UNITED STATES OF AMERICA
DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER
OF THE CURRENCY

IN THE MATTER OF AUGUSTUS I. CAVALLARI, PARTICIPATING IN THE AFFAIRS OF SUMMIT NATIONAL BANK TORRINGTON, CONNECTICUT (INSOLVENT)	Docket No. OCC-AA-EC-92-115

DECISION AND ORDER

I. Summary

On April 6, 1995, Respondent, Augustus I. Cavallari, Jr., filed for bankruptcy under Chapter 7 of the U.S. Bankruptcy Code. On May 11, 1995, the U.S. Court of Appeals for the Second Circuit remanded the Comptroller's Decision and Order in this case, dated July 28, 1994, for further proceedings on the amount of restitution the Respondent should make. For the reasons set forth below:

1. The Administrative Law Judge ("ALJ") is ordered to hold an evidentiary hearing in order to determine the appropriate amount of restitution; and
2. The request by counsel for the Office of the Comptroller of the Currency's ("OCC") Enforcement and Compliance Division ("Enforcement Counsel") for an extension of time by which to reply to Respondent's response to the Comptroller's Order of June 8, 1995, is granted.

II. Procedural Background

On May 11, 1995, in Cavallari v. OCC and Board of Governors, 57 F.3d 137 (2d Cir. 1995), a unanimous panel for the U.S. Court of Appeals for the Second Circuit denied, for the most part, Respondent's petition for review of the Order and Decision of the Comptroller of the Currency dated July 28, 1994. However, the panel vacated that portion of the Comptroller's Decision and Order ordering Respondent to make restitution in the amount of $554,903 plus interest. The panel remanded the case to the Comptroller for further proceedings to determine the amount of restitution that Respondent should make. The Second Circuit did not issue its mandate until June 27, 1995, however.[1] The periods within which Respondent could file a petition for rehearing with the Second Circuit or a petition for certiorari with the U.S. Supreme Court have lapsed.

On June 8, 1995, after the Second Circuit issued its decision but before it finalized the decision via issuance of the mandate, the Comptroller issued an Order requiring Enforcement Counsel and Respondent to begin good faith negotiations on the appropriate amount of restitution. Order dated June 8, 1995.[2] Pursuant to the Order, if the negotiations turned out

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[1]Pursuant to Rule 41(a), Federal Rules of Appellate Procedure, the mandate of a United States Court of Appeals must issue seven days after the time for filing a petition for rehearing expires. The timely filing of a petition for rehearing generally stays the mandate until the petition has been decided. In this instance, where the Second Circuit issued its decision on May 11, 1995, a petition for rehearing must have been filed by June 26, 1995, in order to have been timely. No petition was filed by then, and the Second Circuit issued its mandate on June 27, 1995.

[2]Respondent, in his response to the Comptroller's June 8, 1995 Order, objects to the Order as being premature inasmuch as it was issued before the Second Circuit's mandate issued and before the time to file a petition for certiorari had expired. See Response of Augustus I. Cavallari, Jr. to Order of the Comptroller, at 1. However, Respondent cannot demonstrate any harm to him caused by this purported prematurity, especially now that the

to be unsuccessful, the parties were given until June 29, 1995, to file their views on the appropriate amount of restitution and on whether the Comptroller should direct the ALJ to hold an evidentiary hearing on that issue. Each party was given five calendar days to reply to the other's submission.

On June 29, 1995, Enforcement Counsel filed his response stating his view that: (1) The Comptroller arrived at the correct amount of restitution in his July 28, 1994 Order; (2) the Comptroller should direct the ALJ to conduct an evidentiary hearing; and (3) the evidentiary hearing should be restricted in scope to the issue of whether the OCC's settlements with Richard D. Barbieri, Sr. and Raymond Cordani[3] reduced the amount of losses sustained by Summit National Bank, Torrington, Connecticut ("Summit National Bank"), on its loans to Winthrop Broadcasting Corporation. See The Office of the Comptroller of the Currency's Views on the Appropriate Amount of Restitution, dated June 29, 1995, at 1.

On June 29 and 30, 1995, Respondent filed responses stating his view that: (1) Any continuation of the administrative proceedings would be in violation of the automatic stay under 11 U.S.C. § 362(a), and, in the alternative; (2) there should be an evidentiary hearing before the ALJ, but its scope should be broad enough to cover, inter alia, any "amounts for which a claim could have been made, or amounts for which a claim may be made on behalf

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mandate has issued and the time to file a petition for certiorari has expired.

[3]During the events giving rise to the settlements, Mr. Barbieri served as a consultant to Summit National Bank who recommended Mr. Cordani for his positions as president and chief executive officer of the bank. Mr. Barbieri also had been president and chief executive officer of a thrift institution, Security Savings and Loan of Waterbury, Connecticut.

of or on account of Summit National Bank relative to or in connection with the underlying transaction." Response of Augustus I. Cavallari, Jr. to Order of the Comptroller, dated June 30, 1995, at 2; see also Letter dated June 29, 1995, from Peter C. Schwartz, Esquire, to Eugene Ludwig, Comptroller of the Currency. On July 10, 1995, Enforcement Counsel responded to Respondent's filing, taking the position that the OCC's enforcement action against Respondent falls within an exception to the automatic stay provision, at 11 U.S.C. § 362(b)(4). See Response to the Response of Augustus I. Cavallari, Jr. to the Order of the Comptroller of June 8, 1995.

III. Decision

A. Summary of Facts

1. The Restitution Order

The Comptroller's restitution order was based upon his determination that Respondent was an institution-affiliated party whose actions regarding certain loans from Summit National Bank to Winthrop Broadcasting Corporation constituted reckless disregard for the safety and soundness of the bank and caused a loss of at least $554,903. This amount was the OCC's calculation of the difference between the outstanding loan balance as of July 19, 1992, and the appraised value of the collateral securing the loans.

The OCC settled charges against Messrs. Barbieri and Cordani in connection with their actions affecting the bank. On April 27, 1993, pursuant to a settlement agreement, the OCC, jointly with the Office of Thrift Supervision ("OTS"), issued an order against Mr. Barbieri requiring restitution of $3.1 million to the OTS based on his activities affecting

Summit National Bank, three other national banks[4], and Security Savings & Loan Association, Waterbury, Connecticut. The order did not allocate the amount of restitution each individual institution was due, nor did it specify the specific loan activities in connection with which restitution was sought. On June 15, 1993, the OCC entered into a settlement agreement with Mr. Cordani requiring him to pay $75,000 in restitution to the Federal Deposit Insurance Corporation in connection with his actions at Summit National Bank. That order also did not specify the loan activities for which restitution was sought. Thus, based on the existing record, it cannot be determined with any certainty what portion, if any, of these settlement payments can be allocated to the losses Summit National Bank incurred from the Winthrop loans.

2. Bankruptcy Proceedings

On April 6, 1995, Respondent declared bankruptcy under Chapter 7 of the Bankruptcy Code. The OCC filed a proof of claim on May 19, 1995. On August 9, 1995, the U.S. Bankruptcy Court issued a Discharge of Debtor ordering that Respondent be released from, and that prior judgments were null and void as to all "debts dischargeable under 11 U.S.C. See[sic] 523."

B. Discussion

1. The ALJ Must Hold an Evidentiary Hearing in Order to Resolve the Issue of the Correct Amount of Restitution.

Based on the above facts, the Comptroller finds that the issue of the appropriate amount

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[4]The other three national banks are Enfield National Bank, Enfield, Connecticut, Liberty National Bank, Danbury, Connecticut, and Harbor National Bank of Connecticut, Branford, Connecticut.

of restitution cannot be resolved without further proceedings to supplement the existing record. As explained below, the Comptroller finds that these proceedings can continue to go forward despite Respondent's bankruptcy. The Comptroller also finds that further proceedings should be restricted in scope to the effect, if any, of the settlement agreements entered into between the OCC and Messrs. Barbieri and Cordani on the appropriate amount of restitution to be ordered against Respondent.

(a) These proceedings are not subject to the automatic stay provision in 11 U.S.C. § 362(a).

Pursuant to 11 U.S.C. § 362, a petition filed under the Bankruptcy Code operates to automatically stay:

> [T]he commencement or continuation . . . of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case.

11 U.S.C. § 362(a)(1). However, section 362(b) contains a list of eighteen exceptions to the automatic stay provision, the fourth of which applies to "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power." 11 U.S.C. § 362(b)(4). It is well established that the exception to the automatic stay provision in subsection 362(b)(4) applies to governmental actions, like the instant proceedings, to enforce banking laws. See, e.g., Board of Governors of the Federal Reserve System v. MCorp Financial, Inc., 502 U.S. 32 (1991) (Federal Reserve Board proceedings against a bank holding company under 12 U.S.C. § 1818(i) are not stayed); In re Murray, 128 B.R. 517, 520 (Bankr. N.D. Tex. 1991) (OTS proceeding for a cease and desist order and restitution is exempted from the automatic stay provision where the

proceeding was not an action to collect or enforce a judgment)[5]; Carlton v. Firstcorp, Inc., 967 F.2d 942, 945-46 (4th Cir. 1992) (12 U.S.C. § 1818(i) supersedes the automatic stay provision, preventing it from applying to ongoing administrative proceedings and a temporary cease and desist order issued by the OTS). This exception takes effect automatically and a party to whom it applies need not file a petition with the bankruptcy court for relief from the automatic stay. NLRB v. Edward Cooper Painting, Inc., 804 F.2d 934, 939 (6th Cir. 1986).

Accordingly, the Comptroller finds that the instant proceedings are not stayed by section 362(a), and that the exception in section 362(b)(4) for government police power applies.

(b) The restitution order was not discharged under the Bankruptcy Court's order of August 9, 1995.

As explained below, the Comptroller concludes that the restitution order is not dischargeable under Chapter 7 of the Bankruptcy Code and, therefore, the instant proceedings can continue to go forward.

Although, in general, a discharge under Chapter 7 of the Bankruptcy Code discharges a debtor from all debts that arose before bankruptcy, see 11 U.S.C. § 727(b), certain categories of debts are excepted from discharge pursuant to 11 U.S.C. § 523. Among the different types of debts enumerated under the section, section 523(a)(7) applies to the instant case. Specifically, the section provides that a debt is not discharged if it is "a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." Based on the plain language of the section, a debt will be

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[5]Although the instant proceedings are exempted from the automatic stay by 11 U.S.C. § 362(b)(4), any subsequent proceedings to collect money from Respondent would be barred by the stay if it remained in effect at that time. See 11 U.S.C. § 362(b)(5); City of New York v. Exxon Corp., 932 F.2d 1020, 1023 (2d Cir. 1991).

excepted from discharge if two requirements are satisfied: (1) it is a fine, penalty or forfeiture to and for the benefit of a governmental unit, and (2) it is not compensation for actual pecuniary loss.

The Comptroller's restitution order falls within this exception because it was imposed as a penalty and was not intended to compensate actual pecuniary loss. Although the amount of restitution was calculated with reference to actual pecuniary loss and was to be returned to the victim, i.e., the FDIC as receiver for Summit National Bank, the restitution order qualifies as a penalty within the meaning of section 523(a)(7). This is because, pursuant to the United States Supreme Court's decision in Kelly v. Robinson, 479 U.S. 36 (1986), and its progeny, a restitution order is excepted from discharge under section 523(a)(7) so long as the order serves a penal purpose.

In Kelly v. Robinson, 479 U.S. 36 (1986), the United States Supreme Court addressed the issue of whether a criminal restitution obligation is excepted from discharge under section 523(a)(7). The Supreme Court acknowledged that the restitution obligation was distinguishable from traditional criminal fines because the restitution was forwarded to the victim and calculated with reference to the amount of harm caused by the defendant. Kelly, 479 U.S. at 52. The Supreme Court, nevertheless, held that the restitution obligation was excepted from discharge under section 523(a)(7). In so holding, the Supreme Court observed that, while the restitution obligation resembled a judgment "for the benefit of" the victim, the victim had no control over the decision to award restitution. Id. In addition, the decision to impose restitution did not turn on the victim's injury but on the penal goals of the government and the situation of the defendant. Id. Accordingly, the Supreme Court

concluded that the restitution obligation was imposed to serve the government's interests in rehabilitation and punishment and was not dischargeable, recognizing that discharge in bankruptcy was not intended to create a haven for wrongdoers.

Although the Supreme Court only addressed criminal restitutions, its decision in Kelly has been extended to civil restitution orders. See Pennsylvania Public Welfare Dept. v. Davenport, 495 U.S. 552, 562 (1990) (Kelly explicitly found that section 523(a)(7) codified the judicially created exception to discharge for both civil and criminal fines). Courts have held in a number of contexts that civil restitution orders are excepted from discharge under section 523(a)(7). See,e.g., In re Williams, 158 B.R. 488 (Bankr. D. Idaho 1993) (costs assessed against attorney in a disciplinary proceeding); SEC v. Telsey (In re Telsey) , 144 B.R. 563, 564 (Bankr. S.D. Fla. 1992) (disgorgement order). In HUD v. Cost Control Mktg & Sales Mgmt of Virginia, No. 94-2357, 1995 U.S. App. LEXIS 25285 (4th Cir., Sept. 8, 1995), the United States Court of Appeals for the Fourth Circuit recently addressed a similar issue and concluded that a disgorgement order was not dischargeable in a Chapter 7 bankruptcy. In that case, the district court ordered four individual defendants to disgorge their profits obtained from the sale of real property in violation of the Interstate Land Sales Full Disclosure Act. The amount of disgorgement was measured by the loss to the purchasers, and HUD intended to use its recovery to compensate the victims. While the case was pending, three of the defendants filed a petition for bankruptcy under Chapter 7 and were granted discharge of their debts. The Fourth Circuit concluded that the disgorgement order was not dischargeable under section 523(a)(7), even though the money was to be returned to the victims. The Fourth Circuit stated that "so long as the government's interest

in enforcing a debt is penal, it makes no difference that injured persons may thereby receive compensation for pecuniary loss." HUD, 1995 U.S. App. LEXIS 25285, at *16.

From the above discussion, it is clear that a restitution order falls within the meaning of a penalty under section 523(a)(7) so long as the order is imposed for a penal purpose. The mere fact that the amount of restitution reflects actual pecuniary loss, or that the award will be used to compensate the victims, does not preclude a finding that the restitution order is within the exception. See Kelly, 479 U.S. at 52. The Comptroller's restitution order is therefore not dischargeable under section 523(a)(7) because the Comptroller's interest in imposing the restitution is to punish depository institutions or affiliated parties who have committed violations of banking laws or unsafe or unsound banking practices. Similar to the situation in Kelly, the victim, whether it is a national bank or the FDIC as receiver for the bank, has no control over the amount of restitution awarded or over the decision to award restitution.

To determine the purpose of a restitution order, courts will first look at the statute under which the restitution order is imposed. Kentucky v. Seals, 161 B.R. 615, 619 (W.D. Va. 1993). As a general rule, the starting point in every case of statutory construction is the language itself. Kelly, 479 U.S. at 43. In this case, the Comptroller's restitution order was imposed pursuant to 12 U.S.C. § 1818(b)(6), which provides that:

> The authority to issue an order under this subsection . . . which requires an insured depository institution or an institution-affiliated party to take affirmative action to correct any conditions resulting from any violation or practice with respect to which such order is issued includes the authority to require such depository institution or such party to
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> (A) make restitution or provide reimbursement,

> indemnification, or guarantee against loss if
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> (i) such depository institution or such party was unjustly enriched in connection with such violation or practice; or
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> (ii) the violation or practice involved a reckless disregard for the law or any applicable regulations or prior order of the appropriate Federal banking agency.

The statutory language clearly supports the conclusion that the restitution order is imposed for a penal purpose. First of all, there is no reference in the statute to the imposition of the restitution turning on the victim's actual pecuniary loss.[6] Moreover, the decision to impose restitution depends on considerations that have no bearing on the amount of actual loss. The statute provides that restitution can be imposed only when there is a finding of "unjust enrichment" or "reckless disregard for the law." Simpson v. OTS, 29 F.3d 1418, 1425 (9th Cir. 1994). The plain language of the statute clearly indicates that the primary purpose of the restitution order is to punish the violators rather than to mitigate the damage.

In addition, section 1818(b)(6)(A) cannot be viewed as an isolated provision but must be interpreted in light of the whole legislative scheme under which it is enacted. Kelly, 479 U.S. at 43 (in expounding a statute, courts must not be guided by a single sentence or

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[6]Although the Second Circuit remanded the case to re-determine the amount of restitution so that the amount would not exceed actual loss, there is no statutory requirement that the restitution has to be reflective of the exact loss suffered as a result of the violation. In FDIC v. Wright (In re Wright), 87 B.R. 1011 (Bankr. D.S.D. 1988), a debtor was ordered, as part of his criminal sentence, to pay restitution to the FDIC, as receiver for the bank. Similar to this case, the sentencing judge was prohibited from exceeding the actual loss in ordering restitution. The bankruptcy court nonetheless held that the criminal restitution was excepted from discharge. The bankruptcy court noted that the sentencing judge was not required by statute to order the exact amount of loss provided in each count of the conviction, thereby indicating that the restitution order was intended to punish the defendant rather than to compensate for actual pecuniary loss.

member of a sentence, but look to the provisions of the whole law, and to its object and policy). If section 1818(b)(6)(A) is reviewed in its context, it is clear that the section serves a penal purpose. First of all, the section is part of the statutory provision which grants federal regulatory agencies the authority to bring cease and desist actions against depository institutions and institution-affiliated parties. The purpose of the cease and desist proceedings is to prevent institutions or parties from engaging in unsafe or unsound banking practices or violations of the law. 12 U.S.C. § 1818(b)(1). Although the money recovered from collection on a restitution order is to be used to mitigate the damage resulting from the violations or practices, the Comptroller's interest in seeking the restitution is to punish and to deter such further violations or practices rather than to compensate the victims.

In addition, the legislative history of the statute supports the conclusion that the restitution order is imposed to serve a penal purpose. Congress amended section 1818(b) under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) with the specific intent of increasing the enforcement authority of the regulatory agencies. See H.R. Rep. No. 54, pt. 1, 101st Cong., 1st Sess. 464 (1989) (hereinafter "House Report"); CityFed Financial Corp. v. OTS, 58 F.3d 738, 741 (D.C. Cir. 1995). The amendments were proposed, in part, because the criminal justice system was overwhelmed by the number of bank fraud cases, and "the lack of eventual prosecutions and the imposition of often lenient sentences together constitute[d] the greatest single impediment to deterring criminal behavior in the banking and thrift industry." House Report at 464-465. The amended provisions, therefore, give "the regulators . . . the tools which they need and the responsibilities they must accept, to punish culpable individuals, to turn [the] situation

around, and to prevent [the] tremendous losses to the Federal deposit insurance funds from ever again recurring." House Report at 466.

Particularly, section 1818(b)(6) was included in response to the Seventh Circuit's decision in Larimore v. OCC, 789 F.2d 1244 (7th Cir. 1986) (en banc), which held that the OCC lacked authority to order a bank director to make reimbursement unless the director was unjustly enriched. House Report at 468. In passing FIRREA, Congress not only codified the exception in Larimore but expanded the agencies' authority to impose personal liability when an individual acted with reckless disregard for the law. Rapaport v. OTS, 59 F.3d 212, 219 (D.C. Cir. 1995). The provision "clarifies the situation by specifically authorizing the Comptroller as well as the other Federal Banking agencies to order a party to pay restitution, reimbursement, or indemnification." S. Rep. No. 19, 101st Cong., 1st Sess. 40 (1989) (hereinafter "Senate Report").[7] The underlying concern in enacting section 1818(b)(6) is thus to expand and clarify the authority of banking agencies, and not to compensate the victim's loss. In light of this legislative history, it is clear that the primary purpose of the Comptroller's restitution order is to punish and deter a violator. Accordingly, in accord with the Supreme Court's decision in Kelly and subsequent cases, the Comptroller concludes that the restitution order falls within the exception from discharge under 11 U.S.C. § 523(a)(7).

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[7]The Senate Committee on Banking, Housing and Urban Affairs noted in its report that "[i]t is the Committee's intent, however, that this power [i.e., the power to order restitution] be used only in appropriate cases . . . . It is not intended that this power will be used in cases where the institution-related party engaged in less serious violations or less serious conduct." Senate Report at 40. Once again, the Committee's focus was on the egregiousness of the violation and not the amount of the pecuniary loss, which supports the conclusion that section 1818(b)(6) was enacted to punish the violators.

(c) The scope of the hearing should be limited to the settlement agreements entered into between the OCC and Messrs. Barbieri and Cordani.

In their responses to the Comptroller's June 8, 1995 Order, the parties stated differing views on what the scope of the evidentiary hearing before the ALJ should be. Enforcement Counsel's view is that the hearing should be restricted in scope to what offsetting effect, if any, the settlements that the OCC entered into with Messrs. Barbieri and Cordani should have on the amount of restitution imposed against Respondent. Respondent's view is that the hearing's scope should include evidence on any amounts for which claims could have been or may be made on behalf of Summit National Bank in connection with the Winthrop loans. The Comptroller concurs with Enforcement Counsel's view. The Second Circuit based its decision to remand the restitution order on the following reasoning:

> Since the OCC bears the burden of determining the actual loss to Summit arising from the Winthrop loans after taking these payments into account, evidence should have been considered regarding how to apportion the Cordani and Barbieri payments between the Winthrop loss and other bank losses. We therefore vacate the restitution order against Cavallari and remand the case for further proceedings to determine what amount of restitution Cavallari should make.

57 F.3d at 145. Thus, the scope of the evidentiary hearing should be restricted accordingly.

2. E&C's Request for an Extension of Time to Respond to Respondent's Response is Granted.

Under the Comptroller's Order of June 8, 1995, each party was given five calendar days to reply to the other's submission. Although Respondent's submissions were dated June 29 and 30, 1995, Enforcement Counsel had not received them by July 3, 1995. On that day, Enforcement Counsel filed a request for an extension of time, to July 10, 1995, by which to file its reply. See Office of the Comptroller of the Currency's Request for an Extension of

Time in Which to File a Response. Respondent did not oppose that request, which Enforcement Counsel renewed in its response of July 10, 1995. The Comptroller hereby grants the request.

IV. Order

For the reasons set forth in the accompanying Decision, the Administrative Law Judge is ordered to hold an evidentiary hearing in order to determine the appropriate amount of restitution, if any, that Respondent must make; the request by Enforcement Counsel for an extension of time, to July 10, 1995, by which to reply to Respondent's response to the Comptroller's Order of June 8, 1995, is granted; and his reply of that date is hereby accepted.

IT IS SO ORDERED this 13 day of November, 1995.

EUGENE A. LUDWIG
Comptroller of the Currency