FEDERAL DEPOSIT INSURANCE CORPORATION
WASHINGTON, D.C.

In the Matter of HARRY C. CALCUTT III, Individually and as an Institution- Affiliated Party of NORTHWESTERN BANK, TRAVERSE CITY, MICHIGAN (Insured State Nonmember Bank)	DECISION AND ORDER TO REMOVE AND PROHIBIT FROM FURTHER PARTICIPATION AND ASSESSMENT OF CIVIL MONEY PENALTIES FDIC-12-568e FDIC-13-115k

I. INTRODUCTION

This matter is before the Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC") following the issuance on April 3, 2020, of a Recommended Decision on Remand ("Recommended Decision" or "R.D.") by Administrative Law Judge Christopher B. McNeil ("ALJ"). The ALJ found that Respondent, Harry C. Calcutt III ("Respondent"), the President and Chief Executive Officer ("CEO") of Northwestern Bank ("Bank"), engaged in unsafe and unsound banking practices and breached his fiduciary duties to the Bank by increasing the Bank's exposure to its largest borrower relationship to enable the borrowers to make payments on their existing loans, while concealing the true nature of the transactions from the Bank's board of directors and its regulators.

The ALJ recommended that the Respondent be subject to an order of removal and prohibition pursuant to section 8(e) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e), and be assessed a civil money penalty ("CMP") pursuant to section 8(i) of the FDI Act, 12 U.S.C. § 1818(i). For the following reasons, the Board affirms the Recommended Decision and issues against Respondent an Order of Removal and Prohibition and Order to Pay a CMP in the amount of $125,000.

II. REQUEST FOR ORAL ARGUMENT

After considering the Respondent's Request and the entire record in this matter, the Board finds that (1) the factual and legal arguments are fully set forth in the parties' voluminous submissions, (2) no benefit would be derived from oral argument, and (3) Respondent will not be prejudiced by the lack of oral argument. Therefore, the Board declines to exercise its discretion under section 308.40 of the FDIC's Rules (12 C.F.R. § 308.40) and denies Respondent's Request for Oral Argument.

III. PROCEDURAL HISTORY AND BACKGROUND

The FDIC initiated this action on August 20, 2013, when it issued against Respondent Harry C. Calcutt III, William Green, and Richard Jackson, individually, and as institution-affiliated parties of the Bank, a Notice of Intention to Remove From Office and Prohibit From Further Participation, and Notice of Assessment of Civil Money Penalties, Findings of Fact and Conclusions of Law, Order to Pay, and Notice of Hearing ("Notice").[1] The charges in the Notice focused primarily on (a) the extension of additional credit to a group of entities controlled by the same family, the Nielsons, after the borrowers announced they were unable to service their existing loans; (b) the failure to obtain updated financial information from the Nielson entities before extending additional credit to them and renewing their maturing loans; (c) falsely stating in a loan write up for the Bank Board that a $760,000 loan to the Nielsons was to provide for working capital requirements when in fact it was to enable the Nielsons to make payments on their other loans; (d) violations of the Bank's loan policy which, among other things, requires Board approval for loans in excess of $750,000; (e) the release of cash-equivalent collateral to

[1] William Green was a commercial loan officer at the Bank and Richard Jackson was an Executive Vice President and a member of the Bank's Board. R.D. at 11. In 2015, before the first hearing in this proceeding commenced, Messrs. Green and Jackson stipulated to the entry of Orders prohibiting them from engaging in regulated banking activity. *Id.* at 11-12. Mr. Jackson also consented to the assessment of a $75,000 civil money penalty. *Id.* at 12.

allow the Nielsons to make payments on their loans; (f) the active concealment of the impaired status of the Nielson loans from bank examiners; and (g) the filing of false Call Reports that failed to recognize impairment on any of the Nielsons' loans. R.D. at 13-118; Notice ¶¶ 7-107.[2] The Notice charged that Respondent engaged in unsafe or unsound banking practices and breached his fiduciary duties to the Bank. Notice ¶¶ 122-23. The Notice also alleged that, as a result, the Bank suffered financial loss or other damages, while Respondent received a financial gain or other benefit. *Id.* ¶¶ 124-25. The Notice further alleged that Respondent demonstrated personal dishonesty and a willful or continuing disregard for the safety or soundness of the Bank. *Id.* ¶ 126.

The FDIC sought to remove and prohibit Respondent from further participation in the banking industry. R.D. at 2; Notice at 2. The FDIC also sought to impose a CMP of $125,000 against Respondent pursuant to 12 U.S.C. § 1818(i). Notice at 27. On October 4, 2013, Respondent filed a timely answer to the Notice. On December 9, 2014, Respondent filed a First Amended Answer, and on May 22, 2019, he filed a Second Amended Answer ("Answer"), in which he denied or attempted to minimize many of the FDIC's material allegations and advanced seven affirmative defenses. R.D. at 2. For example, Respondent argued that any misconduct that occurred at the Bank was perpetrated by others without his knowledge and approval, that the hearing before ALJ McNeil did not comply with the Board's remand order, that this proceeding was unconstitutional because ALJ McNeil is shielded from removal by the President, and

[2] The Board conducted an independent review of the record, including the underlying supporting evidentiary documents and transcripts. The Board cites to either the numbered pages in the R.D., to the exhibits ("FDIC Exh." or "JT. Exh." (joint exhibits)), the 2019 hearing transcripts ("Tr."), and the 2015 hearing transcripts ("2015 Tr."). Respondent's Exceptions to the R.D. are cited, respectively, as "R. Exceptions" and exhibits, as "Resp. Exh."

because the proceeding assertedly was barred by the statute of limitations and laches, among other contentions.

Following extensive discovery, an eight-day hearing was held in Grand Rapids, Michigan, between September 15 and 24, 2015. At the hearing, the ALJ received sworn testimony from more than 12 witnesses including Respondent, and thousands of pages of exhibits were admitted into evidence.

On June 6, 2017, the ALJ who was originally assigned to this matter, C. Richard Miserendino, issued a 102-page Recommended Decision. In 2018, before the Board issued a final decision, the case was stayed pending the Supreme Court's decision in *Lucia v. Securities & Exchange Commission*, 138 S. Ct. 2044 (2018), which challenged the Securities and Exchange Commission's ("SEC") reliance on ALJs who had not been appointed consistent with the Appointments Clause of the United States Constitution. After the Supreme Court held that the SEC's ALJs were "inferior officers" who required appointment under the Appointments Clause, 138 S. Ct. 2044, the FDIC Board adopted a Resolution appointing its ALJs and reassigned pending cases to newly appointed and different ALJs. *See* FDIC Resolution Seal No. 085172, Order in Pending Cases (July 19, 2018).

This case was reassigned to ALJ McNeil. *Id.* On March 19, 2019, ALJ McNeil issued an Order Regarding New Oral Hearing advising the parties that he would conduct a new hearing based on the transcripts from the original evidentiary hearing together with limited additional testimony from Respondent. March 19 Order, at 2. Respondent sought interlocutory review of the March 19 Order by the Board, arguing that *Lucia* entitled him to an entirely new proceeding beginning with a new or amended Notice, a new answer, new motions practice, new discovery, and a new evidentiary hearing. By Order entered June 20, 2019, the Board granted Respondent's motion for interlocutory review in part and remanded the matter with instructions to afford

Respondent "a new oral hearing on all issues that were considered at the prior hearing." The Board's June 20 Order denied Respondent's motion in all other respects, including his request that he be granted an entirely new proceeding.

In accordance with the June 20 Order, ALJ McNeil conducted a seven-day hearing between October 29 and November 6, 2019. Twelve witnesses, including Respondent, testified at the new hearing, and more than 1,000 pages of exhibits were admitted into evidence. On April 3, 2020, ALJ McNeil issued a Recommended Decision recommending that Respondent be subject to an order of removal and prohibition and assessing a CMP in the amount of $125,000. Respondent filed timely exceptions on August 3, 2020. Pursuant to 12 C.F.R. § 308.40(c)(2), the Executive Secretary on September 22, 2020, transmitted the record in the case to the Board for final decision.

IV. FACTS

The following discussion summarizes Respondent's misconduct as alleged in the Notice and corroborated by supporting testimonial and documentary evidence in the record.

A. General Background.

Northwestern Bank, of Traverse City, Michigan, was a state-chartered financial institution whose primary federal regulator was the FDIC. Answer ¶ 1. Respondent was President, CEO, and Chairman of the Board of Directors of the Bank from 2000 until 2013. R. Proposed FOF and Conclusions of Law at ¶¶ 3, 5. Respondent also was a member of the Bank's Senior Loan Committee ("SLC"). *Id.* ¶ 3. He retired from the Bank in 2013. *Id.*

Respondent described the Bank as having a "flat" management structure with 20 employees reporting directly to Respondent. R. Proposed FOF and Conclusions of Law at ¶ 5 (citing Tr. 249, 251, 296). Among them was Richard Jackson, who was an Executive Vice President and who served on the Bank's Board, the SLC, the Classified Assets Committee

("CAC"), and the Asset Liability Committee. R.D. at 13; JSOF ¶ 6. In addition, Michael Doherty was head of Credit Administration for commercial lending and was a member of the SLC. R. Proposed FOF and Conclusions of Law at ¶ 5 (citing Tr. 1193). William "Bill" Green served as a commercial loan officer for the Bank and was a member of the CAC. R.D. at 13; Answer ¶ 5.

B. Overview of the Bank's Relationship with the Nielson Family.

The claims against Respondent arise out of the Bank's lending relationship with a group of business entities controlled by the Nielson family ("Nielson Entities"). Answer ¶ 8. The Nielson Entities were centrally managed by one entity called Generations Management, LLC. Tr. at 930 (Nielson). Generations Management, in turn, was managed by Cori Nielson and Keith Nielson. R. Proposed FOF and Conclusions of Law at ¶ 6. Autumn Berden served as the CFO of Generations Management from 2008 to at least 2012. Tr. at 25, 35 (Berden). The Nielson Entities engaged in a variety of business activities, including holding vacant and developed real estate, engaging in commercial and residential property rentals and development, and holding oil and gas interests. Tr. at 29 (Berden).

As of August 2009, the Nielson Entities had $38 million in loans at the Bank ("Nielson Loans") and collectively represented the Bank's largest loan relationship. Answer ¶ 8. Any lending relationship that exceeds 25 percent of the Bank's Tier 1 capital is considered a concentration of credit. JT. Exh. 2, at 18. The Bank's Reports of Examination ("ROE") for 2008 and 2009 treated the Nielson Entities as a single borrower and identified the Nielson Loans as a concentration of credit because they exceeded the 25 percent threshold. JT. Exh. 2, at 20, 37-39. The 2010 ROE again identified the Nielson Loans as a concentration of credit because together they represented approximately 47 percent of the Bank's Tier 1 capital. FDIC Exh. 19, at 11.

A concentration of credit, like a large loan to a single borrower, has the potential to threaten the safety and soundness of a bank in the event the loan or loans stop performing. Tr. at 888 (Miessner); 2015 Tr. at 797-98 (Bird). The Nielson Loans, in addition to making up nearly half the Bank's Tier 1 capital, posed additional risks to the Bank. First, although the Bank's loan policy required the Bank to obtain personal guarantees from the borrowing entity's principals, the Bank did not require any members of the Nielson family to sign a personal guarantee. Tr. at 946-47 (Nielson); FDIC Exh. 86, at 5; JT. Exh. 2, at 36-37. Second, the Nielson Loans were not cross-collateralized, which precluded the Bank from using the collateral of one Nielson Entity to satisfy the obligation of another Nielson Entity in the event of a default. 2015 Tr. 1861-1863 (Calcutt).

C. The Nielson Entities Default in 2009.

In the second quarter of 2009, several of the Nielson Loans were past due, and a number of the Nielson Loans were due to mature on September 1, 2009. FDIC Exh. 3, at 70-77; Joint Stipulation ¶ 10. In the weeks leading up to the September 1 maturity date, representatives of the Nielsons advised the Bank that the Nielson Entities were seeing a slowdown in their respective businesses and would have trouble paying their loans for the foreseeable future. Tr. at 932-33 (Nielson). On August 10, 2009, Generations Management's CFO, Ms. Berden, informed the Bank that the Nielson Entities needed to restructure their loans. FDIC Exh. 3, at 78. When the Bank did not respond favorably to that overture, Cori Nielson sent an email to Respondent on August 21, 2009, advising that the Nielson Entities "will not make our September payment or any further payments until we have the necessary meetings and discussions to reach an overall restructuring of the relationship." Tr. at 936-37 (Nielson); FDIC Exh. 3, at 82. Ms. Nielson was not bluffing. All of the Nielson Entities stopped paying their loans on September 1, 2009. Tr. at 937 (Nielson).

During the fall of 2009, Ms. Nielson continued to communicate with the Bank about options for restructuring the Nielson Loans. Tr. at 938-42 (Nielson). Most of her communications were with Respondent, whom she understood to be the decision-maker for the Bank. Tr. at 934 (Nielson). In a September 21, 2009 email to Respondent, Ms. Nielson proposed that the Bank "suspend [the Nielson Entities'] monthly payments . . . until our cash flow improve[s]." Tr. at 941 (Nielson); FDIC Exh. 3, at 39. She explained that "[t]he real estate market had dropped so dramatically that a lot of our loans were underwater," with no equity left in them, and with little "potential for equity recovery in the near term." *Id.* Respondent testified that he thought the Nielsons merely were "posturing," and that they "did have the funds" to pay their loans. Tr. at 1296 (Calcutt). Yet, Respondent did not do anything to evaluate the financial condition of the Nielson Entities, Tr. at 1382 (Calcutt), and he in fact declined Ms. Nielson's offer to provide updated financial information for the Nielson Entities, Tr. at 938-39 (Nielson).

According to Ms. Nielson, a recurring theme during her discussions with Respondent about a restructuring of the Nielson Loans was that Respondent did not want the Bank to enter into any new agreements that might be "red flags" to the regulators, leading them to scrutinize the Bank's loan relationship with the Nielson Entities. Tr. at 934-35, 986-87 (Nielson). For example, Respondent expressed concern that any loan modifications that reduced the Nielson Entities' debt service would act as "red flags," as would a transaction in which the Bank accepted an assignment of deeds as satisfaction of certain of the loans. Tr. at 934, 947, 987 (Nielson).

D. The Bank Consummates the "Bedrock Transaction" With the Nielson Entities.

While negotiating with the Bank about a restructuring of their loans, none of the Nielson Entities was making loan payments. Joint Stipulation ¶¶ 10, 11. By mid-November 2009, many of the Nielson Loans were about to become 90 days past due; a milestone that had important

ramifications for the Bank because it meant that the loans would be placed on non-accrual status. Joint Stipulation ¶ 11; Tr. at 1377 (Calcutt). Despite this pressure, the Bank and the Nielsons were unable to agree on a workout transaction until November 30, 2009, by which point most of the Nielson Loans had become 90 days past due and were placed on nonaccrual status. Joint Stipulation ¶ 17.

The workout consummated on November 30, 2009, referred to as the "Bedrock Transaction," had several components:

- **Bedrock Loan.** The Bank extended a new loan of $760,000 ("Bedrock Loan") to one of the Nielson Entities, Bedrock Holdings LLC. Answer ¶ 17. The Bedrock Loan was disbursed to Bedrock Holdings on December 1, 2009, after which the proceeds were transferred into deposit accounts that the Bank established for the Nielson Entities, with the understanding that the funds would be used to make payments on each of the Nielson Loans. Joint Stipulation ¶ 15. The Bank and the Nielsons believed that the funds from the Bedrock Loan would be sufficient to cover all loan payments for all of the Nielson Entities through April 2010. Answer ¶ 18.
- **Release of Pillay Collateral**. Pillay Trading LLC, a Nielson Entity, had previously granted the Bank a security interest in certain investment-trading funds when it obtained a loan from the Bank. As part of the Bedrock Transaction, the Bank agreed to release $600,000 of this collateral and bring current all of the past-due Nielson Loans. Answer ¶ 17.
- **Renewal of All Past-Due Nielson Loans**. The Bank granted renewals of all of the matured Nielson Loans. Joint Stipulation ¶ 20. One of the renewed loans was a $4,500,000 loan to Bedrock Holdings. Answer ¶ 30.

To carry out the Bedrock Transaction, the Bank released its interest in $600,000 of the Pillay Collateral, the funds from which were used to cure the arrearages on all past-due Nelson Loans. Joint Stipulation ¶¶ 13, 18. On December 1, 2009, the Nielson Loans were removed from the Bank's nonaccrual list. Joint Stipulation ¶ 19.

Respondent consented to the Bedrock Transaction and was aware of its purpose. Joint Stipulation ¶¶ 14, 16.

E. The Bedrock Transaction Was Tainted By Numerous Irregularities, Including Violations of the Bank's Commercial Loan Policy.

The Bank wholly disregarded its Commercial Loan Policy ("CLP") and safe and sound lending practices when it entered into the Bedrock Transaction. Section 13 of the CLP mandated that "all commercial loans are to be supported by a written analysis of the net income available to service the debt and by written evidence from the third parties supporting the collateral value of the security." FDIC Exh. 86, at 5. Even in the absence of a policy, Mr. Jackson acknowledged that prudent bankers "generally" would want to have financial statements, global cash flow analyses, and current appraisals before approving these loans. 2015 Tr. 1662-63 (Jackson). Yet, the Bank did not gather the required financial information from the Nielsons, nor did it perform the required cash flow analyses and collateral appraisals before funding the Bedrock Loan and releasing the Pillay Collateral. 2015 Tr. 1659-1661 (Jackson); Tr. at 829 (Miessner).

Section 3 of the CLP instructed that "any loans where the total aggregate exposure is between 15 and 25 percent of the Bank's Regulatory Capital, require a 2/3rd majority approval from the Board." FDIC Exh. 86, at 1-2. As of April 2009, the Nielson Loans collectively represented approximately 53 percent of the Bank's Tier 1 capital. Tr. at 733 (Miessner); JT. Exh. 2. The Bedrock Loan, which further increased the Bank's exposure to the Nielson Entities, therefore required the approval of a 2/3rd majority of the Board. 2015 Tr. at 1669 (Jackson). The

Bank nevertheless did not seek Board approval for the Bedrock Loan or any other part of the Bedrock Transaction until March 2010, months after the transaction had been consummated.

Draft findings from the examiners conducting the August 1, 2011, examination flagged the after-the-fact approval of the Bedrock Loan as a "Lending Limit Violation." FDIC Exh. 52, at 1. In response to this draft finding, the Bank claimed that a "documentation oversight" had occurred, in which "[t]he Board was fully aware of this loan prior to the disbursement of the loan, but documentation was lacking supporting the Board's approval in 2009." FDIC Exh. 52, at 2. Respondent, for his part, hewed to this explanation in his testimony. *See* R.D. at 79-80. ALJ McNeil found this explanation to be unworthy of credence, based on evidence that the Bedrock Transaction was not mentioned in any Board minutes during the period September 2009 through March 2010, and based on the testimony of two Board members, Ronald Swanson and Bruce Byl, that the Bedrock Transaction had not been discussed with them before March 2010. R.D. at 79-81 & n.596 (citing Resp. Exhs. 22-24, Tr. at 486-87 (Swanson); *id.* at 1023-25 (Byl)).

Section 12 of the CLP provides that "it is the policy of the [Bank] to require the personal guarantee of the debt by all parties holding a major equity interest in the business enterprise when the borrower is other than a personal entity." FDIC Exh. 86, at 5. In contravention of this provision, the Bank did not obtain a personal guarantee from any of the Nielson family members to support the Bedrock Loan or any of the other loans to the Nielson Entities. Tr. at 273-74 (Gomez). During the 2019 hearing, Respondent testified that the Bank's failure to obtain personal guarantees for the Nielson Loans was not an exception to the CLP. Tr. at 1375 (Calcutt). ALJ McNeil did not credit that testimony because it was squarely contradicted by the plain language of Section 12 of the CLP. R.D. at 70.

The loan write-up for the Bedrock Transaction, presented to the Board after the fact in March 2010, reveals a startling lack of candor. Answer ¶ 31. The write-up seeks approval for

the renewal of Bedrock's existing $4,500,000 loan. *Id.* Inconspicuously placed in the middle of the description for this transaction, the loan write-up states that "[a]s part of this renewal, $600,000 of [collateral] funds will be released" and "[i]n addition a new loan of $760,000 is requested to provide for working capital requirements." JT. Exh. 6, at 2; Answer ¶ 31. The write-up does not disclose that the $4,500,000 loan already had been renewed, that the $600,000 of Pillay Collateral already had been released, and that the new loan in the amount of $760,000 already had been funded in December 2009. JT. Exh. 6. Furthermore, the write-up fails to disclose that: (i) the Nelson Entities had informed the Bank that they were having severe cash flow problems, (ii) all of the Nelson Entities had stopped making payments on their loans in September 2009, and (iii) the proceeds from the new $760,000 loan to Bedrock would be used to make payments on the various Nielson Loans through April 2010. JT. Exh. 6; Answer ¶ 36. The statement in the write-up that the $760,000 loan would be used for "working capital requirements" was materially false because making payments on other loans does not meet the Bank's general definition of the term "working capital." Answer ¶ 32.

Bank credit analyst Ian Hollands prepared the loan write-up. Answer ¶ 31. Respondent, in his capacity as a member of the SCC, received a copy of the loan write-up before it was presented to the Board, and he initialed it. Answer ¶ 38. At the time, Respondent knew that the Bedrock Transaction had been completed three months before the loan application was presented to the Board, and he knew that at least a portion of the proceeds from the $760,000 loan would be used to make payments on all of the Nielson Loans through April 2010. Answer ¶¶ 33, 35.

F. The Nielson Entities Default Again on All of Their Loans in 2010

Many of the Nielson Loans were due to mature in September 2010 but the financial condition of the Nielson Entities had not improved during the preceding 12 months. Accordingly, Cori Nielson contacted the Bank and "tried to initiate renewal discussions." Tr. at

958-59 (Nielson). She sent a series of letters addressed to Respondent to alert him that the Nielson Entities "cannot make their debt service payments," Tr. at 960-61 (Nielson); FDIC Exh. 3 at 31-42, and that they "needed significant loan modifications," Tr. at 958-59 (Nielson).

The Nielsons and the Bank did not reach an agreement before the Nielson Loans began maturing in September 2010. Tr. at 962 (Nielson). All of the Nielson Entities stopped making payments on their loans, effective September 1, 2010. Answer ¶ 42; Tr. at 959 (Nielson). In December 2010, the parties reached an agreement pursuant to which the Nielson Loans were renewed, the Nielson Entities were given interest rate reductions and other concessions, and the Bank released $690,000 in additional Pillay collateral to fund five months of payments, from September 2010 to January 2011. Tr. at 962-64 (Nielson); FDIC Exh. 3 at 165-67; Answer ¶¶ 44, 45. In January 2011, all of the Nielson Entities stopped paying their loans a third time, and all of the Nielson Loans, including the $760,000 Bedrock Loan, have been in default since then. 2015 Tr. 1775-1776 (Calcutt); Joint Stipulation ¶ 29.

G. Respondent Concealed the Problems with the Nielson Loans from the Examiners.

Respondent understood at least as early as 2009 that the Bank's regulators had rated the Nielson relationship as a "special mention" and were closely scrutinizing the Nielson Loans. JT. Exh. 2, at 20, 37-39. Instead of taking steps to address the regulators' concerns, Respondent embarked on a course of conduct designed to conceal the deteriorating financial condition of the Nielson Entities. ALJ McNeil found that Respondent engaged in the following deceptive acts and omissions, among others:

- **<u>Direction to the Nielsons to Mask Inter-Company Transfers</u>**. A number of the Nielson Entities had insufficient cash flow to cover their operating expenses. Tr. at 36 (Berden); FDIC Exh. 135_002. As a result, they were required to sell assets or borrow from other Nielson Entities. Tr. at 37 (Berden). Historically, these transfers would be reflected on the two

company's balance sheets as an intercompany loan. Tr. at 39 (Berden). During a meeting held on April 29, 2008, however, Respondent and Mr. Green requested that the Nielson family's representatives, Cori Nielson and Autumn Berden "not show those inter-company notes on the Borrower's balance sheets anymore." *Id.* at 39 (Berden). Instead, Respondent and Mr. Green asked Ms. Berden to report that, for example, "instead of loaning money to Artesian, [Bedrock] would make a distribution to its members" and "the members would either loan it to Artesian or make a capital contribution as the owners to the other entity." Tr. at 39, 151 (Berden); *see also id.* at 1277 (Calcutt). At some point in time, Ms. Berden learned that Respondent and Mr. Green were concerned that the Nielson Entities' inter-company loans could be construed by bank regulators as a "common use of funds." Tr. at 157 (Berden). Yet Respondent testified that he was not attempting to conceal the interrelatedness of the Nielson Entities from the Bank's regulators; instead, he claimed he was merely providing advice to the Nielsons while wearing his "CPA hat" and his "tax hat." Tr. at 1277, 1308-09 (Calcutt). ALJ McNeil rejected this explanation on the basis of evidence showing that the Bank had a compelling reason to conceal the common ownership of the Nielson Entities. R.D. at 42. For example, Mr. Green informed Ms. Berden in a February 11, 2009 email that "[o]ne item [Respondent] noticed was the inter-company debt was increasing[,] which was the primary item the examiners caught and had a major problem with." Rd. at 47 (quoting Tr. at 55-56 (Berden); FDIC Exh. 3, at 60).

- **<u>2010 Loan Sales & Repurchases</u>**.

On or about April 30, 2010, shortly before examiners were to arrive on site for the Bank's 2010 examination, the Bank arranged to sell a number of Nielson Loans to two affiliate banks, State Savings Bank and Central State Bank. Tr. at 855, 858-59 (Miessner); Resp. Exhs. 42, 44. Respondent was the Chairman of the Board at both banks and at their respective holding companies. Tr. at 884 (Miessner); 2015 Tr. at 167 (O'Niell). Mr. Jackson testified that the Bank

was attempting to reduce its exposure to the Nielson relationship, and he denied that the timing of the sale had any connection to the FDIC examination that was about to commence. 2015 Tr. at 1622 (Jackson). Notwithstanding the loan sale, Mr. Green informed Ms. Berden that he and Respondent would continue to be "[the Nielson Entities'] points of contact and that we [the Nielsons] would work directly with them when it came time for renewals in September." Tr. at 113-114 (Berden). The fact that the Bank expected to maintain control of the loans after selling them suggested to examiners—who learned of the transactions the following year—that the loan sale was a sham. 2015 Tr. 831-832 (Bird); Tr. at 857 (Miessner).

Respondent and Mr. Jackson made the decision to sell the loans in question. 2015 Tr. 1621-1622, 1691-1693 (Jackson); 2015 Tr. at 1766 (Calcutt); Joint Stipulation ¶ 36. In late September 2010, the Bank repurchased each of the Nielson Loans that had been sold prior to the examination. Joint Stipulation ¶ 38. At the time of repurchase, the loans were delinquent and past maturity. *Id.* The Bank's 2011 ROE cited the repurchase transaction as a violation of the Federal Reserve Act because the Bank was acquiring low quality assets from affiliates despite the borrowers' lengthy history of financial problems and delinquent loan payments. FDIC Exh. 48, at 27-29; 2015 Tr. at 163 (O'Niell).

- **2010 Officer's Questionnaire**. In preparation for its 2010 examination of the Bank, the FDIC required Respondent to complete an Officer's Questionnaire. The first question requested a list of "all extensions of credit and their corresponding balances which, since the last FDIC examination, have been renewed or extended . . . without full collection of interest due[,] [or], with acceptance of separate notes for the payment of interest." FDIC Exh. 18, at 2. Respondent answered, "None to the best of my knowledge." *Id.*; Answer ¶ 79. That response was false because, through the Bedrock Transaction, loan proceeds were "used specifically to make interest payments on . . . all of the entities' loans within that relationship." Tr. at 745

(Miessner). Question 3 required Respondent to "[l]ist all extensions of credit made for the accommodation or direct benefit of anyone other than those whose names appear either on the note or on other related credit instruments." FDIC Exh. 18, at 2. Respondent answered, "None to the best of my knowledge." *Id.* This answer also was false because the Bedrock Loan was made for the benefit of other Nielson Entities. Tr. at 746 (Miessner). Respondent conceded that his answers to Questions 1 and 3 were incorrect, but he asserted that the misstatements were "inadvertent[] and unintentional[]." Tr. at 1311 (Calcutt).

- **<u>September 14, 2011 Meeting with Examiners</u>**. On September 14, 2011, FDIC and Michigan examiners met with Respondent and other Bank officials to discuss a number of issues, including the Bedrock Loan. Tr. at 1334-35 (Calcutt); FDIC Exh. 110. During the meeting, the examiners asked Respondent to describe his understanding of how the proceeds of the $760,000 Bedrock Loan were to be used. Respondent told them that Bedrock had purchased Team Services, which had been a Bedrock customer, and that "Bedrock then needed working capital, which was what the loan was for." JT. Exh. 11, at 3. Respondent's explanation was false because he knew that the Bedrock Loan was not going to be used for working capital in connection with an acquisition but, rather, to make payments on the Nielson Loans. Joint Stipulation ¶¶ 14, 16.

During the September 14 meeting, the examiners also asked Respondent to state when the Bank released the Pillay Collateral and to identify the purpose for which the funds were to be used. Respondent answered, "I thought we still had them." JT. Exh. 11, at 4; 2015 Tr. at 591-92 (O'Niell). That statement also was false. Respondent authorized the release of $600,000 in Pillay Collateral in December 2009 and he authorized the release of an additional $690,000 in December 2010. Tr. at 623-24 (Smith); Joint Stipulation ¶¶ 14, 16; Answer ¶¶ 44, 45.

Finally, the examiners asked Respondent where the Nielson Entities obtained the necessary funds to bring current all of their past due loans in December 2010. JT. Exh. 11, at 4. Respondent had authorized the release of $690,000 of the Pillay Collateral in December 2010 so that the Nielson Entities could bring their loans current. Answer ¶¶ 44, 45. Nevertheless, Respondent falsely told the examiners that the Nielson Entities satisfied the arrearages using "[t]heir vast resources between oil, gas, and rentals." JT. Exh. 11, at 4. While testifying during the 2015 hearing, Respondent admitted that his statement was untrue. 2015 Tr. at 1794-95 (Calcutt).

Inaccurate Call Reports. The Bank's 2011 ROE noted that the Bank's Call Reports from December 2009 forward were misstated because they failed to appropriately report the Nielson Loans as nonaccrual since December 2009 and they failed to analyze these loans for impairment, "result[ing] in a material overstatement in earnings both in the form of falsely inflated interest income and of grossly understated provision expense." FDIC Exh. 48, at 42. The 2011 ROE explains that the "Nielson relationship should have been reported as nonaccrual on quarterly Call Reports beginning no later than December 2009 with no interest income recognized subsequent to the payments made in August 2009. *Id.* Respondent signed each of the Call Reports in question. 2015 Tr. at 1724, 1757 (Calcutt). He claimed that he had no involvement in preparing them, Tr. at 1300 (Calcutt); 2015 Tr. at 1724, 1757 (Calcutt), but Respondent could not delegate his responsibility for ensuring the accuracy of the Call Reports, Tr. at 861-62 (Miessner). As a result of the 2011 examination, the Bank was required to restate its earlier Call Reports going back to December of 2009. 2015 Tr. 1082 (Smith).

V. ANALYSIS

A. A Removal and Prohibition Order is Warranted.

The Board may impose a prohibition order if a preponderance of the evidence shows that Respondent engaged in prohibited conduct (misconduct); the effect of which was to cause the Bank to suffer financial loss or damage, to prejudice or potentially prejudice the Bank's depositors, or to provide financial gain or other benefit to the Respondent (effects); and that Respondent acted with personal dishonesty or a willful or continuing disregard for the safety and soundness of the Bank (culpability). 12 U.S.C. § 1818(e)(1); *Dodge v. Comptroller of Currency*, 744 F.3d 148, 152 (D.C. Cir. 2014) (citing *Proffitt v. FDIC*, 200 F.3d 855, 862 (D.C. Cir. 2000)). The Board finds that Respondent's actions during the relevant period satisfy each of these three elements and concludes that a prohibition order is warranted.

1. Misconduct

As noted in the Recommended Decision, misconduct under section 8(e) encompasses participation in activity deemed to be an unsafe and unsound banking practice or in breach of a party's fiduciary duty. 12 U.S.C. § 1818(e)(1)(A); R.D. at 122. The record clearly establishes Respondent's unsafe and unsound practices and breaches of fiduciary duty.

a. Unsafe and Unsound Conduct

An unsafe or unsound banking practice is one that is "contrary to generally accepted standards of prudent operation" whose consequences are an "abnormal risk of loss or harm" to a bank. *Michael v. FDIC*, 687 F.3d 337, 352 (7th Cir. 2012); *see also Seidman v. Office of Thrift Supervision*, 37 F.3d 911, 932 (3d Cir. 1994) ("imprudent act" posing an "'abnormal risk of [financial] loss or damage to an institution, its shareholders, or the agencies administering the insurance funds'" is an unsafe and unsound practice) (citation omitted). Because of their inherent danger, breaches of fiduciary duty also constitute unsafe and unsound practices. *See*

Hoffman v. FDIC, 912 F.2d 1172, 1174 (9th Cir. 1990). As noted in the Recommended Decision, the record in this matter overwhelmingly establishes that Respondent engaged in numerous unsafe or unsound practices while serving as the Bank's President and CEO.

i. Violations of the Commercial Loan Policy ("CLP")

Extending credit in violation of the institution's loan policy constitutes an unsafe or unsound practice. *See Matter of Haynes*, FDIC-11-370e, 11-371k, 2014 WL 4640797 (July 15, 2014); *Matter of Stephens Security Bank*, FDIC-89-234b, 1991 WL 789326 (Aug. 9, 1991); *see also Matter of * * * Bank (Insured State Nonmember Bank)*, FDIC-87-203b, 2 FDIC Enf. Dec. ¶ 5120.3 (1988) (upholding FDIC examiner's classification of two loans that, in violation of the Bank's loan policy, were not collateralized). In violation of Section 13 of the CLP, Respondent approved the Bedrock Transaction without performing (or even reviewing) a written analysis of the net income available to service the debt and without obtaining an appraisal or other evidence from third parties supporting the collateral value of the security. *See* Section IV.E, *supra*. In violation of Section 3 of the CLP, Respondent authorized and funded the Bedrock Loan without securing the approval of a two-thirds majority of the Board, notwithstanding the fact that the Nielson relationship already exceeded 25 percent of the Bank's Tier 1 capital. *See id.* And in violation of Section 12 of the CLP, Respondent did not solicit or obtain personal guarantees from any of the Nielson family members, nor did he document his rationale for failing to do so. *See id.* ALJ McNeil found Respondent's explanations and justifications for these acts and omissions to be insubstantial as a matter of law and belied by the greater weight of the evidence. *See id.*

ii. Imprudent Lending Practices

Even if the CLP did not establish minimum requirements for the approval of commercial loans, Respondent's management of the Nielson borrowing relationship entailed numerous acts and omissions that consistently have been found to be unsafe or unsound lending practices. For

example, extending credit without adequate credit analysis, extending credit without evaluating the borrower's ability to repay the loan, extending credit without assessing the value of the collateral, extending credit to pay off past due loans, and capitalizing unpaid interest (*i.e.*, extending additional credit for the amount of interest owed when loans are renewed), all have been determined to be unsafe or unsound practices. *See First State Bank of Wayne Cty. v. FDIC*, 770 F.2d 81, 82 (6th Cir. 1985) (recognizing that "extending unsecured credit without first obtaining adequate financial information" and "extending secured credit without obtaining complete supporting documentation" constitute unsafe and unsound practices); *Gulf Fed. Sav. & Loan Ass'n v. FHLBB*, 651 F.2d 259, 264 (5th Cir. 1981) (concluding, based on the legislative history of section 1818(e), that "disregarding a borrower's ability to repay" is an unsafe and unsound practice); *Matter of Grubb*, FDIC-88-282k & 89-111e, 1992 WL 813163, at *29 (Aug. 25, 1992) (approving loans without determining the borrower's ability to repay constitutes an unsafe and unsound practice); *Matter of * * * Bank (Insured State Nonmember Bank)*, FDIC-85-42b, 1 FDIC Enf. Dec. ¶ 5062.3 (1986) (recognizing that "[i]mprudent practices include ... the propensity to permit borrowers to capitalize unpaid interest, that is to extend additional credit for the amount of interest owed when loans are renewed"); *Matter of Stephens Security Bank*, FDIC-89-234b; 1991 WL 789326 (Aug. 9, 1991) (capitalizing interest and failing to adequately analyze and document loan transactions are unsafe or unsound practices).

As discussed above, and as described in greater detail in the Recommended Decision, Respondent jeopardized the safety and soundness of the Bank by failing to properly manage the risks posed by the Nielson borrowing relationship. Respondent allowed the Nielson relationship to grow from approximately $31 million in 2008 to approximately $36 million in 2009, even though it already was the Bank's largest borrower. JT. Exh. 2, at 38; Joint Stipulation ¶ 11. In the summer of 2009, the Nielsons informed Respondent that they were in financial distress and

that many of the Nielson Entities would be unable to continuing making loan payments. R.D. at 19-21. A prudent lender would have investigated the matter, but when the Nielsons offered to provide their financial information to the Bank, Respondent, remarkably, declined their offer. R.D. at 21. In September 2009, all the Nielson Entities stopped paying their loans. R.D. at 20 (citing Tr. at 937 (Nielson)). Once the Nielson Loans were 90 days past due, as many of them were by November 30, 2009, they should have been placed on non-accrual status, Tr. at 1377 (Calcutt), and a prudent lender would have begun collection efforts, Tr. at 1296 (Calcutt).

Respondent did not begin collection efforts. He testified that he had every confidence that the Nielson Entities would pay off their loans in full, explaining that he felt certain that the Nielsons "did have the funds" and that they were merely "posturing." R.D. at 23 (quoting Tr. 1296 (Calcutt)). Instead of calling their bluff, however—by, among other things, reviewing the financial records they offered to provide—Respondent approved an additional loan to Bedrock Holdings in the amount of $760,000 and he authorized the release of Pillay Collateral worth $600,000. Answer ¶¶ 17, 18, 20. Again, prior to approving the Bedrock Transaction, Respondent did not perform or review any analysis of the Nielson Entities' ability to repay their loans, he did not obtain appraisals of the collateral securing the loans, and he did not obtain personal guarantees from any of the Nielson Entities' principals. Respondent's acts and omissions were unsafe or unsound by any standard.

iii. Efforts to Mislead Regulators

It is well settled that concealing information from bank examiners and attempting to mislead them constitute unsafe or unsound practices. *See Dodge v. Comptroller of Currency*, 744 F.3d 148, 156 (D.C. Cir. 2014) (misrepresenting bank's financial condition to regulators was unsafe or unsound practice); *Lindquist & Vennum v. F.D.I.C.*, 103 F.3d 1409, 1417 (8th Cir. 1997) (recognizing that lying to bank examiners is an unsafe or unsound practice); *De La Fuente*

II v. FDIC, 332 F.3d 1208, 1224 (9th Cir. 2003) (failing to disclose information concerning problem loans is an unsafe or unsound practice).

As summarized above, and as described in greater detail in the Recommended Decision, the record in this matter confirms that Respondent repeatedly concealed material information about the Nielson Loans from the Bank's regulators. *See* Section IV.G, *supra*; R.D. at 38-39, 41-49, 73-81. Among other deceptive acts and omissions, Respondent failed to inform the examiners that the Nielson Entities had stopped making loan payments in September 2009 and again in September 2010; he arranged for the Bank to sell some of the Nielson loans to affiliate banks shortly before the examiners arrived to conduct the 2010 examination, and he arranged for the Bank to repurchase the loans shortly after the examiners left; he directed the Nielsons to disburse the proceeds of the Bedrock Loan to individual Nielson principals instead of making distributions to other Nielson Entities and recording them as inter-company loans; he made misleading statements to examiners during meetings and in his response to the 2010 Officer's Questionnaire, and he caused the Bank to file inaccurate Call Reports that later had to be amended. *See* Section IV.G, *supra.* An FDIC examiner testified that "through his actions of concealing facts about the Nielson Loans, [Respondent] did materially obstruct our ability to effectively supervise an examination in the institution." Tr. at 808 (Miessner).

Respondent attempted to avoid responsibility for the false and misleading statements he made and the deceptive actions he took by attributing them to a failure of memory, inadvertence, or to his reliance on other Bank employees. *See* Tr. at 1300, 1308 (Calcutt); R.D. at 36 (citing Respondent's testimony). ALJ McNeil did not find Respondent's explanations to be credible or legally sufficient, R.D. at 42, 73-77, 84-85, 99-101, and the Board also is unpersuaded. To the extent Respondent sought to lay the blame on other Bank employees, such deflection is not a colorable defense. *See Matter of Leuthe*, FDIC-95-15e, 95-16k, 1998 WL 438324, at *39 (Feb.

13, 1998) (explaining that "abdication of duty by directors to officers is not a defense," and that "Respondent's duty as a board member, and particularly as Chairman of the Board, was to monitor the activities of bank management, to ensure compliance with laws, regulations, cease and desist orders and the Bank's own loan policy").

c. Breach of Fiduciary Duty

As President and CEO, Respondent owed a duty of care, a duty of loyalty, and a duty of candor to the Bank. *See Seidman*, 37 F.3d at 933. At their most basic, these duties include an obligation to act in good faith and in the best interests of the Bank. *See Matter of* ***, FDIC-85-356e, 1988 WL 583064, at *9 (Mar. 1, 1988). As President and CEO, Respondent was also required to adequately supervise his subordinates. *Id*. "The greater the authority of the director or officer, the broader the range of his duty; the more complex the transaction, the greater the duty to investigate, verify, clarify and explain." *Matter of* ***, 1988 WL 583064, at *9; *Matter of Baker*, FDIC-92-86e, 1993 WL 853599 (July 27, 1993). The duty of candor requires a corporate fiduciary to disclose "everything he knew relating to the transaction," even "if not asked." *De La Fuente II v. FDIC*, 332 F.3d 1208, 1222 (9th Cir. 2003) (fiduciary duty breached by failure to disclose relevant information to bank's board of directors when it was considering a loan even though the bank's board did not ask); *Michael*, 687 F.3d at 350; *Seidman*, 37 F.3d at 935 n.34.

i. Duty of Care

The record in this case establishes that during the relevant period, Respondent engaged in multiple breaches of his duty of care by failing to properly manage the Bank's relationship with the Nielson Entities and by failing to ensure the employees who worked directly for him were not engaging in unsafe or unsound practices in connection with the Nielson Loans. In the summer of 2009, Cori Nielson informed Respondent and others at the Bank that the Nielson

Entities were having financial difficulties and that they would not be able to continue paying all of their loans. *See* Section IV.C, *supra.* In September 2009, all of the Nielson Entities stopped paying their loans, and by the end of November, many of the loans were at least 90 days past due. *See* Section IV.D, *supra.* Instead of initiating collection efforts, Respondent authorized the Bedrock Transaction, which increased the Bank's exposure to what already was its largest borrower relationship. *See id*. While negotiating the Bedrock Transaction with the Nielsons, Respondent failed to comply with the Bank's loan policy. Specifically, he did not perform any credit analysis, he did not secure the approval of the Bank's board, and he did not obtain personal guarantees from the Nielson Entities' principals. *See* Section IV.E, *supra*. Respondent did not demonstrate a higher level of care and attention when the Nielson Entities stopped paying their loans again in September 2010. Without making any effort to evaluate the Nielson Entities' ability to service their loans, Respondent authorized the renewal of all of their loans, the release of additional Pillay Collateral, and granted them lower interest rates and other concessions. *See* Section IV.F, *supra*.

Respondent attempted to shift responsibility for the mishandling of the Nielson Loans onto his subordinates, including Mr. Green (the lender assigned to the Nielson relationship) and the Credit Administration department. *See*, *e.g.*, Tr. at 1281, 1304-05 (Calcutt) (arguing that Mr. Green and the Credit Administration department were responsible for reviewing the Nielson Entities' financial statements); Tr. at 1353 (Calcutt) (denying that he had any responsibility for ensuring that the Bank's loan files were maintained in a safe and secure manner despite having previously admitted that this was his responsibility during the first evidentiary hearing in 2015); Tr. at 1270 (Calcutt) (arguing that overall responsibility for regulatory compliance rested with a number of people in the Commercial area, Credit Administration, and the individual lenders). Even if one were to accept the premise that certain of these activities were not Respondent's

direct responsibility, Respondent's duty of care obligated him, at a minimum, to ensure that his subordinates were handling these tasks in a competent and careful way. The record amply shows that Respondent failed to do even that much.

ii. Duty of Candor

Respondent breached his duty of candor by failing to provide the Bank's board with timely, accurate, and complete information about the status of the Nielson Loans. Given their concentration of credit, the Nielson Entities represented the Bank's largest borrower relationship. When the Nielsons announced in the summer of 2009 that they were having financial difficulties that would prevent their companies from making loan payments, the problem was a big one for the Bank, and Respondent should have disclosed it to the Bank's board. Instead he kept silent. Tr. at 778-79 (Miessner) (Bank board members stated that they were not aware of the problems with the Nielson Loans described in the 2010 ROE); Tr. at 1026-27 (Byl) (stating that, prior to March 2010, no one discussed the Nielson Loans at any of the Bank board meetings he attended, nor did anyone speak with him individually about them); FDIC Exh. 48, at 40 (concluding that "management has actively concealed the accurate condition of [the Nielson] relationship from regulators and from the Bank's board through the failure to maintain complete loan files and through false or misleading verbal and written statements"). When the Nielson Entities stopped paying their loans in September 2009, Respondent did not inform the Bank's board. *See id.* When many of the Nielson Loans became more than 30 days past due, Respondent failed to inform the Bank's board. *See id.* These are all violations of Respondent's duty of care and candor. *See De La Fuente II*, 332 F.3d at 1222 (recognizing that the duty of candor requires a corporate fiduciary to disclose "everything he knew relating to the transaction," even "if not asked"); *Matter of Massey*, FDIC-91-211e, 1993 WL 853749, at *11 (May 24, 1993) (concealment of information from bank's loan committee constituted breach of fiduciary duty).

Respondent's lack of candor in connection with the Bedrock Transaction was particularly egregious. The transaction required Bank board approval, but Respondent did not seek it. In March 2010, months after the new Bedrock Loan had been funded, the Pillay Collateral released, and the original $4.5 million loan to Bedrock renewed, Respondent approved a Bank board presentation concerning the Bedrock Transaction that was materially misleading. In particular, the document did not inform the Bank's board that, in violation of the CLP, the Bank already had consummated the transaction. In addition, the presentation falsely stated that the proceeds of the Bedrock Loan would be used for "working capital" when, as Respondent well knew (having negotiated the transaction with the Nielsons), the funds would be routed to the other Nielson Entities so that they could make payments on their loans. Third, the presentation failed to disclose that all of the Nielson Entities had stopped paying their loans in September 2009 and had refused to resume making payments unless the Bank entered into the Bedrock Transaction. These facts were material, and Respondent's failure to disclose them to the Bank's board was a breach of his duty of candor. *See, e.g.*, *Matter of* ***, 1988 WL 583064, at *9.

2. Effects

To show that misconduct had the required "effect" to impose a prohibition order, the evidence must establish that (1) the bank "has suffered or will probably suffer financial loss or other damage;" (2) the interests of the bank's depositors "have been or could be prejudiced;" or (3) the respondent "received financial gain or other benefit" from his misconduct. 12 U.S.C. § 1818(e)(1)(B)(i)-(iii). An actual loss is not required; a potential loss is sufficient so long as the risk of loss to the Bank was "reasonably foreseeable" to someone in Respondent's position. *See Pharaon v. Bd. of Governors*, 135 F.3d 148, 157 (D.C. Cir. 1998); *De La Fuente II*, 332 F.3d at 1223; *Kaplan v. Office of Thrift Supervision*, 104 F.3d 417, 421 (D.C. Cir. 1997). There may be more than one cause of harm to a bank; an individual respondent need not be the proximate

cause of the harm to be held liable under section 8(e). *See Landry*, 204 F.3d at 1139 (explaining that the fact that other IAPs may have been "more guilty" does not absolve respondent from responsibility for his actions); *Matter of Adams*, 1997 WL 805273, at *5 (recognizing that "multiple factors, and individuals, may contribute to a bank's losses," and that a respondent cannot escape liability simply because others have contributed to the bank's loss as well).

The Board finds ample evidence in the record to support a determination that, as a result of Respondent's misconduct, the Bank suffered or likely will suffer financial loss or other damages, and that Respondent received gain or other financial benefit from his misconduct. First, the Bank recorded a $30,000 charge-off against the $760,000 Bedrock Loan as of July 31, 2012. R.D. at 88 (citing FDIC Exh. 81, at 70). Respondent argues in his Exceptions that "a $30,000 charge-off does not mean that the Bank 'has suffered' a financial loss" within the meaning of 12 U.S.C. § 1818(e)(1)(B). R. Exceptions, at 133. But the Board previously has held that loan charge-offs represent a loss to the bank as a matter of law. *See Matter of Leuthe*, FDIC-95-15e, FDIC-95-16k; 1998 WL 438323, *15 (June 26, 1998); *Matter of Sunshine*, 1 P-H FDIC Enf. Dec. (Bound) at A-581-2 (Aug. 19, 1985). As a fallback, Respondent contends that ALJ McNeil violated his procedural rights by failing to tether the $30,000 charge-off (and other actual and potential losses) to specific acts of misconduct by Respondent. R. Exceptions, at 133. The Board is unpersuaded. The $760,000 Bedrock Loan was one of the main focuses of the 2019 hearing, and the Recommended Decision described at length Respondent's multiple acts of misconduct in approving the loan. *See* R.D. at 5-6, 14, 36-38, 59-63, 69-70, 75-77, 111-12, 123.

The Recommended Decision found that Respondent's misconduct also caused the Bank to suffer $6.443 million in losses on other Nielson Loans. R.D. at 4-5; FDIC Exh. 48 (2011 ROE), at 43, 52, 83-93, and 124; Tr. at 147-48 (Berden). Respondent argues that the $6.443 million in losses on Nielson Loans should not be held against him because the amount merely

represents charge-offs that the FDIC "ordered the Bank" to recognize following the 2011 examination. R. Exceptions at 135. According to Respondent, the charge-offs do not necessarily equate to an "amount owed to the Bank that it was unable to collect from the Neilson [sic] Entities." *Id.* The Board is unpersuaded by this contention. First, as discussed above, the Board has recognized that loan charge-offs constitute a loss to the Bank as a matter of law. Second, Respondent's argument—that charge-offs do not represent losses—leads to the absurd result that banks may avoid losses, and bankers may avoid the consequences for making unsafe and unsound loans, through the simple expedient of not charging off uncollectible loans. At the end of the day, examiners' decision to classify loans as loss is an expert judgment that receives significant deference from the Board and from the courts. *See Sunshine State Bank v. FDIC*, 783 F.2d 1580, 1584 (11th Cir. 1986). Given that the Nielson Loans have been in default since January 2011, Joint Stipulation ¶ 29, Respondent has not presented the Board with any colorable justification for second-guessing the examiners' classifications of the Nielson Loans.

A portion of the $6.443 million in losses could have been avoided had Respondent not released the $1.2 million in Pillay Collateral that secured some of the loans. Specifically, in 2011, $190,000 of the Bank's loans to a Nielson entity called AuSable LLC were classified as loss, as were $712,000 of the Bank's loans to Moxie, LLC, another Nielson entity. FDIC Exh. 48, at 83, 90. The AuSable and Moxie loans were secured by the Pillay Collateral. R.D. at 4-5, 49-51 (citing FDIC Exh. 3, at 59; Tr. 155 (Berden); Resp. Exh. 3). Thus, had Respondent not authorized the release of Pillay Collateral, it would have been available to mitigate the Bank's losses on the AuSable and Moxie loans. Respondent calls this conclusion "specious[]," arguing that because the Bank ***received*** the proceeds of the Pillay Collateral when other Nielson Entities used the funds to make loan payments, it necessarily follows that the release of the Pillay Collateral could not have caused the Bank to ***lose*** money. Although Respondent's argument has

a certain superficial appeal, the fact remains that the Bank suffered losses on the AuSable and Moxie loans that it could have mitigated if the Pillay Collateral had not been released. The AuSable and Moxie losses are sufficient to satisfy the effects element.

ALJ McNeil found that the effects prong also was satisfied by evidence showing that Respondent's misconduct in connection with the Bedrock Transaction caused the Bank to incur other damages in the form of investigative and auditing expenses. *See* R.D., Findings of Fact 4.a & 4.b; R.D. at 5 & nn.20, 21; R.D. at Part II, Sections 5.P–V; Conclusion of Law 6; R.D. at 122. Respondent initially objects to this finding on the ground that "there are no allegations in the Notice that Respondent caused 'other damage' to the Bank." R. Exceptions at 138. In fact, however, the Notice specifically alleges that Respondent's misconduct caused the Bank to "suffer[] significant investigation expense costs and defense costs," Notice ¶ 113, including the retention of a "third-party consulting firm," *id.* ¶ 114, and "nearly $1.7 million in legal fees and expenses," *id.* ¶ 115. At the 2019 hearing, FDIC Enforcement Counsel introduced evidence showing that the Board hired the regional CPA firm of Plante & Moran to perform an "independent loan review of the Nielson relationship," Tr. at 588, 590 (Smith) & FDIC Exh. 77, which cost $281,121, Tr. at 610-614 (Smith) & FDIC Exh. 116, at 1. In addition, FDIC Enforcement Counsel established that the Bank paid $171,122 to the Kus, Ryan law firm for legal services provided to the Bank with respect to regulatory issues involving the Nielson Loans. Tr. at 610-614 (Smith) & FDIC Ex. 116, at 1. Respondent cannot claim to have been surprised that these expenses would be used to establish that the Bank suffered losses as a result of his misconduct; after all, the same evidence was introduced during the 2015 hearing for the same purpose. Furthermore, when the evidence was offered during the 2019 hearing, Respondent did not object that the Plante & Moran and Kus, Ryan expenses were outside the scope of the Notice. *See* 12 C.F.R. § 308.20(b) ("When issues not raised in the notice or answer

are tried at the hearing by express or implied consent of the parties, they will be treated in all respects as if they had been raised in the notice or answer, and no formal amendments are required.”).

Respondent also contends that the investigative expenses and legal fees incurred by the Bank “were caused directly by the Consent Order issued by the FDIC and the threats of Civil Money Penalties made by the FDIC to the Bank’s board and not by any lack of candor by the Respondent.” R. Exceptions, at 139-140. But the Consent Order, by its terms, required only that the Bank commission a management study, *see* FDIC Exh. 70, at 5-7, a project undertaken by the FinPro firm, *see* Tr. at 594-95 (Smith) & FDIC Exhs. 83-84. The Consent Order did not require the Bank to hire a CPA firm to perform a loan review nor did it mandate the retention of counsel. The Board previously has recognized that similar types of professional fees constitute losses within the meaning of Section 8(e). *See Matter of Shollenburg*, FDIC-00-88e; 2003 WL 1986896, at *12 (Mar. 11, 2003) (concluding that additional auditing costs and fees paid to tax consultants as a result of the Respondent’s misconduct were cognizable losses). The Board rejects Respondent’s reliance on *Matter of Proffitt*, 1998 WL 850087, at *10 n.11 (Oct. 6, 1998), for the proposition that the expenses incurred by the Bank “are not legally cognizable as effects because they are simply the normal cost of investigating conduct that has not yet been determined to be wrongful.” R. Exceptions, at 140. In that matter, the Board explained that the payment of legal fees “standing alone cannot be assumed to be enough to support a removal action” because legal fees presumptively are a normal cost of doing business. *Matter of Proffitt*, 1998 WL 850087, at *9 n.11 (Oct. 6, 1998). That presumption of regularity drops away, however, when the legal fees are coupled with other “non-neutral indicia of loss.” *Id.* Here, the legal fees incurred by the Bank were accompanied by other losses, including the fees of a CPA firm (an expense that was not a normal business expense for the Bank) and loan charge-offs.

The applicable test, as Respondent is the first to point out, is that the "effect be a reasonably foreseeable consequence of the misconduct." R. Exceptions, at 139 (citing cases). In the criminal law context, courts applying the felony murder rule have not hesitated to find that it is reasonably foreseeable to a common criminal that when an armed robbery occurs, the police may be called to investigate, the intended victim of the crime may resist, and someone may be fatally shot in the ensuing fracas. *See Santana v. Kuhlmann*, 232 F. Supp. 2d 154, 158 (S.D.N.Y. 2002) (concluding that the evidence was sufficient to support felony murder conviction notwithstanding the fact that "neither the defendant nor his co-defendant fired the gun that killed the police officer"); *Dixon v. Moore*, 318 Fed. Appx. 316, 319 (6th Cir. 2008) (unpublished) ("[e]very robber or burglar knows when he attempts his crime that he is inviting dangerous resistance," and therefore, the death of the appellant's accomplice at the hands of the putative victim "was a natural, logical, and reasonably foreseeable consequence of the armed robbery that Dixon and Lightfoot were committing at the time, when viewed in the light of ordinary human experience"). "As every bank director should reasonably be aware, federal and state regulation of the banking industry is intense," requiring banks to "constantly be dealing with the government and with government inquiries." *Gimbel v. FDIC*, 77 F.3d 593, 600 (2d Cir. 1996). Furthermore, every banker is "deemed to understand that if his bank becomes insolvent or is operated in violation of laws or regulations," the regulators not only will investigate but also may seize control of the institution. *Branch v. U.S.*, 69 F.3d 1571, 1575 (Fed. Cir. 1995). If it is foreseeable to a robber that his crime may result in the death of an innocent person, surely it was foreseeable to Respondent—the President and CEO of a bank—that his misconduct might trigger an investigation that in turn would cause the Bank to incur professional fees.

ALJ McNeil determined that the effects requirement was satisfied for the independent reason that Respondent received a financial benefit from his misconduct in the form of dividends

that would not have been paid, or which would have been reduced in amount, if the true condition of the Nielson Loans had been properly reported. For example, the funds disbursed through the Bedrock Transaction and the second release of Pillay collateral artificially increased the Bank's earnings and resulted in the issuance of a dividend to the Bank's holding company in 2011 that otherwise would not have been warranted. Tr. at 783-87, 895 (Miessner); FDIC Exh. 48, at 65; FDIC Exh. 105, at 9. Respondent, as a large shareholder in the holding company, benefited from the payment of this dividend. Tr. at 895 (Miessner)

In sum, the Board concurs with ALJ McNeil's determination that the Bank suffered losses and Respondent derived personal benefits as a result of Respondent's misconduct.

3. Culpability

Culpability, for purposes of section 1818(e), can be shown by "personal dishonesty" or a "willful or continuing disregard" for the safety and soundness of the financial institution. 12 U.S.C. § 1818(e)(1). "Personal dishonesty" can be established through evidence that an IAP disguised wrongdoing from the institution's board and regulators, or failed to disclose material information. *See Dodge v. Comptroller of Currency*, 744 F.3d 148, 160 (D.C. Cir. 2014) (citing *Landry*, 204 F.3d at 1139-40; *Greenberg v. Bd. of Governors of the Fed. Reserve Sys.*, 968 F.2d 164, 171 (2d Cir. 1992); *Van Dyke v. Bd. of Governors of the Fed. Reserve Sys.*, 876 F.2d 1377, 1379 (8th Cir. 1989)). "Willful disregard" is "deliberate conduct that exposes 'the bank to abnormal risk of loss or harm contrary to prudent banking practices.'" *Michael*, 687 F.3d at 352 (quoting *De La Fuente II*, 332 F.3d at 1223). "Continuing disregard" is "conduct that has been 'voluntarily engaged in over a period of time with heedless indifference to the prospective consequences.'" *Id.* at 353 (quoting *Grubb v. FDIC*, 34 F.3d 956, 962 (10th Cir. 1994)). "Although inadvertence alone is not sufficient to establish culpability, recklessness suffices." *Id.*

(citation omitted). An IAP "cannot claim ignorance by turning a blind eye to obvious violations of his statutory and fiduciary duties." *Id*. at 352.

ALJ McNeil made the following findings with respect to Respondent's personal dishonesty:

> Respondent persistently concealed from both the Bank's Board and its regulatory examiners the true common nature of the Nielson Entities Loan portfolio, problems with that portfolio, and Respondent's efforts in dealing with the Nielson Family's decision to stop making payments on the loans in that portfolio, first in 2009, then in 2010, and finally in 2011. Respondent falsely answered questions presented to him during examinations in 2009, 2010, and 2011, concealed documents showing the true condition of the loans during that period, and falsely testified that Board members had been fully apprised of the nature of the Nielson Loan portfolio.
>
> Respondent envisioned and then implemented the means by which proceeds apparently earmarked for the Bedrock Fund LLC would in fact be distributed to multiple Nielson Entities, using bookkeeping protocols that would withhold from the Bank's own auditors and its examiners the true common nature of the Entities and their loan portfolio.

R.D. at 6. The Board concludes that these findings are well supported by the testimony and exhibits in the record.

Respondent's exceptions to these findings are not well taken. For example, Respondent admits that he advised the Nielsons to "upstream" payments to the principals of other Nielson Entities instead of reporting inter-company transfers on the companies' respective books. R. Exceptions, at 146-147. Respondent argues that because he made this recommendation in April 2008, it could not have been his intention to mask how the Nielson Entities distributed the proceeds of future transactions with the Bank, such as the 2009 Bedrock Transaction. *See id.* The fact that this was a standing instruction to the Nielsons, rather than a directive specific to the Bedrock Transaction, is immaterial. Respondent also renews his arguments that the misstatements and acts of concealment attributed to him were either unintentional or the fault of other bank personnel on whom Respondent relied. *See id.* at 145-154. ALJ McNeil determined

that Respondent's testimony in support of these points was not credible and was squarely contradicted by other record evidence. The Board reaches the same conclusion.

The Board also finds that Respondent's behavior exhibited willful and continuing disregard for the safety and soundness of the Bank. During the relevant period, Respondent took steps to conceal the interrelatedness and the precarious financial condition of the Nielson Entities from the Bank's board, thereby frustrating its efforts to perform its oversight role. Similarly, Respondent actively concealed the same information from the examiners, thereby obstructing them from performing their supervisory role. In violation of the Bank's CLP, Respondent authorized the release of Pillay Collateral and the disbursement of the Bedrock Loan without first obtaining the approval of a 2/3rd majority of the Bank's board. This course of conduct, spanning a period of years, undertaken by the President and CEO of the Bank, constitutes a continuing and willful disregard for the safety and soundness of the Bank.

B. The CMP Assessment is Appropriate.

The ALJ recommended a second tier CMP of $125,000,[3] and the Board concludes that the evidence in the record supports a CMP in that amount. Respondent has not taken exception to the amount of the CMP, arguing only that there is no legal basis for a CMP order for the same reasons that there is no legal basis for a prohibition order. R. Exceptions, at 156-58. The Board rejects that argument for the reasons set forth previously.

A second tier CMP may be imposed against a party who (1) commits any violation of law, regulation, or certain orders or written conditions imposed by regulators; (2) recklessly engages in an unsafe or unsound practice in conducting the affairs of the institution; or (3) breaches any fiduciary duty, and whose "violation, practice, or breach . . . is part of a pattern of misconduct; causes or is likely to cause more than a minimal loss" to the institution; or "results

[3] *See* R.D. at 125.

in pecuniary gain or other benefit" to the party. 12 U.S.C. § 1818(i)(2)(B). The FDI Act authorizes up to $25,000 for each day the violation, practice, or breach continues, subject to adjustments for inflation. 12 U.S.C. § 1818(i)(2)(B); 12 C.F.R. § 509.103.

The Board already has discussed Respondent's breaches of fiduciary duty and unsafe or unsound banking practices, as well as the effects of those acts and omissions. Respondent is subject to a second tier CMP as a result of his breaches of fiduciary duty. Although the breaches of fiduciary duty standing alone would be sufficient to support the recommended CMP, the Board also finds that Respondent's unsafe and unsound practices were committed recklessly, providing an independent basis to support a second tier CMP.

Recklessness is established by acts committed "in disregard of, and evidencing conscious indifference to, a known or obvious risk of a substantial harm." *Cavallari v. OCC*, 57 F.3d 137, 142 (2d Cir. 1995); *see also Simpson v. Office of Thrift Supervision*, 29 F.3d 1418, 1425 (9th Cir. 1994) (similar definition of "reckless[ness]"). Conduct that demonstrates willful or continuing disregard under Section 8(e) has been held to satisfy the recklessness requirement. *See Dodge*, 744 F.3d at 162. For the reasons set forth previously, the Board finds that Respondent's conduct reflected a willful or continuing disregard for the safety and soundness of the Bank.

Because Respondent's misconduct persisted throughout the relevant period, the $125,000 penalty recommended by the ALJ is well within the authorized limit. The Board agrees with the ALJ's analysis of the statutory mitigating factors in 12 U.S.C. § 1818(i)(2)(G), which include: (1) the gravity of the violation, (2) history of previous violations, and (3) the Respondent's financial resources and lack of good faith. R.D. at 7. The gravity of the violations and Respondent's efforts to conceal them support a significant CMP, and the record does not support a finding that Respondent acted in good faith. The Board therefore adopts the ALJ's recommendation of a $125,000 CMP.

C. Respondent's Remaining Exceptions

Respondent has challenged virtually every aspect of the ALJ's findings of fact and legal conclusions. The Board has addressed many of Respondent's exceptions in the relevant sections above and concludes that they lack merit or have no impact on the Board's decision. The Board also is unpersuaded, as discussed below, by Respondent's remaining exceptions. Any exceptions not addressed here or previously are denied.

1. The ALJ Is Not Improperly Shielded from Removal.

Respondent argues that the ALJ is unconstitutionally shielded from removal by the President of the United States. R. Exceptions, at 158-59. As Respondent recognizes, the Board rejected this argument in *Matter of Sapp*, 2019 WL 5823871 (Sept. 17, 2019). R. Exceptions, at 158. Specifically, in *Matter of Sapp*, the Board found:

> In *Lucia*, the Supreme Court remanded the enforcement proceeding to the agency with instructions to reassign the matter to an ALJ directly appointed by the SEC itself—a constitutionally appointed ALJ—and that the ALJ not be the same ALJ who presided over the original proceeding. *Lucia*, 138 S. Ct. at 2055. That is precisely what the FDIC did here. The FDIC Board directly appointed ALJ McNeil and reassigned this matter to him (as noted earlier, a different ALJ had presided over the original hearing). ALJ McNeil then afforded the parties ample time to request a rehearing, which neither party did, and then proceeded to decide the case on the papers. Regardless of whether or not the *Lucia* decision applies to FDIC-appointed ALJs, the FDIC's actions following *Lucia* are entirely consistent with that opinion.

***19**

> Moreover, the ALJ was appointed by a vote of the FDIC Board, the governing body of the FDIC. The FDIC Board possesses the authority to appoint its ALJs, and the FDIC is not subordinate to or contained within any other component of the Executive Branch. 12 U.S.C. § 1812(a) ("The management of the [FDIC] shall be vested in a Board of Directors …."); 12 U.S.C. § 1819 (prescribing corporate powers, including the power to appoint officers); 5 U.S.C. § 3105 (permitting agencies to appoint their own ALJs). Thus, the FDIC is a "Department" for purposes of the Appointments Clause. *See Free Enter. Fund*, 561 U.S. at 510-11 (a component of the Executive Branch that is "not subordinate to or contained within any other such component … constitutes a 'Departmen[t]' for the purposes of the Appointments Clause"); 5 U.S.C. § 105 (an "Executive Agency" under Title 5 includes a Government corporation and an independent establishment, such as the FDIC).

Id. at *19. Respondent has not shown that *Matter of Sapp* was wrongly decided. Accordingly, the Board rejects Respondent's argument for the reasons set forth in *Matter of Sapp*.

2. The Hearing on Remand Complied with *Lucia*.

After the Supreme Court decided *Lucia*, the Board adopted a Resolution appointing its ALJs and reassigned this case from ALJ Miserendino to ALJ McNeil. Respondent asserts that he was "'entitled' to a 'new hearing' before a constitutionally-appointed ALJ." R. Exceptions, at 164 (quoting *Lucia*, 138 S. Ct. at 2055). Although he was granted a new hearing before ALJ McNeil—who had been appointed by the FDIC Board and who had not presided over the earlier proceeding—Respondent argues that he should have been afforded "the full panoply of procedures for a hearing to which he was entitled the first time," including document discovery and depositions. R. Exceptions, at 164-66. Respondent's primary grievance seems to be that that ALJ McNeil considered his testimony from the 2015 hearing along with that of certain other witnesses, and also considered a joint stipulation of facts that the parties entered into in 2015. *See* R. Exceptions, at 18-24. According to Respondent, ALJ McNeil's consideration of these materials "irreparably tainted Respondent's supposedly new hearing." *Id.* at 20. The Board rejects this argument for three reasons.

First, the same argument was presented in *Matter of Sapp* and, as Respondent acknowledges, the Board rejected it there. *See* R. Exceptions, at 162. Respondent has not persuaded us that *Matter of Sapp* was wrongly decided.

Second, Respondent previously presented his demand for an entirely new proceeding to ALJ McNeil, who denied it on November 28, 2018. *See* Decision and Order on Interlocutory Review, at 5 (FDIC June 20, 2019). Four months later, Respondent sought interlocutory review of ALJ McNeil's decision, but the Board denied that portion of his motion as untimely. *See id.* at 5-6. Although the Board has discretion to reconsider its previous rulings in the same matter, it

exercises that power sparingly in deference to the "strong policy favoring finality" of such rulings. *U.S. v. Adegbite*, 877 F.2d 174, 178 (2d Cir. 1989); *accord LaShawn A. v. Barry*, 87 F.3d 1389, 1393 (D.C. Cir. 1996) (observing that "the same issue presented a second time in the same case in the same court should lead to the same result"); *Crocker v. Piedmont Aviation, Inc.*, 49 F.3d 735, 739 (D.C. Cir. 1995) ("When there are multiple appeals taken in the course of a single piece of litigation, law-of-the-case doctrine holds that decisions rendered on the first appeal should not be revisited on later trips to the appellate court."). Here, the policy favoring finality weighs against reconsideration of the Board's prior ruling.

Third, Respondent's "entirely new proceeding" argument cannot be reconciled with the Federal Rules of Evidence nor the FDIC's own rules. *See* 12 C.F.R. § 308.36(a)(3) (permitting the introduction of evidence that would be inadmissible under the Federal Rules of Evidence so long as it is "relevant, material, reliable and not unduly repetitive"). Respondent complains, for example, that ALJ McNeil discounted his 2019 testimony that he "may have signed" a Call Report "once in a blue moon," by "impermissibly reach[ing] back to Respondent's 2015 testimony" that Call Reports were prepared by others and "simply presented to me for signature." R. Exceptions, at 19. In other words, Respondent contends that he should have been free to present a new and different narrative in 2019, unencumbered by his prior testimony at a hearing where he was under oath and represented by counsel. Respondent emphasizes that he did not consent to the use of his 2015 testimony, R. Exceptions, at 19, but his consent was not required. When a case is remanded for a new trial, it is well established that the defendant may be impeached with his prior testimony and the prior testimony also can be used as substantive evidence against him. *See Harrison v. U.S.*, 392 U.S. 219, 222 (1968) (finding it unnecessary to "question the general evidentiary rule that a defendant's testimony at a former trial is admissible in evidence against him in later proceedings"); *U.S. v. Daniels*, 377 F.2d 255, 258 (6th Cir. 1967)

("Statements which are contradictory to statements given in an earlier trial or in a deposition are clearly admissible."); *see also Bondie v. Bic Corp.*, 947 F.2d 1531, 1534 (6th Cir. 1991) (recognizing that, under Federal Rule of Evidence 801(d)(2)(A), "a party's own statement offered against the party is, by definition, not hearsay").

Along the same lines, Respondent complains that, over his objection, ALJ McNeil "improperly admitted and relied upon the Joint Stipulation of Fact entered into between Respondent, former respondents Bill Green and Dick Jackson, and Enforcement Counsel prior to the 2015 hearing." R. Exceptions, at 22. Respondent argues that when the Board remanded this matter for a new hearing, it "necessarily" intended that the parties enter into new stipulations. *Id.* No Order of the Board expresses such an intention, however, and Respondent conspicuously fails to cite any authority for the proposition that stipulations of fact entered into before the first trial of a case become inadmissible in the event of a retrial. Federal courts consistently have held to the contrary. *See*, *e.g.*, *U.S. v. Boothman*, 654 F.2d 700, 703 (10th Cir. 1981) (holding that the district court did not abuse its discretion by admitting, over the defendants' objection, a joint stipulation of facts that the parties entered into before the first trial of the case); *U.S. v. Marino*, 617 F.2d 76, 82 (5th Cir. 1980) ("No authority is cited for the proposition that such a stipulation may not be used in a subsequent trial. We find none.").

Next, Respondent takes exception to ALJ McNeil's use of the 2015 testimony of another witness, Michael Doherty, while questioning Mr. Doherty. R. Exceptions, at 21. Respondent does not cite any cases holding that this use of prior testimony was improper, whether ALJ McNeil was refreshing Mr. Doherty's recollection or, as Respondent would have it, cross-examining him. *See id.* Mr. Doherty's prior testimony properly could be used to refresh his recollection or to impeach him. *See Freudeman v. Landing of Canton*, 702 F.3d 318, 329 (6th Cir. 2012) (recounting district court's explanation to the jury that a witness may be referred to

prior testimony "to refresh the witness's recollection or to impeach the witness's credibility"); *U.S. v. Foster*, 376 F.3d 577, 591 (6th Cir. 2004) (recognizing that Federal Rule of Evidence 613(b) permits the impeachment of a witness by "[e]xtrinsic evidence of a prior inconsistent statement" if "the witness is afforded an opportunity to explain or deny the same and the opposite party is afforded an opportunity to interrogate the witness thereon"); *see also U.S. v. Smith*, 776 F.2d 892, 897 (10th Cir. 1985) (holding that prior inconsistent statement was admissible as substantive evidence Federal Rule of Evidence 801(d)(1)(A) because it was originally given under oath and the witness was subject to cross-examination concerning the statement). In the event of a conflict between Mr. Doherty's 2015 testimony and his 2019 testimony, it would be perfectly reasonable for the finder of fact to give more credence to the former. *See U.S. v. Bigham*, 812 F.2d 943, 946 (5th Cir. 1987) (explaining that the drafters of Federal Rule of Evidence Rule 801 believed that the prior statement of a witness "is more likely to be true as it was made closer in time to the event"); *U.S. v. Distler*, 671 F.2d 954, 959 (6th Cir. 1981) (observing that the Senate, when discussing the adoption of Federal Rule of Evidence Rule 801(d)(1)(A), emphasized the benefits of "allowing the jury to consider testimony given 'nearer in time to the events, when memory was fresher and intervening influence had not been brought into play'") (internal citation omitted).

In sum, the Board finds that Respondent received the new hearing contemplated by the Board's July 19, 2018, Order in Pending Cases.

3. This Proceeding Was Commenced Within the Statute of Limitations.

Respondent argues that this proceeding should be dismissed as untimely because it supposedly was not commenced within the applicable five-year statute of limitations. R. Exceptions, at 166-167. This exception borders on the frivolous. The premise is that many commencement statutes have only one requirement, such as Federal Rule of Civil Procedure 3,

which provides that "[a] civil action is commenced by filing a complaint with the court." R. Exceptions, at 166 (quoting Fed. R. Civ. P. 3). By contrast, according to Respondent, "[t]o commence an enforcement proceeding" under the FDIC's regulations, the FDIC must comply with ***three*** requirements; it "must issue a Notice, serve the Notice upon Respondent, and file the Notice with OFIA." *Id.* (citing 12 C.F.R. § 308.18(a)). ("OFIA" is the acronym for Office of Financial Institutions Adjudication). That is simply incorrect. By its terms, Section 308.18(a)(i) expressly provides that "a proceeding governed by this subpart ***is commenced by issuance of a notice by the FDIC***." 12 C.F.R. § 308.18(a)(i) (emphasis added). The notice must be served on the respondent and filed with OFIA, *see* 12 C.F.R. § 308.18(a)(ii), (iii), just as a federal summons and complaint must be served on the defendant in a civil case, but an FDIC enforcement proceeding "is commenced" upon the FDIC's issuance of the notice, just as a civil case "is commenced" when the complaint is filed with the court. In other words, the FDIC's regulation is not "[u]nlike other commencement statutes." R. Exceptions, at 166. It is effectively just like them for this purpose in the sense that only one requirement must be fulfilled to commence an FDIC enforcement action.[4]

---

[4] Respondent does not argue, nor could he, that because Section 308.18(a) is entitled "Commencement of Proceeding," it necessarily follows that all three subparts of that section—the FDIC's issuance of a notice, service of the notice on the respondent, and filing of the notice with OFIA—must be accomplished to "commence" a proceeding. Such an argument would run afoul of the settled rule that section headings in a statute or regulation "cannot undo or limit that which the text makes plain." Brotherhood of R. R. *Trainmen v. Baltimore & O.R. Co.,* 331 U.S. 519, 528-29 (1947) (explaining that section headings are merely "a short-hand reference to the general subject matter involved," and "are not meant to take the place of the detailed provisions of the text); accord *Spurr v. Pope, 936 F.3d 478, 488* (6th Cir. 2019) ("[A] title or heading should never be allowed to override the plain words of a text.") (quoting Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 222 (2012). Here, the text of 12 C.F.R. § 308.18(a)(i) makes plain that an FDIC enforcement proceeding "is commenced by issuance of a notice by the FDIC." 12 C.F.R. § 308.18(a)(i). Section 308.18(a)'s heading cannot be used to undo those plain words.

When Section 308.18(a)(i) is applied according to its terms, it is apparent that Respondent's statute of limitations argument is wholly without merit. The Bedrock Transaction took place in December 2009. The FDIC issued its Notice with respect to Respondent's misconduct on August 13, 2013. Because the Notice was issued well within the five-year limitations period, this proceeding was timely "commenced" within the meaning of Section 308.18(a)(i). Even if the Board were to accept Respondent's suggestion that an FDIC enforcement action is not commenced until the notice is issued, served on the respondent, and filed with OFIA, *see* R. Exceptions, at 166, it is undisputed that all of those steps took place within the five-year limitations period.

As ALJ McNeil noted in the Recommended Decision, Respondent's limitations defense attempts to engraft an additional provision onto Section 308.18(a) that purportedly requires the FDIC to file the Notice with a "valid tribunal." R.D. at 121-22. According to Respondent, because the FDIC's ALJs were not "constitutionally appointed when the Notice was issued, served, and filed on August 28, 2013," the proceeding was not "commenced" at that time. R. Exceptions, at 166-67. During the proceedings before ALJ McNeil, Respondent did not cite any authority for the proposition that the status of the FDIC's ALJs in 2013, when the Notice was issued, has some bearing on the statute of limitations. Respondent did not address that omission in his Exceptions. Furthermore, he has not offered authority for the proposition that a defect in the appointment process for the ALJs somehow negated the existence of the OFIA as a whole.

The Board notes that Respondent does not attempt to bolster his limitations defense with a policy argument extolling the important purposes served by statutes of limitations. The Supreme Court has explained that statutes of limitations protect defendants from being surprised by "the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared." *Burnett v. New York Cent. R. Co.*, 380

U.S. 424, 428 (1965). Here, Respondent cannot claim to have been unfairly surprised by the FDIC's Notice because it is undisputed that he received it in 2013 long before the statute of limitations expired. R. Exceptions, at 167. Nor could Respondent claim that he was disadvantaged because evidence was lost, memories faded, or witnesses disappeared. To the contrary, his grievance is that documentary and testimonial evidence was ***preserved*** during the 2015 hearing and then used against him during the 2019 hearing. In short, no public policy interest would be advanced by accepting Respondent's statute of limitations defense.

For all of the above reasons, the Board concludes that the proceeding against Respondent was "commenced" within the limitations period.

4. The ALJ's Evidentiary Rulings Were Not an Abuse of Discretion.

A substantial number of Respondent's exceptions focus on ALJ McNeil's evidentiary rulings. *See* R. Exceptions, at i-iii (Nos. 1-9, 23). Among other things, Respondent argues that the ALJ admitted certain exhibits, excluded other exhibits, allowed certain testimony, limited other testimony, permitted FDIC witnesses to offer expert testimony, and denied Respondent's motions *in limine*. *See id.* As a threshold matter, FDIC Rule 308.5 provides the ALJ with broad authority to oversee the proceedings in a fair, impartial, and efficient manner. *See* 12 C.F.R. § 308.5. In particular, the ALJ has broad discretion to "rule upon the admission of evidence and offers of proof." 12 C.F.R. § 308.5(b)(3). When ruling on the admissibility of evidence, the ALJ is not bound by the Federal Rules of Evidence. *See Matter of Michael*, 2010 WL 3849537, at *15 (FDIC Aug. 10, 2010). Instead, the ALJ may receive evidence that would be inadmissible under the Federal Rules of Evidence, provided it is, in the ALJ's estimation, "relevant, material, reliable and not unduly repetitive." 12 C.F.R. § 308.36(a)(3) (permitting the introduction of evidence that would be inadmissible under the Federal Rules of Evidence so long as it is "relevant, material, reliable and not unduly repetitive"). The Board reviews the ALJ's

evidentiary rulings for abuse of discretion. *See Matter of Haynes*, 2014 WL 4640797, at *13-17 (FDIC July 15, 2014). Upon review of Respondents' specific exceptions, the Board is not convinced that ALJ abused his discretion in making any of the evidentiary rulings to which Respondent objected.

5. ALJ McNeil Was Not Biased Against Respondent.

Respondent contends that he was denied a fair hearing for the independent reason that ALJ McNeil was biased against him. R. Exceptions, at 5, 15, 62-77. Respondent raised this issue in the post-hearing brief that he filed with the ALJ on January 31, 2020, and he renews the issue in his Exceptions. Under the Administrative Procedure Act, claims of bias against a "presiding or participating employee" must be supported by the "filing in good faith of a timely and sufficient affidavit of personal bias or other disqualification." 5 U.S.C. § 556(b)(3). Because Respondent did not file such an affidavit, his claim of bias is "not entitled to consideration on the merits by the Board." *Matter of The Bartlett Farmers Bank*, 1994 WL 711717, at *3 (FDIC Nov. 8, 1994); *accord Keating v. Office of Thrift Supervision*, 45 F.3d 322, 327 (9th Cir. 1995) (declining to consider claim that agency head should have recused himself because appellant "failed to accompany his request with a timely and sufficient affidavit stating the grounds for recusal"); *Pfister v. Director, Office of Workers' Compensation Progs.*, 675 F.2d 1314, 1318 (D.C. Cir. 1982) (refusing to consider claim that ALJ was biased because "no affidavit setting forth specific evidence of prejudice [on the part of the ALJ] was ever filed"); *Gibson v. Federal Trade Comm'n*, 682 F.2d 554, 565 (5th Cir. 1982) ("[F]ailure to submit affidavits is thus an independently sufficient basis to deny [the] petitions [alleging bias].") (internal citation omitted).

Even if Respondent had filed the required affidavit, the Board would reject his claim of bias. Respondent, in his exceptions, does not identify any credible evidence demonstrating that

ALJ McNeil harbored some unfair bias against him. Instead, Respondent complains that the ALJ reached "unsupported" conclusions, misstated facts, "discounted or outright ignored evidence supportive of Respondent," raised and sustained objections, elicited testimony adverse to Respondent, and made credibility determinations that Respondent regards as unnecessary or improper. R. Exceptions, at 5. At bottom, the contention is that "because the ALJ ruled against [Respondent], he had to have been biased" against him. *Matter of The Bartlett Farmers Bank*, 1994 WL 711717, at *3 (FDIC Nov. 8, 1994); *accord Marcus v. Director, Office of Workers' Compensation Progs.*, 548 F.2d 1044, 1051 (D.C. Cir. 1976) ("The mere fact that a decision was reached contrary to a particular party's interest cannot justify a claim of bias, no matter how tenaciously the loser gropes for ways to reverse his misfortune. While this proposition may appear self-evident, petitioner's enumerated contentions collapse to little more.").

V. CONCLUSION

After a thorough review of the record in this proceeding, and for the reasons set forth previously, the Board finds that an Order of Removal and Prohibition and Assessment of a CMP is warranted against Respondent. The record demonstrates that Respondent put the Bank at risk by failing to prudently manage the Bank's relationship with its largest borrower. The record further demonstrates that Respondent actively concealed the borrower's financial problems and loan defaults from the FDIC and the Bank's board and that he made material misrepresentations to both the FDIC and the Bank's board. In light of Respondent's unsafe and unsound practices and breaches of his fiduciary duties, the Board is persuaded that Respondent should be barred from the banking industry. In addition, and also in light of the record, the Board finds that the CMP imposed is appropriate and consistent with the statute's purpose.

ORDER TO REMOVE AND PROHIBIT

The Board of Directors ("Board") of the Federal Deposit Insurance Corporation ("FDIC"), having considered the entire record of this proceeding and finding that Respondent Harry C. Calcutt III, formerly the Chief Executive Officer and President of Northwestern Bank ("Bank"), Traverse City, Michigan, engaged in unsafe or unsound banking practices and breaches of his fiduciary duties resulting in loss to the Bank, and that his actions involved willful and continuing disregard for the safety and soundness of the Bank, hereby ORDERS and DECREES that:

1. Harry C. Calcutt III shall not participate in any manner in any conduct of the affairs of any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the Federal Deposit Insurance Act ("FDI Act"), 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

2. Harry C. Calcutt III shall not solicit, procure, transfer, attempt to transfer, vote, or attempt to vote any proxy, consent or authorization with respect to any voting rights in any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

3. Harry C. Calcutt III shall adhere to all voting agreements with respect to any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), except as otherwise permitted, in

writing, by the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

4. Harry C. Calcutt III shall not vote for a director, or serve or act as an institution-affiliated party, as that term is defined in section 3(u) of the FDI Act, 12 U.S.C. § 1813(u), of any insured depository institution, or any other institution, credit union, bank or agency enumerated in section 8(e)(7)(A) of the FDI Act, 12 U.S.C. § 1818(e)(7)(A), without the prior written consent of the FDIC and the appropriate Federal financial institutions regulatory agency, as that term is defined in section 8(e)(7)(D) of the FDI Act, 12 U.S.C. § 1818(e)(7)(D).

5. This ORDER shall be effective thirty (30) days from the date of its issuance.

6. The provisions of this ORDER will remain effective and in force except in the event that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

SO ORDERED.

IT IS FURTHER ORDERED that copies of this Decision and Order shall be served on Harry C. Calcutt III, FDIC Enforcement Counsel, the Administrative Law Judge, and the Office of Financial and Insurance Regulation for the State of Michigan.

By Order of the Board of Directors.

Dated at Washington, D.C. this 15th day of December, 2020.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation

086871

ORDER TO PAY CIVIL MONEY PENALTY

The Board, having considered the entire record in this proceeding, and taking into account the appropriateness of the penalty with respect to the size of the financial resources and good faith of Respondent, the gravity of the violations, and such other matters as justice may require, hereby ORDERS and DECREES that:

1. A civil money penalty is assessed against Harry C. Calcutt III in the amount of $125,000 pursuant to 12 U.S.C.
§ 1818(i).

2. This ORDER shall be effective and the penalty shall be final and payable thirty (30) days from the date of its issuance.

The provisions of this ORDER will remain effective and in force except to the extent that, and until such time as, any provision of this ORDER shall have been modified, terminated, suspended, or set aside by the FDIC.

IT IS FURTHER ORDERED that copies of this Decision and Order shall be served on Respondent Harry C. Calcutt III, FDIC Enforcement Counsel, the Administrative Law Judge, and the Office of Financial and Insurance Regulation for the State of Michigan.

By Order of the Board of Directors.

Dated at Washington, D.C. this 15th day of December, 2020.

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation

086871