closing costs were deducted, the actual price obtained from the buyer provided a small profit of $728.97 to Madison Financial. Technically, this money belonged to Sorensen since he held title to the property. But Sorensen has no recollection of the sale other than being told that the sale was sufficient to cover his construction loan on the property.

Four months later, Maple Creek sales agents obtained a buyer for the first house (the "shoebox" house) that Sorensen built at Maple Creek. It had been on the market for over a year. On April 9, 1985, Madison loaned $47,000 to the new buyer who agreed to pay $49,500 for the house. But Sorensen's original $48,000 construction loan that encumbered the property now had a balance (with accrued interest) of $50,091. Moreover, there were closing costs that were owed by the seller (Sorensen). As a result, the seller (Sorensen) owed at closing $2,448.52. Ex. 70. Since Sorensen did not attend the closing, he did not know that he owed $2,448 for the transaction to close. But McDougal must have known that Sorensen needed these funds to sell the Maple Creek house because on May 6, 1985, McDougal told Greg Young, Madison's chief financial officer, to write a check to Eric Sorensen for $2,448.52. Ex. 71. Young knows that McDougal told him to write the check because the check is written out in Young's handwriting. This was unusual, according to Young. It could only mean that McDougal ordered Young to write the check immediately.[56] Otherwise the check would have been prepared by the computer after the proper documentation had been submitted to the accounting department. Young was given no invoice from

[56]Young will say that McDougal ran Madison Financial. The directions on the check and how it was to be booked had to come from McDougal. But Young will say that Latham may have passed on the directions to Young. However, Young will say that the procedure in the office was that Latham, who ran Madison Guaranty, exercised no direction or control over Madison Financial. If he (Latham) passed on instructions regarding Madison Financial, the directions came from McDougal.

Sorensen but only directions from McDougal to book the payment as an expense from the reserve account of the Fairs Oaks development.

Sorensen never saw the check and did not endorse it. The check was endorsed by Quapaw Title on Sorensen's behalf and was applied to Sorensen's obligation at the April closing on the Maple Creek lot.

E. The December 1985 Inflated Invoice

Now that the two Maple Creek homes were sold, Sorensen did not have to worry about his two construction loans. But he became even more concerned about his $27,000 personal loan. The loan was more than a year old and had a 14 per cent interest rate. Although partial payments had been made on it from the proceeds of the two previously inflated invoices, the $27,000 loan had a balance of approximately $16,000 by December 1985. Sorensen recognized that he had personally signed for the note but that McDougal had promised him that either he (Jim) or Madison would take care of it. Throughout the summer and fall of 1985, Sorensen expressed his concern to Henley and McDougal that the loan be paid off.

There are two McDougal memos that confirm Sorensen's account that McDougal and Henley were trying to help Sorensen retire the $27,000 note. On July 17, 1985, McDougal wrote a memo to Bill Henley (Ex. 72) which said:

> Call me about the Eric Sorensen note which is now due. I think he can earn enough to pay it at El Dorado.

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On July 23, 1985, McDougal sent a second memo to Henley (Ex. 73) which told Henley that "[w]e need to discuss the following ...Eric's note..."

Sue Strayhorn typed both memos and will be able to introduce them at trial.

In the fall of 1985, at McDougal's request, Sorensen was building a three bedroom house at the newer El Dorado subdivision. Sorensen had agreed with McDougal that he would own the lot, build the house to McDougal's specifications, and then sell the house to Madison Financial (to be used as a sales office) when it was completed. Sorensen further agreed that he would sell the house to Madison Financial "at cost."[57]

On September 24, 1985, Sorensen borrowed $62,400 and applied $10,000 of the loan proceeds for purchase of the lot. Ex. 74. He used the remainder of the loan proceeds (approximately $51,000) to build the house. But McDougal ordered some last minute changes to the construction. As a result Sorensen spent

[57]Sorensen's "costs" always included a 10 per cent fee for his own services. That is, Sorensen would add up his expenditures for labor and material and multiply the figure by 10 per cent. The resulting figure for Sorensen was his "cost" in the project.

approximately $12,000 more than was available from the loan proceeds. Sorensen simply overdrafted his account in order to accommodate the changes McDougal wanted in the house. On December 20, 1985, he gave his final bill ($12,662.96) on the Lake Faircrest home to Jim McDougal. McDougal told him to add $10,000 to the invoice which Sorensen did. Ex. 75. Sorensen recalls that McDougal said nothing else. Given the fact that Sorensen had repeatedly complained to McDougal that he had been promised help in retiring the $27,000 loan, Sorensen understood that this was McDougal's way of helping him.

Ex. 76. Sorensen used the extra $10,000 to pay on his $27,000 personal note which brought it down to approximately $7,000.

In the summer of 1986 Sorensen visited Denmark. When he returned everything had changed at Madison. McDougal was no longer around. Sorensen's bank account had a $30,000 negative balance and the bank examiners wanted him to pay it off. Sorensen explained that he had done major remodelling of Bill Henley's house and was waiting for Henley to pay him approximately $23,000. Sorensen also claimed that Madison Financial owed him approximately $14,000 for work done at Castle Grande Estates. The examiners paid him the $14,000 but made him sign a $30,000 note to cover the overdraft. Henley never paid

Sorensen for the remodelling work he had done.[58]

VIII. The 1986 Examination, Robert Palmer, and The Management Questionnaire (Counts 10-11)

The 1986 examination commenced on March 4, 1986. The examiner in charge was Jim Clark, who is currently a national bank examiner in Michigan. Clark had been a Bank Board examiner since 1973 and an examiner in charge since 1976. He and his team (3 other examiners) were from the Indianapolis Region. They had been called to the Dallas Region (which included Little Rock) because the Dallas Region did not have enough qualified examiners to cope with what was turning out to be a multi-billion dollar disaster. Clark will testify that under normal procedures in 1986, the Bank Board would give at least 3-4 weeks notice that an examination (scheduled every two years) was about to commence.

[redacted]

A. The Consulting Fee Invoice (Count 10)

Latham has told us that in February 1986 he told Don Denton (Madison's senior loan officer) that the examiners were coming and to get the files in shape. Denton has confirmed this. According to Little Rock appraiser Robert Palmer, Denton and Sarah Hawkins, Madison's compliance officer, told Palmer and his partner, Bennie Beard, to do appraisals for approximately 79 loan

[redacted]

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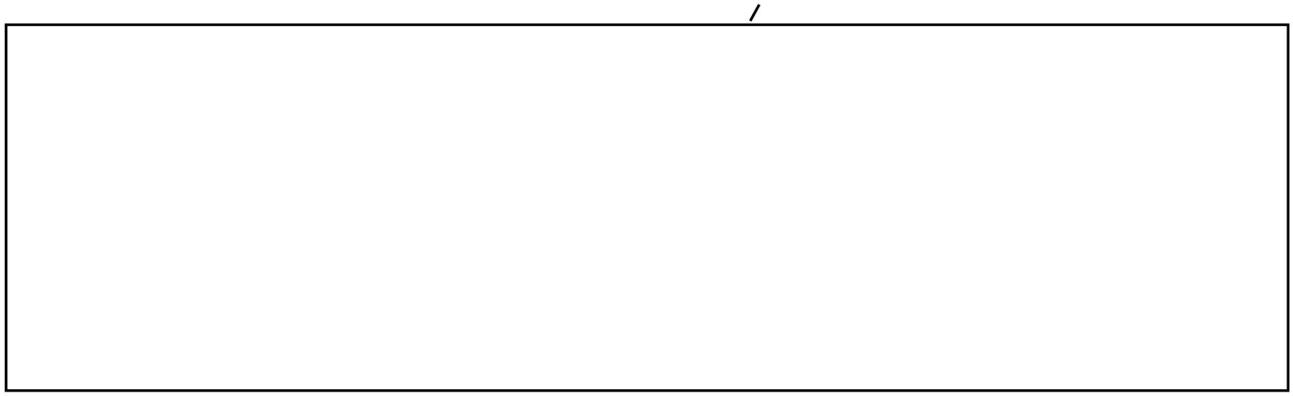
files which contained inadequate appraisals or no appraisals at all. Palmer was told by both Hawkins and Denton to be sure that the date of the appraisals coincided with the date of the loans. This way the examiners would not know that the loan files had been incomplete. Palmer and Beard spent a whole day on a weekend at the Madison office reviewing files. Palmer remembers that on that day McDougal came by and said hello.

On February 27, 1986, Palmer sent a $15,350 itemized bill to Don Denton which listed the 79 appraisals he and Beard had done on the eve of the examination. Ex. 77. Palmer waited to get paid and finally had to call Denton. Denton told Palmer that he would have to talk to Latham. When Palmer reached Latham, Latham told him that there was a problem with writing him a check since "they" did not want the examiners to know that he (Palmer) had done all those appraisals. Latham asked Palmer to submit a "consultant fee" bill to Madison Financial in the same amount. Palmer agreed and that very day presented the "consultant fee" bill to Latham who paid him on the spot. Ex. 78. The date was March 13, 1986. By this time the examiners were on site.



B. The Management Questionnaire (Count 11)

After the examiners arrived, Latham completed the Management Questionnaire. Ex. 79. It was notarized by Latham's assistant, Pat Heritage. According to Jim Clark, the Management Questionnaire is designed to identify affiliated parties, affiliated party transactions, problem loans, contingent liabilities, major service contracts, relations with other financial institutions, and other matters of concern to examiners.

Item 7 of the Management Questionnaire required the association to:

> "List all loans or contracts made or purchased by the institution since the last examination wherein any part of the proceeds was disbursed or credited to the benefit, directly or indirectly, of any affiliated person of the institution... Name the persons benefitted and state the amount and purpose of, and the basis and reasons for, such disbursements or credits."

Latham answered this question by attaching a list of all documented loans to affiliated parties (excluding loans secured by the affiliated parties' principal place of residence). Clark will testify that (i) McDougal's airplane transaction with Seth

Ward, (ii) the Lisa Aunspaugh $64,000 loan, and (iii) McDougal's overdraft use of the Designers Construction account should have been identified in response of Item 7.

[redacted]

C. The Examiner In Charge Confronts McDougal And Latham

Jim Clark spent the first day or two of the Madison exam at the Little Rock District Office of the Federal Home Loan Bank Board. When he reviewed the file on Madison, he familiarized himself with the 1984 exam and Supervisory Agreement. Steve Parr, who ran the small Little Rock office, told Clark that they had had an informant who complained about Madison. Clark recalls that it was some disgruntled employee (relatively low level) who told Parr that Madison had a number of overdraft problems.

When Clark arrived at Madison, he was introduced to Latham. He also met McDougal casually. McDougal had moved out of his spacious office and made it available to the examiners. McDougal had moved to the Castle Grande Estates sales office. A week or so later Latham drove Clark and his fellow examiner Bob Young to Castle Grande to meet McDougal. The meeting was cordial and

[redacted]

Clark and Young listened while McDougal did most of the talking, mainly about his development plans and philosophy. Clark and Young asked few questions.

Clark was required to file an interim 30 day report with the Dallas Regional Office. What he found in his first thirty days foreshadowed the rest of the examination. Concerning three major topics of the Supervisory Agreement, namely, regulatory net worth,[60] affiliated party transactions, and record keeping, Clark concluded that "[s]ome actions have been taken by management which give the appearance of compliance but, from all indications, management has intentionally attempted to evade compliance." Ex. 80.

With respect to affiliated party transactions, Clark mentioned three "companies": Designers Construction, Madison Marketing, and Madison Real Estate. All three entities, Clark noted, had received substantial funds from Madison Guaranty or Madison Financial. With respect to Designers Construction, Clark reported as follows:

> "Lisa Aunspaugh is the sole signatory on Designers Construction's checking account and was the incorporator of Madison Marketing as well as being one

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[60]Clark concluded that Madison (with deposits over $100 million) had a reported net worth of only 2 per cent of assets. Clark concluded that this was too low and violated the regulatory net worth regulation. 12 CFR 563.13. Regulatory net worth is too complicated to explain in a footnote. There was no simple percentage. It was basically a function of a number of factors, including liability (deposit) growth and contingent liabilities. As deposits (liabilities) and assets grew, it was necessary to capitalize earnings to maintain net worth. Clark's major concern was the way Madison recognized income from the sale of Madison Financial properties.

of the signatories on its checking account. Since Ms. Aunspaugh is 22 years old with two years of college, it is difficult to understand how she is capable of owning and operating these businesses. It is the examiner's understanding that James and Susan McDougal actually operate these entities through Ms. Aunspaugh, a friend of Mrs. McDougal's, who acts as a front." Ex. 80.

In his 60 day report to Dallas on May 8, 1985, Clark criticized Madison Financial for the way it recognized income on the first three projects the examiners reviewed.

Finally, in late May, Clark had to make a tactical decision. Up to this point in time he had not disclosed to Madison officials what his findings were. He wanted to know their response but he was fearful that if he disclosed his findings too early, they would alter records or substitute transactions to counter his conclusions. Finally, on May 27, 1986, Clark decided it was necessary to tip his hand and disclose his concerns. He wrote a letter to Latham in which he asked detailed questions about a number of entities, including Designers Construction and Sorensen Enterprises. In the letter, Clark stated that "[a]ssociation records concerning these entities are incomplete and responses to our inquiries regarding them have been inadequate." Ex. 81. He also scheduled a meeting with Latham and McDougal.

Two days later (May 29, 1986) in Latham's office, Jim Clark and Robert Young met Latham and McDougal. It was Clark's third and last meeting with McDougal. Clark decided to leave the most sensitive discussion (payments to affiliated parties) to the end. Clark and Young then outlined for McDougal and Latham why they

felt they would have to classify significant portions of Madison Financial's projects as either "loss," "doubtful," or "substandard." Clark and Young were particularly critical of Madison Financial's recognition of income. Latham and McDougal asked questions, according to Clark, but made little or no effort to challenge Clark and Young. Clark was surprised that Latham and McDougal gave such a lackluster response.

Toward the end of the meeting, Clark broached the topic of payments to affiliated parties, what he called the "McDougal-Henley Group," including Designers Construction. Clark pointed out that these transactions violated the Supervisory Agreement. Clark remembers (and it is reflected in his memo of the meeting) that "[t]hey did not respond." Ex. 82. Again, Clark was surprised by their response. McDougal seemed to understand "affiliated party" and "Supervisory Agreement" and expressed no surprise at Clark's initial findings.

At some point Latham did state that Madison had disclosed to the Bank Board (and sought permission for) Susan McDougal's receipt of real estate commissions. McDougal then elaborated on Susan's brokerage license and real estate activities. Clark asked for the Bank Board correspondence regarding Susan McDougal and a few days later received it. After a brief discussion on Campobello, the meeting broke up.

From that point on, Clark recalls, the communications between the parties became adversarial. Requests for information and responses were in writing. Finally in July 1986, Walter

Faulk, the Principal Supervisory Agent from the Dallas Region summoned Madison Guaranty's Board of Directors to Dallas. Since McDougal was not on the Board, he did not attend. Faulk threatened to take removal action unless the Board signed a Cease and Desist Order which called, in part, for Latham's and McDougal's resignation. A few days later Madison Guaranty's Board signed the Cease and Desist Order. Jim's and Susan's days at Madison were over.

IX. The Law As Applied to McDougal

A. "Connected In A Capacity"

A common element of both statutes (sections 657 and 1006) is the status of the defendant. In McDougal's case we will be required to show that he is "connected in a capacity" with the insured institution, Madison Guaranty. McDougal will no doubt argue that he is not "connected" to the savings and loan association within the meaning of the statute. The evidence will show otherwise. He was the largest single stockholder of Madison Guaranty and was chairman of the board of Madison Financial, a wholly owned subsidiary of Madison Guaranty which was a principle source of income to the association. But we cannot rely on a per se rule to establish that McDougal is "connected in a capacity" to Madison Guaranty. Courts have examined the facts of each case. In United States v. Bolstad, 998 F.2d 597 (8th Cir. 1993), the court concluded that the defendant, who was the president of a wholly owned subsidiary of the savings and loan association and who prepared loan documentation and made loan recommendations to

the association, was sufficiently "connected in a capacity" with the association. Similarly, in United States v. Prater, 805 F.2d 1441 (11th Cir.1986), the court held that under the facts of the case, the president and chief executive officer of a wholly owned subsidiary of a savings and loan association was "connected in a capacity" with that association. The Prater court noted that the phrase "connected in a capacity" should be construed broadly to effectuate congressional intent by protecting federally insured lenders from fraud.[61]

There is overwhelming evidence of McDougal's influence over Madison Guaranty. McDougal's office was on the premises of the association. Bonnie Crocheron, the head cashier, will testify that she furnished McDougal with the daily overdraft report and that on one occasion he called her to his office and complained to her about the size of the overdraft problem. Latham and Young will both testify that McDougal had input and influence over loans affecting Madison Financial.

Moreover, there are memos authored by McDougal which indicate that he is telling Latham what to do regarding various loans. For example, on March 27, 1985, he wrote the following to John Latham:

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> "Have Charles Peacock execute the $50,000 note secured by the air conditioners. Have him carry a blank note

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[61]"Control" is not a requirement in determining whether or not a defendant is "connected in a capacity." United States v. Payne, 750 F.2d 844, 855 (11th Cir. 1985).

> and mortgage as well as a standard Offer and Acceptance form with him for he and his wife, Judy, to execute. Have him resign from the [Madison Guaranty] Board, and do not fund the $50,000 loan. Tell him I will call him about it Friday." (Ex. 83).[62]

With this kind of evidence it will be difficult for McDougal to argue that he exercised no influence over the association and therefore was not "connected in a capacity" with it.

B. "Belonging To Such Institution"

Another element common to both statutes is the insured status of the funds in question. We will be required to prove that the funds misapplied (under section 657) or received (under section 1006) came from the insured institution. There is no problem on this point with respect to those counts relating to Lisa Aunspaugh. The $64,000 loan or the funds in the Designers Construction account are clearly funds under the custody and control of Madison Guaranty. Similarly, the $25,000 McDougal received for the airplane came from a Seth Ward loan from Madison Guaranty. But the $18,000 lease payment to Bill Henley and the payments to Eric Sorensen were payments of Madison Financial not Madison Guaranty. McDougal may argue that he cannot be charged with misapplying funds of the uninsured subsidiary. We will counter with the two cases on point that we have found. In United States v. Cartwright, 632 F.2d 1290, 1292 (5th Cir. 1980),

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[62]See also McDougal's memo to Latham on May 6, 1985, in which he complains that the loan department is slowing up the sales at Maple Creek. "I want processing of these loans to begin today and a report given to Pat Harris that it has been done before the close of business on Monday." (emphasis in the original) Ex. 84.

the court held that "funds of a wholly-owned subsidiary 'belong to' the parent within the meaning of 18 U.S.C. § 657." See also United States v. Mouton, 617 F.2d 1379, 1383 (9th Cir.), cert. denied, 449 U.S. 860 (1980) (as long as the misapplied moneys are assets of an insured institution, it is irrelevant whether they are specifically insured).

C. The Law Of Misapplication--Intent To Defraud

"Misapplication" has no precise meaning and is defined only by case law. It is as old as banking and as versatile as human ingenuity. The Eight Circuit Pattern Instruction (No. 6.18.656) states that:

> "Misapplication" means the unauthorized, or unjustifiable or wrongful use of a bank's funds. Misapplication includes the wrongful taking or use of money of the bank by a bank officer or employee for his own benefit or for the use and benefit of some other person."

Misapplication requires an intent to injure or defraud the institution. According to the same Pattern Instruction, "to act with intent to defraud" means to act with intent to deceive or cheat, for the purpose of causing a financial loss to someone else or bringing about a financial gain to the defendant or another.

Some of the most helpful law on intent to defraud in the misapplication context has come from the Fifth and Ninth Circuits. The Fifth Circuit specifically approved the following instruction in United States v. Cauble, 706 F.2d 1322, 1355, n.138 (5th Cir. 1983), cert. denied, 465 U.S. 1005 (1984):

> "Intent to injure or defraud the savings and loan, within the meaning of this statute [18 U.S.C. §657], means to act knowingly, that is with knowledge. A person acts knowingly, or with knowledge, with respect to a result of his conduct when he is aware that his conduct is reasonably certain to cause the result. The element of intent to injure or defraud is not fulfilled by a mere showing of indiscretion or neglect on the part of the defendant. However, intent to injure or defraud may be inferred from acts knowingly done with a reckless disregard for the interests of the savings and loan. Further, it is not necessary that actual injury to the savings and loan be shown."

See also United States v. Adamson, 700 F.2d 953, 965 (5th Cir.) (en banc), cert. denied. 464 U.S. 833 (1983)("the trier of fact may infer the required intent, i.e., knowledge, from the defendant's reckless disregard for the interest of the bank").

The Ninth Circuit in United States v. Unruh, 855 F.2d 1363, 1371 (9th Cir. 1987)(as amended in 1988), cert. denied, 488 U.S. 974 (1988) succinctly defined misapplication as follows: "misapplication 'occurs when funds are distributed under a record which misrepresents the true state of the record with the intent that bank officials, bank examiners, or the FDIC will be deceived.'"[citation omitted].

In the context of nominee loans, the Eighth Circuit has followed the majority of circuits by holding that the ability of the nominee borrower to pay off the loan in question is irrelevant as long as the loan is a subterfuge. Virtually all cases concerning third party or "nominee" loans have either followed United States v. Gens, 493 F.2d 216 (1st Cir. 1974), an early case limiting the misapplication statute in the context of nominee loans, or have followed United States v. Krepps, 605 F.2d

101 (3d Cir. 1979), which refused to follow Gens. In Gens, the court held that the ability of the nominee borrower to pay off the loan was a factor in determining the fraudulent intent of the bank insider. The Krepps court, on the other hand, viewed as irrelevant the borrower's ability to repay the loan. Krepps at 108 held that:

> "The very existence of a mediated transaction demonstrates that the bank officer had the measure of criminal intent needed to establish a willful misapplication of bank funds."

The Eighth Circuit follows Krepps. United States v. Marx, 991 F.2d 1369, 1373 (8th Cir. 1993).

D. False Entries And Fraudulent Participation Under Section 1006

Regarding the false entry statute the Eighth Circuit Pattern Instruction (6.18.1005)[63] states as follows:

> "An entry is 'false' if untrue when made. An entry may be false if it records a transaction which did not occur, or fails to record a transaction which did occur and should have been accurately recorded, or inaccurately reports or records a transaction."
>
> "To act with 'intent to deceive' means to act with intent to mislead or to cause a person to believe that which is false."

There have been a limited number of reported unlawful participation prosecutions under the third clause of section 1006. Most of them have involved an intent to defraud the institution as well as the United States. United States v. Payne, 750 F.2d at 844 (diversion of loan proceeds by a closing

[63]Except for the terms "intent to defraud," there is no standard jury instruction for the unlawful participation clause of section 1006.

agent to a nominee); United States v. Chenaur, 552 F.2d 294 (9th Cir. 1977)(accepting kickbacks). But in United States v. Beebe, 792 F.2d 1363 (5th Cir. 1986), where the defendant participated in a small business investment company through a sham corporation, the defendant was charged only with intending to defraud the Small Business Administration.

The Fifth Circuit in United States v. Brechtel, 997 F.2d 1108, 1116 (5th Cir. 1993) recently characterized the third clause of section 1006 as a conflict of interest prohibition:

> "We have long recognized the §1006 insider participation provision as a typical conflict of interest prohibition. Thus, a fiduciary who benefits or causes loss to the bank by knowingly subordinating the institution's interests to his own in a transaction for which he has responsibility acts with the "intent to defraud" required by §1006. As direct evidence of mental state is seldom available, the government may demonstrate that element of a §1006 violation by circumstantial evidence. An inference of intent to defraud arises where a responsible bank insider acts to procure a transaction which he knows will benefit him, without disclosing his interest therein."

X. The Case Against McDougal And McDougal's Defense

A. Lisa Aunspaugh And Designers Construction (Counts 1-4)

There are four counts in our proposed indictment relating to Lisa Aunspaugh's $64,000 June 1985 loan. In our April memo we proposed two counts relating to McDougal's interest free use of the Designers Construction account. For the reasons discussed below, we do not recommend charging McDougal for his abuse of the Designers Construction account.

1. Insider Loan Restrictions

We will attempt to prove that the $64,000 loan and sale of McDougal's modular home was an accommodation to McDougal designed to enable McDougal to obtain an additional "commercial" loan from Madison Guaranty that he was not allowed to receive under Bank Board regulations and Madison Guaranty's Bank Policy Manual.[64] The Bank Board's Insurance Regulations at 12 CFR 563.43(b)(5) provide that an insured institution may not loan for "commercial purposes" more than $100,000 to an affiliated person. On May 16, 1985, Jim McDougal obtained from Madison Guaranty an unsecured $85,000 "commercial loan."[65] Ex. 86. In February 1985, McDougal had already obtained a $360,000 loan on his personal residence at #4 Bettswood. Ex. 87. According to Jim Clark, the Bank Board's examiner in charge of the 1986 examination, a loan on McDougal's modular home in Kingston would not have been a loan on his primary residence but would have been characterized as a "commercial loan." But since McDougal had already borrowed $85,000 as a "commercial" loan from Madison Guaranty and was limited under the regulations to $100,000, he could not (without further adjustments) have borrowed $64,000 on his home in Kingston.

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[64]Madison's Lending Policy Manual (prepared by Sarah Hawkins) effectively repeats what is contained in the Bank Board's Insurance Regulations regarding insider loans. Ex. 85.

[65]The note itself does not state a purpose but the Madison Guaranty Minutes of May 16, 1985 approve the loan as a "commercial loan." This loan was one of three loans that McDougal defaulted on.

We cannot prove that McDougal understood the precise restrictions he was under. What we can prove, however, is that he knew that affiliated party loans were under some restrictions and would be scrutinized by the examiners. For this reason he created an accommodation sale of his house so that he could "borrow" additional funds from Madison Guaranty.

In the Eighth Circuit, nominee loans by insiders are clearly misapplications when they are designed to circumvent lending restrictions. This is true whether or not the nominee borrower acknowledges the loan as hers and has the ability to repay it. In United States v. Marx, 991 F.2d 1369, 1373 (8th Cir. 1993), citing prior Eighth Circuit decisions the court held:

> ". . . that when the person who gets the money from a nominee loan is a bank insider, the transaction may be found to have been undertaken with the intent to defraud the bank or deceive its officers or examiners even though the named borrower was able to repay and understood his obligation to do so. In such a case:
>
> > a jury might plausibly deduce that the bank officer, by channeling the funds through another party, sought to conceal from the bank his own interest in the transaction and thereby to circumvent the barrier--imposed by both the statute and the bank's own regulations--to the bank's making the particular loan directly to him....Moreover, by concealing the fact that he is the real beneficiary of the loan, the bank officer has deceived the other bank officers and agents who are appointed to examine the affairs of the bank and who are entitled to be kept informed of all loans to bank officers so that they may properly fulfill their duties." (Citing United States v. Krepps, 605 F.2d 101, 106 (3d Cir. 1979))

Even if Lisa wanted to buy the McDougals' Kingston house as an investment and the transaction was not designed to accommodate

McDougal, Bank Board regulations would have raised serious questions regarding the $64,000 loan to Aunspaugh to purchase the house. 12 CFR 563.43(c)(1) prohibits the institution to finance the sale of real estate owned by an affiliated party (except when the property is the affiliated party's principal place of residence). McDougal might argue that this restriction does not apply since his modular house (like a mobile home) is not "real estate." But Jim Clark, the examiner in charge of the 1986 exam, would point out that since the $64,000 loan was secured by a mortgage that took into account the enhanced value of lot 747 (with the modular home attached to the lot), the modular house would likely have been considered "real estate" for the purposes of the loan. Moreover, Jim Clark will testify that the conflict of interest regulation, 12 CFR 571.7, at the very least would have required full disclosure to the Madison Guaranty Board that McDougal personally gained from the loan, with full disclosure in the minutes for the examiners to review and evaluate. But full disclosure of McDougal's interest in the loan would have triggered a close look at his relationship with Lisa Aunspaugh and the details of her financial statement.

2. Is The Sale And Loan A Sham Or Just An Accommodation?

In our April memo we took the position (and alleged in the proposed indictment) that the loan and sale was a "sham"--that the documentation of the transaction did not reflect the reality of the transaction. This aggressive approach may impose a heavier burden of proof on us than what is necessary to convict

McDougal of misapplication and fraudulent participation. The problem with characterizing the loan and sale as a "sham" in the indictment is that it denies the government certain flexibility at trial. No doubt Lisa will testify that she thought that she was holding the Maple Creek home for Jim and Susan and that repayment of the loan was Jim's obligation and not hers. At trial we will have the flexibility to argue that Lisa's testimony shows that the loan was a sham. But in light of the Eight Circuit's wholehearted adoption of Krepps, all we need to prove is that the loan was an accommodation to McDougal, structured by him to conceal his interest (regardless of whether or not Lisa had the ability to repay and understood her obligation to do so).[66]

Therefore, even though Lisa's testimony will tend to show that she never considered the loan to be her obligation, we have removed from the proposed indictment the allegation that the purchase of the home and the $64,000 loan was a "sham." Instead, we allege that the loan and sale was an "accommodation" to

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[66]There is another danger with characterizing the loan as a sham. The term "sham" may connote to the jury that there was something fictitious about the loan and that Lisa should not have been bound by the terms of the note (like a note with a forged signature could be called a sham). But in the eyes of the law, both the Maple Creek home and the loan belonged to Lisa, not Jim and Susan. There never could have been a deficiency judgment against her if the loan and sale were not binding upon her. Therefore, in one sense the transaction was not a sham. Similarly, in every nominee loan case, when the bank is seeking a judgment against the nominee borrower, it is no legal defense for the borrower to claim that he borrowed the funds for the benefit of (and as an accommodation to) the bank insider and that therefore he is not liable on the loan.

McDougal designed by him to circumvent insider loan restrictions, fraudulently buttressed by Lisa's loan application. This way we will maintain maximum flexibility at trial and the jury will be focused less on how Lisa regarded her obligation on the note and more on McDougal's undisclosed self-dealing.

McDougal will no doubt argue that there was nothing deceptive about the sale, that it was not an accommodation designed by him, and that Lisa's testimony is shaped by the fact that she never wanted to be held responsible for the loan.[67]

To counter this we will argue the following facts:

[redacted]

b) Documents show that McDougal gave Lisa the downpayment to purchase the lot (lot 747);

[redacted]

[67]McDougal may point to two 1985 memos he sent to Lisa Aunspaugh in which he referred to the house as "your house at Maple Creek." In April 1985, among other directions, he told Lisa that he needed "a status report daily on the repairing of your house at Maple Creek." (Ex. 88). In July 1985 he told Lisa that "[w]e need to talk about a dishwasher and changing the closet arrangement on your house at Maple Creek." (Ex. 89). Lisa does not remember receiving the memos although she does remember decorating the house in accordance with McDougal's directions. While the memos refer to the house as "your house," they also show McDougal's hands on approach to the house. Why would he care about Lisa's house if he were not concerned about getting it resold. He knew that Lisa looked to him to retire the $64,000 loan.

d) Bessie Aunspaugh (Lisa's mother), who worked as a receptionist at Madison Guaranty, will testify that Lisa never told her that she planned to move out of the house and live in Maple Creek or that she had ever "purchased" any house as an investment;

e) Lisa took no action to move the Kingston house to Maple Creek and does not know when it arrived;

[redacted]

g) There is a memo from McDougal to Pat Harris telling Harris to "List Lot 747";

h) Lisa never dealt with a loan officer but dealt exclusively with Jim McDougal who gave her the necessary papers to sign;

[redacted]

[redacted]

In short, we will argue that the transaction in part is falsely documented and conceals the fact that it is an accommodation to McDougal. As the court stated in United States v. Unruh, 855 F.2d 1363, 1371 (9th Cir. 1987)(as amended in 1988), cert. denied, 488 U.S. 974 (1988): "misapplication 'occurs when funds are distributed under a record which misrepresents the true state of the record with the intent that bank officials, bank examiners, or the FDIC will be deceived.'"[citation omitted].

3. Did McDougal Create the False Loan Application?

Count 4 charges McDougal with creating a false entry to deceive the examiners, namely, the "residential loan application" which states that Lisa had a net worth of $101,000 and a monthly income of $3682. McDougal will argue that we can not prove that he actually prepared the document.

In response we will argue that McDougal had to have prepared the document or had it prepared under his direction because Lisa dealt only with McDougal.[68] She remembers that he called and asked about her credit card information and that he later gave her the document to sign. Where else did the information come from? Somebody who prepared the document knew about Lisa's involvement in 1308 Main. Who else but McDougal knew this in June 1985? The only documentation existing in June 1985 connecting Lisa to 1308 Main was an Assumption of Mortgage document that McDougal had Lisa sign and a $12,000 Designers Construction check to Jim Guy Tucker that McDougal had her sign and deliver. Who would have known to put a $135,000 piece of real estate on Lisa Aunspaugh's financial statement other than

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[68]Lisa told Borod and Huggins lawyer, Jeff Gerrish, in December 1986, that Bob Secrest handled the $64,000 loan. Lisa has told us that she said this because Susan told her what to say. Robert Secrest, an old AA friend of McDougal's, working in Madison's loan department, has told us recently that he did not recall ever dealing with Lisa but that he did recall McDougal telling him to expedite the $64,000 loan. Secrest is a binge drinker, currently unemployed, who can be contacted only through his father in Louisiana. Secrest had no recollection of ever seeing Lisa's residential loan application. Secrest also signed, as the representative of Madison Guaranty, the March 1985 Assumption Agreement in which Lisa assumed Jim Guy Tucker's 1308 Main mortgage. Secrest has no recollection of the mortgage assumption.

McDougal? There was no appraisal, from what we know, prior to Palmer's October 1985 appraisal.

There is no motive for Lisa, on her own initiative, to have lied about her income on the financial statement. Both Jim and Susan had an idea of what her income was. Moreover, she never exhibited any interest on her own in buying the Maple Creek home. Had she wanted to buy the home (even as an investment), she would have moved out of her apartment 20 minutes away rather than continue to pay rent for the last six months of 1985. Her subsequent conduct shows that she was not motivated to make the $64,000 loan. So why would she on her own submit a false financial statement?

Denton does not recall ever dealing with Aunspaugh and he does not know who originated her two loans.[69] It could have been McDougal or Latham, according to Denton. Denton does recall at some point learning that Lisa owned a home in Maple Creek.[70]

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[69]Denton, however, recognized his initials on some of the loan documents for the October loan but he has no recollection of his involvement on the loan. Only recently, we discovered Denton's initials on the lower left hand corner of the original copy of Lisa's $64,000 note. We believe that Denton will say that he processed the note in some fashion but did not originate the loan.

[70]Denton appeared to draft a memo to McDougal in July 1985 in which he referred to the $64,000 Aunspaugh loan. The memo (Ex. 90) tells McDougal how he can structure the loan to come within the 90 per cent loan to value ratio. Denton, however, does not remember the memo and does not believe that the language in the memo is the kind of language he would use. The memo was typed by Strayhorn. There is also a July 1986 memo (Ex. 91) from Denton to Latham discussing what was contained in the Aunspaugh loan file. Denton believes that he authored this memo on the eve of Latham's fateful visit to Dallas to discuss the 1986 exam with the Federal Home Loan Bank Board. The memo in question was a

[redacted] Like Denton, he too at some point recalls that Lisa bought a home in Maple Creek. According to Latham, such a loan (to buy McDougal's house) would have generated an affiliated party transaction that would have required some legal advice.

4. McDougal's Relationship With Aunspaugh And The $60,000

We can not fully explain why McDougal gave Lisa $60,000 from the sale of 1308 Main. She has told us that she simply thought that her name was being used with respect to the building. Since Lisa was the owner of record for 1308 Main, Jim had to transfer the profit on the sale, at least on paper, to Lisa. McDougal did not use, at least immediately, any of the $60,000 for his own benefit, although he did direct Lisa to return $20,000 of the funds to Designers Construction, which was a negative balance account in which he (McDougal) gained personally through overdrafted funds.[71]

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series of memos that Denton drafted to Latham to inform Latham on the status of certain problem or sensitive loans.

[71]Nonetheless McDougal will be able to argue successfully (because of his last minute $38,000 deposit to the account) that he put more into Designers Construction than what he received from Designers Construction.

Lisa has told us that she did not expect to receive the $60,000. Yet, once she got it, she felt she earned it. When asked why she felt she earned it, she stated that Jim told her that she had earned it. That alone, plus the work she performed, made her believe that she earned the $60,000.

McDougal clearly wanted a relationship with Lisa. There may have been more to their relationship than what Lisa has admitted. But Lisa insists that nothing ever happened between the two of them despite the pressure he placed on her. McDougal may have given her the $60,000 because he was confident that he could still exert influence over her. In fact he told her what to do with part of the funds (pay off the car loan) and he told her to return $20,000 to Designers Construction two weeks later. The influence McDougal exerted over her is exhibited in part by the fact that Lisa transferred $15,000 of the funds to her mother (whose account was at another bank). She has explained to us that, even though the $60,000 was in her personal account, she wanted to transfer the $15,000 to her mother because she felt Jim would still have access to it unless she could tell him that she had already spent it.

Lisa may have been a church going 21 year old, manipulated by McDougal, but she has admitted that she acted behind McDougal's back and withdrew $15,000 from the Designers Construction account in order to pay for the leadership franchise. It was her way of undoing what McDougal had her do only a few days earlier, namely, return $20,000 of the $60,000 to

Designers Construction. The franchise was a naive endeavor on her part since she never succeeded and was completely ill-suited for its promotional aspects. She effectively lost the $18,000 entry fee the promoters had her pay. Part of this was due to the fact that she was married in November 1986. Children followed, and she did not devote the time needed for the franchise.

5. Lisa Aunspaugh's Prior Inconsistent Statements

As we pointed out in our April memo, Lisa admitted lying to the Borrod and Huggins attorney Jeff Gerrish in December 1986. When asked about the $64,000 Maple Creek home loan, Lisa told Gerrish that she had purchased it as an investment. When asked how she could carry so much debt on a "$12,000 a year income," Lisa gave the misleading response that she had other customers besides Madison.[72] Lisa has explained that she gave these misleading responses at the behest of Susan.

In March 1989 during the Madison investigation but before McDougal was indicted, FBI agent Gary Aaron interviewed Lisa. Most of what she said in the interview is consistent with her current version of events, except that she told agent Aaron that she purchased the Maple Creek house "for an investment." She told agent Aaron that the purchase was something McDougal told her to do. Her entire statement on the Maple Creek matter is important since it is largely consistent with her current recollection on a number of key points. For example, Lisa told

[72]Technically Lisa did have other clients but they were all tied to Madison and Jim McDougal.

agent Aaron that McDougal filled out the loan application and that she signed it without reading it. Agent Aaron summarized Lisa's statement to him on the Maple Creek house as follows:

> "Thompson stated that there was another occasion wherein she purchased a house located at Maple Creek Farms at Jim McDougal's urging. This house had been at Huntsville, Arkansas, and it was the house that Jim and Susan McDougal had lived in. Thompson stated that she has never lived in this house and that she bought it for an investment. Once again, it was a situation wherein McDougal was actually telling her to purchase this rather than asking her if she wanted to. Thompson reviewed a copy of an application for the purchase of a piece of property at lot #747 in Maple Creek Farms. Thompson advised that this is the lot on which the particular house is located. Thompson again stated that she believes that Jim McDougal filled out this loan application and that she signed it without reading it. Thompson advised that she does not recall Jim McDougal either giving her or Designers Construction any money which was utilized to make payments on this house. Thompson further stated she still owns the house and that she is currently negotiating with Madison Guaranty to allow Madison Guaranty to take the house back...."

Lisa also told agent Aaron that she purchased 1308 Main at McDougal's urging.

Regarding the entire 1308 Main matter, agent Aaron wrote the following:

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> "Thompson recalled that there was an occasion when Jim McDougal called her to come to his office at Madison. When she got there, McDougal told her that there was a building at 1308 Main Street which was for sale. McDougal asked her if she would like to buy this building, fix it up, and then sell it. Thompson stated that although it was phrased as a question, it was her impression that McDougal meant it as more of a statement of what she should do. Thompson stated that since she had a great deal of trust in McDougal she agreed to do this. Thompson recalled McDougal telling her that the building would be appraised for what it would be worth when the work was done and not to worry

about selling it. McDougal made the additional statement that Madison Financial Corporation would lease part of the building for office space. Thompson further advised that it was her impression that Jim McDougal had filled out the loan application which she signed because when she came to his office it was already filled out and she merely signed where McDougal told her to without reading the application. Thompson advised that she subsequently hired the people to renovate the building and the building was renovated and cleaned up."

[redacted]

For example, agent Aaron wrote as follows:

"Thompson stated that sometime later Jim McDougal told her that Bill Henley needed to purchase the building for tax purposes. Thompson advised she has never talked to Bill Henley and, even in her discussion with McDougal, price was never discussed. She advised this was really not a question of whether or not she wanted to sell the building, it was a situation wherein McDougal was telling her what was going to take place. Thompson recalled that she was on a trip to Florida when the building was actually sold. When she got back to Little Rock, McDougal told her that they had sold the building, paid off her loan, and put $60,000 in her personal account. Thompson recalled that she used this money to pay off a loan which she had on her Mercedes. A portion was used to purchase a franchise called SMI, and the remainder was placed into the Designers Construction company. Thompson advised that she did not know anything about the appraisal which was done on this property and that she certainly never had it appraised."

In our April 27 interview of Lisa, we asked Lisa why she told special agent Aaron (apparently the first FBI agent she talked to about McDougal) that she had purchased McDougal's Maple Creek home "for an investment." Her response was that she was still characterizing or describing the transaction the way Susan had originally told her to describe it back in December 1986 right before Lisa was interviewed by Jeff Gerrish of Borrod &

Huggins. In March 1989 when Aaron interviewed her, Lisa knew that she was stuck with the house and the $64,000 loan. She could not repudiate the loan; it was her signature.

In the summer of 1989 she was sued in a foreclosure action and obtained counsel for the first time.

When we showed her, in March 1995, the Borrod & Huggins report of her interview, she remembered the interview and Susan's role in telling her what to say.

[73]In September 1984, without showing her a copy of the Gerrish interview report or going over details of the Gerrish interview, OIC attorney Tim White and special agent

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6. McDougal's Use of the Designers Construction Funds

We will show that the Designers Construction account was in existence 417 days. During that time it was in a negative balance 363 days. Over those 363 days, it had an average negative balance of $36,123. Treating this as a line of credit at 12.5 percent interest--the same rate that McDougal was required to pay on his May 1985 commercial loan--Designers Construction would have owed Madison Guaranty approximately $4,481 in interest by the time the account closed in February 1986. We can show that a major reason for the size of the Designers Construction negative balance was McDougal's personal use of the account and his failure to make timely deposits to cover his expenditures. We can calculate that, of the $4,481 in lost interest, approximately $2,282 (slightly more than 50 per cent) is attributable to McDougal's own personal deficit in the account.[74] Ex. 92.

McDougal needed an illicit source of funds to continue to renovate his house. He had already borrowed from Madison Guaranty 90 per cent of its appraised value. The concealed

FOIA(b)(7) - (C)

asked her if she recalled being interviewed by Gerrish and telling Gerrish that she had purchased the Maple Creek home as an investment. She told White and [redacted] that she did not recall being interviewed by Gerrish but that, if she made the statement, it would have been because Jim or Susan had told her to make such a statement.

[74]In our April memo we had mistakenly calculated that McDougal was responsible for $3,400 of the $4,481 in lost interest. This figure is too high since we had calculated McDougal's interest even when the Designers Construction account was temporarily in a positive balance.

overdraft violated Bank Board regulation 12 CFR 563.43(b)(1)(i), according to Jim Clark, since it amounted to a loan on his principal place of residence under conditions (loan to value ratios) which would not "be available to members of the general public."

In determining what was spent on behalf of Jim McDougal from the Designers Construction account, we have given McDougal the benefit of the doubt on all deposits and expenditures. For example, if a deposit was made to the Designers Construction account from Madison Marketing, Susan's advertising company, we considered it a contribution to the account (to offset McDougal's expenditures) since Lisa could not recall having Designers Construction do any work or renovation for Madison Marketing.

According to Lisa, at Jim McDougal's direction, Designers Construction spent approximately $12,700 on landscaping, septic, or interior improvements to the Maple Creek house (lot 747). Approximately, another $3,649 from Designers Construction (again at McDougal's direction) went to pay interest or principal on the $64,000 loan. In our April memo we had considered both of these payments (approximately $16,000) as payments for McDougal's personal benefit just as the payments for #4 Bettswood. We had done so since Lisa considered the Maple Creek house (and the loan) as Jim and Susan's and that they (not her) would gain from any improvements on the house once it was sold. But on reconsideration (and to be as conservative as possible) we no

longer consider these payments as payments for the McDougals' benefit.[75]

In our April memo we proposed charging two counts that were tied to McDougal's interest free use of the Designers Construction account. But our recalculation of the amount of interest lost due to McDougal's failure to promptly pay Designers Construction makes us reconsider that option. We can conservatively calculate that, of the $4,481 in lost interest, approximately $2,282 (slightly more than 50 per cent) is attributable to McDougal's own personal deficit in the Designers Construction account. In our April memo we had mistakenly calculated McDougal's share of the lost interest at approximately $3,400.

There is a big difference between $3,400 and $2,282 because the Designers Construction account was assessed $2,380 in overdraft charges. According to Bonnie Crocheron, Madison Guaranty's head cashier, the typical overdraft charge was $15 per check. She remembers that her department was told (by someone--probably Latham) to honor the overdraft checks and not to assess any overdraft charges to Designers Construction. But a review of the account shows that there were occasional charges assessed (at what appears to be $15 per check) for a number of the overdraft

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[75]As a result on this change, instead of receiving $9,000 more from Designers Construction than what he put into Designers Construction (a figure we proposed in our April memo), McDougal in fact put into Designers construction $7,000 more than what he received from Designers Construction. This contribution was made late in the history of the account after months of maintaining a negative balance.

checks that were honored. Crocheron has told us that these occasional charges must have been mistakenly or inadvertently assessed by the people working in her department who either forgot or who were never told that Designers Construction was given special treatment. In fact we have calculated that Designers Construction had 445 overdraft checks honored over the one year life of the account. Had Designers Construction been treated like any other customer with a $15 penalty for each check, Madison Guaranty would have assessed the account a total penalty of $6,675. But Designers Construction was given special treatment because it was doing business with the Madison Guaranty and Madison Financial.[76]

Honoring overdrafts was no simple matter, according to Crocheron. An overdraft report was prepared and circulated every day. The checks had to be manually pulled. A copy of the report was furnished to McDougal, Latham, and Young. Nonetheless, the issue of charging McDougal for his own overdraft abuse of the account has become clouded by the fact that McDougal can argue that his overdraft policy on Designers Construction netted Madison Guaranty $2,380.

B. Seth Ward And The Piper Seminole (Count 5)

There is only one count regarding the airplane (fraudulent participation) that is not time barred. This is McDougal's receipt of the $25,000 for the airplane in July 1985. In April

[76]Greg Young, John Latham, and Bonnie Crocheron mention this when asked why Designers Construction was given special treatment. The explanation originally came from McDougal.

we proposed a false entry count regarding the May 5, 1985 letter in which McDougal, on behalf of Madison Financial, authorized Seth Ward to buy an airplane in the range of $25,000 to $50,000 and to use it for Madison Financial business. He also stated in the letter that Madison Financial would cover all maintenance costs and would guarantee that Ward, if he should later sell the airplane, would not lose money on the sale.

Even though we can no longer charge the May 5th letter as a separate count we can argue that it demonstrates fraudulent intent since it omits the material fact that it was McDougal's personal/Whitewater airplane that McDougal authorized Ward to buy with a money back guarantee from Madison Financial.

Examiner Jim Clark will testify that the examiners never knew about the airplane transaction or, if they did, never knew about McDougal's personal financial connection to it. Clark will testify that the omission of McDougal's ownership of the airplane is highly material. The transaction was designed by McDougal to avoid Bank Board regulation 12 CFR 563.41(b) which provides that "no insured institution...may directly or indirectly...purchase ...from...an affiliated person...any interest in real or personal property unless the transaction is determined by the Principal Supervisory Agent to be fair to, and in the best interest of, the insured institution or subsidiary." The transaction must receive prior written approval based upon an independent appraisal.

There are two ways in which McDougal might defend himself regarding the airplane. First, he could argue that Seth Ward is

lying and that he (McDougal) never expressed any reservations about the regulators knowing about the airplane. ("I'm no friend of Seth Ward's," he told local AP reporter Bill Simmons.) He might argue that Seth Ward, a commissioner at the airport, for some reason (i) wanted the transaction run through Central Flying Service and (ii) wanted the May 5th letter to Ward to omit any reference to the fact that McDougal was selling the aircraft to Ward. Since the airplane count requires an intent to deceive the examiners, McDougal will attempt to show that he never intended to deceive them.

When he was interviewed by reporter Bill Simmons in the presence of his (McDougal's) lawyer, Sam Heuer, sometime in late 1993 or early 1994, McDougal denied that he even knew at the time of the sale that Seth Ward was buying the plane from Central Flying Service. The interview (p. 84 of the transcript) reads as follows:

McDougal: Well, he [Wade] brought it down [to Central Flying Service] as part of the, of the closing of this deal of purchasing the [Whitewater] land.

Simmons: All right.

McDougal: And I don't fly an airplane...

Simmons: Right.

McDougal: ...and, and Whitewater doesn't need an airplane.

Simmons: Right.

McDougal: And we had intended all along to sell it. It was immediately...

Simmons: All right.

McDougal: ...put up for sale. I had never seen the plane.

Simmons: **All right, and Little Rock, uh, Central Flying Service sold the plane. Do you remember who they sold it to.**

McDougal: **No, I had read in the paper that they sold it to Seth Ward, but I'd.., I'm unaware that that's a fact.**

McDougal also denied in the same interview that he knew that Ward borrowed $25,000 from Madison to buy the airplane.

McDougal's explanation at the Simmons interview flatly contradicts Ward and is inconsistent with Richard Holbert at Central Flying Service. McDougal suggests that either he or Wade asked Holbert to sell the plane. But Holbert never dealt with Wade or McDougal, only Ward. Ward never went to Holbert and said, "I want to buy this aircraft...what is the owner willing to sell it for?" On the contrary, Holbert will deny that the aircraft was ever placed with him to sell in the first place. Holbert was asked by Ward to run the transaction through Central Flying Service with the understanding that the parties knew each other and had already agreed to a $25,000 price.

Moreover, McDougal cannot deny dealing directly with Ward without contradicting Chris Wade. In late 1993 or early 1994, Wade was asked by Sam Heuer to come to his office to discuss the newly opened Whitewater investigation with Jim McDougal. During the conversation, McDougal asked Wade if the airplane Wade had sold to him had a bad engine. Wade replied that he did not think so. McDougal went on to say that, when he sold it to Ward, Ward had told him that the airplane had a bad engine. Wade felt that

McDougal suspected that Ward had cheated him by claiming that an engine was bad.

There is a second defense that McDougal may employ. He may argue that what Ward says is substantially true but such testimony is insufficient to establish an intent to deceive the examiners.

Defense counsel may argue that if Ward did not see anything improper with the transaction, why should McDougal? This is not an insurmountable problem for us. We will argue that the issue for the jury is McDougal's intent, not Ward's intent. It is McDougal who had the initial problem of disposing of the airplane, not Ward. It was McDougal who had dealt with examiners in the past and who had the motive to deceive them. And it was McDougal, not Ward, who had the obligation to make full disclosure to Madison and to be sure that the examiners were not deceived. Moreover, Ward was unaware of what disclosures, if any, McDougal had made to Madison Financial's Board of Directors. Since Ward made no money on the transaction and never authored any false document, it is no surprise that Ward saw nothing

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[77]Similarly, Richard Holbert at Central Flying Service did not think he did anything illegal by buying McDougal's airplane and selling it the same day to Ward at no profit.

illegal with the transaction.[78] His perspective was different and arguably his intent was different. What the jury needs to consider is not what Ward's opinion is today but what the conversations were at the time and what the documents reflect. The documents themselves unmistakably conceal an affiliated party transaction in which Madison Financial suffered a loss.[79]

C. Eric Sorensen (Counts 6-7)

[redacted]

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[78]It is for this reason that we told Ward when he first discussed this transaction with us last December that he was not a target with respect to this specific matter. It was his first meeting with OIC counsel (although agents had talked to him earlier) and he wanted some assurance from us that he did not need his lawyer. If we had hesitated in any way, the meeting would have broken up and we would have been dealing with Ward's lawyer. Ward was leery of us because of his bitter experience with RTC lawyers who denied him on appeal (solely on jurisdictional grounds) his hard fought jury victory in state court. He told us that he regarded the airplane transaction as a kind of IRS avoidance matter--something you do to avoid an audit but not something you think is illegal. Since he made no money on the transaction, had authored no false document, was 74 years old, had cooperated earlier with FBI agents, and had explained the transaction in "avoidance" terms, we told him that we thought there was insufficient evidence to conclude that he had committed a crime and that therefore we regarded him as a witness.

[79]Part of the $13,000 loss is attributable to the fact that McDougal did not sell the aircraft to Ward at a fair price. It cost Ward $10,000 to repair the engine and, after the repairs, he could only sell it for $28,500. But Ward's "loss" was passed on to Madison Financial.

[redacted]

did Madison Financial have an obligation to cover Sorensen's loss on the sale of his two Maple Creek homes? Jim McDougal promised Sorensen that he and/or Madison would cover Sorensen's loss if in fact a loss occurred. Did this bind Madison Financial or did it simply bind Jim McDougal personally? Sorensen himself does not know who (Jim or Madison) was obligated to pay him. In Sorensen's eyes, Jim McDougal and Madison were one and the same. All Sorensen can say is that he was promised that his losses would be covered.

It is our view that a misapplication occurs even if Madison Financial was obligated to pay Sorensen for his losses. As the court stated in United States v. Wolf, 820 F.2d 1499, 1503 (9th Cir. 1987):

> "The intent element of 18 U.S.C. 656 is satisfied if the accused intends to deceive bank officials, bank

[redacted]

examiners or the Federal Deposit Insurance Corporation. There need be no intent to injure."

McDougal chose to pay Sorensen in a surreptitious way. Had McDougal acknowledged that Madison Financial was obligated to cover Sorensen's losses, McDougal would have been forced to book the Sorensen loans as an investment of Madison Financial (since only Madison Financial took the risk of ownership). But McDougal knew about the state imposed six percent investment limitation placed on Madison Financial, according to Greg Young. Young will testify that if Madison Financial bore the risk of loss on Eric Sorensen's two Maple Creek homes, Madison Financial would have been forced to regard Sorensen's loans as Madison Financial investments. This would have changed Madison Guaranty's investment figure in its quarterly report to the Federal Home Loan Bank Board, according to Young.

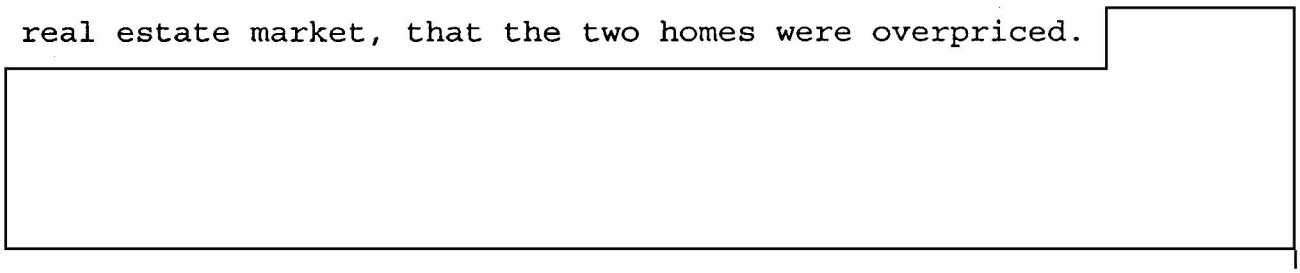
Sorensen built the two Maple Creek homes according to the specifications that either Jim or Susan provided to him. He was told by Jim that he (Sorensen) would have to take out Madison Guaranty construction loans, purchase the lots in question, build the homes, then pay off the construction loans with the proceeds of the sale. Sorensen recalls that McDougal cited certain regulations and told him that Madison was not in the home building business.

The sale of the two homes in question, according to Sorensen, would be handled by Madison Financial sales agents who had a sales office at the Maple Creek site. Sorensen was not looking for a profit from the sale of the two homes. Sorensen

earned his fee by adding ten percent to his out of pocket costs of building the two homes. In other words, at various stages, Sorensen would draw down on the construction loan the amount of his out of pocket costs of construction plus a ten percent fee for his own services.

But the costs of construction (which included Sorensen's ten percent fee) exceeded the amounts available from the two construction loans. This was not an immediate problem for Sorensen since Jim McDougal allowed him to overdraft his checking account to cover additional expenses. After the second Maple Creek house was built, McDougal told Sorensen to take out a personal loan for $27,000 and to use these funds to eliminate the $27,000 overdraft balance in Sorensen's account. Sorensen agreed to do this but realized that he would be personally liable for the $27,000 personal loan in addition to the two construction loans. If the two Maple Creek homes sold for enough to pay off these three loans, Sorensen would suffer no personal loss.

When the two homes were sold, there was insufficient funds to pay off Sorensen's $27,000 personal loan. Sorensen was concerned about how he could pay off his $27,000 debt even before the homes were sold because it was apparent to him, given the real estate market, that the two homes were overpriced.



FOIA(b)(3) - Fed. R. Crim. Pro. 6(e) - Grand Jury

McDougal will no doubt attack the credibility of Sorensen and may call Bill Henley as a defense witness. Henley has denied ever telling Sorensen that he could inflate an invoice. In fact Henley adamantly denied ever talking to McDougal about Sorensen's financial needs or Sorensen's $27,000 note. But Henley's credibility on this point is challenged by two memos that McDougal authored to Henley in the summer of 1985.

The memos were typed by Sue Strayhorn, McDougal's secretary. On July 17, 1985, McDougal wrote to Henley the following:

"Call me about the Eric Sorensen note which is now due. I think he can earn enough to pay it at El Dorado."

On July 23, 1985, McDougal sent a second memo to Henley which told Henley that "[w]e need to discuss the following...Eric's note..."

There are two arguments we can use to bolster the credibility of Eric Sorensen.

Young was given no invoice from Sorensen but only directions from McDougal to book the payment as an expense from the reserve account of the Fair

Oaks development. McDougal could not have done this without wanting to help Eric Sorensen.[81]

Secondly, Sorensen (without immunity) has told substantially the same story since the Borod and Huggins investigation. On December 17, 1986, Sorensen was interviewed by Borod & Huggins consultant Ken Plunk in the office of Sorensen's attorney in Camden. Sorensen told Plunk about McDougal's Maple Creek promise. According to Plunk's memo of the interview, Sorensen stated that "McDougal later instructed [him] to pad his invoices to the extent of $10,000 on one occasion and smaller amounts on several subsequent occasions." [82] Ex. 93.

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[81]Moreover, Sorensen's detailed handwritten monthly ledgers show that he never earned the $2,448 in question.

[82]Sorensen had not reviewed his records at the time of the interview. He estimated to Plunk that he had padded his invoices by $20,000. When Sorensen was interviewed by FBI agent Gary Aaron two and one half years later in July 1989, Sorensen mentioned only one inflated invoice and said that he was not sure but that to the best of his recollection McDougal was behind the instruction he received from Henley. [redacted] Instead, they asked Sorensen about his 1986 statement to Plunk and his 1989 statement to agent Aaron. Sorensen reiterated what he had previously said about the one (December 1984) invoice and he stated that he thought McDougal was aware that Henley had instructed him to inflate his invoice. Two weeks later Sorensen told the same OIC FBI agents that he had reviewed his records and now recalls that there were three inflated invoices. He also told the agents that he only had conversations with McDougal and Henley regarding the $27,000 loan and inflating invoices.

D. The $18,000 Payment To Bill Henley (Counts 8-9)

It is difficult to see how McDougal can defend himself on the $18,000 payment to Bill Henley. The documents are damning. Henley received $18,000 for rent going back to August 1, 1985, when he did not own the building until January 15, 1986.

We are confident we can prove that complete renovation was ongoing until at least December 1985. If rent was owed to anybody in 1985, why did the rent go to somebody other than Lisa Aunspaugh?[83]

Young recalled that sometime in late 1985 or early 1986, while he was in McDougal's office, McDougal told him that Henley was going to take an investment tax credit on 1308 Main (renovating an historic building) and that Henley owned the building even though it was in Lisa's name. Young did not know what arrangements, if any, there were between Henley and Lisa. McDougal, who Young described to us as his "ultimate boss," assured Young that Henley was "liable" for the building to satisfy the investment tax credit. Young was not inclined to ask too many questions. Young's notes indicate that McDougal told

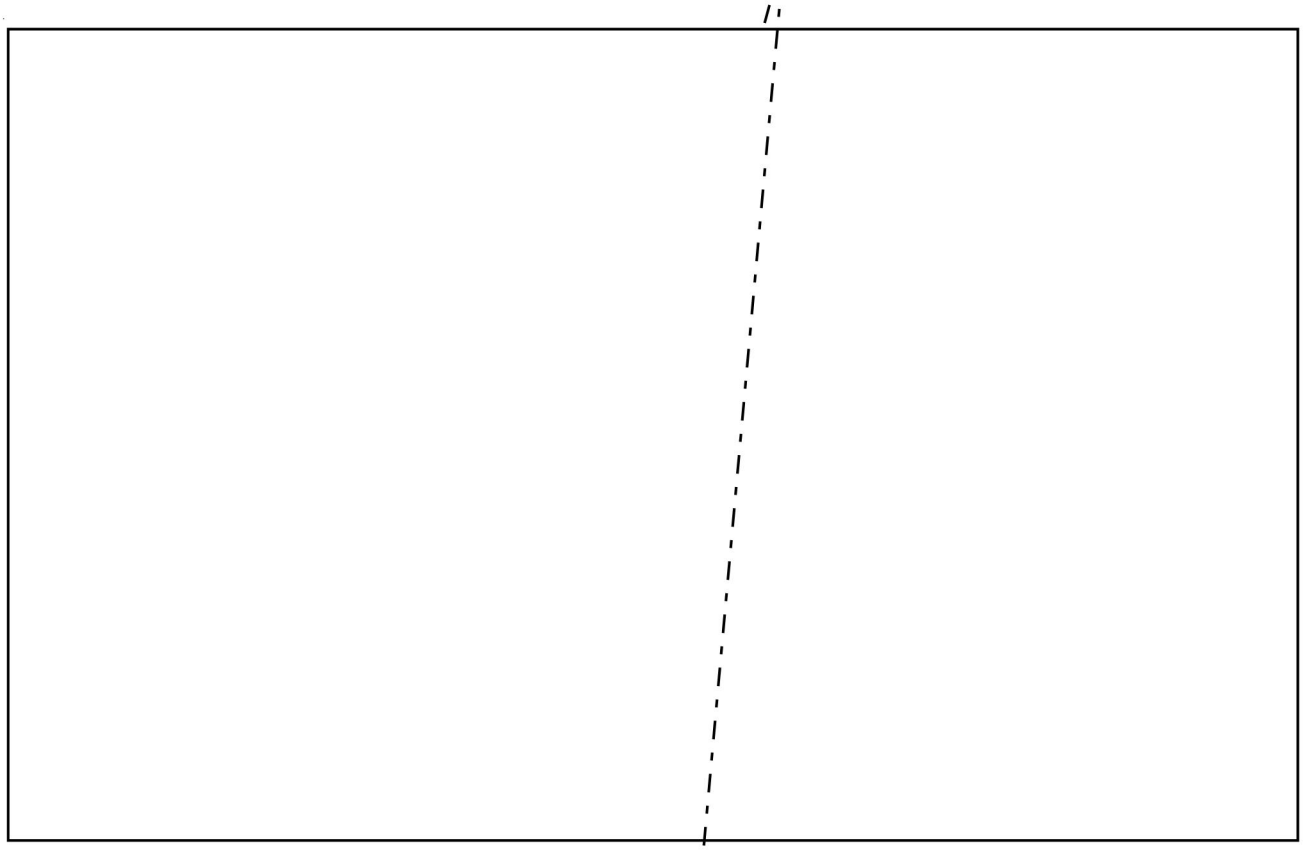
[83] In fact there is an unsigned copy of the Madison Financial minutes in which a resolution was approved authorizing Madison Financial to lease office space from Lisa Aunspaugh at 1308 Main. Ex. 94. We know, however, from Pat Heritage that the Madison Financial minutes (unlike the Madison Guaranty minutes) were prepared months after the fact in an attempt to recall and formalize decisions already made.

Young that the building was placed in service in August 1985, that the purchase price was $60,000 with $130,000 in renovations. With these figures, Young prepared Henley's 1985 return (not filed until August 1986) in which Henley claimed an investment tax credit.

Young is corroborated by Lisa who recalled that at the time of the sale to Henley, McDougal told her he had to backdate a document to help Henley on his taxes. After McDougal told Greg Young to make an $18,000 rent payment to Henley in February 1986, McDougal told Young to transfer $12,840 from Henley's account to the Designers Construction account.

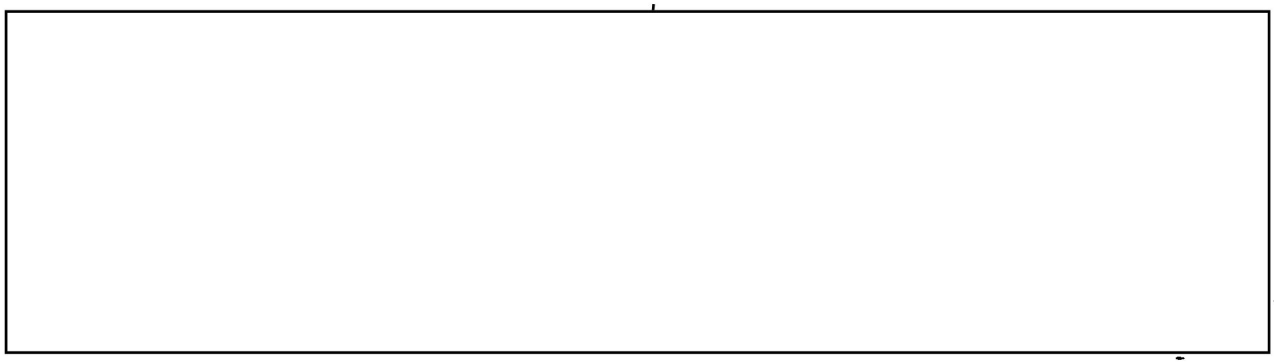
Therefore, we can show McDougal's motive for the backdated lease and the $18,000 payment. The lease and payment provided fraudulent documentary support for Henley's claim to a 1985 investment tax credit. It also put extra funds into the Designers Construction account in February 1986 on the eve of the examination when McDougal was looking for deposits to close out the negative balance account which would have been a red flag to the examiners.

While it may help McDougal to call Bill Henley as a defense witness with respect to Eric Sorensen, it will hurt McDougal with respect to the lease payment counts.



E. Robert Palmer And The Management Questionnaire (Counts 10-11)

McDougal claimed in his 1990 trial (what he continues to say today) that he had little to do with Madison Guaranty once he stepped down from Madison Guaranty's Board of Directors in 1984. He will no doubt claim at trial that he was fully engaged in the investment decisions and operations of Madison Financial and that CEO John Latham ran Madison Guaranty. As a result, he will



categorically deny that he had anything to do with Palmer's "consulting fee" invoice or that he even knew about the Management Questionnaire.

1. John Latham And The Consulting Fee Invoice

Without the testimony of Latham, we can not charge McDougal with count 10 of the proposed indictment. As a result, this is the weakest count in the proposed indictment. Latham will testify that, at McDougal's direction, he asked Greg Young to book the payment on Palmer's bill to Madison Guaranty for $15,350 as a consulting fee for Madison Financial.

Latham's prior statements on this matter show that his memory has improved over time. For example, during the Madison investigation but before Latham pleaded guilty, special agent Gary Aaron interviewed Latham on August 30, 1989. Aaron suspected Palmer was involved in a last minute appraisal production which was concealed by paying Palmer a Madison

Financial "consulting fee." When asked about it, Latham told Aaron that he did not recall how Palmer was paid and did not recall directing anyone to reflect the payment as a consulting fee. Two weeks later in September 1989, in a memo to his attorney Art Allen, Latham wrote as follows:

> "Mr. Aaron asked...whether...Palmer's fees were booked as consulting fees or appraisal fees and who ordered that.
> "... At the time Mr. Aaron asked these questions, I did not really recall the events.
> "...I believe that McDougal wanted the fees for... Palmer...booked as consulting fees so that they would not show up as appraisal fees. Most likely I'm the one that passed that on to Greg Young and asked him to book it as consulting fees."

A month later, Latham was interviewed a second time by special agent Aaron. Aaron wrote in his interview memorandum that "[i]t was Latham's recollection, on October 11, 1989, that McDougal directed that Palmer's work prior to the examination be reflected on the books as a consultant fee at one of the developments."

On November 2, 1989, the United States Attorney's Office, wrote a letter to Latham's attorney stating that it was willing to enter a plea agreement with Latham in which he would plead guilty to one false statement count regarding the Davis Fitzhugh loan. A plea agreement to that effect was signed by the parties on November 8, 1989.

At the 1990 McDougal trial, prosecutors decided not to call Latham as a witness since Latham claimed that he did not see anything wrong with what McDougal did with the Davis Fitzhugh loan. Instead, Latham was called as a defense witness. In the

course of Latham's cross-examination by AUSA Ken Stoll, the following answers were given (p. 806):

> Q. Did you ever get any directions from anyone on how to show the expense for those appraisals to be reflected on the books?
>
> A. I believe that Mr. McDougal had suggested that we might book those as some sort of a consulting fee or something such as that.
>
> Q. Instead of what they actually were?
>
> A. Yes.
>
> Q. Did you ever say, "Look, Mr. McDougal, I'm the chief executive officer of this institution; I don't think we ought to do that"?
>
> A. No, I didn't. It didn't change the financial status of the institution at all. It was booked as an expense either way.
>
> Q. It was an expense either way, but for someone coming in looking at the books it might not raise questions if it was a consulting fee as opposed to a big expense for several appraisals all being done at the same time, is that true.
>
> A. That's correct.

Despite the problems with Latham, there are clear advantages to putting Palmer in a case against McDougal. Palmer's testimony shows how poorly run the institution was. There were no internal controls that would offset McDougal's dominant control of the institution. Moreover, Palmer's testimony against Hawkins and Denton may explain for the jury why the government did not call them as witnesses against McDougal.

2. <u>The Management Questionnaire</u>

Even though Latham signed the Questionnaire, his testimony is not essential to this count. The document was notarized by Pat Heritage. Moreover, Jim Clark received a copy.

The person responsible for the false entries need not have actually made the entry himself; it is enough that he set into motion the actions that necessarily resulted in the making of the entry in the normal course of business. United States v. Wolf, 820 F.2d 1499, 1504 (9th Cir. 1987); United States v. Krepps, 605 F.2d 101, 109 n.28 (3d Cir. 1979). McDougal set in motion the $64,000 loan and the airplane transaction in such a way that there was no disclosure in the bank's records that he benefitted from both transactions. The natural and probable consequence of his actions was that there would be no disclosure to the examiners on the Management Questionnaire.

To rebut the false entry count, McDougal would have to take the stand and claim that he made full disclosure--something which (i) Latham denies, (ii) is never reflected in the minutes or any Madison document, and (iii) is inconsistent with McDougal's earlier behavior.

Appendix

Using Bank Board Regulations In A Case Against McDougal

We have to be cautious with Jim Clark's testimony at trial regarding Bank Board regulations. In a McDougal case the Bank Board regulations are important because the jury has to understand McDougal's motivation for doing what he did. But adducing testimony at trial about bank regulations leaves the

prosecutor open to the charge that the defendant is being criminally tried for what amounts to a civil violation.

This argument succeeded in United States v. Christo, 614 F.2d 486 (5th Cir. 1980). In Christo, the defendant bank officer was charged with misapplication (18 U.S.C. §656) for approving the payment of overdrafts, including his own, in violation of the restrictions on loans to insiders, set forth at 12 U.S.C. §375(a). Indeed, at the conclusion of each count the indictment charged that the offense was in violation of both 18 U.S.C. §656 and 12 U.S.C. §375(a). Id. at 490, n.5. The Fifth Circuit reversed the conviction on the grounds that the instructions allowed the jury to improperly infer criminal intent (sufficient for misapplication) merely from a knowing and willful violation of 12 U.S.C. §375(a).

The Christo holding surfaced later in United States v. Wolf, 820 F.2d 1499, 1505 (9th Cir. 1987), cert. denied, 485 U.S. 960 (1988). In Wolf the defendant was a director of an Oregon bank and part owner of a mortgage company which had borrowed heavily from the bank. When the bank's line of credit to the mortgage company had reached the lending limit, the defendant arranged for loans to other stockholders of the mortgage company which funds, without disclosure to the bank, were simply transferred to the mortgage company. At trial the government introduced evidence of both the lending limit rules and Regulation O. The court of appeals found no error with respect to the government's use of the lending limit rules since the evidence showed that the

defendant had created false loan records to avoid the bank's lending limit. The court of appeals reaffirmed a prior holding that "a misapplication occurs whenever bank funds are lent under a record that misrepresents a material fact, such as the name of the borrower or the purpose of the loan." Id., at §150.3. However, the government also charged, as an alternative theory, that the nominee loans violated Section 656 because the defendant failed to disclose his own interest in the loans in violation of Regulation O. The court of appeals reversed the misapplication counts on the grounds that, given two misapplication theories, the jury might have convicted the defendant simply because he failed to comply with Regulation O (an improper basis for misapplication) rather than for creating false loans records (a proper basis for misapplication).

An analogous situation occurred in United States v. McCright, 821 F.2d 226 (5th Cir. 1987), cert. denied, 484 U.S. 1005 (1988). In McCright the defendant bank officer was convicted of numerous violations, one of which was based on the evidence that he had failed to disclose his personal interest in a loan even though the government failed to show that he had done anything to advance or approve the loan. The government relied heavily on the fact that the defendant violated the bank's "Standards of Conduct" by failing to disclose his personal interest in a bank transaction. The court of appeals reversed the conviction on the grounds that, unlike Regulation O, "[s]ection 656 does not impose an affirmative duty on bank

officers and directors to disclose their personal interest in loans that may be approved by other individuals or departments in the bank." Id. at 230. The court of appeals, however, upheld the conviction of the defendant on a false statement count (Section 1005) regarding his failure to list all his financial interests on the executive officer questionnaire in accordance with Regulation O.

For an upcoming trial of McDougal, the lessons from Christo, Wolf, and McCright, are threefold: (i) prove the regulatory violation only in the context of proving a specific misrepresentation, false statement, or sham transaction; (ii) be certain that the jury is told that they do not have to determine whether a regulatory violation actually occurred, United States v. Kindig, 854 F.2d 703, 707; and (iii) explain the applicable regulation in the context of proving the defendant's motivation behind the sham transaction or false statement. In this way the focus of the case is on the defendant's misrepresentation, designed to avoid the regulation, not on the regulatory violation itself. For example, in United States v. Stefan, 784 F.2d 1093, 1098 (11th Cir. 1986), the court of appeals upheld the government's right to introduce evidence of lending limit violations (12 U.S.C. §84) for the purpose of showing defendant's motivation for arranging sham loans. See also United States v. Unruh, 855 F.2d 1363, 1375 (9th Cir. 1987), cert. denied, 488 U.S. 974 (1988) ("testimony about Regulation O...tended to show [the defendant's] motive for funneling loans to himself through

other borrowers"); United States v. Kindig, 854 F.2d 703, 707 (5th Cir. 1988).

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF ARKANSAS
WESTERN DIVISION

UNITED STATES OF AMERICA	)	
	)	
v.	)	LR-Cr
	)	18 U.S.C. §
JAMES B. MCDOUGAL	)	

INDICTMENT

THE GRAND JURY CHARGES:

That at all times relevant to this Indictment:

COUNT ONE

A. INTRODUCTION

1. The Federal Home Loan Bank Board (Bank Board) was an agency of the United States government established to regulate and supervise savings and loan institutions insured by the Federal Savings and Loan Insurance Corporation (FSLIC). The Bank Board examined insured institutions to assure that they were operated in a safe and sound manner and in conformity with applicable laws and regulations.

2. FSLIC was an agency of the United States established to protect depositors by insuring deposits in savings and loan institutions in amounts up to $100,000 per account.

3. Madison Guaranty Savings and Loan Association ("Madison Guaranty") was a state chartered savings and loan association, located in Little Rock, Arkansas. The accounts of Madison Guaranty were insured by the FSLIC.

4. As a federally insured financial institution, Madison was subject to (i) the regulations promulgated by the Bank Board

and (ii) periodic examinations conducted by Bank Board examiners.

5. Madison Financial Corporation ("Madison Financial") was a wholly owned subsidiary of Madison Guaranty. It engaged in real estate investment and development almost exclusively in the state of Arkansas.

6. JAMES B. MCDOUGAL was the chief executive officer of Madison Financial and the majority stockholder of its parent, Madison Guaranty. As the controlling stockholder of Madison Guaranty, JAMES B. MCDOUGAL was an "affiliated person" of the financial institution as defined at 12 CFR Section 561.29.

7. In order to review affiliated party transactions of a savings and loan association and to determine that those in control of the association operate it free from any conflict of interest, the Bank Board routinely submitted a Management Questionnaire to the chief executive officer of any savings and loan association undergoing a Bank Board examination. The Management Questionnaire, at Item 7, required the association to:

> "List all loans or contracts made or purchased by the institution since the last examination wherein any part of the proceeds was disbursed or credited to the benefit, directly or indirectly, of any affiliated person of the institution... Name the persons benefitted and state the amount and purpose of, and the basis and reasons for, such disbursements or credits."

8. After a 1984 examination, the Bank Board criticized Madison Guaranty regarding a number of loan documentation and lending matters, including Madison Guaranty's failure to maintain, as part of its underwriting procedures for some of its real estate loans, written appraisals in conformity with Federal

Home Loan Bank Board Memorandum R-41b and as required under 12 CFR Section 563.17-1 (c)(1)(iii)(1986), as amended, 12 CFR Section 563.170 (c)(1)(iv). In order to avoid enforcement proceedings by the Bank Board against persons affiliated with Madison Guaranty as a result of the 1984 examination, JAMES B. MCDOUGAL, on behalf of Madison Guaranty, entered into a July 1984 Supervisory Agreement with the Bank Board in which he agreed, among other things, (i) that "Madison and any of its current or future subsidiaries will not enter into any transactions with any 'affiliated person,'...except as provided by applicable regulations" and (ii) that Madison Guaranty will "adopt written loan underwriting standards...which at a minimum will include...a completed appraisal, if appropriate, which conforms in all respects with applicable Federal Home Loan Bank Board regulations and guidelines."

9. From on or about October 1984 until on or about February 1986, as set forth below, JAMES B. MCDOUGAL enriched himself and his wife and assisted certain other friends and family members at the expense of Madison Guaranty and Madison Financial. In order to conceal this pattern of self-dealing from the Bank Board and to prevent any disclosure that he had failed to comply with the 1984 Supervisory Agreement, JAMES B. MCDOUGAL, as set forth below, created false and misleading documents, material omissions, a false financial statement, and sham loans and real estates sales.

10. In March 1986, as set forth below, JAMES B. MCDOUGAL, created false documents and statements to mislead Bank Board

examiners who had commenced their 1986 examination of Madison Guaranty.

B. MISAPPLICATION OF FUNDS (NOMINEE LOAN)--JUNE 1985

11. On or about June 28, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, with intent to injure and defraud Madison Guaranty, knowingly and willfully misapplied and caused to be misapplied moneys and funds in excess of $100 belonging to Madison Guaranty in that the defendant caused a $64,000 loan to be issued to a third party, knowing full well that (i) the third party was borrowing the funds as an accommodation to the defendant, that (ii) the loan proceeds would be used for the benefit of the defendant and his wife, and that (iii) the loan enabled the defendant to circumvent those restrictions that would have prevented Madison Guaranty from making the loan directly to the defendant.

(All in violation of Title 18, United States Code, Sections 657 and 2).

PARTICIPATION IN A BANK TRANSACTION WITH INTENT TO DEFRAUD MADISON GUARANTY AND AN AGENCY OF THE UNITED STATES (JULY 1985)

COUNT TWO

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about July 3, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, knowingly and willfully and with intent to defraud Madison Guaranty and an agency of the United States, namely, examiners of the Federal Home Loan Bank Board, did participate and share in and receive money directly and indirectly through a transaction and loan of Madison Guaranty, in that the defendant received $56,087 from the proceeds of a $64,000 Madison Guaranty loan for the sale of the defendant's modular home.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

PARTICIPATION IN A BANK TRANSACTION WITH INTENT TO DEFRAUD MADISON GUARANTY AND AN AGENCY OF THE UNITED STATES (JULY 1985)

COUNT THREE

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about July 25, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, knowingly and willfully and with intent to defraud Madison Guaranty and an agency of the United States, namely, examiners of the Federal Home Loan Bank Board, did participate and share in and receive money directly and indirectly through a transaction and loan of Madison Guaranty, in that the defendant received $25,000 from the proceeds of a $64,000 Madison Guaranty loan for the sale of the defendant's modular home.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

FALSE ENTRY TO DECEIVE BANK BOARD EXAMINERS--JUNE 1985

COUNT FOUR

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about June 28, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, and with intent to deceive examiners of the Federal Home Loan Bank Board, an agency of the United States, knowingly and willfully made and caused to be made false entries in the books of Madison Guaranty in that the defendant caused a Madison Guaranty "residential loan application" to contain false and inflated financial information of the borrower of a $64,000 loan to be signed and executed as a document of Madison Guaranty.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

PARTICIPATION IN A BANK TRANSACTION WITH INTENT TO DEFRAUD MADISON GUARANTY AND AN AGENCY OF THE UNITED STATES (JULY 1985)

COUNT FIVE

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about July 15, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, knowingly and willfully and with intent to defraud an agency of the United States, namely, examiners of the Federal Home Loan Bank Board, did participate and share in and receive money directly and indirectly through a transaction and loan of Madison Guaranty, in that the defendant, through his separate company, sold a $25,000 asset to a third party, the sale of which was based on an agreement whereby Madison Financial guaranteed to the third party that Madison Financial would bear all the risks of ownership of the $25,000 asset that would otherwise belong to the third party, thereby facilitating the third party's payment to the defendant of $25,000.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

MISAPPLICATION OF FUNDS--DECEMBER 1985

COUNT SIX

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about December 20, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, with intent to injure and defraud Madison Guaranty, knowingly and willfully misapplied and caused to be misapplied moneys and funds in excess of $100 belonging to Madison Financial, a wholly owned subsidiary of Madison Guaranty, in that the defendant--in order to conceal a promise that the defendant made to a family member, namely, that either the defendant or Madison Financial would cover any personal loss that the family member might sustain in connection with his construction and sale of two homes on Madison Financial development property--issued and caused to be issued a Madison Financial check in the amount of $22,662.96 to the family member for work done on an unrelated Madison Financial project, when in fact, as the defendant well knew, the family member had earned only $12,662.96 on said project.

(All in violation of Title 18, United States Code, Sections 657 and 2).

FALSE ENTRY TO DECEIVE BANK BOARD EXAMINERS--DECEMBER 1985

COUNT SEVEN

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about December 20, 1985, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, and with intent to deceive examiners of the Federal Home Loan Bank Board, an agency of the United States, knowingly and willfully made and caused to be made a false and misleading entry in the books of Madison Financial, a wholly owned subsidiary of Madison Guaranty, in that the defendant caused a Madison Financial payment on behalf of a family member in the amount of $22,662.96 to be booked on the general ledger as a sales office expense for Madison Financial's Lake Faircrest development, when in fact, as the defendant well knew, only $12,662.96 represented an expense for the Lake Faircrest sales office.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

MISAPPLICATION OF FUNDS--FEBRUARY 1986

COUNT EIGHT

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about February 18, 1986, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, with intent to injure and defraud Madison Guaranty, knowingly and willfully misapplied and caused to be misapplied moneys and funds in excess of $100 belonging to Madison Financial, a wholly owned subsidiary of Madison Guaranty, in that the defendant, in an attempt to assist a family member, issued and caused to be issued an $18,000 Madison Financial check to the family member for six months of back rent on a building Madison Financial leased from the family member beginning in August 1985, when in fact, as the defendant well knew, no such lease was in effect to justify the $18,000 payment.

(All in violation of Title 18, United States Code, Sections 657 and 2).

FALSE ENTRY TO DECEIVE BANK BOARD EXAMINERS--FEBRUARY 1986

COUNT NINE

1. Paragraphs 1 through 9 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about February 1986, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, and with intent to deceive examiners of the Federal Home Loan Bank Board, an agency of the United States, knowingly and willfully made and caused to be made a false and misleading entry in the books of Madison Financial, a wholly owned subsidiary of Madison Guaranty, in that the defendant, in order to justify an $18,000 payment to a family member, prepared and caused to be prepared a backdated lease agreement which falsely stated that the family member was the owner of the premises leased by Madison Financial on August 1, 1985, when in fact, as the defendant well knew, no such lease was in effect since the family member did not purchase the building until January 1986.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

FALSE ENTRY TO DECEIVE BANK BOARD EXAMINERS--MARCH 1986

COUNT TEN

1. Paragraphs 1 through 8 and 10 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about March 13, 1986, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, and with intent to deceive examiners of the Federal Home Loan Bank Board, an agency of the United States, knowingly and willfully made and caused to be made a false and misleading entry in the books of Madison Financial, a wholly owned subsidiary of Madison Guaranty, in that the defendant--in order to conceal the fact that in late February 1986, on the eve of the March 1986 Bank Board examination, Madison Guaranty officials had ordered over 70 appraisals to be performed covering loans previously issued without appraisals or with inadequate appraisals--caused Robert Palmer, a Little Rock appraiser, to withdraw his bill to Madison Guaranty of $15,350 which had accurately itemized the appraisals that his company had performed over the previous two weeks and to substitute in its place another $15,350 bill, addressed to Madison Financial, which bill falsely described Palmer's work as that of "a real estate consultant" regarding "market feasibility and economic analysis." (All in violation of Title 18, United States Code, Sections 1006 and 2).

FALSE ENTRY TO DECEIVE BANK BOARD EXAMINERS--MARCH 1986

COUNT ELEVEN

1. Paragraphs 1 through 10 of Count One are hereby realleged and incorporated by reference as though set forth herein.

2. On or about March 19, 1986, within the Eastern District of Arkansas, the defendant JAMES B. MCDOUGAL, connected in a capacity with Madison Guaranty, a financial institution the accounts of which were insured by the FSLIC, and with intent to deceive examiners of the Federal Home Loan Bank Board, an agency of the United States, knowingly and willfully made and caused to be made a false and misleading entry in the books of Madison Guaranty, in that the defendant caused the response of Madison Guaranty to Item 7 of the Management Questionnaire--which required Madison Guaranty to identify all loans or contracts in which an affiliated party has a beneficial interest--to be false and incomplete in that the response failed to identify those transactions which are referred to in Counts One, Two, Three and Five of this Indictment.

(All in violation of Title 18, United States Code, Sections 1006 and 2).

KENNETH W. STARR
INDEPENDENT COUNSEL