

**UNITED STATES OF AMERICA
NATIONAL CREDIT UNION ADMINISTRATION
ALEXANDRIA, VIRGINIA**

In the Matter of)
)
KATHARINA WAGNER GULLY)
AKA Karin Gully) NCUA Docket No. 00-0701-I
An Institution-Affiliated Party)
)
Waterside Federal Credit Union)
Forest Hills, New York)

Final Decision and Order

Final Decision

This case is before the National Credit Union Administration Board (the “NCUA Board” or “Board”) for a final decision, following the NCUA Board’s issuance of a Notice of Charges for an Order to Prohibit pursuant to Section 206(g) of the Federal Credit Union Act, 12 U.S.C. §1786(g), and submission of a Recommended Decision to dismiss the action by Administrative Law Judge Ann Z. Cook. The Board adopts portions of Judge Cook’s findings of fact, but does not adopt her conclusion that the criteria for a prohibition order have not been met. Instead, the Board finds that the Respondent’s conduct satisfies the statutory elements necessary to support a prohibition order under Section 206(g) of the Federal Credit Union.

Procedural Background

On July 13, 2000, the National Credit Union Administration Board issued a Notice of Charges for an Order to Prohibit Katharina Wagner Gully, also known as Karin Gully, hereinafter Respondent or Ms. Gully, from participating in the affairs of any federally insured financial institution. The Notice alleged that Ms. Gully, the manager of Waterside Federal Credit Union (FCU), knew that her father, Reinhold Wagner, former manager and then consultant to the FCU, used and continued to use the FCU’s corporate American Express card for personal items and Respondent allowed those charges to be paid with credit union funds, without reimbursing the FCU. The Notice alleges that Ms. Gully placed Mr. Wagner’s pecuniary interests above the credit union’s financial soundness. The Notice alleges further that this misconduct caused a loss to the FCU, prejudiced its members, involved personal dishonesty, demonstrated Ms. Gully’s unfitness, and requested a prohibition against her.

Once the Notice of Charges was issued, Respondent filed an answer, depositions were taken and the case proceeded through the administrative process. A hearing was held before Administrative Law Judge (ALJ) Ann Z. Cook on July 9-10, 2001,

in New York City. Due to illness, two witnesses, former FCU board members Charles Graff and John LeCastre, were unavailable to attend the hearing but were deposed. Their depositions were filed and included in the administrative record. ALJ Cook issued her Recommended Decision (Appendix A) on January 30, 2002, recommending that the Board dismiss the matter against Respondent. ALJ Cook concluded that the standard for prohibition pursuant to Section 206(g) of the FCU Act had not been met. (See Recommended Decision at pp. 6 – 10.) The parties were notified that the Recommended Decision had been issued and that Exceptions to the Recommended Decision could be filed with the Board. Enforcement Counsel filed extensive Exceptions; Respondent did not file Exceptions. The Board voted to close the record on March 8, 2002, and so notified the parties on March 12. According to §747.40 of the NCUA Regulations, the Board has 90 days after the parties are notified that the record is closed to render a final decision. 12 C.F.R. §747.40. The date for a final decision was June 13. On March 13, Respondent filed a Motion to Reply to Enforcement Counsel's Exceptions. There being no provision in the NCUA Regulations to file a reply to exceptions and Respondent providing no justification, the Board denied the motion on April 5 via notation vote. On May 7, 2002, the Board voted to extend the time to render a decision in this case for two weeks, from June 13 to June 27, 2002.

On June 20, 2002, in a closed meeting, the Board determined that the standard for a prohibition was met, but exercised its discretion not to impose a permanent prohibition.

Summary

Mr. Wagner was associated with the Waterside Federal Credit Union, in both volunteer and paid positions, for close to forty years. Respondent grew up with the FCU. The FCU was housed in the Wagners' home for over twenty years, starting around the time when Respondent was born. Ms. Gully became a salaried employee of the FCU in 1982, serving as the assistant manager. At the time, Ms. Gully's mother was the manager of the FCU and her father served in a volunteer capacity. Respondent became the manager of the FCU in 1992. According to testimony presented at the administrative hearing, Mr. Wagner was the dominant force at the FCU's board meetings, even after Respondent became manager.

Mr. Wagner had possession of the FCU's corporate American Express card. He charged in excess of \$30,000 for personal items on the FCU's American Express card from 1992 – 1998. FCU funds were used to pay the American Express bills, and Mr. Wagner did not reimburse the FCU during this time. Mr. Wagner was the only official in the FCU who routinely reviewed the American Express bills

In 1996, when Respondent first noticed Mr. Wagner's personal charges on the American Express card, she paid the bill. She then spoke with her father about it, telling him it was improper and instructing him to pay back the personal charges. Respondent did not report her father's misuse of the American Express card to the FCU's board of directors nor did she follow-up with her father on his expressed

intention to reimburse the FCU for his misuse of the American Express card. Only Mr. Wagner continued to routinely review the American Express bills and to direct either Ms. Gully or staff at the FCU to process checks for payment of the American Express bills after his review. According to Respondent's own testimony, even after she became aware of Mr. Wagner's personal use of the American Express card, she continued to process payments for charges to the American Express bills at her father's instruction, without routinely reviewing the bills.

Mr. Wagner's misuse of the American Express card was discovered by NCUA in 1998, when the FCU was placed in Special Actions and an examination was performed. It was only after NCUA discovered this misuse that Ms. Gully resigned from the FCU and Mr. Wagner stopped working for the FCU and reimbursed the FCU \$31,200.00.

Findings of Fact

The NCUA Board hereby adopts the following findings of fact from the Recommended Decision, with modifications in italics or otherwise noted:

1. Waterside Federal Credit Union was chartered in 1940 and assigned Charter No'. 03947. Waterside is located at 102-12 Queens Blvd., in Forest Hills, New York. Agreed Upon Stipulations, NCUA/Respondent, July 20, 2001 ("Joint Stip.") ¶1.
2. Waterside serves mainly Con Edison employees and is known to be a busy institution, in terms of customer traffic. Notice of Charges at 2; Transcript of Proceedings ("Trans.") at 137, 148 (Reid); 287 (Gully).
3. The Respondent, Katharina Wagner Gully, is also known as Karin Gully. Joint Stip. ¶4.
4. Respondent is the daughter of Reinhold Wagner. Joint Stip. ¶5.
5. Respondent was the assistant manager of Waterside from 1982-1992. Joint Stip. ¶7.
6. Respondent became the manager of the credit union on or about March 1, 1992. *The Board makes no finding with respect to Maria Wagner. Trans. at 183 (Gully); Joint Exhibit ("Joint Ex.") 15. Joint Stip. ¶ 10. ¶*
7. Respondent served as manager until 1998, when she resigned. Trans. at 48-49 (Bilodeau). *Thereafter, the Respondent had not been working in an insured credit union. See, Trans. at 180 (Gully).*
8. Respondent was *believed by some* to be an honest person and an able manager. Trans. at 113 (Clancy); LeCastre Deposition ("Depo.") at 40, 48, 56-57. *The Board recognizes this as opinion of certain witnesses and makes no finding of fact as to Respondent's honesty or ability.*

9. Monica Reid started working at Waterside in 1983 as a teller. She later served as an administrative assistant and accounts executive. In 1992, when Ms. Gully became the manager, Ms. Reid became the assistant manager. Ms. Reid continues today in that position, although her title is now chief operations officer. Trans. at 118-20; Joint Ex. 15.

10. Waterside held a corporate American Express card, in the name of Reinhold Wagner, dating back to the 1980's or early 1990's. The card was to be used for business purposes only. Trans. at 159-60, 241-43 (Wagner). *Respondent recognized that personal charges on the card were inappropriate.* Trans. at 188 (Gully).

11. Mr. Wagner made personal charges on the corporate American Express card from at least 1992-1998. Joint Ex. 5f, Trans. at 159-60 (Wagner).

12. Mr. Wagner was associated with Waterside for almost forty years, as assistant treasurer, treasurer, board member, chief executive officer, and financial consultant. For about thirty years, Mr. Wagner served the credit union as a volunteer, while employed at Con Edison. When he retired from Con Edison in approximately 1987, Mr. Wagner became a salaried employee at Waterside. After 1994, Mr. Wagner retired from Waterside, but was retained as a financial consultant and received a stipend. During the almost forty years Mr. Wagner was associated with the credit union, its assets grew from \$380,000 to \$38,000,000. Trans. at 154-58, 245 (Wagner); 183 (Gully) (1994 retirement).

13. Mr. Wagner physically housed the credit union in the basement of his own home for approximately twenty years. As a result, it was part of the Wagner's family life and Ms. Gully's life from an early age. Trans. at 281 (Gully).

14. After his retirement from Con Edison, Mr. Wagner was in the credit union every day, except when at his second home in Florida, in which case he customarily called into the credit union at least once a day. Trans. at 133-34 (Reid); 158-59 (Wagner); 310 (Gully).

15. After his retirement from Waterside, Mr. Wagner continued to have an office at the credit union, which he shared with Ms. Reid. Trans. at 125 (Reid).

16. The general ledger is a daily record of all transactions at the credit union, including expenses paid. Mr. Wagner maintained the general ledger for many years, and, starting in 1992, Ms. Reid assisted him with that task. Trans. at 120-21, 124, 134 (Reid); 253-54 (Wagner).

17. Wagner took the general ledger home almost every evening and in the 1980's and early 1990's, took the general ledger to Florida with him. While in Florida, the credit union sent him faxes *and overnight packages* regarding activity that needed to be booked in the general ledger. Trans. at 147 (Reid); 253-55 (Wagner).

18. Respondent did not keep the general ledger. Trans. at 124 (Reid).
19. Mr. Wagner was forceful and authoritative in his approach, but was known to be effective, especially with investments. Trans. at 108, 114-15 (Clancy); Graff Depo. at 13, 17; LeCastre Depo. at 25.
20. At the monthly board meetings, Mr. Wagner set the agenda and was the dominant participant. Trans. at 112-15 (Clancy); Graff Depo. at 12-13, 17; LeCastre Depo. at 12 - 13.
21. From at least 1991-1998, the Waterside board of directors consisted of five members: Reinhold Wagner, Karin Gully, John Clancy, Charles Graff, and John LeCastre. Trans. at 94, 105-06 (Clancy); Joint Ex. 7a, 15, 17, 19, 20, 22.
22. Mr. Wagner had been on the board since the 1960's, Mr. Graff since the early 1970's, Messrs. Clancy and LeCastre since the early 1980's, and Ms. Gully since the early 1990's. Trans. at 155, 244-45 (Wagner); Graff Depo. at 9; Trans. at 103 (Clancy); LeCastre Depo. at 7; Trans. at 289 (Gully).
23. Prior to joining the board, Messrs. Graff and LeCastre worked with Reinhold Wagner at Con Edison. Mr. Clancy was also acquainted with Mr. Wagner through Con Edison, although he and Mr. Wagner worked in different plants. All three joined the board at Mr. Wagner's invitation. Trans. at 103 (Clancy); Graff Depo. at 9, 12; LeCastre Depo. at 8, 37.
24. *The Board accepts only that* the members of the [FCU] board had known one another for many years and the majority had worked together at Con Edison. Trans. at 290 (Gully).
25. In terms of Respondent's participation in the meeting, the board expected her to bring important items to their attention, but not all or routine matters. LeCastre Depo. at 57-58; Trans. at 345-47 (Gully).
26. *In general*, the credit union utilized the following process to pay bills: Mr. Wagner took and reviewed bills, made a handwritten list of bills to be paid, and gave the list to someone at the credit union, who would produce the checks and return them to him. He then put the checks in the return envelopes (which he had retained with the statements), and mailed them. When Mr. Wagner was in Florida, certain bills were sent to him, at his request, and the same process was followed. Trans. at 123-24, 139-40 (Reid); 248-52, 255-56 (Wagner); 298, 300-07, 309-10 (Gully).
27. Mr. Wagner could not produce the checks without assistance because the checks were computer-generated, and he was not versed in the use of the computer. Trans. at 123 (Reid); 165-66 (Wagner).
28. Mr. Wagner's listing of each bill included only the payee and amount, and this was the only information needed to produce a check. *Generally, Mr. Wagner was*

the party who would see detailed information regarding bills. Trans. at 251 (Wagner); 303-04 (Gully). *However, Respondent also looked at individual bills.* Trans. at 187 (Gully).

29. The monthly American Express statements were addressed to Reinhold Wagner and were given to him to open. When he was in Florida, they were sent to him unopened. Trans. at 249, 255-56 (Wagner); 301, 310-12 (Gully). *Respondent did, on occasion, see American Express statements although the exact number of times cannot be determined.* Trans. at 188, 276, 278-279, 333 (Gully); 85 (Bilodeau).

30. Between 1992-1998, Ms. Gully and at least six other tellers processed checks for payment to American Express, based on Mr. Wagner's lists of bills to pay. *The majority of the checks for payment of American Express bills were processed by Respondent.* Ex. 11; Trans. at 194-205, 207-09 (Gully); 163, 165-66 (Wagner).

31. In approximately 1996, during the course of a telephone conversation between Mr. Wagner and Ms. Gully, Mr. Wagner mentioned that there was a bill on his desk that needed to be paid. Since he was in Florida and could not retrieve the bill, he told Ms. Gully where to find it. When Ms. Gully retrieved the bill, which was from American Express, she noted what appeared to be some personal charges. Trans. at 276-77 (Gully).

32. As the bill was due, Ms. Gully paid it. Officer Bilodeau found no fault in Ms. Gully's paying a credit union bill that was due. Trans. at 66-67 (Bilodeau); 27677 (Gully).

33. When Mr. Wagner returned to the office from Florida, Ms. Gully spoke with him regarding the personal charges. Mr. Wagner explained that he had used the card because he did not have his personal card with him, but that he would reimburse the credit union from his personal account. Ms. Gully also affirmatively instructed Mr. Wagner to reimburse the credit union. Trans. at 277-78 (Gully); 166 (Wagner).

34. *The Board makes no finding as to whether or not Mr. Wagner was known as a person of integrity.*

35. *The Board makes no finding as to whether or not Mr. Wagner was known as one who followed through on his duties and was annoyed when others did not follow through. The Board finds only that Respondent testified that she believed Mr. Wagner was a person who would follow through and that he would be irritated if follow-up was not immediate.* Trans. at 214, 215, 278 (Gully).

36. Prior to 1998, Mr. Wagner had never been the subject of any enforcement action or disciplinary proceeding. Trans. at 271 (Wagner).

37. Respondent knew that Mr. Wagner had sufficient funds to reimburse the credit union. He held accounts at the credit union with a combined balance of approximately one million dollars. Trans. at 74-75 (Bilodeau); 214 (Gully). *Neither*

Ms. Gully nor Mr. Wagner testified that there was any guarantee or pledge of Mr. Wagner's funds to reimburse the FCU.

38. Respondent *testified that she* believed Mr. Wagner and did not report the problem to the board of directors or follow up with Mr. Wagner to see that reimbursement had been made. Trans. at 188-89, 214 (Gully).

39. Ms. Gully did not normally review the American Express bills, but did have occasion to see a few *although the exact number of times cannot be determined*. Trans. at 186, 188, 214-15, 276, 278-279, 333 (Gully); 165-66 (Wagner); 85 (Bilodeau).

40. Mr. Wagner continued to make personal charges on the corporate credit card, *and Ms. Gully, with knowledge of Mr. Wagner's past use of the credit card for personal use, did not follow up to see if reimbursement was made or check to see if he was continuing to use the card for personal items*. Trans. at 166, 259 (Wagner); 189, 210 (Gully). *The Board does not make a finding of fact that continued use was without Ms. Gully's knowledge or consent.*

41. In 1998, due to an outstanding letter of understanding and agreement, related to some investment and asset liability management issues, NCUA placed Waterside into Special Actions and performed an examination. Joint Stip. ¶¶2; Trans. at 10-11, 33 (Bilodeau).

42. The officer assigned to the case was John Bilodeau, who joined NCUA as a field examiner in 1993, became a problem case officer in 1998, and then a supervisory examiner in 2000. Trans. at 8-10 (Bilodeau).

43. In the course of his examination, Officer Bilodeau learned that Waterside had a corporate American Express card and requested copies of the card's billing statements from Ms. Gully. Trans. at 12 (Bilodeau).

44. Respondent did not have copies, but spoke with Mr. Wagner to obtain them. He provided some statements, perhaps through facsimile, because he was out of town. Ms. Gully gave them to Officer Bilodeau. Trans. at 331-32 (Gully).

45. Because a complete set of *statements* was not available *at the FCU*, a full copy of the statements *was obtained* from American Express for Officer Bilodeau. Due to a statute of limitations, American Express could only provide statements dating back to 1992. Trans. at 15, 62 (Bilodeau); 332-33 (Gully).

46. From the statements and his investigation, Officer Bilodeau concluded that Mr. Wagner had made numerous personal charges on the corporate card. Trans. at 14, 25 (Bilodeau).

47. The personal charges included, but were not limited to, vacation expenses, restaurant dining, electronics, and building supplies for his Florida home. Joint Stip. ¶¶19.

48. Officer Bilodeau spoke with Ms. Gully about the personal charges and she stated that it must have been an oversight. The charges were to have been reimbursed from Mr. Wagner's personal accounts at the credit union. Trans. at 14 (Bilodeau).

49. Board members Clancy, Graff, and LeCastre did not know that a corporate card existed in Reinhold Wagner's name and were therefore unaware of his personal charges. Trans. at 99-100 (Clancy); Graff Depo. at 14-15, 28; LeCastre Depo. at 32-33; 52.

50. Board members Clancy and Graff did not recall that a corporate card existed at all. Board member LeCastre was aware of a corporate credit card, but believed that it was in the name of Ms. Gully and solely for business purposes. Trans. at 99-100 (Clancy); Graff Depo. at 14-15; LeCastre Depo. at 50-52, 60-62.

51. From at least January 1997, the board members received a computerized expense report at the monthly meeting that listed American Express as a line item. Trans. at 339-40 (Gully); 78 (Bilodeau) (American Express listed on computerized general ledger).

52. The board did not have any policies with respect to use of the corporate credit card, which is evidence of a weakness in the credit union's internal controls. Trans. at 18 (Bilodeau); Joint Ex. 8b at 13-11, 12.

53. Assistant manager Reid was aware of the corporate American Express card, but was not aware of Mr. Wagner's personal charges. She saw other bills and recorded American Express payments on the general ledger, but did not see the American Express statements. Trans. at 129, 142, 144-45 (Reid).

54. An independent CPA firm was hired to perform an analysis of the American Express statements. Their analysis confirmed that Mr. Wagner had incurred personal charges on the credit union's corporate card. Joint Ex. 5; 5f.

55. Mr. Wagner paid restitution to the credit union in the amount of \$31,200.15, to reimburse the personal charges. Joint Stip. ¶18 Joint Ex. 5f.

56. In November 1999, Mr. Wagner executed a Stipulation and Consent to Issuance of Order of Prohibition. Joint Stip. ¶20.

57. On August 20, 1999, the credit union was released from Special Actions and returned to its normal examination group. Joint Stip. ¶3.

Conclusions of Law

The NCUA Board adopts Judge Cook's Conclusions of Law numbers 1 and 2, to wit:

1. Respondent was an institution-affiliated party, as that term is defined in 12

U.S.C. § 1786(r). Joint Stip. paragraph 11.

2. NCUA has jurisdiction over institution-affiliated parties, and this action is properly brought pursuant to 12 U.S.C. §1751 *et seq.* and NCUA Rules and Regulations, 12 C.F.R. § 700 *et seq.* Joint Stip. paragraph 12.

The Board rejects Judge Cook's Conclusions of Law numbers 3 through 5 and, instead, substitutes the following:

3. Respondent's conduct constituted an unsafe and unsound practice and breached her fiduciary duty to the FCU. 12 U.S.C. 1786(g)(1)(A)(ii) and (iii).

4. Respondent's conduct resulted in a financial loss to the FCU. 12 U.S.C.

§ 1786(g)(1)(B)(i).

5. Respondent's conduct demonstrated her unfitness to participate in the conduct of the affairs of an insured credit union. 12 U.S.C. § 1786(g)(1)(C)(ii).

Legal Standard for Prohibition

The standard for a prohibition is found in §206(g) of the Federal Credit Union Act ("FCU Act"), 12 U.S.C. § 1786(g). Three elements must be met to support issuance of a prohibition order: misconduct; effect; and personal dishonesty or unfitness. These requirements for a prohibition are similar, but not identical, to those applied by other financial institution regulators. The third element in the FCU Act requires a finding either of personal dishonesty or unfitness to serve, whereas the other regulators must find personal dishonesty or willful or continuing disregard for the safety and soundness of the institution. See, 12 U.S.C. § 1818(g).

Misconduct

In order to meet the element of misconduct, the official must violate a law, regulation (or other written condition), engage in an unsafe or unsound practice, or breach a fiduciary duty. [1] See Section 206(g)(1)(A) of the FCU Act, 12 U.S.C. §1786(g)(1)(A). The Notice of Charges alleges that Respondent engaged in unsafe and unsound practices and breached her fiduciary duty to the FCU by allowing Mr. Wagner (her father) to continue to place personal charges on the American Express credit card, paying for those charges with FCU funds, failing to notify the FCU's board of directors of the charges, and placing her father's pecuniary interests above those of the FCU's.

Respondent admits that, after she became aware of her father's personal use of the FCU credit card, and after she told him to make reimbursement, she did not follow up to see if reimbursement was made, nor did she check to see if he was continuing to use the credit card. However, she did continue to process payments, or permit others to process payments, for expenses on the credit card without verifying that they were legitimate FCU expenses. In effect, she determined that

she had no duty or responsibility to review statements prior to processing payments, but instead, allowed her father to continue his practice of directing payments. This was at a time when her father was not even an FCU employee or official, but rather a consultant.

In her Recommended Decision, ALJ Cook analyzes and compares Ms. Gully's behavior to that of John Doolittle, a credit union manager who was also subject to a prohibition order. The NCUA Board had charged Mr. Doolittle with five counts of misconduct. After an administrative hearing, the ALJ issued a Recommended Decision to permanently prohibit Mr. Doolittle based on the five counts against him. The NCUA Board adopted the ALJ's Recommended Decision as its Final Decision. On appeal, the Doolittle court determined that Count V did not meet the statutory standard for misconduct. [2] This is the count that ALJ Cook believes is analogous to the charges against Ms. Gully. The Board disagrees and finds the facts in the present case distinguishable from the facts in Count V of the Doolittle case.

Respondent became aware (on at least one occasion in 1996, according to her testimony) that her father had used the FCU's corporate credit card for *personal expenses*. She knew that he allowed the use of FCU moneys to fund his personal purchases. She did nothing to follow-up on his repayment to the FCU nor did she do anything to stop him from further use of the credit card for his personal purchases. In fact, she continued to have the credit card bills sent to her father and she herself issued FCU checks to pay the credit card bills (for the amounts as instructed by her father) without reviewing the bills. This is a substantive difference from the facts in Doolittle. The Doolittle court determined that Mr. Doolittle had taken corrective action that appeared sufficient. Respondent, on the other hand, did not. While she may have taken the first step to correct the problem, addressing the issue with her father and instructing him to reimburse the FCU, she then, in effect, actively participated in her father's continued misconduct. Knowing her father had used the FCU credit card and directed the use of FCU funds to pay his personal expenses, she then continued to process, and allowed others to process, checks at her father's direction, without reviewing the expenditures or verifying that reimbursement had been made. Respondent had an obligation, not only to follow-up with her father and see that reimbursement had been made, but also to assure that his personal use of FCU funds had stopped. But her responsibility did not stop there. She either should have obtained the card from her father or verified that there were no longer any personal charges on the card by reviewing all future credit card bills. She both breached her fiduciary duty to the FCU (failed to act in the FCU's best interest) and engaged in an unsafe and unsound practice (her actions, or failure to act, exposed the FCU to risk and financial loss) by allowing her father to continue the practice of using the FCU's funds to cover his personal expenses. The element of misconduct is met.

Effect

In order to meet the effect element, the misconduct element must have the prescribed effect – financial gain or other benefit to the respondent, financial loss or

other damage to the credit union, or prejudice to the credit union's members. See §206(g)(1)(B) of the FCU Act, 12 U.S.C. §1786(g)(1)(B). ALJ Cook found no misconduct on the part of Ms. Gully; she therefore found no link to the effect element. However, ALJ Cook noted that Mr. Wagner's misconduct (misuse of the FCU credit card) did create a negative effect on the FCU. The FCU did not have full use of its funds for several years and, thus, it experienced a financial loss. (See p. 9 of Recommended Decision.) This financial loss to the FCU is directly linked to Respondent's misconduct. For approximately 18 months, she allowed her father to continue his practice, not only by turning a blind eye to his conduct, but also by failing to exercise reasonable diligence. She, in effect, participated in his scheme by processing payments without ever checking the statements. By her failure to take affirmative action to assure reimbursement was made and that no further personal charges would be made on the card, she allowed the financial loss to increase. Thus, for a year and a half, the FCU did not have the benefit of the earning potential of a portion of its funds. Additionally, those funds were not available for member loans. Further, by not assuring reimbursement was made, Respondent allowed her father to continue to receive earnings on funds in his FCU accounts, funds that should have been used to make the reimbursement. This further increased the loss to the FCU. If Respondent had acted appropriately and stopped her father's misuse of the credit card, the negative effect on the FCU would have been lessened. Respondent's misconduct contributed to the financial loss. Thus, the effect element is met.

Personal Dishonesty/Unfitness

In order to meet this third element, the misconduct element must either involve Respondent's personal dishonesty or demonstrate her unfitness to serve. See §206(g)(1)(C) of the FCU Act, 12 U.S.C. §1786(g)(1)(C). The Notice of Charges alleges both personal dishonesty and unfitness on Respondent's part. ALJ Cook believes that neither the personal dishonesty nor the unfitness standard was met^[3]. Again the Board disagrees.

ALJ Cook looks to Mr. Wagner's years of service to the FCU and his reputation among the board members as an explanation for Ms. Gully's lack of following up on her father's misuse of the credit card. She states:

Mr. Wagner had provided a credible explanation for the charges and assured Ms. Gully that reimbursement was forthcoming, and she had no reason to be suspicious. Ms. Gully did not make a conscious decision to keep the matter from the board, but simply believed that the problem had been settled. Ms. Gully's actions were not a manifestation of personal dishonesty or unfitness, but rather of a reasonable belief that the problem was limited in scope and resolved.

Page 10 of Recommended Decision (Appendix A).

The Board cannot agree with ALJ Cook's analysis and conclusion. While

Respondent may not have had reason to be suspicious, she certainly should have been cautious and recognized the need for verification. Even disregarding her duty to the FCU, she should have been concerned that the problem was rectified because it involved her father; it would have been in his best interest. As manager, once she knew there was a problem, she was obligated to follow-up. She certainly should have been reviewing credit card bills, especially in light of the known misuse of the credit card by, and personal benefit to, her father. Although the evidence does not specifically show personal dishonesty on Respondent's part, it clearly demonstrates unfitness to fulfill her responsibilities as the FCU manager when her father, then an outside consultant, played such a dominant role in the FCU. Respondent had the opportunity to correct the problem and she did not. The unfitness standard is met.

Respondent's actions, and failure to act, permitted a third party, her father, to unlawfully utilize the funds of Waterside FCU for his own personal gain. Once she became aware of Mr. Wagner's personal use of the FCU's credit card, she was obligated by her duties and responsibilities as manager of the FCU to take steps to assure corrective action was taken. Unlike the situation in Doolittle relied on by Judge Cook, Respondent continued to allow credit card bills to be processed for payment solely as directed by Mr. Wagner. Even after she became aware of her father's personal charges on the FCU's credit card and asked him about it, she never checked to see if he reimbursed the FCU as he said he would do. Trans. at 189 (Gully). Respondent further admits that, for approximately one and a half years after confronting her father, she continued to process checks for payment of the credit card bills but did not investigate whether her father was continuing to use the card for personal expenses. Trans. at 210 (Gully).

Decision to Suspend an Order of Prohibition

Although the Board has determined that all three elements of the statute necessary to impose a prohibition have been met, the Board has determined not to issue a permanent prohibition order due to the unusual circumstances of this case. Respondent resigned as manager of Waterside FCU in 1998 and has not worked in the credit union since that time. Respondent's father, Reinhold Wagner, a key factor in the reason a prohibition action was initiated against Respondent, executed a Stipulation and Consent to Issuance of an Order of Prohibition in November 1999. Mr. Wagner's consent to a permanent prohibition eliminates the likelihood that the situation that arose between father and daughter in Waterside FCU will reoccur.

Conclusion and Order

After consideration of the administrative record, applicable law and the Recommended Decision of Administrative Law Judge Ann Z. Cook, the NCUA Board finds that the conduct of Respondent Katharina Wagner Gully, also known as Karin Gully, justifies the issuance of an Order to prohibit Respondent from participating in the conduct of the affairs of any insured credit union.

THEREFORE, Pursuant to the authority vested in the National Credit Union Administration Board by Section 206(g)(4) of the Federal Credit Union Act, 12 U.S.C. §1786(g)(4), and in accordance with Part 747 of the NCUA Rules and Regulations, 12 C.F.R. Part 747, it is

Hereby ordered, that the conduct of Respondent Katharina Wagner Gully, as manager of Waterside Federal Credit Union, was sufficient to sustain an order permanently prohibiting her from participating in any manner in the conduct of the affairs of any insured credit union; and

It is further ordered that, due to the unique circumstances of this case, and in consideration of the Respondent's resignation from her position as manager of Waterside Federal Credit Union in 1998, the NCUA Board will not now issue an Order of Prohibition.

Decided on the 20th day of June, 2002, by the National Credit Union Administration Board.

Dated: July 23, 2002

Becky Baker
Secretary, NCUA Board

Appendix A

**UNITED STATES OF AMERICA
NATIONAL CREDIT UNION ADMINISTRATION
NATIONAL CREDIT UNION ADMINISTRATION BOARD
ALEXANDRIA, VIRGINIA**

| | | |
|---------------------------------|---|----------------------|
| _____ |) | |
| In the Matter of |) | |
| KATHARINA WAGNER GULLY |) | RECOMMENDED DECISION |
| AKA Karin Gully |) | |
| An Institution-Affiliated Party |) | NCUA-00-0701-I |
| |) | |
| Waterside Federal Credit Union |) | |
| Forest Hills, New York |) | |
| _____ |) | |

ANN Z. COOK, Administrative Law Judge:

On July 17, 2000, the National Credit Union Administration (NCUA) served a Notice of Charges for an Order to Prohibit on Katharina Wagner Gully, also known as

Karin Gully, the former manager of Waterside Federal Credit Union in Forest Hills, New York. The Notice alleges that Ms. Gully allowed Reinhold Wagner, Waterside board member and her father, to place personal charges on the credit union's corporate American Express card, paid those charges with credit union funds, failed to report the charges to the board of directors, and placed Mr. Wagner's pecuniary interests above the credit union's financial soundness. Further, the Notice asserts that this misconduct caused a loss to the credit union, prejudiced its members, involved personal dishonesty, demonstrated Ms. Gully's unfitness, and thus, requests a prohibition order against her. Ms. Gully timely filed an Answer, disputing the allegations and the proposed order.

A hearing on this matter convened from July 9-10, 2001 in New York City. Due to illness, two witnesses, Messrs. Charles Graff and John LeCaste, were unavailable to attend the hearing but were deposed. Their depositions were filed and included in the evidentiary record.

Having considered the record, applicable law and my observation of the witnesses at the hearing, and as outlined in the findings of fact, conclusions of law and discussion below, it is my recommendation that the Board dismiss this matter. The evidence demonstrated that Ms. Gully was not aware of Mr. Wagner's personal charges, except in one instance. In that instance, she spoke with Mr. Wagner and was assured that he would reimburse the charges. In view of Mr. Wagner's past conduct years of service to Waterside, and reputation for thoroughness and integrity, Ms. Gully's reliance on him was reasonable. While in retrospect Ms. Gully should have taken further action to assure both that Mr. Wagner reimbursed the funds and made no more personal use of the credit card, viewed in context, her conduct does not provide the basis for a prohibition order.

FINDINGS OF FACT

1. Waterside Federal Credit Union was chartered in 1940 and assigned Charter No. 03947. Waterside is located at 102-12 Queens Blvd., in Forest Hills, New York. Agreed Upon Stipulations, NCUA/Respondent, July 20, 2001 ("Joint Stip.") ¶1.
2. Waterside serves mainly Con Edison employees and is known to be a busy institution, in terms of customer traffic. Notice of Charges at 2; Transcript of Proceedings ("Trans.") at 137, 148 (Reid); 287 (Gully).
3. The Respondent, Katharina Wagner Gully, is also known as Karin Gully. Joint Stip. ¶4.
4. Ms. Gully is the daughter of Reinhold Wagner. Joint Stip. ¶5.
5. Ms. Gully was the assistant manager of Waterside from 1982-1992. Joint Stip. ¶7.
6. Ms. Gully became the manager of the credit union on or about March 1, 1992. She took over from her mother, Maria Wagner, the previous manager. Trans. at 159 (Wagner); Joint Exhibit ("Joint Ex.") 15.
7. Ms. Gully served as manager until 1998, when she resigned. Trans. at 48-49 (Bilodeau).

8. Ms. Gully was known to be an honest person and an able manager. Trans. at 113 (Clancy); LeCaste Deposition ("Depo.") at 40, 48, 56-57.
9. Monica Reid started working at Waterside in 1983 as a teller. She later served as an administrative assistant and accounts executive. In 1992, when Ms. Gully became the manager, Ms. Reid became the assistant manager. Ms. Reid continues today in that position, although her title is now chief operations officer. Trans. at 118-20; Joint Ex. 15.
10. Waterside held a corporate American Express card, in the name of Reinhold Wagner, dating back to the 1980's or early 1990's. The card was to be used for business purposes only. Trans. at 159-60, 241-43 (Wagner); LeCaste Depo. at 50-52; 60-62.
11. Mr. Wagner made personal charges on the corporate American Express card from at least 1992-1998. Joint Ex. 5f; Trans. at 159-60 (Wagner).
12. Mr. Wagner was associated with Waterside for almost forty years, as assistant treasurer, treasurer, board member, chief executive officer, and financial consultant. For about thirty years, Mr. Wagner served the credit union as a volunteer, while employed at Con Edison. When he retired from Con Edison in approximately 1987, Mr. Wagner became a salaried employee at Waterside. After 1994, Mr. Wagner also retired from Waterside, but was retained as a financial consultant and received a stipend. During the almost forty years Mr. Wagner was associated with the credit union, its assets grew from \$380,000 to \$38,000,000. Trans. at 154-58, 245 (Wagner); 183 (Gully)(1994 retirement).
13. Mr. Wagner physically housed the credit union in the basement of his own home for approximately twenty years. As a result, it was part of the Wagner's family life and Ms. Gully's life from an early age. Trans. at 281 (Gully).
14. After his retirement from Con Edison, Mr. Wagner was in the credit union every day, except when at his second home in Florida, in which case he customarily called into the credit union at least once a day. Trans. at 133-34 (Reid); 158-59 (Wagner); 310 (Gully)
15. After his retirement from Waterside, Mr. Wagner continued to have an office at the credit union, which he shared with Ms. Reid. Trans. at 125 (Reid).
16. The general ledger is a daily record of all transactions at the credit union, including expenses paid. Mr. Wagner maintained the general ledger for many years, and, starting in 1992, Ms. Reid assisted him with that task. Trans. at 120-121, 124, 134 (Reid); 253-54 (Wagner).
17. Mr. Wagner took the general ledger home almost every evening and in the 1980's and early 1990's, took the general ledger to Florida with him. While in Florida, the credit union sent him faxes regarding activity that needed to be booked in the general ledger. Trans. at 147 (Reid); 253-55 (Wagner).
18. Ms. Gully did not keep the general ledger. Trans. at 124 (Reid).
19. Mr. Wagner was forceful and authoritative in his approach, but was known to be effective, especially with investments. Trans. at 108, 114-15 (Clancy); Graff Depo. at 13, 17; LeCaste Depo. at 25.

20. At the monthly board meetings, Mr. Wagner set the agenda and was the dominant participant. Trans. at 112-15 (Clancy); Graff Depo. at 12-13, 17; LeCastre Depo. at 12-13.

21. From at least 1991-1998, the Waterside board of directors consisted of five members: Reinhold Wagner, Karin Gully, John Clancy, Charles Graff, and John LeCastre. Trans. at 94, 105-06 (Clancy); Joint Ex. 7a, 15, 17, 19, 20, 22.

22. Mr. Wagner had been on the board since the 1960's, Mr. Graff since the early 1970's, Messrs. Clancy and LeCastre since the early 1980's, and Ms. Gully since the early 1990's. Trans. at 155, 244-45 (Wagner); Graff Depo. at 9; Trans. at 103 (Clancy); LeCastre Depo. at 7; Trans. at 289 (Gully).

23. Prior to joining the board, Messrs. Graff and LeCastre worked with Reinhold Wagner at Con Edison. Mr. Clancy was also acquainted with Mr. Wagner through Con Edison, although he and Mr. Wagner worked in different plants. All three joined the board at Mr. Wagner's invitation. Trans. at 103 (Clancy); Graff Depo. at 9, 12; LeCastre Depo. at 8, 37.

24. Since the members of the board had known one another for many years and the majority had worked together at Con Edison, the board was collegial. Tr. at 290 (Gully).

25. In terms of Ms. Gully's participation in the meeting, the board expected her to bring important items to their attention, but not all or routine matters. LeCastre Depo. at 57-58; Trans. at 345-47 (Gully).

26. The credit union utilized the following process to pay bills: Mr. Wagner took and reviewed bills, made a handwritten list of bills to be paid, and gave the list to someone at the credit union, who would produce the checks and return them to him. He then put the checks in the return envelopes (which he had retained with the statements), and mailed them. When Mr. Wagner was in Florida, certain bills were sent to him, at his request, and the same process was followed. Trans. at 123-24, 139-40 (Reid); 248-52, 255-56 (Wagner); 298, 300-07, 309-10 (Gully).

27. Mr. Wagner could not produce the checks without assistance because the checks were computer-generated, and he is not versed in the use of the computer. Trans. at 123 (Reid); 165-66 (Wagner).

28. Mr. Wagner's listing of each bill included only the payee and amount, and thus, only Mr. Wagner was privy to the specific charges. The only information needed to produce a check is payee and amount. Trans. at 251 (Wagner); 303-04 (Gully).

29. The monthly American Express statements were addressed to Reinhold Wagner and were given to him to open. When he was in Florida, they were sent to him unopened. Trans. at 249, 255-56 (Wagner); 301, 310-12 (Gully).

30. Between 1992-1998, Ms. Gully and at least six other tellers processed checks for payment to American Express, based on Mr. Wagner's lists of bills to pay. Joint Ex. 11; Trans. at 207-09 (Gully); 163, 165-66 (Wagner).

31. In approximately 1996, during the course of a telephone conversation between Mr. Wagner and Ms. Gully, Mr. Wagner mentioned that there was a bill on his desk that needed

to be paid. Since he was in Florida and could not retrieve the bill, he told Ms. Gully where to find it. When Ms. Gully retrieved the bill, which was from American Express, she noted what appeared to be some personal charges. Trans. at 276-77 (Gully).

32. As the bill was due, Ms. Gully paid it. Officer Bilodeau found no fault in Ms. Gully's paying a credit union bill that was due. Trans. at 66-67 (Bilodeau); 276 (Gully).

33. When Mr. Wagner returned to the office from Florida, Ms. Gully spoke with him regarding the personal charges. Mr. Wagner explained that he had used the card because he did not have his personal card with him, but that he would reimburse the credit union from his personal account. Ms. Gully also affirmatively instructed Mr. Wagner to reimburse the credit union. Trans. at 277-78 (Gully); 166 (Wagner).

34. Mr. Wagner was known as a person of integrity. Graff Depo. at 24.

35. Mr. Wagner was known as one who followed through on his duties and was annoyed when others did not follow through. Trans. at 215, 278 (Gully); LeCaste Depo. at 45.

36. Prior to 1998, Mr. Wagner had never been the subject of any enforcement action or disciplinary proceeding. Trans. at 271 (Wagner).

37. Ms. Gully knew that Mr. Wagner had sufficient funds to reimburse the credit union. He held accounts at the credit union with a combined balance of approximately one million dollars. Trans. at 74-75 (Bilodeau); 214 (Gully).

38. Ms. Gully believed Mr. Wagner and did not report the problem to the board of directors or follow up with Mr. Wagner to see that reimbursement had been made. Trans. at 188-89, 214 (Gully).

39. Ms. Gully did not normally review the American Express bills, but did have occasion to see a few. Apart from the time she retrieved the bill from Mr. Wagner's desk in 1996, she did not note any suspect charges on the bills. Trans. at 186, 214-15 (Gully); 165-66 (Wagner).

40. Without Ms. Gully's knowledge or consent, Mr. Wagner continued to make personal charges on the corporate credit card. Trans. at 166, 259 (Wagner).

41. In 1998, due to an outstanding letter of understanding and agreement, related to some investment and asset liability management issues, NCUA placed Waterside into Special Actions and performed an examination. Joint Stip. ¶12; Trans. at 10-11, 33 (Bilodeau).

42. The officer assigned to the case was John Bilodeau who joined NCUA as a field examiner in 1993, became a problem case officer in 1998, and then a supervisory examiner in 2000. Trans. at 8- 10 (Bilodeau).

43. In the course of his examination, Officer Bilodeau learned that Waterside had a corporate American Express card and requested copies of the card's billing statements from Ms. Gully. Trans. at 12 (Bilodeau).

44. Ms. Gully did not have copies, but spoke with Mr. Wagner to obtain them. He

provided some statements, perhaps through facsimile, because he was out of town. Ms. Gully gave them to Officer Bilodeau. Trans. at 331-32 (Gully).

45. Because a complete set was not available, Ms. Gully also obtained a full copy of the statements from American Express for Officer Bilodeau. Due to a statute of limitations, American Express could only provide statements dating back to 1992. Trans. at 15, 62 (Bilodeau); 332-33 (Gully).

46. From the statements and his investigation, Officer Bilodeau concluded that Mr. Wagner had made numerous personal charges on the corporate card. Trans. at 14, 25 (Bilodeau).

47. The personal charges included, but were not limited to, vacation expenses, restaurant dining, electronics, and building supplies for his Florida home. Joint Stip. ¶19.

48. Officer Bilodeau spoke with Ms. Gully about the personal charges and she stated that it must have been an oversight. The charges were to have been reimbursed from Mr. Wagner's personal accounts at the credit Union. Trans. at 14 (Bilodeau).

49. Board members Clancy, Graff, and LeCastre did not know that a corporate card existed in Reinhold Wagner's name and were therefore unaware of his personal charges. Trans. at 99-100 (Clancy); Graff Depo. at 14-15, 28; LeCastre Depo. at 32-33; 52.

50. Board members Clancy and Graff did not recall that a corporate card existed at all. Board member LeCastre was aware of a corporate credit card, but believed that it was in the name of Ms. Gully and solely for business purposes. Trans. at 99-100 (Clancy); Graff Depo. at 14-15; LeCastre Depo. at 50-52, 60-62.

51. From at least January 1997, the board members received a computerized expense report at the monthly meeting that listed American Express as a line item. Trans. at 339-40 (Gully); 78 (Bilodeau)(American Express listed on computerized general ledger).

52. The board did not have any policies with respect to use of the corporate credit card, which is evidence of a weakness in the credit union's internal controls. Trans. at 18 (Bilodeau); Joint Ex. 8b at 13-11, 12.

53. Assistant manager Reid was aware of the corporate American Express card, but was not aware of Mr. Wagner's personal charges. She saw other bills and recorded American Express payments on the general ledger, but did not see the American Express statements. Trans. at 129, 142, 144-45 (Reid).

54. An independent CPA firm was hired to perform an analysis of the American Express statements. Their analysis confirmed that Mr. Wagner had incurred personal charges on the credit union's corporate card. Joint Ex. 5; 5f.

55. Mr. Wagner paid restitution to the credit union in the amount of \$31,200.15, to reimburse the personal charges. Joint Stip. ¶18; Joint Ex. 5f.

56. In November 1999, Mr. Wagner executed a Stipulation and Consent to Issuance of Order of Prohibition. Joint Stip. ¶20.

57. On August 20, 1999, the credit union was released from Special Actions and returned to its normal examination group. Joint Stip. ¶3.

CONCLUSIONS OF LAW

1. Respondent was an institution-affiliated party, as that term is defined in 12 U.S.C. §1786(r). Joint Stip. ¶11.
2. NCUA has jurisdiction over institution-affiliated parties, and this action is properly brought pursuant to 12 U.S.C. §1751, *et seq.* and NCUA Rules and Regulations, 12 C.F.R. 700, *et seq.* Joint Stip. ¶12.
3. Respondent did not engage in any unsafe or unsound practice and did not breach her fiduciary duty. 12 U.S.C. §1786(g)(1)(A)(ii) and (iii).
4. Waterside did not suffer a loss or damage, and its members' interests were not prejudiced, as a result of the conduct of Respondent. §1786(g)(1)(B)(i) and (ii).
5. The conduct of Respondent did not involve personal dishonesty or demonstrate her unfitness to serve as a director or officer of, or to otherwise participate in the conduct of the affairs of, an insured credit union §1786(g)(1)(C)(i) and (ii).

APPLICABLE LAW

12 U.S.C. § 178 6(g)(1) articulates three elements that must be established in order to prohibit an institution-affiliated party from participating “in the conduct of the affairs of any insured credit union.” Summarized, these elements are misconduct, effect, and personal dishonesty/unfitness. *In re Doolittle*, Decision and Order on Remand (NCUA Board, Jan. 19, 1994) at 2-5 (subdivision headings). Misconduct may take the form of an unsafe or unsound practice, breach of fiduciary duty, or violation of, *inter alia*, law or regulation. That misconduct must have the effect of a financial loss or damage to the credit union, prejudice to its members' interests, or personal benefit to the Respondent. Lastly, the misconduct must involve personal dishonesty or demonstrate the Respondent's unfitness to participate in the affairs of an insured credit union.

The leading case applying §1786(g)(1) and its elements is *Doolittle v. NCUA*, 992 F.2d 1531 (11th Cir. 1993)(vacating and remanding prohibition order). In that case, a prohibition order had issued against John Doolittle, based on five alleged counts of misconduct. Counts I-IV alleged violations of NCUA regulation, while Count V alleged unsafe/unsound practices and breach of fiduciary duty. As Ms. Gully is charged with unsafe/unsound practices and breach of fiduciary duty, and not with any violation of NCUA regulation, the disposition of Count V is the most applicable to this matter. Also, the facts at issue in Count V are comparable to the facts in this proceeding.

Count V stemmed from Mr. Doolittle's alleged mishandling of certain loans to a Mr. James Mims. Mr. Doolittle, then president of a credit union, discovered that illegal loans were being extended to Mr. Mims. To stop the loans, Doolittle informed credit union personnel and Mims that no more loans would be extended and directed that Mims' file be marked accordingly. Notwithstanding, and without Doolittle's knowledge, four more loans were extended to Mims, which later defaulted at a loss to the credit union. With respect to

the Mims' loans, it was found that Doolittle's "failure to supervise his loan employees effectively and to inform the Board of Directors constituted a breach of his fiduciary duty and an unsafe and unsound practice." *Id.*, at 1535. NCUA entered a prohibition order against Doolittle, based on these charges (Count V), as well as the other counts.

On appeal, the Eleventh Circuit vacated the prohibition order. Specifically as to Count V, the Court found that Doolittle had taken corrective action that appeared to be sufficient. Although in hindsight he should have done more, the Court held that Doolittle's conduct did not constitute a breach of fiduciary duty or an unsafe/unsound practice. The Court also did not find any misconduct with respect to Count IV. On Counts I-III, though, the Court did find misconduct, in part, as alleged. Reasoning that perhaps the previous prohibition order had been based on the totality of the charges, and with the charges reduced, the Court opted not to divine the outcome and remanded to the NCUA Board for decision. On remand, the Board prohibited Mr. Doolittle, based on the remaining charges. *In re Doolittle*, Decision and Order on Remand (Jan. 19, 1994). *See also Doolittle v. NCUA*, 48 F.3d 536 (11th Cir. 1995)(affirming without comment), 516 U.S. 987 (1995)(denying certiorari).

DISCUSSION

Reinhold Wagner admits to placing approximately \$30,000 of personal charges on the Waterside corporate credit card over a period of several years. Without explaining his actions, Mr. Wagner testified that he acted improperly, or as he put it, he had done "bad things." Trans. at 244. Mr. Wagner has now made restitution and been prohibited from participating in the affairs of any insured credit union. At issue in this proceeding is Ms. Gully's conduct in relation to these personal charges and whether it satisfies the criteria for imposing a prohibition order.

MISCONDUCT

The Notice alleges that Ms. Gully engaged in unsafe and unsound practices and breached her fiduciary duty by allowing Mr. Wagner to charge personal items on the Waterside corporate credit card, paying those charges with credit union funds, failing to alert the board of directors regarding Mr. Wagner's misconduct, and placing his pecuniary interests above the financial soundness of the credit union. The Notice also alleges that Ms. Gully actually knew about the personal charges and knew that Mr. Wagner had not reimbursed the credit union.

"Unsafe and unsound banking practices are defined as 'conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder.'" *Doolittle v. NCUA*, 992 F.2d 1531, 1538 (11th Cir. 1993)(citations omitted). Fiduciary duty is a "duty to act in the best interest of the institution, its shareholders and its depositors." *In re Majette*, Final Decision and Order (NCUA Board, March 18, 1999)(incorporating Recommended Decision (RD); definition in RD, Misconduct subsection).

Ms. Gully testified credibly that she discovered Mr. Wagner's personal use of the corporate credit card in only one instance and in that instance, confronted Mr. Wagner and told him that the charges were improper. He provided a credible explanation for the

charges (an exigency, did not have his personal card with him) and assured her that he would repay them. Having grown up with the credit union in her home and knowing firsthand of Mr. Wagner's thoroughness, commitment to the credit union, and central role in its growth, along with knowing that he had sufficient available funds, Ms. Gully believed Mr. Wagner. While Ms. Gully acknowledged processing checks for payment to American Express with credit union funds and not reporting the incident to the board of directors, she denied that such constituted misconduct, since she did not know the extent of Mr. Wagner's personal charges or his failure to make repayment.

Enforcement Counsel argues that Ms. Gully must have know the extent of Mr. Wagner's personal charges because as the manager of the credit union, she reviewed and paid the credit union bills. Although admittedly Ms. Gully reviewed credit union bills and processed checks for payment, including to American Express, it cannot be assumed that she saw the actual American Express statements or knew of the unauthorized charges. The evidence shows that, with rare exception, only Mr. Wagner saw the American Express statements. Unlike other bills, the American Express bill was addressed to Mr. Wagner, the named cardholder, and was routed directly to him. He then opened and reviewed the bill, and at the appropriate time, ordered that a check be drawn to pay the bill. Under this bill paying practice utilized by the credit union, the person drawing the check saw only the information provided by Mr. Wagner (the payee and amount) and not the actual bill, which he retained. In addition, corroborating Ms. Gully's testimony, Monica Reid, the assistant manager of Waterside from 1992 to the present, who shared an office with Mr. Wagner and posted American Express expenses in the general ledger, testified that she, like Ms. Gully, did not see the American Express statements (though she saw other bills) and was unaware of the personal charges on the American Express card. As a result, there is inadequate evidence to conclude that Ms. Gully knew of the personal charges, except on one occasion,

Given Mr. Wagner and Ms. Gully's familial relationship, the bill paying system described above was not advisable and demonstrated a weakness in internal controls. As Officer Bilodeau testified, imposing internal controls to prevent one family member from making payments for expenses incurred by another family member is prudent. And yet, as Officer Bilodeau also testified, such internal controls are not required by law or NCUA regulation. Trans. at 19, 57, 60, 82-84 (Bilodeau). Although not required, and recognizing that Ms. Gully has not been charged with any failure to set up internal controls at the credit union, it is noted that Waterside should have had stronger internal controls in place during 1992-1998, meaning policies to check and segregate bill paying duties. Such policies are now in place at Waterside and might have curtailed Mr. Wagner's misuse of the card, had they been in place between 1992-1998. Trans. at 101-02 (Clancy).

Ms. Gully's situation is very similar to that described in Doolittle v. NCUA, 992 F.2d 1531 (11th Cir. 1993). As stated above, Mr. Doolittle was, like Ms. Gully, charged with unsafe/unsound practices and breach of fiduciary duty, based on a failure to curtail others' misconduct. Mr. Doolittle gave specific corrective instructions to persons he reasonably believed would comply. Ms. Gully did the same, reasonably believing that Mr. Wagner would comply, since he was a highly credible person, had assured her of repayment, and had ample available funds. In the *Doolittle* case, the Eleventh Circuit found no breach of fiduciary duty, stating: "After Doolittle became aware of the problem loans, he took steps that he judged to be sufficient to prevent further escalation of the

situation. Hindsight reveals that he did not do enough, but he cannot be held to have breached his fiduciary duty simply because his underlings failed to follow his orders." *Id.* at 1537. Also, the Court held that Doolittle had not engaged in an unsafe or unsound practice, since his actions were corrective in nature and taken to minimize the risk of loss to the credit union. *Id.* at 1538. Likewise, Ms. Gully took what she believed were sufficient steps to protect the credit union. Her actions, though imperfect in retrospect, were corrective in nature and do not constitute an unsafe or unsound practice or a breach of fiduciary duty.

EFFECT

Section §1786(g)(1)(B) requires a link between the misconduct and effect elements; that is, the effect must occur "by reason of" the misconduct. Having found no misconduct by Ms. Gully, the effect element cannot be met. However, as a note, Mr. Wagner's misconduct did create a negative effect. Since the credit union did not have full use of its funds for several years, it experienced a financial loss.

PERSONAL DISHONESTY/UNFITNESS

Even if the misconduct and effect elements had been satisfied, the evidence did not establish Ms. Gully's personal dishonesty or unfitness. Personal dishonesty is a disposition to lie, cheat or defraud; untrustworthiness; lack of integrity; misrepresentation of facts and deliberate deception by pretense and stealth; or want of fairness and straightforwardness. Van Dyke v. Board of Governors, 876 F.2d 1377, 1379 (8th Cir. 1989)(interpreting FDIC prohibition statute; citations and internal punctuation omitted). Unfitness means the state of being "unsuitable, incompetent or not qualified to participate in the conduct of the affairs of an insured credit union." *In re Doolittle*, Decision and Order on Remand (NCUA Board, Jan. 19, 1994) at 5.

Enforcement Counsel alleges personal dishonesty and unfitness on the part of Ms. Gully for her alleged failure to notify the board of directors of Mr. Wagner's personal charges, or that she "purposefully concealed" Mr. Wagner's misconduct from the board and "stood idle" while the damage continued. Brief in Support of Proposed Findings of Fact and Conclusions of Law at 14.

In evaluating Ms. Gully's conduct, perspective is important. Prior to 1998, Mr. Wagner had been associated with the credit union for over forty years and had an unblemished record. He appeared to be completely dedicated to the credit union, even physically housing the institution in his own home for approximately twenty years. Even after his retirement, Mr. Wagner was still at the credit union, or checked in by telephone every day. He was known as a person of integrity and performed many responsibilities, without follow-up. Over the years, he had held numerous titles at Waterside including assistant treasurer, treasurer, board member, CEO, and investment consultant. His opinion was valued and trusted.

Board members Clancy and LeCastre, who had known and worked with Mr. Wagner for decades, used the same word to describe their reaction when they learned of Mr. Wagner's misconduct: shock. Trans. at 100 (Clancy); LeCastre Depo. at 32-33. Likewise, when asked whether he had ever heard of Mr. Wagner being dishonest at the

credit union, Board member Graff, who had also known and worked with Mr. Wagner for many years, replied, "I would put my life on that, that [Reinhold Wagner] wouldn't be dishonest." Graff Depo. at 24. Reinhold Wagner's misuse of the corporate credit card was truly out of character.

While Mr. Wagner's long history with and contributions to the credit union do not excuse his misconduct, they do help to explain why further action, such as reporting the incident to the board or following up with Mr. Wagner did not present themselves as being necessary to Ms. Gully. Mr. Wagner had provided a credible explanation for the charges and assured Ms. Gully that reimbursement was forthcoming, and she had no reason to be suspicious. Ms. Gully did not make a conscious decision to keep the matter from the board, but simply believed that the problem had been settled. Ms. Gully's actions were not a manifestation of personal dishonesty or unfitness, but rather of a reasonable belief that the problem was limited in scope and resolved.

In addition, there was uncontradicted affirmative evidence presented of Ms. Gully's fitness and personal honesty. John Clancy, the current president of Waterside Federal Credit Union, said that, "[Ms. Gully] was an extremely able manager. She ran the office well." Trans. at 113. John LeCaste, the former board secretary, described Ms. Gully in her role as manager as "certainly qualified," "excellent," "very professional," and stated that she "handled [things at the credit union] very, very well." LeCaste Depo. at 15, 48, 56-57. When asked if he was aware of Ms. Gully taking any dishonest actions, Mr. LeCaste stated, "Oh, God, no." *Id.* at 40. Ms. Gully also credibly testified that she conducted herself in a professional manner during her long tenure at Waterside.

CONCLUSION AND RECOMMENDATION

The criteria for issuance of a prohibition order against Ms. Gully have not been established. It is recommended that the following order be issued: The Notice of Charges for an Order to Prohibit against Katharina Wagner Gully is dismissed.

Dated: **January 30, 2002**

Ann. Z. Cook -

Administrative Law Judge

[1] "Unsafe and unsound banking practices are defined as 'conduct deemed contrary to accepted standards of banking operations which might result in abnormal risk or loss to a banking institution or shareholder.'" Doolittle v. NCUA, 992 F.2d 1531, 1538 (11th Cir. 1993). Fiduciary duty is defined as a "duty to act in the best interest of the institution, its shareholders and its depositors." In re Majette, Final Decision and Order (NCUA Board, March 18, 1999) (*See* p. 7 of Recommended Decision.)

[2] In Count V, Mr. Doolittle became aware of certain commercial loans to one individual that violated NCUA rules as well as the credit union's policies on commercial loans. Mr.

Doolittle told the loan department supervisor not to make any more loans to the individual. There was no allegation that the loan department supervisor or other staff was personally benefiting from the illegal loans. Mr. Doolittle did not inform his board of directors or the NCUA of the problem. Staff (not Doolittle) continued to make illegal loans to the individual who eventually defaulted on them causing a \$42,000 loss to the credit union. The administrative law judge and the NCUA Board concluded that Doolittle's failure to supervise his employees effectively and inform his board of directors constituted a breach of his fiduciary duties and was an unsafe and unsound practice. *See Doolittle* at 1535. The court of appeals reversed and stated that Doolittle "took steps that he judged to be sufficient to prevent further escalation of the situation ... he cannot be held to have breached his fiduciary duty simply because his underlings failed to follow his orders." *Doolittle* at 1537.

[3] Personal dishonesty is a disposition to lie, cheat, or defraud; untrustworthiness; lack of integrity; misrepresentation of the facts and deliberate deception by pretense and stealth; or want of fairness and straightforwardness. *Van Dyke v. Board of Governors*, 876 F.2d 1377, 1379 (8th Cir. 1989). Unfitness means the state of being "unsuitable, incompetent, or not qualified to participate in the conduct of the affairs of an insured credit union." *In re Doolittle*, Decision and Order on Remand (NCUA Board, Jan. 19, 1994) at 5. (*See* p.9 of Recommended Decision