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Testimony

Before the Committee on Banking and Financial Services,
House of Representatives

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**SMALL BUSINESS
ADMINISTRATION**

**Inadequate Oversight of
Capital Management Services,
Inc. - an SSBIC**

Statement of
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Office of Special Investigations



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Mr. Chairman and Members of the Committee:

We are pleased to be here today to discuss our March 1994 report concerning our investigation of Capital Management Services, Inc., a Little Rock, Arkansas, Specialized Small Business Investment Company (SSBIC) licensed by the Small Business Administration (SBA).¹ In 1993, the House Committee on Small Business asked us to determine (1) if SBA properly regulated and oversaw the operations of Capital Management; (2) whether Capital Management adhered to SBA regulations in determining the eligibility of firms it financed; and (3) whether it operated in a businesslike manner in providing financing. That Committee also asked us to analyze the financing that Capital Management provided to Susan McDougal; Castle Sewer and Water Corporation; and Southloop Construction Corporation, Castle's wholly owned subsidiary.

Capital Management was incorporated under Arkansas state law on September 14, 1978, and was licensed by SBA as an SSBIC on March 14, 1979. David L. Hale, president and a director of Capital Management, made all decisions relating to its operations until September 15, 1993, when SBA placed Capital Management into receivership because of capital impairment.

Mr. Hale and two family members provided private capital to the company totaling approximately \$1.4 million. SBA provided funding to Capital Management totaling \$3.4 million on the basis of this private capitalization. Between 1980 and 1993, Capital Management reported 79 financings to SBA, totaling approximately \$9.8 million, to 57 small firms.

In summary, we found that SBA's oversight of Capital Management was inadequate. Capital Management was able to make loans to persons with questionable eligibility, and it violated SBA regulations concerning loans to associates and loans for real estate.

Mr. Hale operated Capital Management in an improper manner, to include taking advantage of SBA's flexible eligibility guidelines in providing financing to individuals that he determined were socially or economically disadvantaged. For example, he made a \$300,000 loan to Susan McDougal, although she and her husband, James McDougal, had a combined net worth of \$2.2 million. In addition, Mr. Hale failed to properly document Mrs. McDougal's questionable eligibility.

Mr. Hale also authorized transactions, such as loans to business associates and loans for real estate purchases, that violated a number of SBA regulations.

¹Small Business Administration: Inadequate Oversight of Capital Management Services, Inc.--an SSBIC (GAO/OSI-94-23, Mar. 21, 1994).

- He made three loans to Retail Liquidators, Inc., totaling \$350,000. Although Robert Boyce, the owner and president of record, was socially and economically disadvantaged, he told us that Mr. Hale was the actual owner and operator, made all the decisions, and used him as a front to borrow money from Capital Management.
- Mr. Hale made a \$65,000 loan to Stephen A. Smith of the Communication Company, which conducted public affairs research and communications consulting. However, correspondence in Capital Management's files reveals that Mr. Smith used the loan to pay off the mortgage for real estate in which he had a one-third interest. Subsequently, Mr. Smith plead guilty to conspiracy to misapply loan proceeds received from Capital Management.

We were unable to fully analyze the transactions with Susan McDougal, doing business as Master Marketing; Castle Sewer and Water; and Southloop Construction because Capital Management's records were incomplete and key participants were unavailable for interview. However, we were able to document the following about the three firms.

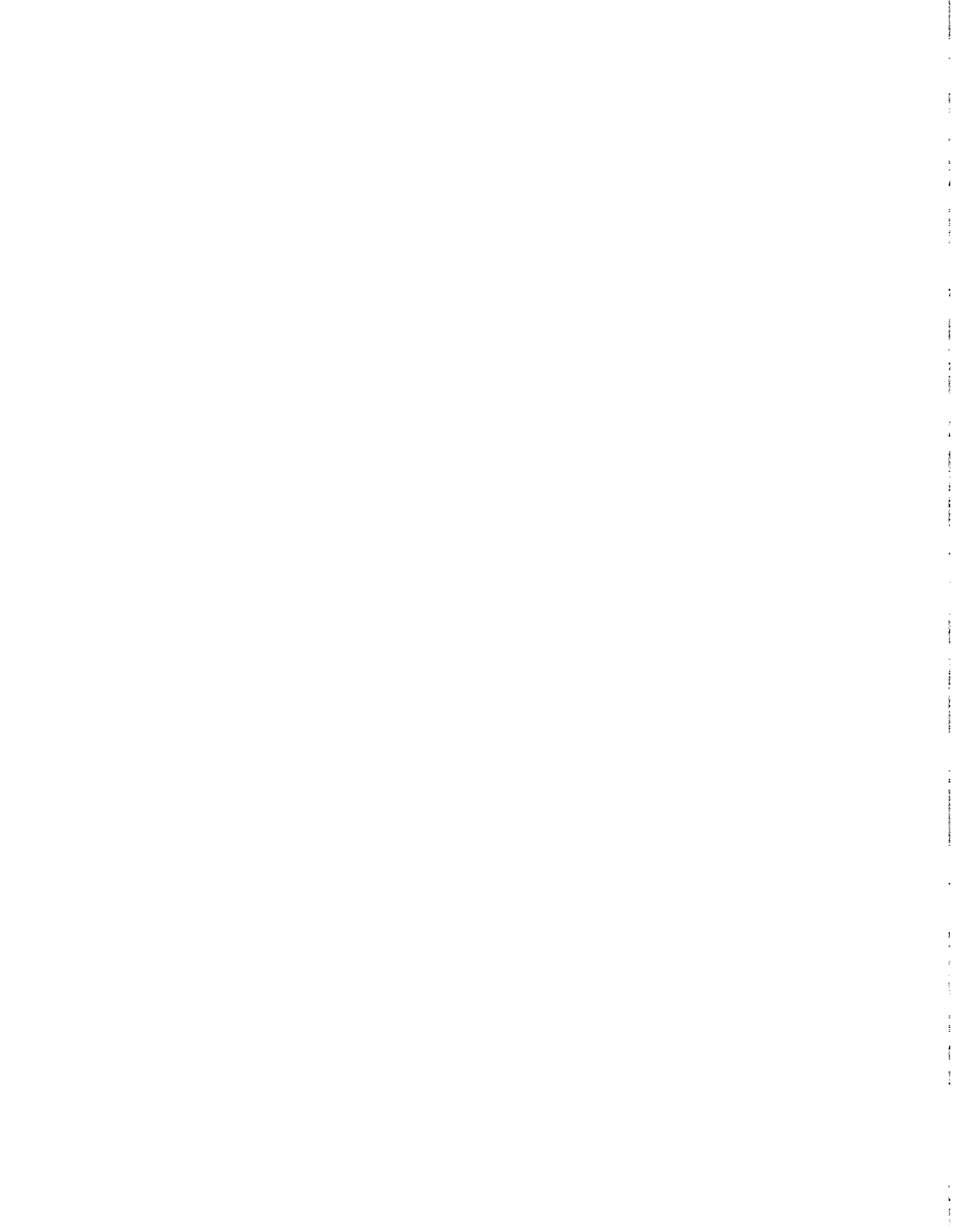
- Capital Management made a \$300,000 loan to Susan McDougal, wife of James McDougal. Subsequent to the issuance of our report, we were able to trace the funds to an individual bank account at Madison Guaranty in the name of Susan and James McDougal.
- Capital Management loaned Castle Sewer and Water \$150,000 for working capital and to purchase a water and sewer facility. R.D. Randolph and Jim Guy Tucker owned Castle. In addition, Mr. Tucker and his wife--through County Cable, Inc.; D&L Communications; and Cablevision Management, Inc.--had previously received loans from Capital Management of approximately \$425,000.
- Capital Management financed a \$100,000 loan to Southloop Construction Company, a wholly owned subsidiary of Castle. Southloop used the \$100,000 loan to purchase and clean up real estate located at the intersection of Pratt Road and Pine Bluff Highway in Little Rock.

As mentioned earlier, our investigation was restricted by the unavailability of certain key witnesses and documentation. David Hale, James McDougal, and Susan McDougal were unavailable for interview, according to their respective attorneys, because they were under either indictment or subpoena to testify before the

federal grand jury. Subsequently, Mr. Hale was convicted of conspiracy to defraud SBA through Capital Management.

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This concludes my opening remarks. I would be happy to answer any questions the Committee may have.



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