No. 20-4303

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

HARRY C. CALCUTT III,

Petitioner,

---- v. ----

FEDERAL DEPOSIT INSURANCE CORPORATION,

Respondent.

ON APPEAL FROM A FINAL DECISION AND ORDER BY THE FEDERAL DEPOSIT INSURANCE CORPORATION

BRIEF OF *AMICUS CURIAE* AMERICAN ASSOCIATION OF BANK DIRECTORS IN SUPPORT OF PETITIONER'S PETITION FOR REHEARING *EN BANC* OR PANEL REHEARING

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UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Disclosure of Corporate Affiliations and Financial Interest

Sixth Circuit Case Number: 20-4303 Case Name: Calcutt v. FDIC

Name of counsel: Robert D. Nachman

Pursuant to 6th Cir. R. 26.1, American Association of Bank Directors
Name of Party
makes the following disclosure:

1. Is said party a subsidiary or affiliate of a publicly owned corporation? If Yes, list below the identity of the parent corporation or affiliate and the relationship between it and the named party:

No.

2. Is there a publicly owned corporation, not a party to the appeal, that has a financial interest in the outcome? If yes, list the identity of such corporation and the nature of the financial interest:

No.

CERTIFICATE OF SERVICE

I certify that on August 1, 2022 the foregoing document was served on all parties or their counsel of record through the CM/ECF system if they are registered users or, if they are not, by placing a true and correct copy in the United States mail, postage prepaid, to their address of record.

s/ Robert D. Nachman
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This statement is filed twice: when the appeal is initially opened and later, in the principal briefs, immediately preceding the table of contents. See 6th Cir. R. 26.1 on page 2 of this form.

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INTEREST OF *AMICUS CURIAE*

The American Association of Bank Directors ("AABD") is a non-profit organization that represents the interests of bank and savings institution directors throughout the United States. Founded in 1989, AABD is the only trade group in the United States devoted solely to bank directors and their information, education, and advocacy needs. In response to the significant increase in the number of investigations and related lawsuits by the Federal Deposit Insurance Corporation ("FDIC") against bank directors since the Great Recession, AABD established a Bank Director Liability Resource Center to serve as a clearinghouse for developments in these areas. In addition, AABD published a book describing the standard of liability in each U.S. jurisdiction. AABD, BANK DIRECTOR STANDARDS OF CARE AND PROTECTIONS: A FIFTY-STATE SURVEY (David Baris ed., 2013).

The issues before this Court – the degree to which bank directors, including those who serve as bank officers, may be banned from banking and fined hundreds of thousands of dollars by the FDIC, despite the FDIC's failure to satisfy the statutory basis for imposing such sanctions and providing them with due process – are vitally important to AABD's membership, especially the independent directors of community banks who comprise most of AABD's membership. These directors are: (i) usually paid relatively minimal directors' fees; (ii) generally not professional bankers; and (iii) continually exposed to potential ruinous liability and

reputational risk caused by the FDIC's and its fellow bank regulators' enforcement actions.

These directors are most often the businessmen and businesswomen of smalltown America — nonbankers who are the realtors, doctors, pharmacists, teachers, and leaders of their respective communities, and who often mainly serve to support the availability of credit in those communities. These directors generally have few resources with which to challenge the federal government, which has virtually limitless resources to extract settlements from these directors.

Draconian actions by the FDIC, and the other bank regulators, can chill the ability of banks to recruit and retain directors. In a survey released by AABD in 2014, 24.5% of bank respondents reported that fear of personal liability was a reason why : (i) a director had resigned; (ii) a person offered a directorship refused to serve; and/or (iii) a director had refused to serve on, or had resigned from, the bank's loan committee. AABD SURVEY RESULTS ON MEASURING BANK DIRECTOR FEAR OF PERSONAL LIABILITY ARE NOT GOOD NEWS (April 9, 2014), http://aabd.org/aabd-survey-results-measuring-bank-director-fear-personal-liability-good-news (last visited July 19, 2022).

Such banking agency actions also can have deleterious effects on how bank boards of directors make decisions. The prospect of high reputational risk, coupled with the risk of personal liability, can cause directors to become overly cautious, to

the point of imprudently avoiding making corporate decisions that may be highly beneficial to a bank and its shareholders.

AABD has conducted research demonstrating that most lawsuits instituted by the FDIC against directors of failed banks challenge the decisions to approve individual loans. *See gen.* David Baris & Loyal Horsley, FDIC DIRECTOR SUITS: LESSONS LEARNED, (2d ed. 2015). These after-the-fact critiques of individual loan decisions made years later ignore the business judgment rule, and often rest on questionable standards. The lawsuits often place a director in the shoes of the loan officer, without acknowledging that directors may delegate duties and responsibilities to bank officers and others, and reasonably rely on them.

Enforcement actions mostly originate through the examination process. Examiners have virtually unbridled authority to adopt procedural actions that can lead to biased results, and exercise their subjective judgments on matters such as loan classifications, quality of management and the board, and the board members' truthfulness. With broad discretionary authority to initiate enforcement actions, a banking agency depends on the unbiased and objective assessment of the facts by its examiners to ensure that the agency has an objective record on which to base its decisions.

The FDIC has broad discretion regarding whether to take enforcement actions, and the form of any particular action. There are a variety of formal administrative

actions, such as formal agreements, cease and desist actions, civil money penalties, and the removal and banning from banking. The FDIC sifts through the record and makes its decisions with the recognition that the agency has the primary responsibility to reach an informed and fair decision, consistent with its statutory standards.

The parties to this appeal have consented to the filing of this brief. No counsel for a party has authored this brief in whole or in part, and no one other than AABD, its members, or its counsel, made any monetary contribution intended to fund the preparation or submission of this brief.

SUMMARY OF ARGUMENT

The FDIC has the statutory authority, under certain circumstances, to remove bank directors and other institution-affiliated parties from their bank positions, permanently bar them from the banking industry, and impose significant monetary fines on them. This authority is not absolute; the FDIC must satisfy specific legal standards to do so. In this case, the panel found that the FDIC failed to satisfy the legal standards for banning and fining Petitioner, and yet the majority failed to remand the case to the FDIC to apply those statutory legal standards. In addition, the panel affirmed the FDIC's decision despite the fact that Petitioner was denied his due process right to cross-examine FDIC witnesses.

ARGUMENT

A. The panel should have remanded the case to the FDIC Board to determine if Petitioner proximately caused Northwestern Bank's losses.

12 U.S.C. § 1818(e) provides the authority for the FDIC to remove a director from his/her position as a director and prohibit that director from any further participation in banking. 12 U.S.C. § 1818(i)(2) provides the authority for the FDIC to impose civil money penalties on directors.

The factual basis for the FDIC's enforcement action relates to the decision of Petitioner, the former president and a director of Northwestern Bank (the "Bank"), to renew a loan and extend additional credit to a borrower, the Nielson Entities, which was managed by the Nielson family (the "Nielsons"). In 2009, the Great Recession had reduced the value of the Nielsons' real estate holdings, which served as collateral for the Bank's loans to them. The Nielsons acknowledged that they could not service their loans, and they stopped repaying their loans at the Bank.

The FDIC focused on the $760,000 loan that the Bank extended to the Nielsons in 2009, referred to as the "Bedrock Transaction." The Bank extended that loan in an effort to allow the Nielsons time to avoid defaulting on their loans. Ultimately, the Nielsons defaulted on their loans.

The FDIC initiated an enforcement action against Petitioner, focusing on the Bedrock Transaction. After two administrative hearings, the FDIC Board entered

an order prohibiting Petitioner from participating in banking and fining him $125,000.

On appeal, the panel correctly ruled that 12 U.S.C. § 1818(e)(1)(B) requires the FDIC to apply a proximate cause standard to Petitioner's conduct. Add.[1] 43–44. The panel also found that the FDIC "was unwilling" to apply the proximate cause standard to Petitioner. (*Id.*)

Once the panel determined that the FDIC failed to apply the proximate cause standard, it should have remanded the case to the FDIC for further administrative hearings. Add. 90; *see also SEC v. Chenery Corp.,* 318 U.S. 80, 88–94 (1943) ("an [administrative] order may not stand if the agency has misconceived the law"); *Gonzales v. Thomas*, 547 U.S. 183, 186 (2006) (per curiam); Henry J. Friendly, Chenery *Revisited: Reflections on Reversal and Remand of Administrative Orders*, 1969 Duke L.J. 199, 209–10).

Instead, the majority reviewed the record itself and determined that the proximate cause standard was met. This was a fundamental error of law that the dissent found to be a violation of basic administrative principles. Add. 90.

AABD submits that the FDIC should be required to satisfy the legal standards of 12 U.S.C. § 1818(e) before directors are sanctioned by the FDIC. The failure to

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[1] "Add." refers to the Addendum attached to Petitioner's Petition for Rehearing *En Banc* or Panel Rehearing.

require the FDIC to satisfy those legal standards renders 12 U.S.C. § 1818(e) meaningless and leaves directors exposed to unchecked actions by the FDIC.

B. The panel should have remanded the case to the FDIC Board to determine the exact amount of the Bank's losses proximately caused by Petitioner.

12 U.S.C. § 1818(e)(1)(B) requires the FDIC to prove that, by reason of the Petitioner's conduct, the Bank has suffered or will probably suffer financial loss or damage, or the Petitioner received a financial benefit as a result of his conduct. The FDIC Board found Petitioner liable for four harms: (i) fees that the Bank paid to its lawyers and accountants; (ii) \$6.443 million in write-offs for the Nielsons' loans; (iii) a \$30,000 write-down on a Nielson loan; and (iv) Petitioner's receipt of dividends from the Bank's holding company.

The panel ruled that the fees paid to Bank lawyers and accountants was not a harm that could be attributed to Petitioner. The panel also ruled that the FDIC did not prove how much of the \$6.443 million in write-offs could be attributed to Petitioner's conduct. In fact, the majority conceded that some portion of the \$6.443 million write-offs would have occurred regardless of Petitioner's conduct. Add. 47. The majority thus acknowledged that the FDIC failed to satisfy its burden of proving exactly how much, if any, of the \$6.443 million in write-offs was proximately caused by Petitioner.

The majority also acknowledged that the FDIC did not point to specific evidence in the record showing that the dividends received by Petitioner reflected earnings from the Nielson Entities. Add. 49. Thus, the majority concedes that the FDIC did not meet its burden of proof regarding those dividends.

Once again, when the majority determined that the FDIC had not proved the causal nexus between Petitioner's conduct and the $6.443 million in write-offs or the dividends he received, the majority should have remanded the case to the FDIC. *Chenery*, 318 U.S. 80, 88–94. Instead, the majority reviewed the record and made its own determination that the Bank would have incurred *some* loss due to Petitioner's conduct.

The majority affirms the FDIC Board's sanctions, despite acknowledging that the FDIC did not meet its burden of proving damages. The effect of this ruling is to expose directors to personal liability for civil money penalties and removal, without requiring the FDIC to prove the harms proximately caused by the director. Again, the statutory standards of 12 U.S.C. § 1818(e) were ignored.

C. The panel affirmed the FDIC decision despite the denial of Petitioner's due process rights.

During the 2019 administrative hearings, the ALJ ruled that the parties were expressly prohibited from cross-examining witnesses about subjects that were not covered during their direct examination. Accordingly, Petitioner was denied the opportunity to cross-examine three FDIC's witnesses, including Case Manager

Anne Miessner and the Nielsons, on critical matters including their personal biases. This denial of the right to cross-examine the witnesses constitutes a fundamental denial of the right to due process. *Goldberg v. Kelly*, 397 U.S. 254, 269 (1970) ("In almost every setting where important decisions turn on questions of fact, due process requires an opportunity to confront and cross-examine adverse witnesses").

Evidence of examiner bias was significant, and essential to be understood fully prior to the examiners' decision to remove or recommend the removal of Petitioner. If permitted, cross-examination could have elicited how the examiners conducted extensive and highly irregular *ex parte* communications with a Nielson family member before, during, and after the examination, and lured Petitioner into a last-minute interview for which he was unprepared, without disclosing to him that they were conducting an investigation of him.

According to the Exceptions and briefs filed in this case, examiner bias looms large. Cori Nielson had attempted to negotiate a workout with the Bank, but when Petitioner and the Bank rejected demands for loan concessions, she threatened Petitioner, "we can destroy your bank, and I'm tempted to do it." A523. Because Nielson wanted "a fresh face to talk to at the bank," Nielson sent a one-sided binder of correspondence in advance of the FDIC's 2011 investigation of the Bank. A213. That binder formed the basis of the FDIC's investigation. A323 (offer of proof).

Ms. Miessner turned the routine examination into an investigation designed to create grounds for a removal proceeding. Ms. Miessner embedded an investigator in the examination team. She wanted to get Petitioner "on record," so she orchestrated a meeting designed to trip up Petitioner on details about the Bedrock Transaction. *See* A323 (offer of proof); A386 (Exceptions). Ms. Miessner also solicited information from Cori Nielson to help build the case. A386-87 (Exceptions).

Based on this record, Ms. Miessner was not objective in her conduct of this one-sided investigation. Another FDIC examiner agreed it was "shocking" for an FDIC examiner to take "a position on the side of the Nielsons questioning what the Bank and its legal counsel [were] doing in collection of debt." A529. Ms. Miessner encouraged the Nielsons to sue the Bank. A620. And Ms. Miessner celebrated with the Nielsons when sharing news about the removal action with the Nielsons – in violation of her duty to keep investigations confidential – calling it "news to brighten your weekend." A622. Cross-examination of the examiners might have uncovered more inappropriate relationships and communications that impacted the examination results and factual record available to the FDIC and the administrative law judge.

The Administrative Procedure Act guarantees each party in an administrative proceeding the right to cross-examine witnesses. 5 U.S.C. § 556(d) provides, in pertinent part, that "[a] party is entitled to present his case or defense by oral or

documentary evidence, to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts." It is a fundamental right of due process to be able to show the bias of a witness testifying against him. *See Goldberg*, 397 U.S. at 269; *Stevens v. Bordenkircher*, 746 F.2d 342, 346 (6th Cir. 1984) (holding that cross-examination concerning the bias or partiality of a witness should always be allowed).

The panel held that Petitioner was not prejudiced because the administrative law judge in the second hearing had access to the record of the first hearing, during which Petitioner did cross-examine the FDIC witnesses. However, the FDIC conceded that the first administrative record was not part of the second hearing. Thus, the panel's ruling was a clear legal error.

Directors do not forfeit their constitutionally and statutorily-guaranteed rights by becoming bank directors. They expect and are entitled to have full due process protections afforded under the law before they are removed, permanently barred from banking, fined hundreds of thousands of dollars by the FDIC, and have their reputations ruined.

CONCLUSION

AABD supports Petitioner's petition for rehearing *en banc* or panel rehearing. Directors should not be subject to prohibition from the banking industry, and the

imposition of significant money penalties, without requiring the FDIC to satisfy the legal standards to do so.

If the Petitioner's petition is denied, and the majority's decision is allowed to stand (notwithstanding the minority's compelling arguments), the AABD believes that it would cause potential and existing bank directors to seriously question whether the benefits of serving on a bank board are worth the significant personal risk to which they potentially could be exposed. The AABD believes that such a chilling effect could have profound implications for our nation's banking system and should be avoided.

Respectfully submitted this 1st day of August, 2022.

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limits of Federal Rule of Appellate Procedure 29(a)(5) because it contains 2,567 words, excluding the parts exempted by Federal Rule of Appellate Procedure 32(f).

I also certify that this brief complies with the typeface and type-style requirements of Federal Rules of Appellate Procedure 32(a)(5) and (6) because it uses 14-point Times New Roman font.

s/Robert D. Nachman
Robert D. Nachman

One of the attorneys for *Amicus Curiae American Association of Bank Directors*

August 1, 2022

CERTIFICATE OF SERVICE

I certify that, on August 1, 2022, I served all counsel of record via the Court's CM/ECF system.

s/ Robert D. Nachman
Robert D. Nachman

One of the attorneys for *Amicus Curiae American Association of Bank Directors*

August 1, 2022